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# Organizing to Strategize in the Face of Interactions: Preventing Premature Lock-in

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Motivated by real examples that run contrary to conventional wisdom, we examine how firms organize themselves to strategize well. Interactions among decisions make strategizing difficult. They raise the spectre that a firm's strategizing efforts will get stuck in a web of conflicting constraints prematurely, before managers explore a wide enough range of possibilities. A key role of organizing is to free strategizing efforts and encourage broad search. At the same time, organizing must ensure that strategizing efforts are stabilized once the firm discovers an effective set of choices. The need to balance search and stability, we argue, is a central challenge of organizing. We explore this challenge with an agent-based simulation of firms that organize to strategize in the face of interactions. The results shed light on our counterintuitive examples. They show why and when firms may benefit from unnecessary overlap between departments; how and when firms can increase firm-wide search by reining in the search efforts of individual managers; and how and when a change in organizational structure – e.g., a shift from decentralization to integration — may reflect an effective sequence of organizing, rather than a reversal of early mistakes. The disparate examples share an underlying logic. The unnecessary overlap, the reining-in of managers, the period of decentralization - all can be seen as organizational mechanisms that help ensure the broad, early search that a firm needs when interactions among strategic decisions raise the danger of locking-in on a strategy prematurely. © 2006 Published by Elsevier Ltd.

## Introduction

Despite five decades of research on organizing, real organizations continue to surprise us. Consider a few examples.

• Conventional wisdom holds that good organizational structures are as modular as possible: integrally related decisions should be grouped under the purview of a single management team, and managerial overlap should be avoided across departments that do not affect one another. Yet in its vehicle development efforts, Toyota intentionally leaves 'unnecessary' overlap across departments. As we describe below, the company does not modularize sets of decisions that, in concept, are decomposable, and it seems to benefit as a result.

- Conventional wisdom argues that to catalyze innovation in a firm, senior managers should liberate low-level decision makers and allow them to explore a wide range of alternatives within their separate domains. Yet in an American industrial computing company discussed below, senior executives prompted an outburst of innovation by *reining in* the exploration conducted by subordinates.
- It is generally held that when top managers restructure their organization, it is to rectify past mistakes, often large and serious ones. In its e-commerce efforts, discount broker Schwab started with an independent subsidiary, but it soon reintegrated its online and conventional operations. This shift might be seen as reversing an earlier organizational error. We will argue below that such sequencing may reflect not a mistake, but an effective way to reach good sets of strategic choices in a novel environment.

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## sometimes not true at all

These examples suggest that what conventional wisdom holds to be true about organizing is sometimes not true at all. Students of organizational design have long recognized that there are few universal truths in their field. In the 1960s mounting evidence that little is always true about organizing led researchers to adopt a contingency outlook: prescriptions for organizing may be valid, but each prescription holds true only for some of the possible environmental conditions.<sup>1</sup> This begs the question, on what environmental conditions is organizational design contingent? And precisely how do environmental conditions lead to different prescriptions for organizing?

To contribute to tackling such ambitious questions, we bring two perspectives to bear. First, we focus on one particular role played by organizing. A key goal of organizing is to enable a company to strategize well. We conceive of a firm's management team as facing a set of decisions about how to procure, sell, deliver, service, hire, design, finance, and so forth. For the management team, *strategizing* is the search for combinations of choices that, together, generate strong performance. *Organizing* is the allocation of rights over decisions as well as the coordination of choices through incentives, communication and hierarchy. [Throughout this article, the term 'decision' refers to a variable on which management has multiple alternatives, and 'choice' refers to a particular resolution of a decision. Whether or not to train a firm's sales force is a decision, for instance; training the sales force is a choice]. In our view, organizing matters greatly because it shapes how a firm strategizes — how it searches for a set of choices and, therefore, what set it eventually adopts.

Figure 1 provides a simple example of the two main concepts of organizing and strategizing. A firm is assumed to have to resolve three decisions: 'to have a sale or not', 'to increase its advertising budget or not', and 'to increase its product breadth or not'. In the case illustrated, the firm *organized* the allocation of rights by assigning the first two decisions to one department and the third decision to another department, and coordinated the departments via an upper-level review committee. (It could, alternatively, have assigned all three decisions to one department, for instance, or dispensed with its coordination mechanism and given the departments full autonomy over the decisions.) *Strategizing* is the search for the best set of choices. Since each decision can be resolved in different ways, different combinations of choices can arise (e.g., 'having a sale, increasing the advertising budget and not increasing the product breadth', or 'not having a sale, increasing the advertising budget and not increasing the product breadth', etc).

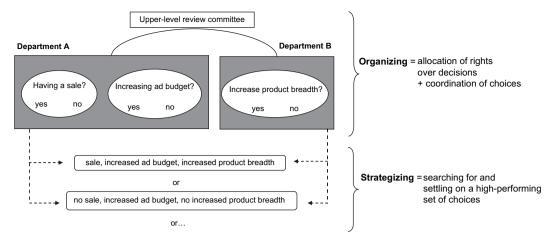


Figure 1. Organizing and strategizing

Organizing affects which combinations of choices are considered and eventually implemented. (Thus Schwab's early choice to organize e-commerce as a separate subsidiary, for example, affected how it marketed, priced, executed and serviced online trades.) This view of the relationship between organizing and strategizing is consistent with past research. Prior work has highlighted how organizational structure might affect a firm's search for a strategy by many paths: by moulding resource allocation and strategic planning processes, by altering how managers perceive opportunity, or by boosting the supply of new managers who pursue new businesses, for instance.<sup>2</sup>

The second perspective we bring to bear is a point of view on what makes strategizing difficult. We focus especially on *interactions among decisions* as a source of challenge. We say two decisions interact if the resolution of one decision affects the costs and benefits associated with the other. Strategy scholars have long emphasized that the decisions managers face are highly intertwined.<sup>3</sup> In its early online operations, for example, Schwab's choice not to offer the very lowest price for an online trade was related to its choice to deploy its valuable brand online: the brand name made it viable to charge a premium over no-name e-brokers, and setting the lowest price might have sullied the brand offline. We argue that interactions are not only pervasive, but also have a profound impact on how difficult it is to strategize well. Searching for an effective set of choices is relatively easy when decisions are independent and can be resolved one by one. Strategizing is harder when decisions depend on one another. Tradeoffs then arise across decisions, and the danger looms that an incremental approach will leave a firm with an internally consistent but not-very-effective set of choices. Such a set of choices would be a local optimum - permitting no improvement by means of small changes - but it might be far from the global optimum, and would therefore allow substantial improvement via systemic change.

