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On the Convergence of Business Policy and Organization Design

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It has been apparent to concerned observers for some time that essential areas of shared interest exist between the business policy and organization theory fields. Organizational variables have captured the attention of policy specialists pursuing process issues such as political determinants of strategy formulation and the effect of employee commitment on the execution of strategic decisions. At the same time, the concept of corporate strategy has become a variable considered by organization theorists attempting to prescribe viable ranges of organization structure and to explain organizational performance. Only recently has robust evidence of the convergence of policy and theory surfaced.

Individuals seeking more accurate explanations and comprehensive understanding of strategy formulation, strategy implementation, corporate performance, and organizational effectiveness have fueled the developing convergence. The phenomenon will be traced from its fragmented origins to its current position on the threshold of major convergence.

The primary intellectual domain reflected in the recent research and teaching of major business schools' policy faculty has been concepts, theory, and practice related to the formulation of corporate and business level strategy, and the relationships between strategy and corporate performance. During these same years, researchers in organization theory have conducted a search for theory and constructs which identify the organizational and environmental determinants of organizational structures and the relationship between structural variables and measures of organizational effectiveness. Although major emphasis in business policy has been on the concept of strategy, while the attention of organization theorists has focused on structure, the strategy and structure concepts are not unrelated.

Earlier Business Policy and Organization Theory

Some twenty years ago, Chandler [1962] proposed that the structure of an organization results from the firm's growth strategy. He posited a causal relationship between strategy and structure which has been investigated extensively by policy researchers. The Harvard studies, reviewed in part by Scott [1973], refined Chandler's theory of diversification [Wrigley, 1970], demonstrated that all multidimensional structural forms were not alike [Rumelt, 1974], extended the analysis to European countries [Channon, 1971], and added the dimension of international expansion to Chandler's original formulation [Stopford and Wells, 1972; Franko, 1974].

As policy researchers investigated Chandler's strategy-structure proposition, researchers in the field of organization theory were developing and testing contingency theories of organization design. The conceptual works of Emery and Trist [1965], Terreberry [1968], and Thompson [1967] emphasized the organization's need to adapt to environmental forces in order to maintain viability. The appropriateness of a particular organization structure was thought to be contingent upon some set of identifiable variables. Subsequent research was designed to specify those variables and to outline their effects on organizations.

The empirical studies conducted by such authors as Burns and Stalker [1961], Lawrence and Lorsch [1967], and Duncan [1972] attempted to relate environmental conditions to types of organization structure. Woodward [1965] and Perrow [1967] extended contingency relationships to include technological determinism. More recently, authors have begun to search for relationships between these two determinants of organization structure, environment and technology [Duncan, 1972; Pennings, 1975; Galbraith, 1977].

The concept of the environment as the ultimate judge of the propriety of a particular strategy or structure is central to both the business policy and organization theory fields.

Emerging Intersection of Business Policy and Organization Theory

Although business policy and organization theory continue to emphasize organization-environment coalignment, each has its own perspective on the subject and has focused on different subsets of variables which impact alignment [Bourgeois, 1980]. Business policy views management as a proactive or opportunistic agent and has centered much of its research on the strategy variable. Organization theory has taken a more reactive stance in viewing the environment as a deterministic force to which organizations must respond through structural rearrangements.

As implementation of strategy came to be recognized as distinct from its formulation [Andrews, 1971], organization structure and design came to be seen as primary strategy implementation vehicles. According to Ansoff [1979], firms find new strategies do not work until the organization's "structure" (including managerial skills, rewards, systems, and organizational values and information, as well as the more traditional elements of structure) is adjusted to support the new strategy. He suggested that a "strategy of structure" concept needs to be developed.

Organization theory has been concerned primarily with the linkage between environmental uncertainty and structure, while business policy has been concerned with the interrelationships of strategy and structure. Each has noted, however, at least indirectly, the other.

As theorists began to view organizations as open systems, attention focused on the nature and composition of the environments in which organizations operated [Emery and Trist, 1965]. Thompson's [1967] discussion of domain choice could certainly be viewed as including strategic issues, although he was primarily an organization theorist. Galbraith and Nathanson [1979] suggested that the concept of domain consensus in organization theory is similar to the business policy concept of product/market distinctive competence. Hrebiniak and Snow [1980] also indirectly considered strategic issues by positing industry as an important variable.

