

Nebojša Janićijević

University of Belgrade
Faculty of Economics
Department of Business Economics and
Management, Belgrade

RISKS OF DIVISIONALIZATION: THREE TYPICAL MISTAKES IN THE STRUCTURING OF A DIVISIONALIZED COMPANY¹

Rizici divizionalizacije: tri tipične greške u strukturiranju divizionalizovanih kompanija

Abstract

The paper analyzes the basic risks in designing and implementing of a divisional organizational model. Divisional organizational model is currently very popular among large and diversified companies since it provides them with a number of advantages. This model enables companies, despite their size, to keep their flexibility and entrepreneurship that are very important in a dynamic business environment. However, divisionalization of companies carries numerous risks of making mistakes, three of which are the most important. The first mistake in designing and implementing of a divisional organizational model is related to incorrect identifying of divisions themselves as well as centralized business functions. The second mistake consists of imbalance in authority and responsibilities of the company and division management. The third mistake in designing and implementing of a divisional model is related to performance standardization as a mechanism for coordination and control of divisions. This mistake consists of either underdeveloped and low-quality, or overdeveloped and bureaucratized system of strategic and business planning through which division performance standardization is operationalized.

Key words: *organization, structure, divisional model, corporation*

Sažetak

U radu se analiziraju osnovni rizici u dizajniranju i primeni divizionalnog modela organizacije. Divizionalni model organizacije je veoma popularan među velikim i diversifikovanim kompanijama jer im omogućuje brojne prednosti. Ovaj model omogućuje da kompanije, i pored svoje veličine, zadrže fleksibilnost i preduzetništvo tako važno u dinamičnim uslovima poslovanja. Međutim, divizionalizacija kompanije nosi i brojne rizike grešaka od kojih su najvažnije tri. Prva greška u dizajnu i primeni divizionalnog modela organizacije vezana je za pogrešno određivanje samih divizija, kao i centralizovanih poslovnih funkcija. Druga greška se sastoji u disbalansu u nadležnostima i odgovornostima kompanijskog i divizionalnog menadžmenta. Treća greška u dizajnu i primeni divizionalnog modela vezana je za standardizaciju performansi kao mehanizam kordinacije i kontrole divizija. Ova greška se sastoji u nedovoljno razvijenom i kvalitetnom, ili preterano razvijenom i birokratizovanom sistemu strateškog i biznis planiranja kroz koji se operacionalizuje standardizacija performansi divizija.

Cljučne reči: *organizacija, struktura, divizionalni model, korporacija*

Introduction

Divisional model of organization of a company is, among all models, certainly the one mostly referred to in both academic and popular literature. And there are two good reasons for this. First, divisional model of organization is implemented by all large, thriving and well-known companies. General Motors, General Electric, IBM, Microsoft, Nestle and many other large and profitable companies

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around the world are organized according to a divisional model. Serbia is no exception, so Delta, Sintelon, NIS and many other large and successful companies in Serbia are organized divisionally. Since such companies draw the attention of both academic researchers and journalists, it is no wonder that by exploring these companies and by writing about them they also indirectly write about the divisional organizational model. The second reason for the popularity of divisional organizational model lies in the fact that it is a very complex, multidimensional and intriguing model of organizational structure. It is the only model of organizational structure with three layers of organizational structure: company, divisional, and functional. Practically, it is about organizational framework which contains several independent organizations, since in this model divisions are some kind of *mini companies*. Divisionally organized companies function as a set of more or less interconnected, autonomous divisions, which in itself represents a challenge to both the management of such companies and organizations, and management researchers. Therefore, designing and implementing of a divisional organizational model requires vast knowledge and experience of a company's management. Then, it is no wonder that this organizational model is built only when a company reaches certain maturity.

The complexity of divisional organizational model is precisely the source of its *sensitivity* to making mistakes. Since it is multidimensional and complex, divisional model is not easy to build, and it is even harder to manage. The possibility of making mistakes while setting up a divisional organization is very high comparing to other organizational models [9]. In addition, even when a divisional model of company organization is well established at the beginning, there is always the risk of mistakes occurring during its exploitation and also the risk of deviating from the set-up divisional organizational model.

Each organizational model has some advantages [8]. Bureaucratic model of organization lowers the costs and makes the company's business operations reliable. Simple organizational model brings flexibility, while adhocracy model brings innovativeness in a sophisticated technological environment. Professional organizational model ensures development of experts. Divisional model ensures

entrepreneurship, dynamics, flexibility, and innovativeness in a large company, and that is not at all simple. It makes all of this possible by enabling divisions, that is, the divisions' management, to express their entrepreneurship within the limits of their limited autonomy, but at the same not at the expense of the corporation as a whole. In addition, divisional model enables a company to manage its own size, and it also enables very large organizations to still function as a whole.

