

Architectural Determinants

As suggested above, optimal architectures will differ across companies. Such structural differences are not random but vary in *systematic* ways with differences in certain underlying characteristics of the companies themselves. To illustrate the point, companies operating in the same industry tend to develop similar architectures. If an important aspect of an industry's environment changes, most companies in that industry will react by readjusting their decision rights and internal control systems.

In [Figure 11.1](#), we summarize those factors which are likely to be most important in designing the optimal architecture for a given firm. At the top of the figure are three aspects of the firm's *external business environment*: *technology*, *markets*, and *regulation*. For any firm, these three factors—technologies that affect the production of or demand for its products, its methods of production, and its information systems; the structure of its markets (competitors, customers, and suppliers); and the regulatory constraints on its activities—are likely to have the greatest influence on its *strategy*. By *strategy*, we mean that broad set of issues discussed in [Chapters 8](#) and [9](#), including the firm's primary goals—nonfinancial as well as financial; the firm's sources of comparative advantage; its choice of industry, products, and services; its target customers; and pricing policies.

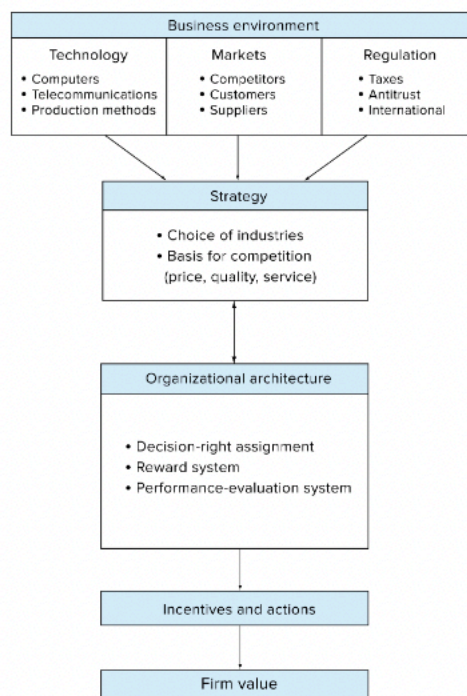


Figure 11.1 The Determinants of Strategy, Organizational Architecture, and Firm Value

Market conditions, technology, and government regulation are important determinants of strategy, which in turn helps determine organizational architecture. Two-way arrows are drawn to show important feedback effects. Both strategy and architecture affect the incentives and actions of employees within the firm and thus help determine the firm's value.



Take the case of AT&T in the early 1980s, before it was separated into a long-distance carrier and regional operating companies called the Baby Bells. Regulation dictated many aspects of the firm's strategy—what services it could offer, what customers it could serve, and how much it could charge them. After the breakup of AT&T and the accompanying deregulation of the telecommunications industry, both the Baby Bells and the new AT&T were forced to devise new strategies to provide new products, serve new customer bases, and develop new pricing structures.

As depicted in [Figure 11.1](#), the ultimate goals of the firm, as reflected in its strategy, in turn affect its optimal organizational architecture. As the celebrated architect Louis H. Sullivan—designer of the first skyscraper and founder of the American school of architecture—once observed, “Form ever follows function.” Applying the same principle within organizations, we see that significant changes in the business environment and hence in strategies typically call for major changes in decision-making authority, performance measures for evaluating employees, and incentive-compensation systems.