# Searching for an effective set of choices is harder when decisions depend on one another

Moreover, interactions make organizing – the allocation of decisions and coordination of choices – relevant for strategizing. If the decisions facing a firm were independent, the allocation of them to decision makers would not affect their resolution, and coordination would be unnecessary. The firm could even assign each decision to a separate decision maker and give each one complete autonomy over their decision. With pervasive interactions, in contrast, organizing can have a deep influence on how strategizing (the search for sets of choices) unfolds and what set of choices

a firm eventually adopts. To the first question we posed above – on what environmental conditions is organizational design contingent? – we would offer a partial answer: interactions among decisions are one important source of contingency. That is, the right way to organize depends in part on the presence of interactions among a firm's strategic decisions. This echoes prior contingency literature, which focuses on the complexity of a firm's task environment as a key contingency.<sup>4</sup>

The second question posed above – precisely how do environmental conditions lead to different prescriptions for organizing? - is harder to address. To tackle it, we first narrow it, focusing on how degrees of interaction affect prescriptions for organizing. We then use the counterintuitive examples above, involving Toyota, the industrial computing firm, and Schwab, and we couple them with an agent-based simulation model of organizing and strategizing. The model offers explanations, related to interactions, for why the seemingly odd phenomena of the examples might arise. Together, the examples and the model provide some general insight about how a firm should organize to strategize well in the face of interactions. The examples appear quite different, but they have an underlying similarity. In all three cases, the challenge before the management team is to organize in such a way that strategizing efforts explore a considerable variety of configurations of interdependent choices before locking in on one particular configuration. 'Unnecessary' overlap between departments in Toyota, restrictions on low-level exploration in the industrial computing firm, and sequenced organizational structures at Schwab serve this purpose. They prevent a management team from prematurely 'locking into' a poor set of choices. We find that firms that organize to strategize well manage to avoid such premature lock-in that can stall the search for good decisions at early, suboptimal, sticking points. However, they also have the discipline to cease exploration once they have discovered an effective set of choices. We describe below how they manage to balance search and stability.

Our plan of attack is as follows. The next section lays out a model of organizing to strategize that is simple, yet is general enough to encompass all three examples. The three following sections examine the examples, each with corresponding results from the simulation. The final section draws the examples together and offers reflections that span the examples and go beyond them.

... in trying to find a good combination of choices, managers lack a full overview of the terrain [and grope about like] explorers in strange territory

### A model of organizational search and organizational design

Techniques and imagery from recent studies of complex adaptive systems can be deployed to visualize how interactions influence both strategizing and organizing. The essential task of a firm's management team, in our conception, is to resolve a host of decisions — to reach choices that, together, make up the firm's strategy. For instance, managers must decide whether or not to broaden the firm's product line, to increase the advertising budget, to invest more heavily in research and development, to invest in customer relationship management software, etc. The management team can be visualized, then, as operating on a multi-dimensional landscape. Each horizontal dimension of the landscape represents one of the decisions, and the vertical dimension records the performance that results from each possible configuration of choices.<sup>5</sup> Management's problem in strategizing is to find a good combination of choices — to discover a high point on the landscape. But lacking a full overview of the terrain, and bounded in their ability to reason,<sup>6</sup> managers search in a way that resembles the groping behaviour of explorers in a strange territory. They do not simply consider all alternatives and leap to the highest point on the landscape, the global peak. A common response to the cognitive limits of individual managers is to distribute authority and responsibility for discrete decisions across a number of managers. The allocation of interdependent decisions to independent managers, accompanied by coordinating devices such as incentives, communication and hierarchy, is at the heart of organizing.

The allocation of interdependent decisions to independent managers, accompanied by coordinating devices, is at the heart of organizing

When a firm's decisions do not interact with each other - in the sense that each decision's contribution to performance does not depend on others - the performance landscape is smooth and single-peaked. Figure 2 shows a highly simplified example of this situation, with just two decisions determining firm performance. The decisions do not interact: the marginal impact of decision 1 on performance does not depend on decision 2, and vice versa (or equivalently, the shape of a crosssection with respect to decision 1 is identical for all levels of decision 2, and vice versa). In such a situation, starting from any combination of choices, one can move to the global optimum by a series of performance-improving changes to individual decisions. Incremental improvement will eventually yield the very best combination of choices, so strategizing — finding a good set of choices — is relatively simple. Moreover, a firm's organizational structure has little bearing on this outcome since, regardless of the allocation of decision 1 and a manager in charge of decision 2, each maximizing his or her independent contributions, will arrive together atop the global peak, even without coordination.

When decisions interact, however, the performance landscape becomes rugged. Local peaks – combinations of choices that provide no opportunity for improvement by means of incremental change – proliferate. Figure 3 shows a simple example of such a situation, with each decision's impact on performance now dependent on the choice made with respect to the other decision.

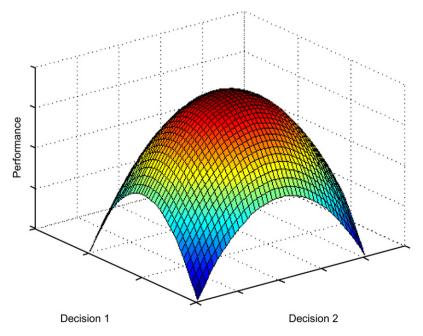


Figure 2. Performance landscape with no interactions

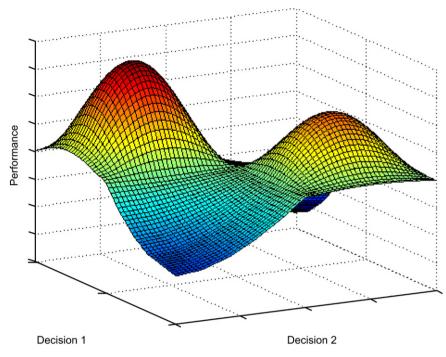


Figure 3. Performance landscape with interactions

Strategizing becomes challenging: the spectre arises that a firm may get stranded on a low local peak, unable to find better options despite poor performance. Also, efforts to organize now affect how well the firm copes with the challenge of strategizing. A choice made by one manager may now alter the performance consequences of another manager's decisions. If the firm is organized so that low-level managers are left to their own devices, those managers may engage in rounds of mutually destructive improvement efforts, each moving uphill on the portion of the landscape they control, but 'sinking' areas managed by others. And if those managers are coordinated by a vertical hierarchy, they may filter information in order to promote parochial interests, thereby damaging the firm as a whole. In the face of interactions, managers must think carefully about how to organize to strategize.

We embody the ideas behind this landscape imagery in an agent-based simulation model, a model in which firms with different approaches to organizing attempt to strategize. Computer simulations have long been used in management science to create 'laboratories' in which researchers have conducted rigorous and fruitful virtual experiments on modelled organizations.<sup>7</sup> In agent-based simulations, which have gained popularity recently, researchers model individual agents — in our case, managers — rather than the system as a whole. We confront modelled managers with a range of stochastically-generated environments, give them heuristics for reacting to the environment, allow them to interact with one another in a series of periods, and record the resulting behaviour over time. By altering the types of environments that managers face and the ways that managers are organized, and by repeating the experiments hundreds of times for each type of environment, we can isolate how well different organizations cope with various types of environments. The following sections describe (1) how we model the environment and (2) how we model managers and organizations.

#### **Environments with interactions**

The environment we model requires the management team of each firm to resolve N binary (i.e., yes/no or 1/0) decisions. For instance,  $a_1$  may represent the decision to increase the advertising budget ( $a_1 = 1$ ) or not ( $a_1 = 0$ ) while  $a_2$  may represent the decision to increase product breadth ( $a_2 = 1$ )

or not  $(a_2 = 0)$ . In total, then, the firm has  $2^N$  possible configurations of choices  $\mathbf{a} = (a_1, a_2, \dots, a_N)$ , each represented by an N-digit string of zeroes and ones. Using an approach described below, the computer generates a payoff,  $V(\mathbf{a})$ , for every configuration of choices. The mapping of all possible choice configurations into payoffs creates the performance landscape on which a firm is operating. A performance landscape consists of N 'horizontal' dimensions, representing the N decisions a firm has to make, and one 'vertical' dimension, which records payoffs.

