CHAPTER 9

Managing Decision Making and Problem Solving

OPENING INCIDENT

Starbucks Corporation has arguably become the highest profile and fastest growing food and beverage company in the United States. Starbucks was started in Seattle in 1971 by three coffee aficionados. Their primary business at the time was buying premium coffee beans, roasting them, and then selling the coffee by the pound. The business performed modestly well and soon grew to nine stores, all in the Seattle area. The three partners sold Starbucks to a former employee, Howard Schultz, in 1987. Schultz promptly reoriented the business away from bulk coffee mail-order sales and emphasized retail coffee sales through the firm's coffee bars. Today, Starbucks is not only the largest coffee importer and roaster of specialty beans, but it is also the largest specialty coffee bean retailer in the United States. In addition, the firm is aggressively moving into several different foreign markets as well.

What is the key to Starbucks' phenomenal growth and success? One important ingredient is its well-conceived and implemented strategy. While Starbucks is opening a new coffee shop somewhere almost every day, this growth is planned and coordinated at each step of the way through careful site selection. And through its astute promotional campaigns and commitment to quality, the firm has elevated the coffee drinking taste of millions of consumers and fueled a significant increase in demand. Another key to Starbucks' success is its near-fanatical emphasis on quality control. For example, milk must be heated to precise temperatures between 150 and 170 degrees, and every espresso shot must be pulled within twenty-three seconds or else it is discarded. And no coffee is allowed to sit on a hot plate for more than twenty minutes. Schultz also refuses to franchise his Starbucks stores, fearing a loss of control and a potential deterioration of quality.

But even a firm as well managed as Starbucks can still make mistakes. Consider what happened, for example, when the firm opened its first store in New York City. Market research showed that New Yorkers strongly preferred drip coffees over the more exotic espresso-style coffees that were Starbucks mainstays in the West. Accordingly, the first Starbucks in New York was opened with more drip coffeemakers and fewer espresso machines than in other stores. But the drip coffees were largely ignored and the line for espresso crept out the door and

"Our management team is 100 percent focused on growing our core business without distraction or dilution from any other initiative."

—Howard Schultz, CEO of Starbucks

LEARNING OBJECTIVES

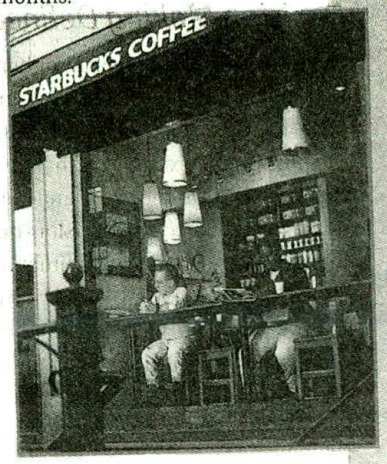
After studying this chapter, you should be able to:

- Define decision making and discuss types of decisions and decision-making conditions.
- Discuss rational perspectives on decision making, including the steps in decision making.
- Describe the behavioral nature of decision making.
- Discuss group and team decision making, including its advantages and disadvantages, and how it can be managed more effectively.

down the block. Thus, a hasty renovation was necessary within the first month the store was open so that it could provide more espresso and less drip coffee.

More recently, Starbucks stumbled again when Schultz announced to a group of investors that he and his management team were focusing their attention on diversification and were busily crafting a grand-scale Internet plan for Starbucks. According to Schultz, the plan would turn the company's web site into a "lifestyle portal" by partnering with various gourmet food vendors and home-decorating businesses. The investors, meanwhile, apparently decided that Schultz was getting too distracted by this plan and that he should remain focused on Starbucks' core businesses. They let him know their feelings by unloading the firm's stock so aggressively that its value plummeted by 28 percent the next day!

Of course, Schultz is a smart executive and he quickly got the message. While not totally abandoning his Internet strategy, he nevertheless began to refocus his attention on Starbucks' core businesses. For example, he stepped up expansion again, which had slowed, and began moving even more aggressively into foreign markets. He also began testing various new concepts for Starbucks coffee shops, such as an expanded lunch menu and a wider assortment of products such as CDs and chocolates. And how did the disgruntled investors take this about-face? They sent the stock price back up by over 30 percent within just a few months.[1]



CHAPTER OUTLINE

- **The Nature of Decision Making**
  - Decision Making Defined
  - Types of Decisions
  - Decision-Making Conditions
- **Rational Perspectives on Decision Making**
  - The Classical Model of Decision Making
  - Steps in Rational Decision Making
- **Behavioral Aspects of Decision Making**
  - The Administrative Model
  - Political Forces in Decision Making
  - Intuition and Escalation of Commitment
  - Risk Propensity and Decision Making
  - Ethics and Decision Making
- **Group and Team Decision Making in Organizations**
  - Forms of Group and Team Decision Making
  - Advantages of Group and Team Decision Making
  - Disadvantages of Group and Team Decision Making
  - Managing Group and Team Decision-Making Processes

Managers at Starbucks make decisions every day, and most of these decisions are good ones. Since no one can be right all the time, however, even a skilled executive like Howard Schultz can occasionally make a mistake. But an important key to organizational effectiveness can be a manager's ability to recognize when a bad decision has been made and to respond quickly to mistakes. Indeed, some experts believe that decision making is the most basic and fundamental of all managerial activities.[2] Thus, we discuss it here in the context of the first management function, planning. Keep in mind, however, that although decision making is perhaps most closely linked to the planning function, it is also part of organizing, leading, and controlling.

We begin our discussion by exploring the nature of decision making. We then describe rational perspectives on decision making. Behavioral aspects of decision making are then introduced and described. We conclude with a discussion of group and team decision making.

The Nature Decision Making

Managers at Ford recently made the decision to buy Land Rover from BMW for nearly $3 billion.[3] At about the same time, the general manager of the Ford dealership in Bryan, Texas, made a decision to sponsor a local youth soccer team for $200. Each of these examples includes a decision, but the decisions differ in many ways. Thus, as a starting point in understanding decision making, we must first explore the meaning of decision making as well as types of decisions and the conditions under which decisions are made.[4]

Decision Making Defined

decision making The act of choosing one alternative from among a set of alternatives

decision-making process Recognizing and defining the nature of a decision situation, identifying alternatives, choosing the "best" alternative, and putting it into practice

Decision making can refer to either a specific act or a general process. **Decision making** per se is the act of choosing one alternative from among a set of alternatives. The decision-making process, however, is much more than this. One step of the process, for example, is that the person making the decision must recognize that a decision is necessary and identify the set of feasible alternatives before selecting one. Hence, the **decision-making process** includes recognizing and defining the nature of a decision situation, identifying alternatives, choosing the "best" alternative, and putting it into practice.[5]

The word *best*, of course, implies effectiveness. Effective decision making requires that the decision maker understand the situation driving the decision. Most people would consider an effective decision to be one that optimizes some set of factors such as profits, sales, employee welfare, and market share. In some situations, though, an effective decision may be one that minimizes loss, expenses, or employee turnover. It may even mean selecting the best method for going out of business, laying off employees, or terminating a contract.

We should also note that managers make decisions about both problems and opportunities. For example, making decisions about how to cut costs by 10 percent



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Decision making is a pervasive part of most managerial activities. Virtually everything that happens in a company involves making a decision or implementing a decision that has been made. While some decisions are grand and significant in scope, others, such as the ones shown in the center panel of this cartoon, involve more routine, day-to-day activities. And still others, illustrated in the right panel, deal with what to have for lunch or when to take a break. Regardless of their goals, however, the people making the decisions need to take them seriously and do what they believe to be best for the company.

reflects a problem—an undesired situation that requires a solution. But decisions are also necessary in situations of opportunity. Learning that the firm is earning higher-than-projected profits, for example, requires a subsequent decision. Should the extra funds be used to increase shareholder dividends, reinvest in current operations, or expand into new markets?

Of course, it may take a long time before a manager can know if the right decision was made. For example, when George Fisher took over as CEO of Kodak, he made several major decisions that will affect the company for decades. Among other things, for example, he sold off several chemical- and health-related businesses, reduced the firm's debt by $7 billion in the process, launched a major new line of advanced cameras and film called Advantix, and made major new investments in emerging technology such as digital photography. But analysts believe that the payoffs from these decisions will not be know for at least ten years.[6]

Types of Decisions

Managers must make many different types of decisions. In general, however, most decisions fall into one of two categories: programmed and nonprogrammed. A **programmed decision** is one that is fairly structured or recurs with some frequency (or both). Starbucks uses programmed decisions to purchase new supplies of coffee beans, cups, and napkins, and Starbucks employees are trained in exact procedures for brewing coffee. Likewise, the Bryan Ford dealer made a decision that he will sponsor a youth soccer team each year. Thus, when the soccer club president calls, the dealer already knows what he will do. Many decisions regarding basic operating systems and procedures and standard organizational transactions are of this variety and can therefore be programmed.[8]

programmed decision A decision that is fairly structured or recurs with some frequency (or both)

Nonprogrammed decisions, on the other hand, are relatively unstructured and occur much less often. Starbucks' decision to focus its Internet strategy on lifestyles and then retreating from that plan are both nonprogrammed decisions. Likewise, Ford's decision to buy Land Rover was also a nonprogrammed decision. Managers faced with such decisions must treat each one as unique, requiring enormous amounts of time, energy, and resources for exploring the situation from all perspectives. Intuition and experience are major factors in nonprogrammed decisions. Most

nonprogrammed decision A decision that is relatively unstructured and occurs much less often than a programmed decision



Most important decisions made in organizations are non-programmed in nature. Consider, for example, just a few of the decisions made by the coaches of the U.S and Costa Rican national soccer teams, shown here in a 2000 Gold Cup match. Before tournament play starts, each coach must decide who would be on the team. In preparing for a match or tournament the coach must decide on a training and practice regime. As a match approaches the coach must decide who will play. And after the match begins the coach must determine how substitutions would be made and which plays to run. While there may be "conventional wisdom" to guide some of these decisions, most coaches will apply their intuition and judgment.

of the decisions made by top managers involving strategy (including mergers, acquisitions, and takeovers) and organization design are nonprogrammed. So are decisions about new facilities, new products, labor contracts, and legal issues.

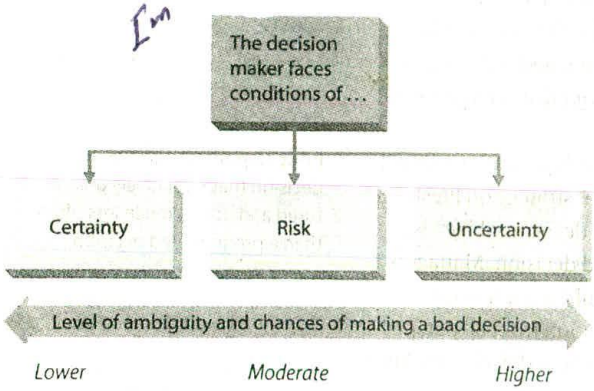
Decision-Making Conditions

Just as there are different kinds of decisions, there are also different conditions in which decisions must be made. Managers sometimes have an almost perfect understanding of conditions surrounding a decision, but at other times they have few clues about those conditions. In general, as shown in Figure 9.1, the circumstances that exist for the decision maker are conditions of certainty, risk, or uncertainty.[9]

Figure 9.1

Decision-Making Conditions

Most major decisions in organizations today are made under a state of uncertainty. Managers making decisions in these circumstances must be sure to learn as much as possible about the situation and approach the decision from a logical and rational perspective.



Decision Making Under Certainty When the decision maker knows with reasonable certainty what the alternatives are and what conditions are associated with each alternative, a **state of certainty** exists. Suppose, for example, that managers at Singapore Airlines make a decision to buy five new jumbo jets. Their next decision is from whom to buy them. Since there are only two companies in the world who make jumbo jets, Boeing and Airbus, Singapore Airlines knows exactly its options. Each has proven products and will guarantee prices and delivery dates. The air-

line thus knows the alternative conditions associated with each. There is little ambiguity and relatively low chance of making a bad decision.

Few organizational decisions are made under conditions of true certainty. The complexity and turbulence of the contemporary business world make such situations rare. Even the airplane purchase decision we just considered has less certainty than it appears. The aircraft companies may not be able to guarantee delivery dates, so they may write cost-increase or inflation clauses into contracts. Thus, the airline may be only partially certain of the conditions surrounding each alternative.

state of certainty A condition in which the decision maker knows with reasonable certainty what the alternatives are and what conditions are associated with each alternative

Decision Making Under Risk A more common decision-making condition is a state of risk. Under a **state of risk**, the availability of each alternative and its potential payoffs and costs are all associated with probability estimates. Suppose, for example, that a labor contract negotiator for a company receives a "final" offer from the union right before a strike deadline. The negotiator has two alternatives: to accept or to reject the offer. The risk centers on whether the union representatives are bluffing. If the company negotiator accepts the offer, she avoids a strike but commits to a costly labor contract. If she rejects the contract, she may get a more favorable one if the union is bluffing; she may provoke a strike if it is not.

state of risk A condition in which the availability of each alternative and its potential payoffs and costs are all associated with probability estimates

On the basis of past experiences, relevant information, the advice of others, and her own judgment, she may conclude that there is about a 75 percent chance that union representatives are bluffing and about a 25 percent chance that they will back up their threats. Thus, she can base a calculated decision on the two alternatives (accept or reject the contract demands) and the probable consequences of each. When making decisions under a state of risk, managers must accurately determine the probabilities associated with each alternative. For example, if the union negotiators are committed to a strike if their demands are not met, and the company negotiator rejects their demands because she guesses they will not strike, her



Decision makers usually face conditions of risk and/or uncertainty. Both conditions were clearly present during the aftermath of the 2000 presidential election. At one level, for example, the individual officials involved in the various recounts in Florida were often trying to decide a voter's intent from looking at a ballot that had not been initially counted for one reason or another. At a different level, political strategists for the two candidates also had to make decisions about which lawsuits to file, which to oppose, and/or which to appeal based on the most likely impact the outcomes of such actions might have on their candidate.

miscalculation will prove costly. As indicated in Figure 9.1, decision making under conditions of risk is accompanied by moderate ambiguity and chances of a bad decision.[10] Ford's decision to buy Land Rover was made under a condition of risk.

state of uncertainty A condition in which the decision maker does not know all the alternatives, the risks associated with each, or the likely consequences of each alternative

Decision Making Under Uncertainty Most of the major decision making in contemporary organizations is done under a **state of uncertainty**. The decision maker does not know all the alternatives, the risks associated with each, or the likely consequences of each alternative. This uncertainty stems from the complexity and dynamism of contemporary organizations and their environments. Starbucks' initial decision to move more aggressively into lifestyle businesses was made under a state of uncertainty, as was its reversal of that decision. Indeed, the emergence of the Internet as a significant force in today's competitive environment has served to increase uncertainty for most managers. The *World of Manage-*

WORLD OF MANAGEMENT

UNCERTAINTY UNDERSCORES ENTREPRENEURIAL DECISIONS IN JAPAN

Uncertainty is a constant for Yasumitsu Shigeta, founder of Japan's Hikari Tsushin, a leading distributor of cell phones and Internet services in Japan. Since founding the company in 1988, when he was in his twenties, Shigeta has ridden wave after wave of new technology to build his business. In 1994, mobile phone service was in its infancy in Japan, with start-ups challenging NTT, the country's long-established telephone service provider. Despite the uncertainty, Shigeta jumped in early to sell phones and service from NTT competitors through a national chain of franchised "Hit Stores." Shigeta's bold decision paid off as mobile phone service—cheaper than traditional phone service because of the competition—became wildly popular.

In 1999, Shigeta again faced a decision under uncertainty. More Japanese were buying personal computers and logging onto the Internet for business and pleasure. The entrepreneur was among the first to see opportunity in helping small businesses access the Internet and set up home pages without hefty investments. He decided to meet this need by providing a "Hit Mail" service with e-mail and web site hosting capabilities for small businesses. He also created a venture capital subsidiary to fund emerging Internet enterprises. Quick decisions were the norm here. As one example, the managing director of this subsidiary moved at Internet speed when he decided on a $16 million investment in a U.S. dot-com after just ten minutes of investigation.

Then things started to go wrong. More consumers began using NTT's mobile phones because it offered web access. Shigeta's Hit Stores didn't sell NTT phones, so sales leveled off. Next, a Japanese magazine criticized the company's aggressive sales techniques, and rumors circulated about the founder's ethnic background. Shigeta called a news conference to defend himself, but he failed to mention that sales were not growing as expected. Within months, however, the entrepreneur publicly admitted that his company would report a loss for the year. This announcement sent Hikari Tsushin's stock tumbling. Shigeta still believes in his Internet initiatives, and his Hit Mail service continues to grow, but the company's future direction is far from certain.

The slightest delay in judgment or decision making will outdate the idea itself, right then and there.

—Posted on web site of Hikari Tsushin venture-capital business.

Reference: Peter Landers and Yumiko Ono, "Without a Net: A Japanese Web Star Takes a Wild Stumble; Can He Rise Again?" *Wall Street Journal*, April 28, 2000, pp. A1, A6 (*quote on p. A6).

ment provides another example of decision making under conditions of uncertainty at NTT, Japan's largest telephone service provider.

To make effective decisions in these circumstances, managers must acquire as much relevant information as possible and approach the situation from a logical and rational perspective. Intuition, judgment, and experience always play major roles in the decision-making process under conditions of uncertainty. Even so, uncertainty is the most ambiguous condition for managers and the one most prone to error.[11] Indeed, many of the problems associated with the massive recall of tires by Firestone and Ford in 2000 were attributed to Firestone's apparent difficulties in responding to ambiguous and uncertain decision parameters regarding the firm's moral, ethical, and legal responsibilities.[12]

MANAGEMENT Managers should remember that decision making is the foundation of much of their work. It is also important to understand the distinction between programmed and nonprogrammed decisions and the different conditions—certainty, risk, and uncertainty—that surround decision-making situations.

■ Rational Perspectives on Decision Making

Most managers like to think of themselves as rational decision makers. And indeed, many experts argue that managers should try to be as rational as possible in making decisions.[13]

The Classical Model of Decision Making

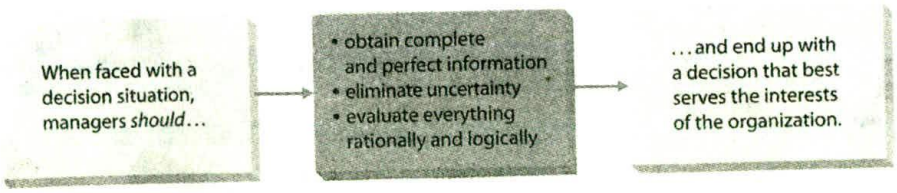
The **classical decision model** is a prescriptive approach to decision making that tells managers how they should make decisions. It rests on the assumptions that managers are logical and rational and that they make decisions that are in the best interests of the organization. Figure 9.2 shows how the classical model views the decision-making process: (1) decision makers have complete information about the decision situation and possible alternatives, (2) they can effectively eliminate

classical decision model A prescriptive approach to decision making that tells managers how they should make decisions. It assumes that managers are logical and rational and that they make decisions that are in the best interests of the organization

Figure 9.2

The Classical Model of Decision Making

The classical model of decision making assumes that managers are rational and logical. It attempts to prescribe how managers should approach decision situations.



uncertainty to achieve a decision condition of certainty, and (3) they evaluate all aspects of the decision situation logically and rationally. As we see later, these conditions rarely, if ever, actually exist.

Steps in Rational Decision Making

steps in rational decision making Recognize and define the decision situation; identify alternatives; evaluate each alternative in terms of its feasibility, satisfactoriness, and consequences; select the best alternative; implement the chosen alternative; follow up and evaluate the results of the chosen alternative

A manager who really wants to approach a decision rationally and logically should try to follow the **steps in rational decision making** listed in Table 9.1. These steps in rational decision making help keep the decision maker focused on facts and logic and help guard against inappropriate assumptions and pitfalls.

Recognizing and Defining the Decision Situation The first step in rational decision making is recognizing that a decision is necessary—that is, there must be some stimulus or spark to initiate the process. For many decisions and problem situations, the stimulus may occur without any prior warning. When equipment malfunctions, the manager must decide whether to repair or replace it. Or when a major crisis erupts, as described in Chapter 3, the manager must quickly decide how to deal with it. As we already noted, the stimulus for a decision may be either

Table 9.1

Steps in the Rational Decision-Making Process

Although the presumptions of the classical decision model rarely exist, managers can approach decision making with rationality. By following the steps of rational decision making, managers ensure that they are learning as much as possible about the decision situation and its alternatives.

Step	Detail	Example
1. Recognizing and defining the decision situation	Some stimulus indicates that a decision must be made. The stimulus may be positive or negative.	A plant manager sees that employee turnover has increased by 5 percent.
2. Identifying alternatives	Both obvious and creative alternatives are desired. In general, the more important the decision, the more alternatives should be generated.	The plant manager can increase wages, increase benefits, or change hiring standards.
3. Evaluating alternatives	Each alternative is evaluated to determine its feasibility, its satisfactoriness, and its consequences.	Increasing benefits may not be feasible. Increasing wages and changing hiring standards may satisfy all conditions.
4. Selecting the best alternative	Consider all situational factors, and choose the alternative that best fits the manager's situation.	Changing hiring standards will take an extended period of time to cut turnover, so increase wages.
5. Implementing the chosen alternative	The chosen alternative is implemented into the organizational system.	The plant manager may need permission from corporate headquarters. The human resource department establishes a new wage structure.
6. Following up and evaluating the results	At some time in the future, the manager should ascertain the extent to which the alternative chosen in step 4 and implemented in step 5 has worked.	The plant manager notes that, six months later, turnover dropped to its previous level.

positive or negative. A manager who must decide how to invest surplus funds, for example, faces a positive decision situation. A negative financial stimulus could involve having to trim budgets because of cost overruns. *Management InfoTech* illustrates how managers at SAP recently recognized and defined a decision situation.

Inherent in problem recognition is the need to define precisely what the problem is. The manager must develop a complete understanding of the problem, its causes, and its relationship to other factors. This understanding comes from careful analysis and thoughtful consideration of the situation. Consider the situation currently being faced in the air travel industry. Because of the growth of international travel related to business, education, and tourism, global carriers like Singapore Airlines, KLM, JAL, British Airways, American Airlines, and others need to increase their capacity for

MANAGEMENT INFOTECH

SAP Plays Catch-up on the Internet

The Internet revolution started without SAP. This German software firm made its name developing sophisticated software for managing key operations such as purchasing, production, and customer transactions. But year after year of rapid sales growth during the 1990s gave way to slower growth and lower profits when SAP's top management failed to recognize how the Internet was changing the way companies do business.

Even as SAP continued to introduce complex stand-alone programs, its corporate customers were demanding software capable of web-based connections with customers and suppliers. Competitors such as Ariba and Siebel were already offering such software, but not SAP. From the vantage point of company headquarters in Walldorf, Germany, top managers were not in a hurry to adapt to the Internet and e-commerce. But when U.S. competitor Oracle began touting its e-commerce expertise in a high-profile advertising campaign, one of SAP's founders recognized that the firm needed an Internet strategy.

Two SAP programmers assigned to the task came up with the concept of enhancing the company's existing software with new programs designed to link suppliers and customers via the Internet. Dubbed mySAP.com, this enhancement worked only with SAP programs, a problem for businesses that use software purchased from different sources. Timing was also an issue: General Motors, for example, selected a rival's e-commerce software rather than risk delays in getting mySAP.com up and running.

SAP faced yet another Internet-related decision. While U.S. competitors were using stock options to attract, retain, and reward talented employees, SAP resisted requests by managers of SAP America for a similar plan. Finally, after SAP America's CEO and president left to join rival firms—amid dozens of other management defections from the United States and from international divisions—SAP devised a stock-option plan.

We made a decision two years ago and there has been a massive paradigm shift to the Internet.

*—Hasso Plattner, co-founder and co-CEO, SAP**

Now mySAP.com is catching up with Hewlett-Packard and other major customers. To speed up software development and keep a closer eye on U.S. Internet trends, SAP has outsourced some work to a Boston-based firm (which was formerly based in Germany). The company has also decided to follow the lead of its U.S. rivals in more aggressively promoting new products and enhancements—even before they are introduced.

References: Neal E. Boudette, "How a Software Titan Missed the Internet Revolution," *Wall Street Journal*, January 18, 2000, pp. B1, B4 (*quote on p. B4); "Software Engineering Isn't All, SAP Decides; Image Matters, Too," *Wall Street Journal*, September 26, 2000, pp. A1, A11.

international travel. Since most major international airports are operating at or near capacity already, adding a significant number of new flights to existing schedules is not feasible. As a result, the most logical alternative is to increase capacity on existing flights. Thus, Boeing and Airbus, the world's only manufacturers of large commercial aircraft, have recognized an important opportunity and have defined their decision situation as how to respond best to the need for increased global travel capacity.[14]

Identifying Alternatives Once the decision situation has been recognized and defined, the second step is to identify alternative courses of effective action. Developing both obvious, standard alternatives and creative, innovative alternatives is generally useful. In general, the more important the decision, the more attention is directed to developing alternatives. If the decision involves a multimillion-dollar relocation, a great deal of time and expertise will be devoted to identifying the best locations. J.C. Penney Company spent two years searching before selecting the Dallas–Fort Worth area for its new corporate headquarters. If the problem is to choose a color for the company softball team uniforms, less time and expertise will be brought to bear.

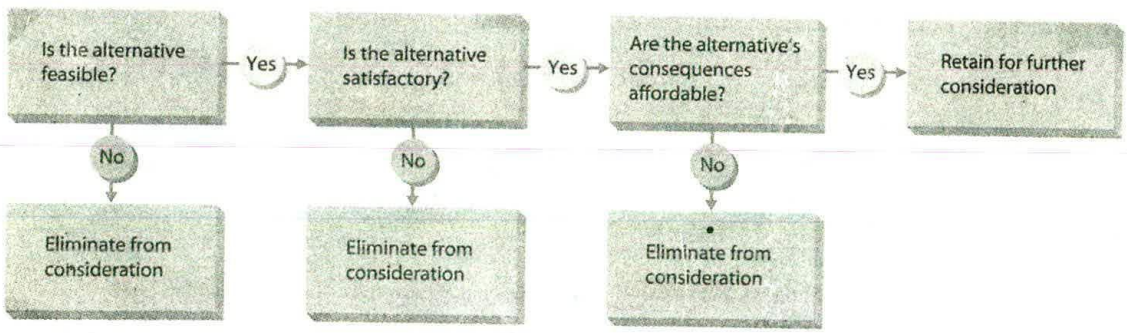
Although managers should seek creative solutions, they must also recognize that various constraints often limit their alternatives. Common constraints include legal restrictions; moral and ethical norms; authority constraints; or constraints imposed by the power and authority of the manager, available technology, economic considerations, and unofficial social norms. Boeing and Airbus each identified three different alternatives to address the decision situation of increasing international airline travel capacity: they could independently develop new large planes, they could collaborate in a joint venture to create a single new large plane, or they could modify their largest existing planes and thus increase their capacity.

Evaluating Alternatives The third step in the decision-making process is evaluating each of the alternatives. Figure 9.3 presents a decision tree that can be used to judge different alternatives. The figure suggests that each alternative be evalu-

Figure 9.3

Evaluating Alternatives in the Decision-Making Process

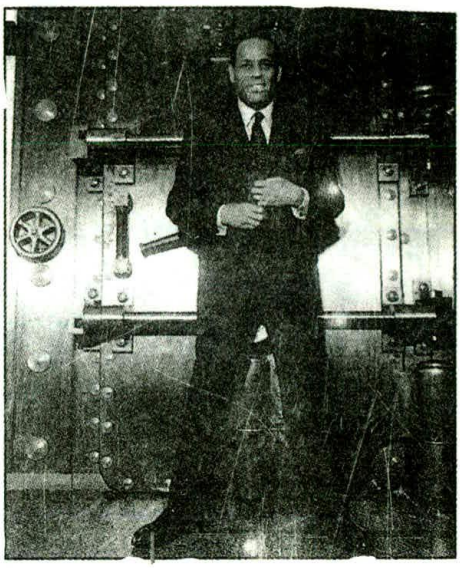
Managers must thoroughly evaluate all the alternatives, which increases the chances that the alternative finally chosen will be successful. Failure to evaluate an alternative's feasibility, satisfactoriness, and consequences can lead to a wrong decision.



ated in terms of its *feasibility*, its *satisfactoriness*, and its *consequences*. The first question to ask is whether an alternative is feasible. Is it within the realm of probability and practicality? For a small, struggling firm, an alternative requiring a huge financial outlay is probably out of the question. Other alternatives may not be feasible because of legal barriers. And limited human, material, and information resources may make other alternatives impractical.

When an alternative has passed the test of feasibility, it must next be examined to see how well it satisfies the conditions of the decision situation. For example, a manager searching for ways to double production capacity might consider purchasing an existing plant from another company. If closer examination reveals that the new plant would increase production capacity by only 35 percent, this alternative may not be satisfactory.

Finally, when an alternative has proven both feasible and satisfactory, its probable consequences must still be assessed. To what extent will a particular alternative influence other parts of the organization? What financial and nonfinancial costs will be associated with such influences? For example, a plan to boost sales by cutting prices may disrupt cash flows, need a new advertising program, and alter the behavior of sales representatives because it requires a different commission structure. The manager, then, must put "price tags" on the consequences of each alternative. Even an alternative that is both feasible and satisfactory must be eliminated if its consequences are too expensive for the total system. Airbus felt it would be at a disadvantage if it tried simply to enlarge its existing planes, since the Boeing 747 is already the largest aircraft being made and could be expanded to remain the largest. Boeing, meanwhile, was seriously concerned about the risk inherent in building a new and even larger plane, even if it shared the risk with Airbus as a joint venture.



Managers generally attempt to follow a logical and rational approach to making decisions. This is especially true of individuals in positions like H. Carl McCall, the sole trustee of the Common Retirement Fund for the state of New York. McCall is responsible for managing a portfolio recently valued at $122 billion. The public trust vested in his position makes it especially important that he rationally consider various investment options and then select the ones that will provide the optimal blend of risk and return for the hundreds of thousands of retired state employees who depend on the fund.

Selecting the Best Alternative Even though many alternatives fail to pass the triple tests of feasibility, satisfactoriness, and affordable consequences, two or more alternatives may remain. Choosing the best of these is the real crux of decision making. One approach is to choose the alternative with the highest combined level of feasibility, satisfactoriness, and affordable consequences. Even though most situations do not lend themselves to objective, mathematical analysis, the manager can often develop subjective estimates and weights for choosing an alternative.

Optimization is also a frequent goal. Because a decision is likely to affect several individuals or units, any feasible alternative will probably not maximize all of the relevant goals. Suppose that the manager of the Kansas City Royals needs to select a new outfielder for the upcoming baseball season. Bill hits .350 but is barely able to catch a fly ball; Joe hits only .175 but is outstanding in the field; and Sam hits .290 and is a solid but not outstanding fielder. The manager would probably select Sam because of the optimal balance of hitting and fielding. Decision makers should also remember that finding multiple acceptable alternatives may be possible—selecting just one alternative and rejecting all the others might not be necessary. For example, the Royals' manager might decide that Sam will start each game,

Bill will be retained as a pinch hitter, and Joe will be retained as a defensive substitute. In many hiring decisions, the candidates remaining after evaluation are ranked. If the top candidate rejects the offer, it may be automatically extended to the number two candidate, and, if necessary, to the remaining candidates in order. For the reasons noted earlier, Airbus proposed a joint venture with Boeing. Boeing meanwhile decided its best course of action was to modify its existing 747 to increase its capacity. As a result, Airbus then decided to proceed on its own to develop and manufacture a new jumbo jet.

Implementing the Chosen Alternative After an alternative has been selected, the manager must put it into effect. In some decision situations, implementation is fairly easy; in others, it is more difficult. In the case of an acquisition, for example, managers must decide how to integrate all the activities of the new business, including purchasing, human resource practices, and distribution, into an ongoing organizational framework. For example, when America Online and Time Warner announced their merger, they also acknowledged that it would take at least a year to integrate the two firms into a single entity. Operational plans, which we discussed in Chapter 7, are useful in implementing alternatives.

Managers must also consider people's resistance to change when implementing decisions. The reasons for such resistance include insecurity, inconvenience, and fear of the unknown. When Penney's decided to move its headquarters from New York to Texas, many employees resigned rather than relocate. Managers should anticipate potential resistance at various stages of the implementation process. (Resistance to change is covered in Chapter 13.) Managers should also recognize that, even when all alternatives have been evaluated as precisely as possible and the consequences of each alternative have been weighed, unanticipated consequences are still likely. Any number of things—unexpected cost increases, a less-than-perfect fit with existing organizational subsystems, or unpredicted effects on cash flow or operating expenses, for example—could develop after implementation has begun. Boeing has set its engineers to work expanding the capacity of its 747 from today's 416 passengers to as many as 520 passengers by adding thirty feet to the plane's body. Airbus engineers, meanwhile, are developing design concepts for a new jumbo jet equipped with escalators and elevators and capable of carrying 655 passengers. Airbus's development costs alone are estimated to be more than $12 billion.

Following Up and Evaluating the Results The final step in the decision-making process requires that managers evaluate the effectiveness of their decision—that is, they should make sure that the chosen alternative has served its original purpose. If an implemented alternative appears not to be working, the manager can respond in several ways. Another previously identified alternative (the second or third choice) could be adopted. Or the manager might recognize that the situation was not correctly defined to start with and begin the process all over again. Finally, the manager might decide that the original alternative is in fact appropriate but has not yet had time to work or should be implemented in a different way.

Failure to evaluate decision effectiveness may have serious consequences. The Pentagon spent $1.8 billion and eight years developing the Sergeant York antiaircraft gun. From the beginning, tests revealed major problems with the weapon

system, but not until it was in its final stages, when it was demonstrated to be completely ineffective, was the project scrapped.[15] The examples in the chapter opening incident illustrate a much more effective approach to evaluating decision effectiveness. When New Yorkers expressed their preferences for espresso over drip coffees, Starbucks quickly revamped its cafés. And when investors let Howard Schultz know that they disapproved of his Internet strategy, he quickly changed it. Meanwhile, experts agree that it will be several years before the outcomes of decisions by Boeing and Airbus can be assessed.

MANAGEMENT IMPLICATIONS Whenever possible managers should strive to apply rationality and logic to the decisions they make. By following the logical sequence of steps that comprise the classical model, managers can lessen risk and reduce uncertainty in many decision-making situations. Of course, at the same time managers should also recognize the "prescriptive" nature of this approach and not adhere to it so rigidly that they fail to consider their own experience and intuition. Finally, they should also know that even using the classical model effectively does not guarantee success.

■ Behaviral Aspects of Decision Making

If all decision situations were approached as logically as described in the previous section, more decisions would prove to be successful. Yet decisions are often made with little consideration for logic and rationality. Some experts have estimated that U.S. companies use rational decision-making techniques less than 20 percent of the time.[16] And even when organizations try to be logical, they sometimes fail. For example, Starbucks' original decision to emphasis drip over espresso coffee in New York was based on marketing research, taste tests, and rational deliberation—but the decision was still wrong. On the other hand, sometimes when a decision is made with little regard for logic, it can still turn out to be correct.[17] An important ingredient in how these forces work is the behavioral aspect of decision making. The administrative model better reflects these subjective considerations. Other behavioral aspects include political forces, intuition and escalation of commitment, risk propensity, and ethics.

The Administrative Model

Herbert A. Simon was one of the first experts to recognize that decisions are not always made with rationality and logic.[18] Simon was subsequently awarded the Nobel Prize in economics. Rather than prescribing how decisions should be made, his view of decision making, now called the **administrative model**, describes how decisions are often actually made. As illustrated in Figure 9.4, the model holds that managers (1) have incomplete and imperfect information, (2) are constrained by bounded rationality, and (3) tend to satisfice when making decisions.

Bounded rationality suggests that decision makers are limited by their values and unconscious reflexes, skills, and habits. They are also limited by less than

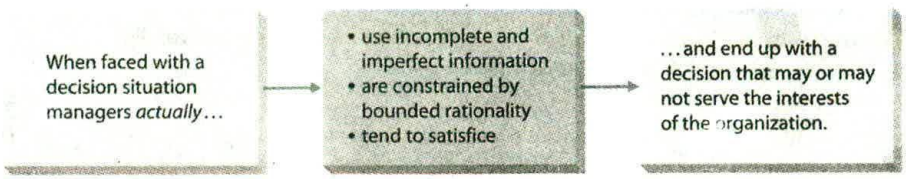
administrative model A decision-making model showing that managers (1) have incomplete and imperfect information, (2) are constrained by bounded rationality, and (3) tend to satisfice when making decisions

bounded rationality A concept suggesting that decision makers are limited by their values and unconscious reflexes, skills, and habits

Figure 9.4

The Administrative Model of Decision Making

The administrative model is based on behavioral processes that affect how managers make decisions. Rather than prescribing how decisions should be made, it focuses more on describing how they are made.



complete information and knowledge. Bounded rationality partially explains how U.S. auto executives allowed Japanese auto makers to get such a strong foothold in their domestic market. For years, executives at GM, Ford, and Chrysler compared their companies' performance only to one another and ignored foreign imports. The foreign "threat" wasn't acknowledged until the domestic auto market had been changed forever. If managers had gathered complete information from the beginning, they might have been better able to thwart foreign competitors. Essentially, then, the concept of bounded rationality suggests that, although people try to be rational decision makers, their rationality has limits.

satisficing The tendency to search for alternatives only until one is found that meets some minimum standard of sufficiency

Another important part of the administrative model is **satisficing**. This concept suggests that rather than conducting an exhaustive search for the best possible alternative, decision makers tend to search only until they identify an alternative that meets some minimum standard of sufficiency. A manager looking for a site for a new plant, for example, may select the first site she finds that meets basic requirements for transportation, utilities, and price, even though further searching might yield a better location. People satisfice for a variety of reasons. Managers may simply ignore their own motives (such as reluctance to spend time making a decision) and therefore not continue searching after a minimally acceptable alternative is identified. The decision maker may be unable to weigh and evaluate large numbers of alternatives and criteria. Also, subjective and personal considerations often intervene in decision situations.

Because of the inherent imperfection of information, bounded rationality, and satisficing, the decisions made by a manager may or may not actually be in the best interests of the organization. A manager may choose a particular location for the new plant because it offers the lowest price and best availability of utilities and transportation. Or she may choose the location because it's in a community in which she wants to live.

In summary, then, the classical and administrative models paint quite different pictures of decision making. Which is more correct? Actually, each can be used to understand how managers make decisions. The classical model is prescriptive: it explains how managers can at least attempt to be more rational and logical in their approach to decisions. The administrative model can be used by managers to develop a better understanding of their inherent biases and limita-

tions.[19] In the following sections, we describe more fully other behavioral forces that can influence decisions.

Political Forces in Decision Making

Political forces are another major element that contributes to the behavioral nature of decision making. Organizational politics is covered in Chapter 17, but one major element of politics, coalitions, is especially relevant to decision making. A **coalition** is an informal alliance of individuals or groups formed to achieve a common goal. This common goal is often a preferred decision alternative. For example, coalitions of stockholders frequently band together to force a board of directors to make a certain decision.

coalition An informal alliance of individuals or groups formed to achieve a common goal

Coalitions led to the formation of Unisys Corporation, a large computer firm. Sperry was once one of the United States' computer giants, but a series of poor decisions put the company on the edge of bankruptcy. Two major executives waged battle for three years over what to do. One wanted to get out of the computer business altogether, and the other wanted to stay in. Finally, the manager who wanted to remain in the computer business garnered enough support to earn promotion to the corporation's presidency. The other manager took early retirement. Shortly thereafter, Sperry agreed to be acquired by Burroughs Wellcome Co. The resulting combined company was called Unisys.

The impact of coalitions can be either positive or negative. They can help astute managers get the organization on a path toward effectiveness and profitability, or they can strangle well-conceived strategies and decisions. Managers must recognize when to use coalitions, how to assess whether coalitions are acting in the best interests of the organization, and how to constrain their dysfunctional effects.[20]

Intuition and Escalation of Commitment

Two other important decision processes that go beyond logic and rationality are intuition and escalation of commitment to a chosen course of action.

Intuition **Intuition** is an innate belief about something without conscious consideration. Managers sometimes decide to do something because it "feels right" or they have a hunch. This feeling is usually not arbitrary, however. Rather, it is based on years of experience and practice in making decisions in similar situations. An inner sense may help managers make an occasional decision without going through a full-blown rational sequence of steps. For example, a few years ago the New York Yankees called three major sneaker manufacturers, Nike, Reebok, and Adidas, and informed them that they were looking to make a sponsorship deal. While Nike and Reebok were carefully and rationally assessing the possibilities, managers at Adidas quickly realized that a partnership with the Yankees made a lot of sense for them. They responded very quickly to the idea and ended up hammering out a contract while the competitors were still analyzing details.[21] Of course, all managers, but most especially inexperienced ones, should be careful not to rely on intuition too heavily. If rationality and logic are continually flaunted for what "feels right," the odds are that disaster will strike one day.

intuition An innate belief about something without conscious consideration

escalation of commitment A decision maker's staying with a decision even when it appears to be wrong

Escalation of Commitment Another important behavioral process that influences decision making is **escalation of commitment** to a chosen course of action. In particular, decision makers sometimes make decisions and then become so committed to the course of action suggested by that decision that they stay with it, even when it appears to be wrong.[22] For example, when people buy stock in a company, they sometimes refuse to sell it even after repeated drops in price. They chose a course of action—buying the stock in anticipation of making a profit—and then stay with it even in the face of increasing losses.

For years Pan American World Airways (Pan Am) ruled the skies and used its profits to diversify into real estate and other businesses. But with the advent of deregulation, Pan Am began to struggle and lose market share to other carriers. When Pan Am managers finally realized how ineffective the airline operations had become, the "rational" decision would have been to sell off the remaining airline operations and concentrate on the firm's more profitable businesses, as experts today point out. But because they still saw the company as being first and foremost an airline, they instead began slowly to sell off the firm's profitable holdings to keep the airline flying. Eventually, the company was left with nothing but an ineffective and inefficient airline, and then it had to sell off its more profitable routes before eventually being taken over by Delta. Had Pan Am managers made the more rational decision years earlier, chances are the firm could still be a profitable enterprise today, albeit one with no involvement in the airline industry.[23]

Thus, decision makers must walk a fine line. On the one hand, they must guard against sticking with an incorrect decision too long. To do so can bring about financial decline. On the other hand, managers should not bail out of a seemingly incorrect decision too soon, as did Adidas several years ago. Adidas once dominated the market for professional athletic shoes. It subsequently entered the market for amateur sports shoes and did well there also. But managers interpreted a sales slowdown as a sign that the boom in athletic shoes was over. They thought that they had made the wrong decision and ordered drastic cutbacks. The market took off again with Nike at the head of the pack, and Adidas never recovered. Fortunately, a new management team has changed the way Adidas makes decisions and, as illustrated earlier, the firm is again on its way to becoming a force in the athletic shoe and apparel markets.

Risk Propensity and Decision Making

risk propensity The extent to which a decision maker is willing to gamble when making a decision

The behavioral element of **risk propensity** is the extent to which a decision maker is willing to gamble when making a decision. Some managers are cautious about every decision they make. They try to adhere to the rational model and are extremely conservative in what they do. Such managers are more likely to avoid mistakes, and they infrequently make decisions that lead to big losses. Other managers are extremely aggressive in making decisions and are willing to take risks.[24] They rely heavily on intuition, reach decisions quickly, and often risk big investments on their decisions. As in gambling, these managers are more likely than their conservative counterparts to achieve big successes with their decisions; they are also more likely to incur greater losses.[25] The organization's culture is a prime ingredient in fostering different levels of risk propensity.

Ethics and Decision Making

As we introduced in Chapter 4, individual ethics are personal beliefs about right and wrong behavior. Ethics are clearly related to decision making in a number of ways. For example, suppose after careful analysis a manager realizes that her company could save money by closing her department and subcontracting with a supplier for the same services. But to recommend this course of action would result in the loss of several jobs, including her own. Her own ethical standards will clearly shape how she proceeds.[26] Indeed, each component of managerial ethics (relationships of the firm to its employees, of employees to the firm, and of the firm to other economic agents) involves a wide variety of decisions, all of which are likely to have an ethical component. A manager must remember, then, that just as behavioral processes such as politics and risk propensity affect the decisions she makes, so too do her ethical beliefs. *Today's Management Issues* highlights an ethical situation faced by decision makers at Coca-Cola.

TODAY'S MANAGEMENT ISSUES

LEARNING TO BALANCE MULTIPLE GOALS

Successful companies sometimes see little incentive to change, even when they have difficulty balancing important financial and ethical goals. Coca-Cola is a case in point. For years, Coca-Cola's managers were focused on keeping sales and profits soaring. Behind the scenes, however, African-American employees were raising concerns about possible discrimination in the organization. Finding company officials unresponsive, the employees eventually filed suit, saying that Coca-Cola discriminated in internal decisions over promotions, appraisals, terminations, and compensation.

Initially, Coca-Cola mounted a forceful defense, which caused one former company human resources manager—who was not involved in the lawsuit—to plan a boycott and call for a $200 million settlement. Then the company demoted Carl Ware, its highest ranking African-American executive. Four years before, Ware had sent a memo to Coca-Cola colleagues with suggestions for improving diversity by helping African-American managers move up in the company. Most of Ware's suggestions were never implemented, however, and he decided to retire a few days after he was demoted.

Coca-Cola continued to dispute the charges of discrimination, but now its sales and profits were stalled, and mounting pressure caused a change in top management. When Doug Daft took over as CEO, he asked Carl Ware to return as executive vice president for global public affairs. In addition, Daft implemented two of Ware's recommendations for improving diversity. First, Daft began communicating that diversity was one of the company's key goals. Second, the CEO set up a new compensation system linking pay to progress in achieving diversity goals.

They ignored me, ignored me, ignored me to the point where I felt I had no other recourse.

—Greg Clark, plaintiff in class-action lawsuit against Coca-Cola*

Although the company reached a tentative settlement with the original eight plaintiffs, a new discrimination lawsuit was quickly filed by four more African-American employees. As the legal wrangles continue, Coca-Cola's management team is working hard to maintain an appropriate balance between the organization's diversity goals and its financial goals.

Reference: Ann Harrington, "Coke Denied ... Prevention Is the Best Defense," *Fortune*, July 10, 2000, p. 188 (*quote on p. 188).

MANAGEMENT IMPLICATIONS Managers must understand that various behavioral processes affect how decisions are made. Their own bounded rationality and satisficing tendencies, for example, should be acknowledged. Managers should be on the alert for political forces as they relate to decision making, and they should also be aware of the role of intuition, escalation of commitment, risk propensity, and ethics.

■ Group and Team Decision Making in Organization

In more and more organizations today, important decisions are made by groups and teams rather than by individuals. Examples include the executive committee of General Motors, product design teams at Texas Instruments, and marketing planning groups at Compaq Computer. Managers can typically choose whether to have individuals or groups and teams make a particular decision. Thus, knowing about forms of group and team decision making and their advantages and disadvantages is important.[27]

Forms of Group and Team Decision Making

The most common methods of group and team decision making are interacting groups, Delphi groups, and nominal groups. Increasingly, these methods of group decision making are being conducted on-line.

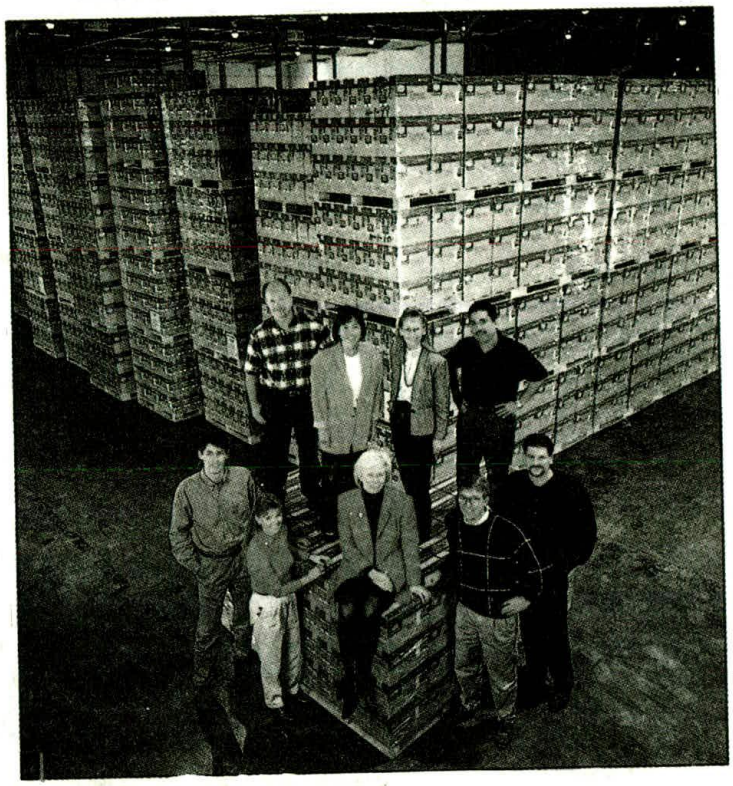
interacting group or team A decision-making group or team in which members openly discuss, argue about, and agree on the best alternative

Interacting Groups or Teams **Interacting groups or teams** are the most common form of decision-making groups. The format is simple—either an existing or a newly designated group or team is asked to make a decision. Existing groups or teams might be functional departments, regular work teams, or standing committees. Newly designated groups or teams can be ad hoc committees, task forces, or newly constituted work teams. The group or team members talk among themselves, argue, agree, argue some more, form internal coalitions, and so forth. Finally, after some period of deliberation, the group or team makes its decision. An advantage of this method is that the interactions between people often spark new ideas and promote understanding. A major disadvantage, though, is that political processes can play too big a role.

Delphi group A form of group decision making in which a group solicits input from a panel of experts who contribute individually; their opinions are combined and, in effect, averaged

Delphi Groups A **Delphi group** is sometimes used for developing a consensus of expert opinion. Developed by the Rand Corporation, the Delphi procedure solicits input from a panel of experts who contribute individually. Their opinions are combined and, in effect, averaged. Assume, for example, that the problem is to establish an expected date for a major technological breakthrough in converting coal into usable energy. The first step in using the Delphi procedure is to obtain the cooperation of a panel of experts. For this situation, experts might

include various research scientists, university researchers, and executives in a relevant energy industry. At first, the experts are asked to predict anonymously a time frame for the expected breakthrough. The persons coordinating the Delphi group collect the responses, average them, and ask the experts for another prediction. In this round, the experts who provided unusual or extreme predictions may be asked to justify them. These explanations may then be relayed to the other experts. When the predictions stabilize, the average prediction is taken to represent the decision of the group of experts. The time, expense, and logistics of the Delphi technique rule out its use for routine, everyday decisions, but it has been successfully used for forecasting technological breakthroughs at Boeing, market potential for new products at General Motors, research and development patterns at Eli Lilly, and future economic conditions by the U.S. government.[28]



More and more often these days, businesses are relying on groups and teams to make critical decisions. Hewlett-Packard recently announced an ambitious program to dramatically improve customer satisfaction with its products. HP assigned the program to two managers, Mei-Lin Cheng and Julie Anderson, and their team. But HP left all the details and major decisions associated with meeting its customer satisfaction goals in the hands of the team.

Nominal Groups Another useful group and team decision-making technique occasionally used is the **nominal group**. Unlike the Delphi method, where group members do not see one another, nominal group members are brought together. The members represent a group in name only, however; they do not talk to one another freely like the members of interacting groups. Nominal groups are used most often to generate creative and innovative alternatives or ideas. To begin, the manager assembles a group of knowledgeable people and outlines the problem to them. The group members are then asked individually to write down as many alternatives as they can think of. The members then take turns stating their ideas, which are recorded on a flip chart or blackboard at the front of the room. Discussion is limited to simple clarification. After all alternatives have been listed, more open discussion takes place. Group members then vote, usually by rank-ordering the various alternatives. The highest ranking alternative represents the decision of the group. Of course, the manager in charge may retain the authority to accept or reject the group decision.

nominal group A structured technique used most often to generate creative and innovative alternatives or ideas

Advantages of Group and Team Decision Making

The advantages and disadvantages of group and team decision making relative to individual decision making are summarized in Table 9.2. One advantage is simply that more information is available in a group or team setting—as suggested by the old axiom, "Two heads are better than one." A group or team represents a broader range of education, experience, and perspective. Partly as a result of this increased information, groups and teams typically can identify and evaluate more alternatives than can one person.[29] The people involved in a group or team decision understand the logic and rationale behind it, are more likely to accept it, and are equipped to communicate the decision to their work groups or departments.[30] Finally, research evidence suggests that groups may make better decisions than do individuals.[31]

Disadvantages of Group and Team Decision Making

Perhaps the biggest drawback of group and team decision making is the additional time and (hence) the greater expense entailed. The increased time stems from interaction and discussion among group or team members. If a given manager's time is worth $50 an hour, and if the manager spends two hours making a decision, the decision "costs" the organization $100. For the same decision, a group of five managers might require three hours of time. At the same $50-an-hour rate, the decision "costs" the organization $750. Assuming the group or team decision is better, the additional expense may be justified, but the fact remains that group and team decision making is more costly.

Group or team decisions may also represent undesirable compromises.[32] For example, hiring a compromise top manager may be a bad decision in the long run because he or she may not be able to respond adequately to various subunits in

Table 9.2

Advantages and Disadvantages of Group and Team Decision Making

To increase the chances that a group or team decision will be successful, managers must learn how to manage the process of group and team decision making. Westinghouse, Federal Express, and IBM are increasingly using groups and teams in the decision-making process.

Advantages	Disadvantages
1. More information and knowledge are available.	1. The process takes longer than individual decision making, so it is costlier.
2. More alternatives are likely to be generated.	2. Compromise decisions resulting from indecisiveness may emerge.
3. More acceptance of the final decision is likely.	3. One person may dominate the group.
4. Enhanced communication of the decision may result.	4. Groupthink may occur.
5. Better decisions generally emerge.	

the organization or have everyone's complete support. Sometimes one individual dominates the group process to the point where others cannot make a full contribution. This dominance may stem from a desire for power or from a naturally dominant personality. The problem is that what appears to emerge as a group decision may actually be the decision of one person.

Finally, a group or team may succumb to a phenomenon known as groupthink. **Groupthink** occurs when the desire for consensus and cohesiveness overwhelms the goal of reaching the best possible decision.[33] Under the influence of groupthink, the group may arrive at decisions that are not in the best interest of either the group or the organization, but the members are more concerned about avoiding conflict among themselves. One of the clearest documented examples of groupthink involved the space shuttle *Challenger* disaster. As NASA was preparing to launch the shuttle, numerous problems and questions arose. At each step of the way, however, decision makers argued that there was no reason to delay and that everything would be fine. Shortly after the launch in January 1986, the shuttle exploded, killing all seven crew members.

groupthink A situation that occurs when a group or team's desire for consensus and cohesiveness overwhelms the goal of reaching the best possible decision

Managing Group and Team Decision-Making Processes

Managers can do several things to help promote the effectiveness of group and team decision making. One is simply being aware at the beginning of the pros and cons of having a group or team make a decision. Time and cost can be managed by setting a deadline by which the decision must be made final. Dominance can be at least partially avoided if a special group is formed just to make the decision. An astute manager, for example, should know who in the organization may try to dominate and can either avoid putting that person in the group or put several strong-willed people together.

To avoid groupthink, each member of the group or team should critically evaluate all alternatives. So that members present divergent viewpoints, the leader should not make his or her own position known too early. At least one member of the group or team might be assigned the role of devil's advocate. And, after reaching a preliminary decision, the group or team should hold a follow-up meeting wherein divergent viewpoints can be raised again if any group members wish to do so.[34] Gould Paper Company used these methods by assigning managers to two different teams. The teams then spent an entire day in a structured debate presenting the pros and cons of each side of an issue to ensure the best possible decision. Sun Microsystems makes most of its major decisions using this same approach.

MANAGEMENT IMPLICATIONS Managers usually have the option of having a decision made by an individual or by a group or team. They should therefore assess the relative advantages and disadvantages of each when deciding how to make a particular decision, as well as the different methods by which groups or teams can be used. If groups or teams are being used, the managers should also take appropriate steps to manage the decision-making process to enhance its effectiveness.

Summary of Key Points

Decisions are an integral part of all managerial activities, but they are perhaps most central to the planning process. Decision making is the act of choosing one alternative from among a set of alternatives. The decision-making process includes recognizing and defining the nature of a decision situation, identifying alternatives, choosing the best alternative, and putting it into practice. Two common types of decisions are programmed and nonprogrammed. Decisions may be made under states of certainty, risk, or uncertainty.

Rational perspectives on decision making rest on the classical model. This model assumes that managers have complete information and that they will behave rationally. The primary steps in rational decision making are (1) recognizing and defining the decision situation, (2) identifying alternatives, (3) evaluating alternatives, (4) selecting the best alternative, (5) implementing the chosen alternative, and (6) following up and evaluating the results of the alternative after it is implemented.

Behavioral aspects of decision making rely on the administrative model. This model recognizes that managers will have incomplete information and that they will not always behave rationally. The administrative model also recognizes the concepts of bounded rationality and satisficing. Political activities by coalitions, managerial intuition, and the tendency to become increasingly committed to a chosen course of action are all important. Risk propensity is another important behavioral perspective on decision making. Finally, ethics also affect how managers make decisions.

To help enhance decision-making effectiveness, managers often use interacting, Delphi, or nominal groups or teams. Group and team decision making in general has several advantages as well as disadvantages relative to individual decision making. Managers can adopt several strategies to help groups and teams make better decisions.

Discussion Questions

Questions for Review

1. Describe the nature of decision making.
2. What are the main features of the classical model of the decision-making process? What are the main features of the administrative model?
3. What are the steps in rational decision making? Which step do you think is the most difficult to carry out? Why?
4. Describe the behavioral nature of decision making. Be certain to provide some detail about political forces, risk propensity, ethics, and commitment in your description.

Questions for Analysis

5. Was your decision about what college or university to attend a rational decision? Did you go through each step in rational decision making? If not, why not?
6. Can any decision be purely rational, or are all decisions at least partially behavioral in nature? Defend your answer against alternatives.
7. Under what conditions would you expect group or team decision making to be preferable to individual decision making, and vice versa? Why?

Questions for Application

8. Interview a local business manager about a major decision that he or she made recently. Try to determine if the manager used each of the steps in rational decision making. If not, which were omitted? Why might the manager have omitted those steps?
9. Interview a local business manager about a major decision that he or she made recently. Try to determine if aspects of the behavioral nature of decision making were involved. If so, which were involved? Why?
10. Interview a department head at your college or university to determine if group or team decision making is used at all. If it is, for what types of decisions is it used?

BUILDING EFFECTIVE *decision-making* AND *communication* SKILLS

Exercise Overview

Decision-making skills refer to the manager's ability to recognize and define problems and opportunities correctly and then to select an appropriate course of action for solving problems and capitalizing on opportunities. Communication skills refer to the manager's abilities both to convey ideas and information to others effectively and to receive ideas and information effectively from others. Not surprisingly, these skills can be highly interrelated. This exercise will give you insights into some of those interrelations.

Exercise Background

Identify a decision that you will need to make sometime in the near future. If you work in a managerial position, you might select a real problem or issue to address. For example, you might use the selection or termination of an employee, the allocation of pay raises, or the selection of someone for a promotion.

If you do not work in a managerial position, you might instead select an upcoming decision related to your academic work. Example decisions might include: what major to select, whether to attend summer school or to work, which job to select, whether to live on or off campus next year, etc. Be sure to select a decision that has not yet been made.

Exercise Task

Using the decision situation you have identified, do each of the following:

1. On a sheet of paper, list the kinds of information that you will most likely use in making your decision. Beside each one, make notes about where you can obtain the information, what form the information will be presented in, the reliability of the information, and other characteristics of the information that you deem to be relevant.
2. Next, assume that you have used the information obtained above and have now made the decision. (It might be helpful at this point to select a hypothetical decision or choice to frame your answers.) On the other side of the paper, list the various communication consequences that come with your decision. For example, if your choice involves an academic major, you may need to inform your advisor and your family. List as many of these communication consequences as you can. Beside each one, make notes about how you would communicate with each party, the timeliness of your communication, and whatever factors that seem to be relevant.
3. What behavioral forces might play a role in your decision?

BUILDING EFFECTIVE *interpersonal* SKILLS

Exercise Overview

Interpersonal skills refer to the manager's ability to understand and motivate individuals and groups. This exercise will allow you to practice your interpersonal skills in a role-playing exercise.

Exercise Background

You supervise a group of six employees who work in an indoor facility in a relatively isolated location. The company you work for has recently adopted an ambiguous policy regarding smoking. Essentially, the policy states that all company work sites are to be smoke free unless the employees at a specific site choose differently and at the discretion of the site supervisor.

Four members of the work group you supervise are smokers. They have come to you with the argument that since they constitute the majority, they should be allowed to smoke at work. The other two members of the group, both nonsmokers, have also discussed the situation with you. They argue that the health-related consequences of secondary smoke should outweigh the preferences of the majority.

To compound the problem, your boss wrote the new policy and is quite defensive about it—numerous individuals have already criticized the policy. You know that your boss will get very angry with you if you also raise concerns about the policy. Finally, you are personally indifferent toward the issue. You do not smoke yourself, but your spouse does smoke. Secondary smoke does not bother you, and you do not have strong opinions about it. Still, you have to make a decision about what to do. You see that your choices are to (1) mandate a smoke-free environment, (2) allow smoking in the facility, or (3) ask your boss to clarify the policy.

Exercise Task

Based on this background information, place yourself in the supervisor's role and do the following:

1. Assume that you have chose option 1. Write down an outline that you will use to announce your decision to the four smokers.
2. Assume that you have chosen option 2. Write down an outline that you will use to announce your decision to the two nonsmokers.
3. Assume that you have chosen option 3. Write down an outline that you will use when you meet with your boss.
4. Are there other alternatives?
5. What would you do if you were actually the group supervisor?

BUILDING EFFECTIVE *technical* SKILLS

Exercise Overview

Technical skills are the skills necessary to accomplish or understand the specific kind of work being done in an organization. This exercise will enable you to practice technical skills using the Internet to obtain information for making a decision.

Exercise Background

Assume that you are a business owner seeking a location for a new factory. Your company makes products that are relatively "clean"—that is, they do not pollute the environment, nor will your factory produce any dangerous waste products. Thus, most communities would welcome your plant.

You are seeking a place that has a stable and well-educated workforce, a good quality of life, good health care, and a good educational system. You have narrowed your choice to the towns listed below:

1. Columbia, Missouri
2. Madison, Wisconsin
3. Manhattan, Kansas
4. College Station, Texas
5. Baton Rouge, Louisiana
6. Athens, Georgia

Exercise Task

With this background information as context, do the following:

1. Use the Internet and research each of these cities.
2. Rank-order each city on the basis of the criteria noted.
3. Select the best city for your new factory.

CHAPTER CLOSING CASE

First Aid for Aetna

Aetna had been offering life insurance and property insurance for more than 140 years when Richard Huber became vice chairman and set in motion major decisions that took the company into an entirely new business. In 1996, Huber foresaw a rosy and profitable future for managed health care, in contrast to the increased competition and interest-rate pressures ahead for Aetna's financial services offerings. So he sold the company's U.S. property and life operations and plunked down $8 billion to buy U.S. Healthcare plus $2 billion to buy Prudential Health. With these purchases, Huber was able to say that Aetna insured one in every ten Americans who have insurance.

In retrospect, however, the price tag for entering the health-care insurance field seems high. Aetna paid the equivalent of $2,800 per member for U.S. Healthcare, compared with a typical price of $600 per managed-care member just four years after Aetna's purchase. The downward direction of these per-member prices reflects the downward direction of profits in the managed health-care business during the late 1990s.

Once Aetna entered the ever-changing world of managed health care, it was subjected to risks and decisions it never faced in the insurance industry. First, it was difficult to project the size of the medical bills Aetna's health-care units might have to pay on behalf of sick or injured members. Second, the units might be sued if they didn't pay for some medical treatments. Third, half of Aetna's health-care members were in managed-care plans. Such plans generally attract older and less healthy members, so costs were on the rise—but by how much was impossible to predict. As a result, Aetna's profit margins became narrower and narrower. According to one analyst, the company's managed-care profit margin was about 7.5 percent when it entered the business but had fallen to just 3.3 percent within four years.

In 1999, Aetna's stock price was battered by two pieces of bad news. The company disclosed that its Prudential health-care unit was losing more money than analysts expected. Only days later, lawyers announced their intention to file charges against Aetna and other managed-care companies over the issue of whether doctors were being forced to restrict member care. Still, Aetna had some strengths that Huber, now CEO, wanted to build on. But as Aetna's share price dropped to its lowest point in more than seven years, Huber submitted his resignation and Bill Donaldson was brought in as CEO.

As one of the founders of investment bank Donaldson, Lufkin and Jenrette, Donaldson was a knowledgeable deal maker. He decided to sell off Aetna's insurance

and financial units so the company could concentrate on turning around its health-care operations, which now formed the core of the corporation. After several months of negotiation, Donaldson arranged for Internationale Nederlanden Groep, a Dutch banking and insurance company, to buy the insurance and financial units for $5 billion. Although this relieved some of the pressure, Donaldson was still looking for someone to take the top slot at the company's health-care business because that CEO had retired several months earlier. More tough decisions were ahead for Donaldson and Aetna.

Case Questions

1. How would you describe Richard Huber's risk propensity?
2. Under what conditions did Donaldson make the decision to sell off Aetna's insurance and financial units? Did Huber confront the same conditions when he decided to buy into the health-care business?
3. Before deciding to sell the financial and insurance units, what other options do you think Donaldson considered? How would you evaluate those other options?

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CHAPTER 10

Managing New Venture Formation and Entrepreneurship

OPENING INCIDENT

Just a few years ago James Koch was a high-flying management consultant pulling in over $250,000 a year. To the surprise of his family and friends, however, he quit this job and invested his life's savings in starting a new business from scratch and going head to head with international competitors in a market that had not had a truly successful specialty product in decades. And to their bigger surprise, he succeeded!

The company Koch founded is Boston Beer Co., and its flagship product is a premium beer called Samuel Adams. Koch's family had actually been brewing beer for generations, and he started with a recipe developed by his great-great-grandfather, who had sold the beer in St. Louis in the 1870s under the name Louis Koch Lager. To fund his operation, he used $100,000 in personal savings and another $300,000 invested by his friends.

He set up shop in an old warehouse in Boston, bought some surplus brewing equipment from a large brewery, and started operations. Because his beer used only the highest quality ingredients, he needed to price it at about $1 more per case than such premium imports as Heineken. Boston-area distributors, meanwhile, doubted that consumers would pay $6 per six-pack for an American beer, and most refused to carry it. Thus, Koch himself began selling the beer directly to retailers and bars himself.

But his big break came when he entered Samuel Adams Lager in the Great American Beer Festival, where it won the consumer preference poll—the industry's equivalent of the Oscar. Koch then used this victory as his advertising mantra, proclaiming Samuel Adams as "The Best Beer in America." Sales began to take off, and national distributors began calling for the beer. To meet surging demand, Koch contracted part of the brewing to a near-deserted Stroh's brewery in Pittsburgh.

During the early 1990s sales of Samuel Adams products grew at an annual rate of over 57 percent and today exceed $250 million per year. Boston Beer also exports Samuel Adams to Germany, where the beer has also become quite popular. Koch, meanwhile, has retained controlling interests in the business and still oversees the day-to-day brewing operations. Indeed, he claims that he has sampled at least one of the firm's products every day since the business started, primarily as a way of monitoring quality.

But Koch's success has not gone unnoticed, especially by industry

"You don't create a whole new national market in the beer business by being frightened."

—James Koch, founder and owner, Boston Beer Co.

