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Using the Star Model to Solve 5 Critical Design Challenges

Amy Kates
Jay R. Galbraith

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Introduction

IN THEIR CLASSIC 1972 work on the structure of multinational corporations, Stopford and Wells noted, "Management has rarely gone through the steps of stating its strategy explicitly and of weighting the contributions and costs associated with alternative organizational structures. . . . Our analysis has imposed an elaborate rational framework on what is largely an intuitive decision process of the businessman" (p. 171). In the intervening thirty-five years, business leaders have become much more aware of the need for a structured, rather than intuitive, approach to making decisions about organization design. Our previous book together, *Designing Dynamic Organizations,* written with Amy Kates's late business partner, Diane Downey, sought to provide that structured, step-by-step process. In that book, which has enjoyed a positive reaction from the business community, we laid out the concepts and process of organization design in the form of a how-to guide in order to provide a clear and explicit framework for decision making and practical application (Galbraith, Downey, and Kates, 2002).

Over the past few years, however, we have noticed five specific organization design challenges that seem to confront a majority of the organizations that we work with, read about, and observe. Our clients have asked us to provide them guidance in dealing with these more complex issues using the same clear step-wise approach. That has been the impetus for this book. Following the first chapter, "Fundamentals of Organization Design," which reviews key concepts and design principles, the remainder of the book is organized around the following five challenges:

- *Designing around the customer.* The growing number of global customers, the increased buying power and access to information that all customers have, and the difficulty in keeping up in the race to create products that stand out in a crowded marketplace are all factors driving many companies to search for ways to deliver integrated interfaces, customized products, and high-value solutions. Such firms are finding that this is impossible without completely rethinking the way in which the components of their organizations work together internally. Chapter Two defines customer-centric strategies and provides guidance on designing three levels of customer-centric organizations.

- *Organizing across borders.* Increasing levels of foreign direct investment, the liberalization of trade within and between countries, and growing markets in emerging economies are motivating more companies to seek nondomestic opportunities and build global organizations. Chapter Three addresses different types of global strategies, focusing on building geographically based organizations and multinational product and customer networks.
- *Making a matrix work.* In response to strategies that require increased collaboration across customer, geographic, function, and product dimensions, many companies are using a matrix to formally connect the disparate elements of their organizations. Despite advances in communication technology, formidable challenges of coordinating work across organizational boundaries remain. Chapter Four presents what we have learned about overcoming these challenges to make the matrix an effective coordinating mechanism.
- *Solving the centralization—decentralization dilemma.* As an organization grows, it has the opportunity to leverage its size and scale. But consolidating decisions can result in a loss of speed and responsiveness. Many companies oscillate between the extremes of centralization and decentralization, never finding a happy medium. Chapter Five explains how an understanding of the business portfolio determines the design of the corporate center and offers an analysis of which decisions are best centralized and which are best left at the business unit level and how to get the benefits of both centralization and decentralization without having to choose between the two.
- *Organizing for innovation.* The final challenge we address is how to design the organization to support organic growth, particularly the breakthrough innovations and new business launches that require a delicate balance between separating from the core business while taking advantage of the parent company's assets. Chapter Six discusses the range of innovation strategies and the design considerations to support them.

This book does not aim to present new research or theory. It draws from Jay Galbraith's writing, particularly his two most recent books, *Designing the Customer-Centric Organization* (2005) and *Designing the Global Corporation* (2000), as well as many other authors' contributions to organization design theory. We expect this book to be helpful to leaders and managers who make choices about their organizations' structures as well as to human resource and organization design and development practitioners who guide and influence those decisions. Our goal is to give readers the same frameworks and tools that we use in our consulting and teaching work to help leaders make sound decisions about their organizations. Each of the referenced tools is included in the Appendix and in electronic form on the accompanying CD-ROM. We encourage you to make use of these tools in your own work. Tools that are included on the CD-ROM are indicated by marginal icons.