The payoffs  $V(\mathbf{a})$  are generated in a stochastic but well-controlled manner. In particular, each decision a<sub>i</sub> is assumed to make a contribution to overall performance. The contribution of decision  $a_i$ ,  $c_i(a_i, a_{-i})$ , depends on how the decision itself is resolved (e.g., whether the advertising budget was increased or not) and on how other decisions are resolved that interact with decision ai (e.g., whether the product line was extended or not). Formally, an influence matrix M tracks the interactions among the decisions. M is an NxN matrix that has an entry in row i, column j if decision *i* affects decision *i*. For instance, Panel A of Figure 4 shows an example of a fully interdependent influence matrix with N = 8 in which each decision affects each other decision, while Panel B of Figure 4 shows a modular influence matrix in which decisions 1-4 affect each other, and decisions 5-8 affect each other, but no interactions exist across these two sets of decisions.

Lastly, for each landscape, the particular values of all possible contributions are determined by drawing randomly from a uniform distribution over the unit interval, i.e.,  $c_i(a_i, a_{-i}) \sim u[0, 1]$ . The payoff associated with a given set of choices  $\mathbf{a}$  is then given by the average of the N contributions:

$$V(\mathbf{a}) = [c_1(a_1, \mathbf{a}_{-1}) + c_2(a_2, \mathbf{a}_{-2}) + ... + c_N(a_N, \mathbf{a}_{-N})]/N$$

#### Organizations and managers

To study the effects of different organizational structures, we place firms with different structures at the same randomly chosen starting point on a performance landscape and let managers within these firms try to find its 'high locations' over a number of periods (up to 200). For each period, we record the performance of each firm, measuring the firm's payoff that period, V(a), as a fraction of the value associated with the best possible combination of choices on the landscape. We then generate a new performance landscape with the same interaction pattern (but with newly drawn contribution values) and let firms again search for high locations. We repeat this procedure 1,000 times to guarantee that performance differences we might detect are driven not by the stochastic elements of the model but by the inherent properties of the different organizational structures.

A. Fully interdependent influence matrix **B. Modular influence matrix** 

X	x	х	X	X	х	Х	x
	x						
x	х	х	x	х	х	х	x
x	X	x	x	X	x	x	x
x	X	x	x	X	x	x	x
x	X	x	x	X	x	x	x
x	X	x	x	X	x	x	x
x	x	x	x	x	x	x	x

x x x x	x	x	x				-
x	x	x	х				
x	х	x	х				
x	x	x	x				
				x	x	x	x
				x	x	x	x
				x	x	x	x
				x	x	x	<b>x</b> _

#### Figure 4. Influence matrices

To illustrate the phenomena outlined in the introduction, we focus on three organizational features: the task allocation; the degree of exploration engaged in by department-level managers; and the presence or absence of a hierarchical structure.

#### Task allocation

The N decisions of the firm can be allocated in various ways to different decision makers. In our model, we focus on firms with either one or two departments. A string of a's and b's denotes the allocation of the N decisions to the two departments. For instance, the task allocation aaaaaaaa would denote an integrated firm that has assigned all eight decisions to one department, while aaaabbbb would denote a firm that has assigned the first four decisions to one department and the other four decisions to the other department.

#### Degree of exploration by department-level managers

In each period, each department manager considers a number of randomly chosen local alternatives (ALT) to the current status quo choices. (Local alternatives are alternatives that differ in one individual choice from the current set of choices.) Thus, ALT measures the degree of exploration that department-level managers engage in. For instance, with task allocation aaaabbbb, current choices 00001111, and ALT = 2, the first manager might consider 1000 and 0010, while the second manager might consider 1011 and 0111. In particular, each manager evaluates the contributions of the decisions that are under his or her control. To continue the example, the first manager, controlling the first four decisions, would compute for each alternative under consideration:

$$V_1(\mathbf{a}) = [c_1(a_1, \mathbf{a_{-1}}) + c_2(a_2, \mathbf{a_{-2}}) + c_3(a_3, \mathbf{a_{-3}}) + c_4(a_4, \mathbf{a_{-4}})]/4$$

#### Decentralized or hierarchical structure

Once the managers have evaluated their ALT alternatives, the firm implements changes or retains the status quo. In a firm with a decentralized structure, each department manager implements the alternative with the highest value for his/her department, or retains the status quo if no alternative yields higher departmental performance. This new choice configuration then serves as the starting point for search in the next period.

In a firm with a hierarchical structure, each manager sends his/her two most preferred alternatives (which may include the status quo) to a 'CEO.' The CEO evaluates all possible combinations of alternatives and status quo choices for the two departments and implements the combination that yields highest firm performance. (Note that because the CEO can always resort to the status quo, the hierarchical firm never moves to a configuration that reduces performance.) Again, the new choice configuration serves as the starting point for search in the next period. (See Figure 5 for a summary of the two organizational structures.)

In the following sections, we present a number of intriguing results generated with this simulation set-up that shed light on the experiences of Schwab, Toyota, and the industrial computing firm that we sketched in the introduction. Due to space constraints, we cannot describe all results in full detail or show various robustness tests of the results. (The interested reader will find more detail in the papers cited in the references.<sup>8</sup>)

### The benefit of changing organizational structures

In 1995, responding to the successful arrival of internet-only brokerage firms, Charles Schwab created a free-standing electronic brokerage unit called 'e.schwab'. The unit was given free rein, moved to a separate building, and held responsible for its own profits and losses.<sup>9</sup> Nicely illustrating the effect that organizing has on strategizing, the new unit responded with an array of new practices, including new internal software that allowed for a purely electronic customer relationship, a flat pricing scheme rather than the sliding scale of commissions that Schwab used in its traditional

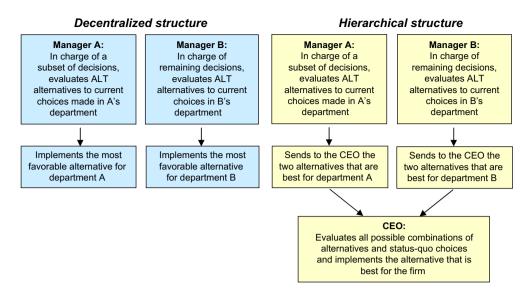


Figure 5. Different organizational structures

brokerage business, and a limited level of services offered to customers. While e.schwab was successful, a number of problems arose. In particular, externally, customers were confused and irritated by the different prices and service levels offered under the same Schwab brand name, while internally the separate computer systems at e.schwab and Schwab made it difficult for customer representatives to gain access to full customer information. In 1998, Charles Schwab decided to reintegrate e.schwab. This included eliminating the separate P&L, renaming e.schwab as Schwab.com, creating flat commissions for all trades, and allowing all customers full access to Schwab's customer services.