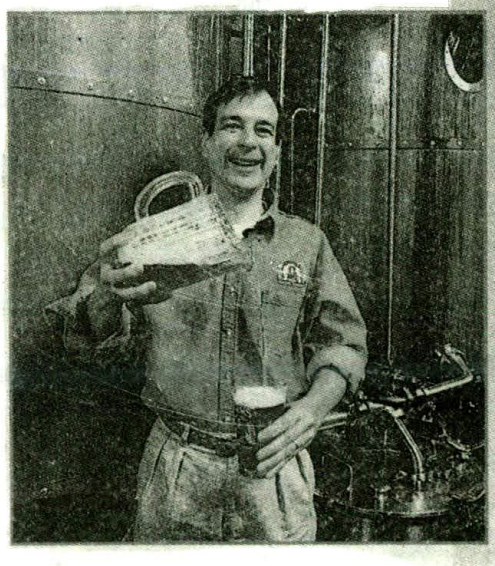
LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- Discuss the nature of entrepreneurship.
- Describe the roles of entrepreneurs in society.
- Understand the major issues involved in choosing strategies for small firms and the role of international management in entrepreneurship.
- Discuss the structural challenges unique to entrepreneurial firms.
- Understand the determinants of the performance of small firms.

giant Anheuser Busch. Anheuser and other national brewers have recently seen their sales take a hit from so-called microbreweries, small regional or local companies that sell esoteric brews made in small quantities and deriving cachet from their very scarcity. The Boston Beer Co. was the first of these to make it big, and most others are trying to follow in its footsteps. Obviously, therefore, Anheuser Busch has a vested interest in not letting these smaller start-ups gain too much market share, most of which would come at its own expense.

Recently, for example, Koch learned that Anheuser had made inquiries about buying the entire crop from a German hops farmer who has an exclusive arrangement with Boston Beer. Had Anheuser succeeded, Koch says, he would have been put out of business. Anheuser has also complained that the labeling on Samuel Adams is misleading, hiding the fact that the beer made in Pittsburgh is actually being brewed under contract by Stroh's, not Boston Beer. And the industry giant has even tried to convince wholesalers, who are highly dependent on Anheuser products like Budweiser, to stop selling specialty beers like Samuel Adams. Koch, meanwhile, simply sees all this attention as a clear sign that he has made it.[1]



CHAPTER OUTLINE

- The Nature of Entrepreneurship
- The Role of Entrepreneurship in Society
  - Job Creation
  - Innovation
  - Importance to Large Businesses
- Strategy for Entrepreneurial Organizations
  - Choosing an Industry
  - Emphasizing Distinctive Competencies
  - Writing a Business Plan
  - Entrepreneurship and International Management
- Structure of Entrepreneurial Organizations
  - Starting the New Business
  - Financing the New Business
  - Sources of Management Advice
  - Franchising
- The Performance of Entrepreneurial Organizations
  - Trends in New Business Start-Ups
  - Reasons for Failure
  - Reasons for Success

Just like James Koch, thousands of people all over the world start new businesses each year. And like the Boston Beer Co., some of these businesses succeed while, unfortunately, many others fail. Some of the people who fail in a new business try again, and sometimes it takes two or more failures before a successful business gets under way. Henry Ford, for example, went bankrupt twice before succeeding with the Ford Motor Co.

This process of starting a new business, sometimes failing and sometimes succeeding, is part of what is called entrepreneurship, the subject of this chapter. We begin by exploring the nature of entrepreneurship. We then examine the role of entrepreneurship in the business world and discuss strategies for entrepreneurial organizations. We then describe the structure and performance of entrepreneurial organizations.

The Nature of Entrepreneurship

entrepreneurship The process of planning, organizing, operating, and assuming the risk of a business venture

entrepreneur Someone who engages in entrepreneurship

Entrepreneurship is the process of planning, organizing, operating, and assuming the risk of a business venture. An **entrepreneur**, in turn, is someone who engages in entrepreneurship. James Koch, as highlighted in the chapter opening incident, fits this description. He put his own resources on the line and took a personal stake in the success or failure of his budding enterprise. Business owners who hire professional managers to run their businesses and then turn their attention to other interests are not entrepreneurs. Although they are assuming the risk of the venture, they are not actively involved in organizing or operating it. Likewise, professional managers whose job is running someone else's business are not entrepreneurs because they assume less-than-total personal risk for the success or failure of the business.



Entrepreneurs find new business through many different approaches. For example, take Dineh Mohajer. A few years ago, when she was studying pre-med at USC, she wanted some blue nail polish to wear to a party but couldn't find just the right shade, so she made it herself. She subsequently decided there is a market among Generation X-ers like herself for new approaches to cosmetics and toiletries. So, she dropped out of school and founded Hard Candy and started marketing nail polish with names like Pimp and Porno. Mohajer's firm now has 25 employees and sales of over $10 million a year.

Entrepreneurs start new businesses. We define a **small business** as one that is privately owned by one individual or a small group of individuals and has sales and assets that are not large enough to influence its environment. A small two-person software development company with annual sales of $100,000 would clearly be a small business, whereas Microsoft Corporation is just as clearly a large business. But the boundaries are not always this clear-cut. For example, a regional retailing chain with twenty stores and annual revenues of $30 million may sound large, but it is really very small when compared to such giants as Wal-Mart and Sears.

small business A business that is privately owned by one individual or a small group of individuals; it has sales and assets that are not large enough to influence its environment

MANAGEMENT IMPLICATIONS Managers should understand the nature and meaning of entrepreneurship and the differentiating factors between it and management.

■ The Role of Entrepreneurship in Society

The history of entrepreneurship and of the development of new businesses is in many ways the history of great wealth and of great failure. Some entrepreneurs have been very successful and have accumulated vast fortunes from their entrepreneurial efforts. For example, when Microsoft Corp. sold its stock to the public in 1986, Bill Gates, then just thirty years old, received $350 million for his share of Microsoft.[2] Today, his holdings—valued at $63 billion—make him the richest person in the United States and one of the richest in the world.[3] Many more entrepreneurs, however, have lost a great deal of money. Research suggests that the majority of new businesses fail within the first few years of founding.[4] Many that last longer do so only because the entrepreneurs themselves work long hours for very little income.

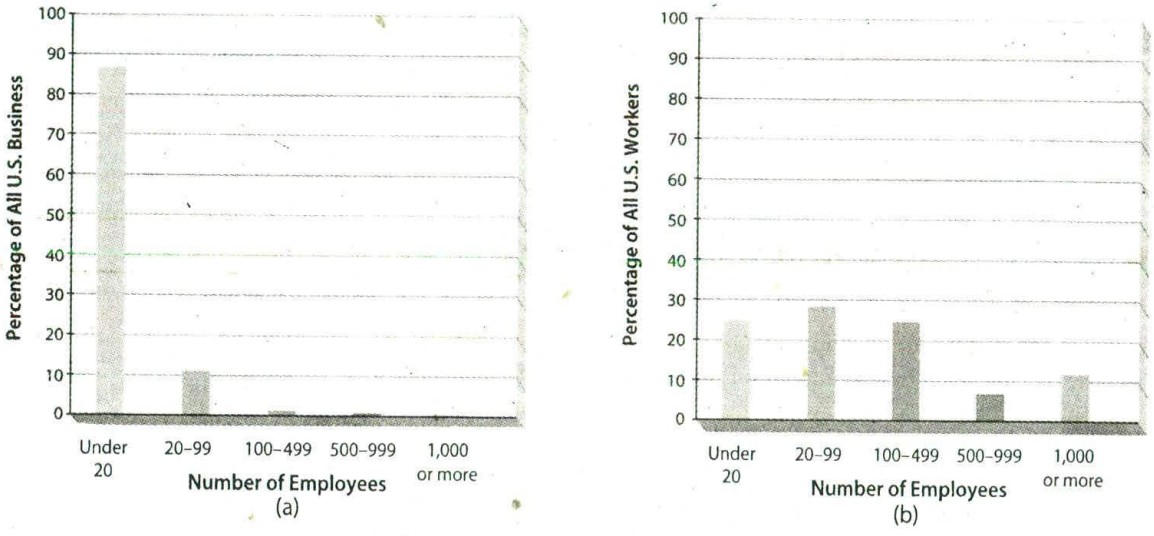
As Figure 10.1 shows, most U.S. businesses employ fewer than one hundred people, and most U.S. workers are employed by small firms. For example, Figure 10.1(a) shows that 86.70 percent of all U.S. businesses employ twenty or fewer people; another 11 percent employ between twenty and ninety-nine people. In contrast, only about one-tenth of 1 percent employ one thousand or more workers. Figure 10.1(b) shows that 25.60 percent of all U.S. workers are employed by firms with fewer than twenty people; another 29.10 percent work in firms that employ between twenty and ninety-nine people. The vast majority of these companies are owner operated.[5] Figure 10.1(b) also shows that 12.70 percent of U.S. workers are employed by firms with one thousand or more total employees.

On the basis of numbers alone, then, small business is a strong presence in the economy, which is true in virtually all the world's mature economies. In Germany, for example, companies with fewer than five hundred employees produce two-thirds of the nation's gross national product, train nine of ten apprentices, and employ four of every five workers. Small businesses also play major roles in the economies of Italy, France, and Brazil. In addition, experts agree that small businesses will be quite important in the emerging economies of countries such as Russia and Vietnam. The contribution of small businesses can be measured in

Figure 10.1

The Importance of Small Business in the United States

Over 86 percent of all U.S. businesses have no more than twenty employees. The total number of people employed by these small businesses is approximately one-fourth of the entire U.S. workforce. Another 29 percent work for companies with fewer than one hundred employees.



Source: U.S. Census Bureau, Statistical Abstract of the United States: 1999 (119th Edition), Washington, D.C., 1999.

terms of their effects on key aspects of an economic system. In the United States, these aspects include job creation, innovation, and importance to big business.

Job Creation

In the early 1980s, a widely cited study proposed that small businesses create eight of every ten new jobs in the United States. This contention touched off considerable interest in the fostering of small business as a matter of public policy. As we will see, relative job growth among businesses of different sizes is not easy to determine. It is clear, however, that small businesses—especially in certain industries—are an important source of new (and often well-paid) jobs in this country. According to the Small Business Administration, for example, seven of the ten industries that added the most new jobs in 1998 were in sectors dominated by small businesses. Moreover, small businesses currently account for 38 percent of all jobs in high-technology sectors of the economy.[6]

Note that new jobs are also being created by small firms specializing in international business. For example, Bob Knosp operates a small business in Bellevue, Washington, that makes computerized sign-making systems. Knosp gets over half his sales from abroad and has dedicated almost 75 percent of his workforce to handling international sales. Indeed, according to the SBA, small

businesses account for 96 percent of all U.S. exporters.[7]

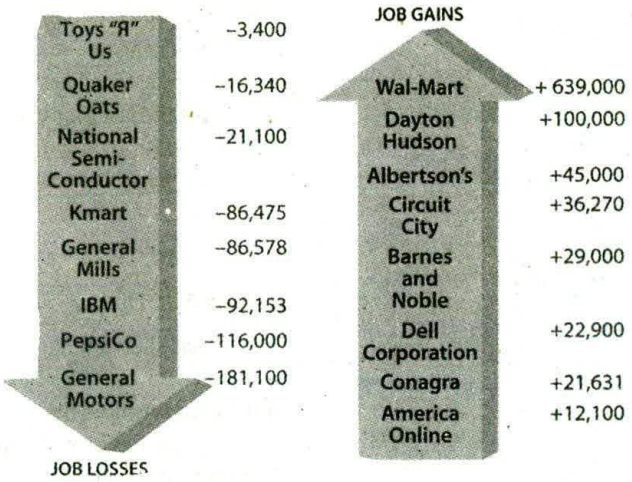
Although small businesses certainly create many new jobs each year, the importance of entrepreneurial big businesses in job creation should also not be overlooked. While big businesses cut thousands of jobs in the late 1980s and early 1990s, the booming U.S. economy resulted in large-scale job creation in many larger businesses beginning in the mid-1990s. Figure 10.2 details the changes in the number of jobs at sixteen large U.S. companies during the ten-year period between 1990 and 1999. As you can see, General Motors eliminated 181,100 jobs and General Mills and Kmart eliminated over 86,000 jobs each. Wal-Mart alone, however, created 639,000 new jobs during the same period and Dayton Hudson, an additional 100,000.

But even these data have to be interpreted with care. PepsiCo, for example, "officially" eliminated 116,000 jobs. But most of those losses came in 1997, when the firm sold its restaurant chains (KFC, Pizza Hut, and Taco Bell) to Tricon. In reality, therefore, many of the jobs weren't actually eliminated but simply transferred to another employer. Likewise, while most of Wal-Mart's 639,000 new jobs are indeed "new," some came when the company acquired other businesses and thus were not net new jobs.

Figure 10.2

Representative Jobs Created and Lost by Big Business, 1990–1999

All businesses create and eliminate jobs. Because of their size, the magnitude of job creation and elimination is especially pronounced in bigger businesses. This figure provides several representative examples of job creation and elimination at many big U.S. businesses during the 1990s. For example, while General Motors cut 181,100 jobs, Wal-Mart created 639,000 during this decade.





One important economic role played by small business start-ups is the creation of new jobs. For example, Susan Webb owns and manages Webb Transitions, a private employment agency that contracts with public agencies and private companies to help disabled employees return to work. Webb Transitions employs six people, and Ms. Webb forecasts a 10 percent annual revenue growth rate for each of the next several years. And as her business grows, she will continue to add new jobs as well.

At least one message is clear: entrepreneurial business success, more than business size, accounts for most new job creation. Whereas successful retailers such as Wal-Mart and Dayton Hudson have been growing and adding thousands of new jobs, struggling chains such as Kmart have been eliminating thousands. At the same time, flourishing high-tech giants such as Dell, Intel, and Microsoft continue to add jobs at a constant pace. It is also essential to take a long-term view when analyzing job growth. Figure 10.2, for example, shows that IBM has eliminated 92,153 jobs. But the firm actually cut a total of 163,381 jobs between 1990 and 1994. Since 1995, it has created 71,228 new jobs while the company has recovered from an economic slump that caused the original job cuts to be so severe.

The reality, then, is that jobs are created by entrepreneurial companies of all sizes, all of which hire workers and all of which lay them off. Although small firms often hire at a faster rate than large ones, they are also likely to eliminate jobs at a far higher rate. Small firms are also the first to hire in times of economic recovery, large firms the last. Conversely, however, big companies are also the last to lay off workers during economic downswings. In 1999, almost 35 percent of all small businesses had job openings, and almost 20 percent were planning to hire new employees.

Innovation

History has shown that major innovations are as likely to come from small businesses (or individuals) as from big businesses. For example, small firms and individuals invented the personal computer and the stainless-steel razor blade, the transistor radio and the photocopying machine, the jet engine and the self-developing photograph. They also gave us the helicopter and power steering, automatic transmissions and air conditioning, cellophane, and the nineteen-cent ballpoint pen. Today, says the SBA, small businesses supply 55 percent of all "innovations" introduced into the American marketplace.[8]

Not surprisingly, history is repeating itself infinitely more rapidly in the age of computers and high-tech communication. For example, much of today's most innovative software is being written at new start-up companies such as Trilogy Software Inc., an Austin-based company started by Stanford dropout Joe Liemandt. Trilogy's products help optimize and streamline complicated sales and marketing processes for big-business customers such as IBM and Whirlpool.[9] Yahoo! and Netscape brought the Internet into the average American living room, and on-line companies such as Amazon.com are using it to redefine our shopping habits. Each of these firms started out as a small business. So did Alain Rossmann's Phone.com, a new but growing enterprise that helps big companies provide wireless access to the Internet. Similarly, eToys, Inc., another dot.com start-up, is making major inroads in the toy-retailing business.

Of course, not all successful new start-ups are leading-edge dot.com enterprises. Drywall installer Jerry Free, for example, was frustrated by conventional methods of joining angled wallboards. In his spare time, he developed a simple, handheld device that makes it easier and faster to perform this common task. He eventually licensed his invention to United States Gypsum, and it is now widely

used throughout the construction industry. As for Free, the experience convinced him that "the cliché about invention being 1 percent inspiration and 99 percent perspiration is true."[10] Popular fashion designer Kate Spade has made it big by introducing a line of stylish purses and handbags sold through such exclusive retailers as Neiman Marcus. Rory Stear and Christopher Staines have succeeded with Freeplay Energy Group, a firm making environmentally friendly wind-up radios that don't need batteries or electricity.[11] Eric Ludewig presides over fast-growing East of Chicago Pizza, a chain he founded when he was twenty-two years old and just out of college.[12]

Importance to Large Businesses

Most of the products made by large manufacturers are sold to consumers by small businesses. For example, the majority of dealerships selling Fords, Chevrolets, Toyotas, and Volvos are independently owned and operated. Moreover, small businesses provide large businesses with many of the services, supplies, and raw materials they need. As we noted, for example, Trilogy Software has become an important supplier to large businesses. Likewise, Microsoft relies heavily on small businesses in the course of its routine business operations. For example, the software giant outsources much of its routine code-writing functions to hundreds of sole proprietorships and other small firms. It also outsources much of its packaging, delivery, and distribution to smaller companies. Dell Computer (www.dell.com) uses this same strategy, buying most of the parts and components used in its computers from small suppliers around the world.

MANAGEMENT IMPLICATION All managers, regardless of the size of their organizations, should recognize the important roles played by entrepreneurs in the areas of job creation, innovation, and supporting large businesses.

■ *Strategy for Entrepreneuerial Organizations*

One of the most basic challenges facing an entrepreneurial organization is choosing a strategy. The three strategic challenges facing small firms, in turn, are choosing an industry in which to compete, emphasizing distinctive competencies, and writing a business plan.[13]

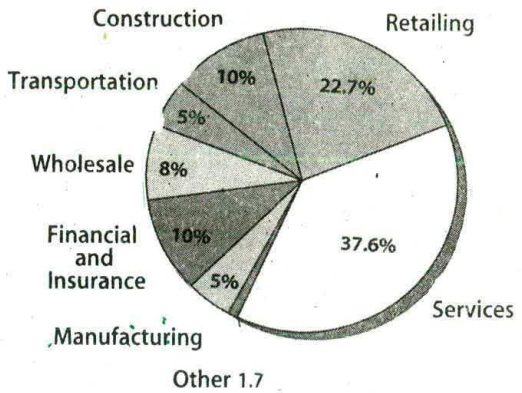
Choosing an Industry

Not surprisingly, small businesses are more common in some industries than in others. The major industry groups that include successful new ventures and small businesses are services, retailing, construction, financial and insurance, wholesaling, transportation, and manufacturing. Obviously, each group differs in its requirements for employees, money, materials, and machines. In general, the more resources an industry requires, the harder it is to start a business and the less likely

Figure 10.3

Small Businesses (Businesses with Less Than Twenty Employees) by Industry

Small businesses are especially strong in certain industries such as retailing and services. On the other hand, there are relatively fewer small businesses in industries such as transportation and manufacturing. The differences are affected primarily by factors such as the investment costs necessary to enter markets in these industries. For example, starting a new airline would require the purchase of large passenger aircraft and airport gates and hiring an expensive set of employees.



Source: U.S. Census Bureau, Statistical Abstract of the United States: 1999 (119th Edition), Washington, D.C., 1999.

that the industry is dominated by small firms. Remember, too, that *small* is a relative term: the criteria (number of employees and total annual sales) differ from industry to industry and are often meaningful only when compared with businesses that are truly large. Figure 10.3 shows the distribution of all U.S. businesses employing fewer than twenty people across industry groups.

Services Primarily because they require few resources, service businesses are the fastest growing segment of small-business enterprise. In addition, no other industry group offers a higher return on time invested. Finally, services appeal to the talent for innovation typified by many small enterprises. As Figure 10.3 shows, 37.6 percent of all businesses with fewer than twenty employees are services businesses.

Small-business services range from shoeshine parlors to car rental agencies, from marriage counseling to computer software, from accounting and management consulting to professional dog walking. In Dallas, for example, Jani-King has prospered by selling commercial cleaning services to local companies. In Virginia Beach, Virginia, Jackson Hewitt Tax



Would-be entrepreneurs can increase their chances for success by identifying a niche or potential market that no other business is serving. Consider, for instance, the success enjoyed by Boston entrepreneur Chris Murphy. He knew that some dog owners felt that they faced the same day-care problems experienced by parents of small children. In response, he started The Common Dog, a service that picks dogs up on a school bus, takes them to a day-kennel while their owners work, and drops them off at the end of the day. The service costs the dog owners $325 a month. At the kennel, the dogs enjoy their own small swimming pool, several lounging couches, and frequent walks. They do, however, have to bring their own lunches!

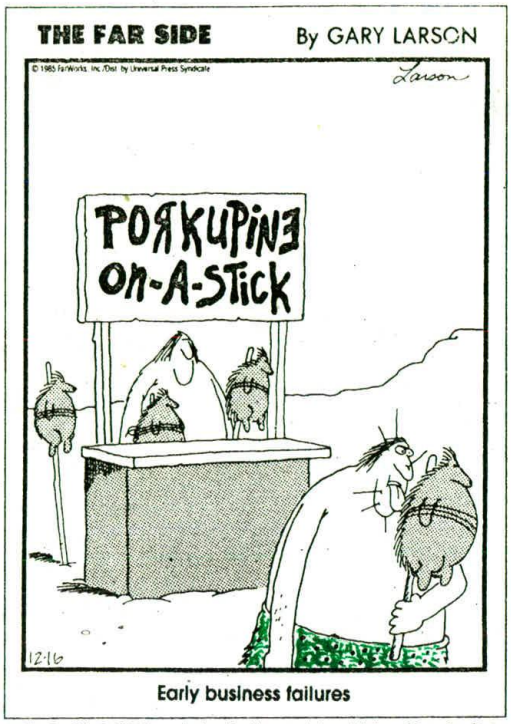
Service has found a profitable niche in providing computerized tax preparation and electronic tax-filing services. Great Clips Inc. is a fast growing, family-run chain of hair salons headquartered in Minneapolis.

David Flanary, Richard Sorenson, and Michael Holloway recently established an Internet-based long-distance telephone service in Austin, Texas, called PointOne Telecommunications. The basic idea was hatched during a tennis match. Recalls Sorenson: "We started getting excited, volleying at the net, and then finally we put the rackets down and went to the side to talk." The firm is off to a great start. Currently, it acts as a wholesale voice carrier, but as soon as its network is completed, PointOne will start signing up its own commercial customers. Investors agree that the company will soon be a major force in telecommunications.[14]

Retailing A retail business sells products manufactured by other firms directly to consumers. There are hundreds of different kinds of retailers, ranging from wig shops and frozen yogurt stands to automobile dealerships and department stores. Usually, however, people who start small businesses favor specialty shops—for example, big men's clothing or gourmet coffees—that let them focus limited resources on narrow market segments. Retailing accounts for 22.7 percent of all businesses with fewer than twenty employees.

John Mackey, for example, launched Whole Foods out of his own frustration at being unable to find a full range of natural foods at other stores. He soon found, however, that he had tapped a lucrative market and started an ambitious expansion program. Today, with ninety outlets in twenty states and Washington, D.C., Whole Foods is the largest natural-foods retailer in the United States, three times larger than its biggest competitor.[15] Likewise, when Olga Tereshko found it difficult to locate just the right cloth diapers and breast-feeding supplies for her newborn son, she decided to start selling them herself. Instead of taking the conventional retailing route, however, Tereshko set up shop on the Internet. Her business, called Little Koala, has continued to expand at a rate of about 10 percent a month, and she has established a customer base of eight thousand to nine thousand loyal customers.[16]

Construction About 10 percent of businesses with fewer than twenty employees are involved in construction. Because many construction jobs are relatively small local projects, local construction firms are often ideally suited as contractors. Many such firms are begun by skilled craftspeople who start by working for someone else and subsequently decide to work for themselves. Common examples of small construction firms include home builders; wood finishers; roofers; painters; and plumbing, electrical, and roofing contractors.



Early business failures

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As noted in the text, successful entrepreneurs must choose an industry, emphasize their distinctive competencies, and develop an effective business plan. Unfortunately, entrepreneurs frequently misjudge or do not effectively implement one or more of these activities. As illustrated in this cartoon, for example, providing a product that people do not really want is almost certain to result in failure. Chocolate confections, sausages, and corn-on-the-cob are often popular treats served on sticks at athletic events, fairs, festivals, and carnivals—but cucumbers, peaches, and porcupines are not as well received!

For example, Marek Brothers Construction in College Station, Texas, was started by two brothers, Pat and Joe Marek. They originally worked for other contractors but started their own partnership in 1980. Their only employee is a receptionist. They manage various construction projects, including new-home construction and remodeling, subcontracting out the actual work to other businesses and/or individual craftspersons. Marek Brothers has an annual gross income of about $5 million.

Finance and Insurance Financial and insurance businesses comprise about 10 percent of all firms with less than twenty employees. In most cases, these businesses either are affiliates of and/or sell products provided by larger national firms. Although the deregulation of the banking industry has reduced the number of small local banks, other businesses in this sector are still doing quite well.

Typically, for example, local State Farm Mutual offices are small businesses. State Farm itself is a major insurance company, but its local offices are run by 16,500 independent agents. In turn, agents hire their own staffs, run their own offices as independent businesses, and so forth. They sell various State Farm insurance products and earn commissions from the premiums paid by their clients. Some local savings and loan operations, mortgage companies, and pawn shops also fall into this category.

Wholesaling Small-business owners often do very well in wholesaling, too; about 8 percent of businesses with fewer than twenty employees are wholesalers. A wholesale business buys products from manufacturers or other producers and then sells them to retailers. Wholesalers usually buy goods in bulk and store them in quantities at locations that are convenient for retailers. For a given volume of business, therefore, they need fewer employees than manufacturers, retailers, or service providers.

They also serve fewer customers—usually those who repeatedly order large volumes of goods—than other providers. Wholesalers in the grocery industry, for instance, buy packaged food in bulk from companies such as Del Monte and Campbell's and then sell it to both large grocery chains and smaller independent grocers. Luis Espinoza has found a promising niche for Inca Quality Foods, a midwestern wholesaler that imports and distributes Hispanic foods for consumers from Mexico, the Caribbean, and Central America. Partnered with the large grocery-store chain Kroger, Espinoza's firm continues to grow steadily.[17]

Transportation Some small firms—about 5 percent of all companies with fewer than twenty employees—do well in transportation and transportation-related businesses. Such firms include local taxi and limousine companies, charter airplane services, and tour operators. In addition, in many smaller markets, bus companies and regional airlines subcontract local equipment maintenance to small businesses.

Consider, for example, some of the transportation-related small businesses at a ski resort like Steamboat Springs, Colorado. Most visitors fly to the town of Hayden, about fifteen miles from Steamboat. While some visitors rent vehicles, many others use the services of Alpine Taxi, a small local operation, to transport them to their destinations in Steamboat. While on vacation, they rely on the local bus ser-

vice, which is subcontracted by the town to another small business, to get to and from the ski slopes each day. Other small businesses offer van tours of the region, hot-air balloon rides, and helicopter lifts to remote areas for extreme skiers. Still others provide maintenance support at Hayden for Continental, American, and United aircraft that serve the area during ski season.

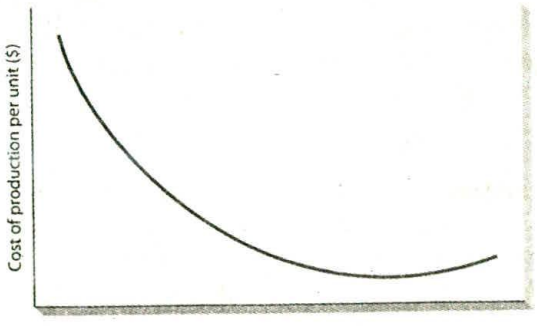
Manufacturing More than any other industry, manufacturing lends itself to big business—and for good reason. Because of the investment normally required in equipment, energy, and raw materials, a good deal of money is usually needed to start a manufacturing business. Automobile manufacturing, for example, calls for billions of dollars of investment and thousands of workers before the first automobile rolls off the assembly line. Obviously, such requirements shut out most individuals. Although Henry Ford began with $28,000, it has been a long time since anyone started a new U.S. car company from scratch.

Research has shown that manufacturing costs often fall as the number of units produced by an organization increases. This relationship between cost and production is called an *economy of scale.*[18] Small organizations usually cannot compete effectively on the basis of economies of scale. As depicted in Figure 10.4(a), organizations with higher levels of production have a major cost advantage over those with lower levels of production. Given the cost positions of small and large firms when there are strong economies of scale in manufacturing, it is not surprising that small manufacturing organizations generally do not do as well as large ones.

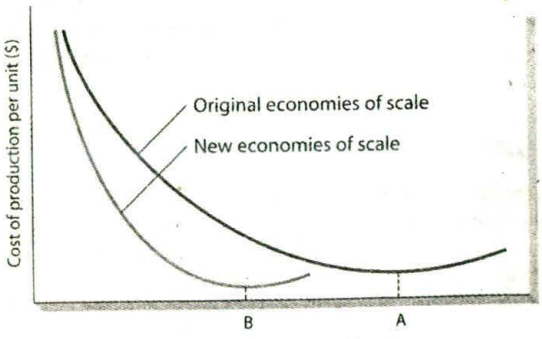
Figure 10.4

Economies of Scale in Small Business Organizations

Small businesses sometimes find it difficult to compete in manufacturing-related industries because of the economies of scale associated with plant, equipment, and technology. As shown in (a), firms that produce a large number of units (that is, larger businesses) can do so at a lower per-unit cost. At the same time, however, new forms of technology occasionally cause the economies-of-scale curve to shift, as illustrated in (b). In this case, smaller firms may be able to compete more effectively with larger ones because of the drop in per-unit manufacturing cost.



(a) Standard economies-of-scale curve



(b) Change in technology that shifts economies of scale and may make small business production possible

Interestingly, when technology in an industry changes, it often shifts the economies-of-scale curve, thereby creating opportunities for smaller organizations. For example, steel manufacturing was historically dominated by a few large companies that owned several huge facilities. With the development of mini-mill technology, however, extracting economies of scale at a much smaller level of production became possible. This type of shift is depicted in Figure 10.4(b). Point A in this figure is the low-cost point with the original economies of scale. Point B is the low-cost point with the economies of scale brought on by the new technology. Notice that the number of units needed for low cost is considerably lower for the new technology. This shift has allowed the entry of numerous smaller firms into the steel industry. Such entry would not have been possible with the older technology.

This example is not meant to suggest that there are no small-business owners who do well in manufacturing—about 5 percent of businesses with fewer than twenty employees are involved in some aspect of manufacturing. Indeed, it is not uncommon for small manufacturers to outperform large businesses in such innovation-driven industries as chemistry, electronics, toys, and computer software. Some small manufacturers prosper by locating profitable niches. For example, brothers Dave and Dan Hanlon and Dave's wife Jennie recently started a new motorcycle-manufacturing business called Excelsior-Henderson. (Excelsior and Henderson are actually names of classic motorcycles from the early years of the twentieth century; the Hanlons acquired the rights to these brand names because of the images they evoke among motorcycle enthusiasts.) The Hanlons started by building four thousand bikes in 1999 and expect to increase slowly to annual production of twenty thousand per year. So far, Excelsior-Henderson motorcycles have been well received (the top-end Excelsior-Henderson Super X sells for about $18,000), and many Harley-Davidson dealers have started to sell them as a means of diversifying their product lines.[19]

Emphasizing Distinctive Competencies

As we defined them in Chapter 8, an organization's distinctive competencies are the aspects of business that the firm performs better than its competitors. The distinctive competencies of small business usually fall into three areas: the ability to identify new niches in established markets, the ability to identify new markets, and the ability to move quickly to take advantage of new opportunities. *Today's Management Issues* explores the world of on-line retailing from the point of view of distinctive competencies.

established market A market in which several large firms compete according to relatively well-defined criteria

Identifying Niches in Established Markets An **established market** is one in which several large firms compete according to relatively well-defined criteria. For example, throughout the 1970s several well-known computer-manufacturing companies, including IBM, Digital Equipment, and Hewlett-Packard, competed according to three product criteria: computing power, service, and price. Over the years, the computing power and quality of service delivered by these firms continued to improve, while prices (especially relative to computing power) continued to drop.

TODAY'S MANAGEMENT ISSUES

On-Line Start-Ups Challenge Store Retailers

Ever since Jeff Bezos pioneered the idea of an on-line bookstore by launching Amazon.com, the Internet has become a hotbed of entrepreneurial activity as more people open web sites to challenge traditional store retailers. According to Shop.org, a trade association, more than thirty thousand web sites are devoted to on-line retailing. This number includes sites operated by traditional chains such as Wal-Mart as well as web-only giants such as Amazon. Still, the vast majority of on-line retailers sell less than $500,000 worth of merchandise in a year, so traditional retailing is far from dead. But can the on-line start-ups successfully challenge their store counterparts?

With Amazon.com (http://www.amazon.com), Bezos seized the first-mover advantage in books. By the time the Barnes and Noble retail chain recognized the danger and opened its web site (http://www.bn.com), Amazon's discount pricing and user-friendly features had created a loyal and lucrative customer following. Although Barnes and Noble's site now ranks among the Internet's most visited, Amazon attracts many more visitors and completes more sales. Barnes and Noble continues to expand its chain and increase store sales, even though Amazon is siphoning off some of its overall market share.

In toys, web-only eToys (http://www.etoys.com) sought first-mover advantage over its counterparts in store retailing. During its first year-end holiday selling season, eToys' electronic wish lists and other novel features drew widespread media attention and helped the company ring up $20 million in sales. By the time eToy's second Christmas rolled around, however, the Toys 'R' Us chain had become a "clicks and mortar" retailer by opening a flashy web site (http://www.toysrus.com) amid much fanfare. Then the Toys 'R' Us site had difficulty handling the onslaught of visitors and fulfilling orders as promised, while eToys' sales soared. But mounting expenses, continuing losses, and intense on-line competition have given eToys headaches of its own and pushed its stock price down.

It won't be about clicks versus mortar but coming up with a combination where a customer can do a transaction anytime, anywhere.

*—Elaine Rubin, chairperson of Shop.org**

Given the high cost of sustaining their first-mover advantage, most on-line retailers are struggling with profitability. Well-established on-line pioneers such as Amazon have the best chance of survival, but many smaller sites are headed for a shakeout as more entrepreneurs and more traditional retailers flock to the Internet.

References: Herb Greenberg, "Dead Mall Walking," *Fortune*, May 1, 2000, p. 304; William Bulkeley and Jim Carlton, "Reality Bites: E-Tail Gets Derailed: How Web Upstarts Misjudged the Game," *Wall Street Journal*, April 5, 2000, pp. A1, A6 (*quote on p. A6); Karl Taro Greenfeld, "Clicks and Bricks," *Time*, December 27, 1999, pp. 88 ff.

Enter Apple Computer and the personal computer. For Apple, user friendliness, not computing power, service, and price, was to be the basis of competition. Apple targeted every manager, every student, and every home as the owner of a personal computer. The major entrepreneurial act of Apple was not to invent a new technology (indeed, the first Apple computers used all standard parts taken from other computers) but to recognize a new kind of computer and a new way to compete in the computer industry.

Apple's approach to competition was to identify a new niche in an established market. A **niche** is simply a segment of a market that is not currently being exploited. In general, small entrepreneurial businesses are better at discovering these niches than are larger organizations. Large organizations usually have so

niche A segment of a market that is not currently being exploited

many resources committed to older, established business practices that they may be unaware of new opportunities. Entrepreneurs can see these opportunities and move quickly to take advantage of them.[20]

Identifying New Markets Successful entrepreneurs also excel at discovering whole new markets. Discovery can happen in at least two ways. First, an entrepreneur can transfer a product or service that is well established in one geographic market to a second market. This is what Marcel Bich did with ballpoint pens, which occupied a well-established market in Europe before Bich introduced them to this country. Bich's company, Bic Corp., eventually came to dominate the U.S. market.

Second, entrepreneurs can sometimes create entire industries. Entrepreneurial inventions of the dry-paper copying process and the semiconductor have created vast new industries. Not only have the first companies in these markets (Xerox and National Semiconductor, respectively) been very successful, but their entrepreneurial activity has spawned the development of hundreds of thousands of other companies and hundreds of thousands of jobs. Again, because entrepreneurs are not encumbered with a history of doing business in a particular way, they are usually better at discovering new markets than are larger, more mature organizations.

first-mover advantage Any advantage that comes to a firm because it exploits an opportunity before any other firm does

First-Mover Advantages A **first-mover advantage** is any advantage that comes to a firm because it exploits an opportunity before any other firm does. Sometimes large firms discover niches within existing markets or new markets at just about the same time as small entrepreneurial firms do but are not able to move as quickly as small companies to take advantage of these opportunities.

There are numerous reasons for this difference. For example, many large organizations make decisions slowly because each of their many layers of hierarchy has to approve an action before it can be implemented. Also, large organizations may sometimes put a great deal of their assets at risk when they take advantage of new opportunities. Every time Boeing decides to build a new model of a commercial jet, it is making a decision that could literally bankrupt the company if it does not turn out well. The size of the risk may make large organizations cautious. The dollar value of the assets at risk in a small organization, in contrast, is quite small. Managers may be willing to "bet the company" when the value of the company is only $100,000. They might be unwilling to "bet the company" when the value of the company is $1 billion.

Writing a Business Plan

business plan A document that summarizes the business strategy and how that strategy is to be implemented

Once an entrepreneur has chosen an industry to compete in and determined which distinctive competencies to emphasize, these choices are usually included in a document called a business plan. In a **business plan** the entrepreneur summarizes the business strategy and how that strategy is to be implemented. The very act of preparing a business plan forces prospective entrepreneurs to crystal-

lize their thinking about what they must do to launch their business successfully and obliges them to develop their business on paper before investing time and money in it. The idea of a business plan is not new. What is new is the growing use of specialized business plans by entrepreneurs, mostly because creditors and investors demand them for use in deciding whether to help finance a small business.

The plan should describe the match between the entrepreneur's abilities and the requirements for producing and marketing a particular product or service. It should define strategies for production and marketing, legal aspects and organization, and accounting and finance. In particular, it should answer three questions: (1) What are the entrepreneur's goals and objectives? (2) What strategies will the entrepreneur use to obtain these goals and objectives? and (3) How will the entrepreneur implement these strategies?

Business plans should also account for the sequential nature of much strategic decision making in small businesses. For example, entrepreneurs cannot forecast sales revenues without first researching markets. The sales forecast itself is one of the most important elements in the business plan. Without such forecasts, it is all but impossible to estimate intelligently the size of a plant, store, or office or to determine how much inventory to carry or how many employees to hire.

Another important component of the overall business plan is financial planning, which translates all other activities into dollars. Generally, the financial plan is made up of a cash budget, an income statement, balance sheets, and a breakeven chart. The most important of these statements is the cash budget because it tells entrepreneurs how much money they need before they open for business and how much money they need to keep the business operating.

Entrepreneurship and International Management

Finally, while many people associate international management with large businesses, many smaller companies are also finding expansion and growth opportunities in foreign countries. For example, Fuci Metals, a small but growing enterprise, buys metal from remote locations in areas such as Siberia and Africa and then sells it to big auto makers like Ford and Toyota. Similarly, California-based Gold's Gym is expanding into foreign countries and has been especially successful in Russia.[21] While such ventures are accompanied by considerable risks, they also give entrepreneurs new opportunities and can be a real catalyst for success. The *World of Management* explores some related issues in entrepreneurship and international business.

MANAGEMENT IMPLICATIONS Entrepreneurs should exercise caution when selecting an industry, recognizing that some are easier and others more difficult for a small business. By emphasizing distinctive competencies and relying on a well-formulated business plan, they increase their chances for success. International opportunities should also be given full consideration by small businesses.

WORLD OF MANAGEMENT

Europe's Immigrant Entrepreneurs

Even as European Union nations look for ways to limit immigration, the newcomers are bringing drive and innovation to their adopted countries. Many Europeans are concerned about legal and illegal immigrants taking jobs away from local workers and swelling welfare rolls. Despite these concerns, one U.N. study indicates that the region's workforce will dwindle unless the countries admit forty million immigrants by 2025. Clearly, immigration is a key element in economic growth, especially since the newcomers open businesses at a far greater rate than native-born entrepreneurs—creating new jobs and paying taxes to their newly adopted lands.

Consider the experience of Chin Thach, whose Chinese family fled Cambodia for France in 1976. Thach started learning the language at night while working in an automobile factory by day. Within a decade, he had earned enough to join two other immigrant friends in launching a computer assembly firm. Thanks to the entrepreneurs' hard work and dedication, the company's annual sales are now $275 million with a payroll of four hundred employees.

But opening a new venture is not always easy for immigrants. Germany, for example, does not allow foreigners to open new businesses until they have resided in the country for at least four years. Under that law, Polish-born Marek Suida would not have been able to start a moving company in Germany—except that his native-born wife, who is also his business partner, was able to register the company.

On the other hand, Kemal Sahin, who came to Germany from Turkey to complete an engineering degree at Aachen University in 1982, lacked the formal paperwork to take a job but was told he could stay in the country if he opened a business. Sahin arranged to open a store in Aachen and sell T-shirts imported from his homeland. Over the years, Sahin did well enough to buy eighteen textile plants in Turkey and manufacture clothing for export all over the European Union and the United States. His retail chain has grown to more than three hundred stores in Germany; the entire business has nearly ten thousand employees, with annual sales of more than $900 million. Now Sahin's success as an immigrant entrepreneur is inspiring other people to leave Turkey and open new ventures in Germany.

My family owned a factory producing soy sauce in Cambodia, and I always wanted my own business.

—Chin Thach, co-founder, Abacus Equipement Éléctronique*

Reference: William Echikson, "Unsung Heroes," *Business Week*, March 6, 2000, pp. 92–100 (*quote on p. 92).

■ Structure of Entrepreneurial Organizations

With a strategy in place and a business plan in hand, the entrepreneur can then proceed to devise a structure that turns the vision of the business plan into a reality. Many of the same concerns in structuring any business, which are described in the next five chapters of this book, are also relevant to small businesses. For example, entrepreneurs need to consider organization design and to develop job descriptions, organization charts, and management control systems.

The Internet, of course, is rewriting virtually all of the rules for starting and operating a small business. Getting into business is easier and faster than ever before,

there are many more potential opportunities than at any time in history, and the ability to gather and assimilate information is at an all-time high. Even so, however, would-be entrepreneurs must still make the right decisions when they start. They must decide, for example, precisely how to get into business. Should they buy an existing business or build from the ground up? In addition, would-be entrepreneurs must find appropriate sources of financing and decide when and how to seek the advice of experts.

Starting the New Business

An old Chinese proverb suggests that a journey of a thousand miles begins with a single step. This is also true of a new business. The first step is the individual's commitment to becoming a business owner. Next comes choosing the goods or services to be offered—a process that means investigating one's chosen industry and market. Making this choice also requires would-be entrepreneurs to assess not only industry trends but also their own skills. Like the managers of existing businesses, new business owners must also be sure that they understand the true nature of their enterprises in which they are engaged.

Buying an Existing Business After choosing a product and making sure that the choice fits their own skills and interests, entrepreneurs must decide whether to buy an existing business or to start from scratch. Consultants often recommend the first approach. Quite simply, the odds are better: if successful, an existing business has already proved its ability to draw customers at a profit. It has also established working relationships with lenders, suppliers, and the community. Moreover, the track record of an existing business gives potential buyers a much clearer picture of what to expect than any estimate of a new business's prospects. Around 30 percent of the new businesses started in the past decade were bought from someone else. The McDonald's empire, for example, was started when Ray Kroc bought an existing hamburger business and then turned it into a global phenomenon. Likewise, Starbucks was a struggling mail-order business when Howard Schultz bought it and turned his attention to retail expansion.

Starting from Scratch Some people, however, prefer the satisfaction that comes from planting an idea, nurturing it, and making it grow into a strong and sturdy business. There are also practical reasons to start a business from scratch. A new business does not suffer from the ill effects of a prior owner's errors. The start-up owner is also free to choose lenders, equipment, inventories, locations, suppliers, and workers, unbound by a predecessor's commitments and policies. Of the new businesses begun in the past decade, 64 percent were started from scratch.

Not surprisingly, though, the risks of starting a business from scratch are greater than those of buying an existing firm. Founders of new businesses can only make predictions and projections about their prospects. Success or failure thus depends heavily on identifying a genuine business opportunity—for example, a product for which many customers will pay well but which is currently unavailable to them. To find openings, entrepreneurs must study markets and answer the following questions: (1) Who are my customers? (2) Where are they? (3) At what price

will they buy my product? (4) In what quantities will they buy? (5) Who are my competitors? and (6) How will my product differ from those of my competitors?

Finding answers to these questions is a difficult task even for large, well-established firms. But where can the new business owner get the necessary information? Other sources of assistance are discussed later in this chapter, but we briefly describe three of the most accessible here. For example, the best way to gain knowledge about a market is to work in it before going into business in it. For example, if you once worked in a bookstore and now plan to open one of your own, you probably already have some idea about the kinds of books people request and buy. Second, a quick scan of the local Yellow Pages or an Internet search will reveal many potential competitors, as will advertisements in trade journals. Personal visits to these establishments and web sites can give you insights into their strengths and weaknesses. And third, studying magazines, books, and web sites aimed specifically at small businesses can also be of help, as can hiring professionals to survey the market for you.

Financing the New Business

Although the choice of how to start a business is obviously important, it is meaningless unless a new business owner can obtain the money to set up shop. Among the more common sources for funding are family and friends, personal savings, banks and similar lending institutions, investors, and governmental agencies. Lending institutions are more likely to help finance the purchase of an existing business than a new business because the risks are better understood. Individuals starting up new businesses, on the other hand, are more likely to have to rely on their personal resources.

Personal Resources According to a study by the National Federation of Independent Business, an owner's personal resources, not loans, are the most important source of money. Including money borrowed from friends and relatives, personal resources account for over two-thirds of all money invested in new small businesses and one-half of that invested in the purchase of existing businesses. When Michael Dorf and his friends decided to launch a New York nightclub dubbed the Knitting Factory, he started with $30,000 of his own money. Within four months of opening, Dorf asked his father to co-sign the first of four consecutive Milwaukee bank loans (for $70,000, $200,000, $300,000, and, to move to a new facility, $500,000, respectively). Dorf and his partners also engaged in creative bartering, such as putting a sound system company's logo on all its advertising in exchange for free equipment. Finally, because the Knitting Factory has become so successful, other investors are now stepping forward to provide funds—$650,000 from one investor and $4.2 million from another.[22]

Strategic Alliances Strategic alliances are also becoming a popular method for financing business growth. When Steven and Andrew Grundy decided to launch a CD-exchange Internet business called Spun.com, they had very little capital and so made extensive use of alliances with other firms. They partnered, for example,

with wholesaler Alliance Entertainment Corp. as a CD supplier. Orders to Spun.com actually go to Alliance, which ships products to customers and bills Spun.com directly. This setup has allowed Spun.com to promote a vast inventory of labels without actually having to buy inventory. All told, the firm has created an alliance network that has provided the equivalent of $40 million in capital.[23]

Lenders Although banks, independent investors, and government loans all provide much smaller portions of start-up funds than the personal resources of owners, they are important in many cases. Getting money from these sources, however, requires some extra effort. Banks and private investors usually want to see formal business plans—detailed outlines of proposed businesses and markets, owners' backgrounds, and other sources of funding. Government loans have strict eligibility guidelines.

Venture Capital Companies **Venture capital companies** are groups of small investors seeking to make profits on companies with rapid growth potential. Most of these firms do not lend money; they invest it, supplying capital in return for stock. The venture capital company may also demand a representative on the board of directors. In some cases, managers may even need approval from the venture capital company before making major decisions. Of all venture capital currently committed in the United States, 29 percent comes from true venture capital firms.[24]

venture capital company A group of small investors seeking to make profits on companies with rapid growth potential

For example, Dr. Drew Pinsky, cohost of MTV's Loveline, recently got venture capital funding to extend his program to the Internet from a group of investors collectively known as Garage.com. Garage.com is comprised of several individuals and other investors who specialize in financing Internet start-ups.[25] Similarly, Softbank Inc. is a venture capital firm that has provided funds to over three hundred web companies, including Yahoo! and E*trade. As founder Masayoshi Son puts it, "We're a strategic holding company, investing in companies that are very important in the digital information industry—in e-commerce, financial services, and media."

Small-Business Investment Companies Taking a more balanced approach in their choices than venture capital companies, small-business investment companies (SBICs) seek profits by investing in companies with potential for rapid growth. Created by the Small Business Investment Act of 1958, SBICs are federally licensed to borrow money from the SBA and to invest it in or lend it to small businesses. They are themselves investments for their shareholders. Past beneficiaries of SBIC capital include Apple Computer, Intel, and Federal Express. In addition, the government has recently begun to sponsor minority enterprise small-business investment companies (MESBICs). As the name suggests, MESBICs specialize in financing businesses that are owned and operated by minorities.

SBA Financial Programs Since its founding in 1953, the SBA has offered more than twenty financing programs to small businesses that meet standards in size and independence. Eligible firms must also be unable to get private financing at reasonable terms. Because of these and other restrictions, SBA loans have never

been a major source of small-business financing. In addition, budget cutbacks at the SBA have reduced the number of firms benefiting from loans. Nevertheless, several SBA programs currently offer funds to qualified applicants.

For example, under the SBA's guaranteed loans program, small businesses can borrow from commercial lenders. The SBA guarantees to repay 75 to 85 percent of the loan amount, not to exceed $750,000. Under a related program, companies engaged in international trade can borrow up to $1.25 million. Such loans may be made for as long as fifteen years. Most SBA lending activity flows through this program.

Sometimes, however, both the desired bank and SBA-guaranteed loans are unavailable (perhaps because the business cannot meet stringent requirements). In such cases, the SBA may help finance the entrepreneur through its immediate participation loans program. Under this arrangement, the SBA and the bank each put up a share of the money, with the SBA's share not to exceed $150,000. Under the local development companies (LDCs) program, the SBA works with a corporation (either for-profit or nonprofit) founded by local citizens who want to boost the local economy. The SBA can lend up to $500,000 for each small business to be helped by an LDC.

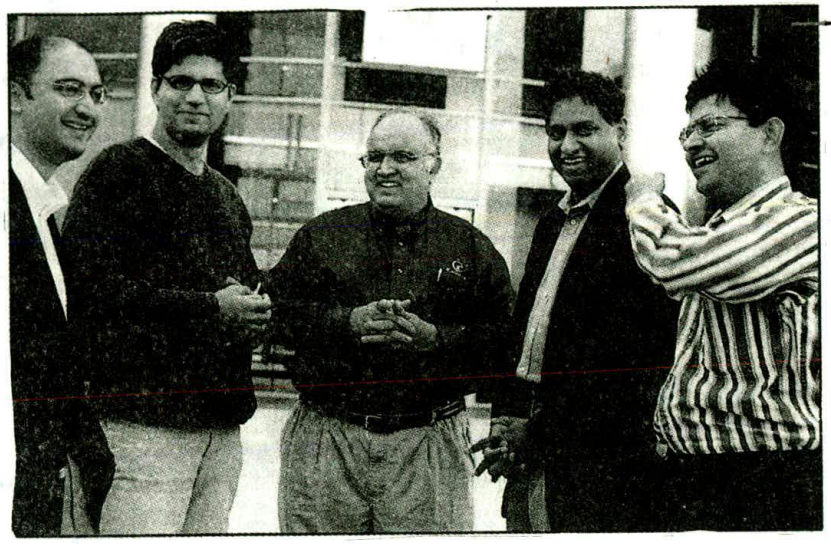
Spurred in large part by the boom in Internet businesses, both venture capital and loans are becoming easier to obtain. Most small businesses, for example, report that it has generally gotten increasingly easier to obtain loans over the last ten years. Indeed, some technology companies are being offered so much venture capital that they are turning down part of it to keep from diluting their ownership unnecessarily.

Sources of Management Advice

Financing is not the only area in which small businesses need help. Until World War II, for example, the business world involved few regulations, few taxes, few records, few big competitors, and no computers. Since then, simplicity has given way to complexity. Today, few entrepreneurs are equipped with all the business skills they need to survive. Small-business owners can no longer be their own troubleshooters, lawyers, bookkeepers, financiers, and tax experts. For these jobs, they rely on professional help. To survive and grow, however, small businesses also need advice regarding management. This advice is usually available from four sources: advisory boards, management consultants, the SBA, and a process called networking.

Advisory Boards All companies, even those that do not legally need a board of directors, can benefit from the problem-solving abilities of advisory boards. Thus, some small businesses create boards to provide advice and assistance. For example, an advisory board might help an entrepreneur determine the best way to finance a plant expansion or to start exporting products to foreign markets.

Management Consultants Opinions vary widely about the value of management consultants—experts who charge fees to help managers solve problems. They often specialize in one area, such as international business, small business,



The famous phrase "no man is an island" relates especially well to would-be entrepreneurs and owners of small business start-ups. Regardless of their talents, women and men running their own businesses need all the advice and information they can get. Fortunately, as noted in the text, there are a variety of sources of advice that are available. One very specialized information source is Kanwal Rekhi, shown here in the middle. He started a successful Silicon Valley software firm several years ago and then sold it to Novell for $210 million. He then founded The Indus Entrepreneurs, a networking group for Indians in the Valley. Today Mr. Rekhi spends his time offering advice and assistance to other Indians in the area who are interested in launching their own enterprises.

or manufacturing. Thus, they can bring an objective and trained outlook to problems and provide logical recommendations. They can be quite expensive, however, because some consultants charge $1,000 or more for a day of assistance.

Like other professionals, consultants should be chosen with care. They can be found through major corporations who have used their services and who can provide references and reports on their work. Not surprisingly, they are most effective when the client helps (for instance, by providing schedules and written proposals for work to be done).

The Small Business Administration Even more important than its financing role is the SBA's role in helping small-business owners improve their management skills. It is easy for entrepreneurs to spend money; SBA programs are designed to show them how to spend it wisely. The SBA offers small businesses four major management counseling programs at virtually no cost.

A small-business owner who needs help in starting a new business can get it free through the Service Corps of Retired Executives (SCORE). All SCORE members are retired executives, and all are volunteers. Under this program, the SBA tries to match the expert to the need. For example, if a small-business owner needs help putting together a marketing plan, the SBA will send a SCORE counselor with marketing expertise.

Like SCORE, the Active Corps of Executives (ACE) program is designed to help small businesses that cannot afford consultants. The SBA recruits ACE volunteers from virtually every industry. All ACE volunteers are currently involved in successful activities, mostly as small-business owners themselves. Together, SCORE and ACE have more than twelve thousand counselors working out of 350 chapters

throughout the United States. They provide assistance to some 140,000 small businesses each year.

The talents and skills of students and instructors at colleges and universities are fundamental to the Small Business Institute (SBI). Under the guidance of seasoned professors of business administration, students seeking advanced degrees work closely with small-business owners to help solve specific problems, such as sagging sales or rising costs. Students earn credit toward their degrees, with their grades depending on how well they handle a client's problems. Several hundred colleges and universities counsel thousands of small-business owners through this program every year.

Finally, the newest of the SBA's management counseling projects is its Small Business Development Center (SBDC) program. Begun in 1976, SBDCs are designed to consolidate information from various disciplines and institutions, including technical and professional schools. Then they make this knowledge available to new and existing small businesses. In 1995, universities in forty-five states took part in the program.

Networking More and more, small-business owners are discovering the value of networking—meeting regularly with one another to discuss common problems and opportunities and, perhaps most important, pool resources. Businesspeople have long joined organizations such as the local chamber of commerce and the National Federation of Independent Businesses (NFIB) to make such contacts.

Today, organizations are springing up all over the United States to facilitate small-business networking. One such organization, the Council of Smaller Enterprises of Cleveland, boasts a total membership of more than ten thousand small-business owners, the largest number in the country. This organization offers its members not only networking possibilities but also educational programs and services tailored to their needs. In a typical year, its eighty-five educational programs draw more than 8,500 small-business owners.

In particular, women and minorities have found networking to be an effective problem-solving tool. The National Association of Women Business Owners (NAWBO) (www.nawbo.org), for example, provides a variety of networking forums. The NAWBO also has chapters in most major cities where its members can meet regularly. Increasingly, women are relying more on other women to help locate venture capital, establish relationships with customers, and provide such essential services as accounting and legal advice. According to Patty Abramson of the Women's Growth Capital Fund, all of these tasks have traditionally been harder for women because, until now, they've never had friends in the right places. "I wouldn't say this is about discrimination," adds Abramson. "It's about not having the relationships, and business is about relationships."

Franchising

The next time you drive or walk around town, be on the alert for a McDonald's, Taco Bell, Subway, Denny's, or KFC restaurant; a 7-Eleven or Circle K convenience store; a RE/Max or Coldwell Banker real estate office; a Super 8 or Ramada motel; a

Blockbuster video store; a Sylvan Learning Center educational center; an Express Oil Change or Precision Auto Wash car-service center; or a Supercuts hair salon. What do these businesses have in common? In most cases, they will be franchised operations, operating under licenses issued by parent companies to local entrepreneurs who own and manage them. These licenses are generally called **franchising agreements**.

franchising agreement Operation by an entrepreneur (the *franchisee*) under a license issued by a parent company (the *franchiser*); the entrepreneur pays the parent company for the use of trademarks, products, formulas, and business plans

As many would-be businesspeople have discovered, franchising agreements are an accessible doorway to entrepreneurship. A franchise is an arrangement that permits the franchisee (buyer) to sell the product of the franchiser (seller, or parent company). Franchisees can thus benefit from the selling corporation's experience and expertise. They can also consult the franchiser for managerial and financial help.

For example, the franchiser may supply financing. It may pick the store location, negotiate the lease, design the store, and purchase necessary equipment. It may train the first set of employees and managers and provide standardized policies and procedures. Once the business is open, the franchiser may offer savings by allowing the business to purchase from a central location. Marketing strategy (especially advertising) may also be handled by the franchiser. Finally, franchisees may benefit from continued management counseling. In short, franchisees receive—that is, invest in—not only their own ready-made businesses but also receive expert help in running them.

Franchises offer many advantages to both sellers and buyers. For example, franchisers benefit from the ability to grow rapidly by using the investment money provided by franchisees. This strategy has enabled giant franchisers such as McDonald's and Baskin Robbins to mushroom into billion-dollar concerns in a brief time.

For the franchisee, the arrangement combines the incentive of owning a business with the advantage of access to large-business management skills. Unlike the person who starts from scratch, the franchisee does not have to build a business step by step. Instead, the business is established virtually overnight. Moreover, because each franchise outlet is probably a carbon copy of every other outlet, the chances of failure are reduced. McDonald's, for example, is a model of consistency—Big Macs taste the same everywhere.

Of course, owning a franchise also involves certain disadvantages. Perhaps the most significant is the start-up cost. Franchise prices vary widely. Fantastic Sam's (www.fantasticsams.com) hair salon franchise fees are $30,000, but a Gingiss Formalwear (www.gingiss.com) franchise can run as high as $125,000. Extremely profitable or hard-to-get franchises are even more expensive. A McDonald's franchise costs at least $650,000 to $750,000, and a professional sports team can cost several hundred million dollars. Franchisees may also have continued obligations to contribute percentages of sales to parent corporations.

Buying a franchise also entails intangible costs. For one thing, the small-business owner sacrifices some independence. A McDonald's franchisee cannot change the way hamburgers or milk shakes are made. Nor can franchisees create individual identities in their communities; for all practical purposes, the McDonald's owner is anonymous. In addition, many franchise agreements are difficult to terminate.

Finally, although franchises minimize risks, they do not guarantee success. Many franchisees have seen their investments—and their dreams—disappear

because of poor locations, rising costs, or lack of continued franchiser commitment. Moreover, figures on failure rates are artificially low because they do not include failing franchisees bought out by their franchising parent companies. An additional risk is that the chain itself could collapse. In any given year, dozens—sometimes hundreds—of franchisers close shop or stop selling franchises.

MANAGEMENT IMPLICATIONS Entrepreneurs should carefully weigh the advantages and disadvantages of different forms of starting a new business, such as buying an existing one or starting from scratch. They should also have a clear plan for financing their business and take advantage of various sources of information and advice. Those considering franchising should be sure they understand its opportunities, advantages, and disadvantages.

The Performance of Entrepreneurial Organizations

The formulation and implementation of an effective strategy plays a major role in determining the overall performance of an entrepreneurial organization. This section examines how entrepreneurial firms evolve over time and the attributes of these firms that enhance their chance for success. For every Henry Ford, Walt Disney, Mary Kay Ash, or Bill Gates—people who transformed small businesses into major corporations—there are many small-business owners and entrepreneurs who fail.

Figure 10.5 illustrates recent trends in new business start-ups and failures. As you can see, over the last ten years new business start-ups have generally run between around 150,000 and 190,000 per year, with 155,141 new businesses being launched in 1998. Over this same period, business failures have generally run between 50,000 and 100,000, with a total of 71,857 failing in 1998. In this section, we look first at a few key trends in small-business start-ups. Then we examine some of the main reasons for success and failure in small-business undertakings.

Trends in New Business Start-Ups

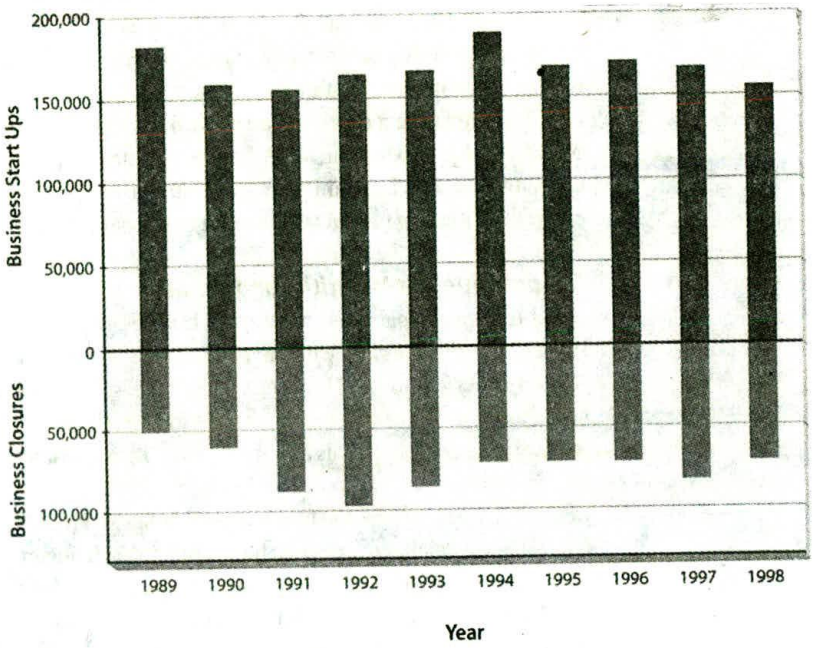
Thousands of new businesses are started in the United States every year. Several factors account for this trend, and in this section we focus on four of them.

Emergence of E-commerce Clearly, the most significant recent trend in small-business start-ups is the rapid emergence of electronic commerce. Because the Internet has provided fundamentally new ways of doing business, savvy entrepreneurs have been able to create and expand new businesses faster and easier than ever before. Such leading-edge firms as America Online, Amazon.com, Garden.com, and eBay, for example, owe their very existence to the Internet. Figure 10.6 amplifies this point by summarizing the tremendous growth in on-line commerce from 1997 through 2001. In addition, one recent study reported that in 1999, the Internet economy grew overall by 62 percent over the previous year and provided jobs for 2.5 million people.[26]

Figure 10.5

Business Start-Up Successes and Failures

Over the most recent ten-year period for which data are available, new business start-ups numbered between 150,000 and 190,000 per year. Business failures during this same period, meanwhile, ranged from about 50,000 to nearly 100,000 per year.



Source: U.S. Census Bureau, Statistical Abstract of the United States: 1999 (119th Edition), Washington, D.C., 1999.

Indeed, it seems as if new ideas emerge virtually every day. Andrew Beebe, for example, is scoring big with BigStep.com, a web business that essentially creates, hosts, and maintains web sites for other small businesses. So far, BigStep.com has signed up seventy-five thousand small-business clients. Beebe actually provides his basic services for free but earns money by charging for so-called premium services such as customer billing. Karl Jacob's Keen.com is a web business that matches people looking for advice with experts who have the answers. Keen got the idea when he and his father were struggling to fix a boat motor and didn't know where to turn for help. Keen.com attracted one hundred thousand subscribers in just three months.[27]

Crossovers from Large Businesses It is interesting to note that increasingly more businesses are being started by people who have opted to leave large corporations and put their experience and know-how to work for themselves. In some cases, these individuals see great new ideas they want to develop. Often, they get

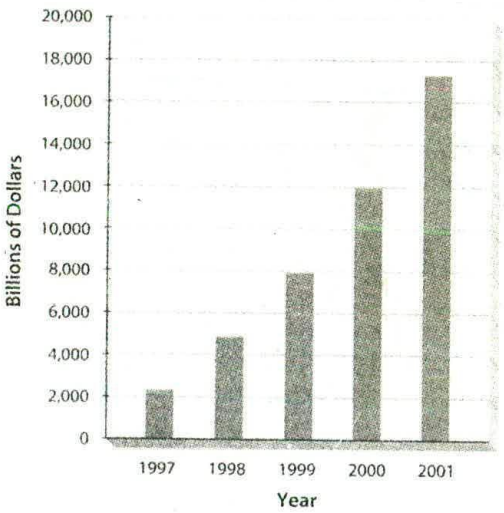
burned out working for a large corporation. Sometimes they have lost their jobs, only to discover that working for themselves was a better idea anyway.

Cisco Systems CEO John Chambers is acknowledged as one of the best entrepreneurs. But he spent several years working first at IBM and then at Wang Laboratories before he set out on his own. Under his leadership, Cisco has become one of the largest and most important technology companies in the world. Indeed, for a few days in March 2000, Cisco had the world's highest market capitalization, and it remains one of the world's most valuable companies.[28] In a more unusual case, Gilman Louie recently left an executive position at Hasbro's on-line group to head a CIA-backed venture capital firm called In-Q-It. The firm's mission is to help nurture high-tech companies making products of interest to the nation's spies.[29]

Figure 10.6

The Growth of On-Line Commerce

On-line commerce is becoming an increasingly important part of the U.S. economy. As shown here, for example, on-line commerce has grown from about $2.5 trillion in 1997 to an estimated $17.4 trillion by 2001. And most indicators suggest that this trend will continue.



Source: U.S. Census Bureau, Statistical Abstract of the United States: 1999 (119th Edition), Washington, D.C., 1999.

Opportunities for Minorities and Women In addition to big-business expatriates, more small businesses are being started by minorities and women. For example, the number of African-American-owned businesses has increased by 46 percent during the most recent five-year period for which data are available and now totals about 620,000. Chicago's Gardner family is just one of thousands of examples illustrating this trend. The Gardners are the founders of Soft Sheen Products Inc., a firm specializing in ethnic hair products. Soft Sheen attained sales of $80 million in the year before the Gardners sold it to France's L'Oréal S.A. for more than $160 million. The emergence of such opportunities is hardly surprising, either to African-American entrepreneurs or to the corporate marketers who have taken an interest in their companies. African-American purchasing power topped $530 billion in 1999. Up from just over $300 billion in 1990, that increase of 73 percent far outstrips the 57 percent increase experienced by all Americans.[30]

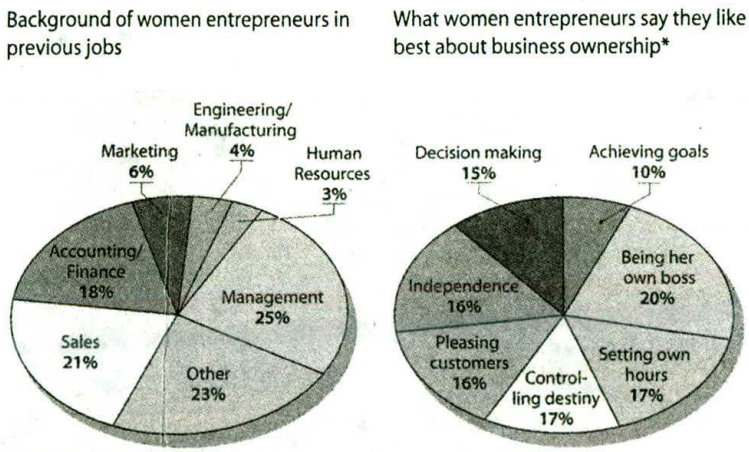
Hispanic-owned businesses have grown at an even faster rate of 76 percent and now number about 862,000. Other ethnic groups are also making their presence felt among U.S. business owners. Business ownership among Asian and Pacific Islanders has increased 56 percent, to over 600,000. Although the number of businesses owned by Native Americans and Alaska Natives is still somewhat small, at slightly over 100,000, the total nevertheless represents a five-year increase of 93 percent.[31]

The number of women entrepreneurs is also growing rapidly. Celeste Johnson, for example, left a management position at Pitney Bowes to launch Obex Inc., which makes gardening and landscaping products from mixed recycled plastics. Katrina Garnett gave up a lucrative job at Oracle to start her own software company, Crossworlds Software Inc. Laila Rubenstein closed her management-consulting practice to create Greeting Cards.com Inc., an Internet-based business selling customizable electronic greetings. "Women-owned business," says Teresa

Cavanaugh, director of the Women Entrepreneur's Connection at BankBoston, "is the largest emerging segment of the small-business market. Women-owned businesses are an economic force that no bank can afford to overlook."[32]

Likewise, the number of women-owned businesses is also growing rapidly. There are now 9.1 million businesses owned by women—about 40 percent of all businesses in the United States. Combined, they generate nearly $4 trillion in revenue a year—an increase of 132 percent since 1992. The number of people employed nationwide at women-owned businesses since 1992 has grown to around 27.5 million—an increase of 108 percent.[33] Figure 10.7 summarizes the corporate backgrounds of women entrepreneurs and provides some insight into what they like about running their own businesses. Corporate positions in general management (25 percent), sales (21 percent), and accounting and finance (18 percent) account for almost two-thirds of the women who start their own businesses. Once in charge of their own businesses, women also report that they like being their own bosses, setting their own hours, controlling their own destinies, relating to customers, making decisions, and achieving goals. *Working with Diversity* provides more information about women as entrepreneurs.