Divisional model of organizational structure has three key characteristics, or elements [9]. First, it implies that primary organizational units, or divisions, are set according to the market principle, so that each division covers a specific market segment. In addition, divisions should be autonomous, and in order for that to be accomplished, the divisions' interdependence as well as the transactions between them should be minimized. Divisions have either full or limited spectrum of business functions at their disposal, which can, but do not have to be concentrated at the corporation top as well [6]. Second, in divisional organizational model, authority and responsibility are finely and sensitively divided between corporation top and divisional management according to the line of strategic – operational decision-making [5]. Third, coordination and control of divisions in this organizational model is done through a developed system of strategic and business planning [8]. In any of these three dimensions of divisional model, its creators can make a mistake, and any of these mistakes can neutralize the key advantage of divisional organizational model: entrepreneurship and flexibility. Divisions, as well as business functions within them and at the corporate top, could be faulty structured, whereby the autonomy of divisions is directly compromised. Fine-tuned and sensitive balance of authority and responsibility established between strategic corporation top and operative division management can be easily disturbed, whereby, again, entrepreneurship and flexibility of divisions are impaired. Finally, the strategic and business planning system can be faulty set up or become ineffective in the process of work, so that the coordination and control of divisions are not conducted efficiently. Unfortunately, all three of these mistakes are interconnected and one leads to another. Thus, it can sometimes happen at any time

that a well-organized divisional company *slips into* either centralized bureaucracy or anarchy and disintegration [9]. In both cases, the main advantages of divisional organization are lost. The aim of this paper is to present the main risks in divisional organization structuring and point to the way in which these risks can be avoided.

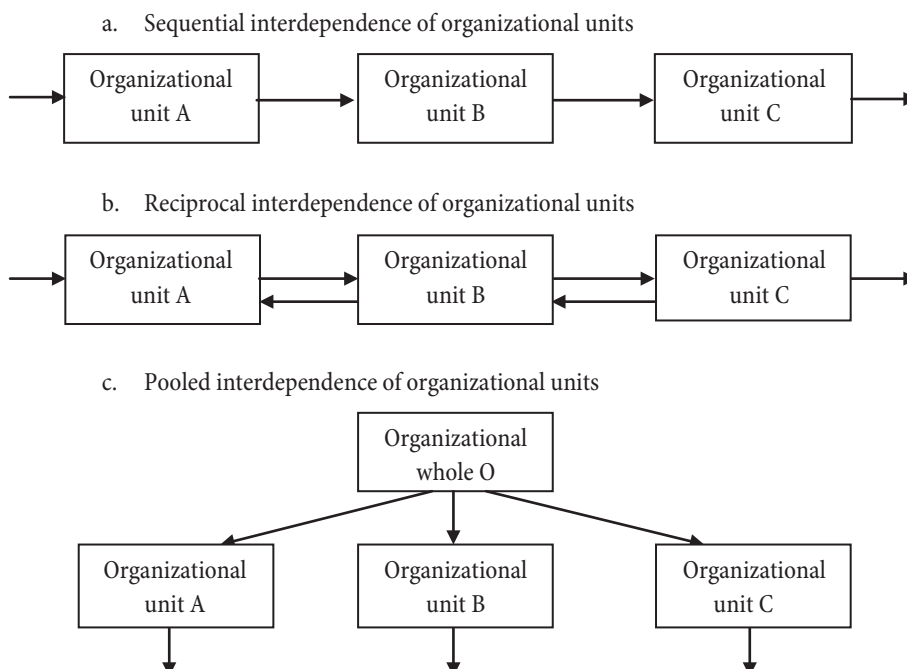
The first risk: Faulty structuring of divisions and centralized functions

The first one of the three key divisional organizational model dimensions is the structuring of macro organizational units. In this organizational model, there are two types of macro organizational units: divisions and centralized functions [10]. The risk of making mistakes while structuring a divisionalized company exists during both the process of organizing the divisions and the process of organizing the centralized functions.

One of the key characteristics of divisional model of organizational structure is market grouping of macro organizational units [9]. These units are usually called divisions, hence the name of the organizational model. Most of large companies apply the development strategy of diversification, and due to this fact enter several different markets. Diversification is in fact the precondition for divisionalization, since only when it is diversified the

company is being forced to be divisionalized as well [2]. With respect to organizational aspect, diversified companies must dedicate one division to each of the market segments they do business in, which will handle business operations at that particular market and which will be responsible for the company’s performance within it [3]. In order for this to be possible, three requirements regarding the organizational units grouping must be met. First, divisions should be formed based on a market segment that is clearly singled out, and only one division should be present in a particular segment. Market segment, and thereby the division dedicated to it, can be differentiated based on a product, territory, or types of buyers [4]. Second, divisions should incorporate within themselves all, or almost all, operative functions necessary to meet the buyers’ needs in the specific market segment they are in charge of. Third, divisions should not be interdependent and should have no or minimum transactions between them. Therefore, divisional model functions best when divisions are complete, autonomous and independent wholes. In order to make this possible, organizational units must be grouped in such a way that a so-called interdependence exists. Namely, there can be three types of interdependence between organizational units (see Figure 1): sequential, reciprocal, and pooled [4].

