Organization Design And Control

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Chapter 3: Organizing in a Changing Global Environment

Textbook:

Jones, G. R., Organizational Theory, Design, and Change Prentice Hall Inc., 7th edition

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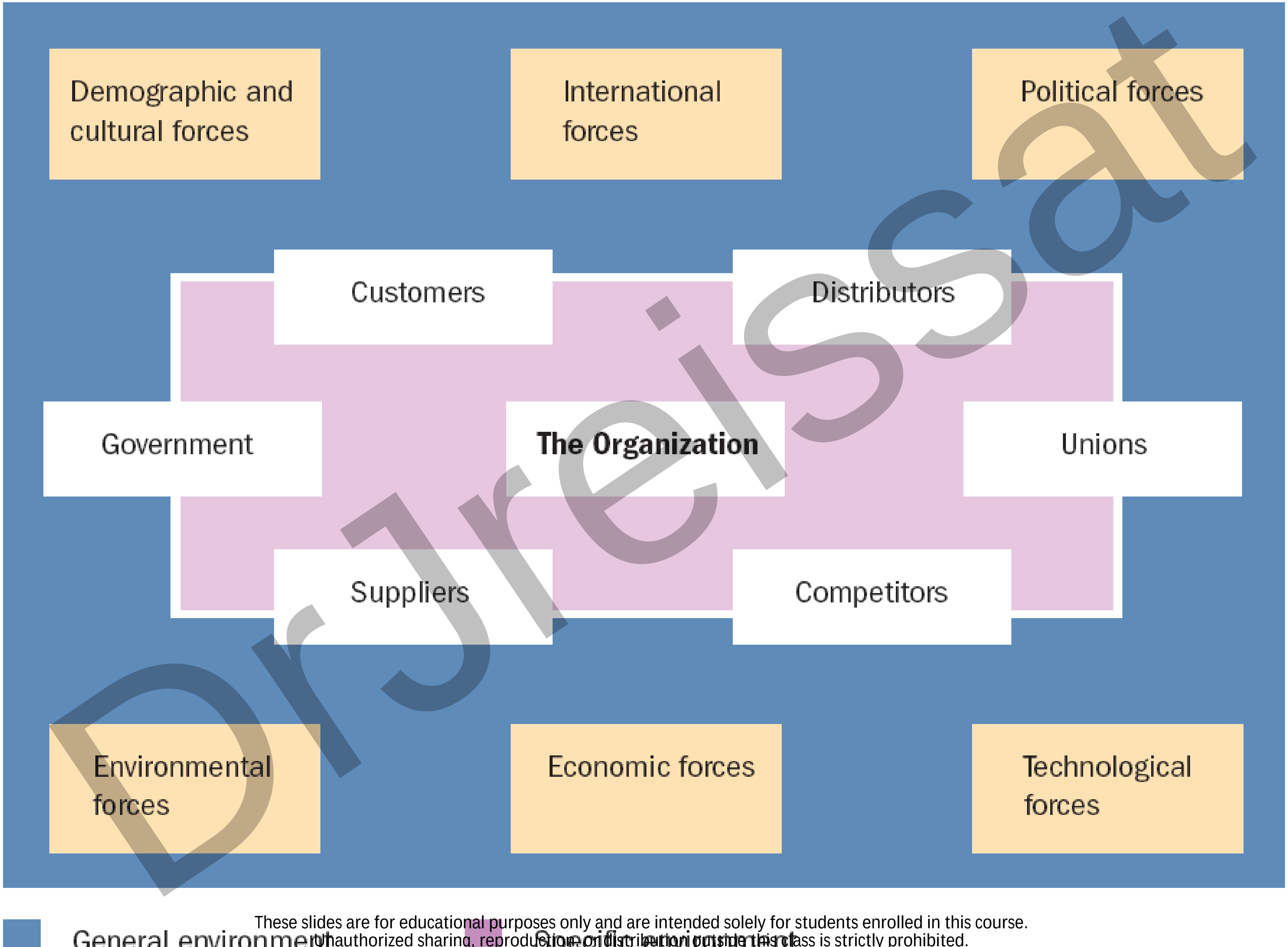
Learning Objectives

- List the forces in an organization's specific and general environment that give rise to opportunities and threats
- Identify why uncertainty exists in the environment
- Describe how and why an organization seeks to adapt to and control these forces to reduce uncertainty
- Understand how resource dependence theory and transaction cost explain why organizations choose different kinds of interorganizational strategies to manage their environments to gain the resources they need to achieve their goals and create value for their stakeholders

What is the Organizational Environment?