Better Survival Rates Finally, more people are encouraged to test their skills as entrepreneurs because the failure rate among small businesses has been declining in recent years. During the 1960s and 1970s, for example, less than half of all new start-ups survived more than eighteen months; only one in five lasted ten years. Now, however, new businesses have a better chance of surviving. Of new businesses started in the 1980s, for instance, over 77 percent remained in operation for at least three years. Today, the SBA estimates that at least 40 percent of all new businesses can expect to survive for six years. For the reasons discussed in the



Source: From "Women Entrepreneurs," *The Wall Street Journal*, May 24, 1999, p. R12. Reprinted by permission.

Figure 10.7

Where Women Entrepreneurs Come From and What They Like About Their Work

Women entrepreneurs come from all sectors of large businesses, although management and sales are especially well represented. Women entrepreneurs indicate that they really like being their own boss, being independent, setting their own hours, and controlling their own destiny.

WORKING WITH DIVERSITY

She's the Boss—and the Owner

More U.S. women are flexing their entrepreneurial muscles, starting businesses at a record rate, boosting the economy, and providing jobs. Nearly four out of every ten U.S. businesses—more than nine million businesses—are owned by women. Their total annual sales top $3.6 trillion, and together they employ twenty-seven million people. From manufacturing and construction to wholesaling and e-commerce, women are starting companies in nearly every type of industry.

Obtaining business financing is still a problem for many women, however. Studies indicate that women have access to smaller credit lines than men and receive less of the venture capital being invested in high-tech start-ups. To address this issue, a growing number of women are founding venture capital firms and searching out suitable investment opportunities among start-ups run by women. The Three Guineas Fund, started by a woman who was formerly a vice president of Cisco Systems, provides funding for women with promising business ideas. It also sponsors a series of venture fairs to allow women entrepreneurs to pitch their ideas to top venture capitalists.

From Silicon Valley in California to Silicon Alley in New York, business incubators are popping up in many areas to help entrepreneurs run high-tech start-ups. Building on this trend, the Three Guineas Fund has financed the Women's Technology Cluster in San Francisco as the first incubator working only with women-owned and -operated businesses. This incubator gives office space to as many as thirteen start-ups at one time and offers both expert advice and networking opportunities to help entrepreneurs guide their businesses through the life cycle. In exchange, the incubator receives 2 percent of the company's equity, which goes toward supporting other start-ups.

Once a company expands beyond thirty employees, it must leave the incubator and operate on its own. LevelEdge.com is one of the businesses that outgrew the Women's Technology Cluster. Founded by Lisa Henderson, LevelEdge (http://www.leveledge.com/) serves as a web-based matchmaker between high school athletes and college recruiters. Just fifteen months after founding LevelEdge, Henderson had garnered enough funding and participation from athletes and colleges to move her fast-growing business out of the incubator and make room for another start-up.

Women have been starting businesses for a decade, but these numbers tell us their companies are playing a much more significant role in the health of the economy.

*—Sharon Hadary, executive director, National Foundation for Women Business Owners**

References: Kevin Ferguson, "Nothing Ventured," *Business Week*, July 10, 2000, pp. F28–F34; Marci McDonald, "A Start-Up of Her Own," *U.S. News & World Report*, May 15, 2000, pp. 34+; Bill Meyers, "Women Increase Standing As Business Owners," *USA Today*, June 29, 1999, p. 1B (*quote on p. 1B).

next section, small businesses suffer a higher mortality rate than larger concerns. Among those that manage to stay in business for six to ten years, however, the survival rate levels off.

Reasons for Failure

Unfortunately, 63 percent of all new businesses will not celebrate a sixth anniversary. Why do some succeed and others fail? Although no set pattern has been established, four general factors contribute to new-business failure. One factor is managerial incompetence or inexperience. Some would-be entrepreneurs assume that they can succeed through common sense, overestimate their own managerial acumen, or

think that hard work alone will lead to success. But if managers do not know how to make basic business decisions or do not understand the basic concepts and principles of management, they are unlikely to be successful in the long run.

Neglect can also contribute to failure. Some entrepreneurs try either to launch their ventures in their spare time or to devote only a limited amount of time to a new business. But starting a new business requires an overwhelming time commitment. Entrepreneurs who are not willing to put in the time and effort that a business requires are unlikely to survive.

Third, weak control systems can lead to serious problems. Effective control systems are needed to keep a business on track and to help alert entrepreneurs to potential trouble. If control systems do not signal impending problems, managers may be in serious trouble before more visible difficulties alert them.

Finally, insufficient capital can contribute to new business failure. Some entrepreneurs are overly optimistic about how soon they will start earning profits. In most cases, however, it takes months or years before a business is likely to start turning a profit. Amazon.com, for example, has still not earned a profit. Most experts say that a new business should have enough capital to operate at least six months without earning a profit; some recommend enough to last a year.[34]

Reasons for Success

Similarly, four basic factors are typically cited to explain new business success. One set of factors is hard work, drive, and dedication. New-business owners must be committed to succeeding and be willing to put in the time and effort to make it happen. Gladys Edmunds, a single teen-age mother in Pittsburgh, washed laundry, made chicken dinners to sell to cab drivers, and sold fire extinguishers and Bibles door-to-door to earn money to launch her own business. Today, Edmunds Travel Consultants employs eight people and earns about $6 million in annual revenue.[35]

Careful analysis of market conditions can help new-business owners assess the probable reception of their products in the marketplace. This analysis will provide insights about market demand for proposed products and services. Whereas attempts to expand local restaurants specializing in baked potatoes, muffins, and gelato have been largely unsuccessful, hamburger and pizza chains continue to have an easier time expanding into new markets.

Managerial competence also contributes to success. Successful new business owners may acquire competence through training or experience or by using the expertise of others. Few successful entrepreneurs succeed alone or straight out of college. Most spend time working in successful companies and/or partner with others to bring more expertise to a new business.

Finally, luck also plays a role in the success of some firms. For example, after Alan McKim started Clean Harbors (www.cleanharbors.com), an environmental cleanup firm based in New England, he struggled to keep his business afloat. Then the U.S. government committed $1.6 billion to toxic waste cleanup—McKim's specialty. He was able to get several large government contracts and put his business on solid financial footing. Had the government fund not been created at just the right time, McKim may well have failed.

MANAGEMENT IMPLICATIONS Entrepreneurs should keep abreast of trends in new-business start-ups. They should also have a clear understanding of the reasons for business failure and success.

Summary of Key Points

Entrepreneurship is the process of planning, organizing, operating, and assuming the risk of a business venture. An entrepreneur is someone who engages in entrepreneurship. In general, entrepreneurs start small businesses. Small businesses are an important source of innovation, create numerous jobs, and contribute to the success of large businesses.

In choosing strategies, entrepreneurs have to consider the characteristics of the industry in which they are going to conduct business. A small business must also emphasize its distinctive competencies. Small businesses generally have several distinctive competencies that they should exploit in choosing their strategy. Small businesses are usually skilled at identifying niches in established markets, identifying new markets, and acting quickly to obtain first-mover advantages. Small businesses are usually not skilled at exploiting economies of scale. Once an entrepreneur has chosen a strategy, the strategy is normally written down in a business plan. Writing a business plan forces an entrepreneur to plan thoroughly and to anticipate problems that might occur.

With a strategy and business plan in place, entrepreneurs must choose a structure to implement them. All of the structural issues summarized in the next five chapters of this book are relevant to the entrepreneur. In addition, the entrepreneur has some unique structural choices to make. For example, the entrepreneur can buy an existing business or start a new one. In determining financial structure, an entrepreneur has to decide how much personal capital to invest in an organization, how much bank and government support to obtain, and whether to encourage venture capital firms to invest. Entrepreneurs can also rely on various sources of advice.

Several interesting trends characterize new-business start-ups today. There are several reasons why some new businesses fail and others succeed.

Discussion Questions

Questions for Review

1. Why are entrepreneurs and small businesses important to society?
2. In which types of industries do small firms often excel? In which types of industries do small firms struggle?
3. List the financing options available to entrepreneurs. What are the advantages and disadvantages of each?
4. What are the elements of success for small businesses?

Questions for Analysis

5. Entrepreneurs and small businesses play a variety of important roles in society. If these roles are so important, do you think that the government should do more to encourage the development of small business? Why or why not?
6. Franchising agreements seem to be particularly popular ways of starting a new business in industries in which retail outlets are widely spread geographically and where the quality

of goods or services purchased can be evaluated only after the purchase has occurred. For example, a hamburger may look tasty, but you know for sure that it is well made only after you buy it and eat it. By going to a McDonald's, you know exactly the kind and quality of hamburger you will receive, even before you walk in the door. What is it about franchise arrangements that makes them so popular under these conditions?

7. If employing family members can cause problems in a small organization, why is this practice so common?
8. What steps might an entrepreneur take before deciding to expand into a foreign market?

Questions for Application

9. Interview the owner of a small business in your town. Evaluate how successful this small business has been. Using the criteria presented in this chapter, explain its success (or lack of success).
10. Using the information about managing a small business presented in this chapter, analyze whether you would like to work in a small business—either as an employee or as a founder. Given your personality, background, and experience, does working in or starting a new business appeal to you? What are the reasons for your opinion?

BUILDING EFFECTIVE *communication* SKILLS

Exercise Overview

Communication skills refer to the manager's abilities both to convey ideas and information effectively to others and to receive ideas and information from others effectively. While communication skills are important to all organizations, some entrepreneurs argue that they are even more important in smaller organizations. This exercise will help you understand some of the complexities in communicating in smaller businesses.

Exercise Background

Assume that you are the owner/manager of a small retail chain. Your company sells moderately priced apparel for professional men and women. You have ten stores located in the Midwest. Each store has a general manager responsible for the overall management of that specific store. Each store also has one assistant manager.

In addition, your corporate office is staffed by a human resource manager, an advertising specialist, and two buyers. In the past, each store was managed at the total discretion of its local manager. As a result, each store had a different layout, a different culture, and different policies and procedures.

You have decided that you want to begin opening more stores at a rapid pace. To expedite this process, however, you also want to standardize your stores. Unfortunately, however, you realize that many of your current managers will be unhappy with this decision. They will see it as a loss of authority and managerial discretion. Nevertheless, you believe it is important that you make changes to achieve standardization in all areas.

Your plans are to remodel all of your stores to fit a standard layout. You also intend to develop a policy and operations manual for each store. This manual will specify exactly how each store will be managed. You plan to inform your managers of this plan first in a memo and then in a follow-up meeting to discuss questions and concerns.

Exercise Task

With the information described above as context, please do the following:

1. Draft a memo that explains your intentions to the store managers.
2. List the primary objections you anticipate.
3. Outline an agenda for the meeting in which you plan to address the managers' questions and concerns.
4. Do you personally agree with this communication strategy? Why or why not?

BUILDING EFFECTIVE *technical* SKILLS

Exercise Overview

Technical skills are the skills necessary to accomplish or understand the specific work being done in an organization. This exercise will allow you to gain insights into your own technical skills and the relative importance of technical skills in different kinds of organizations.

Exercise Background

Some entrepreneurs have the technical skills that they need to open and run their business successfully. For example, a hair stylist who opens a hair salon, an architect who starts a residential design firm, and a chef who launches a new restaurant all have the technical skills needed to do the work of the organization (hair styling, blueprint rendering, and cooking, respectively).

In other cases, the entrepreneur who starts the organization may have general management skills but may essentially "buy" required technical skills in the labor market. For example, an entrepreneur might start a new restaurant without knowing how to cook by hiring a professional chef to perform this function.

Exercise Task

With the background information provided above as a context, do the following:

1. Listed below are examples of ten small businesses that an individual entrepreneur might conceivably launch. Spend a few minutes thinking about each business. (*Hint*: try to conceptualize an existing local business that might generally fit the description.)
   a. Clothing retail store
   b. Computer clone assembly business
   c. Tavern
   d. Sports-card retail store
   e. Aluminum recycling operation
   f. Used compact disc retail store
   g. Drop-in health-care clinic
   h. Gourmet coffee bean shop
   i. Business services operation
   j. Appliance repair shop
2. Make notes about the specific technical skills required for each business.
3. For each business, decide whether it is especially important that the entrepreneur him- or herself possess the technical skills or whether it is feasible to consider hiring others who possess the skills.
4. What are some major factors that determine the viability of buying technical skills in the labor market?

BUILDING EFFECTIVE *conceptual* SKILLS

Exercise Overview

Conceptual skills refer to the manager's ability to think in the abstract. This exercise will help you relate conceptual skills to entrepreneurship.

Exercise Background

Assume that you have made the decision to open a small business in the local business community when you graduate (the community where you are attending college, not your home). Assume that you have funds to start a business without having to worry about finding other investors.

Without regard to market potential, profitability, or similar considerations, list five businesses that you might want to open and operate based solely on your personal interests. For example, if you enjoy bicycling, you might enjoy opening a shop that caters to cyclists.

Next, without regard to personal attractiveness or interests, list five businesses that you might want to open and operate based solely on market opportunities. Evaluate the prospects for success of each of the ten businesses.

Exercise Task

With this background information as context, do the following:

1. Form a small group with three or four classmates and discuss your respective lists. Look for instances of where the same type of business appears on either the same or alternative lists. Also look for cases where the same business appears with similar or dissimilar prospects for success.
2. How important is personal interest in small-business success?
3. How important is market potential in small-business success

CHAPTER CLOSING CASE

CLEAR CHANNEL FOR ENTREPRENEURIAL SUCCESS

When L. Lowry Mays co-founded Clear Channel Communications in 1972, radio was already an old and unglamorous medium. Although he started with one money-losing country-western radio station in San Antonio, Texas, Mays was an entrepreneur with an eagerness to learn the business and a long-term plan. Watching and waiting, he was ready to act when federal regulations governing ownership of electronic media were relaxed in 1984. Then he began buying small, weak radio stations and low-priced television stations. When the Fox network started looking for affiliates, Mays signed up his stations. That decision paid off as Fox's ratings climbed and it became a major network player in broadcast television.

Mays expanded his media empire in 1999 by acquiring AMFM Inc. This $23.5 billion purchase positioned Clear Channel as the largest operator of radio stations in the United States, with 830 stations broadcasting to ninety-six million listeners in 187 markets. The nearest competitor, Infinity Broadcasting, had only 160 U.S. stations but reached fifty-four million listeners because its stations were in larger metropolitan areas. Because of duplication and federal oversight of the AMFM acquisition, Mays had to sell more than one hundred radio stations, but radio still contributed more than three-quarters of Clear Channel's revenues, while television contributed less than 5 percent of revenues.

Billboards, another decidedly dowdy medium, provided the remainder of Clear Channel's revenues. Mays added this part of his business in the late 1990s. Now Clear Channel offered advertisers a choice of 425,000 billboards in forty-seven U.S. cities as well as radio and television broadcast options for reaching audiences. In fact, the combination of billboards and radio was particularly attractive because television advertising was becoming more expensive and more fragmented as the number of channels multiplied. Mays reasoned that billboards would allow advertisers to reach a large audience and radio would give advertisers a way to repeat their messages over and over—a desirable combination for a reasonable fee.

Will the Internet, today's most glamorous and talked-about medium, threaten Clear Channel Communications? Decades ago, some observers believed that television would bury radio, but Mays—who clearly believes in the power of radio—does not see the Internet displacing the other electronic media. Instead, he has carved a profitable niche selling radio ad time and billboard space to dot-com businesses, many of which have only a shoestring budget on which to build their brands.

In addition, Clear Channel has teamed up with SamsDirect Internet to promote a new domain name alternative for individuals and businesses seeking new Internet addresses. The partners are encouraging

people to register for on-line addresses that end in dot-cc (.cc) rather than dot-com (.com), which opens up new opportunities to claim unique or descriptive web addresses. Clear Channel radio stations and billboards in Houston were among the first to carry advertising for the dot-cc domain name registration service. In a dot-com address, the "com" stands for "commercial," to distinguish businesses from nonprofit organizations that use the dot-org (.org) designation. In a dot-cc address, the "cc" stands for CoCos Islands, which are located near Australia, but Clear Channel and SamsDirect see dot-cc as a good alternative for North American businesses that have missed the chance to specific dot-com names. This is yet another example of how Mays has turned innovation to his advantage in the ever-changing world of media.

Case Questions

1. What distinctive competencies has Mays exploited to build Clear Channel Communications?
2. What role has economy of scale played in helping Mays build his business?
3. What else can Mays do to increase synergy among his various businesses?

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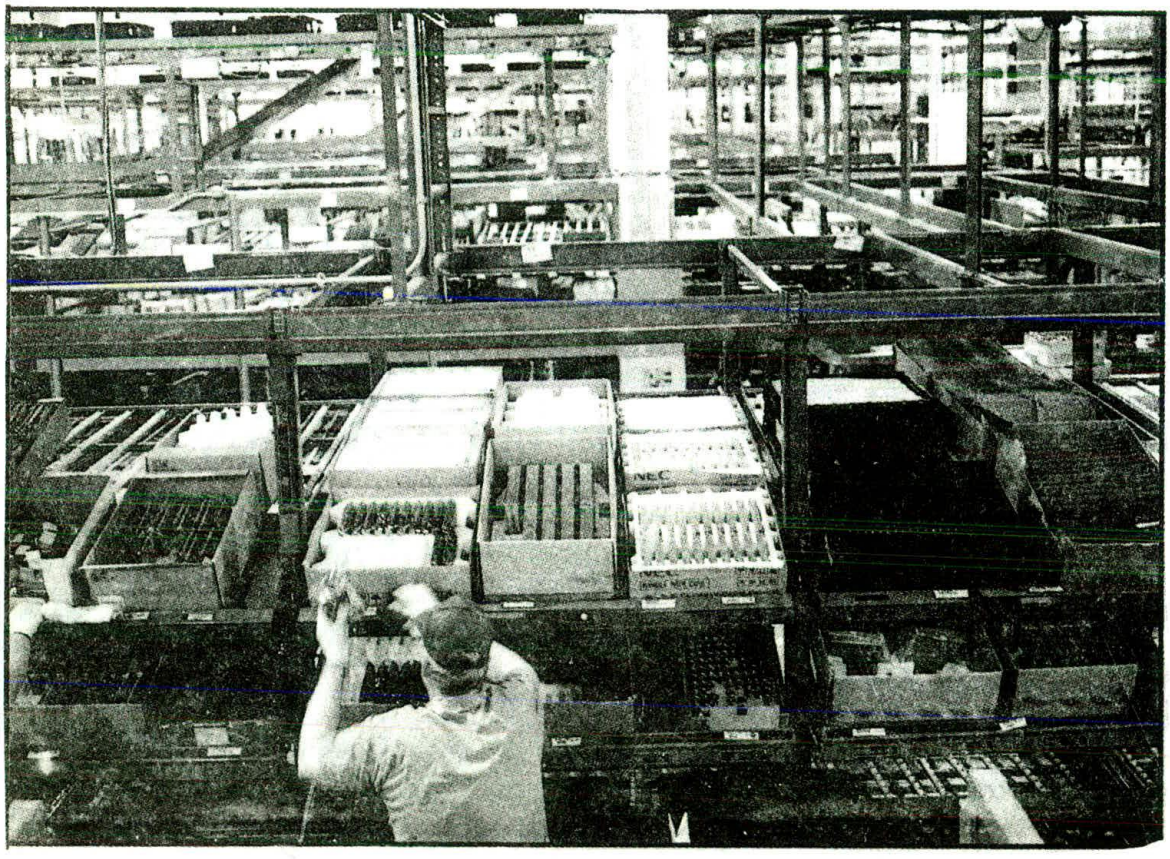
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PART FOUR

The Organizing Process



CHAPTER 11

Basic Elements of Organizing

CHAPTER 12

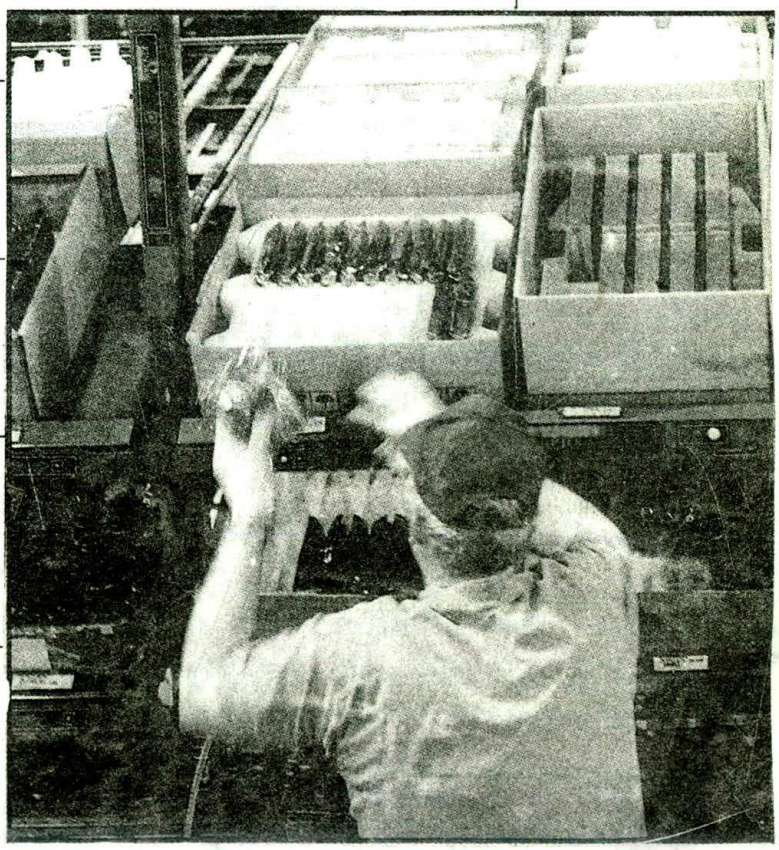
Managing Organization Design

CHAPTER 13

Managing Organization Change and Innovation

CHAPTER 14

Managing Human Resources in Organizations



CHAPTER 11 Basic Elements of Organizing

OPENING INCIDENT

Construction has always been a job that encourages specialization. Very different kinds of skills and expertise are needed, for example, to create a foundation from concrete; erect walls from brick, wood, or steel; create networks of pipes for plumbing and wire for electricity; fabricate a weatherproof roof; and finish off an interior with a high-quality appearance. There are even craft specialists within these jobs, though—building walls from steel and building a roof from shingles are far different jobs from building walls from wood and building a roof from metal.

Putting all these pieces together, then, can be a big and complicated job. Thus, someone has to organize and coordinate the overall process, ensuring to the extent possible that the right materials in the right quantities and the right people are at the job site just as they are needed, but not before or after. Until recently, organizing most building projects relied on paper—blueprints were drawn by architects, schedules were created by contractors, and paperwork between contractors and subcontractors flowed back and forth as materials were requested and ordered, work completed and billed, and so forth. But a simple change, such as a redesigned doorway, or one delay, such as an order of materials coming in late, can have a domino effect across dozens of other subcontractors. And, of course, someone had to monitor the project continually, make scheduling and delivery adjustments, and notify suppliers and subcontractors.

Slowly but surely, though, Internet technology is creeping into the construction industry. And as it does so, it's revolutionizing how contractors and subcontractors work and how they interact with one another. It's also showing signs of enormous potential for lowering costs, shortening construction times, and improving overall efficiency. Indeed, big construction firms like the Turner Corporation and the Bechtel Group have started partnering with e-commerce companies to use web technology for communicating with suppliers and subcontractors.

Now, for example, a project's blueprints can all be provided on-line; each supplier and each subcontractor can review their part of the project, including scheduling details, on-line. E-mails can be sent to everyone affected, work schedules can be posted, and bid requests can be sent to potential suppliers, all with the push of a button or the click of a mouse. The advent of the newer

"Construction has always been a very fragmented industry because it's so local."

—Kent Allen, Boston e-commerce consultant

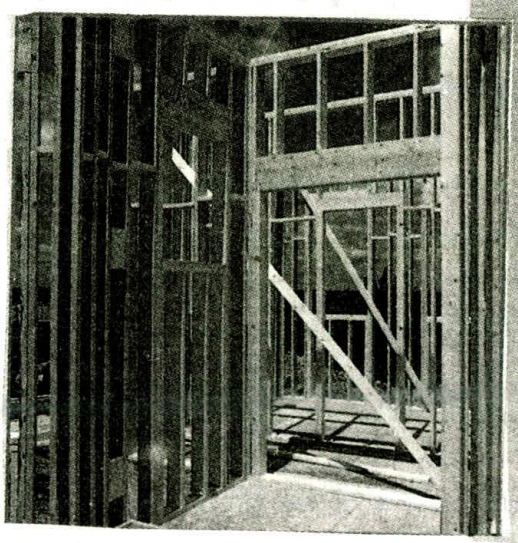
LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- Identify the basic elements of organizations.
- Describe alternative approaches to designing jobs.
- Discuss the rationale and the most common bases for grouping jobs into departments.
- Describe the basic elements involved in establishing reporting relationships.
- Discuss how authority is distributed in organizations.
- Discuss the basic coordinating activities undertaken by organizations.
- Describe basic ways in which positions within an organization can be differentiated.

handheld computers like Palms is also accelerating this change because contractors, subcontractors, supervisors, and workers can more readily access information they need at—or even inside—the construction project.

Indeed, Cephren and Bidcom are at the forefront of applying web technology to construction projects. Cephren, for example, has created a software network that serves as a communication system for contractors and subcontractors on a project. Each part of the construction team receives passwords allowing them access to the part of the project relevant to them. For instance, a middle manager working at the construction site might need access to blueprints but not to the minutes of the senior management team's last meeting. Bidcom, meanwhile, deals more with linking contractors and suppliers. Using the Bidcom system, for example, a contractor can put out a call for bids on, say, one hundred steel doors or five hundred windows, with corresponding specifications and delivery details. Suppliers, meanwhile, can review the call and submit bids directly to the contractor. This overall improvement in efficiency can potentially save thousands of dollars on a big construction project.[1]



CHAPTER OUTLINE

- **The Elements of Organizing**
- **Designing Jobs**
  - Job Specialization
  - Benefits and Limitations of Specialization
  - Alternatives to Specialization
- **Grouping Jobs: Departmentalization**
  - Rationale for Departmentalization
  - Common Bases for Departmentalization
- **Establishing Reporting Relationships**
  - Chain of Command
  - Narrow Versus Wide Spans
  - Tall Versus Flat Organizations
  - Determining the Appropriate Span
- **Distributing Authority**
  - The Delegation Process
  - Decentralization and Centralization
- **Coordinating Activities**
  - The Need for Coordination
  - Structural Coordination Techniques
- **Differentiating Between Positions**
  - Differences Between Line and Staff
  - Administrative Intensity

The construction industry has a long and well-established way of getting tasks done, and this system has served it well. But key organizations are boldly exploring new approaches to designing work, linking jobs, and coordinating activities. And these new approaches, in turn, are fundamentally changing the way jobs, businesses, and relationships between businesses are structured. As you will see in this chapter, managing the basic frameworks that organizations use to get their work done—structure—is a fundamental part of the management process.

This chapter discusses many of the critical elements of organization structure that managers can control and is the first of five devoted to organizing, the second basic managerial function identified in Chapter 1. In Part 3, we describe managerial planning—deciding what to do. Organizing, the subject of Part 4, focuses on how to do it. We first elaborate on the meaning of organization structure. Subsequent sections explore the basic elements that managers use to create an organization.

■ The Elements of Organizing

Imagine asking a child to build a castle with a set of building blocks. She selects a few small blocks and other larger ones. She uses some square ones, some round ones, and some triangular ones. When she finishes, she has her own castle, unlike any other. Another child, presented with the same task, constructs a different castle. He will select different blocks, for example, and combine them in different ways. The children's activities—choosing certain combinations of blocks and then putting them together in unique ways—are analogous to the manager's job of organizing.[2]

organizing Deciding how best to group organizational activities and resources

Organizing is deciding how best to group organizational activities and resources.[3] Just as children select different kinds of building blocks, managers can choose a variety of structural possibilities. And just as the children can assemble the blocks in any number of ways, so too can managers put the organization together in many different ways. Understanding the nature of these building blocks and the different ways in which they can be configured can have a powerful impact on a firm's competitiveness.[4] In this chapter, our focus is on the building blocks themselves—**organization structure**. In Chapter 12 we focus on how the blocks can be put together—organization design.

organization structure The set of elements that can be used to configure an organization

There are six basic building blocks that managers can use in constructing an organization: designing jobs, grouping jobs, establishing reporting relationships between jobs, distributing authority among jobs, coordinating activities between jobs, and differentiating between positions. The logical starting point is the first building block—designing jobs for people within the organization.

MANAGEMENT IMPLICATIONS Managers should understand the basic building blocks of organization structure and recognize that part of the organizing function is knowing how best to assemble these building blocks into an efficient overall structure for the firm.

■ Designing Jobs

The first building block of organization structure is job design. **Job design** is the determination of an individual's work-related responsibilities.[5] For a machinist at Caterpillar, job design might specify what machines are to be operated, how they are to be operated, and what performance standards are expected. For a manager at Caterpillar, job design might involve defining areas of decision-making responsibility, identifying goals and expectations, and establishing appropriate indicators of success. The natural starting point for designing jobs is determining the level of desired specialization.

job design The determination of an individual's work-related responsibilities

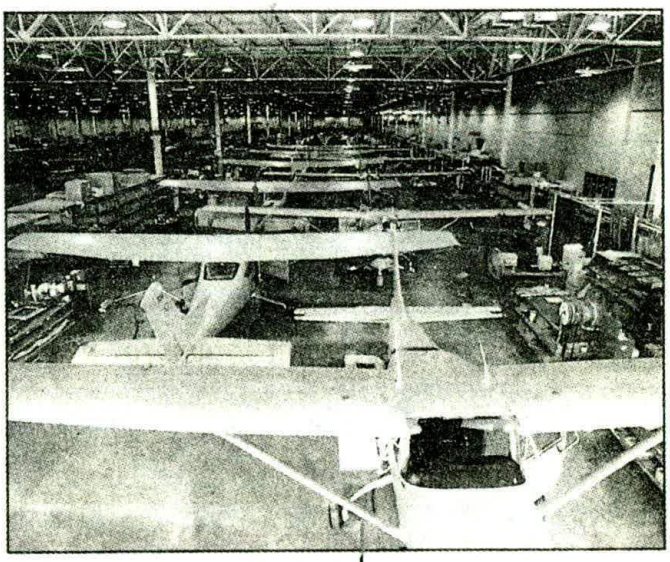
job specialization The degree to which the overall task of the organization is broken down and divided into smaller component parts

Job Specialization

Job specialization is the degree to which the overall task of the organization is broken down and divided into smaller component parts. Job specialization evolved from the concept of *division of labor*. Adam Smith, an eighteenth-century economist, described how a pin factory used division of labor to improve productivity.[6] One man drew the wire, another straightened it, a third cut it, a fourth ground the point, and so on. Smith claimed that ten men working in this fashion were able to produce forty-eight thousand pins in a day, whereas each man working alone could produce only twenty pins per day.

More recently, the best example of the impact of specialization is the automobile assembly line pioneered by Henry Ford and his contemporaries. Mass-production capabilities stemming from job specialization techniques have had a profound impact throughout the world. High levels of low-cost production transformed U.S. society during the last century into one of the strongest economies in the history of the world.[7]

Job specialization is a normal extension of organizational growth. For example, when Walt Disney started his company, he did everything himself—wrote cartoons, drew them, and then marketed them to theaters. As the business grew, he eventually hired others to perform many of these same functions. As growth continued, so too did specialization. For example, as animation artists work on Disney movies today, they may specialize in drawing only a single character. And today, The Walt Disney Company has thousands of different specialized jobs. Clearly, no one person could perform them all.



Designing jobs is a fundamental cornerstone of organizing. Most organizations today rely on a blend of job specialization and such alternatives to specialization as job enrichment and work teams. Take this Cessna factory in Independence, Kansas, for example. All of its assembly employees are expected to have a base specialization. But each is also expected to continuously learn new skills while simultaneously working as part of a team that has a lot to say about how its work gets done.

Benefits and Limitations of Specialization

Job specialization provides four benefits to organizations.[8] First, workers performing small, simple tasks will become very proficient at that task. Second, transfer time between tasks decreases. If employees perform several different tasks, some time is lost as they stop doing the first task and start doing the next. Third, the more narrowly defined a job is, the easier it is to develop specialized equipment to assist with that job. Fourth, when an employee who performs a highly specialized job is absent or resigns, the manager is able to train someone new at relatively low cost. Although specialization is generally thought of in terms of operating jobs, many organizations have extended the basic elements of specialization to managerial and professional levels as well.[9]

On the other hand, job specialization can have negative consequences. The foremost criticism is that workers who perform highly specialized jobs may become bored and dissatisfied. The job may be so specialized that it offers no challenge or stimulation. Boredom and monotony set in, absenteeism rises, and the quality of the work may suffer. Furthermore, the anticipated benefits of specialization do not always occur. For example, a study conducted at Maytag found that the time spent moving work-in-process from one worker to another was greater than the time needed for the same individual to change from job to job.[10] Thus, although some degree of specialization is necessary, it should not be carried to extremes because of the possible negative consequences. Managers must be sensitive to situations in which extreme specialization should be avoided. And indeed, several alternative approaches to designing jobs have been developed in recent years.

Alternatives to Specialization

To counter the problems associated with specialization, managers have sought other approaches to job design that achieve a better balance between organizational demands for efficiency and productivity and individual needs for creativity and autonomy. Five alternative approaches are job rotation, job enlargement, job enrichment, the job characteristics approach, and work teams.[11] In addition to these structural techniques, *Today's Management Issues* describes how firms such as Sempra Energy Information Solutions are using workplace design environments to achieve some of the same benefits.

job rotation An alternative to job specialization that involves systematically moving employees from one job to another

Job Rotation **Job rotation** involves systematically moving employees from one job to another. A worker in a warehouse might unload trucks on Monday, carry incoming inventory to storage on Tuesday, verify invoices on Wednesday, pull outgoing inventory from storage on Thursday, and load trucks on Friday. Thus, the jobs do not change but, instead, workers move from job to job. Unfortunately, for this very reason, job rotation has not been very successful in enhancing employee motivation or satisfaction. Jobs that are amenable to rotation tend to be relatively standard and routine. Workers who are rotated to a "new" job may be more satisfied at first, but satisfaction soon wanes. Although many companies (among them American Cyanamid, Bethlehem Steel, Ford, Prudential Insurance, TRW, and West-

TODAY'S MANAGEMENT ISSUES

DESIGNING WORKPLACES FOR INDIVIDUAL WORK *AND* TEAMWORK

When Sempra Energy Information Solutions went looking for new office furniture, it rejected the stereotypical cubicles ridiculed by Dilbert and his comic-strip colleagues. Sempra wanted its workplace to reflect the company's innovative approach to helping corporate clients manage their energy costs. The goal was to give its employees some privacy and flexibility while allowing them to stay connected to each other. After months of searching, Sempra settled on a new office setup from Herman Miller.

Unlike cubicles, which are often seen as depersonalizing and isolating, Sempra's office furniture has humanizing touches such as built-in flower vases and slits between workstations to encourage spontaneous communication. The workstations can be arranged in a variety of cluster patterns so employees can work individually yet easily consult with nearby coworkers about problems and projects. Employees can raise or lower work tables and rearrange cabinets and other furniture to suit their own preferences. They can also personalize their work areas by adding photos, team logos, or other decorations to the fabric screens that separate the workstations.

When Sempra first installed the Herman Miller furniture, its employees were taken aback by the openness of the workstations, compared to the more closed-in appearance of their cubicles. On the other hand, by fitting one hundred workstations into an office that previously housed eighty cubicles, Sempra was able to carve out a handful of rooms for team meetings. Despite the open space, noise has not been a problem, and internal communication has been enhanced. In fact, some employees say that they are getting acquainted with coworkers they hardly knew before, which can only improve internal connections.

To create new value, companies today have to solve more and more complex problems. It takes people working together to arrive at solutions, and you can't wait for a meeting to make that happen.
*—Jim Long, lead researcher for Resolve products, Herman Miller**

Reference: Chuck Salter, "Designed to Work," *Fast Company,* April 2000, pp. 255–268 (*quote on p. 260).

ern Electric) have tried job rotation, it is most often used today as a training device to improve worker skills and flexibility.

Job Enlargement On the assumption that doing the same basic task over and over is the primary cause of worker dissatisfaction, **job enlargement** was developed to increase the total number of tasks workers perform. As a result, all workers perform a wide variety of tasks, which presumably reduces the level of job dissatisfaction. Many organizations have used job enlargement, including IBM, Detroit Edison, AT&T, the U.S. Civil Service, and Maytag. At Maytag, for example, the assembly line for producing washing-machine water pumps was systematically changed so that work that had originally been performed by six workers, who passed the work sequentially from one person to another, was performed by four workers, each of whom assembled a complete pump.[12] Unfortunately, although job enlargement does have some positive consequences, they are often offset by several disadvantages: (1) training costs usually rise, (2) unions have argued that pay should increase because the worker is doing more tasks, and (3) in many cases the work remains boring and routine even after job enlargement.

Job enlargement An alternative to job specialization that involves increasing the total number of tasks workers perform

job enrichment An alternative to job specialization that involves increasing both the number of tasks the worker does and the control the worker has over the job

Job Enrichment A more comprehensive approach, **job enrichment**, assumes that increasing the range and variety of tasks is not sufficient by itself to improve employee motivation.[13] Thus, job enrichment attempts to increase both the number of tasks a worker does and the control the worker has over the job. To implement job enrichment, managers remove some controls from the job, delegate more authority to employees, and structure the work in complete, natural units. These changes increase subordinates' sense of responsibility. Another part of job enrichment is to assign new and challenging tasks continually, thereby increasing employees' opportunity for growth and advancement.

AT&T was one of the first companies to try job enrichment. In one experiment, eight typists in a service unit prepared customer service orders. Faced with low output and high turnover, management determined that the typists felt little responsibility to clients and received little feedback. The unit was changed to create a typing team. Typists were matched with designated service representatives, the task was changed from ten specific steps to three more general steps, and job titles were upgraded. As a result, the frequency of order processing increased from 27 percent to 90 percent, the need for messenger service was eliminated, accuracy improved, and turnover became practically nil.[14] Other organizations that have tried job enrichment include Texas Instruments, IBM, and General Foods. This approach, however, also has disadvantages. For example, work systems should be analyzed before enrichment but this analysis seldom happens, and managers rarely ask for employee preferences when enriching jobs.

job characteristics approach An alternative to job specialization that suggests that jobs should be diagnosed and improved along five core dimensions, taking into account both the work system and employee preferences

Job Characteristics Approach The **job characteristics approach** is an alternative to job specialization that does take into account the work system and employee preferences.[15] As illustrated in Figure 11.1, the job characteristics approach suggests that jobs should be diagnosed and improved along five core dimensions:

1. *Skill variety:* the number of tasks a person does in a job
2. *Task identity:* the extent to which the worker does a complete or identifiable portion of the total job
3. *Task significance:* the perceived importance of the task
4. *Autonomy:* the degree of control the worker has over how the work is performed
5. *Feedback:* the extent to which the worker knows how well the job is being performed

The higher a job rates on those dimensions, the more employees will experience various psychological states. Experiencing these states, in turn, presumably leads to high motivation, high-quality performance, high satisfaction, and low absenteeism and turnover. Finally, a variable called *growth-need strength* is presumed to affect how the model works for different people. People with a strong desire to grow, develop, and expand their capabilities (indicative of high growth-need strength) are expected to respond strongly to the presence or absence of the basic job characteristics; individuals with low growth-need strength are expected not to respond as strongly or consistently.

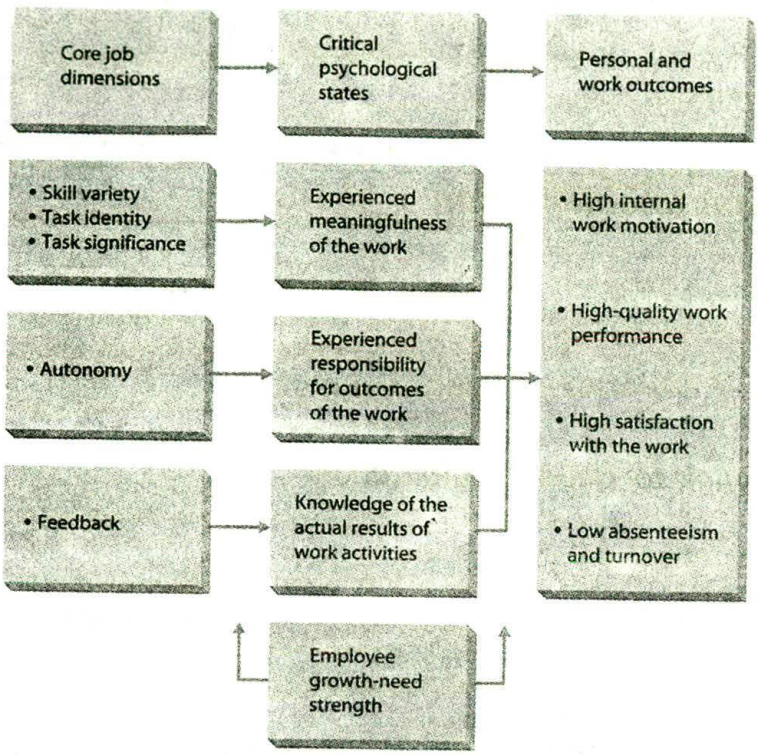


Figure 11.1

The Job Characteristics Approach

The job characteristics approach to job design provides a viable alternative to job specialization. Five core job dimensions may lead to critical psychological states that, in turn, may enhance motivation, performance, and satisfaction while also reducing absenteeism and turnover.

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A large number of studies have been conducted to test the usefulness of the job characteristics approach. The Southwestern Division of Prudential Insurance, for example, used this approach in its claims division. Results included moderate declines in turnover and a small but measurable improvement in work quality. Other research findings have not supported this approach as strongly. Thus, although the job characteristics approach is one of the most promising alternatives to job specialization, it is probably not the final answer.

Work Teams Another alternative to job specialization is **work teams**. Under this arrangement, a group is given responsibility for designing the work system to be used in performing an interrelated set of jobs. In the typical assembly-line system, the work flows from one worker to the next, and each worker has a specified job to perform. In a work team, however, the group itself decides how jobs will be allocated. For example, the work team assigns specific tasks to members, monitors and controls its own performance, and has autonomy over work scheduling.[16] We discuss work teams more fully in Chapter 19.

work team An alternative to job specialization that allows an entire group to design the work system it will use to perform an interrelated set of tasks

MANAGEMENT Managers should know that they have a variety of job design alternatives at their disposal. They should also know the benefits and limitations of each alternative as they decide how to design jobs most appropriately within their organization.

■ Grouping Jobs: Departmentalization

departmentalization The process of grouping jobs according to some logical arrangement

The second building block of organization structure is the grouping of jobs according to some logical arrangement. This process is called **departmentalization**. After establishing the basic rationale for departmentalization, we identify some common bases along which departments are created.[17]

Rationale for Departmentalization

When organizations are small, the owner-manager can personally oversee everyone who works there. As an organization grows, however, personally supervising all the employees becomes more and more difficult for the owner-manager. Consequently, new managerial positions are created to supervise the work of others. Employees are not assigned to particular managers randomly. Rather, jobs are grouped according to some plan. The logic embodied in such a plan is the basis for all departmentalization.[18]

Lucent Technologies, the world's largest telephone equipment maker, recently created four new departments intended to improve its competitiveness. These departments represent activities that have grown large enough within the existing departmental arrangements that they now warrant separate units. One department will focus on optical networking, one will focus on wireless communication, one will be responsible for semiconductor operations, and one will handle Lucent's e-business initiatives. The firm's managers believe that these new departments will sharpen the company's focus on these four high-growth areas.[19]

Common Bases for Departmentalization

Figure 11.2 presents a partial organizational chart for Apex Computers, a hypothetical firm that manufactures and sells computers and software. The chart shows that Apex uses each of the four most common bases for departmentalization: function, product, customer, and location.

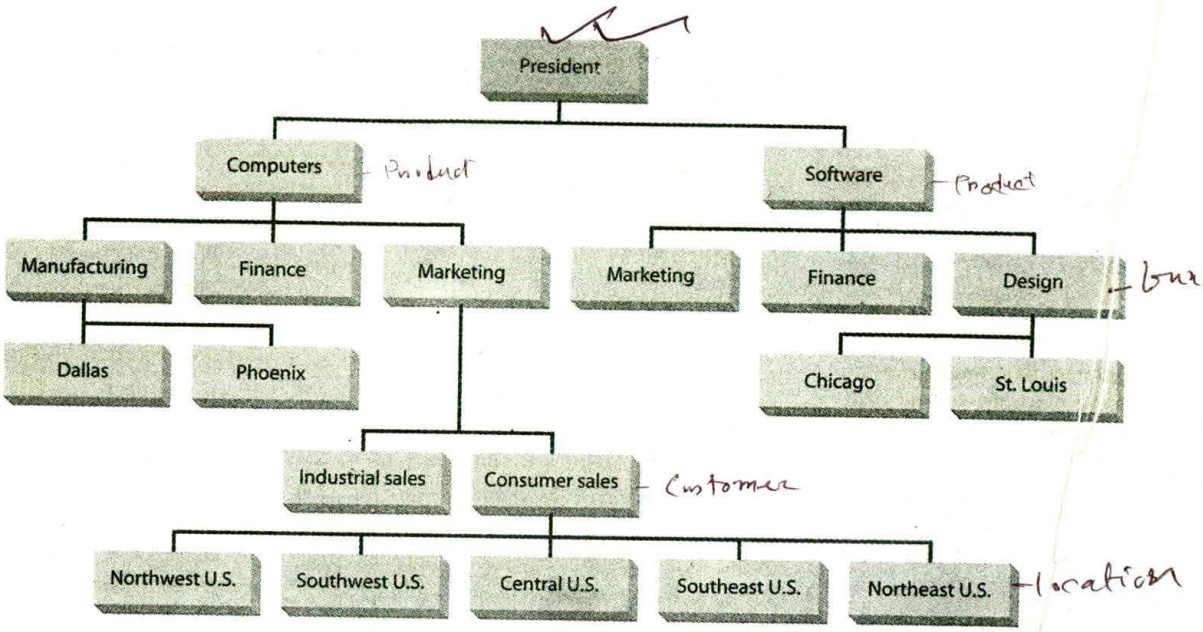
functional departmentalization Grouping jobs involving the same or similar activities

Functional Departmentalization The most common base for departmentalization, especially among smaller organizations, is by function. **Functional departmentalization** groups together those jobs involving the same or similar activities. (The word *function* is used here to mean organizational functions such as finance and production rather than the basic managerial functions such as planning or controlling.) The computer department at Apex has manufacturing, finance, and marketing departments.

Figure 11.2

Bases for Departmentalization: Apex Computers

Organizations group jobs into departments. Apex—a hypothetical organization—uses all four of the primary bases of departmentalization—function, product, customer, and location. Like Apex, most large organizations use more than one type of departmentalization.



This approach, which is most common in smaller organizations, has three primary advantages. First, each department can be staffed by experts in that functional area. Marketing experts can be hired to run the marketing function, for example. Second, supervision is also facilitated because an individual manager needs to be familiar with only a relatively narrow set of skills. And third, coordinating activities inside each department is easier.

On the other hand, as an organization begins to grow in size, several disadvantages of this approach may emerge. For one, decision making tends to become slower and more bureaucratic. Employees may also begin to concentrate too narrowly on their own units and lose sight of the total organizational system. Finally, accountability and performance become increasingly difficult to monitor. For example, determining whether a new product fails because of production deficiencies or a poor marketing campaign may not be possible.

Product Departmentalization **Product departmentalization**, a second common approach, involves grouping activities around products or product groups. Apex Computers has two product-based departments at the highest level of the firm. One is responsible for all activities associated with Apex's personal computer

product departmentalization Grouping activities around products or product groups

business, and the other handles the software business. Most larger businesses adopt this form of departmentalization for grouping activities at the business or corporate level.

Product departmentalization has three major advantages. First, all activities associated with one product or product group can be easily integrated and coordinated. Second, the speed and effectiveness of decision making are enhanced. Third, the performance of individual products or product groups can be assessed more easily and objectively, thereby improving the accountability of departments for the results of their activities.

Product departmentalization also has two major disadvantages. For one, managers in each department may focus on their own product or product group to the exclusion of the rest of the organization. That is, a marketing manager may see her or his primary duty as helping the group rather than helping the overall organization. For another, administrative costs rise because each department must have its own functional specialists for tasks like marketing research and financial analysis.

customer departmentalization Grouping activities to respond to and interact with specific customers or customer groups

Customer Departmentalization Under **customer departmentalization**, the organization groups its activities to respond to and interact with specific customers or customer groups. The lending activities in most banks, for example, are usually tailored to meet the needs of different kinds of customers (i.e., business, consumer, mortgage, and agricultural loans). Figure 11.2 shows that the marketing branch of Apex's computer business has two distinct departments—industrial sales and consumer sales. The industrial sales department handles marketing activities aimed at business customers, whereas the consumer sales department is responsible for wholesaling computers to retail stores catering to individual purchasers.

The basic advantage of this approach is that the organization can use skilled specialists to deal with unique customers or customer groups. It takes one set of skills to evaluate a balance sheet and lend a business $50,000 for operating capital and a different set of skills to evaluate an individual's creditworthiness and lend $10,000 for a new car. However, a fairly large administrative staff is required to integrate the activities of the various departments. In banks, for example, coordination is necessary to make sure that the organization does not overcommit itself in any one area and to handle collections on delinquent accounts from a diverse set of customers.

location departmentalization Grouping jobs on the basis of defined geographic sites or areas

Location Departmentalization **Location departmentalization** groups jobs on the basis of defined geographic sites or areas. The defined sites or areas may range in size from a hemisphere to only a few blocks of a large city. The manufacturing branch of Apex's computer business has two plants—one in Dallas and another in Phoenix. Similarly, the design division of its software design unit has two labs—one in Chicago and the other in St. Louis. Apex's consumer sales group has five sales territories corresponding to different regions of the United States. Transportation companies, police departments (precincts represent geographic areas of a city), and the Federal Reserve Bank all use location departmentalization.

The primary advantage of location departmentalization is that it enables the organization to respond easily to unique customer and environmental characteris-

tics in the various regions. On the negative side, a larger administrative staff may be required if the organization must keep track of units in scattered locations.

Other Forms of Departmentalization Although most organizations are departmentalized by function, product, location, or customer, other forms are occasionally used. Some organizations group certain activities by time. One of the machine shops of Baker Hughes in Houston, for example, operates on three shifts. Each shift has a superintendent who reports to the plant manager, and each shift has its own functional departments. Time is thus the framework for many organizational activities. Other organizations that use time as a basis for grouping jobs include some hospitals and many airlines. In other situations, departmentalization by sequence is appropriate. Many college students, for instance, must register in sequence: seniors on Monday, juniors on Tuesday, and so on. Other areas that may be organized in sequence include credit departments (specific employees run credit checks according to customer name) and insurance claims divisions (by policy number).

Other Considerations Two final points about job grouping remain to be made. First, departments are often called something entirely different—divisions, units, sections, and bureaus are all common synonyms. The higher we look in an organization, the more likely we are to find departments referred to as divisions. H.J. Heinz, for example, is organized into five major divisions. Nevertheless, the underlying logic behind all the labels is the same: they represent groups of jobs that have been yoked together according to some unifying principle. Second, almost any organization is likely to employ multiple bases of departmentalization, depending on level. Although Apex Computer is a hypothetical firm we created to explain departmentalization, it is quite similar to many real organizations because it uses a variety of bases of departmentalization for different levels and different sets of activities.

MANAGEMENT IMPLICATIONS Managers need to understand thoroughly the strengths and weaknesses of each common method or approach to departmentalization. This understanding will enable them to select the best approach to departmentalization for their own unique circumstances.

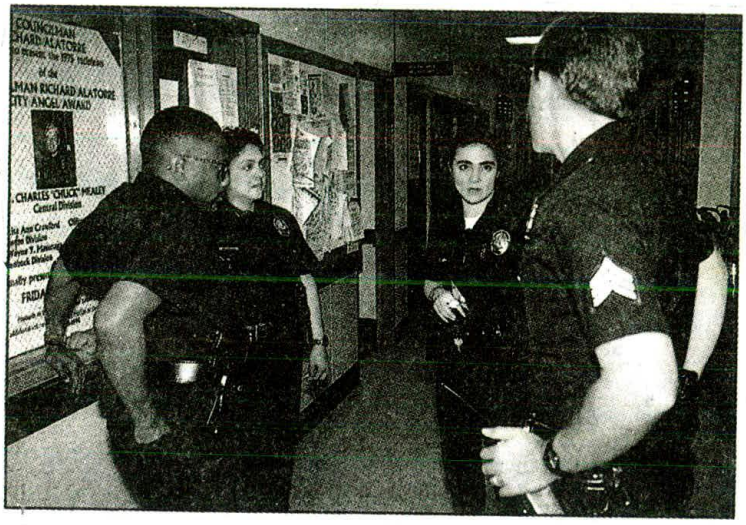
■ *Establishing Reporting Relationships*

The third basic element of organizing is the establishment of reporting relationships among positions. Suppose, for example, that the owner-manager of a small business has just hired two new employees, one to handle marketing and one to handle production. Will the marketing manager report to the production manager? Will the production manager report to the marketing manager? Or will each report directly to the owner-manager? These questions reflect the basic issues involved in establishing reporting relationships: clarifying the chain of command and the span of management.

chain of command Clear and distinct lines of authority among all positions in an organization

Chain of Command

Chain of command is an old concept, first popularized in the early years of the twentieth century. For example, early writers about the **chain of command** argued that clear and distinct lines of authority need to be established among all positions in the organization. The chain of command actually has two components. The first, called *unity of command*, suggests that each person within an organization must have a clear reporting relationship to one and only one boss (as we see in this chapter, newer models of organization design successfully violate this premise). The second, called the *scalar principle*, suggests that there must be a clear and unbroken line of authority that extends from the lowest to the highest position in the organization. The popular saying "The buck stops here" is derived from this idea—someone in the organization must ultimately be responsible for every decision. *Working with Diversity* introduces a novel twist on diversity—family and nonfamily management at J. Crew—in the chain of command.



Clear and precise reporting relationships are important in organizations. Police officers need formally defined reporting relationships so that they know who is in charge during a hostage crisis, a burglary investigation, or a drug bust.

span of management The number of people who report to each manager

Narrow Versus Wide Spans

Another part of establishing reporting relationships is determining how many people will report to each manager, which defines the **span of management** (sometimes called the *span of control*). For years managers and researchers sought to determine the optimal span of management. For example, should it be relatively narrow (with few subordinates per manager) or relatively wide (with many subordinates)? One early writer, A. V. Graicunas, went so far as to quantify span of management issues.[20] Graicunas noted that a manager must deal with three kinds of interactions with and among subordinates: direct (the manager's one-to-one relationship with each subordinate), cross (among the subordinates themselves), and group (between groups of subordinates). The number of possible interactions of all types between a manager and subordinates can be determined by the following formula:

$$I = N(2^N/2 + N - 1)$$

where I is the total number of interactions with and among subordinates and N is the number of subordinates.

If a manager has only two subordinates, six potential interactions exist. If the number of subordinates increases to three, the possible interactions total eigh-

WORKING WITH DIVERSITY

Mixing Family and NonFamily Management

Apparel retailing became the family business when Arthur Cinader and his daughter, Emily Woods, co-founded J. Crew in 1983. J. Crew sells stylish casual clothing—such as chino pants—for men and women through catalogs, retail stores, and the Internet. Over the years, the increasing popularity of casual wear for everyday and work occasions allowed the company to expand through new ventures such as Clifford & Wills and Popular Club Plan.

As the 1990s progressed, however, J. Crew faced more intense competition from Gap, Banana Republic, Abercrombie & Fitch, and other casual-clothing chains. Sales were going up but financial pressures were also increasing. With catalog costs rising, the company wanted to switch more customers to its web site and enlarge its chain of retail stores. In 1998, family ownership gave way to a mixture of family, management, and outside ownership through a leveraged buyout arrangement. Texas Pacific Group, an investment firm, became majority owner, while co-founder Woods retained about 20 percent ownership, and a group of J. Crew managers held about 10 percent ownership.

After operating at a loss in 1998, J. Crew sold off Popular Club Plan and closed Clifford & Wills. These changes helped the company reduce its 1999 losses to $6.6 million on sales of $716 million as part of a turnaround strategy. Woods, serving as chairperson, was still juggling apparel design and other top-management responsibilities, such as supervising a new television advertising campaign. Below her, however, the CEO position was in transition. One nonfamily CEO left after only a year. Again reaching outside for a CEO, the company brought in Mark Sarvary, formerly head of Nestlé's frozen foods division, to supervise the firm's finance and operations functions. Within months, Savary was also given control of the design, merchandising, and marketing functions. This change freed Woods to concentrate on building the J. Crew brand—essential to the retail and Internet growth strategy—without the distractions of watching over day-to-day business details.

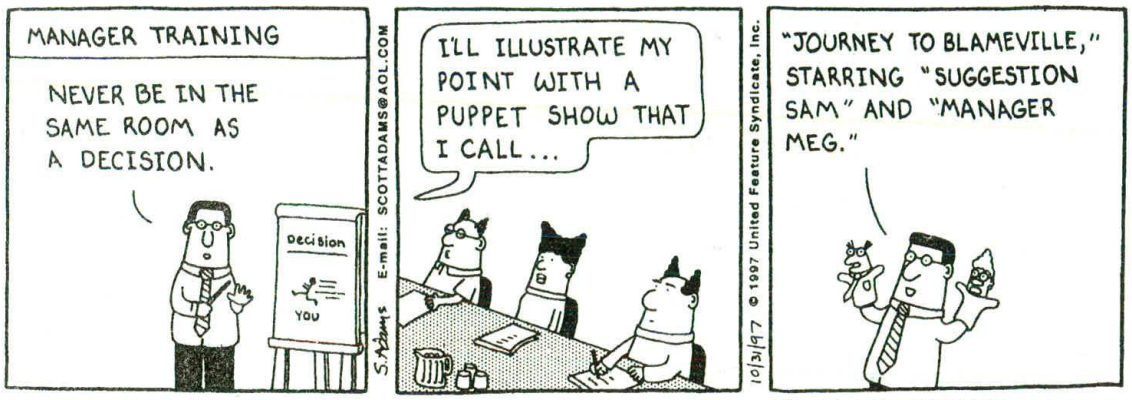
This allows me to focus on near- and long-term strategy and brand development.

*—Emily Woods, chairperson of J. Crew**

References: Thomas J. Ryan, "J. Crew and Old Navy Measure Success By the Square Foot," *Women's Wear Daily,* June 8, 2000, p. 1; Rebecca Quick, "J. Crew CEO Sarvary Broadens Control As Chairman Curbs Day-to-Day Role," *Wall Street Journal,* February 1, 2000, p. B7 (*quote on p. B7); Anne D'Innocenzio, "Megabrands Keep a Firm Grip on the Top 10," *Women's Wear Daily,* January 24, 2000, p. 82S; Thomas J. Ryan, "J. Crew Group Narrows Losses to $6.6 M in Year," *Daily News Record,* April 26, 2000, p. 10.

teen. With five subordinates there are one hundred possible interactions. Although Graicunas offers no prescription for what *N* should be, his ideas demonstrate how complex the relationships become when more subordinates are added. The important point is that each additional subordinate adds more complexity than the previous one did. Going from nine to ten subordinates is very different than going from three to four.

Another early writer, Ralph C. Davis, described two kinds of spans: an operative span for lower-level managers and an executive span for middle and top managers. He argued that operative spans could approach thirty subordinates, whereas executive spans should be limited to between three and nine (depending on the nature of the managers' jobs, the growth rate of the company, and similar factors). Lyndall F. Urwick suggested that an executive span should never exceed six subordinates, and General Ian Hamilton reached the same conclusion.[21] Today we recognize that the span of management is a crucial factor in structuring organizations



Dilbert by Scott Adams © 1997 United Feature Syndicate, Inc.

Distributing authority is a key building block in creating an effective organization. Unfortunately, some managers prefer to avoid accountability for decisions and work to ensure that someone else can always be held responsible for mistakes and errors. This Dilbert cartoon, for instance, illustrates a whimsical view of a manager teaching others how to avoid accountability and pass the buck on to others.

but that there are no universal, cut-and-dried prescriptions for an ideal or optimal span.[22] Later we summarize some important variables that influence the appropriate span of management in a particular situation. First, however, we describe how the span of management affects the overall structure of an organization.

Tall Versus Flat Organizations

Imagine an organization with thirty-one managers and a narrow span of management. As shown in Figure 11.3, the result is a relatively tall organization with five layers of management. With a somewhat wider span of control, however, the flat organization shown in Figure 11.3 emerges. This configuration has only three layers of management.

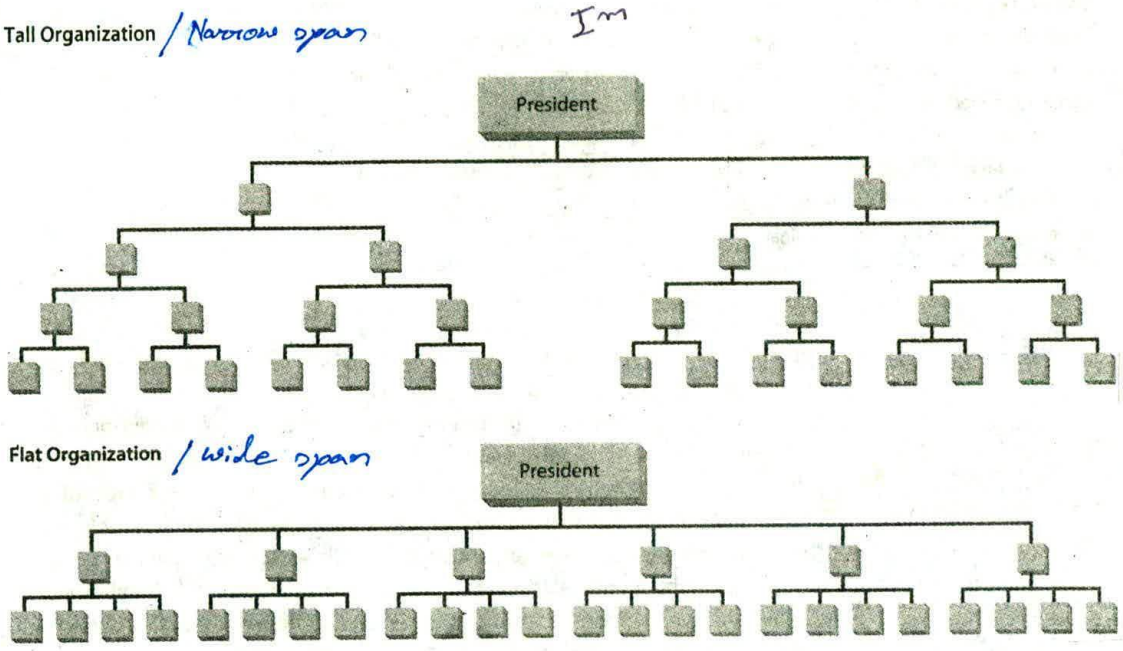
What difference does it make whether the organization is tall or flat? One early study at Sears Roebuck and Co. found that a flat structure led to higher levels of employee morale and productivity.[23] Researchers have also argued that a tall structure is more expensive (because of the larger number of managers involved) and that it fosters more communication problems (because of the increased number of people through whom information must pass). On the other hand, a wide span of management in a flat organization may result in a manager's having more administrative responsibility (because there are fewer managers) and more supervisory responsibility (because there are more subordinates reporting to each manager). If these additional responsibilities become excessive, the flat organization may suffer.[24]

Many experts agree that businesses can function effectively with fewer layers of organization than they currently have. The Franklin Mint, for example, reduced its number of management layers from six to four. At the same time, CEO Stewart Resnick increased his span of management from six to twelve. In similar fashion, IBM has eliminated several layers of management. One additional reason for this trend is that improved organizational communication networks allow managers to stay in touch with a larger number of subordinates than was possible even just a few years ago.[25]

Figure 11.3

Tall Versus Flat Organizations

Wide spans of management result in flat organizations, which may lead to improved employee morale and productivity as well as increased managerial responsibility. Many organizations today, including IBM and General Electric, are moving toward flat structures to improve communication and flexibility.



Determining the Appropriate Span

Of course, the initial question remains: How do managers determine the appropriate span for their unique situations? Although no perfect formula exists, researchers have identified a set of factors that influence the span for a particular circumstance.[26] Some of these factors are listed in Table 11.1. For example, if the manager and subordinates are competent and well trained, a wide span may be effective. Physical dispersion is also important. The more widely subordinates are scattered, the narrower the span should be. On the other hand, if all the subordinates are in one location, the span can be somewhat wider. The amount of nonsupervisory work expected of the manager is also important. Some managers, especially at the lower levels of an organization, spend most or all of their time supervising subordinates. Other managers spend a lot of time doing paperwork, planning, and engaging in other managerial activities. Thus, these managers may need a narrower span.

Some job situations also require a great deal of interaction between supervisor and subordinates. In general, the more interaction that is required, the narrower the span should be. Similarly, if there is a fairly comprehensive set of standard

Table 11.1

Factors Influencing the Span of Management

Although researchers have found advantages to the flat organization (less expensive, fewer communication problems than a tall organization, for example), a number of factors may favor a tall organization.

1. Competence of supervisor and subordinates (the greater the competence, the wider the potential span)
2. Physical dispersion of subordinates (the greater the dispersion, the narrower the potential span)
3. Extent of nonsupervisory work in manager's job (the more nonsupervisory work, the narrower the potential span)
4. Degree of required interaction (the less required interaction, the wider the potential span)
5. Extent of standardized procedures (the more procedures, the wider the potential span)
6. Similarity of tasks being supervised (the more similar the tasks, the wider the potential span)
7. Frequency of new problems (the higher the frequency, the narrower the potential span)
8. Preferences of supervisors and subordinates

procedures, a relatively wide span is possible. If only a few standard procedures exist, however, the supervisor usually has to play a larger role in overseeing day-to-day activities and may find a narrower span more efficient. Task similarity is also important. If most of the jobs being supervised are similar, a supervisor can handle a wider span. When each employee is performing a different task, more of the supervisor's time is spent on individual supervision. Likewise, if new problems that require supervisory assistance arise frequently, a narrower span may be called for. If new problems are relatively rare, though, a wider span can be established. Finally, the preferences of both supervisor and subordinates may affect the optimal span. Some managers prefer to spend less time actively supervising their employees, and many employees prefer to be more self-directed in their jobs. A wider span may be possible in these situations.