We do not want to minimize the complexity inherent in any of the organizational forms examined, although we try to be clear and present the various steps of organization design decisions as distinctly as possible. The rate of change in the business environment continues to increase, and new competitors are constantly entering industries as economies grow around the world and become more interconnected. Today's corporation is more complex than ever before. For example, in 1970, the world's fifty largest companies averaged $29 billion in revenue in 2003 dollars. By 2005, the average was $100 billion. During the same period, the number of consumer products introduced each year increased sixteen-fold. In order to compete successfully, these same companies have to be able to react faster to changes in the business environment. Strategies that depend on developing multiple and fast-changing products, serving demanding customers, and coordinating across organizational unit boundaries complicated by time and cultural distance cannot be achieved with simple organizations. Nor can these strategies be achieved with managers and employees who do not understand why and how their organization is configured as it is and who have not been given the processes, tools, and skills to operate successfully within it. We believe it is worth repeating Harvard Business School professor Chris Bartlett's observation that companies often pursue third-generation strategies using second-generation organizations staffed with first-generation human resources. When first-generation managers attempt to institute third-generation multidimensional organizations, they often fail, and then attribute the failure to the organizational form rather than to their lack of capability (Galbraith, 2000). Our goal with this book is to help you build organizations to successfully execute your third-generation strategies.

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In addition to her consulting work, she teaches Organization Design in the Executive M.B.A. program at the Center for Technology, Economics, and Management in Denmark and co-teaches, with Jay Galbraith, a seminar on the Design of Customer-Centric Organizations at the University of Southern California. She is also on the board of directors of the Organization Design Forum.

Amy Kates is coauthor, with Jay Galbraith and Diane Downey, of *Designing Dynamic Organizations: A Hands-On Guide for Leaders at All Levels* (2002). She has published numerous articles and book chapters on the topics of organization design and talent management, including "The Challenges of General Manager Transitions" in *Filling the Management Pipeline* (Robert Kaiser, ed.). Her article, "(Re)Designing the HR Organization," was featured in the Summer 2006 issue of the *Human Resource Planning Society Journal* and was awarded the HRPS Walker Prize.

Amy Kates holds a master's degree in City and Regional Planning from Cornell University. Prior to joining DKA, Ms. Kates was a planner and urban designer and was selected to serve as an Urban Fellow by the New York City mayor's office. Amy can be contacted at Downey Kates Associates, 139 Fulton Street, Suite 210, New York, N.Y., 10038, by phone at (212) 349–3522 or by email at AKates@DowneyKates.com.

• • •

Jay R. Galbraith, a senior research scientist at the Center for Effective Organizations at the University of Southern California and professor emeritus at the International Institute for Management Development in Lausanne, Switzerland, is an internationally recognized expert on organization design. He is the president and founder of Galbraith Management Consultants, an international consulting firm that specializes in solving strategy and organizational design challenges in companies of all sizes—from small manufacturing companies to large global firms. His theories on gaining a significant competitive advantage through customer-centricity have been heard and implemented by top-level executives throughout the world.

Dr. Galbraith, creator of the widely used Star Model™, has written numerous publications including *Designing the Global Corporation, Designing Dynamic Organizations,* and *Designing Organizations: An Executive Guide to Strategy, Structure and Process.* His latest book, *Designing the Customer-Centric Organization,* introduces the Strategy Locator™, an innovative tool that helps companies determine the degree of customer-centricity their organizations need in order to offer the types of solutions that their customers demand.

In addition, Dr. Galbraith is regularly sought after for his expert opinion by the media, including *BusinessWeek, The Wall Street Journal, Fortune,* and *The Financial Times.* For more information, please visit www.jaygalbraith.com.

Chapter 1

Fundamentals of Organization Design

THIS BOOK is about five of the most common organization design challenges that business leaders face today. This first chapter reviews some fundamental organization design concepts in order to provide readers a firm foundation for understanding the complex organizational forms we discuss. It also defines key terms, highlighted in italics, that we use throughout the rest of the book. (For an in-depth discussion of organization design concepts and processes, refer to Galbraith, 2002, or Galbraith, Downey, and Kates, 2002.)