- Environment: The set of forces surrounding an organization that have the potential to affect the way it operates and its access to scarce resources
- Organizational domain: The particular range of goods and services that the organization produces and the customers and other stakeholders it serves

Figure 3.1 - The Organizational Environment



The Specific Environment

- The forces from outside stakeholder groups that directly affect an organization’s ability to secure resources
- Changes in the number and types of customers, and in customer tastes, are forces that affect an organization

The Specific Environment (cont.)

- Global supply chain management: The coordination of the flow of raw materials, components, semifinished goods, and finished products around the world
- In the global environment, supplies of inputs can be obtained not just from domestic sources but from any country in the world

The Specific Environment (cont.)

- The challenges associated with distributing and marketing products increase in the global environment
  - The tastes of customers vary from country to country
  - Many advertising and marketing campaigns are country specific
  - Many products are customized to overseas customers' preferences

The Specific Environment (cont.)

- An organization that establishes global operations has to forge good working relationships with its new employees and with any unions that represent them
- Each country has its own system of government and its own laws and regulations that control the way business is conducted

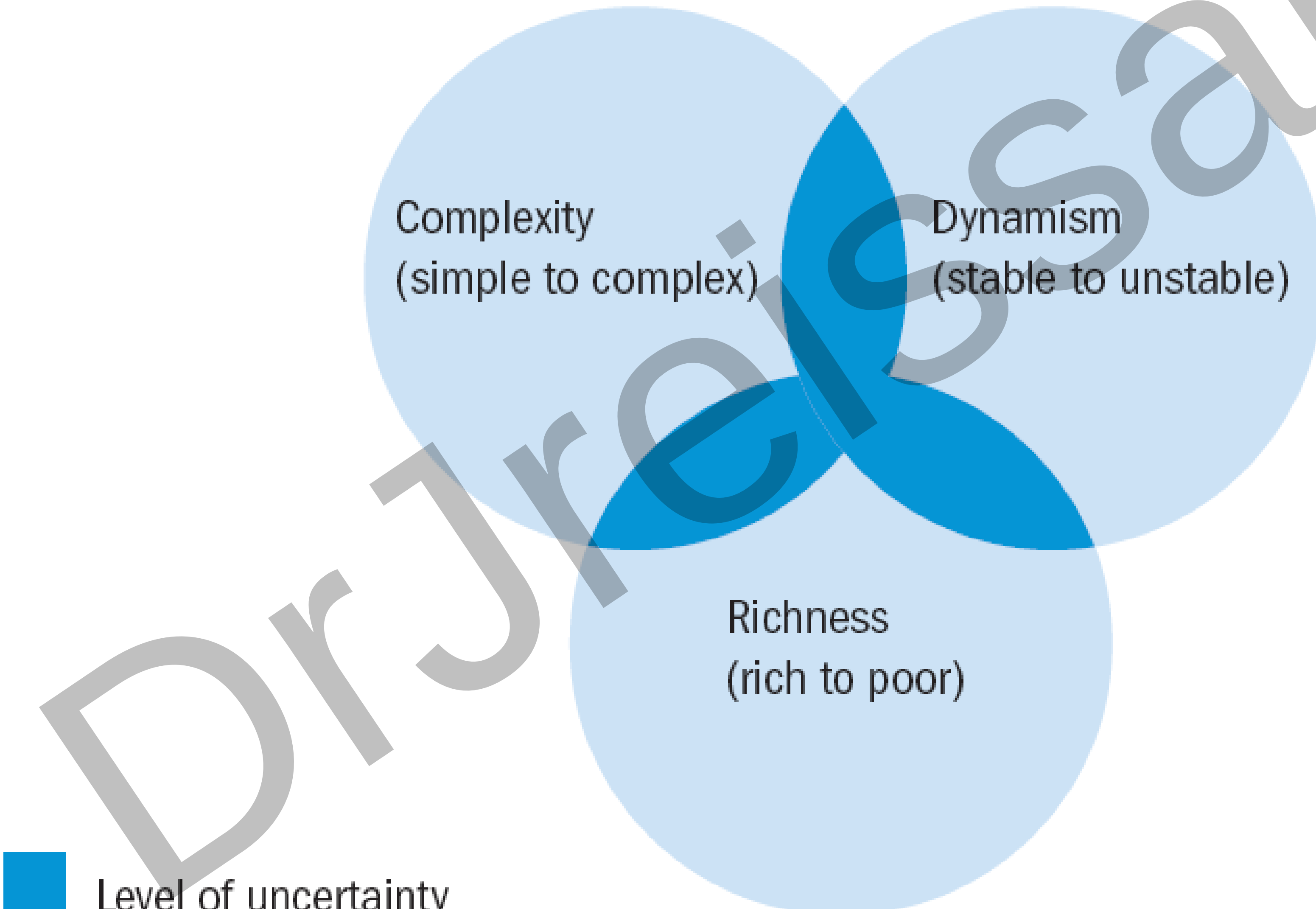
The General Environment

- The forces that **shape** the specific environment and **affect** the ability of all organizations in a particular environment to obtain resources

The General Environment

Economic forces	• Interest rates, the state of the economy, and the unemployment rate, determine the level of demand for products and the price of inputs
Technological forces	• The development of new production techniques and new information-processing equipment influence many aspects of organizations' operations
Political, ethical, and environmental forces	• Influence government policy toward organizations and their stakeholders
Demographic, cultural, and social forces	• The age, education, lifestyle, norms, values, and customs of a nation's people

Figure 3.2 - Three Factors Causing Uncertainty