For example, the Case Corporation factory in Racine, Wisconsin, makes farm tractors exclusively to order in five to six weeks. Farmers can select from among a wide array of options, including engines, tires, power train, and even a CD player. A wide assortment of machines and processes are used to construct each tractor. Workers are highly skilled operators of their particular machines, and each machine is different. In this kind of setup, the complexities of each machine and the advanced skills needed by each operator mean that one supervisor can oversee only a small number of employees.[27]

In some organizational settings, other factors may influence the optimal span of management. The relative importance of each factor also varies in different settings. It is unlikely that all eight factors will suggest the same span; some may suggest a wider span, and others may indicate a need for a narrow span. Hence, managers must assess the relative weight of each factor or set of factors when deciding what the optimal span of management is for their unique situation.

MANAGEMENT IMPLICATIONS Managers should understand the various circumstances that affect the appropriate span of management. They should also be aware of how the span of management specifically results in a relatively taller or flatter organization, as well as the implications of these effects.

Distributing Authority

Another important building block in structuring organizations is the determination of how authority is to be distributed among positions. **Authority** is power that has been legitimized by the organization.[28] Distributing authority is another normal outgrowth of increasing organizational size. For example, when an owner-manager hires a sales representative to market his products, he needs to give the new employee appropriate authority to make decisions about delivery dates, discounts, and so forth. If every decision requires the approval of the owner-manager, he is no better off than he was before he hired the sales representative. The power given to the sales representative to make certain kinds of decisions, then, represents the establishment of a pattern of authority—the sales representative can make some decisions alone and others in consultation with coworkers, and the sales representative must defer some decisions to the boss. Two specific issues that managers must address when distributing authority are delegation and decentralization.[29]

authority Power that has been legitimized by the organization

The Delegation Process

Delegation is the establishment of a pattern of authority between a superior and one or more subordinates. Specifically, **delegation** is the process by which managers assign a portion of their total workload to others.[30]

delegation The process by which managers assign a portion of their total workload to others

Reasons for Delegation The primary reason for delegation is to enable the manager to get more work done. Subordinates help ease the manager's burden by doing major portions of the organization's work. In some instances, a subordinate may have more expertise in addressing a particular problem than the manager does. For example, the subordinate may have had special training in developing

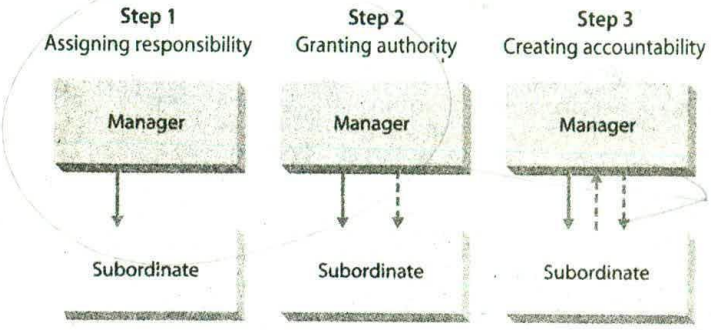


Distributing authority in an organization begins with delegation. At Yahoo!, the big Internet portal, extreme delegation is a fundamental management philosophy. When the firm hired Isabelle Bordry (left) and Clothilde de Mersan to launch and run Yahoo France, U.S. managers were initially concerned about their ability to transfer its management style to the notoriously centralized and rigid French economy. But Bordry and de Mersan have enthusiastically embraced the notion of delegation and are aggressively working to encourage their employees to make their own decisions.

Figure 11.4

Steps in the Delegation Process

Good communication skills can help a manager successfully delegate responsibility to subordinates. A manager must not be reluctant to delegate, nor must he or she fear that the subordinate will do the job so well that the manager's advancement is threatened.



information systems or may be more familiar with a particular product line or geographic area. Delegation also helps develop subordinates. By participating in decision making and problem solving, subordinates learn about overall operations and improve their managerial skills.

Parts of the Delegation Process In theory, as shown in Figure 11.4, the delegation process involves three steps. First, the manager assigns responsibility, or gives the subordinate a job to do. The assignment of responsibility might range from telling a subordinate to prepare a report to placing the person in charge of a task force. Along with the assignment, the individual is also given the authority to do the job. The manager may give the subordinate the power to requisition needed information from confidential files or to direct a group of other workers. Finally, the manager establishes the subordinate's accountability—that is, the subordinate accepts an obligation to carry out the task assigned by the manager.

These three steps do not occur mechanically, however. Indeed, when a manager and a subordinate have developed a good working relationship, the major parts of the process may be implied rather than stated. The manager may simply mention that a particular job must be done. A perceptive subordinate may realize that the manager is actually assigning the job to her. From past experience with the boss, she may also know, without being told, that she has the necessary authority to do the job and that she is accountable to the boss for finishing the job as "agreed."

Problems in Delegation Unfortunately, problems often arise in the delegation process. For example, a manager may be reluctant to delegate. Some managers are so disorganized that they are unable to plan work in advance and, as a result, cannot delegate appropriately. Similarly, some managers may worry that subordinates will do too well and pose a threat to their own advancement. And finally, managers may not trust the subordinate to do the job well. Similarly, some subordinates are reluctant to accept delegation. They may be afraid that failure will result in a reprimand. They may also perceive that there are no rewards for accepting additional responsibility. Or they may simply prefer to avoid risk and, therefore, want their boss to take all responsibility.

Norm Brodsky, a small-business owner who built six successful companies, learned firsthand what happens when the CEO cannot effectively delegate. It took Brodsky seven years to build a messenger service into a $120 million operation—and just fourteen months to go from $120 million into bankruptcy. "Where did I

go wrong?" he asks rhetorically and provides his own answer: "The company needed management, stability, and structure, and I kept it from getting them. I was so desperate to sustain the head rush of start-up chaos that I made all the final decisions and didn't let the managers do their jobs. In the end I paid a steep price."[31]

There are no quick fixes for these problems. The basic issue is communication. Subordinates must understand their own responsibility, authority, and accountability, and the manager must come to recognize the value of effective delegation. With the passage of time, subordinates should develop their skills and abilities to the point where they can make substantial contributions to the organization. At the same time, managers should recognize that a subordinate's satisfactory performance is not a threat to their own career but an accomplishment by both the subordinate who did the job and the manager who trained the subordinate and was astute enough to entrust the subordinate with the project. Ultimate responsibility for the outcome, however, continues to reside with the manager.

Decentralization and Centralization

Just as authority can be delegated from one individual to another, organizations also develop patterns of authority across a wide variety of positions and departments. **Decentralization** is the process of systematically delegating power and authority throughout the organization to middle and lower-level managers. It is important to remember that decentralization is actually one end of a continuum anchored at the other end by **centralization**, the process of systematically retaining power and authority in the hands of higher-level managers. Hence, a decentralized organization is one in which decision-making power and authority are delegated as far down the chain of command as possible. Conversely, in a centralized organization, decision-making power and authority are retained at the higher levels of management. When H. Ross Perot ran EDS he practiced centralization; his successors have used decentralization. No organization is ever completely decentralized or completely centralized: some firms position themselves toward one end of the continuum, and some lean the other way.[32]

decentralization The process of systematically delegating power and authority throughout the organization to middle and lower-level managers

centralization The process of systematically retaining power and authority in the hands of higher-level managers

What factors determine an organization's position on the decentralization-centralization continuum? One common determinant is the organization's external environment. Usually, the greater the complexity and uncertainty of the environment, the greater is the tendency to decentralize. Another crucial factor is the history of the organization. Firms have a tendency to do what they have done in the past, so there is likely to be some relationship between what an organization did in its early history and what it chooses to do today in terms of centralization or decentralization. The nature of the decisions being made is also considered. The costlier and riskier the decision, the more pressure there is to centralize. Organizations also consider the abilities of lower-level managers. If lower-level managers do not have the ability to make high-quality decisions, there is likely to be a high level of centralization. If lower-level managers are well qualified, top management can take advantage of their talents by decentralizing; in fact, if top management doesn't, talented lower-level managers may leave the organization.[33]

A manager has no clear-cut guidelines for determining whether to centralize or decentralize. Many successful organizations such as Sears and General Electric are quite decentralized. Equally successful firms such as McDonald's and Wal-Mart have remained centralized. IBM has recently undergone a transformation from using a highly centralized approach to a much more decentralized approach to managing its operations. A great deal of decision-making authority was passed from the hands of a select group of top executives down to six product and marketing groups. The reason for the move was to speed the company's ability to make decisions, introduce new products, and respond to customers. For years, most Japanese firms have been highly centralized. Recently, though, many leading Japanese firms have moved toward decentralization.

MANAGEMENT IMPLICATIONS All managers should know the steps in the delegation process. In addition, they should also be aware of problems that can occur as a result of ineffective delegation. Finally, they should also know how the distribution of authority results in centralization or decentralization and the factors that affect each.

■ Coordinating Activities

A fifth major element of organizing is coordination. As we discussed earlier, job specialization and departmentalization involve breaking jobs down into small units and then combining those jobs into departments. Once this organization has been accomplished, the activities of the departments must be linked—systems must be put into place to keep the activities of each department focused on the attainment of organizational goals. This focus is accomplished by **coordination**—the process of linking the activities of the various departments of the organization.[34]

coordination The process of linking the activities of the various departments of the organization

The Need for Coordination

The primary reason for coordination is that departments and work groups are interdependent—they depend on each other for information and resources to perform their respective activities. The greater the interdependence between departments, the more coordination the organization requires if departments are to be able to perform effectively. There are three major forms of interdependence: pooled, sequential, and reciprocal.[35]

pooled interdependence When units operate with little interaction; their output is simply pooled at the organizational level

Pooled interdependence represents the lowest level of interdependence. Units with pooled interdependence operate with little interaction—the output of the units is pooled at the organizational level. The Gap clothing stores operate with pooled interdependence. Each store is considered a department by the parent corporation. Each has its own operating budget, staff, and so forth. The profits or losses from each store are "added together" at the organizational level. The stores are interdependent to the extent that the final success or failure of one store affects the others, but they do not generally interact on a day-to-day basis.

In **sequential interdependence**, the output of one unit becomes the input for another in a sequential fashion. This arrangement creates a moderate level of interdependence. At Nissan, for example, one plant assembles engines and then ships them to a final assembly site at another plant where the cars are completed. The plants are interdependent because the final assembly plant must have the engines from engine assembly before it can perform its primary function of producing finished automobiles. But the level of interdependence is generally one-way—the engine plant is not necessarily dependent on the final assembly plant.

sequential interdependence
When the output of one unit becomes the input of another in a sequential fashion

Reciprocal interdependence exists when activities flow both ways between units. This form is clearly the most complex. Within a Marriott Hotel, for example, the reservations department, front-desk check-in, and housekeeping are all reciprocally interdependent. The reservations department has to provide front-desk employees with information about how many guests to expect each day, and housekeeping needs to know which rooms require priority cleaning. If any of the three units does not do its job properly, the others will all be affected.

reciprocal interdependence
When activities flow both ways between units

Structural Coordination Techniques

Because of the obvious coordination requirements that characterize most organizations, many techniques for achieving coordination have been developed. Some of the most useful devices for maintaining coordination among interdependent units are the managerial hierarchy, rules and procedures, liaison roles, task forces, and integrating departments.[36] *Managing in an E-business World* illustrates how the international publishing giant Bertlesmann uses structural coordination techniques.

The Managerial Hierarchy Organizations that use the hierarchy to achieve coordination place one manager in charge of interdependent departments or units. In Kmart distribution centers, major activities include receiving and unloading bulk shipments from railroad cars and loading other shipments onto trucks for distribution to retail outlets. The two groups (receiving and shipping) are interdependent because they share the loading docks and some equipment. To ensure coordination and to minimize conflict, one manager is in charge of the whole operation.

Rules and Procedures Routine coordination activities can be handled via rules and standard procedures. In the Kmart distribution center, an outgoing truck shipment has priority over an incoming rail shipment. Thus, when trucks are to be loaded, the shipping unit is given access to all of the center's auxiliary forklifts. This priority is specifically stated in a rule. But as useful as rules and procedures often are in routine situations, they are not particularly effective when coordination problems are complex or unusual.

Liaison Roles We introduced the liaison role of management in Chapter 1. As a device for coordination, a manager in a liaison role coordinates interdependent units by acting as a common point of contact. This individual may not have any

MANAGING IN AN *e*-BUSINESS WORLD

BERTELSMANN ORGANIZES FOR GLOBAL E-COMMERCE

Germany's Bertelsmann AG is the largest book publisher and second largest music distributor in the world, as well as the European leader in television and magazines. Now the company is using its vast content empire to launch an aggressive expansion into cyberspace. Bertelsmann's CEO, Thomas Middelhoff, got an early start in e-commerce by buying a stake in America Online and arranging to deliver content through an AOL partnership. He tried to negotiate a merger with AOL, but Steve Case, AOL's CEO, chose rival media group Time Warner for his merger partner. So Middelhoff retained the content partnership but divested his holdings in AOL Europe and AOL Australia to rethink the company's on-line activities.

After evaluating Bertelsmann's existing Internet businesses, Middelhoff decided that the company's future should be linked to on-line sales of media content rather than Internet access. As a result of this decision, he sold off Bertelsmann's Internet service provider units and pursued an alliance to participate in a European portal for wireless Internet users. Next, he created a new division, the Bertelsmann E-Commerce Group, as an umbrella for five Internet-related units. These include the e-commerce unit, covering the company's stake in on-line book-retailer barnesandnoble.com and bol.com, its European counterpart; the m-commerce unit, covering wireless web and communications activities; the b-commerce unit, covering broadband and other television activities; BECG Ventures, providing venture capital to new technologies; and the strategic alliances unit, covering partnerships with AOL and other Internet companies.

In Internet time, three months is a year. Make a bad decision or two and you are in trouble. That makes me worried.

—Thomas Middelhoff, CEO of Bertelsmann*

Finally, Middelhoff addressed the critical management issue of coordination. Traditionally, Bertelsmann's divisions had been given a great deal of independence to encourage initiative and innovation. Realizing that Bertelsmann's plans for on-line growth required closer coordination, he created the new position of chief creative officer, charged with identifying internal opportunities for synergy among the diverse global businesses.

References: "Bertelsmann Creates Global E-Commerce Group," *Publishers Weekly*, June 19, 2000, p. 17; "Bertelsmann: Under E-Construction," *The Economist*, June 10, 2000, pp. 69–73 (*quote on p. 70); Deborah Cole, "Powerhouse Cyber Services Make 'Net Gain," *Variety*, May 29, 2000, p. 50.

formal authority over the groups but instead simply facilitates the flow of information between units. Two engineering groups working on component systems for a large project might interact through a liaison. The liaison maintains familiarity with each group as well as with the overall project. She can answer questions and otherwise serve to integrate the activities of all the groups.

Task Forces A task force may be created when the need for coordination is acute. When interdependence is complex and several units are involved, a single liaison person may not be sufficient. Instead, a task force might be assembled by drawing one representative from each group. The coordination function is thus spread across several individuals, each of whom has special information about one of the groups involved. When the project is completed, task force members return

to their original positions. For example, a college overhauling its degree requirements might establish a task force made up of representatives from each department affected by the change. Each person retains her or his regular departmental affiliation and duties but also serves on the special task force. After the new requirements are agreed on, the task force is dissolved.

Integrating Departments Integrating departments are occasionally used for coordination. These are somewhat similar to task forces but are more permanent. An integrating department generally has some permanent members as well as members who are assigned temporarily from units that are particularly in need of coordination. One study found that successful firms in the plastics industry, which is characterized by complex and dynamic environments, used integrating departments to maintain internal integration and coordination.[37] An integrating department usually has more authority than a task force and may even be given some budgetary control by the organization.

In general, the greater the degree of interdependence, the more attention the organization must devote to coordination. When interdependence is pooled or simply sequential, the managerial hierarchy or rules and procedures are often sufficient. When more complex forms of sequential interdependence or simpler forms of reciprocal interdependence exist, liaisons or task forces may be more useful. When reciprocal interdependence is complex, task forces or integrating departments are needed. Of course, the manager must also rely on her or his own experience and insights when choosing coordination techniques for the organization.

MANAGEMENT IMPLICATIONS Managers need to understand how varying degrees of interdependence determine the need for coordination within their organization. In addition, they also need to know how various structural techniques can be used to facilitate coordination.

■ Differentiating Between Positions

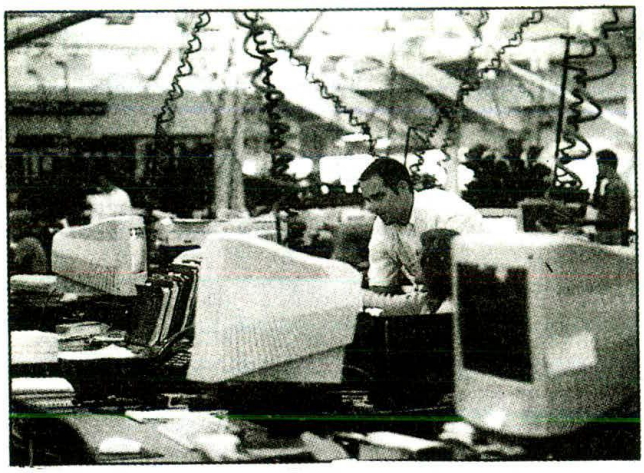
The last building block of organization structure is differentiating between line and staff positions in the organization. A **line position** is a position in the direct chain of command that is responsible for the achievement of an organization's goals. A **staff position** is intended to provide expertise, advice, and support for line positions.

line position A position in the direct chain of command that is responsible for the achievement of an organization's goals

staff position A position intended to provide expertise, advice, and support for line positions

Differences Between Line and Staff

The most obvious difference between line and staff is purpose—line managers work directly toward organizational goals, whereas staff managers advise and assist. But other distinctions exist as well. One important difference is authority. Line



Some organizations still find it necessary to differentiate between positions along such dimensions as line versus staff. But more and more organizations are finding such differentiation not only unnecessary but also counterproductive. SEI Investments is a good example. All employees in the firm's headquarters in Oaks, Pennsylvania, know how to perform virtually every job in the company. Computer hook-ups are even set up so that they drop down from the ceiling allowing employees to do their work regardless of where in the building they may be.

authority is generally thought of as the formal or legitimate authority created by the organizational hierarchy. Staff authority is less concrete and may take a variety of forms. One form is the authority to advise. In this instance, the line manager can choose whether to seek or to avoid input from the staff; even when advice is sought, the manager might still choose to ignore it.

Another form of staff authority is called compulsory advice. In this case the line manager must listen to the advice but can choose to heed it or ignore it. For example, the pope is expected to listen to the advice of the sacred college of cardinals when dealing with church doctrine, but he may follow his own beliefs when making decisions. Perhaps the most important form of staff authority is called functional authority—formal or legitimate authority over activities related to the staff member's specialty. For example, a human resource staff manager may have functional authority when there is a question of discrimination in hiring. Conferring functional authority is probably the most effective way to use staff positions because the organization can take advantage of specialized expertise while also maintaining a chain of command.

Administrative Intensity

administrative intensity The degree to which managerial positions are concentrated in staff positions

Organizations sometimes attempt to balance their emphasis on line versus staff positions in terms of administrative intensity. **Administrative intensity** is the degree to which managerial positions are concentrated in staff positions. An organization with a high administrative intensity is one with many staff positions relative to the number of line positions; low administrative intensity reflects relatively more line positions. Although staff positions are important in many different areas, they tend to proliferate unnecessarily. All else being equal, organizations would like to devote most of their human resource investment on line managers because, by definition, they contribute to the organization's basic goals. A surplus of staff positions represents a drain on an organization's cash and an inefficient use of resources.

Many organizations have taken steps over the past few years to reduce their administrative intensity by eliminating staff positions. CBS has cut hundreds of staff positions at its New York headquarters, and IBM has cut its corporate staff workforce from seven thousand to 2,300. Burlington Northern generates almost $7 billion in annual sales and manages a workforce of forty-three thousand with a corporate staff of only seventy-seven managers!

MANAGEMENT IMPLICATIONS All managers need to understand the fundamental differences that exist between line positions and staff positions in organizations in general and their organization in particular. Managers should also understand the meaning of administrative intensity and how it can be managed most effectively.

Summary of Key Points

Organizations are made up of a series of elements. The most common of these elements involve designing jobs, grouping jobs, establishing reporting relationships, distributing authority, coordinating activities, and differentiating between positions.

Job design is the determination of an individual's work-related responsibilities. The most common form is job specialization. Because of various drawbacks to job specialization, managers have experimented with job rotation, job enlargement, job enrichment, the job characteristics approach, and work teams as alternatives.

After jobs are designed, they are grouped into departments. The most common bases for departmentalization are function, product, customer, and location. Each has its own unique advantages and disadvantages. Large organizations employ multiple bases of departmentalization at different levels.

Establishing reporting relationships starts with clarifying the chain of command. The span of management partially dictates whether the organization is relatively tall or flat. In recent years there has been a trend toward flatter organizations. Several situational factors influence the ideal span.

Distributing authority starts with delegation. Delegation is the process by which the manager assigns a portion of his or her total workload to others. Systematic delegation throughout the organization is decentralization. Centralization involves keeping power and authority at the top of the organization. Several factors influence the appropriate degree of decentralization.

Coordination is the process of linking the activities of the various departments of the organization. Pooled, sequential, or reciprocal interdependence among departments is a primary reason for coordination. Managers can draw on several techniques to help achieve coordination.

A line position is a position in the direct chain of command that is responsible for the achievement of an organization's goals. In contrast, a staff position provides expertise, advice, and support for line positions. Administrative intensity is the degree to which managerial positions are concentrated in staff positions.

Discussion Questions

Questions for Review

1. What is job specialization? What are its advantages and disadvantages?
2. What is meant by departmentalization? Why and how is departmentalization carried out?
3. In what general ways can organizations be shaped? What implications does each of these ways have with regard to the distribution of authority within the organization?

4. How are positions differentiated in organizations? What are the advantages and disadvantages of such differentiation?

Questions for Analysis

5. Seeing how specialization can be utilized in manufacturing organizations is easy. How can it be used by other types of organizations such as hospitals, churches, schools, and restaurants? Should those organizations use specialization? Why or why not?
6. Try to develop a different way to departmentalize your college or university, a local fast-food restaurant, a manufacturing firm, or some other organization. What might be the advantages of your form of organization?
7. Which type of position (line, staff, administrative) is most important to an organization? Why? Could an organization function without any of them? Why or why not?

Questions for Application

8. Go to the library and locate organization charts for ten different organizations. Look for similarities and differences among them and try to account for what you find.
9. Contact two very different local organizations (retailing firm, manufacturing firm, church, civic club, etc.) and interview top managers to develop organization charts for each organization. How do you account for the similarities and differences between them?
10. How many people does the head of your academic department supervise? The dean of your college? The president of your university or college? Why do different spans of management exist for these officials? How might you find out if the spans are appropriate in size?

BUILDING EFFECTIVE *time-management* SKILLS

Exercise Overview

Time-management skills refer to the manager's ability to prioritize work, to work efficiently, and to delegate appropriately. As noted in this chapter, various situational factors affect the appropriate span of management that is optimal for a particular situation. This exercise relates time-management issues with the appropriate span of management.

Exercise Background

Several different factors affect the appropriate span of management for a particular situation. These factors are noted and summarized in Table 11.1 on page 340. The span of management has a direct relationship to the efficient use of the manager's time; that is, a less-than-optimal span of management is likely to result in an inefficient use of time. If the span is too narrow, the manager may have too little work to do, but if the span is too wide, the manager's other work may be neglected.

Exercise Task

Considering the various factors that influence an optimal span of management, respond to the following:

1. Describe how a span inappropriately matched with each factor will result in inefficiencies for both managers and subordinates.
2. If situational factors and the existing span of management are inappropriately matched, it might be possible to change one or the other to achieve a better fit. Examine each factor and decide whether it would be easier to change the factor or the span of management to improve fit.
3. Now assume that you are a manager. Assess the relative importance that you would place on each situational factor to define your own span of management.

BUILDING EFFECTIVE *diagnostic* SKILLS

Exercise Overview

Diagnostic skills are the skills that enable a manager to visualize the most appropriate response to a situation. This exercise will enable you to develop your diagnostic skills as they relate to issues of centralization and decentralization in an organization.

Exercise Background

Managers often find it necessary to change the degree of centralization or decentralization in their organization. Begin this exercise by reflecting on two very different scenarios. In scenario A, assume that you are the top manager in a large organization. The organization has a long and well-known history of being very centralized. For valid reasons beyond the scope of this exercise, assume that you have decided to make the firm much more decentralized. For scenario B, assume the exact opposite situation; that is, assume that you are the top manager of a firm that has always used decentralization but has now decided to become much more centralized.

Exercise Task

With the background information above as context, do the following:

1. List the major barriers you see to implementing decentralization in scenario A.
2. List the major barriers you see to implementing centralization in scenario B.
3. Which scenario do you think would be easiest to implement in reality? That is, is it likely to be easier to move from centralization to decentralization, or from decentralization to centralization? Why?
4. Given a choice of starting your own career in a firm that is either highly centralized or highly decentralized, which do you think you would prefer? Why?

BUILDING EFFECTIVE *conceptual* SKILLS

Exercise Overview

Conceptual skills refer to a person's abilities to think in the abstract. This exercise will help you develop your conceptual skills as they relate to designing jobs.

Exercise Background

Begin by thinking of three different jobs, one that appears to have virtually no enrichment, one that appears to have moderate enrichment, and one that appears to have a great deal of enrichment. These jobs might be positions that you have personally held or positions that you have observed and about which you can make some educated or informed judgments.

Evaluate each job along the five dimensions described in the job characteristics theory. Now see if you can identify ways to improve each of the five dimensions for each job. That is, see if you can determine how to enrich the jobs using the job characteristics theory as a framework.

Finally, meet with a classmate and share your results. See if you can improve your job enrichment strategy based on the critique offered by your classmate.

Exercise Task

With the background information above as context, do the following:

1. What job qualities make some jobs easier to enrich than others?
2. Can all jobs be enriched?
3. Even if a particular job can be enriched, does that always mean that it should be enriched?
4. Under what circumstances might an individual prefer to have a routine and unenriched job?

CHAPTER CLOSING CASE

HEINZ LOOKS BEYOND KETCHUP FOR GROWTH

Heinz's ketchup may flow slowly but its sales are growing quickly. Ketchup is the brightest star among the four thousand products marketed by global food giant H.J. Heinz, which is based in Pittsburgh. Backed by extensive advertising and the introduction of new variations, Heinz ketchup has boosted its U.S. market share from 48 percent to 54 percent in recent years.

However, other Heinz products have lagged behind ketchup's stellar sales performance. Star-Kist tuna, the world's top-selling tuna brand, is faltering because of declining tuna prices and changing consumer tastes. Sales of canned pet foods, such as Heinz's 9-Lives brand, are taking a back seat to sales of dry pet foods, where competitors such as Ralston Purina are stronger. Heinz's Weight Watchers business has felt increased pressure from ConAgra's Healthy Choice and other frozen-food rivals.

To reverse these sales trends and strengthen its global position, Heinz executives have decided to reorganize the company into seven product categories. The largest is the category covering the flagship ketchup brand as well as condiments and sauces such as Heinz 57 steak sauce. This category contributes a bit less than one-third of Heinz's overall sales. The next largest category is frozen foods such as Ore-Ida potato products. The remaining five categories are pet products; soups, beans, and pastas; tuna foods; baby foods; and an "other" category, which covered Weight Watchers until Heinz management decided to sell it.

In the past, local operations managers were in charge of handling Heinz's products in each country. Now Heinz has brought management of all its brands under headquarters control to reduce duplication and improve coordination. Along with job cuts, factory closings, and other changes that enabled the company to focus its resources on fewer products, Heinz was able to shave $200 million off its yearly costs.

The company has also been working on a strategy to grow through acquisitions—although not all its plans have worked out. For example, Heinz wanted to buy the Beech-Nut Nutrition product line to combine with its existing baby foods for more competitive power against Gerber, which holds a 70 percent market share. But the Federal Trade Commission did not allow the purchase because it would have reduced competition in the U.S. market from three strong players to just two. Other acquisitions, such as the purchase of Yoshida brand Asian sauces, have helped Heinz diversify into complementary product areas.

In another change, Heinz has begun investing more to promote current products and launch promising new products. Licensing the Boston Market brand, Heinz has introduced a line of frozen Boston Market Home Style Meals and a line of Boston Market jarred gravies to expand its sales. At the same time, management is carefully nurturing its market-leading products to keep sales on the upswing. One recent innovation is the introduction of green ketchup, enriched with vitamin C, in squeezable containers. The unconventional coloring and easy-grip bottles were designed specifically for children, who make up the largest group of ketchup consumers. Heinz is also starting to package Star-Kist tuna in an easy-open pouch, backing this introduction with a $20 million ad campaign. Ketchup may still be the star of its corporate sales, but Heinz is working hard to give other products a brighter glow.

Case Questions

1. Is Heinz moving toward centralization or decentralization? How is this move likely to affect the balance between line and staff positions?
2. What type of departmentalization is Heinz using? Why is this departmentalization appropriate for the company?
3. How do acquisitions, such as the purchase of Yoshida brand Asian sauces, affect Heinz's organization structure?

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Managing Organization Design

OPENING INCIDENT

Siemens AG, the large German conglomerate, can trace its roots back over 150 years to when its founder, Werner von Siemens, began making telegraph equipment. And since those early days, communication technology and equipment has been at the core of Siemens's global business enterprises. But as the firm grew, it also diversified into other businesses as well. By the beginning of the 1990s, Siemens was making everything from streetcars to satellites and elevators to electron microscopes.

Siemens has always had engineering at the core of its operations—essentially it designed and made the best products possible but paid little attention to what other firms were doing. So focused on product quality were Siemens's engineers that the firm designed and made its own screws because they assumed that other manufacturers could not meet their exacting standards. At one time, television commercials for Siemens's telephones showed a harried user throwing the receiver against a wall, picking it up, and still having to listen to his boss yell at him. Lost on Siemens at the time, however, was the fact that while the telephone featured in the commercials was tough, it was also heavy and unattractive. And this was just about the time that weight and appearance were becoming increasingly important to customers.

Thus, perhaps it should not have really come as a surprise when Siemens began to struggle about ten years ago. Its biggest global competitors—firms like General Electric, Nokia, ABB, and Philips—had all taken steps both to integrate their various business operations more effectively with one another and to become more nimble and responsive to consumers. Siemens, meanwhile, had remained insular in its thinking and bureaucratic in its operations. But about that same time a new CEO, Heinrich von Pierer, came on board and quickly recognized that he needed to get the lumbering behemoth back on track if it was to remain competitive.

Beginning in 1992, von Pierer cut Siemens's workforce by 17 percent and sold off several unrelated businesses for $2 billion. He also stripped out several layers of middle management and tried to change the firm's culture to promote and reward innovation better. And he began to move autonomous but related operations into the same business groups. By 1995, his changes started to pay off with increased revenues, lower operating costs, and increased share in several key markets. Unfortunately, however, the firm's turnaround stalled almost as quickly as it had started.

"In Germany, competition was like a wind. Now, it's like a storm. And it will become a hurricane. You have to move fast or lose."

—Heinrich von Pierer, CEO of Siemens

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

1. Describe the basic nature of organization design.
2. Identify and explain the two basic universal perspectives on organization design.
3. Identify and explain several situational influences on organization design.
4. Discuss how an organization's strategy and its design are interrelated.
5. Describe the basic forms of organization design that characterize many organizations.
6. Describe emerging issues in organization design.

Closer analysis revealed to von Pierer that while Siemens had indeed taken a big step in the right direction, its competitors had taken even bigger steps toward being agile and nimble players in the rapidly changing market for telecommunications technology and equipment. Undaunted, von Pierer redoubled his efforts to reinvent the firm. Among other things, he decided to continue selling off business units that did not contribute to the firm's telecommunications core enterprises. He also went on an acquisitions binge, buying up viable telecommunications businesses around the world. In addition, he totally overhauled the firm's structure by assigning all of its far-flung operations to one of fourteen core business units. And he also decided to make it clear to the engineers running most Siemens operations that he expected them to perform better.

Now, he holds quarterly meetings with the heads of Siemens's fourteen business units and grills them on their performance. About 60 percent of the pay of those business unit heads is now tied directly to their performance. He also reluctantly cut more jobs, including about one-fifth of all top management jobs in the company. And von Pierer continues to sell off businesses that are either underperforming and/or are not central to telecommunications initiatives. So far, at least, his moves seem to be paying off. Siemens has once again established itself as a leader in its chosen markets, and investors have pushed its valuation to an all-time high. Of course, in the volatile world of high technology, the footing can be slippery and one misstep can again lead to a big fall.[1]



CHAPTER OUTLINE

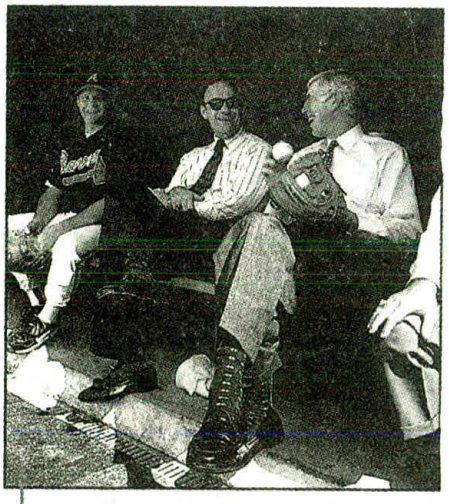
- **The Nature of Organization Design**
- **Universal Perspectives on Organization Design**
  - Bureaucratic Model
  - Behavioral Model
- **Situational Influences on Organization Design**
  - Core Technology
  - Environment
  - Organizational Size
  - Organizational Life Cycle
- **Strategy and Organization Design**
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  - Business-Level Strategy
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  - Matrix Design
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- **Emerging Issues in Organization Design**
  - The Team Organization
  - The Virtual Organization
  - The Learning Organization
  - Issues in International Organization Design

One of the major ingredients in managing any business is the creation of an organization design to link the various elements that comprise the organization. There is a wide array of alternatives that managers in any given organization might select for its design. Heinrich von Pierer and his executive team at Siemens are remaking one of the largest major corporations in the world. The basis for this makeover is the firm's organization design; the reasons behind the change involve the firm's environment and its strategy.

In Chapter 11, we identified the basic elements that go into creating an organization. In this chapter, we explore how those elements can be combined to create an overall design for the organization. We first discuss the nature of organization design. We then describe early approaches aimed at identifying universal models of organization design. Situational factors, such as technology, environment, size, and life cycle, are then introduced. Next we discuss the relationship between an organization's strategy and its structure. Basic forms of organization design are described next. We conclude by presenting four emerging issues in organization design.

organization design The overall set of structural elements and the relationships among those elements used to manage the total organization

■ The Nature of Organization Design



Organization design is a complex and an ever changing process. Take what might appear to be a simple organization—the Atlanta Braves baseball team. The Braves' management team must create a structure that works best for the team itself. They must also include stadium management systems, minor league operations, media contract functions, a licensing group, and a variety of other activities. The design they use is different from all other sports teams, as well as from all other organizations in general.

What is organization design? In Chapter 11, we noted that job specialization and span of management are among the common elements of organization structure. We also described how the appropriate degree of specialization can vary, as can the appropriate span of management. Not really addressed, however, were questions of how specialization and span might be related to one another. For example, should a high level of specialization be matched with a certain span? And will different combinations of each work best with different bases of departmentalization? These and related issues are associated with questions of organization design.[2]

Organization design is the overall set of structural elements and the relationships among those elements used to manage the total organization. Thus, organization design is a means to implement strategies and plans to achieve organizational goals. As we discuss organization design, keep in mind two important points. First, organizations are not designed and then left intact. Most organizations change almost continuously as a result of factors such as situations and people. (The processes of organization change are discussed in Chapter 13.) Second, organization design for larger organizations is extremely complex and has so many nuances and variations that descriptions of them cannot be a full and complete explanation.

MANAGEMENT IMPLICATIONS Managers should know that designing an organization is an ongoing process that is never really finished. They should recognize that organization design for larger organizations is extremely complex.

■ Universal Perspectives on Organization Design

In Chapter 2, we made the distinction between contingency and universal approaches to solving management problems. Recall, for example, that universal perspectives try to identify the "one best way" to manage organizations, and contingency perspectives suggest that appropriate managerial behavior in a given situation depends on, or is contingent on, unique elements in that situation. The foundation of contemporary thinking about organization design can be traced back to two early universal perspectives: the bureaucratic model and the behavioral model.

Bureaucratic Model

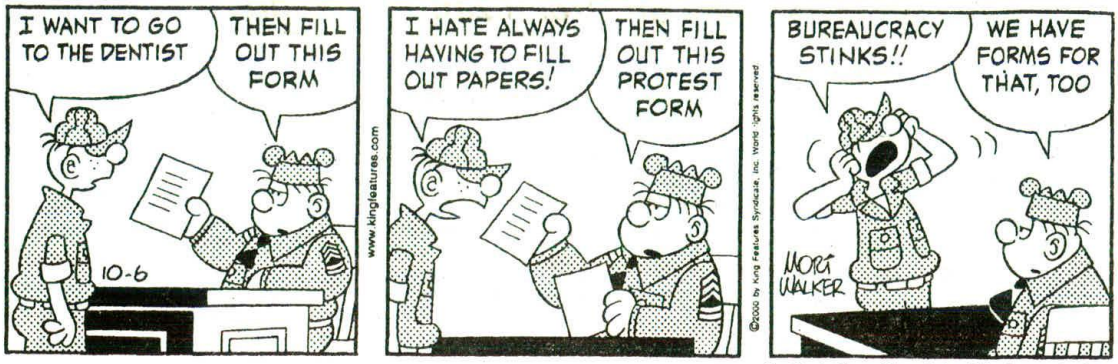
We also noted in Chapter 2 that Max Weber, an influential German sociologist, was a pioneer of classical organization theory. At the core of Weber's writings was the bureaucratic model of organizations.[3] The Weberian perspective suggests that a **bureaucracy** is a model of organization design based on a legitimate and formal system of authority. Many people associate bureaucracy with "red tape," rigidity, and passing the buck. For example, how many times have you heard people refer disparagingly to "the federal bureaucracy"? And many U.S. managers believe that bureaucracy in the Japanese government is a major impediment to U.S. firms' ability to do business there.

bureaucracy A model of organization design based on a legitimate and formal system of authority

Weber viewed the bureaucratic form of organization as logical, rational, and efficient. He offered the model as a framework to which all organizations should aspire: the "one best way" of doing things. According to Weber, the ideal bureaucracy exhibits five basic characteristics:

1. The organization should adopt a distinct division of labor, and each position should be filled by an expert.
2. The organization should develop a consistent set of rules to ensure that task performance is uniform.
3. The organization should establish a hierarchy of positions or offices that creates a chain of command from the top of the organization to the bottom.
4. Managers should conduct business in an impersonal way and maintain an appropriate social distance between themselves and their subordinates.
5. Employment and advancement in the organization should be based on technical expertise, and employees should be protected from arbitrary dismissal.

Perhaps the best examples of bureaucracies today are government agencies and universities. Consider, for example, the steps you must go through and the forms you must fill out to apply for admission to college, request housing, register each semester, change majors, submit a degree plan, substitute a course, and file for graduation. The reason these procedures are necessary is that universities deal with large numbers of people who must be treated equally and fairly. Hence rules, regulations, and standard operating procedures are needed. Large labor unions are also usually organized as bureaucracies.[4] Some bureaucracies, such as the U.S. Postal Service, are trying to portray themselves as less mechanistic and impersonal. The



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The bureaucratic model of organization design relies on logical, rational, and efficient rules and procedures. Many organizations attempt to standardize these rules and procedures by creating forms for people to use when initiating action or requesting approval. Unfortunately, this standardization can lead to such a proliferation of forms that, in turn, people quickly come to see it all as nothing more than "red tape." This point is obviously brought home by Beetle Bailey's request for time off to visit his dentist!

strategy of the postal service is to become more service-oriented as a way to fight back against competitors like Federal Express and UPS. The cartoon illustrates how a bureaucratic organization might operate.

A primary strength of the bureaucratic model is that several of its elements (such as reliance on rules and employment based on expertise) do, in fact, often improve efficiency. Bureaucracies also help prevent favoritism (because everyone must follow the rules) and make procedures and practices very clear to everyone. Unfortunately, however, this approach also has several disadvantages. One major disadvantage is that the bureaucratic model results in inflexibility and rigidity. Once rules are created and put into place, making exceptions or changing them is often difficult. In addition, the bureaucracy often results in the neglect of human and social processes within the organization.

Behavioral Model

behavioral model A model of organization design consistent with the human relations movement and stressing attention to developing work groups and concern about interpersonal processes

Another important universal model of organization design was the **behavioral model**, which paralleled the emergence of the human relations school of management thought. Rensis Likert, a management researcher, studied several large organizations to determine what made some more effective than others.[5] He found that the organizations in his sample that used the bureaucratic model of design tended to be less effective than those that used a more behaviorally oriented model consistent with the emerging human relations movement—in other words, organizations that paid more attention to developing work groups and were more concerned about interpersonal processes.

Likert developed a framework that characterized organizations in terms of eight important processes: leadership, motivation, communication, interactions, decision making, goal setting, control, and performance goals. Likert believed that all organizations could be measured and categorized along a continuum associated with each of these dimensions. He argued that the basic bureaucratic form of organization, which he called a **System 1 design**, anchored one end of each dimension. The characteristics of the System 1 organization in Likert's framework are summarized in Table 12.1.

System 1 design Organization design similar to the bureaucratic model

Table 12.1

System 1 and System 4 Organizations

The behavioral model identifies two extreme types of organization design called System 1 and System 4. The two designs vary in eight fundamental processes. The System 1 design is considered to be somewhat rigid and inflexible.

System 1 Organization	System 4 Organization
1. Leadership process includes no perceived confidence and trust. Subordinates do not feel free to discuss job problems with their superiors, who in turn do not solicit their ideas and opinions.	1. Leadership process includes perceived confidence and trust between superiors and subordinates in all matters. Subordinates feel free to discuss job problems with their superiors, who in turn solicit their ideas and opinions.
2. Motivational process taps only physical, security, and economic motives through the use of fear and sanctions. Unfavorable attitudes toward the organization prevail among employees.	2. Motivational process taps a full range of motives through participatory methods. Attitudes are favorable toward the organization and its goals.
3. Communication process is such that information flows downward and tends to be distorted, inaccurate, and viewed with suspicion by subordinates.	3. Communication process is such that information flows freely throughout the organization—upward, downward, and laterally. The information is accurate and undistorted.
4. Interaction process is closed and restricted. Subordinates have little effect on departmental goals, methods, and activities.	4. Interaction process is open and extensive. Both superiors and subordinates are able to affect departmental goals, methods, and activities.
5. Decision process occurs only at the top of the organization; it is relatively centralized.	5. Decision process occurs at all levels through group processes; it is relatively decentralized.
6. Goal-setting process is located at the top of the organization; discourages group participation.	6. Goal-setting process encourages group participation in setting high, realistic objectives.
7. Control process is centralized and emphasizes fixing of blame for mistakes.	7. Control process is dispersed throughout the organization and emphasizes self-control and problem solving.
8. Performance goals are low and passively sought by managers who make no commitment to developing the human resources of the organization.	8. Performance goals are high and actively sought by superiors who recognize the necessity for making a full commitment to developing, through training, the human resources of the organization.

Source: Adapted from Rensis Likert, *The Human Organization*. Copyright © 1967 by The McGraw-Hill Companies. Reprinted by permission of The McGraw-Hill Companies.

Also summarized in this table are characteristics of Likert's other extreme form of organization design, called **System 4 design**, which was based on the behavioral model. For example, a System 4 organization uses a wide array of motivational processes, and its interaction processes are open and extensive. Other distinctions between System 1 and System 4 organizations are equally obvious. Between the System 1 and System 4 extremes lie the System 2 and System 3 organizations. Likert argued that System 4 should be adopted by all organizations. He suggested that managers should emphasize supportive relationships, establish high performance goals, and practice group decision making to achieve a System 4 organization. Many organizations attempted to adopt the System 4 design during its period of peak popularity. Several years ago, for example, General Motors converted a plant in the Atlanta area from a System 2 to a System 4 organization. Over a period of three years, direct and indirect labor efficiency improved, as did tool-breakage rates, scrap costs, and quality.[6]

System 4 design Organization design similar to the behavioral model

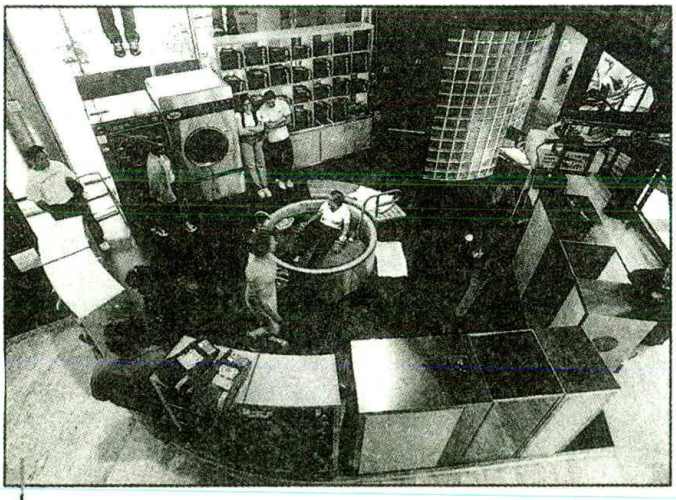
Like the bureaucratic model, the behavioral approach has both strengths and weaknesses. Its major strength is that it emphasizes human behavior by stressing

the value of an organization's employees. Likert and his associates thus paved the way for a more humanistic approach to designing organizations. Unfortunately, the behavioral approach also argues that there is one best way to design organizations—as a System 4. As we see, however, evidence is strong that there is no one best approach to organization design.[7] What works for one organization may not work for another, and what works for one organization may change as that organization's situation changes. Hence, universal models like bureaucracy and System 4 have been largely supplanted by newer models that take contingency factors into account. In the next section, we identify several factors that help determine the best organization design for a particular situation.

situational view of organization design Based on the assumption that the optimal design for any given organization depends on a set of relevant situational factors

MANAGEMENT Managers should understand the basic concepts inherent in the bureaucratic and behavioral models of organization design. While appreciating their strengths and weaknesses, they should also remember that universal models such as these are not truly applicable to today's organization.

■ Situational Influences on Organization Design



An organization's technology can influence its design in a variety of ways. For example, a recent innovation at some Levi Strauss Stores is new technology aimed at helping customers achieve a "perfect fit." As shown here, this sometimes means having the customers sit in a container of water wearing their new "shrink-to-fit" jeans. But this relatively minor technological innovation carries with it a host of organization design implications, such as who will be trained to use, how it will be maintained, and how the firm can limit any potential legal liability.

The **situational view of organization design** is based on the assumption that the optimal design for any given organization depends on a set of relevant situational factors. That is, situational factors play a role in determining the best organization design for any particular circumstance. *The World of Management* describes how situational factors have affected organization design at DaimlerChrysler. Four basic situational factors—core technology, environment, organizational size, and organizational life cycle—are discussed here. Another, strategy is described in the next section.

Core Technology

Technology is the conversion processes used to transform inputs (such as materials or information) into outputs (such as products or services). Most organizations use multiple technologies, but an organization's most important one is called its *core technology*. Although most people visualize assembly lines and machinery when they think of technology,

WORLD OF MANAGEMENT

DaimlerChrysler Steers into a New Organization

When Jürgen Schrempp and Robert Eaton planned the merger of Daimler-Benz and Chrysler, they sought to bring the German and U.S. car manufacturers together in one seamless transnational organization. Daimler was interested in Chrysler's experience in vehicle development and expertise in cost-effective production methods; Chrysler wanted to build on Daimler's core technology and reputation in making upscale vehicles. By merging, the two companies could broaden their market reach and reduce dependence on the highly competitive U.S. market. The combined company would also be in a better position to expand its sales of smaller cars in Europe and in developing countries.

Schrempp and Eaton became co-CEOs of DaimlerChrysler and set up teams to oversee the details of the merger. Although the deal was conceived as a merger of equals, some Chrysler managers soon grumbled that the Daimler side was dominating key positions within the new organization. Chrysler's president was named head of DaimlerChrysler's North American operations, but he left less than a year after the merger, part of a wave of management changes affecting former Chrysler officials. Cultural differences also surfaced, with cost-conscious Chrysler managers aghast at Daimler managers' freer spending.

To smooth the way toward the merger, Schrempp has allowed Chrysler and Mercedes to operate as separate businesses, although they are combining their research and development functions for certain projects. As part of the merger, Mercedes also began manufacturing selected vehicles in Chrysler plants. Although Schrempp says that DaimlerChrysler is now one company, analysts say that the organization won't be able to achieve multibillion-dollar cost-efficiencies without removing more redundancies and sharing more functions throughout the merged organization.

We have a structure where we are now able to cover the world, and we have the whole spectrum of products, and we are the most technologically intensive car company in the world.

*—Jürgen E. Schrempp, CEO of DaimlerChrysler**

References: Christine Tierney, Matt Karnitschnig, and Joann Muller, "Defiant Daimler," *Business Week*, August 7, 2000, pp. 90–94 (*quote on p. 94); Jeffrey Ball and Scott Miller, "Full Speed Ahead: Stuttgart's Control Grows with Shakeup at DaimlerChrysler," *Wall Street Journal*, September 24, 1999, pp. A1, A8.

the term can also be applied to service organizations. For example, a brokerage firm like Dean Witter uses technology to transform investment dollars into income in much the same way that Union Carbide uses natural resources to manufacture chemical products.

technology Conversion processes used to transform inputs into outputs

The link between technology and organization design was first recognized by Joan Woodward.[8] Woodward studied one hundred manufacturing firms in southern England. She collected information about such things as the history of each organization, its manufacturing processes, its forms and procedures, and its financial performance. Woodward expected to find a relationship between the size of an organization and its design, but no such relationship emerged. As a result, she began to seek other explanations for differences. Close scrutiny of the firms in her sample led her to recognize a potential relationship between technology and organization design. This follow-up analysis led Woodward first to classify the

organizations according to their technology. Three basic forms of technology were identified by Woodward:

1. *Unit or small-batch technology.* The product is custom-made to customer specifications or else it is produced in small quantities. Organizations using this form of technology include a tailor shop like Brooks Brothers (custom suits), a printing shop like Kinko's (business cards, company stationery), and a photography studio.
2. *Large-batch or mass-production technology.* The product is manufactured in assembly-line fashion by combining component parts into another part or finished product. Examples include automobile manufacturers like Subaru, appliance makers like Whirlpool Corporation, and electronics firms like Philips.
3. *Continuous-process technology.* Raw materials are transformed into a finished product by a series of machine or process transformations. The composition of the materials themselves is changed. Examples include petroleum refineries like Exxon and Shell and chemical refineries like Dow Chemical and Hoescht Celanese.

These forms of technology are listed in order of their assumed levels of complexity; that is, unit or small-batch technology is presumed to be the least complex and continuous-process technology the most complex. Woodward found that different configurations of organization design were associated with each technology.

As technology became more complex in Woodward's sample, the number of levels of management increased (that is, the organization was taller). The executive span of management also increased, as did the relative size of its staff component. The supervisory span of management, however, first increased and then decreased as technology became more complex, primarily because much of the work in continuous-process technologies is automated. Fewer workers are needed, but the skills necessary to do the job increase. These findings are consistent with the discussion of the span of management in Chapter 11—the more complex the job, the narrower the span should be.

At a more general level of analysis, Woodward found that the two extremes (unit or small-batch and continuous-process) tended to be very similar to Likert's System 4 organization, whereas the middle-range organizations (large-batch or mass-production) were much more like bureaucracies or System 1. The large-batch and mass-production organizations also had a higher level of specialization.[9] Finally, she found that organizational success was related to the extent to which organizations followed the typical pattern. For example, successful continuous-process organizations tended to be more like System 4 organizations, whereas less successful firms with the same technology were less like System 4 organizations.

Thus, technology appears to play an important role in determining organization design. As future technologies become even more diverse and complex, managers will have to be even more aware of technologies' impact on the design of organizations. For example, the increased use of robotics may necessitate alterations in organization design to accommodate different assembly methods better. Likewise, increased use of new forms of information technology will almost certainly

cause organizations to redefine the nature of work and the reporting relationships among individuals.[10]

Environment

In addition to the various relationships described in Chapter 3, environmental elements and organization design are specifically linked in a number of ways. The first widely recognized analysis of environment–organization design linkages was provided by Tom Burns and G. M. Stalker.[11] Like Woodward, Burns and Stalker worked in England. Their first step was identifying two extreme forms of organizational environment: stable (one that remains relatively constant over time) and unstable (subject to uncertainty and rapid change). Next they studied the designs of organizations in each type of environment. Not surprisingly, they found that organizations in stable environments tended to have a different kind of design from organizations in unstable environments. The two kinds of design that emerged were called mechanistic and organic organization.

A **mechanistic organization**, quite similar to the bureaucratic or System 1 model, was most frequently found in stable environments. Free from uncertainty, organizations structured their activities in rather predictable ways by means of rules, specialized jobs, and centralized authority. Mechanistic organizations are also quite similar in nature to bureaucracies. Although no environment is completely stable, Kmart and Wendy's use mechanistic designs. Each Kmart store, for example, has prescribed methods for store design and merchandise-ordering processes. No deviations are allowed from these methods. An **organic organization**, on the other hand, was most often found in unstable and unpredictable environments, in which constant change and uncertainty usually dictate a much higher level of fluidity and flexibility. Motorola (facing rapid technological change) and The Limited (facing constant change in consumer tastes) each use organic designs. A manager at Motorola, for example, has considerable discretion over how work is performed and how problems can be solved.

mechanistic organization Similar to the bureaucratic or System 1 model; most frequently found in stable environments

organic organization Very flexible and informal model of organization design; most often found in unstable and unpredictable environments

These ideas were extended in the United States by Paul R. Lawrence and Jay W. Lorsch.[12] They agreed that environmental factors influence organization design but believed that this influence varies between different units of the same organization. In fact, they predicted that each organizational unit has its own unique environment and responds by developing unique attributes. Lawrence and Lorsch suggested that organizations could be characterized along two primary dimensions.

One of these dimensions, **differentiation**, is the extent to which the organization is broken down into subunits. A firm with many subunits is highly differentiated; one with few subunits has a low level of differentiation. The second dimension, **integration**, is the degree to which the various subunits must work together in a coordinated fashion. For example, if each unit competes in a different market and has its own production facilities, it may need little integration with other units. Lawrence and Lorsch reasoned that the degree of differentiation and integration needed by an organization depends on the stability of the environments that its subunits faced.

differentiation The extent to which the organization is broken down into subunits

integration The degree to which the various subunits must work together in a coordinated fashion

Organizational Size

organizational size The total number of full-time or full-time-equivalent employees

The size of an organization is yet another factor that affects its design.[13] Although several definitions of size exist, we define **organizational size** as the total number of full-time or full-time-equivalent employees. A team of researchers at the University of Aston in Birmingham, England, believed that Woodward had failed to find a size-structure relationship (which was her original expectation) because almost all the organizations she studied were relatively small (three-fourths had fewer than five hundred employees).[14] Thus, they decided to undertake a study of a wider array of organizations to determine how size and technology both individually and jointly affect an organization's design.

Their primary finding was that technology did in fact influence structural variables in small firms, probably because all their activities tended to be centered around their core technology. In large firms, however, the strong technology-design link broke down, most likely because technology is not as central to ongoing activities in large organizations. The Aston studies yielded a number of basic generalizations: when compared to small organizations, large organizations tend to be characterized by higher levels of job specialization, more standard operating procedures, more rules, more regulations, and a greater degree of decentralization.

Organizational Life Cycle

Of course, size is not constant. As we noted in Chapter 10, for example, some small businesses are formed but soon disappear. Others remain as small, independently operated enterprises as long as their owner-managers live. A few, like Compaq Computer, Dell Computer, Liz Claiborne, and Reebok, skyrocket to become organizational giants. And occasionally large organizations reduce their size through layoffs or divestitures. For example, Navistar is today far smaller than was its previous incarnation as International Harvester Co.

organizational life cycle Progression through which organizations evolve as they grow and mature; consists of four stages: birth, youth, midlife, and maturity

Although no consistent pattern always explains changes in size, many organizations progress through a four-stage **organizational life cycle**.[15] The first stage is the *birth* of the organization. The second stage, *youth*, is characterized by growth and the expansion of organizational resources. *Midlife* is a period of gradual growth evolving eventually into stability. Finally, *maturity* is a period of stability, perhaps eventually evolving into decline. Montgomery Ward is an example of a mature organization—it is experiencing little or no growth and appears to be falling behind the rest of the retailing industry today.

Managers must confront a number of organization design issues as the organization progresses through these stages. In general, as an organization passes from one stage to the next, it becomes bigger, more mechanistic, and more decentralized. It also becomes more specialized, devotes more attention to planning, and takes on an increasingly large staff component. Finally, coordination demands increase, formalization increases, organizational units become geographically more dispersed, and control systems become more extensive. Thus, an organization's

size and design are clearly linked, and this link is dynamic because of the organizational life cycle.[16]

MANAGEMENT Managers should remember that organization design is neither static nor universal. It is therefore important that they also understand how situational factors such as environment, technology, organizational size, and organizational life cycle should be considered when designing an organization.

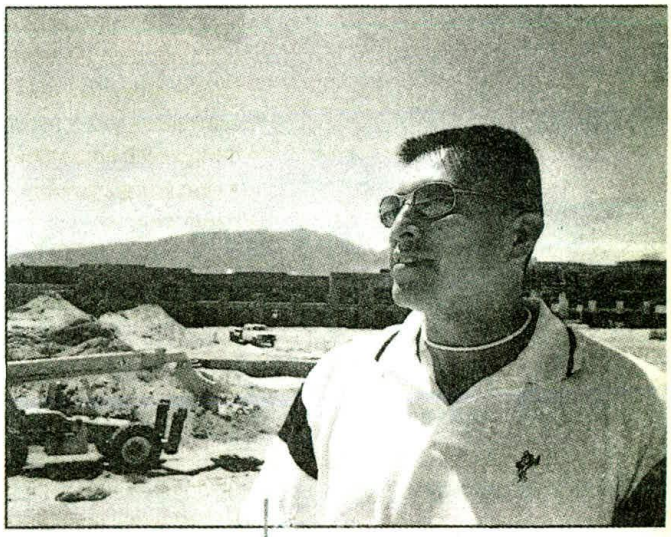
■ Strategy and organization Design

Another important determinant of an organization's design is the strategy adopted by its top managers.[17] In general, corporate and business strategies both affect organization design. Basic organizational functions such as finance and marketing can also affect organization design in some cases.[18]

Corporate-Level Strategy

As we noted in Chapter 8, an organization can adopt a variety of corporate-level strategies. Its choice will partially determine what type of design will be most effective. For example, a firm that pursues a single-product strategy likely relies on functional departmentalization and can use a mechanistic design. If either unrelated or related diversification is used to spur growth, managers need to decide how to arrange the various units within the organizational umbrella. For example, if the firm is using related diversification, there needs to be a high level of coordination among the various units to capitalize on the presumed synergistic opportunities inherent in this strategy. On the other hand, firms using unrelated diversification more likely rely on a strong hierarchical reporting system so that corporate managers can better monitor the performance of individual units within the firm.

An organization that adopts the portfolio approach to implement its corporate-level strategies must also ensure that its design fits its strategy. For example, each strategic business unit may remain a relatively autonomous unit within the organization. But managers at the corporate level need to decide how much decision-making latitude to give the heads of each unit (a question of decentralization); how many corporate-level executives are needed to oversee the operations of various units (a question of span of management); and what information, if any, is shared among the units (a question of coordination).[19]



An organization's strategies can have a major impact on its design. Lawrence Montoya, shown here, is the governor of the Pueblo of Santa Ana tribe of Native Americans near Albuquerque, New Mexico. He leads a thriving set of corporate initiatives on behalf of the tribe, including a hotel and resort, a conference center, and a casino. But each business has its own unique design, and the businesses are linked only very loosely at the corporate level under Montoya's watchful eye.

Business-Level Strategy

Business-level strategies affect the design of individual businesses within the organization as well as the overall organization itself. An organization pursuing a defender strategy, for example, is likely to be somewhat tall and centralized, have narrow spans of management, and perhaps take a functional approach to departmentalization. Thus, it may generally follow the bureaucratic approach to organization design.

In contrast, a prospecting type of organization is more likely to be flatter and decentralized. With wider spans of management, it tries to be very flexible and adaptable in its approach to doing business. A business that uses an analyzer strategy is likely to have an organization design somewhere between these two extremes (perhaps as a System 2 or System 3 organization). Given that a reactor is essentially a strategic failure, its presumed strategy is probably not logically connected to its design.

Generic competitive strategies can also affect organization design. A firm using a differentiation strategy, for example, may structure departments around whatever it is using as a basis for differentiating its products (i.e., marketing in the case of image, manufacturing in the case of quality). A cost leadership strategy necessitates a strong commitment to efficiency and control. Thus, such a firm is more centralized as it attempts to control costs. And a firm using a focus strategy may design itself around the direction of its focus (i.e., location departmentalization if its focus is geographic region, customer departmentalization if its focus is customer groups).

Organizational Functions

The relationship between an organization's functional strategies and its design is less obvious and may be subsumed under corporate- or business-level concerns. If the firm's marketing strategy calls for aggressive marketing and promotion, separate departments may be needed for advertising, direct sales, and promotion. If its financial strategy calls for low debt, it may need only a small finance department. If production strategy calls for manufacturing in diverse locations, organization design arrangements need to account for this geographic dispersion. Human resource strategy may call for greater or lesser degrees of decentralization as a way to develop the skills of new managers at lower levels in the organization. And research and development strategy may dictate various designs for managing the R&D function itself. A heavy commitment to R&D, for example, may require a separate unit with a vice president in charge. A lessor commitment to R&D may be achieved with a director and a small staff.

MANAGEMENT IMPLICATIONS Strategy is also an important factor in determining the best design for a particular organization. Thus, managers should clearly understand both their corporate, business, and functional strategies and how those strategies impinge upon the organization design that is best for the situation.

■ Basic Forms of Organization Design

Because technology, environment, organizational size, organizational life cycle, and strategy can all influence organization design, it should come as no surprise that organizations adopt many different kinds of designs. Most designs, however, fall into one of four basic categories. Others are hybrids based on two or more of the basic forms.

Functional (U-Form) Design

U-form or **functional design** An organizational arrangement based on the functional approach to departmentalization

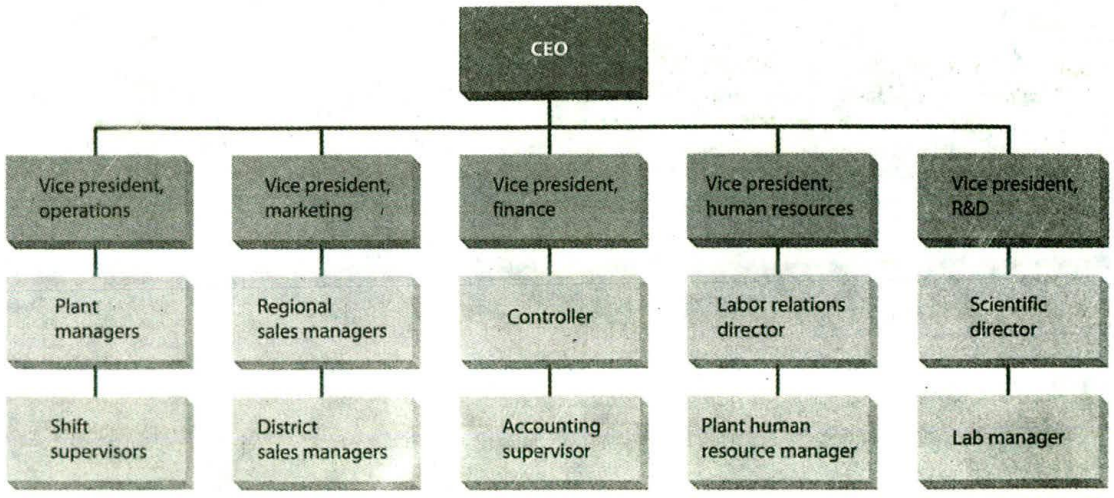
The **functional design** is an organizational arrangement based on the functional approach to departmentalization as detailed in Chapter 11. This design has been termed the **U-form** (for unitary) by the noted economist Oliver E. Williamson.[20] Under the U-form arrangement, the members and units in the organization are grouped into functional departments such as marketing and production.

For the organization to operate efficiently in this design, there must be considerable coordination across departments. This integration and coordination are most commonly the responsibility of the CEO and members of senior management. Figure 12.1 shows the U-form design as applied to the corporate level of a small manufacturing company. In a U-form organization, none of the functional areas can survive without the others. Marketing, for example, needs products from

Figure 12.1

Functional or U-Form Design for a Small Manufacturing Company

The U-form design is based on functional departmentalization. This small manufacturing firm uses managers at the vice presidential level to coordinate activities within each functional area of the organization. Note that each functional area is dependent on the others.



operations to sell and funds from finance to pay for advertising. The WD-40 Company, which makes a popular lubricating oil, and the McIlhenny Company, which makes Tabasco sauce, are both examples of firms that use the U-form design.

In general, this approach shares the basic advantages and disadvantages of functional departmentalization. Thus, it allows the organization to staff all important positions with functional experts and facilitates coordination and integration. On the other hand, it also promotes a functional rather than an organizational focus and tends to promote centralization. And as we noted in Chapter 11, functionally based designs are most commonly used in small organizations because an individual CEO can easily oversee and coordinate the entire organization. As an organization grows, the CEO finds staying on top of all functional areas increasingly difficult.

Conglomerate (H-Form) Design

H-form or **conglomerate design**
An arrangement used by an organization made up of a set of unrelated businesses

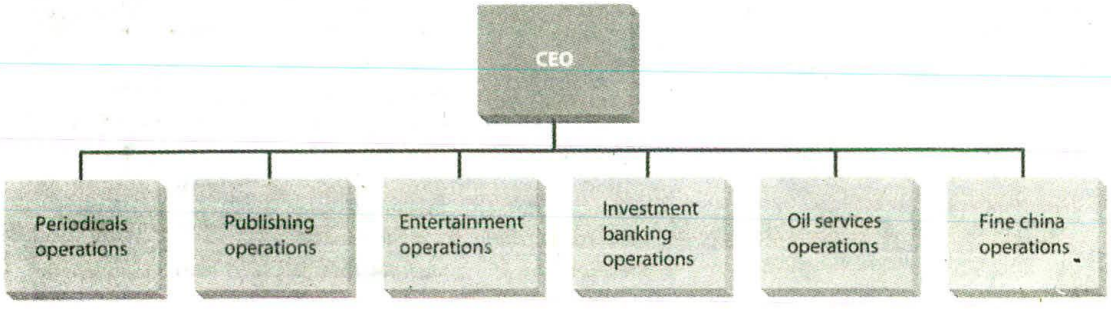
Another common form of organization design is the conglomerate, or H-form, approach.[21] The **conglomerate** design is used by an organization made up of a set of unrelated businesses. Thus, the **H-form design** is essentially a holding company that results from unrelated diversification. (The *H* in this term stands for "holding.")

This approach is based loosely on the product form of departmentalization (see Chapter 11). Each business or set of businesses is operated by a general manager who is responsible for its profits or losses, and each general manager functions independently of the others. Pearson PLC, a British firm, uses the H-form design. As illustrated in Figure 12.2, Pearson consists of six business groups. Although its periodicals and publishing operations are related to one another, all of its other businesses are clearly unrelated. Other firms that use the H-form design include General Electric (aircraft engines, appliances, broadcasting, financial services, lighting products, plastics, and other unrelated businesses) and Tenneco (pipelines, auto parts, shipbuilding, financial services, and other unrelated busi-

Figure 12.2

Conglomerate (H-Form) Design at Pearson PLC

Pearson PLC, a British firm, uses the conglomerate form of organization design. This design, which results from a strategy of unrelated diversification, is a complex one to manage. Managers find that comparing and integrating activities among the dissimilar operations are difficult. Companies may abandon this design for another approach, such as the M-form design.



nesses). *Today's Management Issues* describes how Johnson & Johnson is using this approach.