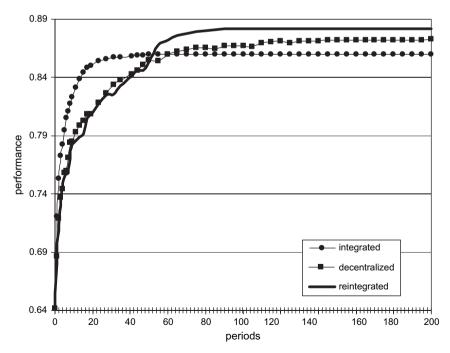


Figure 6. The benefits of reintegration in the presence of interactions

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In sum, the eventual firm became a mix of the e.schwab experiment and the traditional Schwab brokerage.

One reading of this experience is that Schwab did not correctly anticipate the eventual difficulties that arose from creating a spin-off and this forced it to reintegrate e.schwab at a later point. While this might certainly be true, the approach of first decentralizing and later reintegrating turns out to be, as our simulation model shows, a powerful one for a firm that faces interdependent decisions and needs to reconfigure its set of choices significantly.

To model the effects of different ways of organizing (integration, decentralization, and reintegration), we consider three firms that each faces eight decisions (N = 8). A fully integrated firm assigns all decisions to one 'department' (aaaaaaaa). A decentralized firm assigns decisions to two departments and lets each department implement those alternatives it finds profitable (aaaabbbb). A reintegrating firm operates as a decentralized firm (aaaabbbb) for 50 periods, then adopts the integrated task allocation (aaaaaaaa). (The results are not sensitive to the choice of 50 periods.) For the simulation presented here, we assume that firms operate on fully interdependent performance landscapes, where each decision affects all others. All three firms are placed on the same randomly chosen starting point, and each firm's performance is recorded over 200 periods. Figure 6 charts the average performance trajectories of these three firms over 1,000 landscapes.

Figure 6 reveals three patterns. First, in the short run, the integrated firm has a performance advantage over the decentralized firm. Due to the pervasive interactions across the two divisions, each department in a decentralized firm is likely to engage in actions that are beneficial for itself but which may hurt the firm overall or undermine the improvement efforts of the other department. Such actions slow down the overall performance improvement of the decentralized firm as compared to an integrated firm, which rejects changes that could hurt the performance of the whole firm, even temporarily.

When there are many interactions, the performance landscape

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# get stuck.

Second, in contrast, the decentralized firm outperforms the integrated firm in the long run. In the presence of many interactions, the typical performance landscape becomes very rugged, with many 'local peaks' on which firms can get stuck. As a result, broad search is valuable. The decentralized firm, with each department free to implement changes that benefit it alone, tends to engage in much broader search than does an integrated firm, which implements only those alternatives that improve performance for the entire firm. Consequently, the decentralized firm fares better than the integrated firm in the long run.

Third, and most striking, the reintegrating firm outperforms either pure structure. To understand this result — and more broadly to understand the general effect of organizing on strategizing — the concept of an organizational 'sticking point' is helpful.<sup>10</sup> Organizational sticking points are configurations of choices which represent the eventual outcomes of many periods of strategizing, i.e., of searching for high-performing configurations. They are thus positions from which firms do not move. Sticking points have two origins. First, a sticking point can arise when boundedly rational actors have exhausted their knowledge about possible alternatives that they would find more attractive than the status quo. This type of sticking point is very much akin to the notion of a 'competency trap.'<sup>11</sup> Second, a sticking point can arise when no alternative can be found that is acceptable to all those in the organization who must consent to its implementation.

Organizational structure has a profound effect on organizational sticking points. For the integrated structure discussed above, a configuration  $\mathbf{a}$  is a sticking point if no other configuration  $\mathbf{a}$ ' can be found that differs from  $\mathbf{a}$  in one element and that has higher performance than  $\mathbf{a}$ . In contrast, for the decentralized structure, configuration **a** is a sticking point only if neither department manager finds a profitable deviation for his or her department. Thus, different organizational structures lead strategizing efforts to terminate at different sticking points. Moreover, different structures lead to different numbers of sticking points. Decentralized firms are less likely to become stuck, as they will move if either department manager can spot a parochial improvement. For this reason, decentralized firms tend to search rugged landscapes much more broadly than integrated firms. On the other hand, the decentralized firm suffers from two drawbacks. First, it may wander forever, with department managers adopting sequences of changes that undermine each other. In contrast, the integrated firm always stabilizes around some sticking point — albeit sometimes a less-than-ideal configuration. Second, the decentralized firm may become stuck at a point where an incremental change that is attractive for the firm as a whole is left unexploited, simply because the change is not parochially appealing to the department that must implement it. The integrated firm, in contrast, never leaves incremental improvements untapped in the long run.

The reintegrating firm couples the broad search of the decentralized firm with the stability and exploitative power of the integrated firm. In its early days, when it resembles a decentralized firm, the reintegrator migrates to a promising area of the landscape. After it changes to become integrated, the reintegrator climbs and eventually becomes stuck on a high spot within that area. The early, broad search provided by the decentralized structure puts the firm in a favourable position for further search once the firm reintegrates.

In these results, we see the first instance of a pattern that will recur: appropriate organizing (or a change in organizing) can help a firm by preventing its strategizing efforts from terminating too early, i.e., by 'shaking it off' low-performing sticking points.

...appropriate organizing can help prevent strategizing efforts from terminating too early and can shake firms off low-performing sticking points.

Our finding – that sequenced organizing improves strategizing – does not hold up under all circumstances. We would emphasize two limitations. First, the finding depends crucially on the presence of interactions among decisions. Without them, there is little need for the broad search that the decentralized structure provides. Figure 7 repeats the simulation of Figure 6 but with no interactions among choices. The decentralized firm now has a short-term advantage over the integrated firm because its structure benefits from parallel processing of alternatives in each department. In the long run, all three structures end up on the same global peak of the landscape. Thus, in this case, sequencing from a decentralized to an integrated structure does not help the firm at all.

The second limitation concerns a firm's starting point. When a firm needs to adjust its configuration of choices only slightly, the broad exploration generated by a period of decentralization may lead the firm too far astray. In such cases, an integrated structure can perform better than reintegration. Suppose in our simulation that a firm begins its search D changes away from the best possible configuration of choices, the global peak. A firm with a low D level only needs a few changes in its choices to perform at its best, whereas a firm with a greater D level will require more changes. Figure 8 compares the performances in period 200 of integrated and reintegrated firms that start the same distance from the global peak, as a function of that distance. When the firms require only modest adjustment (very low D), the integrated structure outperforms the reintegrated structure (and, though not shown, the decentralized structure as well). Only firms that require a larger number of changes to reach the global peak will benefit from the initial period of broad search.