Resource Dependence Theory

- A theory that argues the goal of an organization is to minimize its dependence on other organizations for the supply of scarce resources in its environment and to find ways of influencing them to make resources available

Resource Dependence Theory (cont.)

- An organization must simultaneously manage two aspects of its resource dependence:
  - It has to exert influence over other organizations so it can obtain resources
  - It must respond to the needs and demands of the other organizations in its environment

Resource Dependence Theory (cont.)

- The strength of one organization’s dependence on another depends on:
  - How vital the resource is to the organization’s survival
  - The extent to which other organizations control the resource

Interorganizational Strategies for Managing Resource Dependencies

- Linkage mechanisms, while controlling interdependency, require coordination
- Coordination reduces each organization's freedom to act
- Organizations aim to choose the interorganizational strategy that offers the most reduction in uncertainty with the least loss of control

Figure 3.3 - Interorganizational Strategies for Managing **Symbiotic** Interdependencies

Reputation is a state in which an organization is held in high regard and trusted by other parties because of its fair and honest business practices.

Cooptation This is a strategy that manages symbiotic interdependencies by neutralizing problematic forces in the specific environment. An organization that wants to bring opponents over to its side gives them a stake in or claims in what it does and tries to satisfy their interests. A linkage that results when a director from one company sits on the board of another company is called an **interlocking directorate** and helps in ensuring supplies of scarce capital, exchanging information, and strengthening ties between organizations.

A **strategic alliance** is an agreement that commits two or more companies to share their resources to develop joint new business opportunities. Strategic alliances are becoming an increasingly common mechanism for managing symbiotic (and competitive) interdependencies between companies inside one country or between countries. There are **several types of strategic** alliances like long-term contracts, networks, minority ownership, and joint ventures.