The first two questions to address are: What is an organization? and What is organization design? For our purposes, the term *organization* is used broadly to refer to an entire firm, as well as to just one part of it. It can be made up of many thousands of people or only a handful. For a corporate leader, the organization encompasses the entire company, and from the vantage point of a unit manager, the organization may be simply that unit. Most of what we discuss in this book is applicable to the whole organization, as well as to the smaller organizations nested within the larger firm. Although we frequently refer to companies and firms, the concepts apply equally to nonprofit and government entities.

Organization design is the deliberate process of configuring structures, processes, reward systems, and people practices to create an effective organization capable of achieving the business strategy. The organization is not an end in itself; it is simply a vehicle for accomplishing the strategic tasks of the business. It is an invisible construct used to harness and direct the energy of the people who do the work. We believe that the vast majority of people go to their jobs each day wanting to contribute to the mission of the organization they work for. Too often, however, the organization is a barrier to, not an enabler of, individual efforts. We have observed that when left to their own devices, smart people figure out how to work around the barriers they encounter, but they waste time and energy that they could direct instead to improving products and services, creating innovations, or serving customers. One of the main purposes of organizational design is to align individual motivations with the interests of the organization and make it easy for individual employees to make the right decisions every day. Furthermore, a well-designed organization makes the collective work of accomplishing complex tasks easier.

This chapter begins with an overview of the Star Model,™ which provides a decision-making framework for organization design. We highlight the key concepts associated with each point on the star, which we expand on in the other chapters. The chapter concludes with a summary of themes that serve as our design principles.

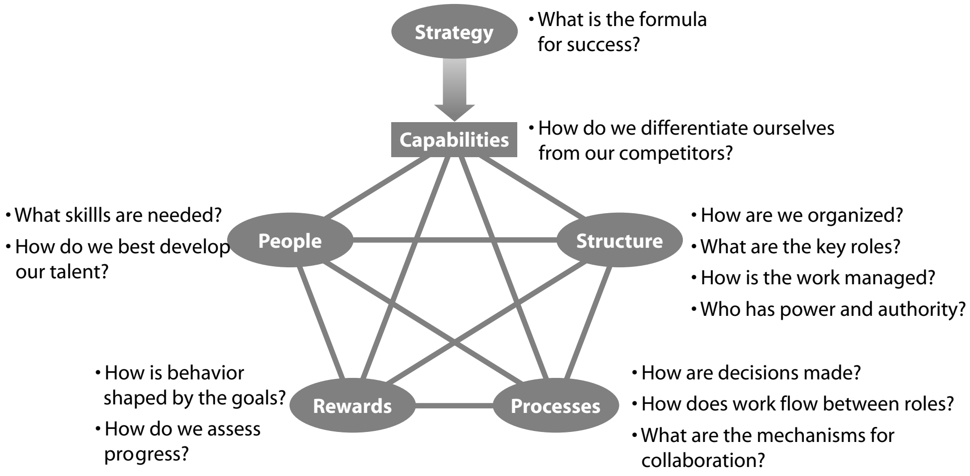
The Star Model™: A Framework for Decision Making

Organization design is a decision-making process with numerous steps and many choices to make. A decision made early in the process will constrain choices made later, foreclose avenues of exploration, and eliminate alternatives, resulting in far-reaching impacts on the ultimate shape of the organization. Making sound decisions at these early, critical junctures requires a theoretical framework that gives credence to one choice over another. Yet many leaders and their teams still make organization design decisions based largely on their own individual experience and observation. A common framework for decision-making has a number of benefits. It:

- Provides a common language for debating options and articulating why one choice is better than another in objective, impersonal terms
- Forces design decisions to be based on longer-term business strategy rather than the more immediate demands of people and politics
- Provides a clear rationale for the choices considered and an explanation of the implications of those choices as the basis for communication and successful change management
- Allows decision makers to be able to evaluate outcomes, understand root causes, and make the right adjustments during implementation

The Star Model (Figure 1.1), which serves as our framework, has been used and refined over the past thirty years. Its basic premise is simple but powerful: different strategies require different organizations to execute

FIGURE 1.1 **Star Model.**


Strategy
• What is the formula for success?
Capabilities
• How do we differentiate ourselves from our competitors?
People
• What skillls are needed?
• How do we best develop our talent?
Structure
• How are we organized?
• What are the key roles?
• How is the work managed?
• Who has power and authority?
Rewards
• How is behavior shaped by the goals?
• How do we assess progress?
Processes
• How are decisions made?
• How does work flow between roles?
• What are the mechanisms for collaboration?

them. A strategy implies a set of capabilities at which an organization must excel in order to achieve the strategic goals. The leader has the responsibility to design and influence the structure, processes, rewards, and people practices of the organization in order to build these needed capabilities.

