

Lesson Note – Organizational Structures

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What is Organizational Structure?

An organization structure explains how everybody in an organization works together. It explains the tasks that different employees do and the relationships among employees. Usually, companies have a diagram for their organizational structure. You will see examples later in this lesson note.

Why is Organizational Structure Important?

When you are the leader of a small team of say, 3 to 10 people, the team structure is probably quite obvious. There's probably 1 leader that is keeping the team on-track and accountable to the team goal. But what happens when your team grows to 100 people? 1000 people? You can't have 999 people reporting to 1 leader. That's why organizations create an organizational structure.

Often, when people think of organizational structure, they just think, "*Oh it's those diagrams that shows who reports to who, who is who's boss.*" While that's true, organizational structures actually have a very deep impact on the culture of an organization, and the culture of an organization has big impact on employee productivity and happiness.

Types of Organizational Structure

There are three common types of organizational structures:

1. Functional
2. Divisional
3. Matrix

Each type has its own pros and cons. There isn't necessarily one best type, but rather, organizations need to pick the type that suits their needs and goals best.

1. Functional Structure

The **functional structure** groups employees into units based on their activities, such as marketing, finance, human resources, engineering, accounting, and sales. It is the most basic type of organizational structure.

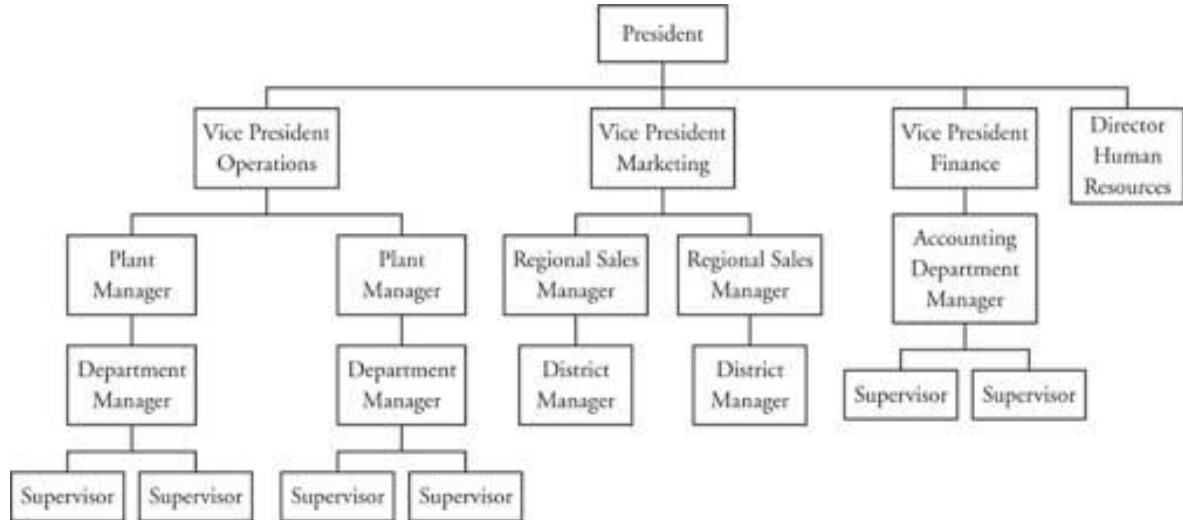
Advantages of functional structure

- Easy to understand
- Clear lines of communication (who is who's boss)

Disadvantages of function structure

- Slow decision-making process because of the many levels of hierarchy to go through
 - Example: employee asks supervisor, supervisor asks department manager, department manager asks plant manager, plant manager asks VP, VP asks President.
- Each function is isolated from other functions, which limits creativity and collaboration

Example of Functional Structure



[Image Source](#)

2. Divisional Structure

Some companies have many major product lines. So rather than organizing their company around departments, they organize the company around those major product lines. Under each product line, there might be a functional structure.

Example of Divisional Structure: Walt Disney

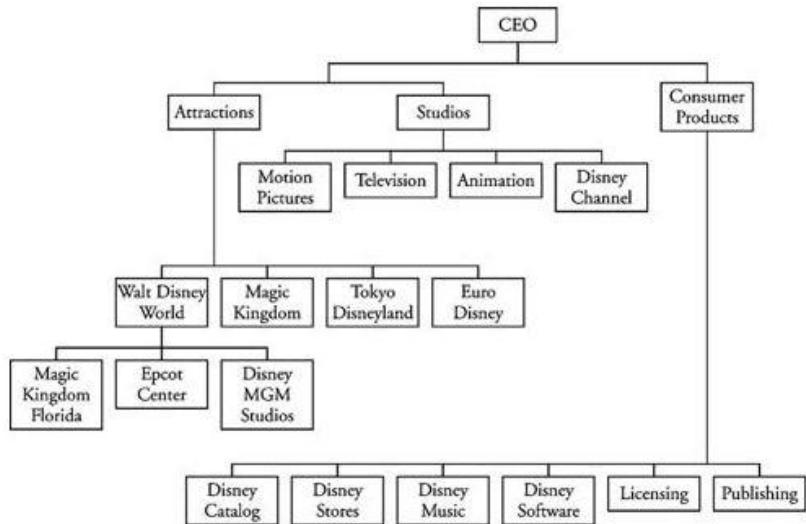


Figure 2

The divisional structure—Disney in the early 1990s.