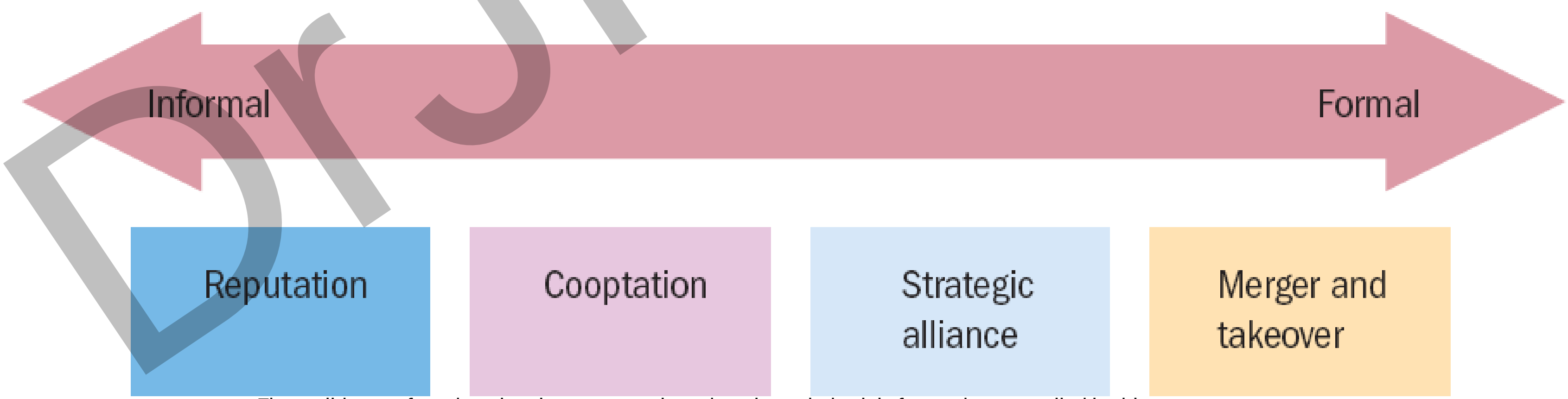


Figure 3.4 - Types of Strategic Alliance

Long-term contracts: Alliances spelled out in long-term contracts between two or more organizations are undertaken with the purpose of reducing costs by sharing resources or by sharing the risk of research and development, marketing, construction, and other activities.

Networks: A network is a cluster of different organizations whose actions are coordinated by contracts and agreements rather than through a formal hierarchy of authority. Members of a network work closely to support and complement one another's activities.

Minority ownership: A more formal alliance emerges when organizations buy a minority ownership stake in each other. Minority ownership makes organizations extremely interdependent, and that interdependence forges strong cooperative bonds.

Joint Venture: This is a strategic alliance among two or more organizations that agree to establish and share the ownership of a new business. Joint ventures are the most formal of the strategic alliances because the participants are bound by a formal legal agreement that spells out their mutual rights and responsibilities.

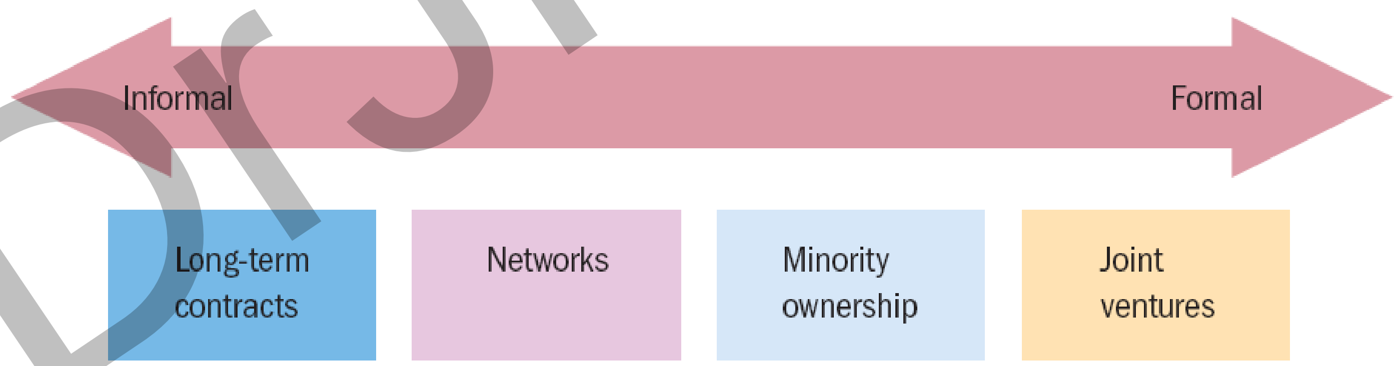


Figure 3.5 - The Fuyo Keiretsu

The Japanese system of *keiretsu* shows how **minority ownership networks** operate. A **keiretsu** is a group of organizations, each of which owns shares in the other organizations in the group and all of which work together to further the group's interests. Japanese companies employ two basic forms of keiretsu. Capital keiretsu is used to manage input and output linkages. Financial keiretsu is used to manage linkages among many diverse companies and usually have a large bank at their center.