Figure 1: Types of interdependence between organizational units



Sequential interdependence of organizational units exists when the units are connected in a chain in such a way that the output of one organizational unit is at the same time the input of the next unit, and its output is at the same time the input of the another unit, and so on all the way to the last unit in the chain whose output leaves the frame of organizational whole in which the units are contained. Reciprocal interdependence exists when the output of one organizational unit is the input of the next unit, but the output of that unit is also the input of the preceding unit. Pooled interdependence exists when organizational units do not exchange any products, information or services among themselves, but only share mutual resources of wider organizational whole. Each organizational unit acquires resources either directly from its surrounding or from company management, while outputs of all organizational units are placed directly outside of organizational whole in which the units are situated.

Why is it important for pooled interdependence to exist between divisions? Because divisional model is based on the fact that division management has the authority to independently manage business operations of its division, but is also responsible for the performance the division achieves. In order for this to be possible, division must acquire all or a large majority of material, financial or human resources from external market, and also place all or a large majority of the products and services it produces to the external market. If significant amount of sequential or reciprocal transactions were to exist between divisions, it would not be possible for the divisions to be autonomous operative units, their management could not be assigned with the authority to lead the business operations and, therefore, it would not be possible to control them by means of performance standardization, which is a prerequisite for building a divisional model. Transactions between divisions are not liable to external evaluation by the market, but they are liable to internal evaluation by the company' management and divisional managers, which jeopardizes their objectivity, and thereby also the division performance evaluation based on which the divisions are controlled. Internal transactions between divisions are conducted according to the so-called transaction prices which are liable to subjective influences, power relations,

and lobbying, so they often contain unjustified cost that the external market would not acknowledge. In addition, stronger connections between divisions impose the need for them to be harmonized in daily business operations. This harmonization cannot be achieved by using performance standardization, but it must be done by means of some other coordination mechanisms, such as direct monitoring or standardization of processes. This would in turn prevent the building of a genuine divisional model. The whole point of divisional model is precisely to avoid mutual adjustment of the work of divisions, which is not possible in the case of their sequential and reciprocal connection. This is why pooled connectedness of organizational units is the main precondition for building a divisional organizational model. If significant sequential or reciprocal interdependence between organizational units exist, the company should not be organized according to divisional model.

In practice, however, situation is never as clear as it is in theory. There are numerous situations where there are certain sequential or reciprocal connections between organizational units, but still their pooled connectedness dominates. Consequently, organizational units acquire most inputs from external market to which they also place most of the outputs. However, one part of inputs is indeed acquired from other organizational units as well, while at the same time it is also possible to place one portion of the outputs to other units. In such situations there is always a dilemma: Are the transactions between the units so significant that it will disable the functioning of the divisional model? The answer to this dilemma can be given only through the evaluation by the company's management. The common sense rule is that divisional organizational model should not be built if the mutual transactions between divisions exceed 30% of their total transactions.

Many companies have made this mistake because they have, in the situation of sequential or even reciprocal interdependence of organizational units, turned these units into divisions and thus built a divisional model. In that case, most divisions have not been placing their products or services to an external market, but they have been "selling" them at the transactional prices on internal market to other divisions. These division prices

are mostly formed by “cost-plus” method of pricing in such a way that divisions add their total, both justified and unjustified, costs to a certain profit percentage. Trade at such prices leads to the situation where all the divisions are *profitable* except the one that must actually go into external market with its products or services, and the market, unless monopolized, does not accept these products or services at such inflated prices. In addition, intensive exchange between divisions usually gives rise to the need for company top to get involved into regulating divisional relationships. This *interventionism* from the top kills every kind of autonomy of divisions, and thereby also their initiative, entrepreneurship and accountability for the results, which is the very essence of divisional organizational model. Eventually, these divisions are turned into a mere production plants with a divisional manager at the head who is responsible only for fulfilling the production plan.

Besides divisions, centralized functions are a separate and a very important question of structuring in divisional model [11]. Centralized functions are the functions that are performed jointly for all the divisions and are therefore centralized at the company top. The selection of business functions to be centralized carries another risk of making a mistake in divisional organizational model building. Namely, the theoretical divisional structure model implies that divisions have all the business functions necessary for normal conducting of business operations: supply, production, sales, finances, accounting, logistics, human resources management, IT, maintenance, quality assurance, etc. Managers of all business functions are directly subordinate to divisional manager. All business functions within divisions need to be performed fully in order for divisions to be able to function normally and to be held accountable, by the corporation management, for business results that the corporation makes in a specific market segment. In that case, the company management deals with their divisions’ investment portfolio management [6]. Divisions have no points of contact, because they do not even share joint business functions. This is a clear situation, so this type of divisional model of organizational structure is called *pure divisional model*. But, this type of divisional model can be found much more rarely than