[Image Source](#)

As you can see from the diagram, Walt Disney organized their business into three major divisions: attractions, studios, and consumer products. Within each division, there's sub-divisions. These subdivisions might use the functional structure.

Advantages of divisional structure

- Department employees can focus on their resources and efforts better
- Performance is easier to monitor
- Structure is flexible and responsive to change

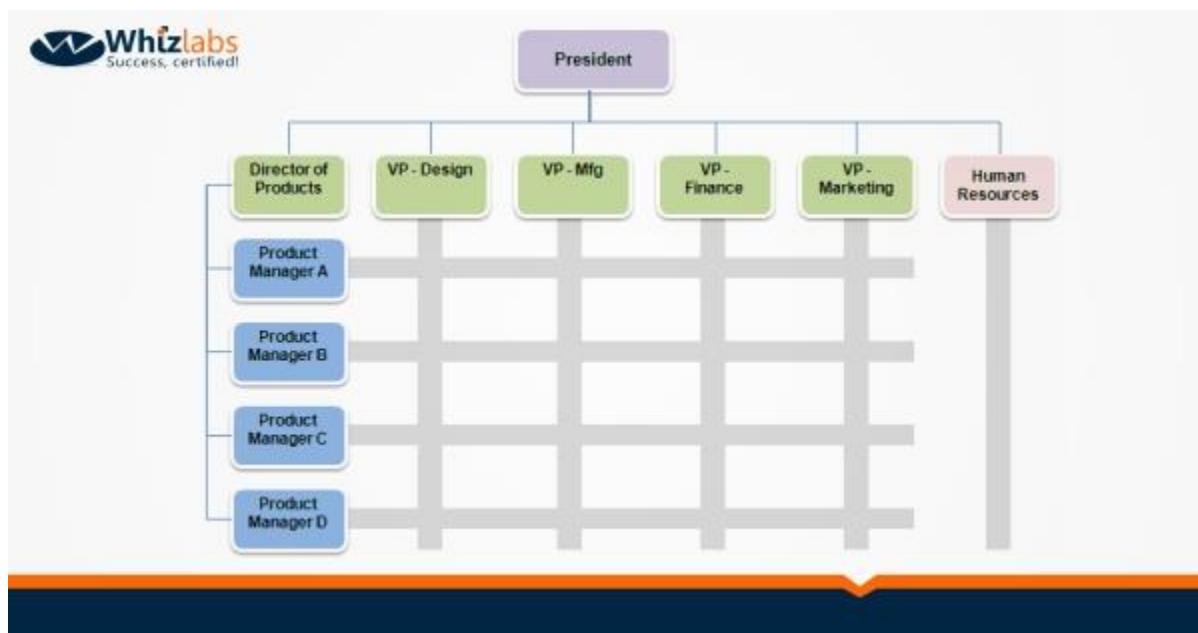
Disadvantages of divisional structure

- Inefficiencies in terms of duplicating work.
 - Example: A marketing employee from Division A does a lot of similar work to a marketing employee from Division B. But since they are separated by division, they both end up doing the work. Whereas in a functional structure, only 1 person would do that work.
- Divisions might compete for resources (budget and employees), thereby prioritizing their division over the company as a whole
 - Example: The VP of Division A wants his department to do well, and he doesn't care if that means taking resources that Department B needs.

3. Matrix Structure

The matrix structure combines functional and divisional structures. As a result, employees report to two bosses, a functional boss and a division boss.

Example of Matrix Structure



[Image Source](#)

From the diagram, we can see that Product Manager A has an employee from the design team, manufacturing team, finance team, and marketing team. So all these people on her team can focus on Product A. Additionally, the VP Design has employees on Product A, Product B, Product C, and Product D, so all these employees can work together to do design work for the whole company. This eliminates duplication of work.