Although culture is an essential part of an organization, it is not an explicit part of the model because the leader cannot design the culture directly. An organization's culture consists of the common values, mindsets, and norms of behavior that have emerged over time and that most employees share. It is an outcome of the cumulative design decisions that have been made in the past and of the leadership and management behaviors that result from those decisions.

The idea of *alignment* is fundamental to the Star Model. Each component of the organization, represented by a point on the model, should work to support the strategy. The more that the structure, processes, rewards, and people practices reinforce the desired actions and behaviors, the better able the organization should be to achieve its goals. Just as important as initial alignment is having the ability to realign as circumstances change. The configuration of resources, the processes used, and the mental models that contribute to today's success will influence the plans made for the future. In a time of stability, this creates efficiency. In a time of change, such static alignment can become a constraint. The organization must have alignment, but it also needs the flexibility to recognize and respond to opportunities and threats.

It is always easier to change a business strategy than to change an organization, just as it is easier to change a course beforehand than it is to turn a large ship that is already under way. The more rapidly the organization can be realigned, the faster the leaders can "turn the ship" and execute new strategies and opportunities as they arise. This is especially important for large companies that must compete against smaller, nimbler organizations. Therefore, alignment is best thought of as an ongoing process rather than a one-time event.

The ideas of strategy dictating organizational form and of organizational elements aligning with strategy are based on a body of thought called contingency theory (Lawrence and Lorsch, 1967). *Contingency theory* does not prescribe any one best way to organize, but rather suggests that organization design choices are contingent on both the strategy selected and the environment in which the business is operating. Contingency theory has been extended with *complementary systems* theory, which comes to organization design from the field of economics (Milgrom and Roberts, 1995). The notion of complementarity holds that design choices work as coherent systems and that the application of one practice will influence the results of a corresponding practice—whether positive or negative. This underscores the practical application of the Star Model. For example, if a strategy depends on cross-unit coordination, contingency theory suggests it would be wise to formally link those units with processes and create measures and rewards that encourage teamwork. Research into complementary systems goes further, suggesting that in order to derive the full benefit of these choices, they should be employed as a system, and that negative consequences may occur if the practices are employed individually and not together (Whittington and others, 1999). This research confirms what many suspect: piecemeal adoption of management practices has little impact on business performance. It also means that simple benchmarking and copying of another company's structures and processes has little useful application in organization design. For example, using a matrix is neither a good nor a bad practice in itself. But when a matrix is installed without the appropriate and corresponding role clarity, governance processes, reward systems, performance management methods, and training that are needed to make it effective, its introduction can actually have a negative impact on the organization.

Thinking of organization design choices as complementary systems also has implications for the organization design process. While each point on the star in the model represents many choices, they are not as unlimited, and thus not as overwhelming, as they first seem. Once the strategy is set, there are then sets of complementary options available to support that strategy. As we address each major topic in this book, we have structured the discussion around the Star Model and have highlighted the set of complementary choices and considerations that align with each strategy.

Another concept underlying the Star Model is *complexity.* In this context, it refers to the idea that complex business models cannot be executed with simple organizations (Ashby, 1952). The more dimensions a business has—for example, number of products, business units, or customer sets—and the larger its size, the greater the number of interfaces that will need to be managed internally. In addition, when the company is geographically dispersed, new challenges of national culture, time, and distance are introduced. Many strategies today require high levels of cross-organization collaboration at multiple levels. As a result, units tend to have more "surface area" and a greater number of interactions between units required to get work done (Lawler and Worley, 2006). Such organizations will not spontaneously self-organize. Employees in large companies, no matter how good their intentions, are unlikely to be able to gain a broad enough view to make the right decisions about how units should be configured and who should interact with whom. Complex strategies and organizations need firm and clear guidance, and this is an activity for senior leadership.