the one usually called *mixed divisional model*. In mixed divisional model of organizational structure, divisions do not separately perform all the business functions they need, but some business functions are centralized and performed at one place for all the divisions. In that case, centralized functions are subordinated to the company management, that is, the centralized function manager is directly subordinate to the company’s president. The reason for this modification of the basic divisional organizational model is obvious. By centralized performing of some business functions, several important advantages can be gained [5]. First, resources can be economized. For example, instead of each of the ten divisions having its own human resources management sector with five employees each, which gives a total of 50 employees, a centralized function of human resources management can effectively perform these tasks for all divisions with much less employees. It is not only human resources that are hereby economized, but material resources as well, so the costs of this function are in general from the perspective of the entire company certainly lower. The second very important advantage of the centralization of functions is a higher quality of performing of their tasks. By concentrating experts for certain function at the level of the entire company, instead of dispersing them throughout divisions, a critical mass of competent people is created, who can execute certain tasks with a higher quality performance and develop the function in question. Finally, business functions performance quality and control is facilitated when they are centralized at the company top. However, centralization of business functions at the company top also has some disadvantages [5]. The most important weakness of this solution is that it directly jeopardizes the very fundamentals of divisional structure concept and poses a threat to gaining the primary advantages of this organizational model. Namely, when some business functions, such as human resources management, finances, or IT function, are drawn from divisions and set at the level of company, both division authority and division responsibility for its business performance are decreasing. If division management does not have the control over all the business functions of the division, then it cannot fully manage the business and, consequently, cannot be held

fully accountable for the division performance, which is the basic idea of divisional organizational model. And, the more centralized functions there are, the more the autonomy of divisions is impaired, and the organization is moving further away from divisional model and is returning to functionally organized bureaucracy. In more extreme cases, divisional model turns into a hybrid that is somewhere between divisional and bureaucratic organization [9]. Such is the case when, for example, division performs only production business functions and the related tasks, such as maintenance, quality assurance or engineering, while all other functions, including commercial, financial, and marketing function, are dealt with at the company level. Another disadvantage of the centralization of business functions is complicating the relations within the company, and especially between divisions and centralized functions [7]. The first question that arises is that of financing the work of centralized functions. Since divisions are responsible for the profit, and centralized functions perform certain tasks for the divisions, it is only logical that the divisions finance the work of centralized functions and treat that cost as a business operations expense. However, numerous problems arise in this respect, starting from determining the real cost of centralized functions, to determining the real percentage of divisions' participation in covering these costs. In addition, in divisions-centralized functions relation, problems occur regarding the conducting of work and tasks of these functions, since divisions are often dissatisfied with the quality and promptness of services delivered by centralized functions. Tensions in relations between divisions and centralized functions lead the company management into a situation to be an arbiter and to solve their conflicts, which additionally impairs the autonomy of divisions. The consequence of the described tensions is the tendency of divisions to perform those tasks themselves, despite the existence of centralized functions. Thus, for example, despite the existence of company IT department, IT experts are also employed in divisions and thus divisions' IT departments slowly round up, which should ensure that the divisions are not dependent on the centralized IT department while performing IT tasks. This, of course, doubles the resources

and additionally decreases the economic effectiveness of divisional model of organizing a company.

For the success of divisional model, a proper selection of centralized functions is very important [5]. If business functions that should not be centralized get centralized, divisions will not be able to fundamentally influence their business performance and so they will not be responsible for them. Excessive centralization of functions at corporate level *deprives* divisions of their business functions, and then they turn into mere production or service plants. On the other hand, missing the opportunity to gain all of the described advantages by means of business functions centralization also endangers divisional organizational model and its effectiveness. In this regard, there is one very important question: Which business functions should be centralized in divisional model? Experience shows that the following business function should be centralized: human resources management, research and development (R&D), IT, public relations (PR), legal duties, corporate finances, and planning and controlling [6]. Will some business function be a candidate for centralization, it depends on numerous factors, but the most important one is the following: will this centralization enable leverage; that is, will it enable economically effective resources management and higher quality of task performance? This will in turn depend on the nature of the division's activity. If divisions are in the same technical-technological sphere, it makes sense to centralize the resources for performing research and development activities, but if they are not in the same sphere, then there is no need for centralization. Also, if the business activities that divisions engage in are such that they require homogenous workforce, then it does make sense that the activities of selection, recruitment, training, and development are performed in a centralized function of human resources management instead of every division performing it by itself. Will a business function be centralized and which one will be centralized, it depends on the management style practiced by the company management [6]. If company top management deals exclusively with business/divisions portfolio management and strives to be the least involved in the work of divisional managers, then business functions centralization does not exist at all or it would be minimal. However, if the company

management wishes to be included in and influence the work of divisions as much as possible, then a larger number of business functions are usually centralized. In that case, among other numerous roles, company management also plays the role of centralized services provider.