Galbraith and Nathanson [1979] explicitly recognized the interdependence of strategy and structure in their proposition that effective financial performance is obtained through congruence of strategy, structure, processes, rewards, and people. Recently, some support has been provided for the hypothesis that a match between strategy and structure facilitates coping with environmental pressures [Grinyer, Yasai-Ardekani, and Al-Bazzaz, 1980]. In their research, a "match" reduced an organization's perception of environmental hostility, which in turn was related to financial performance.

Strategy and structure are linked by the concept of environment--the appropriateness of choices in both strategy and structure is affected by environmental conditions. There are ongoing controversies, however, over the direction of causality in the strategy-structure and structure-environment relationships.

Strategy, Structure, and Environment

Strategy-Structure. The notion that strategic change necessitates adjustment to structural arrangements is rooted in Chandler's [1962] work. The proposition has been tested, and, for the most part, affirmed by a number of researchers [Wrigley, 1970; Stopford and Wells, 1972; Channon, 1973; Rumelt, 1974; Grinyer, Yasai-Ardekani, and Al-Bazzaz, 1980]. It has not, however, gone unchallenged [Hall and Saias, 1980].

In 1972, Child proposed that strategic choice was the critical variable in a theory of organizations. Organization decision makers may be in a position to institute modifications of the context (through, for instance, a revised environmental strategy) in order to retain a preferred structure without a serious detriment to performance. Thus, the process could be opposite from that described by earlier structure-contingency models. Decision makers may impose a desired structure on a particular environmental context, or they may employ proactive strategies to bring context in line with current structure [Child, 1972; Weick, 1969].

Where Child [1972] and Montanari [1978, 1980] viewed contextual factors as constraints which define the range of managerial discretion with respect to components of the strategy mix, Bobbit and Ford [1980] feel context should be viewed simply as a source of information. Hall and Saias [1980] reverse the sequence, viewing structure as a constraint on strategic choice.

In Galbraith and Nathanson's [1978] view, a move from one strategy to another requires disengaging an existing alignment and reconnecting all of these factors, which implies that strategy leads to structure. But Galbraith's notion [1977] of managing the environment (based on Thompson's outline of interorganizational strategies [1967]), as an alternative to adjusting structure when the environment changes, implies that the strategy-structure causality may be reversed if the organization chooses to take a proactive stance with respect to its environment. Miles [1980], in his model of organizational choice and adaptation, also recognizes that organizations may be both reactive and proactive in their attempts to deal with important sectors of the environment.

A similar discussion is taking place in the field of organization theory—do environmental conditions dictate the appropriate structure of an organization as does the structure mediate the impact of the environment?

<u>Environment-Structure</u>. Dill's [1958] case study was among the first attempts to trace variation in organization structure to environmental factors. Burns and Stalker [1961] extended this structural-contingency notion by noting that successful firms in a stable environment tended to have "mechanistic" or highly bureaucratized structures and processes, while successful firms in changing and uncertain environments tended to have "organic" or flexible structures and processes. Research on this relationship has continued at the organizational and subunit levels [Lawrence and Lorsch, 1967; Duncan, 1972; Sathe, 1976; Jones, 1977; Leifer and Huber, 1977].

The direct relationship between environment and structure may be mediated, however, by perceptions; i.e., the same "objective" environment may appear different to different organizations. Miles, Snow, and Pfeffer [1974] feel that an organization responds only to what it perceives; those things which are not noticed do not affect the organization's decisions and actions. These researchers found that, within the same objective environment, organizations whose top managers perceived little change or uncertainty in the environment coexisted with organizations whose top managers perceived continuous change and uncertainty in that same environment.

In addition, the conceptual work of Downey and Slocum [1975] and Galbraith [1973], and Weick's notion of "enacted" environment [1969], have all suggested that the organizational design actions a firm takes in response to its environment may well be more consistent with perceptions of the environment than with more objective indicators of environmental conditions.

There is also a compelling argument for reciprocal causation between environmental uncertainty and organizational structure [Bourgeois, McAllister and Mitchell, 1978]. Huber, O'Connell, and Cummings [1975] found, for example, that changes in structure led to changes in perceived environmental uncertainty.

A final set of relationships which must be examined is those between strategy and environment.

Strategy-Environment. Analysis of the risks, opportunities, and trends in the environment has long been heralded as one of the first steps in the formulation of a firm's strategy [Andrews, 1971; Thompson and Strickland, 1980; Christiansen, Berg, and Salter, 1980]. Factors which influence goals, strategy, and structure, and are beyond the firm's direct control, comprise the organization's environment. A major problem in environmental analysis, aside from the difficulty of accurately forecasting future values of particular variables, is knowing which factors to examine in the first place. The nature and condition of the environment constrains an organization's strategic choices.