In an H-form organization, a corporate staff usually evaluates the performance of each business, allocates corporate resources across companies, and shapes decisions about buying and selling businesses. The basic shortcoming of the H-form design is the complexity associated with holding diverse and unrelated businesses. Managers usually find comparing and integrating activities across a large number of diverse operations difficult. Research by Michael Porter suggests that many organizations following this approach achieve only average to weak financial performance.[22] Thus, although some U.S. firms are still using the H-form design, many have also abandoned it for other approaches.

TODAY'S MANAGEMENT ISSUES

JOHNSON & JOHNSON STAYS ON THE CONGLOMERATE PATH

Can Johnson & Johnson effectively manage all three of its distinctly different divisions? Its professional business makes medical devices such as surgical products, coronary stents, and wound closures; its pharmaceuticals business makes drugs such as Procrit for anemia and Levaquin for infections; its consumer products business makes baby products, Band-Aids, and Neutrogena skin-care products. This diverse combination of operations generates more than $27 billion in annual sales—with pharmaceuticals, the largest division, bringing in most of the recent sales growth.

CEO Ralph Larsen believes that having three separate divisions under one corporate umbrella gives Johnson & Johnson financial balance in case of a downturn in one division. He also says that this decentralized organization design encourages entrepreneurial spirit within each division. In fact, some parts of this diverse conglomerate are doing quite well—while others are plodding along, causing some concern about the company's diversification strategy.

In the pharmaceuticals division, for example, Johnson & Johnson had to withdraw a heartburn drug from the U.S. market after learning of serious side effects. Another setback occurred when federal regulators refused to approve a diabetes drug that the company spent $20 million to license from its maker. Despite these problems, pharmaceutical products to treat all kinds of medical conditions are in growing demand in both domestic and global markets, so this division remains a particular focus within Johnson & Johnson.

At the same time, other divisions are seeing slower growth. The consumer products division is not growing as quickly as the other two divisions, in part because of declines in international sales. The professional division has suffered because competitors offering improved coronary stents are siphoning off most of Johnson & Johnson's sales of this product. To prevent similar problems in the future, the company is now planning for improvements even before it introduces its first version of a new product. With tighter controls and better planning, Larsen is sticking to his organization design rather than breaking the company into three separate businesses.

Twenty years from now, you can tell me whether I am right or wrong. But I am convinced that the future belongs to those companies that are broadly based.

—Ralph Larsen, CEO of Johnson & Johnson*

References: Jeff May, "Strong First Quarter Relieves Johnson & Johnson's Pain," *The Star-Ledger (Newark)*, April 18, 2000; "Johnson & Johnson 1999 EPS Rose 13.8% on Sales Increase of 14.5%," *PR Newswire*, January 25, 2000, http://www.jnj.com; Robert Langreth and Ron Winslow, "At J&J, A Venerable Strategy Faces Questions," *Wall Street Journal*, March 5, 1999, pp. B1, B4 (*quote on p. B1).

Divisional (M-Form) Design

M-Form or divisional design An organizational arrangement based on multiple businesses in related areas operating within a larger organizational framework

In the divisional design, which is becoming increasingly popular, a product form of organization is also used; in contrast to the H-form design, however, the divisions are related. Thus, the **divisional design**, or **M-form** (for "multidivisional"), is based on multiple businesses in related areas operating within a larger organizational framework. This design results from a strategy of related diversification.

Some activities are extremely decentralized down to the divisional level; others are centralized at the corporate level.[23] As shown in Figure 12.3, The Limited uses this approach. Each of its divisions is headed by a general manager and operates with reasonable autonomy, but the divisions also coordinate their activities as is appropriate. Other firms that use this approach are The Walt Disney Company (theme parks, movies, and merchandising units, all interrelated) and Hewlett-Packard (computers, printers, scanners, electronic medical equipment, and other electronic instrumentation).

The opportunities for coordination and shared resources represent one of the biggest advantages of the M-form design. The Limited's marketing research and purchasing departments are centralized. Thus, a buyer can inspect a manufacturer's entire product line, buy some designs for The Limited chain, others for Express, and still others for Lerner New York. The M-form design's basic objective is to optimize internal competition and cooperation. Healthy competition among divisions for resources can enhance effectiveness, but cooperation should also be promoted. Research suggests that the M-form organization that can achieve and maintain this balance will outperform large U-form and all H-form organizations.[24]

Matrix Design

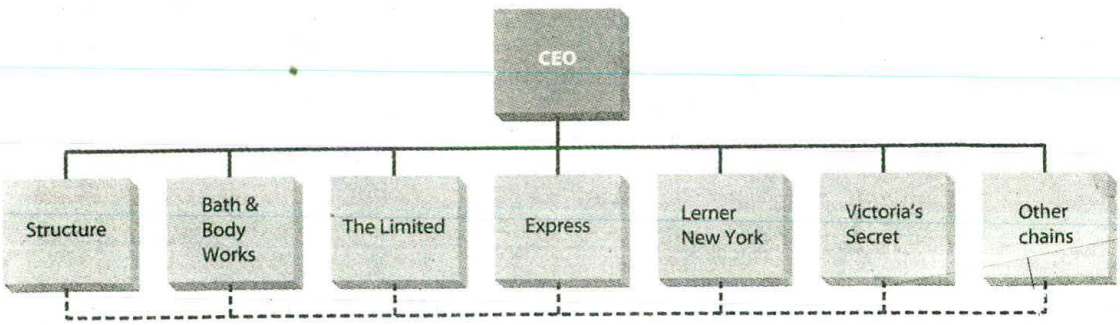
matrix design An organizational design based on two overlapping bases of departmentalization

The **matrix design**, another common approach to organization design, is based on two overlapping bases of departmentalization.[25] The foundation of a matrix is a set

Figure 12.3

Multidivisional (M-Form) Design at The Limited, Inc.

The Limited, Inc., uses the multidivisional approach to organization design. Although each unit operates with relative autonomy, all units function in the same general market. This design resulted from a strategy of related diversification. Other firms that use M-form designs include PepsiCo and Woolworth Corporation.



of functional departments. A set of product groups, or temporary departments, is then superimposed across the functional departments. Employees in a matrix are simultaneously members of a functional department (such as engineering) and of a project team.

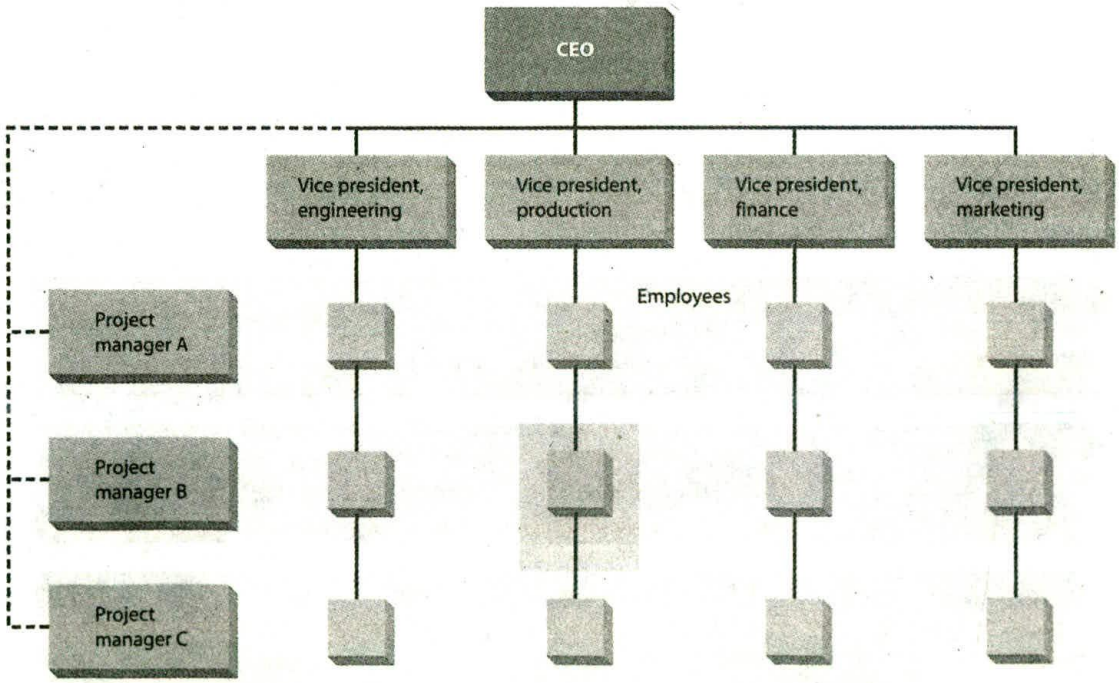
Figure 12.4 shows a basic matrix design. At the top of the organization are functional units headed by vice presidents of engineering, production, finance, and marketing. Each of these managers has several subordinates. Along the side of the organization are a number of positions called *project manager*. Each project manager heads a project group composed of representatives or workers from the functional departments. Note from the figure that a matrix reflects a *multiple-command structure*—any given individual reports to both a functional superior and one or more project managers.

The project groups, or teams, are assigned to designated projects or programs. For example, the company might be developing a new product. Representatives are chosen from each functional area to work as a team on the new product. They also retain membership in the original functional group. At any given time, a person

Figure 12.4

A Matrix Organization

A matrix organization design is created by superimposing a product form of departmentalization onto an existing functional organization. Project managers coordinate teams of employees drawn from different functional departments. Thus, a matrix relies on a multiple-command structure.



may be a member of several teams as well as a member of a functional group. Ford used this approach in creating its popular Focus automobile. It formed a group called "Team Focus" made up of designers, engineers, production specialists, marketing specialists, and other experts from different areas of the company. This group facilitated getting a very successful product to the market at least a year earlier than would have been possible using Ford's previous approaches.

Martha Stewart has also created a matrix organization for her burgeoning lifestyle business. The company was first organized broadly into media and merchandising groups, each of which has specific product and product groups. Layered on top of this structure are teams of lifestyle experts organized into groups such as cooking, crafts, weddings, and so forth. Each of these groups is targeted toward specific customer needs, but they work as necessary across all of the product groups. For example, a wedding expert might contribute to an article on wedding planning for a Martha Stewart magazine, contribute a story idea for a cable television program, and supply content for a Martha Stewart web site. This same individual might also help select fabrics suitable for wedding gowns for retailing.[26]

Many other organizations have also used the matrix design. Notable among them are American Cyanamid, Monsanto Company, NCR, The Chase Manhattan Bank, Prudential, General Motors, Compaq Computer, and several state and federal government agencies. Some organizations, however, such as Citibank and the Dutch firm Philips, adopted and then dropped the matrix design. Thus, it is important to recognize that a matrix design is not always appropriate.

The matrix form of organization design is most often used in one of three situations.[27] First, a matrix may work when there is strong pressure from the environment. For example, intense external competition may dictate the sort of strong marketing thrust that is best spearheaded by a functional department, but the diversity of a company's products may argue for product departments. Second, a matrix may be appropriate when large amounts of information need to be processed. For example, creating lateral relationships by means of a matrix is one effective way to increase the organization's capacity to process information. Third, the matrix design may work when there is pressure for shared resources. For example, a company with ten product departments may have resources for only three marketing specialists. A matrix design would allow all the departments to share the company's scarce marketing resources.

Both advantages and disadvantages are associated with the matrix design. Researchers have observed six primary advantages of matrix designs. First, it enhances flexibility because teams can be created, redefined, and dissolved as needed. Second, because they assume a major role in decision making, team members are likely to be highly motivated and committed to the organization. Third, employees in a matrix organization have considerable opportunity to learn new skills. A fourth advantage of a matrix design is that it provides an efficient way for the organization to take full advantage of its human resources. Fifth, team members retain membership in their functional unit so that they can serve as a bridge between the functional unit and the team, enhancing cooperation. Sixth, the matrix design gives top management a useful vehicle for decentralization. Once the day-to-day operations have been delegated, top management can devote more attention to areas such as long-range planning.

On the other hand, the matrix design also has some major disadvantages. Employees may be uncertain about reporting relationships, especially if they are simultaneously assigned to a functional manager and to several project managers. To complicate matters, some managers see the matrix as a form of anarchy in which they have unlimited freedom. Another set of problems is associated with the dynamics of group behavior. Groups take longer than individuals to make decisions, may be dominated by one individual, and may compromise too much. They may also get bogged down in discussion and not focus on their primary objectives. Finally, in a matrix, more time may be required for coordinating task-related activities.[28]

Hybrid Designs

Some organizations use a design that represents a hybrid of two or more of the common forms of organization design.[29] For example, an organization may have five related divisions and one unrelated division, making its design a cross between an M-form and an H-form. Indeed, few companies use a design in its pure form: most firms have one basic organization design as a foundation to managing the business but maintain sufficient flexibility so that temporary or permanent modifications can be made for strategic purposes. Ford, for example, used the matrix approach to design the Taurus and the Mustang, but the company is basically a U-form organization showing signs of moving to an M-form design. As we noted earlier, any combination of factors may dictate the appropriate form of design for any particular company.

MANAGEMENT IMPLICATIONS Managers need to understand the various basic forms of organization design, as well as the strengths and weaknesses of each. In addition, it is especially important that key decision makers know the best circumstances for using each approach. Further, they should not follow any given approach too rigidly. Instead, consistent with the hybrid model, managers should pick and choose the best of each model of organization design that fits their own unique needs.

■ Emerging Issues in Organization Design

Finally, in today's complex and ever-changing environment, it should come as no surprise that managers continue to explore and experiment with new forms of organization design. As discussed in *Managing in an E-business World,* for example, Schwab is doing just that. Many organizations today are creating designs for themselves that maximize their ability to adapt to changing circumstances and to a changing environment. They try to accomplish this adaptability by not becoming too compartmentalized or too rigid. As we noted earlier, bureaucratic organizations are hard to change, slow, and inflexible. To avoid these problems, then, organizations can try to be as different from bureaucracies as possible—relatively few rules, general job descriptions, and so forth. This final section highlights some of the more important emerging issues.[30]

MANAGING IN AN *e*-BUSINESS WORLD

THE WEB'S INFLUENCE ON ORGANIZATION DESIGN

No organization design lasts forever, but e-businesses have to be especially attentive to design as they evolve and adapt to the dynamic Internet environment. The number of Internet users continues to rise every day, as does the number of companies opening web-based businesses. Because the Internet offers many choices and allows convenient comparisons between competing products and services, buyers have more power than ever before. As a result, e-businesses stand to lose customers if they fail to adjust to emerging needs and trends.

The Web is also erasing geographic and time boundaries separating companies and consumers, business units and industrial suppliers. With a click of the mouse, customers can quickly find, price, and buy the best products for their requirements—regardless of location or time of day. These changes can spell disaster for bureaucratic organizations unprepared to respond quickly to shifts in customer buying patterns.

Charles Schwab, one of the largest U.S. discount brokerage firms, confronted these issues when management realized that the Internet was changing the way investors buy and sell stocks and bonds. At first, the company set up a separate e-business to offer basic brokerage services with lower fees for web-only transactions. Soon its Internet customers were clamoring for the same service and choices as non-Internet customers. Meantime, non-Internet customers were asking for on-line trading privileges with the same low fees paid by Internet customers. In response, Schwab merged its Internet and non-Internet businesses to create one brokerage firm with multiple access choices for customers and the low fee structure offered by the Internet unit. Now nearly 70 percent of all customer transactions move through the company's web site—making Schwab the leading broker on the Internet.

We used to reinvent the company about every ten years. Now it seems like we have to reinvent our company every two years.

—David P. Pottruck, president of Charles Schwab*

References: Fred Andrews, "Rock-Solid Values at Reinvention's Core," *New York Times,* April 30, 2000, sec. 3, p. 7 (*quote on p. 7); Megan Barnett, "Schwab's MVP," *Industry Standard,* May 1, 2000, p. 270; Gary Hamel and Jeff Sampler, "The E-Corporation," *Fortune,* December 7, 1998, pp. 80–92.

The Team Organization

team organization An approach to organization design that relies almost exclusively on project-type teams, with little or no underlying functional hierarchy

Some organizations today are using the **team organization**, an approach to organization design that relies almost exclusively on project-type teams, with little or no underlying functional hierarchy. Within such an organization people float from project to project as necessitated by their skills and the demands of those projects. At Cypress Semiconductor, T. J. Rodgers refuses to allow the organization to grow so large that it can't function this way. Whenever a unit or group starts getting too large, he simply splits it into smaller units. Consequently, all units within the organization are small. This approach allows them to change direction, explore new ideas, and try new methods without a rigid bureaucratic organizational context. Although few organizations have actually reached this level of adaptability, Apple Computer and Xerox are among those moving toward it.[31]

The Virtual Organization

Closely related to the team organization is the virtual organization. A **virtual organization** is one that has little or no formal structure. Such an organization typically has only a handful of permanent employees and a very small staff and administrative headquarters facility. As the needs of the organization change, its managers bring in temporary workers, lease facilities, and outsource basic support services to meet the demands of each unique situation. As the situation changes, the temporary workforce changes in parallel, with some people leaving the organization and others entering. Facilities and the services subcontracted to others change as well. Thus, the organization exists only in response to its needs. And increasingly, virtual organizations are conducting most—if not all—of their business on-line.[32]

virtual organization One that has little or no formal structure

For example, Global Research Consortium is a virtual organization. GRC offers research and consulting services to firms doing business in Asia. As clients request various services, GRC's staff of three permanent employees subcontract the work to an appropriate set of several dozen independent consultants and/or researchers with whom it has relationships. At any given time, therefore, GRC may have several projects underway and twenty or thirty people working on projects. As the projects change, so too does the composition of the organization.

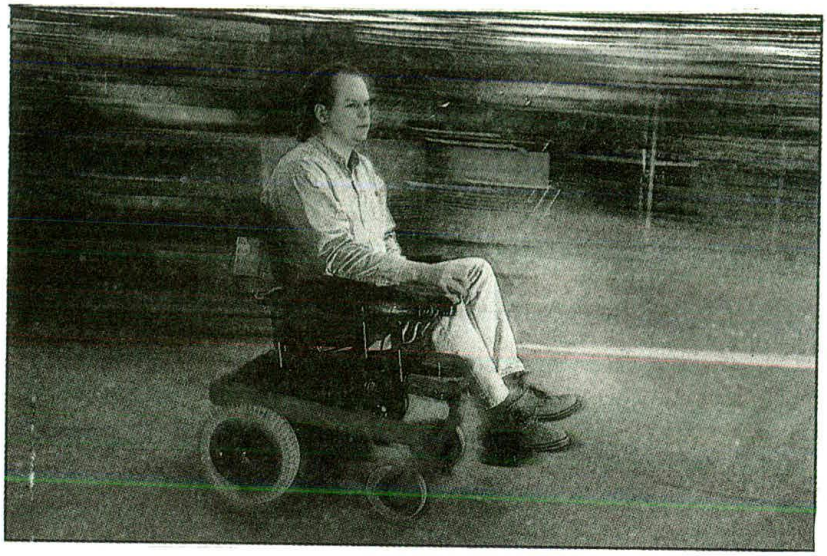
The Learning Organization

Another recent approach to organization design is the so-called learning organization. Organizations that adopt this approach work to integrate continuous improvement with continuous employee learning and development. Specifically, a **learning organization** is one that works to facilitate the lifelong learning and personal development of all of its employees while continually transforming itself to respond to changing demands and needs.[33]

learning organization One that works to facilitate the lifelong learning and personal development of all of its employees while continually transforming itself to respond to changing demands and needs

While managers might approach the concept of a learning organization from a variety of perspectives, improved quality, continuous improvement, and performance measurement are frequent goals. The idea is that the most consistent and logical strategy for achieving continuous improvement is by constantly upgrading employee talent, skill, and knowledge. For example, if each employee in an organization learns one new thing each day and can translate that knowledge into work-related practice, continuous improvement will logically follow. Indeed, organizations that wholeheartedly embrace this approach believe that only constant learning by employees can make continuous improvement really occur.

In recent years many different organizations have implemented this approach. For example, the Shell Oil Company recently purchased an executive conference center north of its headquarters in Houston. The center boosts state-of-the-art classrooms and instructional technology, lodging facilities, a restaurant, and recreational amenities such as a golf course, swimming pool, and tennis courts. Line managers at the firm rotate through the Shell Learning Center, as the facility has been renamed, and serve as teaching faculty. Such teaching assignments last anywhere from a few days to several months. At the same time, all



Firms that want to expand internationally often find it necessary to alter their organization design as they grow. For example, Invacare is a growing manufacturer of wheelchairs and other equipment for disabled workers. But because of different working conditions and government regulations in different countries, Invacare has different units for designing and constructing its wheelchairs bound for such countries as Germany, England, and France.

Shell employees routinely attend training programs, seminars, and related activities, all the while learning the latest information they need to contribute more effectively to the firm. Recent seminar topics have ranged from time management to implications of the Americans with Disabilities Act, to balancing work and family demands, to international trade theory.

Issues in International Organization Design

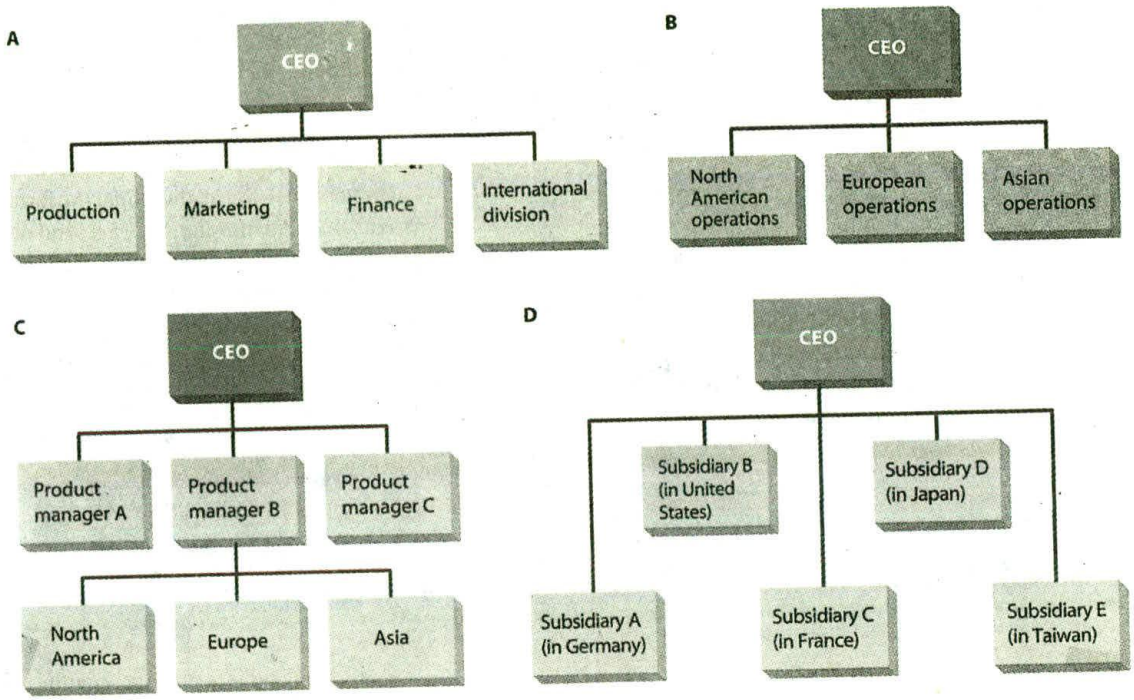
Another emerging issue in organization design is the trend toward the internationalization of business. As we discussed in Chapter 5, most businesses today interact with suppliers, customers, or competitors (or all three) from other countries. The relevant issue for organization design is how to design the firm to deal most effectively with international forces and to compete in global markets. For example, consider a moderate-size company that has just decided to go international. Should it set up an international division? Should it retain its current structure and establish an international operating group? Or should it make its international operations an autonomous subunit?[34]

Figure 12.5 illustrates four of the most common approaches to organization design used for international purposes. The design shown in A is the simplest, relying on a separate international division. Levi Strauss & Co. uses this approach. The design shown in B, used by Ford Motor Co., is an extension of location departmentalization to international settings. An extension of product departmentalization, with each product manager being responsible for all product-related activities regardless of location, is shown in C. Finally, the design shown in D, most typical of larger multinational corporations, is an extension of the multidivisional structure

Figure 12.5

Common Organization Designs for International Organizations

Companies that compete in international markets must create an organization design that fits their own unique circumstances. These four general designs are representative of what many international organizations use. Each is derived from one of the basic forms of organization design.



with branches located in various foreign markets. Nestlé and Unilever use this type of design.

MANAGEMENT IMPLICATIONS Managers should be aware of emerging issues in organization design. They need to be prepared to capitalize on the newest thinking and breakthroughs regarding organization design to keep pace with their competitors. Of course, they should also be wary of jumping on any bandwagon too quickly and falling victim to an ineffective fad.

Summary of Key Points

Organization design is the overall set of structural elements and the relationships among those elements used to manage the total organization. Two early universal models of organization design were the bureaucratic model and the behavioral model. These models attempted to prescribe how all organizations should be designed.

The situational view of organization design is based on the assumption that the optimal organization design is a function of situational factors. Four important situational factors are technology, environment, organizational size, and organizational life cycle. Each of these factors plays a role in determining how an organization should be designed.

An organization's strategy also helps shape its design. In various ways, corporate- and business-level strategies both affect organization design. Basic organizational functions like marketing and finance also play a role in shaping design.

Many organizations today adopt one of four basic organization designs: functional (U-form), conglomerate (H-form), divisional (M-form), or matrix. Other organizations use a hybrid design derived from two or more of these basic designs.

Four emerging issues in organization design are the team organization, the virtual organization, the learning organization, and how international businesses should be designed.

Discussion Questions

Questions for Review

1. Compare and contrast the bureaucratic and behavioral models of organization design. What are the advantages and disadvantages of each?
2. What are the basic situational factors that affect an organization's design?
3. How are an organization's strategy and its structure related?
4. Describe the basic forms of organization design. Outline the advantages and disadvantages of each.

Questions for Analysis

5. Can bureaucratic organizations avoid the problems usually associated with bureaucracies? If so, how? If not, why not? Do you think bureaucracies are still necessary? Why or why not? Is retaining the desirable aspects of bureaucracy and eliminating the undesirable ones possible? Why or why not?
6. The matrix organization design is complex and difficult to implement successfully. Why then do so many organizations use it?
7. Identify common and unique problems in organization design confronted by international businesses when compared with domestic businesses.

Questions for Application

8. What form of organization does your university or college use? What form does your city or town government use? What form do other organizations with which you are familiar use? What similarities and differences do you see? Why?
9. A question in Chapter 8 asks you to interview the manager of a local small business to determine how (or if) he or she formu-

lates strategy. Interview that same manager again to obtain a description of his or her organization design. Can you identify any links between the manager's strategy and the structure of his or her organization? Share your findings with the class.

10. Interview members of a local organization (fast-food chain, department store, bookstore, bank, church, home and school association, etc.) to ascertain how adaptable they perceive their organization to be.

BUILDING EFFECTIVE *communication* SKILLS

Exercise Overview

Communication skills refer to the manager's abilities both to convey ideas and information effectively to others and to receive ideas and information effectively from others. This exercise will enable you to see how communication works in different kinds of organization design.

Exercise Background

This chapter introduces you to several kinds of organization design that a business might use to structure itself. Given that organization design defines, at least in part, the interrelationships among different jobs and positions within the organization, it stands to reason that organization design and communication patterns will be interrelated. Using a sheet of paper, sketch basic organization designs based on the bureaucratic, U-form, M-form, H-form, and matrix designs. Each design should be several levels high and several positions wide.

Exercise Task

With the background information above as context, do the following:

1. Identify a single position toward the middle of each of the organization designs you have drawn and assume that you are holding that position in the organization.
2. Think of a circumstance in which you might need to communicate with four other individuals in the organization. Each should be in a different area and in a different level from your own.
3. Describe the processes you might need to follow for each communication; that is, consider issues such as chain of command, reporting relationships, and so forth.
4. Decide which forms of organization design are most conducive to communication and which are least conducive.
5. Does the content of the message matter? In what ways?

BUILDING EFFECTIVE *conceptual* SKILLS

Exercise Overview

Conceptual skills include a manager's ability to think in the abstract. This exercise will encourage you to apply your conceptual skills to the concepts associated with the situational influences on organization design.

Exercise Background

As noted in this chapter, several factors affect the appropriate design of an organization. The key factors discussed in the text are core technology, the organization's environment, its size, and its life cycle. The chapter does not provide

detail, however, about how the situational factors working together in different combinations might affect organization design. For example, how might a particular form of technology and certain environmental forces together influence organization design?

The text also notes several basic forms of organization design, such as the functional, conglomerate, divisional, and matrix approaches. Some implications are also drawn about how situational factors relate to each design.

Exercise Task

With these ideas in mind, do the following:

1. Identify a firm for each of the four basic forms of organization design. Assess the technology, environment, organizational size, and organizational life cycle for the four firms.
2. Now relate each situational factor to the design used by each firm.
3. Form an opinion about the actual relationship between each factor and the design used by each firm. That is, do you think that each firm's design is directly determined by its environment, or is the relationship you observe coincidental?
4. Can you prioritize the relative importance of the situational factors across the firms? Does the rank-order importance of the factors vary in any systematic way?

BUILDING EFFECTIVE *decision-making* SKILLS

Exercise Overview

Decision-making skills refer to the manager's ability to recognize and define problems and opportunities correctly and then to select an appropriate course of action to solve problems and capitalize on opportunities. The purpose of this exercise is to give you insights into how managers must make decisions within the context of creating an organization design.

Exercise Background

Assume that you have decided to open a casual sportswear business in your local community. Your products will be athletic caps, shirts, shorts, and sweats emblazoned with the logos of your college and local high schools. You are a talented designer and have developed some ideas that will make your products unique and very popular. You have also inherited enough money to get your business up and running and to cover about one year of living expenses (i.e., you do not need to pay yourself a salary).

You intend to buy sportswear in various sizes and styles from other suppliers. Your firm will then use silkscreen processes to add the logos and other decorative touches to the products. Local clothing store owners have seen samples of your products and have indicated a keen interest in selling them. You know, however, that you will still need to service accounts and keep your customers happy.

At the present time, you are trying to determine how many people you need to get your business going and how to group them most effectively into an organization. You realize that you can start out quite small and then expand as sales warrant. However, you also worry that if you are continually adding people and rearranging your organization that confusion and inefficiency will result.

Exercise Task

Step One: Under each of the scenarios below, decide how best to design your organization. Sketch a basic organization chart to show your thoughts.

Scenario 1—You will sell the products yourself, and you intend to start with a workforce of five people.

Scenario 2—You intend to oversee production yourself and to start with a workforce of nine people.

Scenario 3—You do not intend to handle any one function yourself but will instead oversee the entire operation, and you intend to start with a workforce of fifteen people.

Step Two: Form small groups of four to five people each. Compare your various organization charts, focusing on similarities and differences.

Step Three: Working in the same group, assume that five years have passed and that your business has been a big success. You have a large plant for making your products, and you are shipping them to fifteen states. You employ almost five hundred people. Create an organization design that you think fits this organization best.

Follow-up Questions

1. How clear or ambiguous were the decisions about organization design?
2. What are your thoughts about starting out too large to maintain stability as opposed to starting small and then growing?
3. What basic factors did you consider in choosing a design?

CHAPTER CLOSING CASE

MANAGING THE GOLDEN ARCHES AROUND THE WORLD

From Boston to Beijing and beyond, the golden arches of McDonald's look out on highways and streets in nearly every country around the world. The Illinois-based fast-food chain is working toward higher sales and is defending its market leadership in partnership with the five thousand franchise owners who operate twenty-seven thousand restaurants in the United States and abroad. Although a variety of hamburgers and fish sandwiches built the chain into a powerhouse, McDonald's has not had a large-scale, new-product hit for some years. Therefore, in addition to boosting sales in franchised restaurants, a good portion of McDonald's future growth may have to come from its stakes in nonburger chains, including Donatos Pizza, Chipotle Mexican Grill, and Boston Market.

For years, managers at McDonald's Illinois headquarters tightly controlled prices, product development, and other key functions to ensure chainwide consistency and quality. However, franchisees objected to some corporate decisions. For example, many U.S. franchisees refused to follow the corporation's strategy of cutting prices on Big Macs and breakfast items in 1997. Following that clash between franchisees and corporate management, McDonald's reversed course to decentralize pricing, among other operational details. Now the specially priced Happy Meal is the only discount that headquarters supports with national advertising, leaving other pricing to the discretion of local franchisees.

McDonald's has also divided its global business into five regional zones and delegated decision-making authority to the managers overseeing each of these regions. This structure put the focus on each region's opportunities and challenges to encourage faster and more responsive reaction to emerging changes and trends. On the local level, franchisees have the freedom to tailor their restaurants and menus to each local market. Customers at one McDonald's in Burleson, Texas, can play computer games while they sip their soft drinks; at a store in Plano, Texas, they sit on richly stained chairs beneath chandeliers. Halfway around the world, customers who visit McDonald's in Hong Kong can order tea and lounge around reading or bring their children to meet Uncle McDonald (the local counterpart of chain mascot Ronald McDonald).

Although the golden arches are clearly a symbol of American culture, franchisees carefully blend the corporation's efficient operating methods with locally influenced food and decor. They also follow McDonald's time-tested practice of promoting from within to build

the ranks of local management. Behind the scenes, the fast-food giant searches out local suppliers for international restaurants rather than relying on long-distance shipments of potatoes and other ingredients from a few central suppliers. These details matter because McDonald's has all but saturated the U.S. market, so management is keenly interested in international expansion.

With even more attention to detail, the company is improving its operational expertise by introducing a sophisticated cooking system to speed food preparation and keep menu items hot. Meanwhile, back in the kitchens at McDonald's Illinois headquarters, new-product experts are cooking up new offerings to supplement the chain's traditional menu selections. Did somebody say higher sales?

Case Questions

1. Which organization design is McDonald's using internationally? How is this design appropriate for the company's international situation?
2. How does McDonald's working relationship with franchisees make it a learning organization?
3. Where in the organizational life cycle would you position McDonald's? How does this affect the company's organization design?

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CHAPTER 13

Managing Organization Change and Innovation

OPENING INCIDENT

Nike, of course, is the world's preeminent athletic show company. In 1996, Nike was earning about $4 billion a year from its footwear business and another $2 billion from sports apparel and equipment. That same year the firm's founder and CEO Philip Knight stunned investors and competitors alike when he announced a goal of doubling the firm's annual revenues to a staggering $12 billion by the year 2001. But Nike has recently encountered a series of setbacks that have compelled Knight to embark on a major overhaul of the firm.

Things started coming apart for Nike in the late 1990s. The retirement of Michael Jordan, Nike icon and arguably the world's best-known professional athlete, deprived the firm of its best spokesperson. There was also an unexpected major shift among teen-agers away from athletic shoes to hiking boots and casual leather shoes. Third, a series of reports involving substandard wages and working conditions at foreign Nike production facilities resulted in a public-relations nightmare and caused some consumers to avoid the company's products. And finally, Nike's brash in-your-face reputation was beginning to get tiresome to many consumers. By 1998, Knight had been forced to back off his bold forecasts from the recent past and Nike was posting lower-than-expected earnings reports virtually every quarter.

This dramatic and unexpected series of events caused Knight to recognize that some big changes were necessary. And it didn't really take him too long to figure out what had happened—the brash upstart had turned into the very establishment that Nike had long deplored; that is, as it had grown, the firm had also been transformed from a nimble and free-form organization into a traditional bureaucratic behemoth. In addition, market conditions had also changed so completely that Nike's traditional way of doing business would simply no longer work.

Knight was quick to take up the challenge and has set about trying to restore the firm's lost luster. For one thing, he has totally revamped Nike's top management team, and today nine of Nike's forty-one vice presidents have been with the firm less than two years. He has also created a new sense of urgency about costs—in the old days revenues grew so fast that costs almost didn't matter, but

"I'm sure Nike's looking for fresh perspective, and newcomers bring a fresh perspective."

—Paul Heffernan, executive at Nike rival New Balance

LEARNING OBJECTIVES

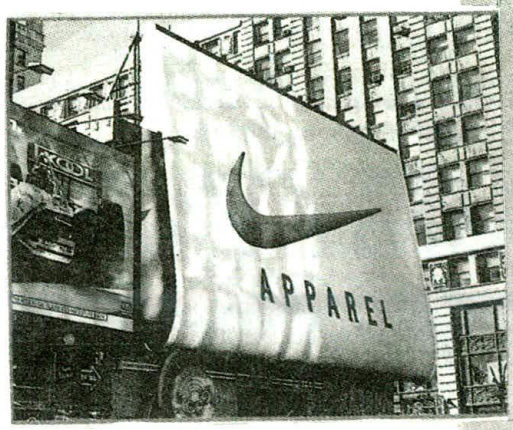
After studying this chapter, you should be able to:

- Describe the nature of organization change, including forces for change and planned versus reactive change.
- Discuss the steps in organization change and how to manage resistance to change.
- Identify and describe major areas of organization change.
- Discuss the assumptions, techniques, and effectiveness of organization development.
- Describe the innovation process, forms of innovation, the failure to innovate, and how organizations can promote innovation.

today they are continuously scrutinized. Knight also has Nike focusing on new, emerging, and/or growing markets such as women's sports, extreme sports, and international markets. And he is paying much closer attention to foreign factories and production facilities.

Beyond these specific areas, however, Knight is also working to remake the very fabric of Nike. He wants to transform the company into one that incorporates the best of both worlds—an enterprise with the entrepreneurial spark and vision that fueled Nike in its early years combined with a more reasoned and structured business model. Toward this end, he has taken a more hands-on approach to business, spending more time at the company, being an active participant in key meetings, and voicing his opinion more strongly than he has in the past.

Knight has even acknowledged that Nike may have overdosed with its familiar "swoosh" logo by plastering it so prominently across all its various products and on so many different sporting venues. As a result, the swoosh emblem is being made smaller for some products. And other products are being launched with totally new logos. In a lot of ways, then, it seems that Nike is taking its own message to heart—the firm needed to "just do it," so it is![1]



CHAPTER OUTLINE

- **The Nature of Organization Change**
  - Forces for Change
  - Planned Versus Reactive Change
- **Managing Change in Organizations**
  - Steps in the Change Process
  - Understanding Resistance to Change
  - Overcoming Resistance to Change
- **Areas of Organization Change**
  - Changing Structure and Design
  - Changing Technology and Operations
  - Changing People
  - Reengineering in Organizations
- **Organization Development**
  - OD Assumptions
  - OD Techniques
  - The Effectiveness of OD
- **Organizational Innovation**
  - The Innovation Process
  - Forms of Innovation
  - The Failure to Innovate
  - Promoting Innovation in Organizations

Philip Knight has had to grapple with something all managers must eventually confront: the need for change. He first perceived that Nike needed to make certain changes because of its growth and because of changes in the marketplace. He then had to figure out how to make those changes. And now that most of them are completed, it will be some time before he and the rest of his managers know whether or not the changes they have made are having the intended effects.

Understanding when and how to implement change is a vital part of management. This chapter describes how organizations manage change. We first examine the nature of organization change and identify the basic issues of managing change. We then identify and described major areas of change, including reengineering, a major type of change undertaken by many firms recently. We examine organization development and conclude by discussing a related area, organizational innovation.

The Nature of Organization Change

organization change Any substantive modification to some part of the organization

Organization change is any substantive modification to some part of the organization.[2] Thus, change can involve almost any aspect of an organization: work schedules, bases for departmentalization, span of management, machinery, organization design, people themselves, and so on. It is important to keep in mind that any change in an organization may have effects extending beyond the actual area where the change is implemented. For example, when Northrup Grumman recently installed a new automated production system at one of its plants, employees were trained to operate new equipment, the compensation system was adjusted to reflect new skill levels, the span of management of supervisors was altered, and several related jobs were redesigned. Selection criteria for new employees were also changed, and a new quality control system was installed.[3] In addition, it is quite common for multiple organization change activities to be going on simultaneously.[4]

Forces for Change

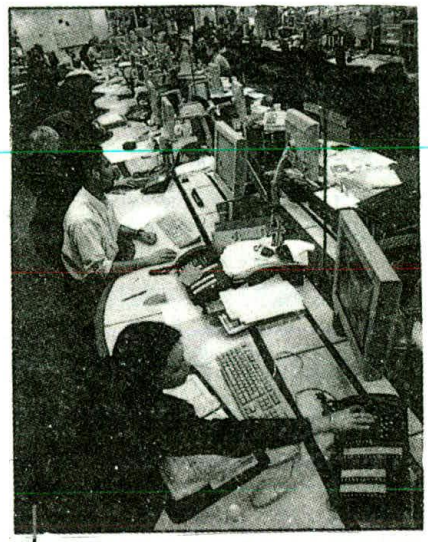
Why do organizations find change necessary? The basic reason is that something relevant to the organization either has changed or is going to change. The organization consequently has little choice but to change as well. Indeed, a primary reason for the problems that organizations often face is failure to anticipate or respond properly to changing circumstances. Forces for change may be external or internal to the organization.[5]

External Forces External forces for change derive from the organization's general and task environments. For example, two energy crises, an aggressive Japanese automobile industry, floating currency exchange rates, and floating international interest rates—all manifestations of the international dimension of the general environment—profoundly influenced U.S. automobile companies. New

rules of production and competition forced them to alter dramatically the way they do business. In the political area, new laws, court decisions, and regulations affect organizations. The technological dimension may yield new production techniques that the organization needs to explore. The economic dimension is affected by inflation, the cost of living, and money supplies. The sociocultural dimension, reflecting societal values, determines what kinds of products or services will be accepted in the market.

Because of its proximity to the organization, the task environment is an even more powerful force for change. Competitors influence an organization through their price structures and product lines. When Compaq lowers the prices it charges for computers, Dell and Gateway have little choice but to follow suit. Because consumers, as a group, often determine what products can be sold at what prices, organizations must be concerned with consumer tastes and preferences. Suppliers affect organizations by raising or lowering prices or changing product lines. Regulators can have dramatic effects on an organization. For example, if OSHA rules that a particular production process is dangerous to workers, it can force a firm to close a plant until it meets higher safety standards. Unions can force change when they negotiate for higher wages or when their members strike.[6]

Internal Forces A variety of forces inside the organization may cause change. If top management revises the organization's strategy, organization change is likely to result. A decision by an electronics company to enter the home computer market or a decision to increase a ten-year product sales goal by 3 percent would occasion many organization changes. Other internal forces for change may be reflections of external forces. As sociocultural values shift, for example, workers' attitudes toward their jobs may also shift—and workers may demand a change in working hours or working conditions. In such a case, even though the force is rooted in the external environment, the organization must respond directly to the internal pressure generated.[7]



A variety of forces, some internal and some external, can be important forces for change. Enron Corporation, for example, has become one of the most successful companies in the world by looking for opportunities for change. In simple terms, Enron buys and sells gas and electricity and earns profits on the margin between what it pays and what it earns. Enron managers were among the first, however, to see energy as a commodity that can be traded. These Enron traders in Europe play a major role in determining Europe's gas and power production rates by influencing the prices that buyers will pay. Enron is now branching out into other areas of trading, such as excess capacity on fiber-optic networks.

Planned Versus Reactive Change

Some change is planned well in advance; other change is a reaction to unexpected events. **Planned change** is change that is designed and implemented in an orderly and timely fashion in anticipation of future events. **Reactive change** is a piecemeal response to events as they occur. Because reactive change may be hurried, the potential for poorly conceived and executed change is increased. Planned change is almost always preferable to reactive change.[8]

planned change Change that is designed and implemented in an orderly and timely fashion in anticipation of future events

reactive change A piecemeal response to events as they occur

Georgia-Pacific, a large forest-products business, is an excellent example of a firm that went through a planned and well-managed change process. When A. D. Correll became CEO, he quickly became alarmed at the firm's high accident rate—

nine serious injuries per one hundred employees each year, and twenty-six deaths during the most recent five-year period. While the forest-products business is inherently dangerous, Correll believed that the accident rate was far too high and started a major change effort for improvement. He and other top managers developed a multistage change program intended to educate workers about safety, improve safety equipment in the plant, and eliminate a long-standing part of the firm's culture that made injuries almost a badge of courage. And today, Georgia-Pacific has the best safety record in the industry, with relatively few injuries.[9]

On the other hand, a few years ago Caterpillar was caught flat-footed by a worldwide recession in the construction industry, suffered enormous losses, and took several years to recover. Had managers at Caterpillar anticipated the need for change earlier, they might have been able to respond more quickly. Similarly, Kodak recently announced plans to cut ten thousand jobs, a reaction to sluggish sales and profits. Again, anticipation might have forestalled these job cuts. The importance of approaching change from a planned perspective is reinforced by the frequency of organization change. Most companies or divisions of large companies implement some form of moderate change at least every year and one or more major changes every four to five years.[10] Managers who sit back and respond only when they have to are likely to spend a lot of time hastily changing and rechanging things. A more effective approach is to anticipate forces urging change and plan ahead to deal with them.[11]

MANAGEMENT Managers should understand the meaning and pervasiveness of change, as well as its potential impact throughout their organization. They should also realize that change seldom stops and that multiple changes may be necessary simultaneously. Managers must also recognize that the need for change can be induced by either external or internal forces. Moreover, they should also value the importance of planned versus reactive change. Their goal should be to plan for change whenever possible.

■ Managing Change in Organizations

Organization change is a complex phenomenon. A manager cannot simply wave a wand and implement a planned change like magic. Instead, any change must be systematic and logical to have a realistic opportunity to succeed. To implement planning for change, the manager needs to understand the steps of effective change and how to counter employee resistance to change.[12]

Steps in the Change Process

Over the years, researchers have developed a number of models or frameworks outlining steps for change.[13] The Lewin model was one of the first, although a more comprehensive approach is usually more useful.

The Lewin Model Kurt Lewin, a noted organizational theorist, suggested that every change requires three steps.[14] The first step is *unfreezing*—individuals who will be affected by the impending change must be led to recognize why the change is necessary. Next, the *change itself* is implemented. Finally, *refreezing* involves reinforcing and supporting the change so that it becomes part of the system. For example, one of the changes Caterpillar faced in response to the recession noted earlier involved a massive workforce reduction. The first step (unfreezing) was convincing the United Auto Workers to support the reduction because of its importance to long-term effectiveness. After this unfreezing was accomplished, thirty thousand jobs were eliminated (implementation). Then Caterpillar worked to improve its damaged relationship with its workers (refreezing) by guaranteeing future pay hikes and promising no more cutbacks. As interesting as Lewin's model is, it unfortunately lacks operational specificity. Thus, a more comprehensive perspective is often needed.

A Comprehensive Approach to Change The comprehensive approach to change takes a systems view and delineates a series of specific steps that often lead to successful change. This expanded model is illustrated in Figure 13.1. The first step is recognizing the need for change. Reactive change might be triggered by employee complaints, declines in productivity, or turnover; court injunctions; sales slumps; or labor strikes. Recognition may simply be managers' awareness that change in a certain area is inevitable. For example, managers may be aware of the general frequency of organizational change undertaken by most organizations and recognize that their organization should probably follow the same pattern. The immediate stimulus might be the result of a forecast indicating new market potential, the accumulation of cash surplus for possible investment, or an opportunity to achieve and capitalize on a major technological breakthrough. Managers might also initiate change today because indicators suggest that it will be necessary in the near future.

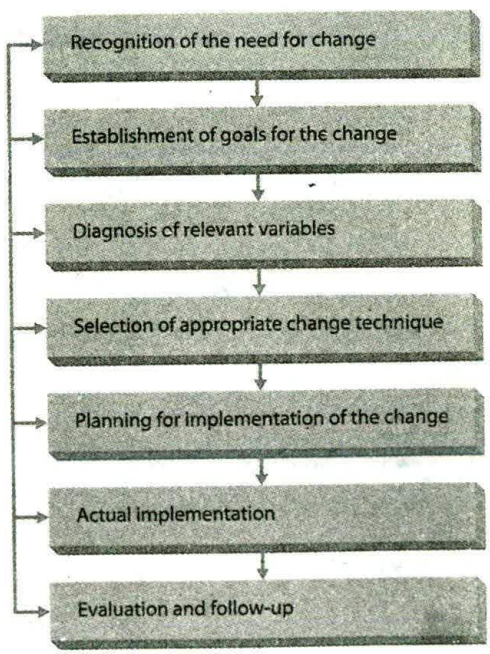
Managers must next set goals for the change. To increase market share, to enter new markets, to restore employee morale, to settle a strike, and to identify investment opportunities all might be goals for change. Third, managers must diagnose what brought on the need for change. Turnover, for example, might be caused by low pay, poor working conditions, poor supervisors, or employee dissatisfaction. Thus, although turnover may be the immediate stimulus for change, managers must understand its causes to make the right changes.

The next step is to select a change technique that will accomplish the intended goals. If turnover is caused by low pay, a new reward system may be needed. If the cause is poor supervision, interpersonal skills training may be called for. (Various change techniques are summarized later in this chapter.) After the appropriate

Figure 13.1

Steps in the Change Process

Managers must understand how and why to implement change. A manager who, when implementing change, follows a logical and orderly sequence such as the one shown here is more likely to succeed than a manager whose change process is haphazard and poorly conceived.



Change is a common event in most organizations today. And while much of this change is necessary and beneficial, managers sometimes engage in change activities that are either unnecessary or poorly conceived. When this happens, it increases the chances that employees will resist the change—they will experience uncertainty, threatened self-interests, different perceptions, and/or feelings of loss. Indeed, as shown in this cartoon, change can be so poorly managed that employees sense it before it even occurs and develop resistance without even knowing the details.



DILBERT by Scott Adams reprinted by permission of United Feature Syndicate.

technique has been chosen, its implementation must be planned. Issues to consider include the costs of the change, its effects on other areas of the organization, and the degree of employee participation appropriate for the situation. If the change is implemented as planned, the results should then be evaluated. If the change was intended to reduce turnover, managers must check turnover after the change has been in effect for a specified amount of time. If turnover is still too high, other changes may be necessary.[15]

Understanding Resistance to Change

Another element in the effective management of change is understanding the resistance that often accompanies change.[16] Managers need to know why people resist change and what can be done about their resistance. When Westinghouse first provided all its managers with personal computers, most people responded favorably. One manager, however, resisted the change to the point where he began leaving work every day at noon. It was some time before he began staying in the office all day again. This same phenomenon is illustrated in the cartoon. Such resistance is common for a variety of reasons.

Uncertainty Perhaps the biggest cause of employee resistance to change is uncertainty. In the face of impending change, employees may become anxious and nervous. They may worry about their ability to meet new job demands, they may think that their job security is threatened, or they may simply dislike ambiguity. Nabisco was once the target of an extended and confusing takeover battle, and during the entire time employees were nervous about the impending change. The *Wall Street Journal* described them this way: "Many are angry at their leaders and fearful for their jobs. They are swapping rumors and spinning scenarios for the ultimate outcome of the battle for the tobacco and food giant. Headquarters staffers in Atlanta know so little about what's happening in New York that some call their office 'the mushroom complex,' where they are kept in the dark."[17]

Threatened Self-Interests Many impending changes threaten the self-interests of some managers within the organization. A change might potentially diminish their

power or influence within the company, so they fight it. Managers at Sears, Roebuck and Co. recently developed a plan calling for a new type of store. The new stores would be somewhat smaller than typical Sears stores and would not be located in large shopping malls. Instead, they would be located in smaller strip centers. They would carry clothes and other "soft goods" but not hardware, appliances, furniture, or automotive products. When executives in charge of the excluded product lines heard about the plan, they raised such strong objections that the plan was put on hold.

Different Perceptions A third reason that people resist change is due to different perceptions. A manager may make a decision and recommend a plan for change on the basis of her own assessment of a situation. Others in the organization may resist the change because they do not agree with the manager's assessment or perceive the situation differently.[18] Executives at 7-Eleven are currently battling this problem as they attempt to enact a major organizational change. The corporation wants to take its convenience stores a bit upscale and begin selling fancy fresh foods to go, the newest hardcover novels, and some gourmet products. But many franchisees are balking because they see this move as taking the firm away from its core blue-collar customers.[19]

Feelings of Loss Many changes involve altering work arrangements in ways that disrupt existing social networks. Because social relationships are important, most people resist any change that might adversely affect those relationships. Other intangibles threatened by change include power, status, security, familiarity with existing procedures, and self-confidence.

Overcoming Resistance to Change

Of course, a manager should not give up in the face of resistance to change. Although there are no sure-fire cures, several techniques have at least the potential to overcome resistance.[20]

Participation Participation is often the most effective technique for overcoming resistance to change. Employees who participate in planning and implementing a change are better able to understand the reasons for the change. Uncertainty is reduced, and self-interests and social relationships are less threatened. Having had an opportunity to express their ideas and assume the perspectives of others, employees are more likely to accept the change gracefully. A classic study of participation monitored the introduction of a change in production methods among four groups in a Virginia

People in organizations often resist change for a number of different reasons. Today's breathtaking technological advancements in areas such as biotechnology and information processing seem especially troubling to some people. Harvard business professor Clayton Christensen has helped managers in many firms overcome their fear of technological change through his path-breaking work on what he calls disruptive technology. He argues, for instance, that making change a fundamental part of an organization's culture can dramatically reduce resistance to change on the part of people who are members of that organization.



pajama factory.[21] The two groups that were allowed to participate fully in planning and implementing the change improved their productivity and satisfaction significantly relative to the two groups that did not participate. 3M Company recently attributed $10 million in cost savings to employee participation in several organization change activities.[22]

Education and Communication Educating employees about the need for and the expected results of an impending change should reduce their resistance. If open communication is established and maintained during the change process, uncertainty can be minimized. Caterpillar used these methods to reduce resistance during many of its cutbacks. First, it educated United Auto Worker (UAW) representatives about the need for and potential value of the planned changes. Then management told all employees what was happening, when it would happen, and how it would affect them individually.

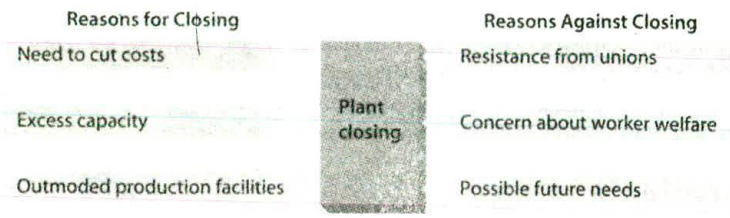
Facilitation Several facilitation procedures are also advisable. For instance, making only necessary changes, announcing those changes well in advance, and allowing time for people to adjust to new ways of doing things can help reduce resistance to change.[23] One manager at a Prudential regional office spent several months systematically planning a change in work procedures and job design. He then became too hurried, coming in over the weekend with a work crew and rearranging the office layout. When employees walked in on Monday morning, they were hostile, anxious, and resentful. What was a promising change became a disaster, and the manager had to scrap the entire plan.

Force-Field Analysis Although force-field analysis may sound like something out of a Star Trek movie, it can help overcome resistance to change. In almost any change situation, forces are acting for and against the change. To facilitate the change, managers start by listing each set of forces and then trying to tip the balance so that the forces facilitating the change outweigh those hindering the change.

Figure 13.2

Force-Field Analysis for Plant Closing at General Motors

A force-field analysis can help a manager facilitate change. A manager able to identify forces acting both for and against a change can see where to focus efforts to remove barriers to change (such as offering training and relocation to displaced workers). Removing the forces against the change can at least partially overcome resistance.



It is especially important to try to remove or at least minimize some of the forces acting against the change. Suppose, for example, that General Motors is considering a plant closing as part of a change. As shown in Figure 13.2, three factors are reinforcing the change: GM needs to cut costs, it has excess capacity, and the plant has outmoded production facilities. At the same time, there is resistance from the UAW, concern for workers losing their jobs, and a feeling that the plant might be needed again in the future. GM might start by convincing the UAW that the closing is necessary with profit and loss figures. It could then offer relocation and retraining to displaced workers. And it might shut down the plant and put it in "moth balls" so that it could be renovated later. The three major factors hindering the change are thus eliminated or reduced in importance.

MANAGEMENT Managers should approach change from a logical and rational perspective and understand that they should proceed through a progression of events as they enact change. They should also understand that some people are likely to resist change, but that certain techniques can be used to overcome this resistance at least partially.

■ Areas of Organization Change

We noted earlier that change can involve virtually any part of an organization. In general, however, most change interventions involve organization structure and design, technology and operations, or people. The most common areas of change within each of these broad categories are listed in Table 13.1.

Table 13.1

Areas of Organization Change

Organization change can affect any part, area, or component of an organization. Most change, however, fits into one of three general areas: organization structure and design, technology and operations, and people.

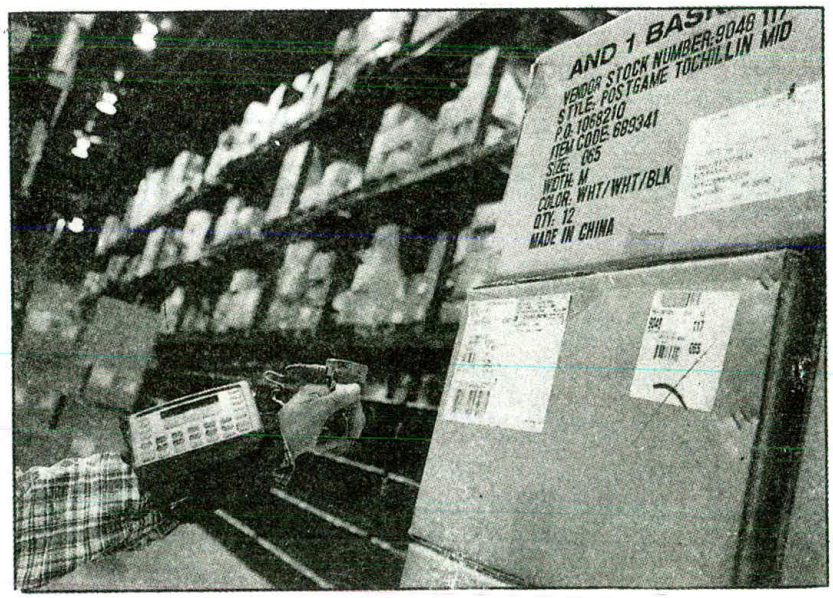
Organization Structure and Design	Technology and Operations	People
Job design	Information technologies	Abilities and skills
Departmentalization	Equipment	Performance
Reporting relationships	Work processes	Perceptions
Authority distribution	Work sequences	Expectations
Coordination mechanisms	Control systems	Attitudes
Line-staff structure		Values
Overall design		
Culture		
Human resource management		

Changing Structure and Design

Organization change might be focused on any of the basic components of organization structure or on the organization's overall design. Thus, the organization might change the way it designs its jobs or its bases of departmentalization. Likewise, it might change reporting relationships or the distribution of authority. For example, we noted in Chapter 11 the trend toward flatter organizations. Coordination mechanisms and line and staff configurations are also subject to change. On a larger scale, the organization might change its overall design. For example, a growing business could decide to drop its functional design and adopt a divisional design. Or it might transform itself into a matrix. Finally, the organization might change any part of its human resource management system, such as its selection criteria, its performance appraisal methods, or its compensation package.[24] Toyota has been undergoing a significant series of changes in its organization structure and design that are intended to make it a flatter and more decentralized enterprise and thus more responsive to its external environment.[25]

Changing Technology and Operations

Technology is the conversion process used by an organization to transform inputs into outputs. Because of the rapid rate of all technological innovation, technological changes are becoming increasingly important to many organizations. Table 13.1 lists several areas where technological change is likely to be experienced. One important area of change today revolves around information technology. The adoption and institutionalization of information technology innovations is almost con-



Change can take place in a variety of areas in an organization. Technological change is an especially important area of change today. United Parcel Service, for example, is always on the alert for new technology that can improve its efficiency and effectiveness. One of its newest innovations is the wrist-mounted bar-code reader. Users can simply point their hand in the direction of a box, package, or other parcel and the bar-code reader registers the vital information needed to keep the shipment on-track. And users no longer have to stop and look for their reader, since it's strapped to their wrist!

stant in most firms today. Sun Microsystems, for example, has adopted a very short-range planning cycle to be prepared for environmental changes.[26] Another important form of technological change involves equipment. To keep pace with competitors, firms find that replacing existing machinery and equipment periodically with newer models is necessary.

A change in work processes or work activities may be necessary if new equipment is introduced or new products are manufactured. In manufacturing industries, the major reason for changing a work process is to accommodate a change in the materials used to produce a finished product. Consider a firm that manufactures battery-operated flashlights. For many years flashlights were made of metal, but now most are made of plastic. A firm might decide to move from metal to plastic flashlights because of consumer preferences, raw materials costs, or other reasons. Whatever the reason, the technology necessary to make flashlights from plastic differs significantly from that used to make flashlights from metal. Work process changes may occur in service organizations as well as in manufacturing firms. As traditional barber shops and beauty parlors are replaced by hair salons catering to both sexes, for example, the hybrid organizations have to develop new methods for handling appointments and setting prices.

A change in work sequence may or may not accompany a change in equipment or a change in work processes. Making a change in work sequence means altering the order or sequence of the workstations involved in a particular manufacturing process. For example, a manufacturer might have two parallel assembly lines producing two similar sets of machine parts. The lines might converge at one central quality control unit where tolerances are verified by inspectors. The manager, however, might decide to change to periodic rather than final inspection. Under this arrangement, one or more inspections are established farther up the line. Work sequence changes can also be made in service organizations. The processing of insurance claims, for example, could be changed. The sequence of logging and verifying claims, requesting checks, getting countersignatures, and mailing checks could be altered in several ways, such as combining the first two steps or routing the claims through one person while another handles checks. Organizational control systems may also be targets of change.[27]

Changing People

A third area of organization change has to do with human resources. For example, an organization might decide to change the skill level of its workforce. This change might be prompted by changes in technology or by a general desire to upgrade the quality of the workforce. Thus, training programs and new selection criteria might be needed. The organization might also decide to improve its workers' performance level. In this instance, a new incentive system or performance-based training might be in order. Reader's Digest has been attempting to implement significant changes in its workforce. For example, the firm has eliminated 17 percent of its employees, reduced retirement benefits, and taken away many of the perks they once enjoyed. Part of the reason for the changes was to instill in the remaining employees a sense of urgency and the need to adopt a new perspective on how they did their jobs.[28]

Perceptions and expectations are also a common focus of organization change. Workers in an organization might believe that their wages and benefits are not as high as they should be. Management, however, might have evidence that the firm is paying a competitive wage and providing a superior benefit package. The change, then, would be centered on informing and educating the workforce about the comparative value of its compensation package. A common way to do this is to publish a statement that places an actual dollar value on each benefit provided and compares that amount to what other local organizations are providing their workers. Change might also be directed at employee attitudes and values. In many organizations today, managers are trying to eliminate adversarial relationships with workers and adopt a more collaborative relationship. In many ways, changing attitudes and values is perhaps the hardest task to do. *Today's Management Issues* provides a good case in point.

TODAY'S MANAGEMENT ISSUES

New Leaders, New Management?

Does new leadership at the top automatically mean change in upper-management appointments? Often, a new CEO or top business manager prefers to replace the existing layer of senior management with handpicked choices who are more familiar to the leader or more in tune with the leader's planned change in strategy or focus. Sometimes, however, a new leader believes that leaving the current managers in place will ensure stability during the changeover at the top.

At Andersen Consulting (now named Accenture), for example, Joe W. Forehand became global managing partner and CEO following the resignation of the previous CEO, who left to join an Internet company. Within a few months, Forehand had made his own selection of thirteen managers to serve on the twenty-member executive committee governing this international technology consulting company. Four of the new members were from other countries, part of Forehand's strategy to become the leading consulting firm around the world. (The managers who were replaced stayed with Andersen, but in different positions.)

In addition, the CEO established the new position of international chairman and appointed an Andersen veteran to oversee the company's growth in global markets. Forehand's expansion strategy extends to e-commerce, where he is planning to attract consulting contracts from more Internet-based businesses. In a unique twist, Andersen has also set aside $1 billion to invest in promising Internet businesses, with the investments to be recouped if and when the firms go public and begin to sell shares.

Despite the change at the top, Andersen does not want to encourage turnover within the organization. In fact, management is reaching out to employees who recently left, encouraging them to consider returning and thus take advantage of elements of organizational change such as increased benefits, improved career opportunities, and more web-related assignments. Clearly, the one thing that never changes is an organization's need for talented people at all levels.

We are realigning Andersen Consulting's leadership to reflect our strong global presence.

—Joe W. Forehand, CEO of Andersen Consulting*

References: Joanne Gordon, "Humbled Giant," *Forbes*, July 24, 2000, http://www.forbes.com/forbes/00/0724/6517060a.htm (August 4, 2000); Larry Greenemeier, "Andersen Plans for E-Business Growth," *Information Week*, April 24, 2000, p. 40; Elizabeth MacDonald, "Andersen Consulting's New Leader Overhauls Firm's Top Management," *Wall Street Journal*, January 20, 2000, p. B18 (*quote on p. B18).

Reengineering in Organizations

Many organizations today have also gone through a massive and comprehensive change program involving all aspects of organization design, technology, and people. Although various terms are used, the term currently in vogue for these changes is *reengineering*. Specifically, **reengineering** is the radical redesign of all aspects of a business to achieve major gains in cost, service, or time.[29] Corning, for example, has undergone a major reengineering over the last few years. Whereas the 150-year-old business once manufactured cookware and other durable consumer goods, it has transformed itself into a high-tech powerhouse making such items as the ultra-thin screens used in products like Palm Pilots and laptop computers.[30]

reengineering The radical redesign of all aspects of a business to achieve major gains in cost, service, or time

The Need for Reengineering Why are so many organizations finding it necessary to reengineer themselves? We noted in Chapter 2 that all systems, including organizations, are subject to entropy—a normal process leading to system decline. An organization is behaving most typically when it maintains the status quo, doesn't change in synch with its environment, and starts consuming its own resources to survive. In a sense, that is what happened to Kmart. In the early and mid-1970s Kmart was in such a high-flying growth mode that it passed first J.C. Penney and then Sears to become the world's largest retailer. But then the firm's managers grew complacent and assumed that the discount retailer's prosperity would continue and that they need not worry about environmental shifts, the growth of Wal-Mart, and so forth—and entropy set in. The key is to recognize the beginning of the decline and to move immediately toward reengineering. Major problems occur when managers either don't recognize the onset of entropy until it is well advanced or else are complacent in taking steps to correct it.

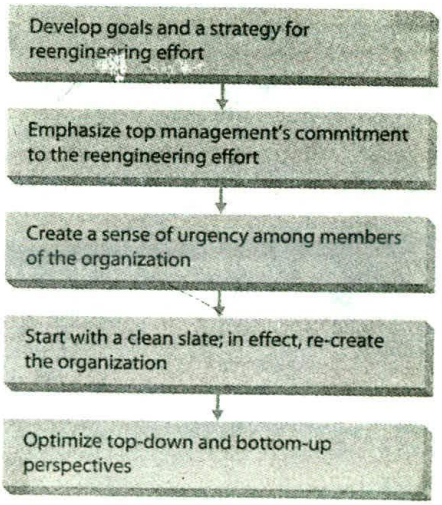
Approaches to Reengineering Figure 13.3 shows general steps in reengineering. The first step is setting goals and developing a strategy for reengineering. The organization must know in advance what reengineering is supposed to accomplish and how those accomplishments will be achieved. Next, top managers must begin and direct the reengineering effort. If a CEO simply announces that reengineering is to occur but does nothing else, the program is unlikely to be successful. But if the CEO is constantly involved in the process, underscoring its importance and taking the lead, reengineering stands a much better chance of success.

Most experts also agree that successful reengineering is usually accompanied by a sense of urgency. People in the organization must see the clear and present need for the changes being implemented and appreciate their importance. In addition, most successful reengineering efforts start with a new, clean slate; that is, rather than assuming that the existing organization is a starting point and then trying to modify it, reengineering usually starts by asking questions such as, How are customers best served and competitors best neutralized? New approaches and systems are then created and imposed in place of existing ones.

Figure 13.3

The Reengineering Process

Reengineering is a major redesign of all areas of an organization. To be successful, reengineering requires a systematic and comprehensive assessment of the entire organization. Goals, top management support, and a sense of urgency help the organization re-create itself and blend both top-level and bottom-up perspectives.