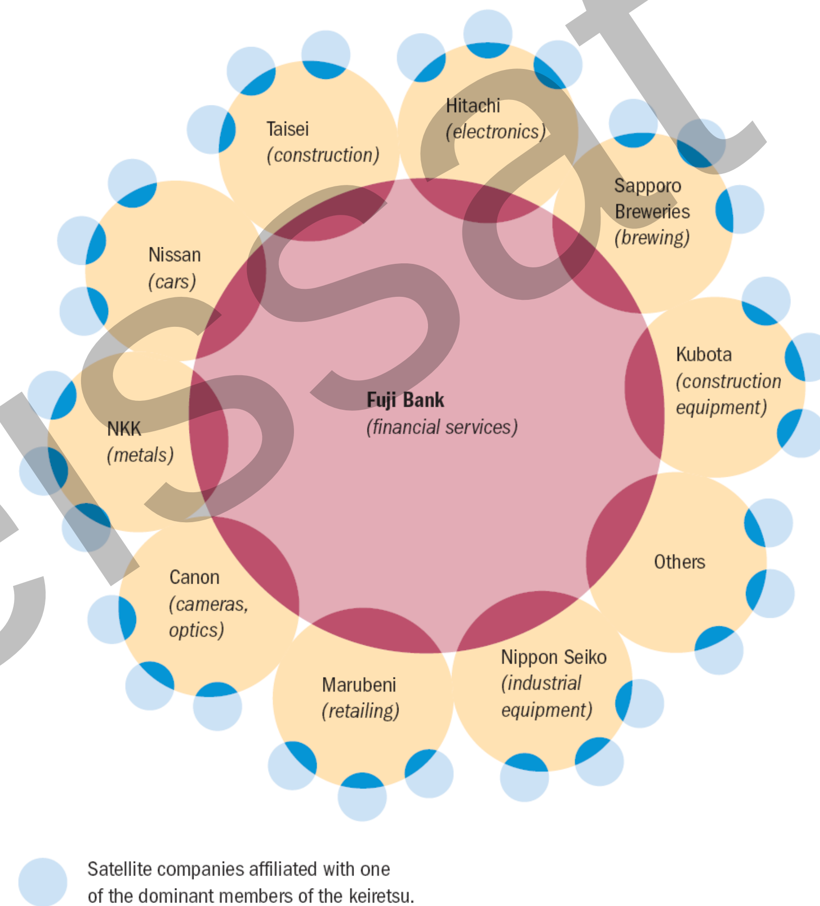


Figure 3.6 - Joint Venture Formation

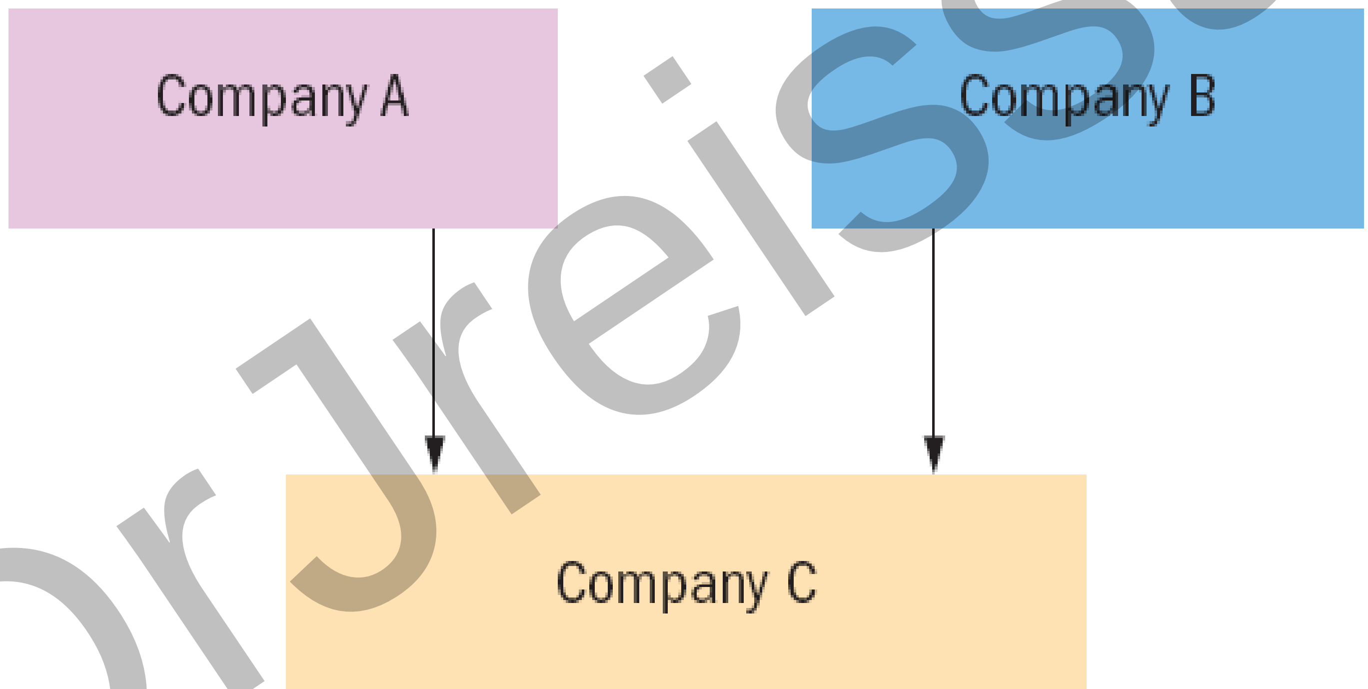
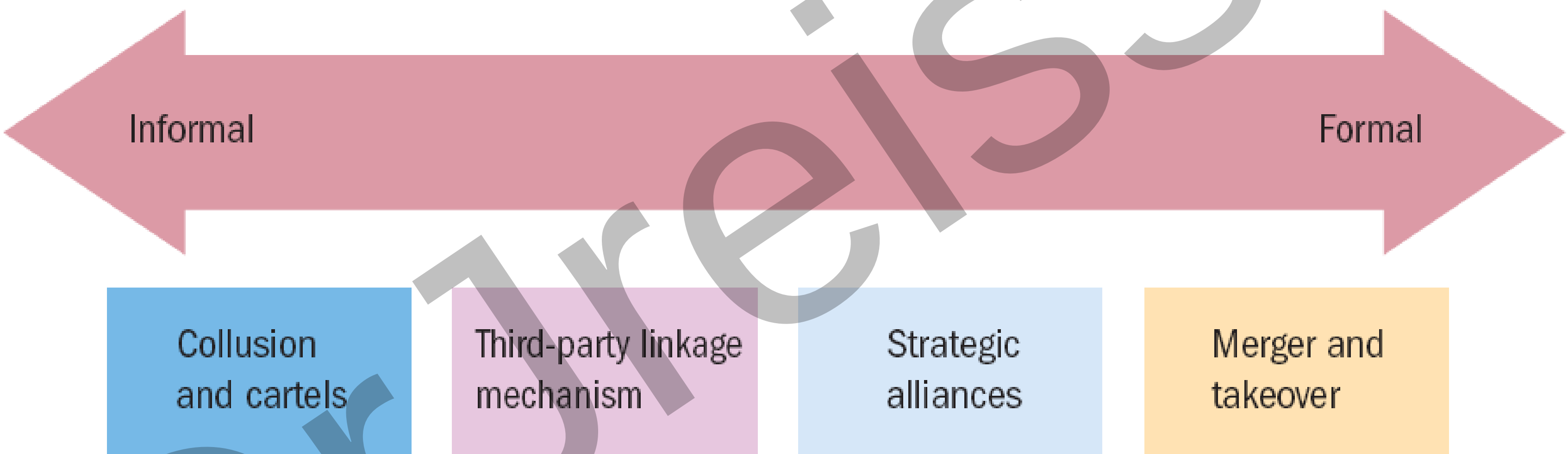


Figure 3.7 - Interorganizational Strategies for Managing Competitive Interdependencies



Interorganizational Strategies for Managing Resource Dependencies

- **Collusion**: A secret agreement among competitors to share information for a deceitful or illegal purpose such as keeping prices high as in the flash memory chip industry
- **Cartel**: An association of firms that explicitly agrees to coordinate their activities

****Cartels and collusion** **increase the stability and richness** of an organization's environment and **reduce the complexity** of relations among competitors.

- **Third-party linkage mechanism**: A regulatory body that allows organizations to share information and regulate the way they compete. **A trade association**, for example, is an organization that represents companies in the same industry and enables competitors to meet, share information, and informally allow them to monitor one another's activities
  - **A more formal but indirect way for competing organizations to coordinate their activities**

Interorganizational Strategies for Managing Resource Dependencies (cont.)

- **Strategic alliances** - Can be used to manage both symbiotic and competitive interdependencies
- **Merger and takeover:**
  - The ultimate method for managing problematic interdependencies
  - The most formal strategy for managing **symbiotic and competitive** resource interdependencies is to **merge with or take over** a supplier or distributor because now **resource exchanges** occur within **one organization** rather than between organizations. As a result, an organization can **no longer be held hostage** by a powerful supplier or by a powerful customer.