Advantages of matrix structure

- Better cooperation and problem solving
- Highly skilled employees are shared across functions and projects

Disadvantages of matrix structure

- Power fights between the functional boss and the divisional boss, which can then lead to confusion to the employee about who to listen to
- Higher workload for employees since they have to do both functional work and divisional work

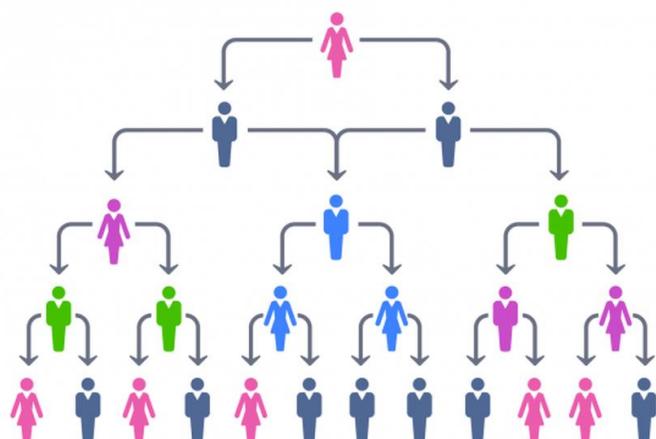
Hierarchical versus Flat Structures

Two common words people use to describe an organization's structure are **hierarchical** versus **flat** or **centralized** versus **decentralized**. As mentioned before, an organization's structure impacts the culture greatly, so people also use these two words to describe a company culture. These two words can be applied to any of the three structures mentioned above. So you can have a structure that is hierarchical and function, flat and divisional, etc.

Hierarchical/Centralized

A **hierarchy** is basically a ranking; there's people above, below, and at the same level. So a **hierarchical structure** means there are a lot of levels in the organizational structure. Functional structures tend to be very hierarchical. There's a supervisor who reports to the district manager who reports to the regional manager who reports to the VP. You get the idea. The structure looks kind of like a pyramid.

HIERARCHICAL ORGANIZATIONS



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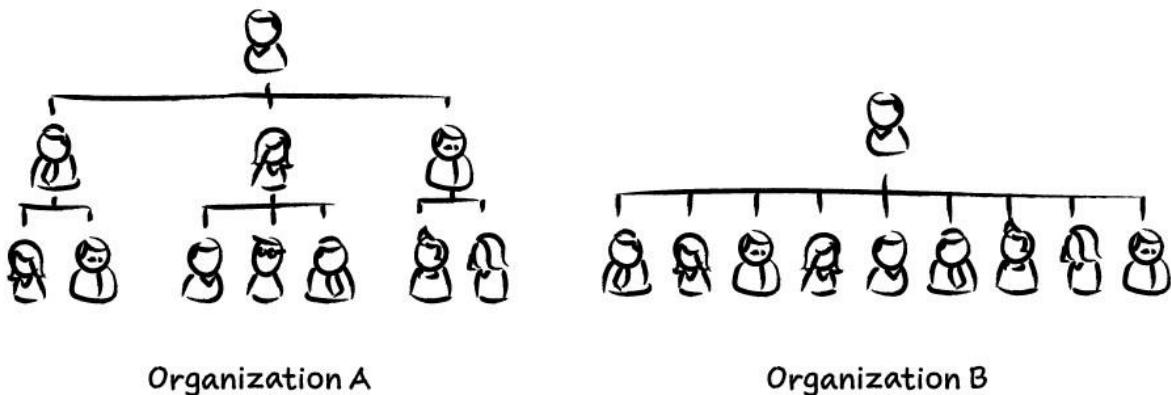
[Image Source](#)

A hierarchical structure is also called a centralized structure because most of the decision-making power is centralized into the top leaders.

The advantage of a hierarchical structure is that employees get very specialized in their function as they move up the ladder. The disadvantage is that decision-making is extremely slow because the idea has to get approval from the bottom employee all the way up to the top leader.

Flat/Decentralized

A **flat structure** means there's very little hierarchy. Usually, the middle level of management is taken out, which gives employees direct access to the top leaders. A flat structure works easier for smaller companies with less employees.



[Image Source](#)

Organization A is a hierarchical one (has middle managers) whereas Organization B is more flat.

We can also call a flat structure decentralized because employees have more decision-making power and autonomy.

The advantages of a flat structure are that decisions can get made faster, there's more collaboration, and leaders get the employees involved in decision-making. The disadvantage is that communications get messier. Whereas in the hierarchical structure, there's a clear communication channel, that doesn't exist in the flat structure.

Conclusion

Organizational structure explains the relationship of all the employees in an organization. There are many different ways to set up these relationships, such as functional, divisional, and matrix. Your choice of the organizational structure will impact the organization's culture and employee productivity.

To see an example of the impact of organizational structure, you will read about the company Patagonia.

Check Your Understanding Questions

1. What is organizational structure?
2. Why is it important for a business to choose an organizational structure carefully?
3. What are the pros and cons for functional, divisional, and matrix structures?
4. What are the pros and cons for hierarchical versus flat structures?
5. What type of organizational structure do you prefer to work in? Why?