Finally, reengineering requires a careful blend of top-down and bottom-up involvement. On the one hand, strong leadership is necessary, but too much involvement by top management can make the changes seem autocratic. Similarly, employee participation is important, but too little involvement by leaders can undermine the program's importance and create a sense that top managers don't care. Thus, care must be taken to balance these two countervailing forces carefully.

MANAGEMENT IMPLICATIONS Managers need to understand the breadth of areas in which organization change can be necessary. They should also note the potential areas of interdependence among areas of change. For example, a change in technology may also necessitate a change in organization structure and people. Finally, managers should understand reengineering, a relatively recent perspective on change that involves massive and total change throughout an organization spanning all three of the traditional change areas of organization design, technology, and people.

■ Organization Development (OD)

We noted in several places the importance of people and change. A special area of interest that focuses almost exclusively on people is organization development.

OD Assumptions

organization development A planned effort that is organizationwide and managed from the top, and is intended to increase organization effectiveness and health through planned interventions in the organization's process using behavioral science knowledge

Organization development is concerned with changing attitudes, perceptions, behaviors, and expectations. More precisely, **organization development** is a planned effort that is organizationwide and managed from the top, and is intended to increase organization effectiveness and health through planned interventions in the organization's 'process' using behavioral science knowledge.[31] The theory and practice of OD are based on several very important assumptions. The first is that employees have a desire to grow and develop. Another is that employees have a strong need to be accepted by others within the organization. Still another critical assumption of OD is that the total organization and the way it is designed will influence the way individuals and groups within the organization behave. Thus, some form of collaboration between managers and their employees is necessary to (1) take advantage of the skills and abilities of the employees and (2) eliminate aspects of the organization that retard employee growth, development, and group acceptance. Because of the intense personal nature of many OD activities, many large organizations rely on one or more OD consultants (either full-time employees assigned to this function or outside experts hired specifically for OD purposes) to implement and manage their OD program.[32]

OD Techniques

Several kinds of interventions or activities are generally considered to be part of organization development.[33] Some OD programs may use only one or a few of these; other programs use several of them at once.

Diagnostic Activities Just as a physician examines patients to diagnose their current condition, an OD diagnosis analyzes the current condition of an organization. To carry out this diagnosis, managers use questionnaires, opinion or attitude surveys, interviews, archival data, and meetings to assess various characteristics of the organization. The results from this diagnosis may generate profiles of the organization's activities, which can then be used to identify problem areas in need of correction.

Team Building Team-building activities are intended to enhance the effectiveness and satisfaction of individuals who work in groups or teams and to promote overall group effectiveness. Given the widespread use of teams today, these activities have taken on increased importance. An OD consultant might interview team members to determine how they feel about the group; then an off-site meeting could be held to discuss the issues that surfaced and to iron out any problem areas or member concerns. Caterpillar used team building as one method for changing the working relationships between workers and supervisors from confrontational to cooperative. An interesting new approach to team building involves having executive teams participate in group cooking classes to teach them the importance of interdependence and coordination.[34]

Survey Feedback In survey feedback, each employee responds to a questionnaire intended to measure perceptions and attitudes (for example, satisfaction and supervisory style). Everyone involved, including the supervisor, receives the results of the survey. The aim of this approach is usually to change the behavior of supervisors by showing them how their subordinates viewed them. After the feedback has been provided, workshops may be conducted to evaluate results and suggest constructive changes.

Education Educational activities focus on classroom training. Although such activities can be used for technical or skill-related purposes, an OD educational activity typically focuses on "sensitivity skills"—that is, it teaches people to be more considerate and understanding of the people they work with. Participants often go through a series of experiential or role-playing exercises to understand better how others in the organization feel.

Intergroup Activities The focus of intergroup activities is on improving the relationships between two or more groups. We noted in Chapter 11 that, as group interdependence increases, so do coordination difficulties. Intergroup OD activities are designed to promote cooperation or resolve conflicts that arose as a result of interdependence. Experiential or role-playing activities are often used to achieve these goals.

Third-Party Peacemaking Another approach to OD is through third-party peacemaking, which is used most often when substantial conflict exists within the organization. Third-party peacemaking can be appropriate at the individual, group, or organization level. The third party, usually an OD consultant, uses a variety of mediation or negotiation techniques to resolve any problems or conflicts between individuals or groups.

Technostructural Activities Technostructural activities are concerned with the design of the organization, the technology of the organization, and the interrelationship of design and technology with people on the job. A structural change such as an increase in decentralization, a job design change such as an increase in the use of automation, and a technological change involving a modification in work flow all qualify as technostructural OD activities if their objective is to improve group and interpersonal relationships within the organization.

Process Consultation In process consultation, an OD consultant observes groups in the organization to develop an understanding of their communication patterns, decision-making and leadership processes, and methods of cooperation and conflict resolution. The consultant then provides feedback to the involved parties about the processes he or she has observed. The goal of this form of intervention is to improve the observed processes. A leader who is presented with feedback outlining deficiencies in his or her leadership style, for example, might be expected to change to overcome them.

Life and Career Planning Life and career planning helps employees formulate their personal goals and evaluate strategies for integrating their goals with the goals of the organization. Such activities might include specification of training needs and plotting a career map. General Electric has a reputation for doing an outstanding job in this area.

Coaching and Counseling Coaching and counseling provide nonevaluative feedback to individuals. The purpose is to help people both develop a better sense of how others see them and learn behaviors that will assist others in achieving their work-related goals. The focus is not on how the individual is performing today; instead, it is on how the person can perform better in the future.

Planning and Goal Setting More pragmatically oriented than many other interventions are activities designed to help managers improve their planning and goal setting. Emphasis still falls on the individual, however, because the intent is to help individuals and groups integrate themselves into the overall planning process. The OD consultant might use the same approach as in process consultation, but the focus is more technically oriented on the mechanics of planning and goal setting.

The Effectiveness of OD

Given the diversity of activities encompassed by OD, it is not surprising that managers report mixed results from various OD interventions. Organizations that actively practice some form of OD include American Airlines, Texas Instruments, Procter & Gamble, Polaroid, and B.F. Goodrich. Goodrich, for example, has trained sixty persons in OD processes and techniques. These trained experts have subsequently become internal OD consultants to assist other managers in applying the techniques.[35] Many other managers, in contrast, report that they have tried OD but discarded it.[36]

OD will probably remain an important part of management theory and practice. Of course, there are no guarantees when dealing with social systems such as

organizations, and the effectiveness of many OD techniques is difficult to evaluate. Because all organizations are open systems interacting with their environments, an improvement in an organization after an OD intervention may be attributable to the intervention, but it may also be attributable to changes in economic conditions, luck, or other factors.[37]

MANAGEMENT IMPLICATIONS Organization development is an important form of organization change that focuses on process issues. Managers should recognize the nature of OD before attempting to use any given OD technique. Top management support is necessary for OD to be successful, but managers need to realize also that no matter how well planned it is, OD may still not always work in every situation or for every organization.

■ Organizational Innovation

A final element of organization change that we address is innovation. **Innovation** is the managed effort of an organization to develop new products or services or new uses for existing products or services. Innovation is clearly important because, without new products or services, any organization will fall behind its competition.[38]

innovation The managed effort of an organization to develop new products or services or new uses for existing products or services

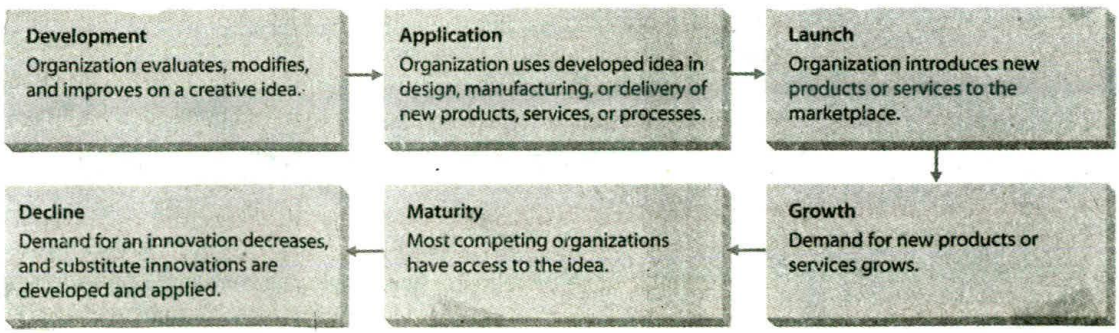
The Innovation Process

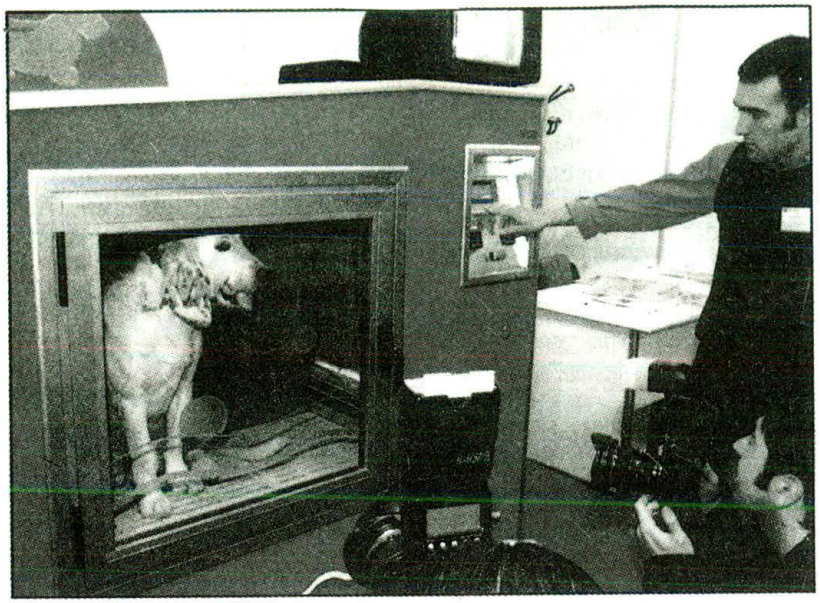
The organizational innovation process consists of developing, applying, launching, growing, and managing the maturity and decline of creative ideas.[39] This process is depicted in Figure 13.4.

Figure 13.4

The Innovation Process

Organizations actively seek to manage the innovation process. These steps illustrate the general life cycle that characterizes most innovations. Of course, as with creativity, the innovation process will suffer if it is approached too mechanically and rigidly.





Innovation comes in a variety of forms. Take this new product, for example—it's a low-flow washing machine that pet owners can use to bathe their dogs and cats. This represents an incremental innovation, since it is derived from existing washing machine technology. It is also a technical rather than a managerial innovation and a product rather than a process innovation.

Innovation Development Innovation development involves the evaluation, modification, and improvement of creative ideas. Innovation development can transform a product or service with only modest potential into a product or service with significant potential. Parker Brothers, for example, decided during innovation development not to market an indoor volleyball game but instead sell separately the appealing little foam ball designed for the game. The firm will never know how well the volleyball game would have sold, but the Nerf ball and numerous related products generated millions of dollars in revenues for Parker Brothers.

Innovation Application Innovation application is the stage in which an organization takes a developed idea and uses it in the design, manufacturing, or delivery of new products, services, or processes. At this point the innovation emerges from the laboratory and is transformed into tangible goods or services. One example of innovation application is the use of radar-based focusing systems in Polaroid's instant cameras. The idea of using radio waves to discover the location, speed, and direction of moving objects was first applied extensively by Allied forces during World War II. As radar technology developed during the following years, the electrical components needed became smaller and more streamlined. Researchers at Polaroid applied this well-developed technology in a new way.[40]

Application Launch Application launch is the stage in which an organization introduces new products or services to the marketplace. The important question is not "Does the innovation work?" but "Will customers want to purchase the innova-

tive product or service?" History is full of creative ideas that did not generate enough interest among customers to be successful. Some notable innovation failures include Sony's seat warmer, the Edsel automobile, and Polaroid's SX-70 instant camera (which cost $3 billion to develop but never sold more than one hundred thousand units in a year).[41] Thus, despite development and application, new products and services can still possibly fail at the launch phase.

Application Growth Once an innovation has been successfully launched, it then enters the stage of application growth. This period is one of high economic performance for an organization because demand for the product or service is often greater than the supply. Organizations that fail to anticipate this stage may unintentionally limit their growth, as Gillette did by not anticipating demand for its Mach III razor blades. At the same time, overestimating demand for a new product can be just as detrimental to performance. Unsold products can sit in warehouses for years.

Innovation Maturity After a period of growing demand, an innovative product or service often enters a period of maturity. Innovation maturity is the stage in which most organizations in an industry have access to an innovation and are applying it in approximately the same way. The technological application of an innovation during this stage of the innovation process can be very sophisticated. Because most firms have access to the innovation, either as a result of developing the innovation on their own or copying the innovation of others, however, it does not provide competitive advantage to any one of them. The time that elapses between innovation development and innovation maturity varies notably, depending on the particular product or service. Whenever an innovation involves the use of complex skills (such as a complicated manufacturing process or highly sophisticated teamwork), moving from the growth phase to the maturity phase will take longer. In addition, if the skills needed to implement these innovations are rare and difficult to imitate, then strategic imitation may be delayed and the organization may enjoy a period of sustained competitive advantage.

Innovation Decline Every successful innovation bears its own seeds of decline. Because an organization does not gain a competitive advantage from an innovation at maturity, it must encourage its creative scientists, engineers, and managers to begin looking for new innovations. This continued search for competitive advantage usually leads new products and services to move from the creative process through innovation maturity and finally to innovation decline. Innovation decline is the stage during which demand for an innovation decreases and substitute innovations are developed and applied.

Forms of Innovation

Each creative idea that an organization develops poses a different challenge for the innovation process. Innovations can be radical or incremental, technical or managerial, and product or process. *Management InfoTech* summarizes how Lucent is pursuing multiple forms of innovation simultaneously.

MANAGEMENT INFOTECH

LUCENT'S BELL LABS RESEARCHERS LOOK AHEAD

Bell Labs is Lucent's secret weapon for innovation. With annual sales topping $40 billion, Lucent—spun off from AT&T in 1996—is the world's leading manufacturer of sophisticated telecommunications equipment such as fiber-optic-network switches. With the spin-off, Lucent gained Bell Labs, the world-renowned research center responsible for such radical innovations as the transistor (which replaced vacuum tubes in midcentury electronic equipment) and cellular telephone technology. Now Bell Labs, which has nurtured eleven Nobel Prize winners and receives four patent approvals every business day, is continuing its quest under the Lucent banner for innovations of the future.

The largest group of researchers is investigating near-term product and process innovations designed to be marketable within five years. This approach is a break from the past, when Bell Labs researchers pursued promising lines of scientific inquiry without having to consider the potential commercial implications. Researchers at today's Bell Labs are much more geared toward studies with real-world applications. From such research has come PathStar, a Lucent product for allowing voice signals to be transmitted along Internet networks, and the Lambda-Router, a large-scale all-optical switching device.

Despite the emphasis on products and processes that have more immediate commercial application, about 20 percent of Bell Labs researchers doing basic research are looking for breakthroughs that might lead to radical innovations in the distant future. In addition, Bell Labs maintains a venture capital unit to fund internal research into diverse projects, such as fingerprint identification technology. Even as product-oriented incremental research and development continues in other parts of Lucent, Bell Labs keeps its researchers pointed toward the innovations of tomorrow—and beyond.

The world's smartest people still work here, and everyone is expected to change the landscape.

*—David Bishop, head of micromechanics research, Bell Labs**

References: Stephanie N. Mehta, "Lucent's New Spin," *Fortune*, August 14, 2000, pp. 30–31; Neil Weinberg and Nikhil Hutheesing, "Wired and Restless," *Forbes*, February 7, 2000, pp. 90–96; Nikhil Hutheesing, "Lucent's Labs," *Forbes*, February 7, 2000, p. 93 (*quote on p. 93).

radical innovation A new product, service, or technology developed by an organization that completely replaces the existing product, service, or technology in an industry

incremental innovation A new product, service, or technology that modifies an existing one

Radical Versus Incremental Innovations **Radical innovations** are new products, services, or technologies developed by an organization that completely replace the existing products, services, or technologies in an industry.[42] **Incremental innovations** are new products, services, or technologies that modify existing ones. Firms that implement radical innovations fundamentally shift the nature of competition and the interaction of firms within their environments. Firms that implement incremental innovations alter, but do not fundamentally change, competitive interaction in an industry.

Over the last several years, organizations have introduced many radical innovations. For example, compact disk technology has virtually replaced long-playing vinyl records in the recording industry, and high-definition television seems likely to replace regular television technology (both black-and-white and color) in the near future. Whereas radical innovations like these tend to be very visible and public, incremental innovations actually are more numerous. One example is Ford's sports utility vehicle, the Explorer. Although other companies had similar prod-

ucts, Ford combined more effectively the styling and engineering that resulted in increased demand for all sports utility vehicles.

Technical Versus Managerial Innovations **Technical innovations** are changes in the physical appearance or performance of a product or service, or the physical processes through which a product or service is manufactured. Many of the most important innovations over the last fifty years have been technical. For example, the serial replacement of the vacuum tube with the transistor, the transistor with the integrated circuit, and the integrated circuit with the microchip has greatly enhanced the power, ease of use, and speed of operation of a wide variety of electronic products. Not all innovations developed by organizations are technical, however. **Managerial innovations** are changes in the management process by which products and services are conceived, built, and delivered to customers. Managerial innovations do not necessarily affect the physical appearance or performance of products or services directly. In effect, reengineering represents a managerial innovation, as we discussed earlier.

technical innovation A change in the physical appearance or performance of a product or service, or the physical processes through which a product or service is manufactured

managerial innovation A change in the management process by which products and services are conceived, built, and delivered to customers

Product Versus Process Innovations Perhaps the two most important types of technical innovations are product innovations and process innovations. **Product innovations** are changes in the physical characteristics or performance of existing products or services or the creation of brand-new products or services. **Process innovations** are changes in the way products or services are manufactured, created, or distributed. Whereas managerial innovations generally affect the broader context of development, process innovations directly affect manufacturing.

The implementation of robotics, as we discussed earlier, is a process innovation. As Figure 13.5 shows, the effect of product and process innovations on economic return depends on the stage of the innovation process that a new product

product innovation A change in the physical characteristics or performance of existing products or services or the creation of brand-new products or services

process innovation A change in the way a product or service is manufactured, created, or distributed

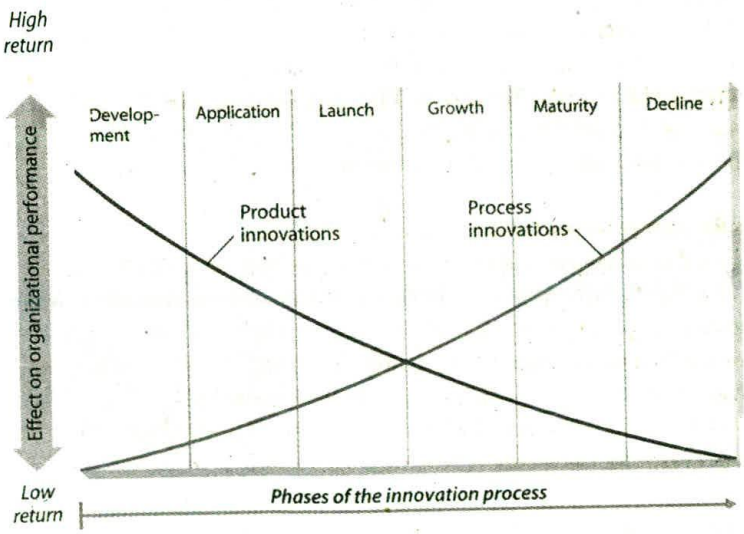


Figure 13.5

Effects of Product and Process Innovation on Economic Return

As the innovation process moves from development to decline, the economic return from product innovations gradually declines. In contrast, the economic return from process innovations increases during this same process.

or service occupies. At first, during development, application, and launch, the physical attributes and capabilities of an innovation most affect organizational performance. Thus, product innovations are particularly important during these beginning phases. Later, as an innovation enters the phases of growth, maturity, and decline, an organization's ability to develop process innovations such as fine-tuning manufacturing, increasing product quality, and improving product distribution becomes important to maintaining economic return.

Japanese organizations have often excelled at process innovation. The market for 35mm cameras was dominated by German and other European manufacturers when, in the early 1960s, Japanese organizations such as Canon and Nikon began making cameras. Some of these early Japanese products were not very successful, but these companies continued to invest in their process technology and eventually were able to increase quality and decrease manufacturing costs. Now these Japanese organizations dominate the worldwide market for 35mm cameras, and the German companies, because they were not able to maintain the same pace of process innovation, are struggling to maintain market share and profitability.

The Failure to Innovate

To remain competitive in today's economy, organizations must be innovative. And yet many organizations that should be innovative are not successful at bringing out new products or services, or do so only after innovations created by others are very mature. Organizations may fail to innovate for at least three reasons.

Lack of Resources Innovation is expensive in terms of dollars, time, and energy. If a firm does not have sufficient money to fund a program of innovation or does not currently employ the kinds of employees it needs to be innovative, it may lag behind in innovation. Even highly innovative organizations cannot become involved in every new product or service its employees think of. For example, numerous other commitments in the electronic instruments and computer industry forestalled Hewlett-Packard from investing in Steve Jobs and Steve Wozniak's original idea for a personal computer. With infinite resources of money, time, and technical and managerial expertise, Hewlett-Packard might have entered this market early. Because the firm did not have this flexibility, however, it had to make some difficult choices about which innovations to invest in.

Failure to Recognize Opportunities Because firms cannot pursue all innovations, they need to develop the capability to evaluate innovations carefully and to select the ones that hold the greatest potential. To obtain a competitive advantage, an organization usually must make investment decisions before the innovation process reaches the mature stage. The earlier the investment, however, the greater the risk. If organizations are not skilled at recognizing and evaluating opportunities, they may be overly cautious and fail to invest in innovations that turn out later to be successful for other firms.

Resistance to Change As we discussed earlier, many organizations tend to resist change. Innovation means giving up old products and old ways of doing things

in favor of new products and new ways of doing things. These kinds of changes can be personally difficult for managers and other members of an organization. Thus, resistance to change can slow the innovation process.

Promoting Innovation in Organizations

A wide variety of ideas for promoting innovation in organizations has been developed over the years. *The World of Management* describes how Microsoft is trying to stimulate innovation. Three specific ways for promoting innovation are through the reward system, the organizational culture, and a process called intrapreneurship.[43]

The Reward System A firm's reward system is the means by which it encourages and discourages certain behaviors by employees. Major components of the reward system include salaries, bonuses, and perquisites. Using the reward system

WORLD OF MANAGEMENT

NEW PRODUCTS LEAD MICROSOFT'S DRIVE INTO ASIA

Microsoft, the worldwide heavyweight in software products, wants to move beyond computers to become a powerful player in new arenas, including Internet access via mobile phones and televisions. Following through on this goal, the company has created a broadband strategy for high-speed delivery of telecommunications, information, and entertainment content to tech-hungry customers in China, Japan, and other Asian countries. Computers are not as prevalent as mobile phones and televisions in Asia, so Microsoft has had to develop an entire array of new products—and work hard to grab market leadership so it can have more influence in shaping the regional broadband industry.

Intrapreneurship is a way of life within Microsoft, where new ideas bubble up all the time from many organizational levels and niches. One of Microsoft's ideas for new broadband products in Asia came from an engineer in the company's Beijing research center. He saw a child trying to surf the Web with an English-language browser, which is cumbersome to use because of the effort in picking out the keyboard equivalents of thousands of Chinese characters.

Based on this observation, the engineer and his colleagues set out to create an easy-to-use Internet-access device, dubbed Venus, that attaches to televisions. Instead of typing in commands, Venus users move around the Web using arrow keys on a remote control. Consumers with keyboards can also use Venus for basic word processing, although games such as chess work well with only the remote. Many more Chinese families have televisions than computers, and Venus costs less than half the price of a locally produced computer, which broadens its appeal.

Venus plays into our strategic intent in Asia. And that is to promulgate broadband.

—Pieter Knook, Microsoft vice president for Asia*

Because Microsoft's management believes that local companies are best equipped to analyze and respond to local trends and needs, they have forged alliances with Asian giants such as China's Legend. They are also seeking out more companies to provide additional content suitable for access through Venus. The stakes are high, and Microsoft's hard-driving culture is a definite asset in its quest for market leadership. However, consumers are a vital and unknown part of the equation. Will they embrace these new products? Microsoft hopes the answer is yes.

Reference: Neel Chowdhury, "Gates & Co. Attack Asia," *Fortune*, April 17, 2000, pp. 197–208 (*quote on p. 198).

to promote innovation is a fairly mechanical but nevertheless effective management technique. The idea is to provide financial and nonfinancial rewards to people and groups that develop innovative ideas. Once the members of an organization understand that they will be rewarded for such activities, they are more likely to work creatively. With this end in mind, Monsanto Company gives a $50,000 award each year to the scientist or group of scientists that develops the biggest commercial breakthrough.

It is important for organizations to reward creative behavior, but it is vital to avoid punishing creativity when it does not result in highly successful innovations. It is the nature of the creative and innovative processes that many new product ideas will simply not work in the marketplace. Each process is fraught with too many uncertainties to generate positive results every time. An individual may have prepared herself to be creative, but an insight may not be forthcoming. Or managers may attempt to apply a developed innovation, only to recognize that it does not work. Indeed, some organizations operate according to the assumption that if all their innovative efforts succeed, then they are probably not taking enough risks in research and development. At 3M, nearly 60 percent of the creative ideas suggested each year do not succeed in the marketplace.

Managers need to be very careful in responding to innovative failure. If innovative failure is due to incompetence, systematic errors, or managerial sloppiness, then a firm should respond appropriately, for example, by withholding raises or reducing promotion opportunities. People who act in good faith to develop an innovation that simply does not work out, however, should not be punished for failure. If they are, they will probably not be creative in the future. A punitive reward system will discourage people from taking risks and therefore reduce the organization's ability to obtain competitive advantages.

Organizational Culture As we discussed in Chapter 3, an organization's culture is the set of values, beliefs, and symbols that help guide behavior. A strong, appropriately focused organizational culture can be used to support innovative activity. A well-managed culture can communicate a sense that innovation is valued and will be rewarded and that occasional failure in the pursuit of new ideas is not only acceptable but even expected. In addition to reward systems and intrapreneurial activities, firms such as 3M, Corning, Monsanto, Procter & Gamble, Texas Instruments, Johnson & Johnson, and Merck are all known to have strong, innovation-oriented cultures that value individual creativity, risk taking, and inventiveness.[44]

Intrapreneurship in Larger Organizations In recent years, many large businesses have realized that the entrepreneurial spirit that propelled their growth becomes stagnant after they transform themselves from a small but growing concern into a larger one. To help revitalize this spirit, some firms today encourage what they call intrapreneurship. **Intrapreneurs** are similar to entrepreneurs except that they develop a new business in the context of a large organization. There are three intrapreneurial roles in large organizations.[45] To use intrapreneurship successfully for encouraging creativity and innovation, the organization must find one or more individuals to perform these roles.

intrapreneurs Similar to entrepreneurs except that they develop a new business in the context of a large organization

The *inventor* is the person who actually conceives of and develops the new idea, product, or service by means of the creative process. Because the inventor may lack the expertise or motivation to oversee the transformation of the product or service from an idea into a marketable entity, however, a second role comes into play. A *product champion* is usually a middle manager who learns about the project and becomes committed to it. He or she helps overcome organizational resistance and convinces others to take the innovation seriously. The product champion may have only limited understanding of the technological aspects of the innovation. Nevertheless, product champions are skilled at knowing how the organization works, whose support is needed to push the project forward, and where to go to secure the resources necessary for successful development. A *sponsor* is a top-level manager who approves of and supports a project. This person may fight for the budget needed to develop an idea, overcome arguments against a project, and use organizational politics to ensure the project's survival. With a sponsor in place, the inventor's idea has a much better chance of being successfully developed.

Several firms have embraced intrapreneurship as a way to encourage creativity and innovation. Colgate-Palmolive has created a separate unit, Colgate Venture Company, staffed with intrapreneurs who develop new products. General Foods developed Culinova Group as a unit to which employees can take their ideas for possible development. S.C. Johnson & Sons established a $250,000 fund to support new product ideas, and Texas Instruments refuses to approve a new innovative project unless it has an acknowledged inventor, champion, and sponsor.

MANAGEMENT IMPLICATIONS Managers need to realize that innovation is the life-blood of most organizations. Innovation is a process that can be successfully managed, but this management requires managers to understand the various forms of innovation that can exist, why some organizations fail to innovate, and some of the specific activities for promoting innovation.

Summary of Key Points

Organization change is any substantive modification to some part of the organization. Change may be prompted by forces internal or external to the organization. In general, planned change is preferable to reactive change.

Managing the change process is very important. The Lewin model provides a general perspective on the steps involved in change, although a comprehensive model is usually more effective. People tend to resist change because of uncertainty, threatened self-interests, different perceptions, and feelings of loss. Participation, education and communication, facilitation, and force-field analysis are methods for overcoming this resistance.

Many different change techniques or interventions are used. The most common involve changing organizational structure and design, technology, and people. There are several specific areas of change within each of these broad categories. Reengineering is the radical redesign of all aspects of a business to achieve major

gains in cost, service, or time. It is occasionally needed to offset entropy. The basic steps are developing goals and strategies, conveying the involvement of top management, creating a sense of urgency, starting with a clean slate, and balancing top-down and bottom-up perspectives.

Organization development is concerned with changing attitudes, perceptions, behaviors, and expectations. Its effective use relies on an important set of assumptions. There are conflicting opinions about the effectiveness of several OD techniques.

The innovation process has six steps: development, application, launch, growth, maturity, and decline. Basic categories of innovation include radical, incremental, technical, managerial, product, and process. Despite the importance of innovation, many organizations fail to innovate because they lack the required creative individuals, or they are committed to too many other creative activities, fail to recognize opportunities, or resist the change that innovation requires. Organizations can use various tools for overcoming these problems, including the reward system, organizational culture, and intrapreneurship.

Discussion Questions

Questions for Review

1. What forces or kinds of events lead to organization change? Identify each force or event as a planned or reactive change.
2. How is each step in the process of organization change implemented? Are some of the steps likely to meet with more resistance than others? Why or why not?
3. What are the various areas of organization change? How are they similar and how do they differ?
4. What are the steps in the innovation process?

Questions for Analysis

5. Could reactive change of the type identified in question 1 have been planned for ahead of time? Why or why not? Should all organization change be planned? Why or why not?
6. A company has recently purchased equipment that, when installed, will do the work of one hundred employees. The workforce of the company is very concerned and is threatening to take some kind of action. If you were the human resource manager, what would you try to do to satisfy all parties concerned? Why?
7. Think of several relatively new products or services that you use. What form of innovation is represented by each?

Questions for Application

8. Some people resist change, while others welcome it enthusiastically. To deal with the first group, one needs to overcome resistance to change; to deal with the second, one needs to overcome resistance to stability. What advice can you give a manager facing the latter situation?
9. Can a change made in one area of an organization—in technology, for instance—not lead to change in other areas? Why or why not?
10. Find out more about one of the techniques for organization development presented in this chapter. What are the advantages and disadvantages of that technique relative to other techniques?

BUILDING EFFECTIVE *time-management* SKILLS

Exercise Overview

Time-management skills refer to the manager's ability to prioritize work, to work efficiently, and to delegate appropriately. Using time-management skills wisely can change how a person works.

Exercise Background

Almost every task we perform can theoretically be performed more efficiently. The next time you work on a particular task, such as studying for a test, writing a paper, or working on a project, note your work habits. You might even consider videotaping yourself while you work and reviewing the tape later.

Take special note of what you do that appears not to contribute to task performance. Examples might include going to the refrigerator and getting food, watching television while you are working, daydreaming, making an unnecessary telephone call, and so forth. Next, estimate how much of the total "work" time was actually spent on activities besides working.

Exercise Task

With the background information above as context, do the following:

1. Assess the extent to which each nonwork activity was wasted effort or contributed in some way to task performance.
2. Describe how the work might have been completed had you not done any of the nonwork activities.
3. Assuming that you might want to change your work habits and thus use your time more efficiently, describe a change approach to do just that.

BUILDING EFFECTIVE *interpersonal* SKILLS

Exercise Overview

A manager's interpersonal skills include her or his abilities to understand and to motivate individuals and groups. These abilities are especially important during a period of change. This exercise will help you understand how to apply your interpersonal skills to a change situation.

Exercise Background

Assume that you are the manager of a retail store in a local shopping mall. Your staff consists of seven full-time and ten part-time employees. The full-time employees have worked together as a team for three years. The part-timers are all local college students; while a couple of them have worked in the store for over a year, there tends to be a lot of turnover among this group.

Your boss, the regional manager, has just informed you that the national chain that owns your store is planning to open a second store in the same mall. She has also informed you that you must plan and implement the following changes:

1. You will serve as manager of both stores until the sales volume of the new store warrants its own full-time manager.
2. You are to designate one of the full-time employees in your present store as the assistant manager because you will be in the store less often now.
3. To have experienced workers in the new store, you are to select three of your current full-time workers to move to the new store; one of them should also be appointed as assistant manager of that store.
4. You can hire three new people to replace those transferred from your present store and three new people to work at the new store.

5. You can decide for yourself how to deploy your part-timers, but you will need a total of ten in the present store and eight at the new store.

You realize that many of your employees will be unhappy with these changes. They all know each other and work well together. However, the new store will be in a new expansion of the mall and will be a very nice place to work.

Exercise Task

With this background information in mind, do the following:

1. Determine the likely reasons for resistance to this change from your workers.
2. Determine how you will make decisions about promotions and transfers. Make whatever assumptions that you think are warranted.
3. Outline how you will inform your employees about what is going to happen.
4. An alternative strategy that could be adopted would involve keeping the existing staff intact and hiring new employees for the new store. Outline a persuasion strategy for trying to convince your boss that you want to implement this alternative strategy.

BUILDING EFFECTIVE *diagnostic* SKILLS

Exercise Overview

Diagnostic skills help a manager visualize the most appropriate response to a situation. These skills are especially important during a period of organization change.

Exercise Background

Assume that you are the general manager of a hotel located on a tropical island. The hotel is situated along a beautiful stretch of beach and is one of six large resorts in the area. The hotel is owned by a group of foreign investors and is one of the oldest on the island. For several years, the hotel has been operated as a franchise unit of a large international hotel chain, as are all of the others on the island.

For the last few years, the hotel's owners have been taking most of the profits earned for themselves and putting relatively little back into the hotel. They have also let you know that their business is not in good financial health; the money earned from your hotel is being used to offset losses they are incurring elsewhere. In contrast, most of the other hotels around you have recently been refurbished, and plans have just been announced to build two new ones in the near future.

A team of executives from franchise headquarters has just visited your hotel. They expressed considerable disappointment in the property. They feel that it has not kept pace with the other resorts on the island. They also informed you that if the property is not brought up to their standards, the franchise agreement, up for review in a year, will be revoked. You see this move as potentially disastrous because you would lose their "brand name," access to their reservation system, and so forth.

Sitting alone in your office, you have identified several alternatives that seem viable:

1. Try to convince the owners to remodel the hotel. You estimate that it will take $5 million to meet the franchisor's minimum standards and another $5 million to bring the hotel up to the standards of the top resort on the island.
2. Try to convince the franchisor to give you more time and more options for upgrading the facility.
3. Allow the franchise agreement to terminate and try to succeed as an independent hotel.

4. Assume that the hotel will fail and start looking for another job. You have a good reputation, although you might have to start at a lower level (i.e., as an assistant manager) with another firm.

Exercise Task

With the background information presented above, do the following:

1. Rank-order the four alternatives in terms of their potential success. Make assumptions as appropriate.
2. Identify other alternatives not noted above.
3. Can any alternatives be pursued simultaneously?
4. Develop an overall strategy for trying to save the hotel while also protecting your own interests.

CHAPTER CLOSING CASE

GENERAL ELECTRIC'S GLOBAL CULTURE OF CHANGE

Jack Welch, the long-time CEO of General Electric (GE), was well aware that large organizations can be unwieldy and complacent, even though they need to be streamlined and speedy. This predicament is why Welch and his successor worked out various strategies for managing change and innovation to take advantage of GE's size rather than being tripped up by it. Over the years, GE has been successfully transformed from a largely U.S.-focused company into a truly global, boundaryless business—one of the world's most profitable.

General Electric has long had a few joint ventures in Europe, but for years, its main international business activity was exporting. This situation changed in 1987, when the company exchanged its consumer electronics business for ownership of a French-based medical equipment manufacturer. Within two years, GE made another European acquisition, this time buying a Hungarian lighting manufacturer. Since then, GE has bought more than 133 European firms in industries ranging from insurance to energy equipment, swelling its European payroll to ninety thousand and generating more than $20 billion in annual revenue from the area.

After so many years, GE has worked out a pattern for effectively managing change during and after an acquisition. Even before management has finished negotiating a deal, experts from finance and human resources are drafting a plan to set change in motion immediately after the contract is signed. The first change that occurs after a deal has been completed is that GE's finance expert shows up and starts converting the firm's financial systems to the accepted GE format. GE also sends in an integration manager to supervise the unification effort, while the overall manager of the acquired company concentrates on operations and profitability issues.

Within one hundred days or less, GE has the basic change plan well underway, covering activities ranging from cost-cutting measures to plans for switching from matrix or geographical departmentalization (where it exists) to a functional organization. By this time, GE's experts will have identified and taken steps to remove people who seem to be blocking change within the acquired firm. They will also have identified which personnel should be retained; these people are offered key roles within the integrated organization.

Next, GE introduces its special brand of management tools, including highly effective quality management programs and other best-practices tools that have proven to boost profit margins significantly in other acquired firms. One tool, known as Work-Out, encourages employees to get together and think of a plan for solving any problem in the business, then to present it to management for immediate approval or rejection. This seemingly informal, no-nonsense team tool brings about needed change more quickly and with more grass-roots support than the traditional method of passing the problem up and down the hierarchy in the course of debating and making a decision. In fact,

teams are commonplace in every GE unit around the world, moving information through the organization at lightning speed and allowing employees to get the job done without intense management supervision.

The Internet is a powerful catalyst for overall change within GE because top management sees the Web as redefining relationships with customers, employees, and suppliers. To get the corporation ready to take advantage of emerging web-related opportunities, management called for a three-month Work-Out procedure held entirely on-line. Participants shared ideas for breaking down bureaucratic blocks and moving more quickly to implement e-commerce strategies that represent GE's future. GE has also invited web-savvy executives such as Sun Microsystem's Scott McNealy to join its board of directors and prod management about key technology issues. GE knows that with the advent of the Internet, no country is isolated, so it plans to continue its winning ways by bringing systematic change to every unit around the world.

Case Questions

1. Does Work-Out represent planned or reactive change? Explain your answer.
2. Identify some of the most important internal and external forces for change affecting GE.
3. In what areas does GE intervene to make change after an acquisition? Why does GE concentrate on these areas?

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CHAPTER 14

Managing Human Resources in Organizations

OPENING INCIDENT

SAS Institute Inc., based in rural North Carolina, is perhaps the least-known major software company in the world today. SAS creates software that helps big companies better manage and analyze especially large quantities of data and information. For example, Marriott Hotels uses SAS software to manage its frequent-visitor program; the U.S. government uses SAS software to compute the consumer price index and other complex measures; and pharmaceutical companies like Pfizer and Merck use SAS software to compare near-infinite combinations of elements as they develop new drugs.

Because SAS is a private firm, the general public knows little about its revenues and profits. A few details are illuminating, however. The firm's founder and leader, Jim Goodnight, with a net worth of $3 billion, is listed by *Forbes* as the forty-third richest individual in the United States. (This rank is based on his two-thirds ownership of the company; the other one-third is owned by senior vice president John Sall, who still spends much of his time writing code.) SAS also hires several hundred new employees each year, a clear indicator that the firm is consistently growing at a strong pace. And the firm also continues to invest in impressive—and clearly expensive—buildings and related facilities.

But SAS is even more impressive under the surface. For example, even though it pays salaries that are merely competitive for the industry, the firm's employees are almost fanatical in their devotion to SAS in general and to Jim Goodnight in particular. As a result, annual turnover at SAS is less than 4 percent, far below that of other firms in the industry, and employees are constantly coming up with new and better ways of doing things for the company. And both insiders and outside experts agree that the key to all this is how Goodnight treats his employees.

For example, all SAS employees get unlimited sick days, and they can use sick days to stay home and care for sick family members. To keep work from interfering with employees' families, SAS operates the largest child-care facility in the state. And company cafeterias have baby seats and high chairs so employees can eat with their children. SAS has also adopted a seven-hour workday; the company switchboard shuts down at 5:00 each day, and the front

"Jim's idea is that if you hire adults and treat them like adults, then they'll behave like adults."

—David Russo, head of human resources at SAS)

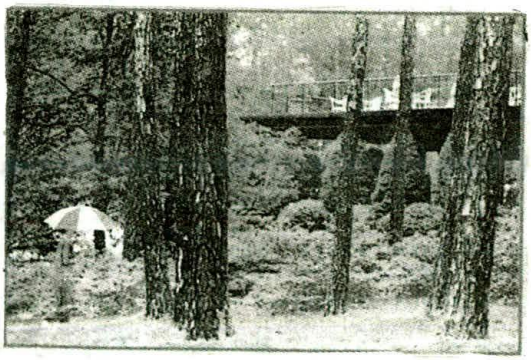
LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- **Describe the environmental context of human resource management, including its strategic importance and its relationship with legal and social factors.**
- **Discuss how organizations attract human resources, including human resource planning, recruiting, and selecting.**
- **Describe how organizations develop human resources, including training and development, performance appraisal, and performance feedback.**
- **Discuss how organizations maintain human resources, including the determination of compensation and benefits and career planning.**
- **Discuss labor relations, including how employees form unions and the mechanics of collective bargaining.**
- **Describe the issues associated with managing knowledge, contingent, and temporary workers.**

gate is locked at 6:00. Unlike many high-tech firms in other parts of the country, Goodnight doesn't want his employees to work late or to come back to the office on the weekend.

If they want, however, they can come in early—to work out in a lavish 36,000-square-foot gym and health center. The center also offers massages several times a week, as well as classes in golf, tennis, tai chi, and African dance. And center staff even launder dirty workout clothes at the end of the day and return them clean and neatly folded. SAS provides unlimited free soda, coffee, tea, and juice, and has live piano music in the cafeteria. The company shuts down for the week between Christmas and New Year's Day each year, but everyone still gets paid. An on-site health clinic has two full-time physicians and six nurses; health insurance is free for everyone. And all this comes from Jim Goodnight's most fundamental philosophy: if you treat people with dignity and respect and reward them for their contributions, they will treat you the same in return. And when this relationship can be established and maintained within the context of a business, everyone can win.[1]



CHAPTER OUTLINE

- **The Environmental Context of Human Resource Management**
  - The Strategic Importance of HRM
  - The Legal Environment of HRM
  - Change and HRM
- **Attracting Human Resources**
  - Human Resource Planning
  - Recruiting Human Resources
  - Selecting Human Resources
- **Developing Human Resources**
  - Training and Development
  - Performance Appraisal
  - Performance Feedback
- **Maintaining Human Resources**
  - Determining Compensation
  - Determining Benefits
  - Career Planning
- **Managing Labor Relations**
  - How Employees Form Unions
  - Collective Bargaining
- **New Challenges in the Changing Workplace**
  - Managing Knowledge Workers
  - Contingent and Temporary Workers

SAS is one of the most successful businesses around these days. And human resources are clearly an integral part of its success. From its earliest days, Jim Goodnight made a strategic commitment to identify, hire, and retain the best and brightest people available. The firm has been able to maintain this strategy and today is still the employer of choice for many talented people in a highly volatile industry.

This chapter is about how organizations manage the people that comprise them. This set of processes is called human resource management, or HRM. We start by describing the environmental context of HRM. We then discuss how organizations attract human resources. Next we describe how organizations seek to develop the capacities of their human resources. We also examine how high-quality human resources are maintained by organizations. We conclude by discussing labor relations.

The Environmental Context of Human Resource Management

human resource management (HRM) The set of organizational activities directed at attracting, developing, and maintaining an effective workforce

Human resource management (HRM) is the set of organizational activities directed at attracting, developing, and maintaining an effective workforce.[2] Human resource management takes place within a complex and ever-changing environmental context. Three particularly vital components of this context are HRM's strategic importance and the legal and social environment of HRM.

The Strategic Importance of HRM

Human resources are critical for effective organizational functioning. HRM (or personnel, as it is sometimes called) was once relegated to second-class status in many organizations, but its importance has grown dramatically in the last two decades. Its new importance stems from increased legal complexities, the recognition that human resources are a valuable means for improving productivity, and the awareness today of the costs associated with poor human resource management.[3]

Indeed, managers now realize that the effectiveness of their HR function has a substantial impact on the bottom-line performance of the firm. Poor human resource planning can result in spurts of hiring followed by layoffs—costly in terms of unemployment compensation payments, training expenses, and morale. Haphazard compensation systems do not attract, keep, and motivate good employees, and outmoded recruitment practices can expose the firm to expensive and embarrassing discrimination lawsuits. Consequently, the chief human resource executive of most large businesses is a vice president directly accountable to the CEO, and many firms are developing strategic HR plans and integrating those plans with other strategic planning activities.[4]

Even organizations with as few as two hundred employees usually have a human resource manager and a human resource department charged with overseeing these activities. Responsibility for HR activities, however, is shared between the HR department and line managers. The HR department may recruit and initially

screen candidates, but the final selection is usually made by managers in the department where the new employee will work. Similarly, although the HR department may establish performance appraisal policies and procedures, the actual evaluating and coaching of employees is done by their immediate superiors.

The Legal Environment of HRM

A number of laws regulate various aspects of employee-employer relations, especially in the areas of equal employment opportunity, compensation and benefits, labor relations, and occupational safety and health. Several major laws are summarized in Table 14.1.

Table 14.1

The Legal Environment of Human Resource Management

As much as any area of management, HRM is subject to wide-ranging laws and court decisions. These laws and decisions affect the human resource function in many areas. For example, AT&T was once fined several million dollars for violating Title VII of the Civil Rights Act of 1964.

Equal Employment Opportunity

Title VII of the Civil Rights Act of 1964 (as amended by the *Equal Employment Opportunity Act of 1972*): forbids discrimination in all areas of the employment relationship

Age Discrimination in Employment Act: outlaws discrimination against people older than forty years

Various executive orders, especially *Executive Order 11246* in 1965: requires employers with government contracts to engage in affirmative action

Pregnancy Discrimination Act: specifically outlaws discrimination on the basis of pregnancy

Vietnam Era Veterans Readjustment Assistance Act: extends affirmative action mandate to military veterans who served during the Vietnam War

Americans with Disabilities Act: specifically outlaws discrimination against disabled persons

Civil Rights Act of 1991: makes it easier for employees to sue an organization for discrimination but limits punitive damage awards if they win

Compensation and Benefits

Fair Labor Standards Act: establishes minimum wage and mandated overtime pay for work in excess of forty hours per week

Equal Pay Act: requires that men and women be paid the same amount for doing the same jobs

Employee Retirement Income Security Act: regulates how organizations manage their pension funds

Family and Medical Leave Act of 1993: requires employers to provide up to twelve weeks of unpaid leave for family and medical emergencies

Labor Relations

National Labor Relations Act: spells out procedures by which employees can establish labor unions and requires organizations to bargain collectively with legally formed unions; also known as the *Wagner Act*

Labor-Management Relations Act: limits union power and specifies management rights during a union-organizing campaign; also known as the *Taft-Hartley Act*

Health and Safety

Occupational Safety and Health Act: mandates the provision of safe working conditions

Title VII of the Civil Rights Act of 1964 Forbids discrimination on the basis of gender, race, color, religion, or national origin in all areas of the employment relationship

Equal Employment Opportunity **Title VII of the Civil Rights Act of 1964** forbids discrimination on the basis of gender, race, skin color, religion, or national origin in all areas of the employment relationship. The intent of Title VII is to ensure that employment decisions are made on the basis of an individual's qualifications rather than personal biases. The law has reduced direct forms of discrimination (refusing to promote blacks into management, failing to hire men as flight attendants, refusing to hire women as construction workers) as well as indirect forms of discrimination (using employment tests that whites pass at a higher rate than blacks).

adverse impact When minority group members pass a selection standard at a rate less than 80 percent of the rate of majority group members

Employment requirements such as test scores or other qualifications are legally defined as having an **adverse impact** on minorities and women when such individuals meet or pass the requirement at a rate less than 80 percent of the rate of majority group members. Criteria that have an adverse impact on protected groups can be used only when there is solid evidence that they effectively identify individuals who are better able than others to do the job. The **Equal Employment Opportunity Commission** is charged with enforcing Title VII as well as several other employment-related laws.

Equal Employment Opportunity Commission Charged with enforcing Title VII of the Civil Rights Act of 1964, as well as several other employment-related laws

Age Discrimination in Employment Act Outlaws discrimination against people older than forty years; passed in 1967, amended in 1978 and 1986

The **Age Discrimination in Employment Act**, passed in 1967, amended in 1978, and amended again in 1986, is an attempt to prevent organizations from discriminating against older workers. In its current form, it outlaws discrimination against people older than forty years. Both the Age Discrimination Act and Title VII require passive nondiscrimination, or equal employment opportunity. Employers are not required to seek out and hire minorities but they must treat fairly all who apply.

affirmative action Intentionally seeking and hiring employees from groups that are underrepresented in the organization

Several executive orders require that employers holding government contracts engage in **affirmative action**—intentionally seeking and hiring employees from groups that are underrepresented in the organization. These organizations must have a written affirmative action plan that spells out employment goals for underutilized groups and how those goals will be met. These employers are also required to act affirmatively in hiring Vietnam-era veterans and qualified disabled individuals.

Americans with Disabilities Act Forbids discrimination on the basis of disabilities and requires employers to provide reasonable accommodations for disabled employees

In 1990, Congress passed the **Americans with Disabilities Act,** which forbids discrimination on the basis of disabilities and requires employers to provide reasonable accommodations for disabled employees. More recently, the **Civil Rights Act of 1991** amended the original Civil Rights Act, as well as other related laws, by both making it easier to bring discrimination lawsuits (which partially explains the aforementioned backlog of cases) while simultaneously limiting the amount of punitive damages that can be awarded in those lawsuits.

Civil Rights Act of 1991 Amends the original Civil Rights Act, making it easier to bring discrimination lawsuits while also limiting punitive damages that can be awarded in those lawsuits

Compensation and Benefits Laws also regulate compensation and benefits. The **Fair Labor Standards Act**, passed in 1938 and amended frequently since then, sets a minimum wage and requires the payment of overtime rates for work in excess of forty hours per week. Salaried professional, executive, and administrative employees are exempt from the minimum hourly wage and overtime provisions. The **Equal Pay Act of 1963** requires that men and women be paid the same amount for doing the same jobs. Attempts to circumvent the law by having different job titles and pay rates for men and women who perform the same work are also illegal. Basing an employee's pay on seniority or performance is legal, how-

Fair Labor Standards Act Sets a minimum wage and requires overtime pay for work in excess of forty hours per week; passed in 1938 and amended frequently since then

ever, even if it means that a man and a woman are paid different amounts for doing the same job.

The provision of benefits is also regulated in some ways by state and federal laws. Certain benefits are mandatory—for example, worker's compensation insurance for employees who are injured on the job. Employers who provide a pension plan for their employees are regulated by the **Employee Retirement Income Security Act of 1974 (ERISA)**. The purpose of this act is to help ensure the financial security of pension funds by regulating how they can be invested. The **Family and Medical Leave Act of 1993** requires employers to provide up to twelve weeks of unpaid leave for family and medical emergencies.

Equal Pay Act of 1963 Requires that men and women be paid the same amount for doing the same jobs

Employee Retirement Income Security Act of 1974 (ERISA) Sets standards for pension plan management and provides federal insurance if pension funds go bankrupt

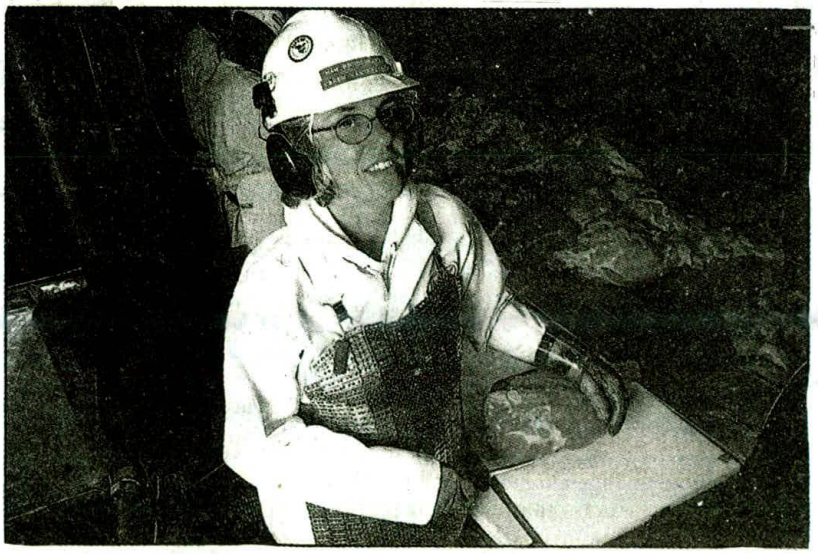
Family and Medical Leave Act of 1993 Requires employers to provide up to twelve weeks of unpaid leave for family and medical emergencies

Labor Relations Union activities and management's behavior toward unions constitute another heavily regulated area. The **National Labor Relations Act** (also known as the Wagner Act), passed in 1935, sets up a procedure for employees of a firm to vote whether to have a union. If they vote for a union, management is required to bargain collectively with the union. The **National Labor Relations Board** was established by the Wagner Act to enforce its provisions. Following a series of severe strikes in 1946, the **Labor-Management Relations Act** (also known as the *Taft-Hartley Act*) was passed in 1947 to limit union power. The law increases management's rights during an organizing campaign. The Taft-Hartley Act also contains the *National Emergency Strike* provision, which allows the president of the United States to prevent or end a strike that endangers national security. Taken together, those laws balance union and management power. Employees can be represented by a legally created and managed union, but the business can make non-employee-related business decisions without interference.

National Labor Relations Act Passed in 1935 to set up procedures for employees to vote whether to have a union; also known as the Wagner Act

National Labor Relations Board Established by the Wagner Act to enforce its provisions

Labor-Management Relations Act Passed in 1947 to limit union power; also known as the Taft-Hartley Act



Employee safety and health have become major issues for organizations and their human resource managers. For example, Karen Vanderstoep's job at Hormel requires that she lift heavy pieces of meat and operate dangerous equipment. Note that she is wearing a hard hat, ear protectors, and a heavy apron and gloves. She also stands on a springy rubber mat to reduce fatigue and strain on her knees. These and myriad other improvements have dramatically reduced injuries at the Hormel facility.

Occupational Safety and Health Act of 1970 (OSHA) Directly mandates the provision of safe working conditions

Health and Safety The **Occupational Safety and Health Act of 1970 (OSHA)** directly mandates the provision of safe working conditions. It requires that employers (1) provide a place of employment that is free from hazards that may cause death or serious physical harm and (2) obey the safety and health standards established by the Department of Labor. Safety standards are intended to prevent accidents, whereas occupational health standards are concerned with preventing occupational disease. For example, standards limit the concentration of cotton dust in the air because this contaminant has been associated with lung disease in textile workers. The standards are enforced by OSHA inspections, which are conducted when an employee files a complaint of unsafe conditions or when a serious accident occurs. Spot inspections of plants in especially hazardous industries such as mining and chemicals are also made. Employers who fail to meet OSHA standards may be fined.

Emerging Legal Issues Several other areas of legal concern have emerged during the past few years. One is sexual harassment. Although sexual harassment is forbidden under Title VII, it has received additional attention in the courts recently as more and more victims have decided to confront the problem publicly. Another emerging human resource management issue is alcohol and drug abuse. Both alcoholism and drug dependence are major problems today. Recent court rulings have tended to define alcoholics and drug addicts as disabled, protecting them under the same laws that protect other disabled people. Finally, AIDS has emerged as an important legal issue as well. AIDS victims too are most often protected under various laws protecting the disabled.

Change and HRM

Beyond the objective legal context of HRM, various social changes are also affecting how organizations interact with their employees. First, many organizations are using more and more temporary workers today. This trend, discussed more fully later in the chapter, allows organizations to add workers as necessary without the risk that they may have to eliminate their jobs in the future.

Second, dual-career families are much more common today than just a few years ago. Organizations are finding that they must make accommodations for employees who are dual-career partners. These accommodations may include delaying transfers, offering employment to the spouses of current employees to retain them, and providing more flexible work schedules and benefits packages. A related aspect of social change and HRM, workforce diversity, was covered more fully in Chapter 6.

employment-at-will A traditional view of the workplace in which organizations can fire their employees for any reason; recent court judgments are limiting employment-at-will

Employment-at-will is also becoming an important issue. Although employment-at-will has legal implications, its emergence as an issue is socially driven. **Employment-at-will** is a traditional view of the workplace in which organizations can fire an employee for any reason. Increasingly, however, people are arguing that organizations should be able to fire only people who are poor performers or who violate rules and, conversely, not be able to fire people who report safety violations to OSHA or who refuse to perform unethical activities.

Several court cases in recent years have upheld this latter emerging view and have limited many organizations' ability to terminate employees to those cases where there is clear and just cause or as part of an organizationwide cutback.

MANAGEMENT IMPLICATIONS Managers need to understand and appreciate the value of human resources as perhaps the most important determinant of an organization's success. Taking a strategic orientation to human resource management is also becoming more popular. In addition, managers must be familiar with the various laws and related regulations that govern human resource practices. The role of change and HRM must also be carefully acknowledged.

■ Attracting Human Resources

With an understanding of the environmental context of human resource management as a foundation, we are now ready to address its first substantive concern—attracting qualified people who are interested in employment with the organization.

Human Resource Planning

The starting point in attracting qualified human resources is planning. HR planning, in turn, involves job analysis and forecasting the demand and supply of labor.

Job Analysis **Job analysis** is a systematic analysis of jobs within an organization. A job analysis is made up of two parts. The *job description* lists the duties of a job; the job's working conditions; and the tools, materials, and equipment used to perform it. The *job specification* lists the skills, abilities, and other credentials needed to do the job. Job analysis information is used in many human resource activities. For instance, knowing about job content and job requirements is necessary to develop appropriate selection methods and job-relevant performance appraisal systems and to set equitable compensation rates.

job analysis A systematic analysis of jobs within an organization

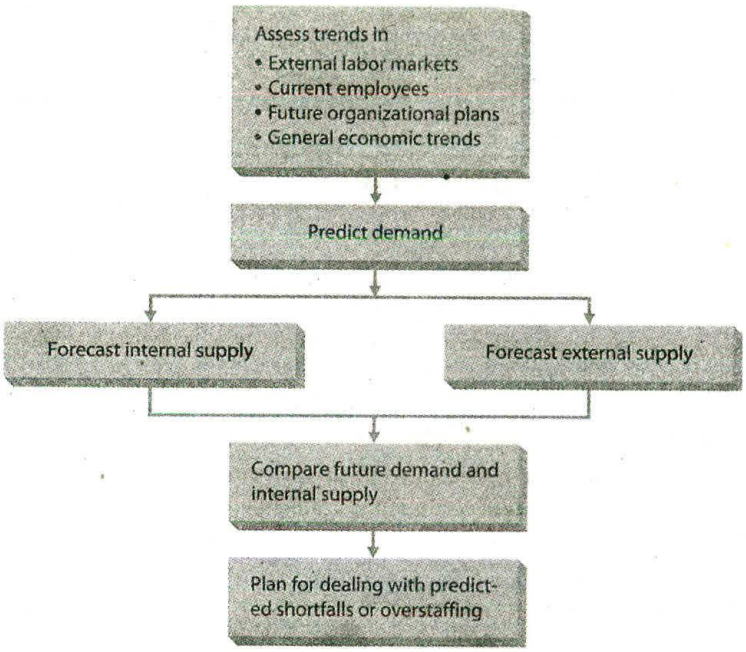
Forecasting Human Resource Demand and Supply After managers fully understand the jobs to be performed within the organization, they can start planning for the organization's future human resource needs. Figure 14.1 summarizes the steps most often followed. The manager starts by assessing trends in past human resources usage, future organizational plans, and general economic trends. A good sales forecast is often the foundation, especially for smaller organizations. Historical ratios can then be used to predict demand for employees such as operating employees and sales representatives. Of course, large organizations use much more complicated models to predict their future human resource needs.

Forecasting the supply of labor is really two tasks: forecasting the internal supply (the number and type of employees who will be in the firm at some future date) and forecasting the external supply (the number and type of people who will

Figure 14.1

Human Resource Planning

Attracting human resources cannot be left to chance if an organization expects to function at peak efficiency. Human resource planning involves assessing trends, forecasting supply and demand of labor, and then developing appropriate strategies for addressing any differences.



be available for hiring in the labor market at large). The simplest approach merely adjusts present staffing levels for anticipated turnover and promotions. Again, though, large organizations use extremely sophisticated models to make these forecasts.

Union Oil Company of California, for example, has a complex forecasting system for keeping track of the present and future distributions of professionals and managers. The Union Oil system can spot areas where there will eventually be too many qualified professionals competing for too few promotions or, conversely, too few competent people available to fill important positions.[5]

replacement chart Lists each important managerial position in the organization, who occupies it, how long he or she will probably stay in it before moving on, and who is or will be a qualified replacement

At higher levels of the organization, managers plan for specific people and positions. The technique most commonly used is the **replacement chart**, which lists each important managerial position, who occupies it, how long he or she will probably stay in it before moving on, and who (by name) is now qualified or soon will be qualified to move into the position. This technique allows ample time to plan developmental experiences for persons identified as potential successors to critical man-

agerial jobs. Charles Knight, CEO of Emerson Electric Co., has an entire room dedicated to posting the credentials of his top seven hundred executives.[6]

To facilitate both planning and identifying persons for current transfer or promotion, some organizations also have an **employee information system**, or **skills inventory**. Such systems are usually computerized and contain information on each employee's education, skills, work experience, and career aspirations. Such a system can quickly locate all the employees in the organization who are qualified to fill a position requiring, for instance, a degree in chemical engineering, three years of experience in an oil refinery, and fluency in Spanish.

employee information system (skills inventory) Contains information on each employee's education, skills, work experience, and career aspirations; usually computerized

Forecasting the external supply of labor is a different problem altogether. How does a manager, for example, predict how many electrical engineers will be seeking work in Georgia three years from now? To get an idea of the future availability of labor, planners must rely on information from outside sources such as state employment commissions, government reports, and figures supplied by colleges on the number of students in major fields.

recruiting The process of attracting qualified persons to apply for jobs that are open

Matching Human Resource Supply and Demand

After comparing future demand and internal supply, managers can make plans to manage predicted shortfalls or overstaffing. If a shortfall is predicted, new employees can be hired, present employees can be retrained and transferred into the understaffed area, individuals approaching retirement can be convinced to stay on, or labor-saving or productivity-enhancing systems can be installed.

If the organization needs to hire, the external labor supply forecast helps managers plan how to recruit, based on whether the type of person needed is readily available or scarce in the labor market. As we noted earlier, the trend in hiring temporary workers also helps managers in staffing by affording them extra flex ibility. If overstaffing is expected to be a problem, the main options are transferring the extra employees, not replacing individuals who quit, encouraging early retirement, and laying people off.



Bertha Freeman was Detroit's first black female tool-and-die maker. A die is a form carved out of a block of steel to create a reverse version of, say, a car door. It's then installed in a machine that stamps out thousands of car doors. Ms. Freeman got her opportunity when General Motors first opened its apprenticeship program to women in the early 1970s. At the time, GM was doing a lot of internal recruiting; Ms. Freeman was working on one of the company's assembly lines, but was looking for better opportunities. She took the required tests and was the only woman to pass. After a rigorous four-year apprenticeship, she emerged as one of the company's top tool-and-die makers. Today she is with Focus: HOPE, a private nonprofit organization that trains mostly black inner-city kids to become precision machinists.

Recruiting Human Resources

Once an organization has an idea of its future human resource needs, the next phase is usually recruiting new employees. **Recruiting** is the process of attracting qualified persons to apply for the jobs that are open. Where do recruits come from? Some recruits are found internally; others come from outside the organization. *Management InfoTech* describes how some firms are using the Internet to recruit new employees.

MANAGEMENT INFOTECH

Attracting Applicants with High-Tech Tools

DVCi Technologies, which specializes in e-commerce, is one of a growing number of organizations boosting their recruiting efforts by giving job-seekers a high-tech, behind-the-scenes view of the work environment. DVCi aims cameras at employees working in its New York office and posts the images on its web site so potential applicants can get a sense of the workplace and the daily rhythm of activities. This virtual, realistic job preview sets DVCi apart from other Internet firms that are recruiting for similar jobs, and it is a proven recruiting tool: Marta Sant, now senior art director, applied for the job after she spent time looking at the images on the DVCi site.

The U.S. Army takes another approach to on-line recruiting by offering a virtual visit to a typical barracks facility. Potential enlistees can click their way through views of the sleeping quarters, laundry rooms, and other areas. They can also use on-line chat mode to converse with army recruiters or click to download a video clip of a tank. In this way, military recruiters can attract web-savvy recruits who might otherwise have little knowledge of army living arrangements and career opportunities.

Telecommunications giant Sprint invites e-mail inquiries about job openings from people who browse its web site. If no appropriate positions are open, the company retains the inquiries and, through an automated system, e-mails the applicants when suitable jobs become available. Sprint's human resources experts see e-mail as a good way to build relationships with job-seekers and to encourage them to keep the company in mind as a potential employer.

Cisco Systems, which makes systems that power Internet activities, also uses e-mail in its recruiting process. Knowing that applicants are keenly interested in an insider's view of the company, Cisco offers to have employees answer questions by e-mail. This program, dubbed "Make Friends at Cisco," helps job-seekers learn more about actual working conditions from the people who are in the best position to know. At the same time, it ensures that newly hired employees know at least one colleague when they join Cisco.

Every company is looking at ways to maximize the Internet as a recruiting tool.

*—Sonja Ambur, national staffing director for Sprint**

Reference: Stephanie Armour, "Companies Put Web to Work as Recruiter," *USA Today*, January 25, 2000, p. 1B (*quote on p. 1B).

internal recruiting Considering present employees as candidates for openings

Internal recruiting means considering present employees as candidates for openings. Promotion from within can help build morale and keep high-quality employees from leaving the firm. In unionized firms, the procedures for notifying employees of internal job change opportunities are usually spelled out in the union contract. For higher-level positions, a skills inventory system may be used to identify internal candidates, or managers may be asked to recommend individuals who should be considered. One disadvantage of internal recruiting is its "ripple effect." When an employee moves to a different job, someone else must be found to take his or her old job. In one organization, 454 job movements were necessary as a result of filling 195 initial openings!

external recruiting Attracting persons outside the organization to apply for jobs

External recruiting involves attracting persons outside the organization to apply for jobs. External recruiting methods include advertising, campus interviews, employment agencies or executive search firms, union hiring halls, referrals by present employees, and hiring "walk-ins" or "gate-hires" (people who show up

without being solicited). Of course, a manager must select the most appropriate methods, using the state employment service to find maintenance workers but not a nuclear physicist, for example. Private employment agencies can be a good source of clerical and technical employees, and executive search firms specialize in locating top-management talent. Newspaper ads are often used because they reach a wide audience and thus allow minorities "equal opportunity" to find out about and apply for job openings.

