Activity 9.1 What does 'organisation structure' mean?

Before reading the chapter, write some notes on what you think 'organisation structure' means. Choose the organisation or people who may be able to help you learn about the topic. You may find it helpful to discuss the topic with a manager you know, or reflect on an activity you have managed.

- Identify a structural issue someone has faced, and describe it briefly.
- How (if at all) did they discuss any links between structure and strategy?
- What methods did they use to divide and coordinate work?
- What reasons, if any, did they give for choosing those methods?

Keep these notes as you will be able to use them later.

9.1 Introduction

Managers at GlaxoSmithKline (GSK) regularly revise the structure of the business to ensure it performs well. Although the market for pharmaceutical products is growing, so is the cost of developing them – and the company faces competition from cheap 'generic' brands of products which are no longer protected by patents. Managers are especially concerned about how best to organise their large research and development (R&D) activity (on which they spend about 14 per cent of revenue). They also face decisions about how to organise its global business – avoiding duplication while also responding to local conditions.

Senior managers of other companies face similar choices. Motorola's mobile devices had been losing market share for several years and, in 2009, the board responded by dividing the company in two – one unit to focus on the handset market, the other on communication networks. Others follow a policy of frequent small changes. The (then) Chairman of L'Oréal, the world's biggest beauty company refers to its

> culture of permanent mini-restructuring. I don't think there has ever been a major restructuring in the whole of L'Oréal's corporate history . . . but there have been hundreds of little ones. What we do is try to live a life of permanent small change to avoid the major disasters. (*Financial Times*, 3 March 2008)

Structural choices also include decisions about whether to acquire another business, and then how to integrate it. **Outsourcing** is also a practice which changes an organisation's structure.

Outsourcing is the practice of contracting out defined functions or activities to companies who can do the work more cost-effectively.

When an owner-manager is running a small business they decide what tasks to do and co-ordinate them. If the enterprise grows, the entrepreneur usually passes some of the work to newly recruited staff, though the division will probably be flexible and informal – direct communication makes co-ordination easy. If the business continues to grow, they find that informal ways of working begin to cause problems – so introduce more formality. They divide and clarify tasks to ensure people know what to do, and devise ways to co-ordinate the separate tasks.

This chapter outlines how people divide and co-ordinate work, and how these choices lead to the contrasting 'mechanistic' and 'organic' forms of structure. These choices reflect personal preferences, views (even if implicit) about theories of structure and knowledge of the organisation's strategy. A central theme of the chapter is that developing the right structure for the situation (context) is likely to benefit an organisation's performance. Figure 9.1 shows these themes.

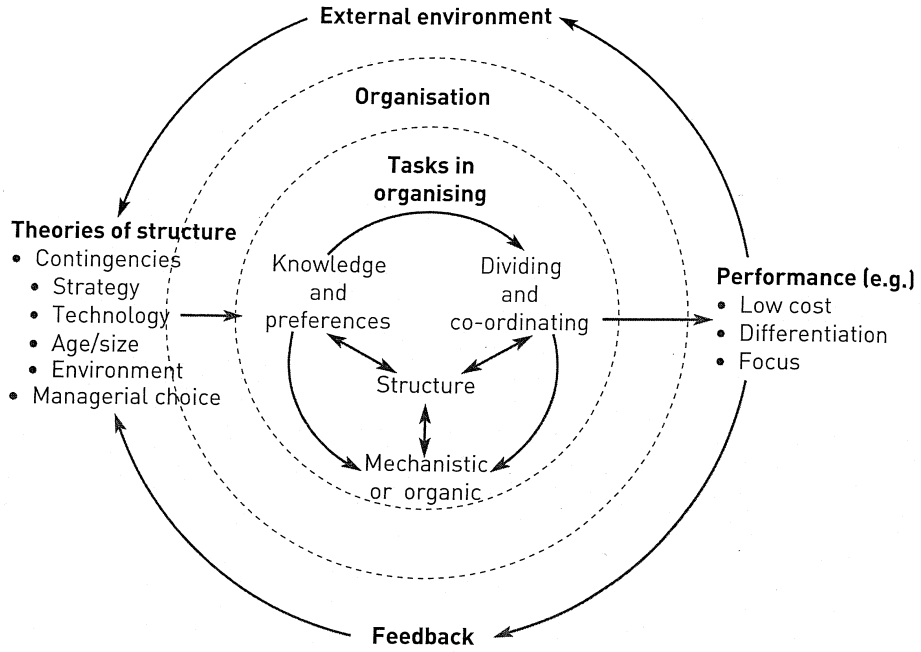

Figure 9.1 Themes of the chapter

9.2 Structure, strategy and performance

Alfred Chandler (1962) traced the evolution of America's largest industrial firms, showing how their strategies of growth and diversification placed too many demands on the centralised structures they had created. As the diversity of products and geographies grew, issues arose which those at the (increasingly remote) centre could not handle, as they lacked the knowledge of local circumstances. Chandler's historical analysis of Du Pont, General Motors, Standard Oil and Sears, Roebuck shows how they responded by creating decentralised, divisional structures – a significant organisational innovation which many companies use today. It allowed managers at corporate headquarters to provide overall guidance and control, leaving the detailed running of each division to local managers ('strategy shaped structure').

Chandler also shows that structure could influence strategy. A new legal requirement to break Standard Oil into small regional companies encouraged one of these – Standard Oil (New Jersey) to expand into foreign markets as a way of increasing profits ('structure shaped strategy').