Many companies make a mistake in the selection of centralized business functions, so they centralize the functions that should not be centralized, and do not centralize the functions that should. The author's experience in structuring of companies in Serbia speaks in favor of the thesis that centralizing too many business functions at the company top is a more common mistake. The reason for this is a very prominent general tendency of managers in Serbia to centralize the management. By unnecessary centralizing some business functions, it is not only that autonomy of divisions is impaired and the main advantages of divisional model are jeopardized, but these centralized functions push the company into bureaucracy and unresponsiveness to the divisions' needs. Divisions then naturally react and form their own business functions that they need, whereby the economic effectiveness of business operations is additionally jeopardized.

The second risk: The imbalance of authority and responsibility between headquarters and divisional managers

The second dimension of divisional companies organizing that is very different comparing to all other organizational models is the delegation of authority. In divisional organizational model, there is a limited vertical decentralization [9]. Company headquarters have kept the authority of strategic decision-making, while authority of operative decision-making is delegated to divisional managers. In that way, the authority and the responsibility have been divided between managers, which enabled the management at the strategic level of the company to concentrate their attention to development and strategic issues, while divisions' managers deal with operative business activities. Thereby the problem of the "congestion at the top" has been overcome, which exists in all large centralized organizations and which emerges due to lack of capacity of the top management in large and complex companies

to reach numerous operative decisions and deal with everyday problems. By decentralization of authority, large companies overcome the main barrier to growth and can continue to grow; hence, almost all very large companies in the world have implemented the divisional model. When a company becomes so large that it cannot be managed from one center, then several smaller units are created in which the authority for operational decision making is delegated, so the whole company can function effectively. By decentralization of authority, divisions have also gained certain autonomy, so that they function as relatively autonomous organizational units. Thereby a possibility is created that the divisional managers and employees to be fully demonstrate their initiative, entrepreneurship, and capabilities. Divisional managers can then freely run business operations of the company in the way they think is the best as long as they operate within the frames of growth strategy of the company and as long as they show results.

Since delegation of authority in divisional model is based on a strict division of the roles between strategic top management and divisional managers [8], it is very important to identify the content of these roles. The company headquarters should assume the following roles [5], [9], [11]:

- *Formulation and implementation of company growth strategy.* The strategic company top has the authority and responsibility to formulate and implement the company growth strategy. Company growth strategy determines the direction, the tempo and the method in which company will grow and develop. This strategy shows in which businesses the company will engage in business activities. This role implies that the company top will develop the strategic plan of company growth and then enable its implementation. In this role, the strategic top of the company actually manages the strategic portfolio of businesses and divisions by investing or divesting in them. The company top decides in which businesses the company will engage in business activities, and based on that decision invests the capital in one and divests in other businesses. In addition, the strategic company

top establishes or buys new divisions, and shuts down or sells the existing ones.

- *Evaluation and approval of divisions' competitive strategy and business plans.* The strategic company top of a divisionalized company does not create, but it does evaluate and approve (authorize) divisions' competitive or business strategies. Competitive or business strategy shows how a division will beat the competition in the market area in which it operates. It can accomplish that in three basic ways: become a cost leader, through differentiation, and by focusing. Divisions' competitive strategies are formulated by divisional managers, and business plans emerge as a result of this activity. It is critical that divisional managers have the autonomy to independently formulate business strategy. But, since they are a part of a wider system, it is not possible that these strategies are reached without company top being aware of them and without being able to evaluate, correct and approve of them.
- *Divisions' performances control.* In divisional organizational model, standardization of results is the basic mechanism for coordination and control. Therefore, company strategic top must build a system which provides the information about divisional performance, analyze that information, and take corrective measures if necessary. It is common that divisional performances are controlled with respect to the planned performances contained in the previously approved business plan. It is essential that corporation management has real information regarding divisional performances. In addition, this does not apply only to financial performance, although they are traditionally the most important ones and are of the most interest to the strategic company top. Aside from financial performance, company management collects, analyzes and evaluates the information regarding divisions' performances on the market (sales, market share), technology performances, human resources management, etc. When divisional performances do not satisfy the company top management criteria, that is, when divisions do not fulfill the set business plan, the

strategic company top management actually has two options that depend on the evaluation of the cause of the dissatisfactory performance. If they assess that poor performances of divisions are the result of objective circumstances (bad market conjuncture, a new competitor entering the market, and the like), the strategic company top may react by helping divisional management in all sorts of ways (by financial injection, for example). But, if the company top concludes that poor performances of divisions are the result of the poor work of divisional management, then the consequence is clear – dismissal of divisional management. The only thing that the strategic company top should not do in the case of poor divisional performances is to get, through its decisions, personally involved into divisions' business operations; for example, by personally reaching a decision to change some product, sales channel, marketing strategy, etc.