It seems equally plausible that choice of strategy would also influence the amount of environmental uncertainty an organization experiences [Thompson, 1967; Galbraith, 1977]. Choice of strategy defines, in part, the domain of elements in the environment which are relevant to the organization [Miles, Snow, and Pfeffer, 1974; Miles and Snow, 1978].

Bourgeois [1980] has suggested that a "marriage" of strategy and environment variables, as treated in their separate disciplines, would be of benefit to both business policy and organization theory. In his view, the general task environment identified by organization theorists is relevant to corporate-level strategies, while the task environment is directly related to business-level strategies. As with the strategy-structure and environment-structure relationships, the relationship between strategy and environment can be viewed as reciprocal.

The reciprocal sets of relationships among the strategy, structure, and environment variables may be depicted graphically, as in Figure 1.

Insert Figure 1 about here

As the environment changes, firms are forced to alter their strategies in order to remain viable competitors. In order to implement new strategies, structures must be adjusted. Initially, interdependence among the constructs is likely to be sequential in nature. A new firm would probably begin by looking at the environment to see what opportunities are available, and would then develop a strategy/mission on the basis of the analysis. Once the organization's intended mission has been established, resources would be engaged to allow the organization to fill its mission; and from this, structure develops. Over the long run, however, the relationships between environment, strategy, and structure are likely to be reciprocally interdependent. Strategic adjustments may alter the nature of the environment, which in turn may require structural adjustments. Existing structures may also constrain the strategic choices considered by, or available to, the organization.

Further research needs to be conducted to determine the exact nature of the interrelationships between strategy, structure, and environment, particularly at the interface of the three concepts. To date, only one study has explicitly considered all three [Grinyer, Yasai-Ardekani, and Al-Bazzaz, 1980]. Their data showed clearly that a match between strategy and structure is related to perceived environmental pressure.

Implications of Convergence

It seems fair to say that few researchers in business policy have not found themselves wishing they had firmer grounding in organization theory and design as they pursue examinations of the processes by which strategic decisions are implemented. Similarly, most individuals with research interests in organizational issues are aware, either dimly or acutely, that strategy is a key variable in determining and constraining organizational arrangements. Yet few possess sufficient information to proceed beyond the simple awareness of the limits of their knowledge. Galbraith and Nathanson [1979] note, for example, that although a number of people are moving toward consensus on strategy and structure, little thinking or language of one field enters the other, and vice versa.

Interdisciplinary research which examines the interface between strategy, structure, and environment in greater detail may result in the development of a meta-theory which integrates the interests of both fields. Measures of constructs, such as environment, which are important to both fields may be developed and shared, enhancing the further development of integral theories. In addition to increasing our understanding of the relationships between organization theory and business policy, it may also encourage more critical examinations of the fields as separate entities.

As an example, the concept of environment, shared by the policy and theory fields, has been viewed in the past from different perspectives. Most of the business policy literature dealing with the concept of environment has focused on trends, ratios, forces, or other aggregations. The contribution from the organization theory literature has been in identifying the sources of these movements [Bourgeois, 1980]. The work available from organization theory could help policymakers identify environmental types and ranges of appropriate activity within those environments. Typologies of environments and categories of strategic behavior consistent with particular environmental types may contribute to the development of an integrated theory. Such cross-classifications of environmental types and strategic alternatives might also help predict longer-run effectiveness of a particular business or corporate strategy.

Business policy has tended, in the past, to focus on the policy formulation process. The policies developed by organizations to manage their environmental context have been the central issue--how the organization should approach its environment, how distinctive competence should best be exploited, what resources can be utilized, and whether the proposed strategy is feasible given the limitations of available resources.

Schendel and Hofer [1979] suggest that the issue of strategy implementation has been given far less attention than strategy formulation; yet managers of ongoing organizations spend far more time and effort in implementing and managing strategies than on formulating them [Schendel and Hofer, 1979]. As attention shifts to strategy implementation in business policy, the interface with organization theory will become increasingly important, because structure--the control, coordination, and communication mechanisms of an organization--operationalizes strategy.

Recognition of this interdependence will create a new class of strategic decisions to be examined by policy researchers. For example, when an organization is attempting to achieve coherence among strategy, structure, and environment, when should strategy be the altered variable?

The concept of organizational effectiveness must also be reevaluated by the policy and theory fields as convergence continues. The effectiveness of a firm's structure and strategy must be evaluated not only in an externally relative way (compared to competitors), and in an absolute way (in terms of social responsibility and consistency with management philosophies), but also relative to one another internally. The question becomes not only is the strategy a good one, but is it feasible given the constraints imposed by the current design and environment?