The organization must also keep in mind that recruiting decisions often go both ways—the organization is recruiting an employee, but the prospective employee is also selecting a job.[7] Indeed, recruiters have faced a difficult job in recent years as unemployment has continued to drop. By early two thousand unemployment had dropped to a twenty-five-year low of 4.3 percent. As a result, recruiters at firms such as Sprint, PeopleSoft, and Cognex had started to stress how much "fun" it is to work for them, reinforcing this message with ice cream socials, karaoke contests, softball leagues, and free movie nights.[8] Thus, the organization wants to put its best foot forward, treat all applicants with dignity, and strive for a good person-job fit. Recent estimates suggest that hiring the "wrong" operating employee—one who flops and either quits or must be fired—generally costs the organization at least $5,000 in lost productivity and training. Hiring the wrong manager can cost the organization far more.[9]

One generally successful method for facilitating a good person-job fit is through the so-called **realistic job preview (RJP)**. As the term suggests, the RJP involves providing the applicant with a real picture of what performing the job that the organization is trying to fill would be like.[10]

realistic job preview (RJP) Provides the applicant with a real picture of what performing the job that the organization is trying to fill would be like

Selecting Human Resources

Once the recruiting process has attracted a pool of applicants, the next step is to select whom to hire. The intent of the selection process is to gather from applicants information that will predict their job success and then to hire the candidates likely to be most successful. Of course, the organization can gather information only about factors that are predictive of future performance. The process of determining the predictive value of information is called **validation**.

validation Determining the extent to which a selection device is predictive of future job performance

Two basic approaches to validation are predictive validation and content validation. *Predictive validation* involves collecting the scores of employees or applicants on the device to be validated and correlating their scores with actual job performance. A significant correlation means that the selection device is a valid predictor of job performance. *Content validation* uses logic and job analysis data to establish that the selection device measures the exact skills needed for successful job performance. The most critical part of content validation is a careful job analysis showing exactly what duties are to be performed. The test is then developed to measure the applicant's ability to perform those duties.

Application Blanks The first step in selection usually is asking the candidate to fill out an application blank. Application blanks are an efficient method of gathering information about the applicant's previous work history, educational back-

ground, and other job-related demographic data. They should not contain questions about areas unrelated to the job such as gender, religion, or national origin. Application blank data are generally used informally to decide whether a candidate merits further evaluation, and interviewers use application blanks to familiarize themselves with candidates before interviewing them.

Tests Tests of ability, skill, aptitude, or knowledge that is relevant to the particular job are usually the best predictors of job success, although tests of general intelligence or personality are occasionally useful as well. In addition to being validated, tests should be administered and scored consistently. All candidates should be given the same directions, should be allowed the same amount of time, and should experience the same testing environment (temperature, lighting, distractions).[11]

Interviews Although a popular selection device, an interview is sometimes a poor predictor of job success. For example, biases inherent in the way people perceive and judge others on first meeting affect subsequent evaluations by the interviewer. Interview validity can be improved by training interviewers to be aware of potential biases and by increasing the structure of the interview. In a structured interview, questions are written in advance and all interviewers follow the same question list with each candidate they interview. This procedure introduces consistency into the interview procedure and allows the organization to validate the content of the questions to be asked.[12]

For interviewing managerial or professional candidates, a somewhat less structured approach can be used. Question areas and information-gathering objectives are still planned in advance, but the specific questions vary with the candidates' backgrounds. Trammell Crow Real Estate Investors uses a novel approach in hiring managers. Each applicant is interviewed not only by two or three other managers but also by a secretary or young leasing agent. This technique provides information about how the prospective manager relates to nonmanagers.

Assessment Centers Assessment centers are popular methods used to select managers and are particularly good for selecting current employees for promotion. The assessment center assessment is a content-valid simulation of major parts of the managerial job. A typical center lasts two to three days, with groups of six to twelve persons participating in a variety of managerial exercises. Centers may also include interviews, public speaking, and standardized ability tests. Candidates are assessed by several trained observers, usually managers several levels above the job for which the candidates are being considered. Assessment centers are quite valid if they are properly designed and are fair to members of minority groups and women.[13] For some firms, the assessment center is a permanent facility created for these activities. For other firms, the assessment activities are performed in a multipurpose location such as a conference room. AT&T pioneered the assessment center concept. For years the firm has used assessment centers to make virtually all of its selection decisions for management positions.

Other Techniques Organizations also use other selection techniques depending on the circumstances. Polygraph tests, once popular, are declining in popularity. On the other hand, more and more organizations are requiring that applicants in whom they are interested take physical exams, Organizations are also increasingly using drug tests, especially in situations in which drug-related performance problems could create serious safety hazards. For example, applicants for jobs in a nuclear power plant would likely be tested for drug use. And some organizations today even run credit checks on prospective employees. *Today's Management Issues* describes some additional new high-tech methods that are being used.

MANAGEMENT IMPLICATIONS Managers need to remember that attracting the best possible human resources is an important part of organizational effectiveness. Planning is the first step so that they know how many people the

TODAY'S MANAGEMENT ISSUES

Tools for Screening Job Candidates

Reach out and screen someone? Procter & Gamble is doing it, and Office Depot is doing it, Metokote is doing it. These companies are using a sophisticated interactive voice response (IVR) system to screen out inappropriate job candidates via telephone.

Procter & Gamble used IVR to manage the large number of applications received during a national recruiting campaign seeking skilled production technicians. The recruiting ad included a special phone number and job code. When potential applicants called, they first listened to a taped message about the job specification. This initial step allowed job-seekers to screen themselves out if they lacked the proper qualifications. The IVR system then helped callers schedule local appointments to fill out applications with P&G recruiters. After the application process, recruiters asked candidates to call the IVR system to find out whether they were selected to take a skills test. Those who took the skills test were asked to call the IVR system one more time to find out whether they passed; those who passed used the system to schedule interviews with P&G human resources personnel. This telephone-based system helped P&G screen out inappropriate applicants much earlier in the selection process, thus saving time and money.

Computerized candidate profiling is a screening tool used by Texas New Mexico Power, Optio Software, and Apex Capital to assist in the selection process for salespeople. After screening for suitable credentials, Texas New Mexico Power asks each remaining candidate to take a computerized test designed to profile his or her personality and thinking structure. The system compares each candidate's traits to the traits for success on the job and then generates a report about how well the candidate matches the ideal profile. The system even suggests specific questions for the company's interviewers to ask, along with guidelines for evaluating candidates' answers. This technique helps the interviewers customize their questions for individual candidates and probe more deeply about specific traits and tendencies so they can screen out candidates who are not good matches for the job or the company.

People are more honest when interacting with interactive voice response than with a human being.

*—Linda S. Prince, human resources administrator for Procter & Gamble**

References: Ruth E. Thaler-Carter, "Reach Out and Hire Someone: Automated Response Systems Can Speed Large-Scale Hiring," *HR Magazine*, May 1999, pp. S8–S11 (*quote on p. S11); Elana Harris, "Reduce the Recruiting Risks," *Sales & Marketing Management*, May 2000, p. 18.

organization will need in the future and the array of skills those people will need to possess. Recruiting a pool of qualified applicants and then using the optimal combination of selection techniques to hire the best applicants can be of significant importance to the success of the organization.

■ Developing Human Resources

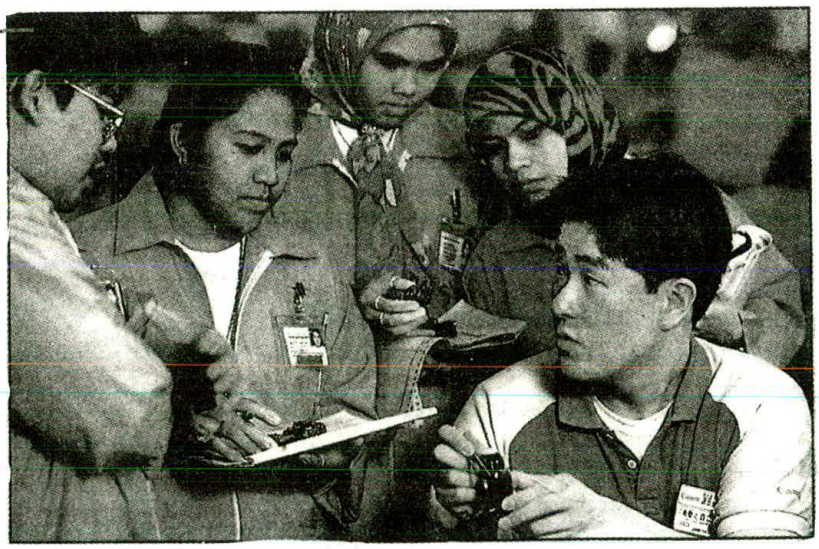
Regardless of how effective a selection system is, however, most employees need additional training if they are to grow and develop in their jobs. Evaluating their performance and providing feedback are also necessary.

Training and Development

training Teaching operational or technical employees how to do the job for which they were hired

development Teaching managers and professionals the skills needed for both present and future jobs

In HRM, **training** usually refers to teaching operational or technical employees how to do the job for which they were hired. **Development** refers to teaching managers and professionals the skills needed for both present and future jobs. Most organizations provide regular training and development programs for managers and employees. For example, IBM spends more than $700 million annually on programs and has a vice president in charge of employee education. U.S. businesses spend more than $30 billion annually on training and development programs away from the workplace. And this figure doesn't include wages and benefits paid to employees while they are participating in such programs. *The World of Management* discusses how two firms are using the Internet to train employees in different parts of the world.



Training and developing people is an important part of human resource management. Canon, for example, invests heavily in training its employees as part of its goal to remain a leading manufacturer of photography equipment. One of its biggest problems has been trying to balance the trend toward moving production to cheaper labor markets while maintaining high performance levels. One tactic Canon uses is to send its newly hired Malaysian workers to one of its plants in Japan for training. After these workers have gained proficiency, they are sent back to Malaysia to work in Canon's factory there.

WORLD OF MANAGEMENT

BRIDGING THE DISTANCE THROUGH INTERNET TRAINING

Lockheed Martin and SAP are just two of the rapidly growing number of companies using the Internet to deliver training courses to employees separated by hundreds or thousands of miles. Because travel expenses make up nearly half the cost of classroom training, Internet-based training is far less expensive and can reach many more employees than traditional in-person training. Employees learn at their own speed without leaving their desks, so they remain productive throughout the training period. Finally, employees are actively involved in absorbing and reviewing on-line material, searching out additional details, asking questions, and completing assignments, all of which boosts retention and makes Internet-based training more enjoyable than more passive training methods.

Employees who work for Maryland-based Lockheed Martin are spread across more than fifty nations. To keep employee skills current and to provide specialized training for new hires, the company is piloting a number of Internet-based training programs. Although the defense contractor still offers classroom training, it sees the Internet as a way to avoid the scheduling headaches and travel expenses of bringing employees together for training at central sites. In one of the Lockheed Martin pilot programs, the company is integrating audio and graphics to facilitate on-line interaction among students and instructors. The company has also created a computerized learning library for employees who want to study on their own.

SAP, a software company based in Pennsylvania, is taking a slightly different approach. It uses the Internet to beam live audio and video coverage of instructors' training presentations, accompanied by written notes, to employees around the world. Students can ask questions or make comments by speaking into their computers' built-in microphones. They can also click to view live demonstrations of the software being discussed. Through this kind of Internet-based training, SAP keeps its global workforce updated on the latest software products and techniques.

Trying to get workers and managers to carve out time for five days of training off the job site is like extracting teeth without an anesthetic.

—Robert Vicek, project manager of Enterprise Information Systems University for Lockheed Martin*

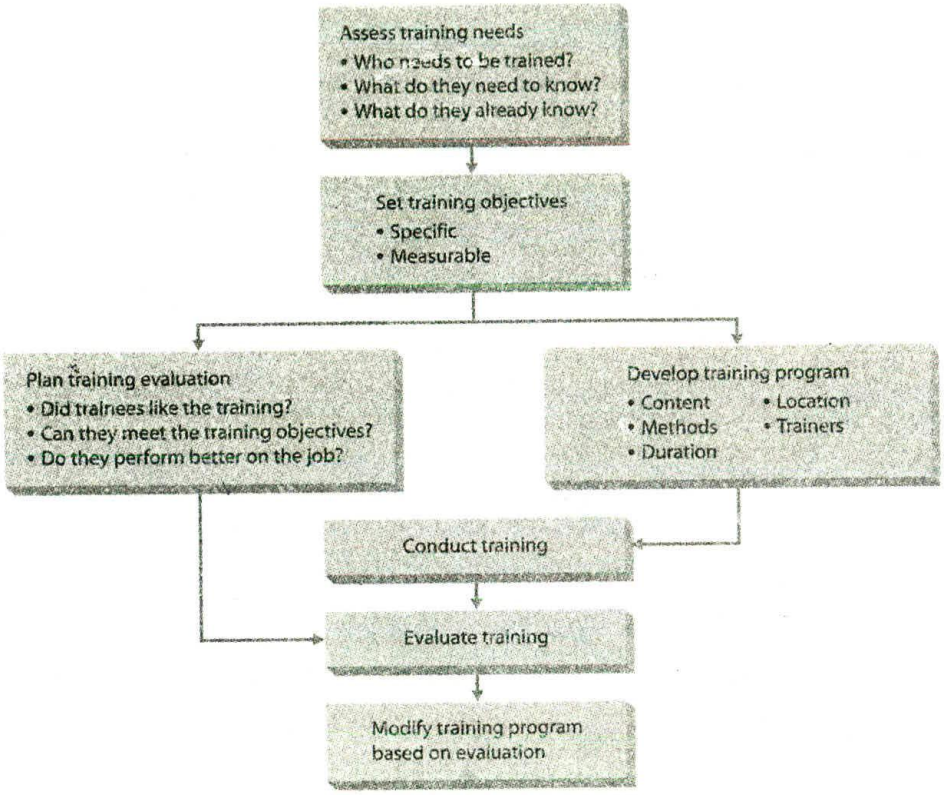
References: Ronald W. Berman, "Internet Training Works for SAP," *Business Week,* May 29, 2000, p. 6; Judith N. Mottle, "Learn at a Distance: Online Learning Is Poised to Become the New Standard," *Information Week,* January 3, 2000, p. 75+ (*quote on p. 75); Jack Wilson, "Internet Training: The Time Is Now," *HR Focus,* March 1999, p. 6.

Assessing Training Needs The first step in developing a training plan is to determine what needs exist. For example, if employees do not know how to operate the machinery necessary to do their jobs, a training program on how to operate the machinery is clearly needed. On the other hand, when a group of office workers is performing poorly, training may not be the answer. The problem could be motivation, aging equipment, poor supervision, inefficient work design, or a deficiency of skills and knowledge. Only the last could be remedied by training. As training programs are being developed, the manager should set specific and measurable goals specifying what participants are to learn. Managers should also plan to evaluate the training program after employees complete it. The training process from start to finish is diagrammed in Figure 14.2.

Figure 14.2

The Training Process

Managing the training process can go a long way toward enhancing its effectiveness. If training programs are well conceived and well executed, both the organization and its employees benefit. Following a comprehensive process helps managers meet the objectives of the training program.



Common Training Methods Many different training and development methods are available. Selection of methods depends on many considerations, but perhaps the most important is training content. When the training content is factual material (such as company rules or explanations of how to fill out forms), assigned reading, programmed learning, and lecture methods work well. When the content is interpersonal relations or group decision-making, however, firms must use a method that allows interpersonal contact such as role-playing or case-discussion groups. When employees must learn a physical skill, methods allowing practice and the actual use of tools and material are needed, as in on-the-job training or vestibule training. (Vestibule training enables participants to focus on safety, learning, and feedback rather than productivity.) CD-rom and Internet-based

training are also becoming popular. Xerox, Massachusetts Mutual Life Insurance, and Ford have all reported tremendous success with these methods. Most training programs rely on a mix of methods. Boeing, for example, sends managers to an intensive two-week training seminar involving tests, simulations, role-playing exercises, and CD-ROM flight-simulation exercises.[14]

Evaluation of Training Training and development programs should always be evaluated. Typical evaluation approaches include measuring one or more relevant criteria (such as attitudes or performance) before and after the training and determining whether the criteria changed. Evaluation measures collected at the end of training are easy to obtain, but actual performance measures collected when the trainee is on the job are more important. Trainees may say that they enjoyed the training and learned a lot, but the true test is whether their job performance improves after their training.

Performance Appraisal

When employees are trained and settled into their jobs, one of management's next concerns is performance appraisal. **Performance appraisal** is a formal assessment of how well employees are doing their job. Employees' performance should be evaluated regularly for many reasons. One reason is that performance appraisal may be necessary for validating selection devices or assessing the impact of training programs. A second reason is administrative—to aid in making decisions about pay raises, promotions, and training. Still another reason is to provide feedback to employees to help them improve their present performance and plan future careers.

performance appraisal A formal assessment of how well an employee is doing his or her job

Because performance evaluations often help determine wages and promotions, they must be fair and nondiscriminatory. In the case of appraisals, content validation is used to show that the appraisal system accurately measures performance on important job elements and does not measure traits or behavior that are irrelevant to job performance.

Common Appraisal Methods Two basic categories of appraisal methods commonly used in organizations are objective methods and judgmental methods. *Objective measures of performance* include actual output (that is, number of units produced), scrap rate, dollar volume of sales, and number of claims processed. Objective performance measures may be contaminated by "opportunity bias" if some persons have a better chance to perform than others. For example, a sales representative selling snow blowers in Michigan has a greater opportunity than does a colleague selling the same product in Arkansas. Fortunately, adjusting raw performance figures for the effect of opportunity bias and thereby arriving at figures that accurately represent each individual's performance is often possible.

Another type of objective measure, the special performance test, is a method in which each employee is assessed under standardized conditions. This kind of appraisal also eliminates opportunity bias. For example, GTE Southwest Inc. has a series of prerecorded calls that operators in a test booth answer. The operators are graded on speed, accuracy, and courtesy in handling the calls. Performance tests

measure ability but do not measure the extent to which one is motivated to use that ability on a daily basis. (A high-ability person may be a lazy performer except when being tested.) Special performance tests must therefore be supplemented by other appraisal methods to provide a complete picture of performance.

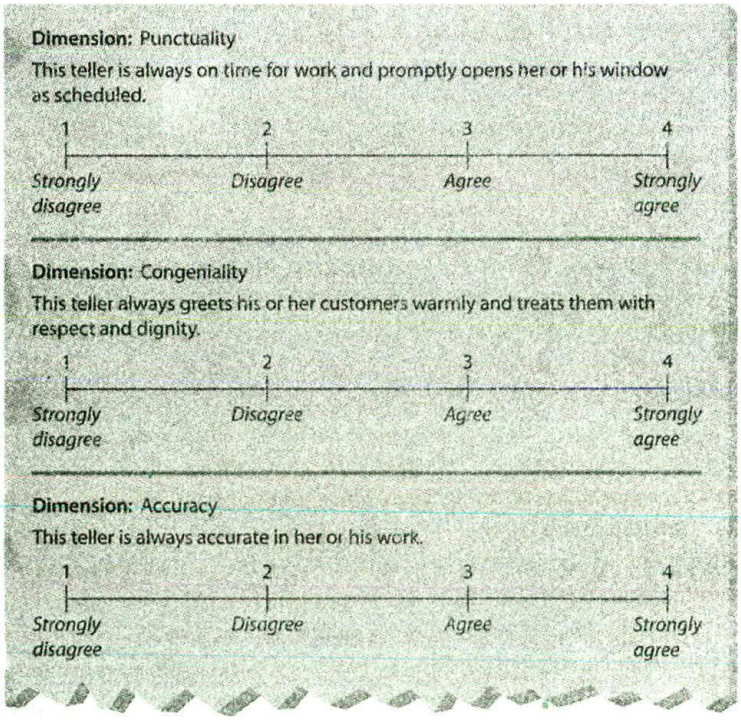
Judgmental methods, including ranking and rating techniques, are the most common way to measure performance. Ranking compares employees directly with each other and orders them from best to worst. Ranking has a number of drawbacks. Ranking is difficult for large groups because the persons in the middle of the distribution may be hard to distinguish from one another accurately. Comparisons of people in different work groups are also difficult. For example, an employee ranked third in a strong group may be more valuable than an employee ranked first in a weak group. Another criticism of ranking is that the manager must rank people on the basis of overall performance, although each person likely has both strengths and weaknesses. Furthermore, rankings do not provide useful information for feedback. To be told that one is ranked third is not nearly so helpful as to be told that the quality of one's work is outstanding, its quantity is satisfactory, one's punctuality could use improvement, and one's paperwork is seriously deficient.

Rating differs from ranking because it compares each employee with a fixed standard rather than with other employees. A rating scale provides the standard. Figure 14.3 gives examples of three graphic rating scales for a bank teller. Each

Figure 14.3

Graphic Rating Scales for a Bank Teller

Graphic rating scales are very common methods for evaluating employee performance. The manager who is doing the rating circles the point on each scale that best reflects her or his assessment of the employee on that scale. Graphic rating scales are widely used for many different kinds of jobs.



consists of a performance dimension to be rated (punctuality, congeniality, and accuracy) followed by a scale on which to make the rating. In constructing graphic rating scales, performance dimensions relevant to job performance must be selected. In particular, they should focus on job behaviors and results rather than on personality traits or attitudes.

The **behaviorally anchored rating scale (BARS)** is a sophisticated and useful rating method. Supervisors construct rating scales with associated behavioral anchors. They first identify relevant performance dimensions and then generate anchors—specific, observable behaviors typical of each performance level. Figure 14.4 shows an example of a behaviorally anchored rating scale for the dimension "inventory control."

behaviorally anchored rating scale (BARS) A sophisticated rating method in which supervisors construct a rating scale associated with behavioral anchors

The other scales in this set, developed for the job of department manager in a chain of specialty stores, include "handling customer complaints," "planning special promotions," "following company procedures," "supervising sales personnel," and "diagnosing and solving special problems." BARS can be effective because it requires that management take proper care in constructing the scales and it provides useful anchors for supervisors to use in evaluating people. It is costly, however, because outside expertise is usually needed and because scales must be developed for each job within the organization.

Errors in Performance Appraisal Errors or biases can occur in any kind of rating or ranking system. One common problem is recency error—the tendency to base judgments on the subordinate's most recent performance because it is most easily recalled. Often a rating or ranking is intended to evaluate performance over an entire time period, such as six months or a year, so the recency error does introduce error into the judgment. Other errors include overuse of one part of the scale—being too lenient, being too severe, or giving everyone a rating of "average."

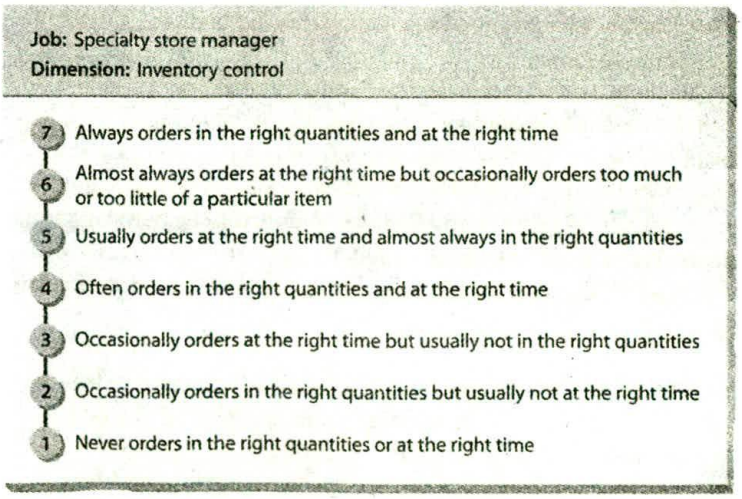


Figure 14.4

Behaviorally Anchored Rating Scale

Behaviorally anchored rating scales help overcome some of the limitations of standard rating scales. Each point on the scale is accompanied by a behavioral anchor—a summary of an employee behavior that fits that spot on the scale.



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Providing performance feedback is a difficult process for many managers. For example, they may have a hard time giving negative feedback or simply feel uncomfortable with the process. And in some cases, as illustrated here, a manager may feel that it is only his or her opinion that counts. The employee, of course, is likely to figure out what is going on and thus the information value of the performance feedback process can be completely lost.

Halo error is allowing the assessment of an employee on one dimension to "spread" to ratings of that employee on other dimensions. For instance, if an employee is outstanding on quality of output, a rater might tend to give her or him higher marks than deserved on other dimensions. Errors can also occur because of race, gender, or age discrimination, intentionally or unintentionally. The best way to offset these errors is to ensure that a valid rating system is developed at the outset and then to train managers in how to use it.

Performance Feedback

The last step in most performance appraisal systems is giving feedback to subordinates about their performance. This step is usually done in a private meeting between the person being evaluated and his or her boss. The discussion should generally be focused on the facts—the assessed level of performance, how and why that assessment was made, and how it can be improved in the future. Feedback interviews are not easy to conduct. Many managers are uncomfortable with the task, especially if feedback is negative and subordinates are disappointed by what they hear. These points are amplified in the cartoon. Properly training managers, however, can help them conduct more effective feedback interviews.[15]

A recent innovation in performance appraisal used in many organizations today is called "360 degree" feedback: managers are evaluated by everyone around them—their boss, their peers, and their subordinates. Such a complete and thorough approach provides people with a far richer array of information about their performance than does a conventional appraisal given just by the boss. Of course, such a system also takes considerable time and must be handled to avoid breeding fear and mistrust in the workplace.[16]

MANAGEMENT IMPLICATIONS Managers need to remember that even though they may hire outstanding applicants as employees, it is still usually necessary to develop their skills through training and development. Managers must also understand the purpose and techniques of performance appraisal. Especially

important, in addition, is providing performance feedback to employees after appraisals have been conducted.

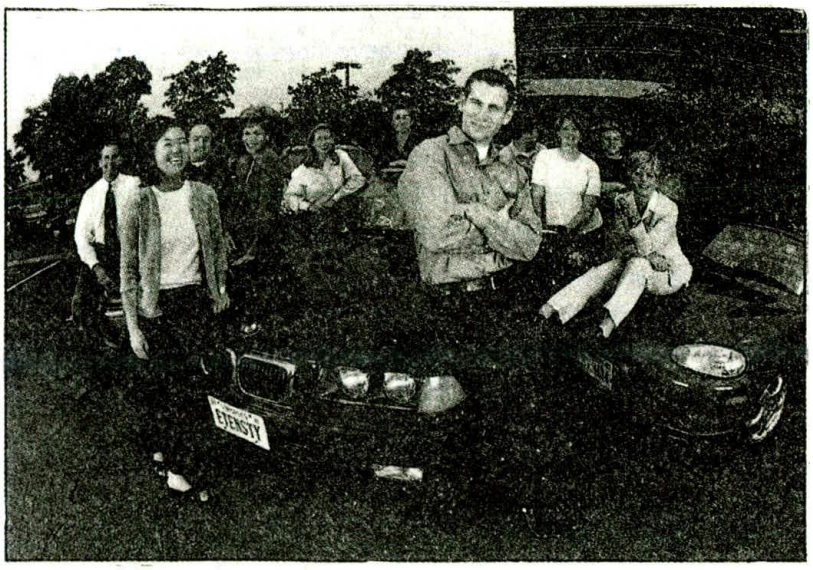
■ Maintaining Human Resoureces

After organizations have attracted and developed an effective workforce, they must also make every effort to maintain that workforce. To do so requires effective compensation and benefits as well as career planning.

Determining Compensation

Compensation is the financial remuneration given by the organization to its employees in exchange for their work. There are three basic forms of compensation. *Wages* are the hourly compensation paid to operating employees. The current federal minimum hourly wage is $5.15. *Salary* refers to compensation paid for total contributions, as opposed to being based on hours worked. For example, managers earn an annual salary, usually paid monthly. They receive the salary regardless of the number of hours they work. Some firms have started paying all their employees a salary instead of hourly wages. For example, all employees at Chaparral Steel Company earn a salary, starting at $20,000 a year for entry-level operating employees. Finally, *incentives* represent special compensation opportunities that are usually tied to performance. Sales commissions and bonuses are among the most common incentives.

compensation The financial remuneration given by the organization to its employees in exchange for their work



The acute shortage of qualified high-tech employees has led many employers to seek new and unusual ways to attract and retain knowledge workers. Etensity is a web-consulting and services firm. Among a wide array of other benefits, Etensity offers its employees a program it calls Hot Wheels. Essentially, employees can buy the car of their dreams and the company will make half of their car payments for them—as long as the individual remains with the firm. Another Etensity program called Raise the Roof makes interest-free loans of up to $10,000 to help employees buy a home; the loan will then be forgiven if the employees remain with the company for a specified period of time.

Compensation is an important and complex part of the organization-employee relationship. Basic compensation is necessary to provide employees with the means to maintain a reasonable standard of living. Beyond this point, however, compensation also provides a tangible measure of the value of the individual to the organization. If employees do not earn enough to meet their basic economic goals, they will seek employment elsewhere. Likewise, if they believe that their contributions are undervalued by the organization, they may leave or exhibit poor work habits, low morale, and little commitment to the organization. Thus, designing an effective compensation system is clearly in the organization's best interests.[17]

A good compensation system can help attract qualified applicants, retain present employees, and stimulate high performance at a cost reasonable for one's industry and geographic area. To set up a successful system, management must make decisions about wage levels, the wage structure, and the individual wage determination system.

Wage-Level Decision The wage-level decision is a management policy decision about whether the firm wants to pay above, at, or below the going rate for labor in the industry or the geographic area. Most firms choose to pay near the average, while those that cannot afford more pay below average. Large, successful firms may like to cultivate the image of being "wage leaders" by intentionally paying more than average and thus attracting and keeping high-quality employees. IBM, for example, pays top dollar to get the new employees it wants. McDonald's, on the other hand, often pays close to the minimum wage. The level of unemployment in the labor force also affects wage levels. Pay declines when labor is plentiful and increases when labor is scarce.

Once managers make the wage-level decision, they need information to help set actual wage rates. Managers need to know what the maximum, minimum, and average wages are for particular jobs in the appropriate labor market. This information is collected by means of a wage survey. Area wage surveys can be conducted by individual firms or by local HR or business associations. Professional and industry associations often conduct surveys and make the results available to employers.

job evaluation An attempt to assess the worth of each job relative to other jobs

Wage-Structure Decision Wage structures are usually set up through a procedure called **job evaluation**—an attempt to assess the worth of each job relative to other jobs. At Ben & Jerry's Homemade, company policy once dictated that the highest-paid employee in the firm could not make more than seven times what the lowest-paid employee earns. But this policy had to be modified when the company found that it was simply unable to hire a new CEO without paying more than this amount. The simplest method for creating a wage structure is to rank jobs from those that should be paid the most (for example, the president) to those that should be paid the least (for example, a mail clerk or a janitor).

In a smaller firm with few jobs (like Ben & Jerry's, for example), this method is quick and practical, but larger firms with many job titles require more sophisticated methods. The next step is setting actual wage rates on the basis of a combination of survey data and the wage structure that results from job evaluation. Jobs of equal value are often grouped into wage grades for ease of administration.

Individual Wage Decisions After wage-level and wage-structure decisions are made, the individual wage decision must be addressed. This decision concerns how much to pay each employee in a particular job. Although the easiest decision is to pay a single rate for each job, a range of pay rates is more typically associated with each job. For example, the pay range for an individual job might be $5.85 to $6.39 per hour, with different employees earning different rates within the range.

A system is then needed for setting individual rates. This determination may be done on the basis of seniority (enter the job at $6.85, for example, and increase ten cents per hour every six months on the job), initial qualifications (inexperienced people start at $6.85, more experienced people start at a higher rate), or merit (raises above the entering rate are given for good performance). Combinations of these bases may also be used.

Because of today's tight labor market, many job seekers are finding it possible to demand higher salaries than ever before. The Internet is also playing a key role in this trend, because job seekers and current employees can more easily get a sense of what their true market value is. If they can document the claim that their value is higher than what their current employer now pays or is offering, they are in a position to demand higher salaries. Consider the case of one compensation executive who met recently with a subordinate to discuss her raise. He was surprised when she produced data from five different web sites supporting her claim for a bigger raise than he had intended to offer.[18]

Determining Benefits

Benefits are things of value other than compensation that the organization provides to its workers. The average company spends an amount equal to more than one-third of its cash payroll on employee benefits. Thus, an average employee who is paid $18,000 per year averages about $6,588 more per year in benefits.

benefits Things of value other than compensation that an organization provides to its workers

Benefits come in several forms. Pay for time not worked includes sick leave, vacation, holidays, and unemployment compensation. Insurance benefits often include life and health insurance for employees and their dependents. Workers' compensation is a legally required insurance benefit that provides medical care and disability income for employees injured on the job. Social security is a government pension plan to which both employers and employees contribute. Many employers also provide a private pension plan to which they and their employees contribute. Employee service benefits can include tuition reimbursement and recreational opportunities.

Some organizations have instituted "cafeteria benefit plans," whereby basic coverage is provided for all employees but employees are then allowed to choose which additional benefits they want (up to a cost limit based on salary). An employee with five children might choose medical and dental coverage for dependents, a single employee might prefer more vacation time, and an older employee might elect increased pension benefits. Flexible systems are expected to encourage people to stay in the organization and even help the company attract new employees.[19]

In recent years, companies have also started offering even more innovative benefits as a way of accommodating different needs and to deal with a very tight

labor market. On-site childcare, mortgage assistance, and generous paid-leave programs are becoming popular.[20] A good benefits plan may encourage people to join and stay with an organization, but it seldom stimulates high performance because benefits are tied more to membership in the organization than to performance. To manage their benefits programs effectively, companies should shop carefully, avoid redundant coverage, and provide only those benefits that employees want. Benefits programs should also be explained to employees in clear and straightforward language so that they can use the benefits appropriately and appreciate what the company is providing.

Career Planning

A final aspect of maintaining human resources is career planning. Few people work in the same jobs their entire career. Some people change jobs within one organization, others change organizations, and many do both. When these movements are haphazard and poorly conceived, both the individual and the organization suffer. Thus, planning career progressions in advance is in everyone's best interest. Of course, planing a thirty-year career for a newcomer just joining the organization is difficult. But planning can help map out what areas the individual is most interested in and help the person see what opportunities are available within the organization.[21]

MANAGEMENT IMPLICATIONS Managers should recognize the critical importance of compensation and benefits. On the one hand, these represent significant costs for the organization and should therefore be carefully monitored and controlled. On the other hand, compensation and benefits are also tangible indicators to the employee of his or her value to the organization and so should be fair and equitable. Career planning is also something all managers should consider for both themselves and their employees.

■ *Managing Labour Relations*

labor relations The process of dealing with employees when they are represented by a union

Labor relations is the process of dealing with employees when they are represented by a union.[22] Managing labor relations is an important part of HRM.

How Employees Form Unions

For employees to form a new local union, several events must occur. First, employees must become interested in having a union. Nonemployees who are professional organizers employed by a national union (such as the Teamsters or United Auto Workers) may generate interest by making speeches and distributing literature outside the workplace. Inside, employees who want a union try to convince other workers of the benefits of a union.

The second step is to collect employees' signatures on authorization cards. These cards state that the signer wishes to vote to determine if the union will represent him or her. Thirty percent of the employees in the potential bargaining unit must sign these cards to show the National Labor Relations Board (NLRB) that interest is sufficient to justify holding an election. Before an election can be held, however, the bargaining unit must be defined. The bargaining unit consists of all employees who will be eligible to vote in the election and to join and be represented by the union if one is formed.

The election is supervised by an NLRB representative (or, if both parties agree, the American Arbitration Association—a professional association of arbitrators) and is conducted by secret ballot. If a simple majority of those voting (not of all those eligible to vote) votes for the union, then the union becomes certified as the official representative of the bargaining unit.[23] The new union then organizes itself by officially signing up members and electing officers; it will soon be ready to negotiate the first contract. The union-organizing process is diagrammed in Figure 14.5. If workers become disgruntled with their union, or if management presents strong evidence that the union is not representing workers appropriately, the NLRB can arrange a decertification election. The results of such an election determine whether the union remains certified.

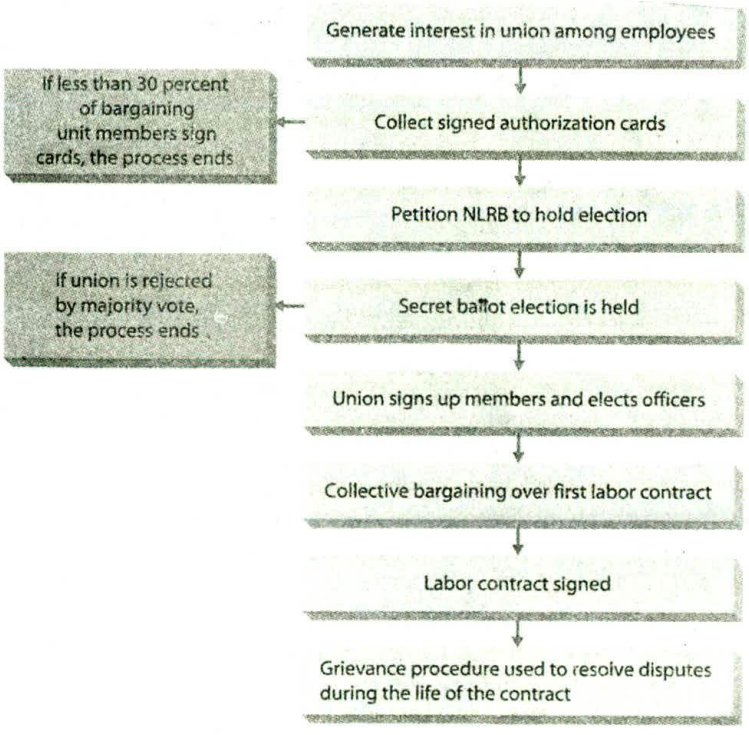


Figure 14.5

The Union-Organizing Process

If employees of an organization want to form a union, the law prescribes a specific set of procedures that both employees and the organization must follow. Assuming that these procedures are followed and the union is approved, the organization must engage in collective bargaining with the new union.

Organizations usually prefer that employees not be unionized because unions limit management's freedom in many areas. Management may thus wage its own campaign to convince employees to vote against the union. "Unfair labor practices" are often committed at this point. For instance, it is an unfair labor practice for management to promise to give employees a raise (or any other benefit) if the union is defeated. Experts agree that the best way to avoid unionization is to practice good employee relations all the time—not just when threatened by a union election. Providing absolutely fair treatment with clear standards in the areas of pay, promotion, layoffs, and discipline; having a complaint or appeal system for persons who feel unfairly treated; and avoiding any kind of favoritism will help make employees feel that a union is unnecessary.

Collective Bargaining

collective bargaining The process of agreeing on a satisfactory labor contract between management and a union

The intent of **collective bargaining** is to agree on a satisfactory labor contract between management and the union. The contract contains agreements about issues such as wages, hours, conditions of employment promotion, layoffs, discipline, benefits, methods of allocating overtime, vacations, rest periods, and the grievance procedure. The process of bargaining may go on for weeks, months, or longer, with representatives of management and the union meeting to make proposals and counterproposals. The resulting agreement must be ratified by the union membership. If it is not approved, the union may strike to put pressure on management, or it may choose not to strike and simply continue negotiating until a more acceptable agreement is reached.

grievance procedure The means by which a labor contract is enforced

The **grievance procedure** is the means by which the labor contract is enforced. Most of what is in a contract concerns how management will treat employees. When employees feel that they have not been treated fairly under the contract, they file a grievance to correct the problem. The first step in a grievance procedure is for the aggrieved employee to discuss the alleged contract violation with her immediate superior. Often the grievance is resolved at this stage. If the employee still believes that she is being mistreated, however, the grievance can be appealed to the next level. A union official can help an aggrieved employee present her case. If the manager's decision is also unsatisfactory to the employee, additional appeals to successively higher levels are made, until finally all in-company steps are exhausted. The final step is to submit the grievance to binding arbitration. An arbitrator is a labor-law expert who is paid jointly by the union and management. The arbitrator studies the contract, hears both sides of the case, and renders a decision that both parties must obey. The grievance system for resolving disputes about contract enforcement prevents any need to strike during the term of the contract.

MANAGEMENT IMPLICATIONS Labor relations is a very important part of human resource management in many firms. Managers need to understand the legal and procedural elements of unionization, the process of collective bargaining, and the importance of a grievance system.

New Challenges in the Changing Workplace

As we have seen throughout this chapter, human resource managers face several ongoing challenges in their efforts to keep their organizations staffed with effective workforces. To complicate matters, new challenges arise as the economic and social environments of business change. We conclude this chapter with a look at two of the most important human resource management issues facing business today.

Managing Knowledge Workers

Employees traditionally added value to organizations because of what they did or because of their experience. In the "information age," however, many employees add value because of what they know.[24]

The Nature of Knowledge Work Employees whose contributions to an organization are based on what they know are usually called **knowledge workers,** and the skill with which they are managed is a major factor in determining which firms will be successful in the future. Knowledge workers, including computer scientists, engineers, and physical scientists, provide special challenges for the HR manager. They tend to work in high-technology firms and are usually experts in some abstract knowledge base. They often like to work independently and tend to identify more strongly with their professions than with any organization—even to the extent of defining performance in terms recognized by other members of their professions.

knowledge workers Employees whose contributions to an organization are based on what they know

As the importance of information-driven jobs grows, the need for knowledge workers continues to grow as well. But these employees require extensive and highly specialized training, and not every organization is willing to make the human capital investments necessary to take advantage of these jobs. In fact, even after knowledge workers are on the job, retraining and training updates are critical to prevent their skills from becoming obsolete. It has been suggested, for example, that the "half-life" of a technical education in engineering is about three years. The failure to update such skills will not only result in the loss of competitive advantage but will also increase the likelihood that the knowledge workers will go to another firm that is more committed to keeping them updated in their field.

Knowledge Worker Management and Labor Markets In recent years, the demand for knowledge workers has been growing at a dramatic rate. As a result, organizations that need these workers must introduce regular market adjustments (upward) to pay them enough to keep them. This point is especially critical in areas in which demand is growing because even entry-level salaries for these employees are skyrocketing. Once an employee accepts a job with a firm, the employer faces yet another dilemma. Once hired, workers are more subject to the company's internal labor market, which is not likely to be growing as quickly as the external market for knowledge workers as a whole. Consequently, the longer an

employee remains with a firm, the further behind the market his or her pay falls—unless, of course, it is regularly adjusted (upward).

Not surprisingly, the growing demand for these workers has inspired some fairly extreme measures for attracting them in the first place.[25] High starting salaries and sign-on bonuses are common. British Petroleum Exploration was recently paying starting petroleum engineers with undersea platform-drilling knowledge—not experience, just knowledge—salaries in the six figures, plus sign-on bonuses of over $50,000 and immediate profit sharing. Even with these incentives, HR managers complain that in the Gulf Coast region, they cannot retain specialists because young engineers soon leave to accept sign-on bonuses with competitors. Laments one HR executive: "We wind up six months after we hire an engineer having to fight off offers for that same engineer for more money."[26]

Contingent and Temporary Workers

A final contemporary HR issue of note involves the use of contingent and/or temporary workers. Indeed, recent years have seen an explosion in the use of such workers by organizations.

Trends in Contingent and Temporary Employment In recent years, the number of contingent workers in the workforce has increased dramatically. A contingent worker is a person who works for an organization on something other than a permanent or full-time basis. Categories of contingent workers include independent contractors, on-call workers, temporary employees (usually hired through outside agencies), and contract and leased employees. Another category is part-time workers. The financial-services giant Citigroup, for example, makes extensive use of part-time sales agents to pursue new clients. About 10 percent of the U.S. workforce currently uses one of these alternative forms of employment relationships. Experts suggest, however, that this percentage is increasing at a consistent pace.

Managing Contingent and Temporary Workers Given the widespread use of contingent and temporary workers, HR managers must understand how to use such employees most effectively; that is, they need to understand how to manage contingent and temporary workers.

One key is careful planning. Even though one of the presumed benefits of using contingent workers is flexibility, it is still important to integrate such workers in a coordinated fashion. Rather than having to call in workers sporadically and with no prior notice, organizations try to bring in specified numbers of workers for well-defined periods of time. The ability to do so comes from careful planning.

A second key is understanding contingent workers and acknowledging both their advantages and disadvantages; that is, the organization must recognize what it can and can't achieve from the use of contingent and temporary workers. Expecting too much from such workers, for example, is a mistake that managers should avoid.

Third, managers must carefully assess the real cost of using contingent workers. We noted above, for example, that many firms adopt this course of action to

save labor costs. The organization should be able to document precisely its labor-cost savings. How much would it be paying people in wages and benefits if they were on permanent staff? How does this cost compare with the amount spent on contingent workers? This difference, however, could be misleading. We also noted, for instance, that contingent workers might be less effective performers than permanent and full-time employees. Comparing employee for employee on a direct-cost basis, therefore, is not necessarily valid. Organizations must learn to adjust the direct differences in labor costs to account for differences in productivity and performance.

Finally, managers must fully understand their own strategies and decide in advance how they intend to manage temporary workers, specifically focusing on how to integrate them into the organization. On a very simplistic level, for example, an organization with a large contingent workforce must make some decisions about the treatment of contingent workers relative to the treatment of permanent, full-time workers. Should contingent workers be invited to the company holiday party? Should they have the same access to such employee benefits as counseling services and child care? There are no right or wrong answers to such questions. Managers must understand that they need to develop a strategy for integrating contingent workers according to some sound logic and then follow that strategy consistently over time.[27]

MANAGEMENT IMPLICATIONS Managers should stay abreast of changing workplace conditions and situations. At present, these key issues include the management of knowledge workers and the use of contingent and temporary workers.

Summary of Key Points

Human resource management is concerned with attracting, developing, and maintaining the human resources an organization needs. Its environmental context consists of its strategic importance and the legal and social environments that affect human resource management.

Attracting human resources is an important part of the HRM function. Human resource planning starts with job analysis and then focuses on forecasting the organization's future need for employees, forecasting the availability of employees both within and outside the organization, and planning programs to ensure that the proper number and type of employees are available when needed. Recruitment and selection are the processes by which job applicants are attracted, assessed, and hired. Methods for selecting applicants include application blanks, tests, interviews, and assessment centers. Any method used for selection should be properly validated.

Organizations must also work to develop their human resources. Training and development enable employees to perform their present jobs effectively and to prepare for future jobs. Performance appraisals are important for validating selection devices, assessing the impact of training programs, deciding pay raises and promotions, and determining training needs. Both objective and judgmental methods

of appraisal can be applied, and a good system usually includes several methods. The validity of appraisal information is always a concern because it is difficult to evaluate accurately the many aspects of a person's job performance.

Maintaining human resources is also important. Compensation rates must be fair compared with rates for other jobs within the organization and with rates for the same or similar jobs in other organizations in the labor market. Properly designed incentive or merit pay systems can encourage high performance, and a good benefits program can help attract and retain employees. Career planning is also a major aspect of human resource management.

If the majority of a company's nonmanagement employees so desire, they have the right to be represented by a union. Management must engage in collective bargaining with the union in an effort to agree on a contract. While the contract is in effect, the grievance system is used to settle disputes with management.

Two important new challenges in the workplace include the management of knowledge workers and issues associated with the use of contingent and temporary workers.

Discussion Questions

Questions for Review

1. What is job analysis and how is it related to human resource planning?
2. Describe recruiting and selection. What are the major sources for recruits? What are the common selection methods?
3. What is the role of compensation and benefits in organizations? How should the amount of compensation and benefits be determined?
4. What are the basic steps that employees can follow if they wish to unionize?

Questions for Analysis

5. What are the advantages and disadvantages of internal and external recruiting? Which do you feel is best in the long term? Why? Be sure to think about this issue from the standpoint of both the organization and individuals (whether inside or outside the organization) who might be considered for positions.
6. How do you know if a selection device is valid? What are the possible consequences of using invalid selection methods? How can an organization ensure that its selection methods are valid?
7. Are benefits more important than compensation to an organization? To an individual? Why?

Questions for Application

8. Write a description and specifications for a job that you have held (office worker, checkout clerk, salesperson, lifeguard). Then contact a company with such a job and obtain an actual description and specifications from that firm. How are your description and specifications like theirs? How are they different?
9. Contact a local organization to determine how that organization evaluates the performance of employees in complex jobs such as middle or higher-level manager, scientist, lawyer, or market researcher. What problems with performance appraisal can you note?
10. Interview someone who is or has been a member of a union to determine his or her reasons for joining. Would you join a union? Why or why not?

BUILDING EFFECTIVE *technical* SKILLS

Exercise Overview

Technical skills refer to the manager's abilities to accomplish or understand work done in an organization. Many managers must have technical skills to be able to hire appropriate people to work in the organization. This exercise will help you use technical skills as part of the selection process.

Exercise Background

Variation One: If you currently work full-time or have worked full-time in the past, select two jobs with which you have some familiarity. Select one job that is relatively low in skill level, responsibility, required education, and pay and one job that is relatively high in the same categories. It will make the exercise more useful to you if you use real jobs that you can relate to at a personal level.

Variation Two: If you have never worked full-time or if you are not personally familiar with an array of jobs, assume that you are a manager for a small manufacturing facility. You need to hire individuals to fill two jobs. One job is for the position of plant custodian. This individual will sweep floors, clean bathrooms, empty trash cans, and so forth. The other person will be office manager. This individual will supervise a staff of three clerks and secretaries, administer the plant payroll, and coordinate the administrative operations of the plant.

Exercise Task

With the information above as background, do the following:

1. Identify the most basic skills that you think are necessary for someone to perform each job effectively.
2. Identify the general indicators or predictors of whether or not a given individual can perform each job.
3. Develop a brief set of interview questions that you might use to determine whether or not an applicant has the qualifications to perform each job.
4. How important is it that a manager hiring employees to perform a job have the technical skills to do that job him- or herself?

BUILDING EFFECTIVE *communication* SKILLS

Exercise Overview

All managers must be able to communicate effectively with others in the organization. Communication is especially important in the human resource area because people are the domain of human resource management.

Exercise Background

Many companies provide various benefits to their workers. These benefits may include pay for time not worked, insurance coverage, pension plans, and so forth. These benefits are often very costly to the organization. As noted in the text, for example, benefits often equal about one-third of what employees are paid in wages and salaries. In some countries, such as Germany, the figures are even higher.

Yet many employees often fail to appreciate the actual value of the benefits their employers provide to them. For example, they frequently underestimate the dollar value of their benefits. And when comparing their income to that of others or when comparing alternative job offers, many people focus almost entirely on direct compensation—wages and salaries paid directly to the individual.

For example, consider a college graduate who has two offers. One job offer is for $20,000 a year and the other is for $22,000. The individual is likely to see the second offer as being more attractive, even if the first offer has sufficiently more attractive benefits to make the total compensation packages equivalent to one another.

Exercise Task

With this information as context, respond to the following:

1. Why do you think most people focus on pay when assessing their compensation?
2. If you were the human resource manager for a firm, how would you communicate the value of benefits to your employees?
3. Suppose an employee comes to you and says that he is thinking about leaving for a "better job." You then learn that he is defining "better" only in terms of higher pay. How might you help him compare total compensation (including benefits)?
4. Some firms today are cutting their benefits. How would you communicate a benefit cut to your employees?

BUILDING EFFECTIVE *decision-making* SKILLS

Exercise Overview

Decision-making skills include the manager's ability to recognize and define problems and opportunities correctly and then to select an appropriate course of action to solve problems and capitalize on opportunities. This exercise will help you develop decision-making skills by applying them to a human resource problem. Managers must frequently select one or more employees from a pool of employees for termination, layoffs, special recognition, training, or promotion. Each such selection represents a decision.

*Exercise Task**

Your company recently developed a plan to identify and train top hourly employees for promotion to first-line supervisor. As part of this program, your boss has requested a ranking of the six hourly employees who report to you with respect to their promotion potential. Given their biographical data, rank them in the order in which you would select them for promotion to first-line supervisor; that is, the person ranked number one would be first in line for promotion. Repeat this process in a group with three or four of your classmates.

Biographical Data

1. *Sam Nelson:* White male, age forty-five, married, with four children. Sam has been with the company for five years, and his performance evaluations have been average to above average. He is well liked by the other employees in the department. He devotes his spare time to farming and plans to farm after retirement.
2. *Ruth Hornsby:* White female, age thirty-two, married, with no children; husband has a management-level job with a power company. Ruth has been with the company for two years and has received above-average performance evaluations. She is very quiet and keeps to herself at work. She says that she is working to save for a down payment on a new house.
3. *Joe Washington:* Black male, age twenty-six, single. Joe has been with the company for three years and has received high performance evaluations. He is always willing to take on new assignments and to work overtime. He is attending college in the evenings and someday wants to start his own business. He is well liked by the other employees in the department.

4. *Ronald Smith:* White male, age thirty-five, recently divorced, with one child, age four. Ronald has received excellent performance evaluations during his two years with the company. He seems to like his present job but has removed himself from the line of progression. He seems to have personality conflicts with some of the employees in the department.
5. *Betty Norris:* Black female, age forty-four, married, with one grown child. Betty has been with the company for ten years and is well liked by fellow employees. Her performance evaluations have been average to below-average, and her advancement has been limited by a lack of formal education. She has participated in a number of technical training programs conducted by the company.
6. *Roy Davis:* White male, age thirty-six, married, with two teen-age children. Roy has been with the company for ten years and has received excellent performance evaluations until last year. His most recent evaluation was average. He is friendly and well liked by his fellow employees. One of his children has had a serious illness for over a year, resulting in a number of large medical expenses. Roy is working a second job on weekends to help with these expenses. He has expressed a serious interest in promotion to first-line supervisor.

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CHAPTER CLOSING CASE

How the Most Admired Companies Manage Human Resources

The most admired companies in America have at least one thing in common: they all pay careful attention to the management of that most precious asset, their employees. General Electric, which appears at the top of many "best-managed" lists, has made training and development one of its top priorities. Through ongoing training, assignment rotation, and performance evaluation, GE gives promising managers the skills and seasoning they need to move up and to handle increased responsibilities. The company has also created a unique mentoring program that pairs tech-savvy younger employees with tech-wary senior managers. As the younger employees teach the senior managers how to navigate the Internet, both benefit from the sharing of ideas and expertise. Given GE's intense focus on human resources, it's not surprising that the company attracts twenty applicants for every job opening.

Another company widely admired for its management of human resources is Southwest Airlines. Consistently profitable in a notoriously competitive industry, Southwest hires a mere 4 percent of the ninety thousand people who apply for jobs every year. The airline uses personality tests to identify applicants with the right mix of can-do attitude, communication skills, decision-making skills, and team spirit. New hires are immersed in intensive training at the company's University for People before they start their jobs. When internal conflicts occasionally erupt between employees who handle different jobs, Southwest has the employees switch jobs for a day so they can see the issue from the other side—a tactic that generally diffuses the tension.

Wal-Mart, a perennial on most-admired lists, calls its human resources management group the People Division as a reflection of the firm's no-nonsense approach. Wal-Mart, like other retailing firms, has been

plagued by turnover that can run as high as 70 percent among hourly store workers. As many as four hundred thousand employees leave and must be replaced every year. Factoring in new store openings, Wal-Mart winds up hiring some 550,000 employees annually. Now the company is aiming to slash this turnover rate by being more selective in hiring, training, and communicating more effectively, and offering recognition and pay for performance. The effort is already paying off: turnover is dropping, which means Wal-Mart is well on its way toward saving a huge chunk of its recruiting and training budget. The retailer is also known for promoting from within, which attracts ambitious people who are looking for opportunity and who are willing to be held accountable for their decisions—another Wal-Mart hallmark.

Chip-maker Intel, much admired for its management excellence, is always on the lookout for new employees with potential. Competition for applicants with high-tech skills is so fierce that Intel has set up an internship program to attract college students before they are in the market for full-time jobs. Every year, one thousand college interns rotate through different departments, moving from service operations to procurement and other groups to get hands-on, practical experience in the work world. The interns also get immersed in Intel's culture and form relationships that come in handy if they continue working at Intel after graduation—which 70 percent do. Intel invites interns to participate in benefits such as the stock purchase plan and counts their internship period toward vacation time once they sign on as full-time employees. These college internships help Intel tap a fresh pool of talented employees every year.

Case Questions

1. What recruiting techniques are being used by the companies in this chapter closing case? Why are these techniques effective?
2. Why would Southwest and other companies go beyond the use of applications and interviews when selecting new employees?
3. How do training and development programs help companies reduce turnover?

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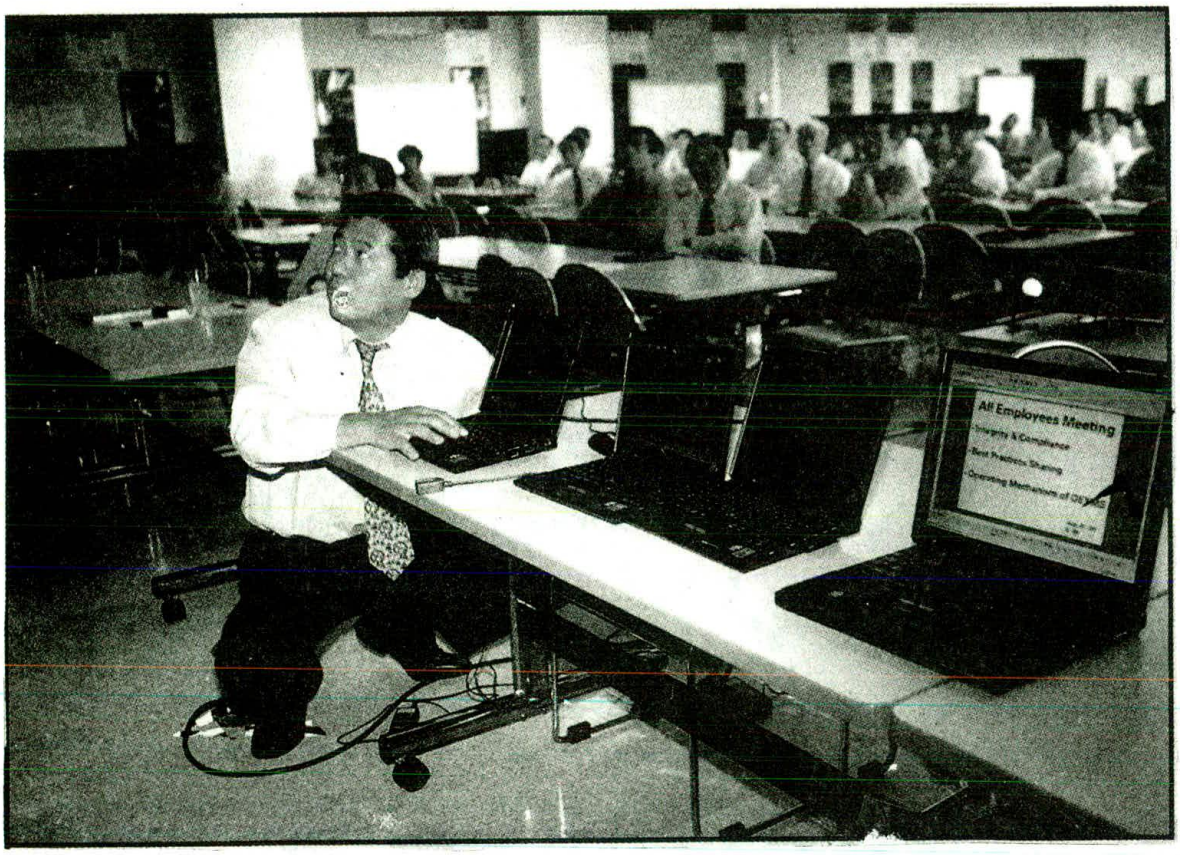
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PART FIVE

The Leading Process



CHAPTER 15

Basic Elements of Individual Behavior in Organizations

CHAPTER 16

Managing Employee Motivation and Performance

CHAPTER 17

Managing Leadership and Influence Processes

CHAPTER 18

Managing Interpersonal Relations and Communications

CHAPTER 19

Managing Work Groups and Teams



CHAPTER 15

Basic Elements of Individual Behavior in Organizations

OPENING INCIDENT

Levi Strauss & Co. and the ubiquitous denim blue jeans it sells around the world have been virtual icons for as long as baby-boomers can remember. Levi's real growth started in the late 1950s when its denim jeans became a virtual uniform for the youth of the United States. The momentum continued into the 1960s as denim took its place alongside incense, tie-died T-shirts, peace signs, and long hair as symbols of a rebellious youth. And as the baby-boomers of the 1950s and 1960s grew into adulthood, Levi's jeans became a fashion staple. Indeed, even the name Levi's became almost synonymous with blue jeans. During the 1970s through the 1990s, Levi's also expanded rapidly overseas and today sells its products in more than seventy countries.

Over the decades, Levi's also forged an innovative relationship with its employees. High levels of job security, an innovative reward structure, and an open and participative approach to management had created a loyal and dedicated workforce that helped keep the organization at the top of its industry. Indeed, when experts first began ranking "best places to work," Levi Strauss was always near the top of the list. Many employees spent their entire careers at Levi, seeing it almost like family and defending it against any and all critics.

But as the decade of the 1990s grew to a close, Levi Strauss seemed to hit a wall. And as a result, the firm found it necessary to re-examine every aspect of its business operations while simultaneously redefining its relationship with its workforce. The catalyst for change was a relatively sudden drop in market share. For example, in 1990 Levi held about one-third of the jeans market in the United States. But by the end of the decade, that figure had been cut in half. Especially disturbing was the fact that today's young consumers particularly had seemed to lose interest in Levi's products.

As a result of this alarming trend, company executives faced an intense and detailed period of introspection to find out what was happening to the company. Their conclusion was that they had been so successful with their core baby-boomer consumers that they had essentially neglected younger consumers. As a result, top-end designers like Tommy Hilfilger and Ralph Lauren and discounted store brands sold at Sears and J.C. Penney had seized significant market share from Levi. In addition, the firm's cost structure was out of line with other clothing manufacturers who had already moved most of their production to lower-cost facilities in other

"You can stretch denim over a wide butt, but you can't stretch it over too many generations. The problem is, your parents wore Levi's, and kids want to wear something different."

*—Al Ries, Atlanta-based marketing consultant**

LEARNING OBJECTIVES

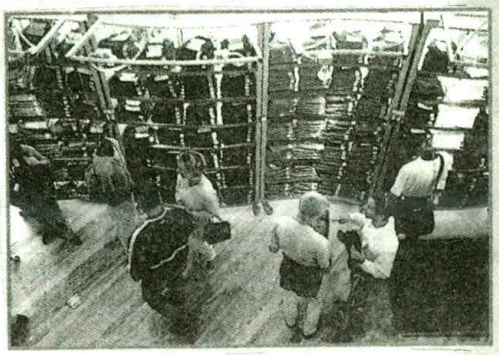
After studying this chapter, you should be able to:

- Explain the nature of the individual-organization relationship.
- Define personality and describe personality attributes that affect behavior in organizations.
- Discuss individual attitudes in organizations and how they affect behavior.
- Describe basic perceptual processes and the role of attributions in organizations.
- Discuss the causes and consequences of stress and describe how it can be managed.
- Describe creativity and its role in organizations.
- Explain how workplace behaviors can directly or indirectly influence organizational effectiveness.

countries. In contrast, Levi had tried to maintain most of its production inside the United States, even though labor costs in this country are higher than at many other locations.

Once they saw their problem, Levi managers took quick action along several fronts. Most painfully, in 1997 the firm announced that it was closing eleven U.S. factories and laying off one-third of its North American workforce—its first layoff in history. In 1999, another twenty-two plants were shuttered and almost six thousand more workers released. Needless to say, these steps dramatically and unalterably changed the firm's relationship with its workforce. Its previously loyal workers quickly became disenchanted and embittered, for example, and went from being the company's staunchest defenders to its biggest critics.

The company also acknowledged that it needed to alter the composition of its executive team to boost creativity and market knowledge. Too many company officials, executives said, had come up through the ranks and knew only one way of doing things—the old tried-and-true Levi's way. Thus, one goal now is to fill 30 percent of all new management jobs with outsiders. Experts agree that it will take the firm a while to get its act together again, but they also acknowledge that the changes seem to fit the situation as well as a pair of the firm's jeans fit after a long day at the office.[1]



CHAPTER OUTLINE

- **Understanding Individuals in Organizations**
  - The Psychological Contract
  - The Person-Job Fit
  - The Nature of Individual Differences
- **Personality and Individual Behavior**
  - The "Big Five" Personality Traits
  - Other Personality Traits at Work
- **Attitudes and Individual Behavior**
  - Work-Related Attitudes
  - Affect and Mood in Organizations
- **Perception and Individual Behavior**
  - Basic Perceptual Processes
  - Perception and Attribution
- **Stress and Individual Behavior**
  - Causes and Consequences of Stress
  - Managing Stress
- **Creativity in Organizations**
  - The Creative Individual
  - The Creative Process
  - Enhancing Creativity in Organizations
- **Types of Workplace Behavior**
  - Performance Behaviors
  - Withdrawal Behaviors
  - Organizational Citizenship

Levi Strauss and Co. and its employees are in the process of redefining their relationship with one another. To do so, they are each having to assess how well their respective needs and capabilities now match the other. And different and unique characteristics of each and every employee affect how they feel about these changes and how they will alter their future attitudes about the firm and how they perform their jobs. These characteristics reflect the basic elements of individual behavior in organizations.

This chapter describes several of these basic elements and is the first of several chapters designed to develop a more complete perspective on the leading function of management. In the next section we investigate the psychological nature of individuals in organizations. The next section introduces the concept of personality and discusses several important personality attributes that can influence behavior in organizations. We then examine individual attitudes and their role in organizations. The role of stress in the workplace is then discussed, followed by a discussion of individual creativity. Finally, we describe several basic individual behaviors that are important to organizations.

■ Understanding Individuals in Organizations

As a starting point in understanding human behavior in the workplace, we must consider the basic nature of the relationship between individuals and organizations. We must also gain an appreciation of the nature of individual differences.

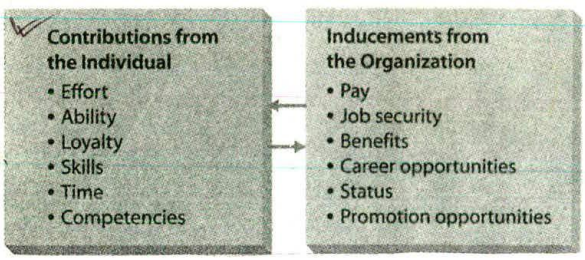
The Psychological Contract

Most people have a basic understanding of a contract. Whenever we buy a car or sell a house, for example, both buyer and seller sign a contract that specifies the terms of the agreement. A psychological contract is similar in some ways to a standard legal contract but is less formal and well defined. In particular, a **psychological contract** is the overall set of expectations held by an individual with respect to what he or she will contribute to the organization and what the organization will provide in return.[2] Thus, a psychological contract is not written on paper nor are all of its terms explicitly negotiated.

Figure 15.1

The Psychological Contract

Psychological contracts are the basic assumptions that individuals have about their relationships with their organization. Such contracts are defined in terms of contributions by the individual relative to inducements from the organization.



The essential nature of a psychological contract is illustrated in Figure 15.1. The individual makes a variety of **contributions**—effort, skills, ability, time, loyalty, and so forth—to the organization. These contributions presumably satisfy various needs and requirements of the organization; that is, because the organization may have hired the person because of her skills, it is reasonable for the organization to expect that she will subsequently display those skills in the performance of her job.

In return for these contributions, the organization provides **inducements** to the individual. Some inducements, like pay and career opportunities, are tangible rewards. Others, like job security and status, are more intangible. Just as the contributions available from the individual must satisfy the needs of the organization, the inducements offered by the organization must serve the needs of the individual; that is, if a person accepts employment with an organization because he thinks he will earn an attractive salary and have an opportunity to advance, he will subsequently expect that those rewards will be forthcoming.

If both the individual and organization perceive that the psychological contract is fair and equitable, they will be satisfied with the relationship and will likely continue it. On the other hand, if either party sees an imbalance or inequity in the contract, that perception may initiate a change. For example, the individual may request a pay raise or promotion, decrease her contributed effort, or look for a better job elsewhere. The organization can also initiate change by requesting that the individual improve his skills through training, transfer the person to another job, or terminate the person's employment altogether.