- *Financial resources allocation.* The practice of most divisionalized companies is to accumulate at the company level the profit gained at the divisional level, and then invest in different purposes through decisions reached by the company strategic management. In other words, the strategic company top reallocates the financial resources by extracting more financial assets from some divisions than it invests in them (the *cash cows* in BCG matrix), while doing exactly the opposite in some other divisions (the *stars* in BCG matrix). This is one of the reasons why divisionalized companies are so vital, because this kind of reallocation ensures that financial resources are always invested in those branches or businesses that are the most promising ones at the given moment.
- *Development and implementation of systems in a company.* Divisional organizational model is burdened by the existence of permanent centrifugal forces whose carriers are divisional managers. Wishing to capture as large portion of autonomy as possible with respect to the company top, they can seriously jeopardize the unity of a divisionalized company. In order to provide this unity, the company top creates

and implements uniform systems of operations in all the divisions. A uniform IT system, system of rewards, employees' evaluation system, planning system, quality system, and especially divisions' performances control system are actually the *glue* that holds the company together. If all divisions must in the same way handle planning process, human resources management, quality assurance and the like, they will function as one whole. Creators of uniform systems of centralized functions are usually at the company top.

- *Defining the mission, vision and culture of the company.* Uniform systems are the *hard glue* that keeps a divisionalized company together. The *soft glue* is mission, vision, and organizational culture, that is, the shared values. Although intangible, vision or values sometimes keep the divisions closer together than different kinds of formal systems. The role and the responsibility of the strategic company top are to formalize and communicate the mission and the vision of the company as a whole, but also a set of shared values held at the level of the entire company. This is, after all, by definition the responsibility of the company leader and top management. This is not an easy task, since it is difficult to build a strong organizational culture as well as to provide the acceptance and implementation of a uniform mission and vision. But, when all employees and managers in divisions believe in the same mission, vision and the same values, it will be no problem to coordinate and control them, and the entire company will behave as a single organism.
- *Appointing, dismissing and rewarding of divisional managers.* Corporate top has the authority to select divisional managers, so this is another mechanism of their control. Thus, a possible solo act of divisional managers is prevented and the power of centrifugal forces tending to disintegrate a divisionalized company is diminished. Knowing that his/her position depends on the company top management's decision, the divisional manager will strive to fulfill the requirements of this authority thorough his/her work. It is common practice that company top rewards divisions' managers. The managers' bonuses directly depend on the decision of the company top. Finally, when it estimates that the incompetence of a divisional manager has led to the division's poor performance, the company top can punish the manager (which happens rarely) or replace or dismiss him/her (which happens more often).
- *Divisions operations monitoring and interventions.* The strategic company top often assigns itself with a task to personally monitor and control the work of divisions, outside of the frames of regular divisions performances control system. This is because the strategic company top must not wait for the periodic report on divisions' business operations, but must react as soon as a problem in their business operations is discovered. In addition, formalized divisions' performance control systems are sometimes not very sophisticated and precise, so some important signals implying the occurrence of possible problems in divisions' business operations sometimes cannot be noticed just by relying on the said systems. This is the reason why company top managers visit the divisions or summon divisional managers for meetings in order to get informed through direct communication about the divisions and their performances.
- *Providing centralized service.* Company top has the role of providing centralized services, since the centralized business functions that provide these services are under a direct control of company management. The company management must provide responsiveness of the centralized functions according to divisions' needs on the one hand, as well as the discipline of the divisions in financing of the centralized functions, on the other.
- *Regulation of interrelationships between divisions.* It was already stated that divisional model implies having no or minimum transactions between divisions, that is, their pooled interconnectedness. In practice, however, it is relatively often the case that, aside from pooled interconnectedness, there is also reciprocal and sequential interconnectedness of

divisions, so in such cases certain interactions and transactions do occur between divisions. When one division sells some products or services to another division, then this raises the issue of transactional or internal prices of this sale. In such transactions, certain discrepancies, and even conflicts, often emerge between divisions. All these problems must be solved by the company top, and this is precisely its obligation. The company top must be some kind of arbiter that all the divisions turn to in order to solve their relationships.

The role of divisional managers is to operatively run the business in divisions and achieve the expected results. Divisional managers should therefore have the authority to independently make all the decisions within the operational management sphere that do not concern the interests of other divisions. It is common practice that the authority and responsibility of divisional managers spread in the following spheres [5], [9], [11]:

- *Formulation and implementation of competitive division strategy.* Divisional managers formulate the strategy of fighting the competition in their area of business. When strategic company top approves the strategy, divisional managers implement it independently. Once approved, competitive strategy becomes the foundation for the work of divisional manager, who then have total autonomy in its implementation.
- *Formulation and implementation of division's business plan.* Divisions formulate a business plan draft in which they project the goals that the division will achieve within one year in its area of business as well as the resources needed for achieving of the projected goals. The company top management approves the division's business plan with or without previously modifying it. Once approved, business plan becomes the framework for the work of divisional management, and they do not have to seek further approval from the company top management for the decisions that are within the framework of the approved business plan. Therefore, divisional manager has the authority and responsibility to make all the decisions and

take all the actions that are within the framework and in accordance with the business plan.