But how does a firm achieve a "fit" among strategy, structure, and environment? What is the nature of the relationships among the firm's selected strategy, the environment within which it operates, the organizational arrangements selected for implementation, and corporate performance and effectiveness? What definite statements can be made about the quality of the "fit" between various strategies, sets of organizational arrangements, and environments, as measured by performance and effectiveness? What are the specific effects of organizational and human resource variables in the process of strategy formulation and its outcomes? The work of Miles and Snow [1978] extends this question far beyond structure to the values and attitudes of the dominant management group and their influence on strategic choice. Some research questions this raises include:

--To what extent does the structure of an organization function as an information filter regarding strategic activity? Does a particular design affect the type of information the organization is able to perceive, collect, and use?

--To what extent does an organization's design enhance or detract from management's ability to <u>make</u> strategic decisions? Does the culture or do procedural operations within the firm affect the ability of management personnel to make effective decisions?

--Does the organization's structure bias the information search process of collecting data for strategic decisions? Does the structure encourage the organization to collect one, but not another, type of data or data source?

--Does the structure facilitate or delay the transfer of information from the environment through the organization? Does it increase the lag time between the occurrence of an event and the recognition of the event by the organization? How much lag is acceptable, and for which strategies and which types of decisions?

--Is the strategy-structure relationship sequentially interdependent in strategy alteration and reciprocal in strategy maintenance?

Dynamic concepts of strategic management, such as strategic business units (SBU's), imply the feasibility of developing analytical methods of assessing a diversified firm's present and potential strategies. They also imply the desirability of organizing and managing units of the firm to play varying strategic roles differently. Researchable questions are only now being formulated in this area. Organization theorists and designers should be in a strong position to bring both theoretical strength and research methodologies to these essentially organizational questions.

Similarly, as organization theory and design move toward viewing organizations as both reactive and proactive in their attempts to deal with important sectors of the environment [Miles, 1980], issues of strategic choice will need to be better understood. Business policy has much to contribute from its many years of studying strategic alternatives.

The interdependence of the strategy, structure, and environment variables, which is highlighted by the convergence of policy and theory, underscores the need to address structure and strategy simultaneously. Although it may prove difficult, we must overtly recognize that strategy, structure, and environment all shape one another--none can be altered, developed, or accounted for in isolation. Management of the interrelations of these three variables is, in our view, an absolute requirement for organizational success and effectiveness in the long run.

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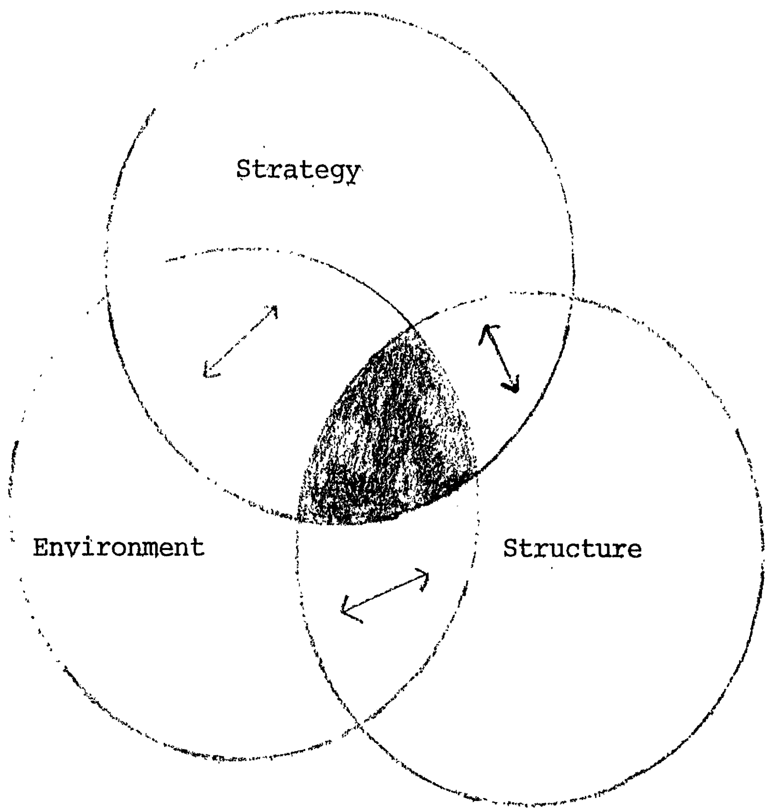

Figure 1

The Interrelationships Between
Strategy, Structure, and Environment