The design goal should be to keep the organization clear and simple for customers and the majority of employees. It is the job of leaders and managers to manage the complexity that is created by the organization's design. The different elements of a design that will need to be managed—the points on the Star Model—are explained in further detail below.

Strategy

Strategy is a company's formula for success. It sets the organization's direction and encompasses the company's vision and mission, as well as its short- and long-term goals. The strategy derives from the leadership's understanding of the external factors (competitors, suppliers, customers, and emerging technologies) that bear on the firm, combined with their understanding of the strengths of the organization in relationship to those factors. The organization's strategy is the cornerstone of the organization design process. Without knowledge of the goal, no one can make rational choices along the way. In other words, if you do not know where you are going, any road will get you there.

The purpose of a strategy is to gain *competitive advantage*: the ability to offer a customer better value through either lower prices or greater benefits and services than competitors can (Porter, 1998). These advantages can be gained through external factors such as location or favorable government regulation. They can also be secured through superior internal organizational capabilities. We define *organizational capabilities* as the unique combination of skills, processes, technologies, and human abilities that differentiate a company. They are created internally and are thus difficult for others to replicate. Creating superior organizational capabilities in order to gain competitive advantage is the goal of organization design. We will also refer to *transferring capabilities.* To transfer and, when necessary, adapt a company's capabilities or advantages is one of the key jobs of any manager when opening up a new location or unit.

Business model is a broad term used to encompass the internal logic of a company's method of doing business. It encompasses the business's value proposition, target customer segments, distribution channels, cost structure, and revenue model. For example, an Internet music site may operate on a subscription basis (unlimited songs available for a monthly fee) or on a straight fee-per-song basis. Each approach represents a different business model, although both companies are in the same business. Each model is built on a different revenue and cost structure, and therefore each company requires a different set of organizational capabilities to succeed.

A *business portfolio* is the set of product lines or business units that a firm manages. How similar (or different) the business models are for each of the units in the portfolio drives different organization design decisions. A *profit center* (often called a *business unit*) is a unit in an organization that is considered a separate entity for purposes of calculating revenue and cost. How much influence the manager of a profit center has over the variables that generate revenue and costs is also an organization design decision.

Organizational Capabilities: Translating Strategy into Design Criteria

Organization design is a series of choices and decisions. In any decision-making process, clear criteria serve the purpose of allowing alternatives to be evaluated against agreed-on standards. The criteria used for organization design decisions are the organizational capabilities that will differentiate the organization and help it execute its strategy. The organizational capabilities are the link between the strategy and organizational requirements the strategy demands. We use the words *organizational capability* and *design criteria* interchangeably.

Different strategies require different organizational capabilities and therefore different organization designs. The right design choices increase the likelihood of building the right organizational capabilities. Each design decision can be tested against the design criteria to determine if it will be helpful in creating the desired organizational capabilities. We can expand on the definition of organizational capabilities offered above. Organizational capabilities are:

- Unique, integrated combinations of skills, processes, and human abilities. These are not simple programs or technologies that can be copied from other companies.
- Created by and housed within an organization. They are not bought or conferred by regulation or location or monopoly position. Rather, they are developed, refined, and protected internally.
- Factors that differentiate the organization and provide competitive advantage. This is important, as there are many things at which a company has to be as good at as its competitors, but just a few where it truly needs to be better.