- *Operational division management.* Divisional management has total autonomy in divisions' business functions. Thus, in the production sphere, the divisional manager together with his colleagues, and primarily with the production manager, independently makes the decisions regarding the selection of technology, technical solutions, equipment maintenance tactics and strategy, raw materials and supplies, spatial organization of production, production time cycles, etc. In the domain of finances, divisional manager independently plans and implements cash flows, provision of funding resources within the framework of the business plan, placement of financial assets (investing) within the framework of the business plan, collecting of receivables, as well as payments of liabilities, etc. In the marketing sphere, divisional management has the authority to choose suppliers, as well as sales channels, to conduct products pricing, to formulate and conduct the advertising strategy and sales promotion strategy, etc. This authority can be denied in special cases when procurement is centralized, for example, in order to attain a better negotiating position with respect to suppliers. Divisional manager independently suggests the number of employees in the division, which becomes part of his/her business plan. Upon the business plan approval, the divisional manager can independently make decisions on hiring or firing the employees. Divisional manager rewards or penalizes the lower level managers and employees in the division, of course, in accordance with the system of rewards usually designed at the strategic company top. Divisional manager has the authority and the responsibility to create macro and micro organizational structure of the division; he/she creates the organizational scheme and approves of job systematization and job descriptions.

The described division of the roles, authorities and responsibilities between the strategic company top management and the divisional management in divisional

model is general in character. In each individual case, in each particular company, this division of authority between the two levels of decision-making can be modified and adjusted to the specific circumstances of the given company. Some of the circumstances are objective in character, such as, for example, the number of divisions, their interconnectedness (pooled, sequential or reciprocal), technology, market structure, etc. Some of the factors that impact the division of roles in divisional companies' management are purely subjective: the leadership style of the corporate top and personal orientation of corporate managers, the level of competencies of divisional managers, the company cultural values, tradition and history, etc. Therefore, the described division of authority and responsibility between corporate top management and divisional management provides enough space to demonstrate very different styles of divisionalized company management within it [6].

Divisional model is very sensitive and unstable; hence, its survival depends on the division of roles between strategic and operative management. The risk of imbalance in the delegation of authority and responsibility between corporate top and operative management hangs over a divisionalized company like the Sword of Damocles. The roles of strategic and operative management should not be confused, because it would jeopardize the very idea of divisional model of organizational structure and all the advantages that it has to offer. The division of roles between strategic and operative management enables to increase the capacity of company top strategic management on the one hand while, on the other, the space is being freed at the same time to manifest entrepreneurship of divisional management. If the two groups of managers, the company management and the divisional management, do not stick to this division of roles, then none of the two key advantages of divisional model will be exploited. When the strategic top management embarks upon operative management of divisions by impacting their everyday operative decisions or solving their operative problems, then it has neither time nor space left to deal with the strategic problems of the company, which is very dangerous for the company's survival and development. On the other hand, this at the same time makes the

divisional managers passive, and they then express no entrepreneurship, initiative, or independence. In that case, divisional model can easily slip into a model of complex centralized bureaucratic organization. Another mistake is to let divisional management take over too high d of authority and independence in decision-making, while the strategic company top *abdicates* not performing the role of strategic management. In that case, divisionally structured company turns into a set of independent companies. This is why sticking to a strict division of roles and areas of authority and responsibility between the strategic company top and divisional managers is crucial for the success of divisional model of organization.

The third risk: Inefficient system of strategic and business planning

Performance standardization is the basic mechanism of coordination and control in divisional model of organizational structure [9]. It is realized through the processes of strategic and business planning. For the purpose of divisions' coordination and control, a direct monitoring by top management, and even work process standardization, can also be implemented in a smaller degree along with performance standardization. But, for divisional model success, it is crucial that performance standardization becomes the primary method of divisions' coordinating and controlling. Otherwise, divisional model makes no sense, all of its advantages perish, and it slowly turns into some other model of organization, such as, for example, bureaucratic model.

The main idea of performance standardization is not to prescribe in advance the decisions and actions of individuals and organizational units, but to control the consequences of these decisions and actions, that is, the performance that emerge as their result. Therefore, performance standardization implies a high autonomy of organizational units, such as divisions. Performance standardization is important for divisional model, because it is only this mechanism of coordination that enables autonomy of divisions and manifestation of entrepreneurship within them, and also the already described division of roles between strategic and divisional management in

company management. Performance standardization is, on the other hand, enabled by vertical delegation of authority, as well as by pooled interconnectedness of divisions. Decision-making centralization at the strategic company top, as well as transactions between divisions, could to a large degree disable performance standardization as a coordination mechanism and make it ineffective.