This finding sheds light on an observation in the financial services industry: some very successful firms did not follow a path of decentralization followed by reintegration. For instance,

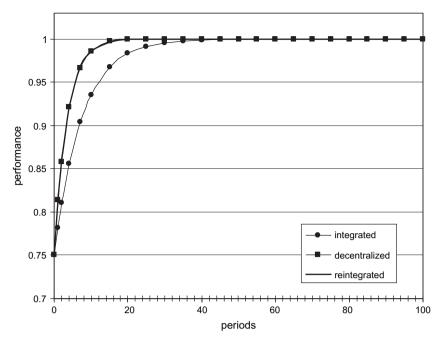


Figure 7. Reintegration does not yield a benefit in the absence of interactions

Vanguard, one of the world's largest and most successful mutual fund providers, never created an e-commerce division, but adopted Internet technology within its integrated structure from the outset. The contrast between Vanguard and Schwab reflects, we believe, a difference in their starting positions. Vanguard had long had a direct distribution system and mail-based customer information activities. The company therefore found that the Internet could be plugged into its

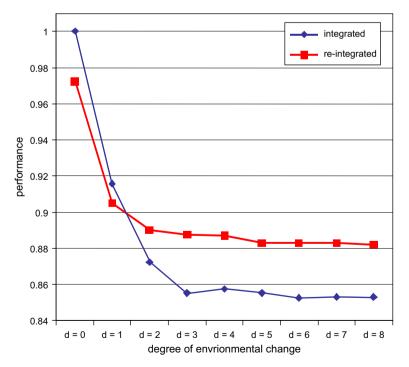


Figure 8. The benefit of reintegration as a function of the degree of environmental change

existing strategy quite naturally, and only relatively modest adjustments were required. In contrast Schwab faced change on many dimensions and thus needed the broad search that a decentralized structure provides.

This example highlights a general point. In the technological innovation literature, technological changes have traditionally been classified as either competence-destroying or competence-enhancing.<sup>12</sup> We would argue that the character of a technological change is not an inherent property of the change, but depends on a firm's current set of choices. Imagine two firms whose past strategizing efforts have led them to different sticking points. A technological change now raises a new global peak distant from one firm, but close to the other. The change is competence-destroying for the first firm, requiring change in many choices, but competence-enhancing for the other, where only modest adjustments are needed. Moreover, while both firms experience the same environmental change, very different organizational responses are required: the first firm needs an organizational structure that encourages broad exploration, while the second firm does not. The difference arises because past strategizing efforts have left the firms on different sticking points, thus influencing the appropriate way to organize for the future.

This section has focused on one particular sequence of structures, from decentralization to integration, and we have argued that early exploration under decentralization can free a firm from low sticking points. This argument can be broadened. In related work, we have explored organizational structures beyond the integrated and decentralized structures considered here. When interactions exist, each structure is associated with a different set of sticking points.<sup>13</sup> After a number of periods of search under any one structure, a firm gravitates towards a stable set of choices. A change to a different organizational structure can dislodge a firm from this stable set, rejuvenating search and leading the firm to a better configuration.<sup>14</sup> A shift in structure does not necessarily imply that the old structure was bad and that the new structure is inherently better; as Figure 6 showed, the new structure, had it been adopted from the beginning, would have led to lower performance on average. The benefit arises from adopting a structure with different sticking points, not from adopting a 'better' structure. When decisions interact, changes in organizing can spark productive strategizing. This is true even in a stable environment. The academic literature on organizations tends to assume that environmental changes come before, and drive, changes in organizing. Our argument gives reasons why top managers might consider reorganizing even in a perfectly stable environment, just to 'shake things up.'

For practicing managers, our results have two key implications.

- First, if a firm can afford a period of broad search and needs to reconfigure its choices substantially, the firm can benefit by first adopting an organizational structure with parochially-minded sub-divisions, then shifting to a structure that reins in sub-divisions and makes them accountable for their firm-wide impact;
- Second, when a firm's performance stagnates a sign that it may have reached an organizational sticking point a change in organizing may help the management team dislodge itself from its current set of choices and restart its strategizing efforts, heading towards higher regions of its performance landscape.

### Not modularizing the decomposable

A central tenet of organizational design theory is to group together those tasks that interact with each other. Indeed, the desired end state of modularization is to decompose a system into sub-systems that are entirely independent of each other, or that interact with each other in predictable ways via tightly specified interfaces. In this way, decisions made in one sub-system do not affect other sub-systems in unanticipated ways, making further coordination unnecessary and allowing project teams to work on sub-systems in parallel. Such modularity has been touted to lead, for instance, to

faster product innovation. The search for good sets of choices – the equivalent of strategizing in this context – is enhanced by modular organizing.<sup>15</sup>

In light of these potential benefits, a number of U.S. car manufacturers have embraced the idea of modular product design. Cars were decomposed into various sub-systems, and cross-functional teams were assigned to each module. To achieve this structure, firms such as Chrysler disbanded their functional organizations in favour of organizing around products and assigning people to temporary project teams.<sup>16</sup> It is thus somewhat surprising to see that Toyota's vehicle-development process – the most efficient in the industry – has maintained a functionally based organization, with very limited use of cross-functional teams. At Toyota, coordination is not achieved (or perhaps more fittingly, made less relevant) by a modular design: rather, high-level chief engineers provide coordination and integration.

Why does Toyota intentionally organize so that interdependencies are not contained within group boundaries? To shed light on this question, we consider a decision problem that is perfectly decomposable: the interaction structure is the one shown in Panel B of Figure 4. With this interaction pattern, the task allocation aaaabbbb creates two sub-systems that capture all interactions within the two departments and leave no interactions across departments. This structure, thus, would correspond to a modular set-up. In contrast, Toyota does not perfectly decompose but uses high-level coordination. This would correspond, for instance, to a task allocation aabbbbaa embedded in a hierarchical structure. In this case, interactions across the two departments (the two functions) still exist, and each department needs to involve the chief engineer (or in our model, the CEO) before implementing choices.

The first two columns in Figure 9 show the average performance in period 200 of firms with these two structures. Surprisingly, even though the decision problem is perfectly decomposable, a task allocation that completely decomposes the decision problem (column 1) does not produce the highest performance. The incompletely decomposed task allocation embedded in a hierarchical structure (column 2) does better. To achieve the superior performance, one needs *both* the task allocation aabbbbaa *and* the hierarchical structure. Adding a chief engineer to the decomposed task allocation aaabbbb creates no benefit, as a comparison of the first and third columns in Figure 9 shows: once the decision problem is perfectly decomposed and no cross-departmental interdependencies remain, coordination is unnecessary and the extra hierarchical level does nothing (i.e., the first and the third columns show identical performance). Likewise, as the fourth column in Figure 9 shows, adopting a task allocation with overlap but leaving the departments decentralized leads to the worst outcome.

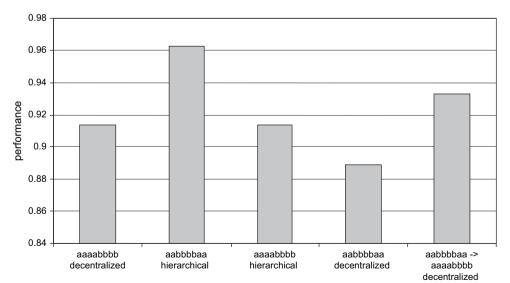


Figure 9. The benefits of unnecessary overlap

Why does an incompletely decomposed task allocation, together with the coordination that a chief engineer provides, lead to higher performance than a completely decomposed task allocation? Even when the task allocation places all interactions within departments, each department faces rich internal interactions: that is, it faces a strategizing problem with many local peaks. Each department therefore runs a risk of becoming locked into a suboptimal solution before it explores the range of possibilities broadly. In the firm with the completely decomposed task allocation, each department tends to settle prematurely into a sub-optimal set of choices. In the firm with incomplete decomposition, interactions *across* modules create a very different search dynamic: changes in each department alter conditions in the other, levering departments away from equilibria and requiring each department to continue its search. Without a coordinator, such conflict between departments leads to instability and low performance (as seen in the fourth column of Figure 9). A coordinator, however, vetoes parochially beneficial proposals that undermine total firm performance, thus providing stability while 'unnecessary' overlap between departments generates extra search. Together, the two can produce superior final results.