How a company chooses to compete determines the most important organizational capabilities. For example, a pharmaceutical company developing novel prescription drugs requires a strong research and development capability and an ability to build relationships with physicians. But a pharmaceutical company that specializes in selling over-the-counter medicines needs efficient manufacturing processes and a strong consumer marketing capability. Some companies build a capability in product innovation. Procter & Gamble has not only a strong research and development capacity but also the capability of bringing ideas to market. Its Crest Whitestrips product comes from blending the company's technological expertise in the unrelated areas of bleaching, dental care, and adhesives. Other companies choose to compete based on marketing or distribution capabilities. The Campbell Soup Company does not necessarily make better soup than its competitors do. Instead, it creates innovative packaging and works effectively with retailers on displays that highlight the convenience of its product. Professional service firms such as Bechtel, which provides engineering and construction services, or Accenture, which provides consulting and outsourcing services, need different capabilities than consumer goods companies do. They compete on their abilities to staff and manage large-scale projects and to create and apply knowledge.

As a company's strategy changes, so do the differentiating organizational capabilities it needs. For example, Thorn Lighting, a U.K.-based firm, had a sixty-year history of innovation in the design and production of light bulbs. In the early 1990s, the company changed its strategy to focus on the more lucrative business of providing lighting solutions. It sold its manufacturing arm and now works with governments and property developers to design and implement lighting projects for stadiums, office complexes, and highways. The company still maintains an expertise in lighting technology. However, the organizational capabilities required by the two business models are quite different. The original business was built on product design, manufacturing, and consumer marketing. The new organization is built on customer relationship management, large-scale project management, and integrated solutions development.

The process of identifying the most important organizational capabilities is the first step in drawing the connection between the strategy and the form of the organization. Once the capabilities have been identified, a set of organizational implications can be generated to form the basis for a discussion of alternatives. Metrics can also be developed as a way to gauge progress. Figure 1.2 illustrates the thought process—from strategy to organizational capabilities to organizational implications—for a Latin American division of a cable television network. This process engaged the network's leadership in collectively understanding and agreeing on the criteria that an acceptable organizational design would have to meet.

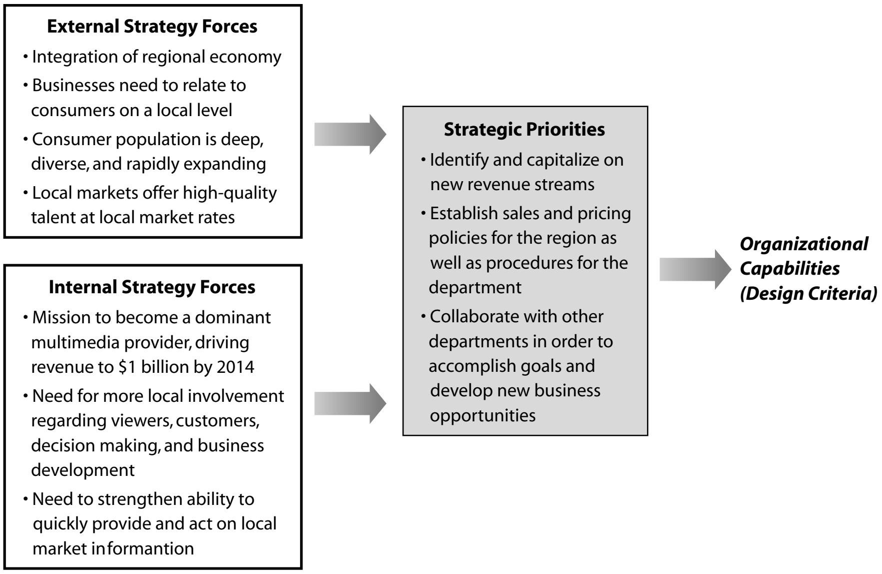
The identification of organizational capabilities is carried out by the leader or leadership team that has ultimate responsibility for design decisions. This is not an activity that can be delegated, as it requires the broad strategic perspective of the leadership level. These organization capabilities become the criteria against which all subsequent design decisions are judged, so they must be agreed on at the most senior level of the organization.

Once the design criteria are in place, the question can be asked at each step in the design process: Which option will better help us preserve or build the organizational capabilities we have said are critical to our success? We suggest that the leaders identify no more than five organizational capabilities to serve as design criteria. It is the act of generating possible capabilities and then narrowing them down into those that can truly differentiate the company that creates healthy discussion and debate about what direction is truly most important to the organization. The Developing Design Criteria tool located in the Appendix provides detailed guidance on identifying, selecting, and using organization capabilities in the design process.