Chandler's aim was to study the interaction of strategy and structure in a changing business environment. In successive cases he traces how strategies to launch new products or enter new regions strained current structures, and how managers responded by gradually, through trial and error, developing new ways of dividing and co-ordinating work.

That research tradition continues in, for example, Grant's (2003) study of strategy in major oil companies – see Chapter 8. Eli Lilly (www.lilly.com), a pharmaceutical company, provides further evidence. The company faced commercial disaster when it unexpectedly lost patent protection of Prozac, at the time its most profitable drug. Colville and Murphy (2006) show how managers had intense debates about a new strategy and a new structure, followed by rapid implementation. This was so successful that the group began launching new drugs at an unprecedented rate, rapidly returning to profit.

Case study GlaxoSmithKline (GSK) www.gsk.com

GSK is one the world's largest pharmaceutical companies, formed in 2000 by the merger of Glaxo-Wellcome and SmithKlineBeecham. In 2010, it had sales of £28.4 billion, with over 98,000 staff working in 100 countries – including 16,000 in Research & Development.

Like other major pharmaceutical companies, the company's survival depends on developing new drugs which it can sell profitably. New products are discovered, developed and launched – and are protected by patents for about ten years. These prevent other companies from taking the idea and manufacturing and selling an equivalent product. This means that while the drug has patent protection the company has a monopoly over its supply – enabling it to make high profits (if doctors find the drug useful to their patients).

When the patent expires, other companies can copy the drug and produce what are known as 'generic' versions. These sell at very low prices, and radically reduce the original company's income. Their R&D must therefore continually replace older product with new ones, to stop the company's revenue from falling. Without an adequate revenue flow, the company is unable to invest in the R&D required for new drugs.

Companies like GSK are finding it increasingly difficult to maintain an adequate flow of the new drugs they aim to launch each year. Common reasons are that the diseases that are relatively easy to treat have been tackled; tighter regulations have greatly increased the cost of getting approval from the regulatory authorities before it can sell the drug; and the rising costs of every aspects of scientific research. Discovering and developing a new medicine takes about 12 years before it begins to produce revenue – and during that time it is draining resources from the company.

Senior management at GSK also believe that part of the problem is the way in which they organise R&D. Their R&D activity had become very large and bureaucratic, and this had become an impediment to the creative atmosphere in which scientists work best. Increasing the size of the organisation had led to an industrial-type process, which was impeding the personal accountability, transparency and personal enthusiasm essential for drug discovery and development.

Roger Bamber/Alamy

In the 1960s, the company employed fewer than a 1000 scientists, who worked in a functional structure – chemists, pharmacologists, clinical development and so on. There were few management layers, few projects and most scientists worked on a single campus. Communication, co-ordination and the exchange of ideas with colleagues was quite easy. In the following decades, employment grew rapidly and the early functional structure was unable to cope. Scientists were spread over several sites and countries, so communication was difficult. Matrix structures were created, whereby scientists reported to the head of their discipline, and also to the head of the one or more projects on which they were working. Continuing growth meant that these structures became more complex, further slowing communication and decision-making.

The chief executive of GSK concluded that this traditional structure was obsolete, and replaced it with a set of 'Centres of Excellence for Drug Discovery' (CEDD). Each is focused on a family of related diseases (such as Alzheimer's or obesity), has a CEO with the authority to initiate and end projects, and contains several hundred scientists from the relevant disciplines. There are only two or three management layers between the CEO and the bench scientists.

The intention was to increase the speed of decision-making and restore freedom of action to the scientist conducing the research. It had also overhauled the incentive system, to ensure that those who made the discoveries could expect a share in the financial rewards they brought. By 2008 it had 12 CEDDs, and the results appeared promising. When it began changing the structure in 2005, GSK

had only two products in the 'late stage development' phase: by 2008 it had 34 – the most in the industry.

A more recent structural innovation is to work much more closely with external partners. To speed up the development process it will no longer depend on its own research: by 2020 half of the new drug discovery projects at the company may be undertaken by external partners as part of a radical overhaul designed to improve the pipeline of new drugs at the group. The research and development will be co-ordinated by the CEDDs. The company's Research Director estimated that between one-quarter to one-third of GSK's existing research pipeline of new drugs already involved work conducted with external partners and a growing role would be played by the CEDD, managing a 'virtual' portfolio of research run by such companies:

> **In the future we are going to have many more external projects.**

In 2010, it announced a further change: a group of 14 scientists would move into a separate, standalone company specialising in pain relief. They will take with them the rights to several patents, in exchange for an 18 per cent stake in the company. This will enable GSK to reduce overhead costs, while still benefiting from the revenue from sales. It is expected that the scientists will be more highly motivated in their own small company than as a small group within the pharmaceutical giant.

Sources: *Financial Times*, 31 May 2006; 5 October 2010; Garnier (2008).

Questions

1. What links can you see between strategy, structure and performance in the case? (Refer to Section 9.2.)
2. Note which structural forms mentioned in the chapter have been used at GSK. (Refer to Sections 9.3, 9.4 and 9.5.)
3. How does the company co-ordinate activities? (Refer to Section 9.6.)
4. How would you describe the balance between mechanistic and organic structures in GSK? (Refer to Section 9.7.)
5. Is this change consistent with the ideas of contingency theory? (Refer to Section 9.7.)