Sobek, Liker and Ward portray exactly this dynamic in their description of Toyota's product development process.<sup>29</sup> For instance, in designing a new model of the Celica sports car, the styling department suggested a design change to the front panel, giving the car a more exciting look. This change, however, forced manufacturing to re-think its existing tooling. In response, manufacturing made suggestions, which in turn led to changes in design. The coordination of this exchange was orchestrated at the level of the chief engineer and the general manager of manufacturing. From this 'conflict' emerged an innovative and easily manufactured design, one that would have been unlikely to arise without interdependencies across these functions.

This situation gives us the second instance of our general pattern: a good choice of organizing prevents strategizers from locking into sets of choices prematurely, while still allowing the firm to hold onto good solutions. In this case, the 'unnecessary' overlap between the departments dislodges each department from early solutions and rejuvenates the search process, while the coordinator makes sure that promising sets of choices are not lost. Similarly, for the previous section's reintegrators, the early period of decentralization ensured broad search, while the later period of integration made good choices permanent.

apparently 'unnecessary' overlap between departments can dislodge them from early solutions and rejuvenate the search process

To show that the underlying mechanism in this section and the last section are very similar, we conduct one further simulation. Rather than using the hierarchical form to create coordination, we construct a decentralized firm that sequences its task allocation from one with overlap (aabbbbaa) to one that perfectly decomposes the system (aaaabbbb). As the fifth column in Figure 9 shows, this sequencing also produces better performance than the perfectly decomposed structure alone can achieve. While the hierarchical structure with overlap creates a simultaneous balance between search and coordination, the sequenced decentralized firm creates this balance over time. In either case, firms that manage this trade-off well perform better than those that look, at least at first glance, optimally organized for the decomposable problem they face.

The implication for managers is as follows: even in a perfectly decomposable system, it may make sense to leave some 'unnecessary' overlap between subsystems. This is true when each subsystem is complex (so that broad search is needed within each department) and a cross-department coordinator is present (so there is a source of stability in the long run).

#### Low-level exploration that reduces firm-level exploration

When a firm's environment changes rapidly and radically, top managers often want to encourage the firm to explore a broad range of new possibilities. A common way to do this involves a shift in organizing: give low-level managers wider freedom to consider changes in individual departments, divisions or regions. This approach has been advocated strongly in popular management literature. When facing large changes in one's industry, Intel's Andy Grove recommends '*letting chaos reign*' for a while to foster creative new options. Hamel exhorts top managers to find '*activists*' and '*rebels*' far down in the organization, while Handy urges firms to place low-level managers in a '*federal*' structure where '*power resides at the lowest possible point*.'<sup>17</sup> Unleashed, the low-level managers will explore creative new options, and thus so will the firm.

An implicit assumption in such an organizational shift is that wider exploration at the bottom of a firm will result in broader exploration for the firm as a whole and, conversely, that restricting the exploratory efforts of low-level managers will narrow overall exploration. But is this assumption always valid? Case examples cast doubt on it. Consider, for example, an American industrial computing firm that, a few years ago, increased the latitude of department managers to seek innovations.<sup>18</sup> In response, department managers broadened the array of creative options they considered. Many of the options that department managers brought forward, however, corporate managers felt they had to quash because the proposals did not fit with the direction of the corporation; low-level exploration led to little innovation that was useful to the firm. Subsequently, senior managers forced departments to trim their list of innovative projects by 33%. The rate of new product introductions – a rough proxy for the firm's exploratory success – then *rose* by 150%. In this last turn of events, restrictions on lower-level exploration appeared, paradoxically, to enhance the exploration of the firm as a whole.

Our simulation sheds light on why lower-level exploration might backfire, narrowing the exploration of the firm as a whole, and why restrictions on lower-level exploration might broaden firm-level exploration. Consider a set of hierarchical firms that face a fully interdependent set of decisions, as in Figure 4A, and have task allocation aaaabbbb. The firms differ from each other in terms of ALT, the number of alternatives to the status quo that each department manager can consider per period. Capturing the degree of lower-level exploration, ALT ranges from 1 (i.e., a department manager can weigh only a single option each period) to 4 (the manager can explore all four single-decision changes that are possible in the department).

Simulation results, reported in Figure 10, show that average performance *declines* significantly as department managers engage in greater exploration. The performance decline derives from differences in firm-wide exploration: though all firms face the same performance landscapes, firms with higher ALT explore *less* of each landscape before locking in on a configuration of choices. For instance, a firm with ALT = 1 adopts about twice as many distinct configurations on average during a 200-period simulation than does a firm with ALT = 4. Likewise, the average number of sticking points — configurations of choices from which a firm with a given structure will not change, so long as the environment does not change — rises with ALT, as show in Figure 10. These two patterns suggest that, as department-level exploration increases, the firm as a whole gets frozen at more locations and explores less of the landscape. Narrow exploration then causes poor performance.<sup>19</sup>

But what is the mechanism by which an increase in departmental exploration narrows exploration for the firm as a whole? The answer lies in the organizational structure of the firm: the incentives, flow of information, and decision allocation within it. Because department managers have a charter to evaluate and sort alternatives before discussing them with the upper-level coordinating body, department managers can screen out proposals they do not like and shield them from the view of senior management. The more department managers explore, the more thoroughly they can engage in screening. Consider, for instance, two firms that start with the same configuration of choices: 00001111 (0000 in department A and 1111 in department B). The firms differ only in terms of ALT: ALT = 4 in one firm, and ALT = 1 in the other. Suppose that, among department A's four alternatives, 0001 and 0010 are better than 0000 for the department, and 0100 and 1000

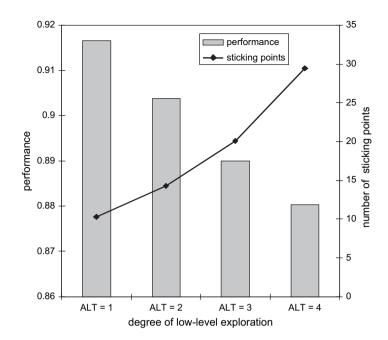
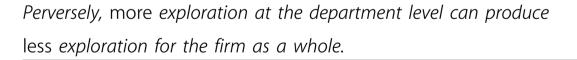


Figure 10. The potential pitfall of lower level exploration

are worse. Finally, recall that department managers are required to send the CEO two proposals each period. In a firm where departmental managers can explore all four alternatives every period (ALT = 4), the manager of department A will always choose 0001 and 0010 as the two proposals to send, and screen out 0100 and 1000, even though those options might be better for the firm as a whole. In contrast, in a firm with ALT = 1 (i.e., where the department manager can only consider a single alternative), the manager has little room for manoeuvre. Since he is required to submit two proposals, he must send up to the CEO whichever alternative he picked to explore, whether he likes it or not, together with the status quo. Unable to screen out alternatives he doesn't like, this manager can hide nothing from the CEO, whereas the manager who considers a wider range of alternatives that might have good potential for the firm. Thus, perversely, *more* exploration at the department level can produce *less* exploration for the firm as a whole, while narrower exploration by a department can promote wider exploration for the entire firm.