Structure

An organization's structure determines where formal power and authority are located. Typically, units are formed around functions, products, geographies, or customers, and are then configured into a hierarchy for

FIGURE 1.2 **Example of Organizational Capabilities.**



External Strategy Forces

- Integration of regional economy
- Businesses need to relate to consumers on a local level
- Consumer population is deep, diverse, and rapidly expanding
- Local markets offer high-quality talent at local market rates

Internal Strategy Forces

- Mission to become a dominant multimedia provider, driving revenue to $1 billion by 2014
- Need for more local involvement regarding viewers, customers, decision making, and business development
- Need to strengthen ability to quickly provide and act on local market informantion

Strategic Priorities

- Identify and capitalize on new revenue streams
- Establish sales and pricing policies for the region as well as procedures for the department
- Collaborate with other departments in order to accomplish goals and develop new business opportunities

Organizational Capabilities (Design Criteria)

Organizational Capabilities	Organizational Implications	Metrics
Position our networks and products to meet local market interests	• Marketplace expertise/presence in the region • Empowered local business units with decision-making ability related to local matters • Increased level of knowledge and "feeling" of local markets • Improved speed, flexibility, and fluidity in the business • Focus on longer-term strategy and planning	• Relationships, accounts and viewers retained and added • Annual revenue growth • Annual profit growth • Designation of profit/loss responsibilities • Historical profitability by priority markets
Share talent across product lines	• Responsibilities, authority, and resources for identifying and responding to market expansion are clearly assigned • Clear line of accountability and responsibilities between all functions (especially country management and revenue) • Increase innovative capabilities • Talent is broadened, career opportunities are available	• Individual and departmental goals are aligned with business priorities • Goals are met • Talent ready for broader assignments
Execute new ideas efficiently	• Realize economies of scale • Avoid fragmentation • Minimal bureaucracy	• Average cost to produce • Our costs vs. competition • Overhead as a percentage of total costs

management and decision making. The structure is what is shown on a typical organization chart.

Organization design is not limited to structural considerations, and many variations of a structure can be made to work. But if the structure is not approximately right, then it will be harder to align the other design elements with the strategy. The structure sets out the reporting relationships, power distribution, and communication channels. It determines who comes in contact with whom. The structure projects a message about what work is most important. If the structure does not at least nominally support the strategy, then everyone in the organization will find themselves working around a formidable obstacle.

The four primary building blocks of organizational structure are function, product, geography, and customer. We also refer to these as *structural dimensions.* Most companies use a mix of all four and add dimensions as the business grows. Small companies and those with a single product line are typically organized by function. As the firm diversifies, each new major product line becomes a product division, with each division organized by function. We would describe this as a *multidimensional* organization, structured primarily along the lines of product and secondarily by function. When the firm expands into new territories, a geographic dimension may be added. Recently, with the increase in customer buying power, many companies are finding the need to add customer segments and markets as a structural dimension. The complex organizations we discuss in this book generally have multidimensional structures. In order to analyze, understand, and design such organizations, it is useful to briefly review each dimension.

Functional Structure

A functional structure is organized around major activity groups such as finance, human resources, research and development, manufacturing, and marketing. All employees in each function are managed together in order to promote sharing of knowledge and greater specialization. Functional structures promote standardization, reduce duplication, and create economies of scale. The concept of *scale* arises often in organization design. In general, common work done together reduces its cost, providing the larger unit or firm with an advantage. However, grouping work together may also slow it down, and the advantages of scale will be outweighed by a decrease in speed.

The functional structure is suitable for small businesses. It is also good for large companies that are in a single line of business and need to realize the benefits of scale, such as retailers or semiconductor manufacturers. Variations of functional structures can be used successfully for different purposes. A fast food and a pharmaceutical company both use a functional organization. The fast food company is focused on low price and consistency. Its primary functions are therefore supply chain, marketing, training, real estate, and franchisee relations. A pharmaceutical firm's primary functions are focused on research and development, government relations,