Transaction Cost Theory

- **Transaction costs:**

The costs of negotiating, monitoring, and governing exchanges between people arise whenever people work together and also when organizations exchange resources or information.

- Transaction cost theory:

The goal of an organization is to **minimize** the costs of exchanging resources in the environment and the costs of managing exchanges inside the organization

Figure 3.8 - Sources of Transaction Costs

Transaction costs result from a combination of human and environmental factors.

Environmental uncertainty and bounded rationality

The environment is characterized by considerable uncertainty and complexity. People, however, have only a limited ability to process information and to understand the environment surrounding them. Because of this limited ability, or bounded rationality, the higher the level of uncertainty in an environment, the greater the difficulty of managing transactions between organizations.

Opportunism and small numbers

Most people and organizations behave honestly and reputably most of the time, but some always behave opportunistically—that is, they cheat.

Risk and specific assets

- **Specific assets** are investments—in skills, machinery, knowledge, and information—that **create value** in **one particular exchange relationship** but have no value in any other exchange relationship. An organization that sees any prospect of **being trapped or blackmailed** will judge the **investment** in specific assets to be **too risky**. The transaction costs associated with the investment become too high, and value that could have been created is lost.

Transaction Costs and Linkage Mechanisms

Organizations base their choice of inter-organizational linkage mechanisms on the level of transaction costs involved in an exchange relationship

- Transaction costs are low when:
  - Organizations are exchanging nonspecific goods and services
  - Uncertainty is low
  - There are many possible exchange partners

Transaction Costs and Linkage Mechanisms (cont.)

- Transaction costs **increase** when:
  - Organizations begin to exchange more specific goods and services
  - Uncertainty increases
  - The number of possible exchange partners falls

Transaction Costs and Linkage Mechanisms (cont.)

- Bureaucratic costs - Internal transaction costs
  - Bringing transactions inside the organization minimizes but does not eliminate the costs of managing transactions
- Formal linkage mechanisms reduce transaction costs but may not be used because internal or bureaucratic transaction costs are still incurred. Integration and communication are costly, whereas **time spent in a meeting** could have created value.

Using Transaction Cost Theory to Choose an Interorganizational Strategy

- Transaction cost theory can be used to choose an interorganizational strategy
- Managers can weigh the savings in transaction costs of particular linkage mechanisms against the bureaucratic costs

- Because transaction cost theory brings into focus the costs associated with different linkage mechanisms to reduce uncertainty, it is able to make better predictions than is resource dependence theory about why and when a company will choose a certain interorganizational strategy. Transaction cost theory suggests that formal linkage mechanisms are appropriate when transaction costs are high. Otherwise, informal mechanisms with lower bureaucratic costs should be selected.

Using Transaction Cost Theory to Choose an Interorganizational Strategy (cont.)

- Managers deciding which strategy to pursue must take the following steps:
  - **Locate** the sources of transaction costs that may affect an exchange relationship and decide how high the transaction costs are likely to be
  - **Estimate** the transaction cost savings from using different linkage mechanisms
  - **Estimate** the bureaucratic costs of operating the linkage mechanism
  - **Choose** the linkage mechanism that gives the most transaction cost savings at the lowest bureaucratic cost

Three Mechanisms minimize transaction costs while avoiding bureaucratic costs:

1. Keiretsu

- Japanese system for achieving the benefits of formal linkages without incurring its costs
  - Example: Toyota has a minority ownership in its suppliers
    - Affords substantial control over the exchange relationship
    - Avoids problems of opportunism and uncertainty with its suppliers

- ***Keiretsu*** can be seen as a mechanism for achieving the benefits of a formal linkage mechanism without incurring its costs. The policy of owning a minority stake in its suppliers' companies gives the other company substantial control over the exchange relationship and allows it to avoid problems of opportunism and uncertainty with its suppliers.

2. Franchising

- A franchise is a business that is authorized to sell a company's products in a certain area
- The franchiser sells the right to use its resources (name or operating system) in return for a flat fee or share of profits

3. Outsourcing

- The process of moving a value creation that was performed inside an organization to outside problems of opportunism and uncertainty with its suppliers
- Decision is prompted by the weighing the bureaucratic costs of doing the activity against the benefits
  - Increasingly, organizations are turning to specialized companies to manage their information processing needs