This simulation result – that greater exploration at the department level dampens exploration for the entire firm – proves to be quite robust. In related work, we have found that the result holds up even when department managers have the cognitive power to consider more distant alternatives in their domains, when CEOs can weigh more options per period, when more proposals flow from the departments to the CEO, and when there is less than full interdependence among the firm's decisions.<sup>20</sup> Only two, extreme, changes to the model eliminate the result. First, if there are no interactions at all across the departments, then what is best for the each department is best for the firm as a whole, and the screening out of information does no harm, since department managers choose to promote precisely what is in the firm's best interests. Second, screening and its harmful

effects disappear if department managers are required to send all possible alternatives to the CEO - an unrealistic situation.

Note that the mechanism at play here is quite similar to the ones in Sections 3 and 4. In each instance, interactions raise the danger that strategizers will lock-in prematurely and get stuck on 'low' sticking points. Restrictions on low-level search, a period of decentralization, 'unnecessary' overlap across departments – all of these are approaches to organizing that, by design or by happenstance, encourage adequate exploration in the process of strategizing.<sup>21</sup>

The practical implications of our result that low-level exploration can backfire become clear through three examples, which illustrate three critical elements of the model. The model posits, first, that managers in one part of a firm may spot an opportunity that is good for the firm as a whole but opt not to communicate it because it is not in their parochial interests. This issue arises often in firms that attempt to cross-sell from one division to another. In the 1980s and 1990s, for instance, Andersen Worldwide struggled greatly to encourage partners in its audit practice to refer leads for consulting engagements to its consulting wing. But the accounting partners, eager to book consulting revenue *within* the audit division and fearful of damaging their reputations with clients, were reluctant to reveal leads, even when doing so would have been profitable for Andersen as a whole. As Nanda observed, *'most companies have problems cross-selling across their business units...*[since the main challenge is] *to get one end of the business to help another.*' In Andersen's case, the struggle ended in an acrimonious corporate divorce.<sup>22</sup>

The second critical element of our model is that high-level managers do act to rein in low-level proposals that do not fit corporate objectives. Such high-level discretion is illustrated by events at Whirlpool, the world's largest appliance maker. In 1999, Whirlpool's Executive Committee sought to encourage *'innovation from everywhere and everyone'* in order to escape a *'stalemate'* in its core appliance business. Regional organizations set up 'I-teams' to pursue new innovations, established 'I-boards' to support the I-teams, set up local seed funds for new ideas, and learned innovation techniques from consultants. The resulting burst of pilot projects covered a wide spectrum, including, for instance, a line of exercise equipment, a household maid service and a modular system of equipment for tailgate parties. But many of the suggested projects were so far removed from Whirlpool's core business that, by 2001, the Executive Committee had to put new mechanisms in place to rein in the innovations and tie them to existing brands.<sup>23</sup>

# high-level managers must rein in low-level proposals that do not fit corporate objectives

Finally, our model implies that low-level exploration, information screening, and high-level oversight can combine to produce inertia. As an example, consider Clayton Christensen's description of how hard-drive manufacturer Seagate failed to respond to the advent of 3.5-inch architecture. When top executives at Seagate received proposals from engineers to support the development of the 3.5-inch product, its marketing organization responded with extensive information indicating that the new product's market and margins were small. Pursuing its interests, the marketing department was more eager to develop high-margin products for existing customers and had little incentive to push the new product. Given the alternatives made available by the engineering and marketing departments, top management essentially decided to stick with the technological status quo and forego broader technological and market exploration. Eventually, this led to a severe decline in Seagate's market position.<sup>24</sup>

These examples suggest four practical responses to the tension we identify between low-level and firm-level exploration. All four call on a firm to alter how it organizes in order to affect how it strategizes.

- First, department managers might be given incentives to take firm-level interactions into account when evaluating and proposing alternatives. This would mitigate the problem of parochial screening of information, but risks dulling department-level incentives and creating a costly need to provide department managers with the expertise and information to take interactions into account. Andersen, for instance, worked to find incentive-based solutions to its referral problem, but ultimately failed to find a system that gave auditors and consultants appropriate incentives both to perform well within their own domains and to refer clients to the other part of the business.
- Second, a firm might avoid parochial screening by requiring department managers to send up a range of radically different proposals (in our simulation model, more than the two proposals per department), particularly if prior proposals have been rejected. This ensures that a rich variety of ideas reaches the level of the organization at which firm-wide implications can be assessed, and might pry firms off of low-lying sticking points. Such a requirement, however, increases the coordinating and processing burden on top management. At Whirlpool, for instance, it is hard to imagine getting the desired results from *'innovation from everywhere and everyone'* by having all 68,000 employees submit proposals, unfiltered, to the nine-person Executive Committee.
- Third, top management might define arenas within which low-level managers can explore freely. This makes it less likely that senior managers will subsequently quash departmental initiatives. Whirlpool eventually took this approach, with the CEO identifying the existing brands as the 'sandbox' in which regional innovators could 'play.' This approach puts some limits on exploration, of course, and it presumes that top managers have the information and insight necessary to spot promising arenas for strategizing. Moreover, the approach must be taken delicately, lest it suffocate productive sparks of creativity at low levels of a firm. At Whirlpool, for instance, the senior managers who were pulling innovation efforts back into the sandbox had to be very careful to recognize and reward managers who had explored more broadly before the sandbox was defined. This sent a signal that future innovators, now exploring within the sandbox, would be rewarded for their contributions.
- Lastly, one radical change to the approach to organizing might be the removal of the coordinating body, in our case, the CEO. Such 'decapitation' would eliminate an important source of stability – the CEO, who in our model retains the status quo rather than endorsing any exploration that degrades performance – which would lead to broader search. But, like the decentralized firm noted in our first example, such an organization would bear a severe risk of poor coordination between department managers.

In sum, we see several practical responses that might mitigate the tension between low-level and firm-level exploration, but none that could resolve it costlessly.

### Discussion and conclusion

Decades of research on organizations have produced a rich variety of valuable perspectives on the role of organizing. Organizational design decisions have been viewed in light of their impact on a firm's ability to process information, their effect on the motivation of employees to expend effort, and their influence on firm incentives to invest in relationship-specific assets, for instance.<sup>25</sup> The lens we adopt highlights the impact of organizing on strategizing. Organizing affects how a management team searches for a set of intertwined choices that enables a firm to thrive in its environment – that is, how the team strategizes. In emphasizing the effect of organizing on strategizing and stressing the role of interactions – the fact that a choice related to one decision may affect the costs and benefits associated with other decisions – we echo classic research on organizations: Alfred Chandler on structures that enable strategies involving massive coordination of goods; Paul Lawrence and Jay Lorsch on organizations that integrate differentiated parts; and James Thompson on organizations that handle pooled, sequential, and reciprocal interdependence among tasks.<sup>26</sup>

Our claim is not that organizing matters only because it affects strategizing. Rather, our view is that one major role of organizing is to set the stage for strategizing. We feel that recent research has paid too little attention to this role and, in particular, to the way that interactions among decisions affect this role.

Good organizational structures help both to search broadly for a good combination of strategic choices, and to lock in on such a combination once it is discovered.