A basic challenge faced by the organization, then, is to manage psychological contracts. The organization must insure that it is getting value from its employees. At the same time, it must also be sure that it is providing employees with appropriate inducements. If the organization is underpaying its employees for their contributions, for example, they may perform poorly or leave for better jobs elsewhere. On the other hand, if they are being overpaid relative to their contributions, the organization is incurring unnecessary costs.[3]

psychological contract The overall set of expectations held by an individual with respect to what he or she will contribute to the organization and what the organization will provide to the individual

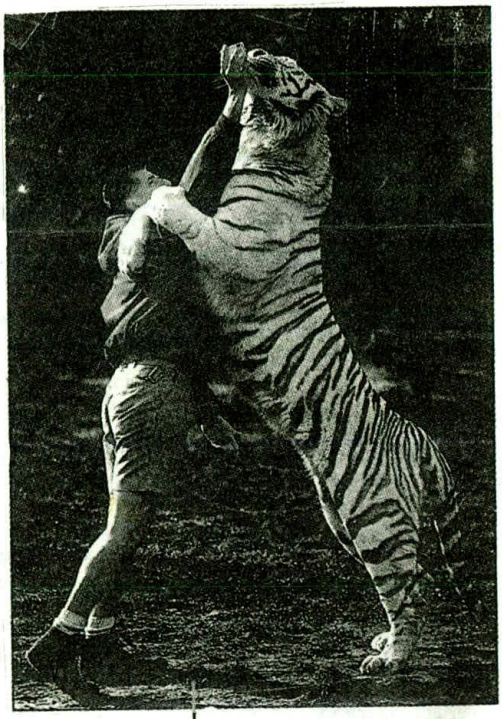
contributions What the individual provides to the organization

inducements What the organization provides to the individual

The Person-Job Fit

One specific aspect of managing psychological contracts is managing the person-job fit. **Person-job fit** is the extent to which the contributions made by the individual match the inducements offered by the organization. In theory, each employee has a specific set of needs that he wants fulfilled and a set of job-related behaviors and abilities to contribute. Thus, if the organization can take perfect advantage of those behaviors and abilities and exactly fulfill his needs, it will have achieved a perfect person-job fit. *Management InfoTech* explains how some organizations are using technology in an effort to improve person-job fit.

Of course, such a precise level of person-job fit is seldom achieved, for several reasons. For one thing, organizational selection procedures are imperfect. Organizations can make approximations of employee skill levels when making hiring decisions and can improve them through training. But even simple performance dimensions are hard to measure objectively and validly. The cartoon provides a humorous example of poor person-job fit.



The person-job fit is an important relationship in any organizational setting. For example, many people would balk at the idea of cleaning the outside windows on the top of a skyscraper, of cutting logs in harsh weather, or, as shown here, trying to train a white tiger. But for Gregg Lee, the animal trainer at Marine World Africa USA in California, it's just all in a day's work!

MANAGEMENT INFOTECH

Using Technology to Get the Right Person-Job Fit

In today's high-speed, highly competitive business environment, knowledge is power. Opportunities and challenges can pop up without warning, so companies need people with the right mix of expertise and skills for each situation. The ability to tap employee knowledge effectively is particularly important when companies organize work activities as a series of cross-functional or problem-solving projects rather than as ongoing functional tasks. In this dynamic work environment, how can companies be sure that the right people are working on the right tasks?

For a growing number of firms, the answer is to use technology to identify and catalogue the talents and capabilities of each employee systematically. For example, KPMG, a multinational accounting and consulting firm, uses software from Tacit Knowledge Systems to examine employees' e-mail messages. Based on the content of these messages, the system builds a profile of each employee's areas of expertise. After the employee reviews and edits the personal profile, it is stored in a database. Then, when a KPMG employee needs help with a specific problem or project, he or she queries the system. The software searches the database to identify the expert with the right set of skills and, with the expert's permission, makes the connection with the employee who needs help. This system is only part of the $100 million worth of tech projects KPMG has mounted to capture and share its employees' knowledge.

At Monitor Group, a Boston-based consulting firm, a chief knowledge officer (CKO) is responsible for sharing information about employees' expertise and removing organizational barriers that can slow access to knowledge and experts. Monitor uses the Internet, among other technology tools, to match the right person to the right job—again and again. Jobs, titles, and tasks are constantly in flux as the firm groups and regroups people into teams to tackle a wide variety of projects for clients. And once a project is over, that team's experts are ready to put their knowledge to work on new assignments.

Like nomads, we pitch tents ana fight battles, then fold up the tents and move on.

*—Alan Kantrow, chief knowledge officer, Monitor Group**

Reference: Neil Gross, "Mining a Company's Mother Lode of Talent," *Business Week*, August 28, 2000, pp. 135, 137 (*quote on p.137).

person-job fit The extent to which the contributions made by the individual match the inducements offered by the organization

Another reason for an imprecise person-job fit is that both people and organizations change. An individual who finds a new job stimulating and exciting may find the same job boring and monotonous after a few years of performing it. And when the organization adopts new technology, it has changed the skills it needs from its employees. Still another reason for imprecision in the person-job fit is that each individual is unique. Measuring skills and performance is difficult enough. Assessing needs, attitudes, and personality is far more complex. Each of these individual differences serves to make matching individuals with jobs a difficult and complex process.

The Nature of Individual Differences

individual differences Personal attributes that vary from one person to another

Individual differences are personal attributes that vary from one person to another. Individual differences may be physical, psychological, and emotional. Taken

together, all of the individual differences that characterize any specific person serve to make that individual unique from everyone else. Much of the remainder of this chapter is devoted to individual differences. Before proceeding, however, we must also note the importance of the situation in assessing the behavior of individuals.

Are specific differences that characterize a given individual good or bad? Do they contribute to or detract from performance? The answer, of course, depends on the circumstances. One person may be very dissatisfied, withdrawn, and negative in one job setting but very satisfied, outgoing, and positive in another. Working conditions, coworkers, and leadership are all important ingredients.



Person-job fit is a very important construct in organizations. A good person-job fit benefits both the employee and the organization. But a poor person-job fit can result in a dissatisfied and low-performing employee. In the example portrayed here, for example, the manager is literally picking a "bull" to work in a "china shop." And the result is likely to be chaos!

Thus, whenever an organization attempts to assess or account for individual differences among its employees, it must also be sure to consider the situation in which behavior occurs. Individuals who are satisfied or productive workers in one context may prove to be dissatisfied or unproductive workers in another. Attempting to consider both individual differences and contributions in relation to inducements and contexts, then, is a major challenge for organizations as they attempt to establish effective psychological contracts with their employees and achieve an optimal fit between people and jobs.

MANAGEMENT IMPLICATIONS Managers should understand the psychological contracts they establish with their employees and take care to be fair and equitable. They also need to realize that people may not be precisely matched with their jobs but still attempt to do as good a job as possible in optimizing this relationship. Finally, managers should also recognize and appreciate the fact that every individual is unique.

■ *Personality and Individual Behavior*

Personality traits represent some of the most fundamental sets of individual differences in organizations. **Personality** is the relatively stable set of psychological and behavioral attributes that distinguish one person from another.[4] Managers should strive to understand basic personality attributes and the ways they can affect people's behavior in organizational situations, not to mention their perceptions of and attitudes toward the organization.

personality The relatively stable set of psychological and behavioral attributes that distinguish one person from another

The "Big Five" Personality Traits

Psychologists have identified literally thousands of personality traits and dimensions that differentiate one person from another. But in recent years, researchers have identified five fundamental personality traits that are especially relevant to organizations. Because these five traits are so important and because they are currently the subject of so much attention, they are commonly referred to now as the **"big five" personality traits**.[5] Figure 15.2 illustrates the "big five" traits.

"big five" personality traits A popular personality framework based on five key traits that are especially relevant to organizations

agreeableness A person's ability to get along with others

Agreeableness refers to a person's ability to get along with others. Agreeableness causes some people to be gentle, cooperative, forgiving, understanding, and good-natured in their dealings with others. But it results in others being irritable, short-tempered, uncooperative, and generally antagonistic toward other people. While research has not yet fully investigated the effects of agreeableness, it would seem likely that highly agreeable people will be better able to develop good working relationships with coworkers, subordinates, and higher-level managers, whereas less agreeable people will not have particularly good working relationships. This same pattern might also extend to relationships with customers, suppliers, and other key organizational constituents.

conscientiousness The number of goals on which a person focuses

Conscientiousness refers to the number of goals on which a person focuses. People who focus on relatively few goals at one time are likely to be organized, systematic, careful, thorough, responsible, and self-disciplined as they work to pursue those goals. Others, however, tend to take on a wider array of goals and, as a result, to be more disorganized, careless, and irresponsible, as well as less thorough and self-disciplined. Research has found that more conscientious people tend to be higher performers than less conscientious people across a variety of different jobs. This pattern seems logical, of course, because more conscientious people will take their jobs seriously and will approach the performance of their jobs in a highly responsible fashion.

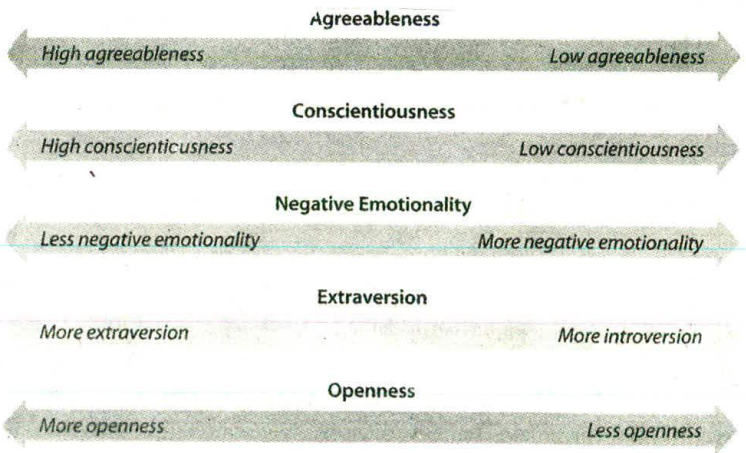


Figure 15.2

The "Big Five" Model of Personality

The "big five" personality model represents an increasingly accepted framework for understanding personality traits in organizational settings. In general, experts tend to agree that personality traits toward the left end of each dimension, as illustrated in this figure, are more positive in organizational settings, whereas traits closer to the right are less positive.

The third of the "big five" personality dimensions is **negative emotionality**. People with less negative emotionality will be relatively poised, calm, resilient, and secure. But people with more negative emotionality will be more excitable, insecure, reactive, and subject to extreme mood swings. People with less negative emotionality might be expected to handle job stress, pressure, and tension better. Their stability might also lead them to be seen as more reliable than their less stable counterparts.

negative emotionality The extent to which a person is poised, calm, resilient, and secure

Extraversion refers to a person's comfort level with relationships. People who are called extraverts are sociable, talkative, assertive, and open to establishing new relationships. But introverts are much less sociable, talkative, and assertive, and not as open to establishing new relationships. Research suggests that extraverts tend to be higher overall job performers than introverts, and that they are also more likely to be attracted to jobs based on personal relationships like sales and marketing positions.

extraversion A person's comfort level with relationships

Finally, **openness** refers to a person's rigidity of beliefs and range of interests. People with high levels of openness are willing to listen to new ideas and to change their own ideas, beliefs, and attitudes as a result of new information. They also tend to have broad interests and to be curious, imaginative, and creative. On the other hand, people with low levels of openness tend to be less receptive to new ideas and less willing to change their minds. They also tend to have fewer and narrower interests and to be less curious and creative. People with more openness might be expected to be better performers, owing to their flexibility and the likelihood that they will be better accepted by others in the organization. Openness may also encompass an individual's willingness to accept change. For example, people with high levels of openness may be more receptive to change, whereas people with low levels of openness may be more likely to resist change.

openness A person's rigidity of beliefs and range of interests

The "big five" framework continues to attract the attention of both researchers and managers. The potential value of this framework is that it encompasses an integrated set of traits that appear to be valid predictors of certain behaviors in certain situations. Thus, managers who can develop both an understanding of the framework and the ability to assess these traits in their employees will be in a good position to understand how and why they behave as they do.[6] On the other hand, managers must also be careful not to overestimate their ability to assess the "big five" traits in others. Even assessment using the most rigorous and valid measures, for instance, is still likely to be somewhat imprecise. Another limitation of the "big five" framework is that it is based primarily on research conducted in the United States. Thus, there are unanswered questions about its generalizability to other cultures. And even within the United States, a variety of other factors and traits are also likely to affect behavior in organizations.

Other Personality Traits at Work

Besides the "big five," there are also several other personality traits that influence behavior in organizations. Among the most important are locus of control, self-efficacy, authoritarianism, Machiavellianism, self-esteem, and risk propensity. *Managing in an e-Business World* discusses the role that some of these traits played in the formation of Internet Capital Group.

MANAGING IN AN e-BUSINESS WORLD

FOUNDERS FUEL E-COMMERCE WITH PERSONALITY

Entrepreneurs Walter W. Buckley III and Kenneth A. Fox share a passion for e-commerce—among other traits. The two worked together scouting deals for a technology investment firm before teaming up in 1996 to found Internet Capital Group (ICG), a company that invests in e-commerce companies. Although other investment firms hold stakes in on-line businesses, ICG's founders were among the first to confine their investments solely to e-commerce start-ups, such as Computerjobs.com, Deja.com, and VerticalNet.

Both Buckley and Fox have a strong entrepreneurial drive that comes from an internal locus of control. Buckley once operated a cleaning service; as the boss, he routinely washed windows and handled whatever tasks needed to be done. When Fox was in high school, he pooled his money with a buddy to buy a snowblower and start a business clearing snow from residential driveways.

In addition, both have high self-efficacy in their roles at ICG. As CEO, Buckley manages overall activities while Fox is managing director of West Coast operations. Given the company's $300 million investment in more than three dozen fast-growing start-ups, the co-founders also have the high risk propensity they need to do business in the volatile e-commerce world. Just as important, they are highly agreeable individuals who know how to establish and strengthen connections with all kinds of people. This trait is especially critical for recruiting talented employees, forging partnerships, and negotiating investments.

At the same time, the entrepreneurs have clearly capitalized on their differences. Buckley, who is ten years older, is expert at nurturing relationships and building synergy among the various firms in which ICG has invested. One example: Deja.com has set up a special career discussion area on its site with a link to Computerjobs.com. Extroverted and conscientious Fox, on the other hand, is a determined deal-maker who pursues potential investments with great tenacity. Between the two, ICG is well positioned to take advantage of e-commerce opportunities now and in the future.

Ken is more outwardly aggressive. But inwardly, Walter is just as bad.

—Warren V. Musser, CEO of Safeguard Scientifics*

Reference: Amy Barrett, "Internet Capital's Young Turks," *Business Week*, November 1, 1999, pp. EB64–EB70 (*quote on p. EB70).

locus of control The extent to which people believe that their behavior has a real effect on what happens to them

Locus of control is the extent to which people believe that their behavior has a real effect on what happens to them.[7] Some people believe, for example, that if they work hard they will succeed. They may also believe that people who fail do so because they lack ability or motivation. People who believe that individuals are in control of their lives are said to have an *internal locus of control.* Other people think that fate, chance, luck, or other people's behavior determines what happens to them. For example, an employee who fails to get a promotion may attribute that failure to a politically motivated boss or just bad luck rather than to her or his own lack of skills or poor performance record. People who think that forces beyond their control dictate what happens to them are said to have an *external locus of control.*

self-efficacy A person's beliefs about her or his capabilities to perform a task

Self-efficacy is a related but subtly different personality characteristic. **Self-efficacy** is a person's beliefs about his or her capabilities to perform a task.[8] People with high self-efficacy believe that they can perform well on a specific task, while people with low self-efficacy tend to doubt their ability to perform a specific task. While self-assessments of ability contribute to self-efficacy, so too does the indi-

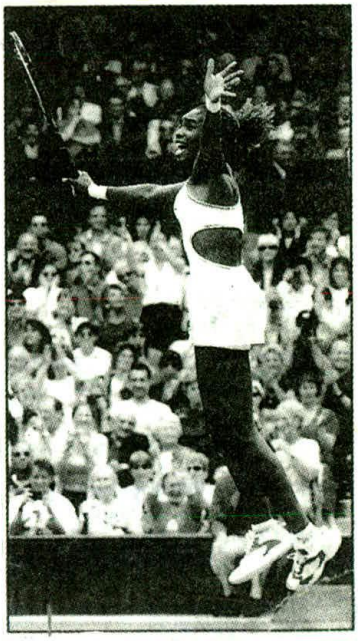
vidual's personality. Some people simply have more self-confidence than others do. This belief in their ability to perform a task effectively results in them being more self-assured and more able to focus their attention on performance.

Another important personality characteristic is **authoritarianism**, the extent to which an individual believes that power and status differences are appropriate within hierarchical social systems like organizations.[9] For example, a person who is highly authoritarian may accept directives or orders from someone with more authority purely because the other person is "the boss." On the other hand, while a person who is not highly authoritarian may still carry out appropriate and reasonable directives from the boss, he or she is also more likely to question things, express disagreement with the boss, and even to refuse to carry out orders if they are objectionable for some reason. A highly authoritarian manager may be autocratic and demanding, and highly authoritarian subordinates will be more likely to accept this behavior from their leader. On the other hand, a less authoritarian manager may allow subordinates a bigger role in making decisions, and less authoritarian subordinates will respond positively to this behavior.

Machiavellianism is another important personality trait. This concept is named after Niccolo Machiavelli, a sixteenth-century author. In his book entitled *The Prince*, Machiavelli explained how the nobility could more easily gain and use power. **Machiavellianism** is now used to describe behavior directed at gaining power and controlling the behavior of others. Research suggests that Machiavellianism is a personality trait that varies from person to person. More Machiavellian individuals tend to be rational and nonemotional, may be willing to lie to attain their personal goals, put little weight on loyalty and friendship, and enjoy manipulating others' behavior. Less Machiavellian individuals are more emotional, less willing to lie to succeed, value loyalty and friendship highly, and get little personal pleasure from manipulating others.

Self-esteem is the extent to which a person believes that he or she is a worthwhile and deserving individual.[10] A person with high self-esteem is more likely to seek higher status jobs, be more confident in his ability to achieve higher levels of performance, and derive greater intrinsic satisfaction from his accomplishments. In contrast, a person with less self-esteem may be more content to remain in a lower-level job, be less confident of her ability, and focus more on extrinsic rewards. Among the major personality dimensions, self-esteem is the one that has been most widely studied in other countries. While more research is clearly needed, the published evidence suggests that self-esteem as a personality trait does indeed exist in a variety of countries and that its role in organizations is reasonably important across different cultures.[11]

Risk propensity is the degree to which an individual is willing to take chances and make risky decisions. A manager with a high risk propensity, for example, might be expected to experiment with new ideas and gamble on new products. She might also lead the organization in new and different directions. This manager might also be a catalyst for innovation. On the other hand, the same individual might also jeopardize the continued well-being of the organization if the risky decisions prove to be bad ones. A manager with low risk propensity might lead to a



Locus of control is the degree to which an individual believes that behavior has a direct impact on the consequences of that behavior. Most professional athletes, for instance, are very self-confident and assume that they can defeat their opponent. Venus Williams, for instance, shown here winning the Wimbledon title, expects to win every time she steps on the tennis court. Thus, she clearly has an internal locus of control.

authoritarianism The extent to which an individual believes that power and status differences are appropriate within hierarchical social systems like organizations

Machiavellianism Behavior directed at gaining power and controlling the behavior of others

self-esteem The extent to which a person believes that he or she is a worthwhile and deserving individual

risk propensity The degree to which an individual is willing to take chances and make risky decisions

stagnant and overly conservative organization, or help the organization successfully weather turbulent and unpredictable times by maintaining stability and calm. Thus, the potential consequences of risk propensity to an organization are heavily dependent on that organization's environment.

MANAGEMENT Managers need to realize that people vary along a wide array of personality traits. The "big five" and other traits provide useful frameworks for understanding how and why people differ. At the same time, managers should also realize that myriad other traits exist and that assessing and understanding precisely how a given trait affects behavior is difficult, at best.

■ Attitudes and Individual Behavior

attitudes Complexes of beliefs and feelings that people have about specific ideas, situations, or other people

Another important element of individual behavior in organizations is attitudes. **Attitudes** as complexes of beliefs and feelings that people have about specific ideas, situations, or other people. Attitudes are important because they are the mechanism through which most people express their feelings. An employee's statement that he feels underpaid by the organization reflects his feelings about his pay. Similarly, when a manager says that she likes the new advertising campaign, she is expressing her feelings about the organization's marketing efforts. *Working with Diversity* focuses on the role of diverse attitudes in companies.

Attitudes have three components. The *affective component* of an attitude reflects feelings and emotions an individual has toward a situation. The *cognitive component* of an attitude is derived from knowledge an individual has about a situation. It is important to note that cognition is subject to individual perceptions (something we discuss more fully later). Thus, one person might "know" that a certain political candidate is better than another, while someone else may "know" just the opposite. Finally, the *intentional component* of an attitude reflects how an individual expects to behave toward or in the situation.

To illustrate these three components, consider the case of a manager who places an order for some supplies for his organization from a new office supply firm. Suppose many of the items he orders are out of stock, others are overpriced, and still others arrive damaged. When he calls someone at the supply firm for assistance, he is treated rudely and gets disconnected before his claim is resolved. When asked how he feels about the new office supply firm, he might respond, "I don't like that company (affective component). They are the worst office supply firm I've ever dealt with (cognitive component). I'll never do business with them again (intentional component)."

cognitive dissonance The conflict individuals experience among their own attitudes

People try to maintain consistency among the three components of their attitudes as well as among all their attitudes. However, circumstances sometimes arise that lead to conflicts. The conflict individuals experience among their own attitudes is called **cognitive dissonance**.[12] Say, for example, that an individual who has vowed never to work for a big, impersonal corporation intends instead to open her own business and be her own boss. Unfortunately, a series of financial setbacks leaves

WORKING WITH DIVERSITY

WANTED—EMPLOYEES WITH ECLECTIC BACKGROUNDS

Just as the gray flannel suit is no longer the stereotypical corporate uniform, the "just follow orders" attitude is no longer valued by organizations. With every part of the environment subject to change, companies are looking for employees with an appetite for new opportunities and challenges—people who aren't afraid to take risks and possibly fail. At iXL Enterprises, for example, CEO Bill Nussey likes hiring people with an entrepreneurial background. He even hopes new employees will experience a washout early in their tenure so they don't let fear of failure stand in the way of trying new ideas.

Companies are also searching for employees with the speed and flexibility needed to be effective in today's fast-paced, dynamic work environment. What worked yesterday may not work today or tomorrow, so managers are hungry for employees who also view rapid, constant change in a positive light.

Willingness to get involved is another attitude valued by corporate leaders. Daniel A. Carp, Kodak's CEO, encourages employees at all levels to e-mail him with suggestions or updates. Of course, the flip side of this practice is that managers on the receiving end of these e-mails must have a positive attitude toward comments and feedback from peers and subordinates.

Given the increasing diversity of the workforce in many countries, companies such as Omnicom Group, an advertising conglomerate, want to hire employees with positive attitudes toward cultural differences. They also want employees who can look below the surface to gain a better understanding of coworkers, managers, and subordinates. Finally, leaders such as John J. Dooner, Jr., president of the New York–based advertising giant Interpublic Group, want employees with a sense of humor—a prized quality that can help employees in any organization cope with the unexpected.

The glorification of the individual is over.

—Bruce A. Pasternick, managing partner for Booz Allen & Hamilton's Organization and Strategic Leadership Center*

Reference: Diane Brady, "Wanted: Eclectic Visionary with a Sense of Humor," *Business Week*, August 28, 2000, pp. 143–144 (*quote on p. 144).

her with no choice but to take a job with a large company and work for someone else. Thus, cognitive dissonance occurs: the affective and cognitive components of the individual's attitude conflict with intended behavior. To reduce cognitive dissonance, which is usually an uncomfortable experience for most people, the individual described above might tell herself the situation is only temporary and that she can go back on her own in the near future. Or she might revise her cognitions and decide that working for a large company is more pleasant than she had ever expected.

Work-Related Attitudes

People in organizations form attitudes about many different things. For example, employees are likely to have attitudes about their salary, promotion possibilities, boss, employee benefits, the food in the company cafeteria, and the color of the company softball team uniforms. Of course, some of these attitudes are more important than others. Especially important attitudes are job satisfaction or dissatisfaction and organizational commitment.[13]

job satisfaction or **dissatisfaction** An attitude that reflects the extent to which an individual is gratified by or fulfilled in his or her work

Job Satisfaction or Dissatisfaction. **Job satisfaction** or **dissatisfaction** is an attitude that reflects the extent to which an individual is gratified by or fulfilled in his or her work. Extensive research conducted on job satisfaction has indicated that personal factors such as an individual's needs and aspirations determine this attitude, along with group and organizational factors such as relationships with coworkers and supervisors and working conditions, work policies, and compensation.[14]

A satisfied employee also tends to be absent less often, to make positive contributions, and to stay with the organization.[15] In contrast, a dissatisfied employee may be absent more often, may experience stress that disrupts coworkers, and may be continually looking for another job. Contrary to what a lot of managers believe, however, high levels of job satisfaction do not necessarily lead to higher levels of performance. One survey has also indicated that contrary to popular opinion, Japanese workers are less satisfied with their jobs than their counterparts in the United States.[16]

organizational commitment An attitude that reflects an individual's identification with and attachment to the organization itself

Organizational Commitment **Organizational commitment** is an attitude that reflects an individual's identification with and attachment to the organization itself. A person with a high level of commitment is likely to see herself as a true member of the organization (for example, referring to the organization in personal terms like, "We make high-quality products"), to overlook minor sources of dissatisfaction with the organization, and to see herself remaining a member of the organization. In contrast, a person with less organizational commitment is more likely to see himself as an outsider (for example, referring to the organization in less personal terms like, "They don't pay their employees very well"), to express more dissatisfaction about conditions, and not to see himself as a long-term member of the organization. Research suggests that Japanese workers may be more committed to their organizations than are U.S. workers.[17]

Research suggests that commitment strengthens with an individual's age, years with the organization, sense of job security, and participation in decision making.[18] Employees who feel committed to an organization have highly reliable habits, plan a long tenure with the organization, and muster more effort in performance. While there are few definitive guidelines that organizations can follow to promote commitment, there are a few specific guidelines available. For one thing, if the organization treats its employees fairly and provides reasonable rewards and job security, those employees will more likely be satisfied and committed. Allowing employees to have a say in how things are done can also promote all three attitudes.

Affect and Mood in Organizations

Researchers have recently started to focus renewed interest on the affective component of attitudes. Recall from our discussion above that the affect component of an attitude reflects feelings and emotions. While managers once believed that emotions and feelings varied among people from day to day, research now suggests that while some short-term fluctuation does indeed occur, there are also underlying stable predispositions toward fairly constant and predictable moods and emotional states.[19]

Some people, for example, tend to have a higher degree of **positive affectivity**. They are relatively upbeat and optimistic, they have an overall sense of well-being, and they usually see things in a positive light. Thus, they always seem to be in a good mood. Other people, those with more **negative affectivity**, are just the opposite. They are generally downbeat and pessimistic and they usually see things in a negative way. They seem to be in a bad mood most of the time.

positive affectivity A tendency to be relatively upbeat and optimistic, have an overall sense of well-being, see things in a positive light, and seem to be in a good mood

negative affectivity A tendency to be generally downbeat and pessimistic, see things in a negative way, and seem to be in a bad mood

Of course, as noted above, there can be short-term variations among even the most extreme types. People with a lot of positive affectivity, for example, may be in a bad mood if they have just received some bad news—being passed over for a promotion, getting extremely negative performance feedback, or being laid off or fired, for instance. Similarly, those with negative affectivity may be in a good mood—at least for a short time—if they have just been promoted, received very positive performance feedback, or had other good things befall them. After the initial impact of these events wears off, however, those with positive affectivity will generally return to their normal positive mood, whereas those with negative affectivity will gravitate back to their normal bad mood.

MANAGEMENT IMPLICATIONS All managers should appreciate the importance of attitudes in organizations. They should be especially concerned with such job-related attitudes as job satisfaction and dissatisfaction and organizational commitment. It is also helpful to understand the causes and consequences of these attitudes.

■ Perception and Individual Behavior

As noted earlier, an important element of an attitude is the individual's perception of the object about which the attitude is formed. Since perception plays a role in a variety of other workplace behaviors, managers need to have a general understanding of basic perceptual processes.[20] The role of attributions is also important.

Basic Perceptual Processes

Perception is the set of processes by which an individual becomes aware of and interprets information about the environment. As shown in Figure 15.3, basic perceptual processes that are particularly relevant to organizations are selective perception and stereotyping.

perception The set of processes by which an individual becomes aware of and interprets information about the environment

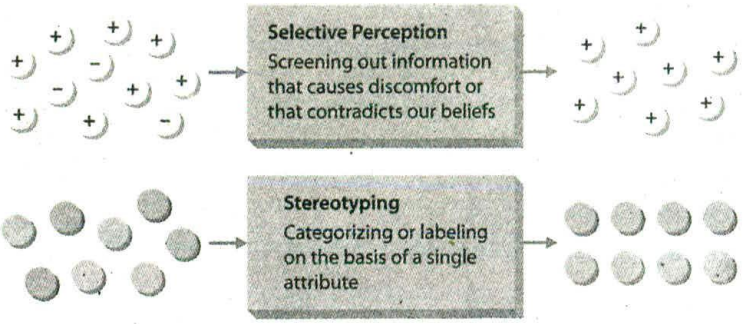
Selective Perception **Selective perception** is the process of screening out information that we are uncomfortable with or that contradicts our beliefs. For example, suppose a manager is exceptionally fond of a particular worker. The manager has a very positive attitude about the worker and thinks he is a top performer. One day the manager notices that the worker seems to be goofing off. Selective perception may cause the manager to forget quickly what he observed. Similarly, suppose

selective perception The process of screening out information that we are uncomfortable with or that contradicts our beliefs

Figure 15.3

Perceptual Processes

Two of the most basic perceptual processes are selective perception and stereotyping. As shown here, selective perception occurs when we screen out information (represented by the – symbols) that causes us discomfort or that contradicts our beliefs. Stereotyping occurs when we categorize or label people on the basis of a single attribute, illustrated here by color.



a manager has formed a very negative image of a particular worker. She thinks this worker is a poor performer and never does a good job. When she happens to observe an example of high performance from the worker, she, too, may not remember it for very long. In one sense, selective perception is beneficial because it allows us to disregard minor bits of information. Of course, this holds true only if our basic perception is accurate. If selective perception causes us to ignore important information, however, it can become quite detrimental.

stereotyping The process of categorizing or labeling people on the basis of a single attribute

Stereotyping **Stereotyping** is the process of categorizing or labeling people on the basis of a single attribute. Common attributes from which people often stereotype are race and gender. Of course, stereotypes along these lines are inaccurate and can be harmful. For example, suppose a manager forms the stereotype that women can perform only certain tasks and that men are best suited for other tasks. To the extent that this affects the manager's hiring practices, the manager is (1) costing the organization valuable talent for both sets of jobs, (2) violating federal law, and (3) behaving unethically. On the other hand, certain forms of stereotyping can be useful and efficient. Suppose, for example, that a manager believes that communication skills are important for a particular job and that speech communication majors tend to have exceptionally good communication skills. As a result, whenever he interviews candidates for jobs, he pays especially close attention to speech communication majors. To the extent that communication skills truly predict job performance and that majoring in speech communication does indeed provide those skills, this form of stereotyping can be beneficial.

Perception and Attribution

attribution A mechanism through which we observe behavior and then attribute causes to it

Perception is also closely linked with another process called attribution. **Attribution** is a mechanism through which we observe behavior and then attribute causes to it.[21] The behavior that is observed may be our own or that of others. For example, suppose someone realizes one day that she is working fewer hours than before, that she talks less about her work, and that she calls in sick more frequently. She might conclude from this realization that she must have become disenchanted with her job

and subsequently decide to quit. Thus, she observed her own behavior, attributed a cause to it, and developed what she thought was a consistent response.

More common is attributing cause to the behavior of others. For example, if the manager of the individual described above has observed the same behavior, he might form exactly the same attribution. On the other hand, he might instead decide that she has a serious illness, that he is driving her too hard, that she is experiencing too much stress, that she has a drug problem, or that she is having family problems.

The basic framework around which we form attributions is *consensus* (the extent to which other people in the same situation behave the same way), *consistency* (the extent to which the same person behaves in the same way at different times), and *distinctiveness* (the extent to which the same person behaves in the same way in other situations). For example, suppose a manager observes that an employee is late for a meeting. The manager might further realize that he is the only one who is late (low consensus), recall that he is often late for other meetings (high consistency), and subsequently realize that the same employee is sometimes late for work and returning from lunch (low distinctiveness). This pattern of attributions might cause the manager to decide that the individual's behavior is something that should be changed. As a result, the manager might meet with the subordinate and establish some punitive consequences for future tardiness.

MANAGEMENT IMPLICATIONS Managers need to recognize the role of perception in organizational behavior. Specifically, they should know how selective perception and stereotyping affects not only the behavior of others, but their own behavior as well. Understanding the attribution process is also helpful.

■ Stress and Individual Behavior

Another important element of behavior in organizations is stress. **Stress** is an individual's response to a strong stimulus.[22] This stimulus is called a *stressor*. Stress generally follows a cycle referred to as the **general adaptation syndrome**, or GAS,[23] shown in Figure 15.4. According to this view, when an individual first encounters a stressor, the GAS is initiated and the first stage, alarm, is activated. He may feel panic, wonder how to cope, and feel helpless. For example, suppose a manager is told to prepare a detailed evaluation of a plan by his firm to buy one of its competitors. His first reaction may be, "How will I ever get this done by tomorrow?"

stress An individual's response to a strong stimulus, which is called a **stressor**

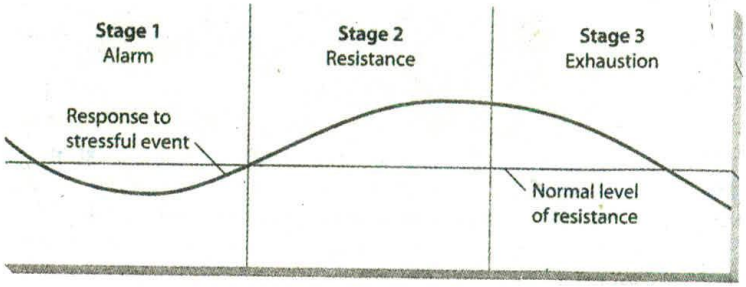
general adaptation syndrome General cycle of the stress process

If the stressor is too intense, the individual may feel unable to cope and never really try to respond to its demands. In most cases, however, after a short period of alarm, the individual gathers some strength and starts to resist the negative effects of the stressor. For example, the manager with the evaluation to write may calm down, call home to say that he's working late, role up his sleeves, order coffee, and get to work. Thus, at stage 2 of the GAS, the person is resisting the effects of the stressor.

In many cases, the resistance phase may end the GAS. If the manager can complete the evaluation earlier than expected, he may drop it in his briefcase, smile to himself, and head home tired but satisfied. On the other hand, prolonged

Figure 15.4

The General Adaptation Syndrome
The general adaptation syndrome represents the normal process by which we react to stressful events. At stage 1—alarm—we feel panic and alarm and our level of resistance to stress drops. Stage 2—resistance—represents our efforts to confront and control the stressful circumstance. If we fail, we may eventually reach stage 3—exhaustion—and just give up or quit.



exposure to a stressor without resolution may bring on stage 3 of the GAS—exhaustion. At this stage, the individual literally gives up and can no longer resist the stressor. The manager, for example, might fall asleep at his desk at 3 A.M. and never finish the evaluation.

We should note that stress is not all bad. In the absence of stress, we may experience lethargy and stagnation. An optimal level of stress, on the other hand, can result in motivation and excitement. Too much stress, however, can have negative consequences. It is also important to understand that stress can be caused by "good" as well as "bad" events. Excessive pressure, unreasonable demands on our time, and bad news can all cause stress. But receiving a bonus and then having to decide what to do with the money can be stressful. So, too, can receiving a promotion, gaining recognition, and similar "good" occurrences.

type A Individuals who are extremely competitive, are very devoted to work, and have a strong sense of time urgency

type B Individuals who are less competitive, are less devoted to work, and have a weaker sense of time urgency

One important line of thinking about stress focuses on Type A and Type B personalities.[24] **Type A** individuals are extremely competitive, are very devoted to work, and have a strong sense of time urgency. They are likely to be aggressive, impatient, and very work-oriented. They have a lot of drive and want to accomplish as much as possible as quickly as possible. **Type B** individuals are less competitive, are less devoted to work, and have a weaker sense of time urgency. Such individuals are less likely to experience conflict with other people and more likely to have a balanced, relaxed approach to life. They can work at a constant pace without time urgency. Type B people are not necessarily more or less successful than Type A people, but they are less likely to experience stress.

Causes and Consequences of Stress

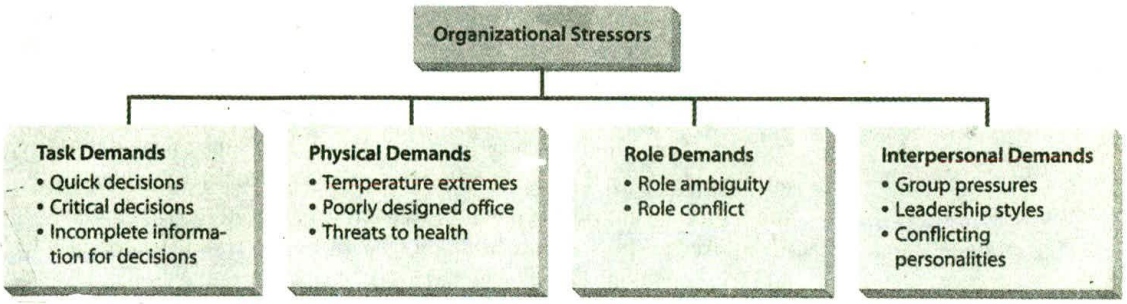
Stress is obviously not a simple phenomenon. As depicted in Figure 15.5, several different events can cause stress. Note that this list includes only work-related conditions. We should keep in mind that stress can also be the result of personal circumstances as well.[25]

Causes of Stress Work-related stressors fall into one of four categories—task, physical, role, and interpersonal demands. *Task demands* are associated with the task itself. Some occupations are inherently more stressful than others. Having to

Figure 15.5

Causes of Work Stress

There are several causes of work stress in organizations. Four general sets of organizational stressors are task demands, physical demands, role demands, and interpersonal demands.



make fast decisions, decisions with less than complete information, or decisions that have relatively serious consequences are some of the situations that can make some jobs stressful. The jobs of surgeon, airline pilot, and stockbroker are relatively more stressful than the jobs of dentist, airplane baggage loader, and office receptionist. While a dentist makes important decisions, he is also likely to have time to make a considered diagnosis and fully explore several different treatments. But during surgery, the surgeon must make decisions quickly, all the while realizing that the wrong one may endanger her patient's life.

Physical demands are stressors associated with the job setting. Working outdoors in extremely hot or cold temperatures, or even in an improperly heated or cooled office, can lead to stress. A poorly designed office that makes it difficult for people to have privacy or promotes too little social interaction can result in stress, as can poor lighting and inadequate work surfaces. Even more severe are actual threats to health. Examples include jobs like coal mining, poultry processing, and toxic waste handling.

Role demands can also cause stress. (Roles are discussed more fully in Chapter 18.) A role is a set of expected behaviors associated with a position in a group or organization. Stress can result from either role ambiguity or role conflict that people can experience in groups. For example, an employee who is feeling pressure from her boss to work longer hours or to travel more while also being asked by her family for more time at home will almost certainly experience stress.[26] Similarly, a new employee experiencing role ambiguity because of poor orientation and training practices by the organization will suffer from stress.

Interpersonal demands are stressors associated with relationships that confront people in organizations. For example, group pressures regarding restriction of output and norm conformity can lead to stress. Leadership style may also cause stress. An employee who feels a strong need to participate in decision making may feel stress if his boss refuses to allow participation. And individuals with conflicting personalities may experience stress if they are required to work too closely

together. A person with an internal locus of control might be frustrated when working with someone who prefers to wait and see what happens.

Consequences of Stress As noted earlier, the results of stress may be positive or negative. The negative consequences may be behavioral, psychological, or medical. Behaviorally, for example, stress may lead to detrimental or harmful actions, such as smoking, alcoholism, overeating, and drug abuse. Other stress-induced behaviors are accidents, violence toward oneself or others, and appetite disorders.

Psychological consequences of stress interfere with an individual's mental health and well-being. These outcomes include sleep disturbances, depression, family problems, and sexual dysfunction. Managers are especially prone to sleep disturbances when they experience stress at work.[27] Medical consequences of stress affect an individual's physiological well-being. Heart disease and stroke have been linked to stress, as have headaches, backaches, ulcers and related disorders, and skin conditions such as acne and hives.

Individual stress also has direct consequences for businesses. For an operating employee, stress may translate into poor quality work and lower productivity. For a manager, it may mean faulty decision making and disruptions in working relationships. Withdrawal behaviors can also result from stress. People who are having difficulties with stress in their jobs are more likely to call in sick or to leave the organization. More subtle forms of withdrawal may also occur. A manager may start missing deadlines, for example, or taking longer lunch breaks. Employees may also withdraw by developing feelings of indifference. The irritation displayed by people under great stress can make them difficult to get along with. Job satisfaction, morale, and commitment can all suffer as a result of excessive levels of stress. So, too, can motivation to perform.

burnout A feeling of exhaustion that may develop when someone experiences too much stress for an extended period of time

Another consequence of stress is **burnout**—a feeling of exhaustion that may develop when someone experiences too much stress for an extended period of time. Burnout results in constant fatigue, frustration, and helplessness. Increased rigidity follows, as does a loss of self-confidence and psychological withdrawal. The individual dreads going to work, often puts in longer hours but accomplishes less than before, and exhibits mental and physical exhaustion. Because of the damaging effects of burnout, some firms are taking steps to help avoid it. For example, British Airways provides all of its employees with training designed to help them recognize the symptoms of burnout and develop strategies for avoiding it.

Managing Stress

Given the potential consequences of stress, it follows that both people and organizations should be concerned about how to limit its more damaging effects. Numerous ideas and approaches have been developed to help manage stress. Some are strategies for individuals, while others are strategies for organizations.[28]

One way people manage stress is through exercise. People who exercise regularly feel less tension and stress, are more self-confident, and are more optimistic. Their better physical condition also makes them less susceptible to many common illnesses. People who don't exercise regularly, on the other hand, tend to feel more stress and are more likely to be depressed. They are also more likely to have

heart attacks. And because of their physical condition, they are more likely to contract illnesses.

Another method people use to manage stress is relaxation. Relaxation allows individuals to adapt to, and therefore better deal with, their stress. Relaxation comes in many forms, such as taking regular vacations. A recent study found that people's attitudes toward a variety of workplace characteristics improved significantly following a vacation. People can also learn to relax while on their jobs. For example, some experts recommend that people take regular rest breaks during their normal workday.

People can also use time management to control stress. The idea behind time management is that many daily pressures can be reduced or eliminated if individuals do a better job of managing time. One approach to time management is to write a list every morning of the tasks to be done that day. The items on the list are then grouped into three categories: critical activities that must be performed, important activities that should be performed, and optional or trivial activities that can be delegated or postponed. The individual performs the items on the list in their order of importance.

Finally, people can manage stress through support groups. A support group can be as simple as a group of family members or friends to enjoy leisure time with. Going out after work with a couple of coworkers to a basketball game or a movie, for example, can help relieve stress built up during the day. Family and friends can help people cope with stress on an ongoing basis and during times of crisis. For example, an employee who has just learned that she did not get the promotion she has been working toward for months may find it helpful to have a good friend to lean on, to talk to, or to vent frustration with. People also may make use of more elaborate and formal support groups. Community centers or churches, for example, may sponsor support groups for people who have recently gone through a divorce, the death of a loved one, or some other tragedy.

Organizations are also beginning to realize that they should be involved in helping employees cope with stress. One argument for this trend is that, because the business is at least partially responsible for stress, it should also help relieve it. Another is that stress-related insurance claims by employees can cost the organization considerable sums of money. Still another is that workers experiencing lower levels of detrimental stress will be able to function more effectively. AT&T has initiated a series of seminars and workshops to help its employees cope with the stress they face in their jobs. The firm was prompted to develop these seminars for all three of the reasons noted above.

A wellness/stress management program is a special part of the organization specifically created to help deal with stress. Organizations have adopted stress management programs, health promotion programs, and other kinds of programs for this purpose. The AT&T seminar program noted earlier is similar to this idea, but true wellness programs are ongoing activities that have several different components. They commonly include exercise-related activities as well as classroom instruction programs dealing with smoking cessation, weight reduction, and general stress management.

Some companies are developing their own programs or using existing programs of this type. Johns-Manville, for example, has a gym at its corporate headquarters. Other firms negotiate discounted health club membership rates with local establishments. For the instructional part of the program, the organization can again either

sponsor its own training or perhaps jointly sponsor seminars with a local YMCA, civic organization, or church. Organization-based fitness programs facilitate employee exercise, a very positive consideration, but such programs are also quite costly. Still, more and more companies are developing fitness programs for employees.

MANAGEMENT IMPLICATIONS Managers should know the processes through which stress affects people. Being able to assess and deal with the causes and consequences of stress is especially important. Knowing if people are more prone toward Type A or Type B behavior is also of value to managers. Finally, managers need to recognize that they have the capacity to help themselves and others cope with stress more effectively.

■ Creativity in Organization



Organizations frequently look for new ways to make their employees more creative and to promote innovation and entrepreneurial activity. Second City, the improvisational comedy troupe that launched the careers of Bill Murray and John Belushi, has developed a lucrative business by using comedy to help businesses promote creativity. Rob Nickerson, a Canadian comic working for Second City, is helping this room full of Nortel accountants think more creatively. People who attend the sessions swear by them; Second City, meanwhile, charges between $2,500 and $8,500 for a day-long program.

Creativity is yet another important component of individual behavior in organizations. *Today's Management Issues* explores the potential role of workspace in creativity. **Creativity** is the ability of an individual to generate new ideas or to conceive of new perspectives on existing ideas. What makes a person creative? How do people become creative? How does the creative process work? Although psychologists have not yet discovered complete answers to these questions, examining a few general patterns can help us understand the sources of individual creativity within organizations.[29]

The Creative Individual

Numerous researchers have focused their efforts on attempting to describe the common attributes of creative individuals. These attributes generally fall into three categories: background experiences, personal traits, and cognitive abilities.

Background Experiences and Creativity Researchers have observed that many creative individuals were raised in an environment in which creativity was nurtured. Mozart was raised in a family of musicians and began composing and performing music at age six. Pierre and Marie Curie, great scientists in their own right, also raised a daughter, Irene, who won the Nobel Prize in chem-

TODAY'S MANAGEMENT ISSUES

CAN THE WORKSPACE IMPROVE CREATIVITY?

Although today's employees can share ideas with the click of a mouse or the beep of a cell phone, architects Charles Rose and Maryann Thompson believe that the design of an organization's workspace is equally important for enhancing creativity. These architects are designing technology-free spaces within the office or on the grounds where employees can retreat (alone or in small groups) to think through problems and brainstorm new ideas. They are also designing spaces such as gardens where employees can come together and collaborate in a quiet, contemplative setting.

More companies are designing workspaces with an eye toward fostering interaction and spontaneous discussion of issues and challenges. At Deloitte Consulting in Pittsburgh, for example, consultants often bring their laptops to the office cybercafé, where they can sip a free cappuccino and exchange thoughts about current projects. The office also boasts several "touchdown areas" where coworkers can relax in comfortable chairs while sharing ideas.

How can companies design workspaces to accommodate the idea-storming needs of teams? Sapient, an e-commerce consulting firm, has set aside separate team rooms for engineers working on particular projects. Each team has exclusive use of its room for the duration of its project, which can last for ten weeks or as long as eighteen months. Teams are encouraged to personalize their rooms, making the space more welcoming and more stimulating.

Sometimes the best way to spark creativity is to leave the office altogether. Stephen Zades, CEO of Long Haymes Carr, a North Carolina advertising agency, takes his employees and selected clients on an annual "creative odyssey." On this yearly four-day tour around New York City, the group attends avant-garde theater performances, ogles way-out art, and visits hip boutiques and night spots. During the trip, Zades makes time for participants to talk about the places they've visited and the trends they've spotted. These new experiences give rise to new ways of viewing the world and new ideas for all kinds of client projects.

Where do idea companies get their ideas? How do they tap into something that's on its way in, rather than already passed?

– Stephen Zades, CEO of advertising agency Long Haymes Carr*

References: Bruce Nussbaum, "Architectural Visions: Designs for the Future," *Business Week,* August 28, 2000, pp. 153–164; Curtis Sittenfeld, "The Creative Odyssey," *Fast Company,* October 1999, pp. 54–56 (*quote on p. 54); Daintry Duffy, "Cube Stakes," *CIO Enterprise,* April 15, 1999, http://www.cio.com/archive/enterprise/041599_wksp_content.html (September 12, 2000).

istry. Thomas Edison's creativity was nurtured by his mother. However, people with background experiences very different from those just mentioned have also been creative. The African-American abolitionist and writer Frederick Douglass was born into slavery in Tuckahoe, Maryland, and had very limited opportunities for education. Nonetheless, his powerful oratory and creative thinking helped lead to the Emancipation Proclamation, which outlawed slavery in the United States.

creativity The ability of an individual to generate new ideas or to conceive of new perspectives on existing ideas

Personal Traits and Creativity Certain personal traits have also been linked to creativity in individuals. The traits shared by most creative people are openness, an attraction to complexity, high levels of energy, independence and autonomy, strong self-confidence, and a strong belief that one is, in fact, creative. Individuals who possess these traits are more likely to be creative than are those who do not have them.

Cognitive Abilities and Creativity Cognitive abilities are an individual's power to think intelligently and to analyze situations and data effectively. Intelligence may be a precondition for individual creativity—although most creative people are highly intelligent, not all intelligent people necessarily are creative. Creativity is also linked with the ability to think divergently and convergently. *Divergent thinking* is a skill that allows people to see differences between situations, phenomena, or events. *Convergent thinking* is a skill that allows people to see similarities between situations, phenomena, or events. Creative people are generally very skilled at both divergent and convergent thinking.

Japanese managers have recently questioned their own creative ability. The concern is that their emphasis on group harmony has perhaps stifled individual initiative and hampered the development of individual creativity. As a result, many Japanese firms, including Omron Corporation, Fuji Photo, and Shimizu Corporation, have launched employee training programs intended to boost the creativity of their employees.[30]

The Creative Process

Although creative people often report that ideas seem to come to them "in a flash," individual creative activity actually tends to progress through a series of stages. Not all creative activity has to follow these four stages, but much of it does.

Preparation The creative process normally begins with a period of *preparation*. Formal education and training are usually the most efficient ways of becoming familiar with this vast amount of research and knowledge. To make a creative contribution to business management or business services, individuals must usually receive formal training and education in business. This foundation is one reason for the strong demand for undergraduate and master's level business education. Formal business education can be an effective way for an individual to get "up to speed" and begin making creative contributions quickly. Experiences that managers have on the job after their formal training is finished can also contribute to the creative process. In an important sense, the education and training of creative people never really ends. It continues as long as they remain interested in the world and curious about the way things work.

Incubation The second phase of the creative process is *incubation*—a period of less intense conscious concentration during which the knowledge and ideas acquired during preparation mature and develop. A curious aspect of incubation is that it is often helped along by pauses in concentrated rational thought. Some creative people rely on physical activity such as jogging or swimming to provide a "break" from thinking. Others may read or listen to music. Sometimes sleep may even supply the needed pause.

Insight Usually occurring after preparation and incubation, insight is a spontaneous breakthrough in which the creative person achieves a new understanding of some problem or situation. *Insight* represents a coming together of all the scat-

tered thoughts and ideas that were maturing during incubation. It may occur suddenly or develop slowly over time. Insight can be triggered by some external event, such as a new experience or an encounter with new data that forces the individual to think about old issues and problems in new ways, or it can be a completely internal event in which patterns of thought finally coalesce in ways that generate new understanding. One manager's key insight led to a complete restructuring of Citibank's back room operations. "Back room operations" refers to the enormous avalanche of paperwork that a bank must process to serve its customers—listing checks and deposits, updating accounts, and preparing bank statements. Historically, back room operations at Citibank had been managed as if they were part of the regular banking operation. But a new executive realized that back room operations had less to do with banking and more to do with manufacturing. The insight, then, was that back room operations could be managed as a paper-manufacturing process. On the basis of this insight, he hired former manufacturing managers from Ford and other automobile companies. By reconceptualizing the nature of back room operations, the executive was able to reduce substantially the costs of these operations for Citibank.

Verification Once an insight has occurred, *verification* determines the validity or truthfulness of the insight. For many creative ideas, verification includes scientific experiments to determine whether or not the insight actually leads to the results expected. Verification may also include the development of a product or service prototype. A prototype is one product or a very small number of products built just to see if the ideas behind this new product actually work. Product prototypes are rarely sold to the public but are very valuable in verifying the insights developed in the creative process. Once the new product or service is developed, verification in the marketplace is the ultimate test of the creative idea behind it.

Enhancing Creativity in Organizations

Managers who wish to enhance and promote creativity in their organizations can do so in several ways.[31] One important method for enhancing creativity is to make it part of the organization's culture, often through explicit goals. Firms that truly want to stress creativity, like 3M and Rubbermaid, for example, state goals that some percentage of future revenues are to be gained from new products. This goal clearly communicates that creativity and innovation are valued.

Another important part of enhancing creativity is to reward creative successes while being careful not to punish creative failures. Many ideas that seem worthwhile on paper fail to pan out in reality. If the first person to come up with an idea that fails is fired or otherwise punished, others in the organization will become more cautious in their own work. And as a result, fewer creative ideas will emerge.

MANAGEMENT IMPLICATIONS Managers need to understand the creative process. The ability to recognize and nurture creativity in others can be especially valuable, as can creating an environment in which creativity is more likely to emerge.

■ Types of Workplace Behavior

workplace behavior A pattern of action by the members of an organization that directly or indirectly influences organizational effectiveness

Now that we have looked closely at how individual differences can influence behavior in organizations, let's turn our attention to what we mean by workplace behavior. **Workplace behavior** is a pattern of action by the members of an organization that directly or indirectly influences organizational effectiveness. Important workplace behaviors include performance and productivity, absenteeism and turnover, and organizational citizenship.

Performance Behaviors

performance behaviors The total set of work-related behaviors that the organization expects the individual to display

Performance behaviors are the total set of work-related behaviors that the organization expects the individual to display. Thus, they derive from the psychological contract. For some jobs, performance behaviors can be narrowly defined and easily measured. For example, an assembly line worker who sits by a moving conveyor and attaches parts to a product as it passes by has relatively few performance behaviors. He or she is expected to remain at the workstation and attach the parts correctly. Performance can often be assessed quantitatively by counting the percentage of parts correctly attached.

For many other jobs, however, performance behaviors are more diverse and much more difficult to assess. For example, consider the case of a research and development scientist at Merck. The scientist works in a lab trying to find new scientific breakthroughs that have commercial potential. The scientist must apply knowledge learned in graduate school with experience gained from previous research. Intuition and creativity are also important elements. And the desired breakthrough may take months or even years to accomplish. As we discussed in Chapter 14, organizations rely on a number of different methods for evaluating performance. The key, of course, is to match the evaluation mechanism with the job being performed.

Withdrawal Behavior

absenteeism When an individual does not show up for work

Another important type of work-related behavior is that which results in withdrawal—absenteeism and turnover. **Absenteeism** occurs when an individual does not show up for work. The cause may be legitimate (illness, jury duty, death in the family, etc.) or feigned (reported as legitimate but actually just an excuse to stay home). When an employee is absent, her or his work does not get done at all or a substitute must be hired to do it. In either case, the quantity or quality of actual output is likely to suffer. Obviously, some absenteeism is expected. The key concern of organizations is to minimize feigned absenteeism and reduce legitimate absences as much as possible. High absenteeism may be a symptom of other problems as well, such as job dissatisfaction and low morale.

turnover When people quit their jobs

Turnover occurs when people quit their jobs. An organization usually incurs costs in replacing individuals who have quit, but if turnover involves especially

productive people, it is even more costly. Turnover seems to result from several factors, including aspects of the job, the organization, the individual, the labor market, and family influences. In general, a poor person-job fit is also a likely cause of turnover. The current labor shortage is also resulting in higher turnover in many companies due to the abundance of more attractive alternative jobs available to highly qualified individuals.[32]

Efforts to manage turnover directly are frequently fraught with difficulty, even in organizations that concentrate on rewarding good performers. Of course, some turnover is inevitable and in some cases it may even be desirable. For example, if the organization is trying to cut costs by reducing its staff, having people voluntarily choose to leave is preferable to having to terminate them. And if the people who choose to leave are low performers or express high levels of job dissatisfaction, the organization may also benefit from turnover.

organizational citizenship The behavior of individuals that makes a positive overall contribution to the organization

Organizational Citizenship

Organizational citizenship refers to the behavior of individuals that makes a positive overall contribution to the organization.[33] Consider, for example, an employee who does work that is acceptable in terms of both quantity and quality. However, she refuses to work overtime, she won't help newcomers learn the ropes, and she is generally unwilling to make any contribution to the organization beyond the strict performance of her job. While this person may be seen as a good performer, she is not likely to be seen as a good organizational citizen.

Another employee may exhibit a comparable level of performance. In addition, however, he will always work late when the boss asks him to, he takes time to help newcomers learn their way around, and he is perceived as being helpful and committed to the organization's success. While his level of performance may be seen as equal to that of the first worker, he is also likely to be seen as a better organizational citizen.

The determinant of organizational citizenship behaviors is likely to be a complex mosaic of individual, social, and organizational variables. For example, the personality, attitudes, and needs of the individual will have to be consistent with citizenship behaviors. Similarly, the social context, or work group, in which the individual works will need to facilitate and promote such behaviors (we discuss group dynamics in Chapter 18). And the organization itself, especially its culture, must be capable of promoting, recognizing, and rewarding these types of behaviors if they are to be maintained. While the study of organizational citizenship is still in its infancy, preliminary research suggests that it may play a powerful role in organizational effectiveness.[34]

MANAGEMENT IMPLICATIONS Managers should realize that employees can exhibit a wide array of workplace behaviors. They should try to determine which behaviors are most important and seek ways of encouraging those behaviors instead of alternative behaviors.



Organizational citizenship refers to the behavior of individuals that makes a positive overall contribution to the organization. The recent spate of so-called "reality programs" on television often rely on citizenship behaviors. These three people, for example, were part of the original *Survivor* television show. People worked together in various games and competitive activities, but the group then voted individuals out of the group one-by-one. In most cases, participants who displayed good citizenship behaviors were among the final contestants vying for the big prize.

Summary of Key Points

Understanding individuals in organizations is an important consideration for all managers. A basic framework that can be used to facilitate this understanding is the psychological contract—the set of expectations held by people with respect to what they will contribute to the organization and what they expect to get in return. Organizations strive to achieve an optimal person-job fit, but this process is complicated by the existence of individual differences.

Personality is the relatively stable set of psychological and behavioral attributes that distinguish one person from another. The "big five" personality traits are agreeableness, conscientiousness, negative emotionality, extraversion, and openness. Other important traits are locus of control, self-efficacy, authoritariansim, Machiavellianism, self-esteem, and risk propensity.

Attitudes are based on emotion, knowledge, and intended behavior. Whereas personality is relatively stable, some attitudes can be formed and changed easily. Others are more constant. Job satisfaction or dissatisfaction and organizational commitment are important work-related attitudes.

Perception is the set of processes by which an individual becomes aware of and interprets information about the environment. Basic perceptual processes include selective perception and stereotyping. Perception and attribution are also closely related.

Stress is an individual's response to a strong stimulus. The general adaption syndrome outlines the basic stress process. Stress can be caused by task, physical, role, and interpersonal demands. Consequences of stress include organizational and individual outcomes, as well as burnout. Several steps can be taken to manage stress.

Creativity is the capacity to generate new ideas. Creative people tend to have certain profiles of background experiences, personal traits, and cognitive abilities. The creative process itself includes preparation, incubation, insight, and verification.

Workplace behavior is a pattern of action by the members of an organization that directly or indirectly influences organizational effectiveness. Performance behaviors are the set of work-related behaviors the organization expects the individual to display and thus fulfill the psychological contract. Basic withdrawal behaviors are absenteeism and turnover. Organizational citizenship refers to behavior that makes a positive overall contribution to the organization.

Discussion Questions

Questions for Review

1. What is a psychological contract? Why is it important?
2. Identify and describe five basic personality attributes.
3. Identify and discuss the steps in the creative process.
4. Identify and describe several important workplace behaviors.

Questions for Analysis

5. An individual was heard to describe someone else as having "no personality." What is wrong with this statement? What did the individual actually mean?
6. Describe a circumstance in which you formed a new attitude about something.
7. As a manager, how would you try to make someone a better organizational citizen?

Questions for Application

8. Write the psychological contract you have in this class. That is, what do you contribute, and what inducements are available? Compare your contract with those of some of your classmates. In what ways are they similar, and in what ways is yours unique?
9. Assume that you are going to hire three new employees for the department store you manage. One will sell shoes, one will manage the toy department, and one will work in the stockroom. Identify the basic characteristics you want in each of the people to achieve a good person-job fit.
10. List the things that cause stress for the typical college student. Now list the ways that college students manage stress. Discuss your lists with those of three of your classmates.

BUILDING EFFECTIVE *conceptual* AND *diagnostic* SKILLS

Exercise Overview

Conceptual skills refer to a manager's ability to think in the abstract, while diagnostic skills focus on responses to situations. These skills must frequently be used together to understand the behavior of others in the organization, as illustrated by this exercise.

Exercise Background

Human behavior is a complex phenomenon in any setting but especially so in organizations. Understanding how and why people choose to diplay particular behaviors can be difficult and frustrating. but quite important. Consider, for example, the following scenario.

Sandra Buckley has worked in your department for several years. Until recently, she has been a model employee. She was always on time or early for work and stayed late whenever necessary to get her work done. She was upbeat and cheerful, and she worked very hard. She frequently said that the company was the best place she had ever worked and that you were the perfect boss.

About six months ago, however, you began to see changes in Sandra's behavior. She began to come in late occasionally, and you cannot remember the last time she agreed to work past 5:00. She also complains a lot. Other workers have started to avoid her because she is so negative all the time. You also suspect that she may be looking for a new job.

Exercise Task

Using the scenario described above as background, do the following:

1. Assume that you have done some background work to find out what has happened. Write a brief case with more information that explains why Sandra's behavior has changed (i.e., your case might include the fact that you recently promoted someone else when Sandra might have expected to get the job). Make the case as descriptive as possible.
2. Relate elements of your case to the various behavioral concepts discussed in this chapter.
3. Decide whether or not you might be about to resolve the situation with Sandra to overcome any issues that have arisen.
4. Which behavioral process or concept discussed in this chapter is easiest to change? Which is the most difficult to change?

BUILDING EFFECTIVE *time-management* SKILLS

Exercise Overview

Time-management skills help people prioritize work, work more efficiently, and delegate appropriately. Poor time-management skills, in turn, may result in stress. This exercise will help you relate time-management skills to stress reduction.

Exercise Background

List several of the major events or expectations that cause stress for you. Stressors might involve school (i.e., hard classes, too many exams, etc.), work (i.e., financial pressures, demanding work schedule), and/or personal circumstances (i.e., friends, romance, family, etc.). Try to be as specific as possible. Also try to identify at least ten different stressors.

Exercise Task

Using the list that you developed, do each of the following:

1. Evaluate the extent to which poor time-management skills on your part play a role in how each stressor affects you. For example, do exams cause stress because you delay studying?
2. Develop a strategy for using time more efficiently in relation to each stressor that relates to time.
3. Note interrelationships among different kinds of stressors and time. For example, financial pressures may cause you to work, but work may interfere with school. Can any of these interrelationships be managed more effectively vis-à-vis time?
4. How do you manage the stress in your life? Is it possible to manage stress in a more time-effective manner?

BUILDING EFFECTIVE *interpersonal* SKILLS

Exercise Overview

Interpersonal skills refer to the ability to communicate with, understand, and motivate individuals and groups. Implicit in this definition is the notion that a manager should try to understand the important characteristics of others, including their personalities. This exercise will give you insights into both the importance of personality in the workplace as well as some of the difficulties associated with assessing personality traits.

Exercise Background

You will first try to determine which personality traits are most relevant for different jobs. You will then write a series of questions that you think may help assess or measure those traits in prospective employees. First, read each of the job descriptions below.

1. *Sales representative:* This position involves calling on existing customers to ensure that they remain happy with your firm's products. It also requires that the sales representatives work to get customers to increase the quantity of your products that they are buying and to attract new customers. It is also important that a sales representative be aggressive but not pushy.
2. *Office manager:* The office manager oversees the work of a staff of twenty secretaries, receptionists, and clerks. The manager hires them, trains them, evaluates their performance, and sets their pay. The manager also schedules working hours and, when necessary, disciplines or fires workers.

3. *Warehouse worker:* Warehouse workers unload trucks and carry shipments to shelves for storage. They also pull customer orders from shelves and take products for packing. The job requires that workers follow orders precisely, and there is little room for autonomy or interaction with others during work.

Exercise Task

Working alone, think of a single personality trait that you think is especially important for a person to perform each of these three jobs effectively. Next, write five questions that, when answered by a job applicant, will help you assess how that applicant scores on that particular trait. These questions should be of the type that can be answered on five-point scales (i.e., strongly agree, agree, neither agree nor disagree, disagree, strongly disagree).

After you have completed writing your questions, exchange them with those of one of your classmates. Pretend you are a job applicant. Provide honest and truthful answers to each question. After each of you has finished answering each other's questions, discuss the traits each of you identified for each position and how well you think your classmate's questions actually measure those traits.

Conclude by addressing the following questions:

1. How easy is it to measure personality?
2. How important do you believe it is for organizations to consider personality in hiring decisions?
3. Do perceptions and attitudes affect how people answer personality questions?

CHAPTER CLOSING CASE

THE RISE OF FREE AGENTS

The sports tradition of free agents is taking hold in the business world. Free agents—self-employed individuals who contract for organizational work on a project basis—already make up more than one-quarter of the U.S. workforce. Within a decade, as many as four in ten workers are likely to be free agents, going from project to project and company to company as their talents are needed.

Several factors are fueling this trend. First, companies that downsized in earlier years find they sometimes need specialists with particular skills to handle certain projects, technologies, or clients. Second, companies can avoid the expense and hassles of constant hiring-and-firing cycles by selectively contracting with free agents to supplement their full-time, permanent workforce during peak sales, planning, or production periods. And third, companies now have the technology to transcend organizational and geographical boundaries by connecting free agents outside the organization with employees inside for effective teamwork and collaboration.

For their part, free agents gain more flexibility in choosing among clients and projects, learning and applying new skills, managing time and other resources, balancing work and family obligations, and negotiating compensation. Free agents can work solo or come together as needed for specific projects. For example, web site designer Andrew Keeler often establishes temporary teams to work with him on projects for Adobe Systems, Hewlett-Packard, and other clients. Keeler has had face-to-face contact with only a few of his free-agent colleagues; in most cases, he uses e-mail to assemble a team, coordinate all work, and complete the project—quickly.

Keeler's experience illustrates one of the downsides to being a free agent: lack of personal interaction. E-mailing a joke adorned with a smiley face just isn't the same as sharing a laugh with a colleague while standing

around the proverbial water cooler. Also, free agents can't always find as much work as they'd like, nor do they always get paid on time. Still, free agents in high-demand fields such as e-commerce technology can earn significantly more as independents than as employees, even though they have to arrange for their own health insurance and fund their own retirement accounts instead of receiving those items as corporate benefits.

Companies are increasingly using free agents to keep their organizations flat and lean. When the Finnish telecommunications giant Nokia began selling computer displays in the United States, it hired only five permanent employees to staff the new office. The company relied on a network of free agents and outside suppliers to manage a wide range of activities, from marketing and sales to shipping and technical support.

But how do companies and free agents find each other? In addition to word of mouth communication, more matches are being made on the Internet. Monster Talent Market (http://www.talentmarket.monster.com) allows free agents to post information about their skills, schedules, and prices so companies can bid for their services. FreeAgent.com (http://www.freeagent.com) stores free agents' résumés for review by prospective clients and lists projects open for free agents' bids; similarly, eLance (http://www.elance.com) displays résumés and projects for which companies are seeking free agents. Free-agents in search of community can visit Guru.com (http://www.guru.com), a site that goes beyond project and free-agent listings to offer articles and advice about working independently. Watch for even more web sites as the free-agent movement gathers momentum outside high-tech industries.

Case Questions

1. How is the free-agent movement likely to influence workplace behaviors?
2. What work-related attitudes are more important for employees than for free agents?
3. Which personality traits do free agents need to be effective?

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