Interactions among decisions make strategizing difficult. This raises the spectre that an incremental search for a good set of choices will leave a firm prematurely stuck — saddled with less-thanexcellent performance, yet lacking a clear path for improvement. A role of organizing is to help managers cope with this challenge. Good organizational structures help a firm achieve two ends that may seem at odds with each other: to search broadly for a good combination of strategic choices, and to lock in on such a combination once it is discovered. The seemingly odd features of our main examples — the period of decentralization at Schwab, the unnecessary overlap across departments at Toyota, and the reining in of low-level managers at the industrial computing company — were all mechanisms to encourage broad search. Each served to shake strategizing efforts off low sticking points and guide them toward higher optima. Each prevented a firm from locking into a sticking point prematurely, before a wide range of options was considered. And each was coupled with an organizational device to achieve stability in the long run: the reintegration at Schwab, the chief engineer at Toyota, and the CEO at the industrial computing company. In the face of interactions, a key challenge of organizing efforts is to balance search and stability.

The model that produces this insight has certain limits. For example, it examines only the formal aspects of organizational design such as the vertical hierarchy and the allocation of tasks to department managers. It ignores informal aspects of design such as corporate culture and social networks, which surely play important roles in achieving coordination in real firms. Informal design elements are an intriguing subject for future research. Even though the model in this article ignores informal aspects of design, it clearly illustrates two general ways in which agent-based simulations of organizational design are useful. First, the model offers a tool for exploring design choices that seem odd yet are effective. Second, such simulations enable us to drill down to fundamental considerations that drive design in the face of interactions — for instance, the need to balance search and stability.

The onus for striking this balance falls on senior management. More broadly, senior managers bear responsibility for dealing with interactions among decisions, particularly interactions that span department borders. In a sense, it is such interactions that make senior management necessary: without cross-cutting interactions, department managers could make choices independently and the firm would be no worse for it. Our perspective is that effective senior managers usually cope with intricate interactions not by 'figuring it all out' and enacting the perfect strategy up-front, but by crafting an organization that can search effectively for and stabilize around a successful strategy. The shift in mindset from 'my job is to design a great strategy' to 'my job is to design an organization that can search effectively for a great strategy but crucial.

The need to balance search and stability has an intriguing implication. It is widely acknowledged that firms ossify as they age. This tendency is often bemoaned in the popular business press, where dinosaurs are urged to dance. Among scholars, the presence of inertia is more willingly accepted. In particular, Michael Hannan and John Freeman have argued that customers and other constituencies want organizations to be reliable and accountable, and these traits may require some structural inertia.<sup>27</sup> Thus there are reasons why, in ecological competition, firms with significant inertia may be

selected for survival. While this logic identifies some benefits of inertia once it arrives, it does not explain why the *gradual onset* of inertia may be beneficial.

customers and other constituencies want organizations to be reliable and accountable, and these traits may require some structural inertia

Our models and our examples identify, however, a virtue of creeping ossification – gradual movement from ways of organizing that encourage broad search toward ways of organizing that embrace stability. In the face of interactions, a firm that is stable from the outset will lock in on a sticking point quickly, even if the sticking point produces less than optimal performance. A firm that never stabilizes will wander broadly, again achieving poor performance on average (despite fleeting moments of brilliance). A happy medium resides in a firm that shifts over time from broad search toward stability. Early on, it embraces temporary downward movement on the performance landscape, accepting this as the cost of broad search. Over time, it becomes less accepting of downward movement until it locks in permanently on a way of doing business. This process resembles 'simulated annealing,' a well-known mathematical technique for solving tough combinatorial optimization problems.<sup>28</sup> In this logic, we see an argument, albeit a speculative one, that firms may benefit from the gradual onset of inertia, not just the presence of inertia. The key to successful strategizing may lie in organizing to manage the transition from search to stability, and back to search should an environmental change require renewed adaptation. Competition may favour the survival of those firms that organize well to strategize.

successful strategizing may lie in organizing to manage the transition from search to stability, and back to search when environmental change [demands].

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Subsequent research has confirmed the mutual dependence of strategizing and organizing: 'structure follows strategy as the left foot follows the right in walking.... None takes precedence; each always precedes the other, and follows it...' (H. Mintzberg, The design school: Reconsidering the basic premises of strategic management, Strategic Management Journal 11: 171–195 (1990), p. 183). Empirical evidence has supported the notion that the two are reciprocally dependent (e.g., T. L. Amburgey and T. Dacin, As the left foot follows the right? The dynamics of strategic and structural change, Academy of Management Journal 37: 1427–1452 (1994)).

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- 13. For a broader range of structures, see N. Siggelkow and J. W. Rivkin, and N. Siggelkow and D. A. Levinthal, both op cit at Ref 8.
- 14. On average, this rejuvenation tends to be beneficial. Call a firm's current organizational structure A, and the new structure B. Each structure generates a set of sticking points. Some sticking points are unique to each structure; some are sticking points for both structures. Joint sticking points tend to have much higher performance than unique sticking points (because these are configurations that are seen as non-improvable by two structures rather than only by one). When a firm changes from A to B, it gets dislodged from the low, unique sticking points but not from the higher-performing joint sticking points. Many of the dislodged firms will end up on the high joint sticking points and the remaining on the unique sticking points of B. On average, then, performance increases due to the organizational change.
- For early expositions of the effects of grouping interdependent decisions together, see J. D. Thompson, Organizations in Action, McGraw-Hill, New York (1967); J. R. Galbraith, Designing Complex Organiza- tions, Addison-Wesley, Reading, MA (1973). For a detailed treatment of modularity and its implications, see C. Y. Baldwin and K. B. Clark, Design Rules: The Power of Modularity, MIT Press, Cambridge, (2000). The effects of modularity on product innovation are also highlighted in R. Sanchez and J. T. Mahoney, Modularity, flexibility, and knowledge management in product and organization design, Strategic Man-agement Journal 17(winter special issue), 63–76 (1996).
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- 17. A. S. Grove, *Only the Paranoid Survive*, Doubleday, New York (1996); G. Hamel, *Leading the Revolution*, Harvard Business School Press, Boston (2000); C. Handy, Balancing corporate power: A new Federalist paper, *Harvard Business Review* **70**(6), 59–67 (1992).
- 18. We are grateful to Nitin Nohria for this example. The identity of the corporation has been kept in confidence.
- 19. While the relationship between ALT and the number of sticking points is monotonic, the relationship between ALT and performance need not always be monotonic. There can exist an intermediate level of ALT at which performance is maximized, since higher levels of ALT increase the degree to which good opportunities are utilized. Performance, however, always declines as ALT reaches very high levels. For additional details, see N. Siggelkow and J. W. Rivkin, op. cit at ref 8.
- 20. N. Siggelkow and J. W. Rivkin, op. cit at ref 8.
- 21. Despite their surface similarity, the first and third sets of simulations are quite different. The period of decentralization in the first set of simulations produces true exploration for the firm as a whole, before reintegration stabilizes the firm's search effort. In contrast, in the third set of simulations, department managers with high ALT actually suppress whole-firm exploration. The departments only send up parochial proposals, and the CEO turns them all down: the result is stalemate, with the time spent considering unsuitable proposals crowding out reflection on ideas that could have been genuinely useful for the firm as a whole.
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# **Biographies**

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