Performance standardization implies that the strategic company top prescribes in advance what performances are expected from divisions and then lets the divisions' management determine how the prescribed performances will be achieved [9]. The strategic company top should not (at least not to larger extent) get involved in business operations of divisions through which they achieve the required results. The company top should only prescribe what kind of results they expect from a division, and then monitor and control if they are being achieved. Performances that are standardized are mainly financial in nature (profits, ROI, revenues), but they are also of market nature (sales, market share, etc.). The success or failure in achieving the prescribed performance directly affects the rewards and penalties, promotion or dismissal of divisional managers. Those who constantly achieve the prescribed performances are being rewarded and promoted, while others are being penalized and, eventually, dismissed. But, in practice, different styles of managing a divisionalized company can be observed. In some companies, the strategic company top is somewhat more involved in the process of formulation and implementation of operative plans and competitive strategies at divisional level; hence, they also take some part of the responsibility for divisions' results. In such companies, performance standards prescribed for divisions are not as strict, and they are more just guidelines for the divisional managers' work than some clearly defined figures that must be achieved. On the other hand, there are divisional companies in which the strategic company top only prescribes the expected performance and then waits if they would be achieved, being completely uninterested in the work of the divisions. There are numerous varieties between these two opposite styles of divisional company management [6].

Performance standardization as a mechanism of coordination and control is operationalized through

strategic and, especially, business plans [8]. The strategic company top formulates growth strategy and makes company strategic plans, usually in a time horizon lasting three to five years. These plans determine in which business area the company will operate in the period that lies ahead, at what pace and in which way it will grow and develop. Strategic plans also determine the company investments within the following period, so investments plans are actually a part of the company strategic plan. In accordance with the strategic plan, as well as with the financial, market, technological, and human resources at their disposal, divisions suggest business plans for the period of one year. The company strategic plan is operationalized through these plans. A division business plan should, in simple way, predict the total business operations of the division for the period of one year, resources needed for the business operations, as well as the results that can be expected. Business plan estimates the sales according to products and markets, production quantity, procurement of the needed supplies, raw materials and energy, and financial and human resources needed to achieve the desired performance. Business plan also specifies the results that the division will accomplish and expresses them in financial measurements: revenue, profit, etc. When divisional management submits a business plan, it is analyzed, evaluated, modified if necessary, and approved by company top management. To what extent the strategic company top will immerse in the divisional business plans subject matter, and to what extent they will modify the said plans, it all depends on the management style of the strategic company top. In some companies, divisions business plans are automatically approved, while in other companies they are the subject of a long-lasting process of analysis in which, after many iterations, strategic and divisional management's opinion are finally reconciled. Once approved, the business plan becomes the framework for divisions' business operations. For the success of divisional model, it is essential that divisional management has the autonomy in the business plan realization. As long as a decision of divisional management stays within the framework of the approved business plan, they do not have to ask the strategic company top to approve of the said decision. Divisional management has the authority

to make all the decisions and take all the actions needed to execute the business plan.

In order to be able to implement the performance standardization, it is necessary that, in terms of centers of responsibility, divisions are profit centers. Therefore, divisions as organizational units should be responsible for the profit they make. In order for that to be possible, three conditions must be fulfilled. First, divisional management should have the authority to decide about both inputs and outputs of its division, because only in that way it can influence the profit that it is responsible for. Second, in order for divisions to be profit centers, it is necessary that accounting and information systems provide precise and accurate allocation of revenues and expenditures per division. This is not always simple, especially when expenditures are concerned, because it raises the issue of divisions' participation in covering the mutual expenses of the company top and centralized functions. Third, it is necessary to correctly determine the so-called internal, or transfer, prices. These are the prices that divisions use to exchange products or services among themselves in cases when sequential or reciprocal relations exist between the divisions. This is important because the total revenue of a division is the consequence of not only its sales at the external market, but also of its sales to other divisions (at the internal market). This is why division's revenue, and even other division's performances, depends of objectivity of internal prices.

In the sphere of coordination and control of divisions, companies often make two types of mistakes that are opposite in nature and character. The first mistake concerns insufficiently developed system of strategic and business planning, and the second mistakes concerns excessively developed system of strategic and business planning. The underdeveloped strategic planning system results in the absence of or a poor quality, clarity, and precision of strategic plans. In that case, confusion and perplexity dominate the company's mission, vision and goals, the strategic orientation of company development, and the company's priorities. Divisions do not have clear instructions from the company top about drafting of the business plans. The differences in interpretation of the development orientation can easily emerge, and even

conflicts, tensions and frictions between divisions. Divisions' managers, who feel that they have no clear guidance from the top, can decide to pursue a solo act and maximize their own autonomy, which altogether leads to disintegration of the company. If business plans are underdeveloped, of poor quality, unclear, and imprecise, then control of the divisions' work will be disabled. Simply put, it will not be possible to precisely determine the success or failure of a division since the planned performances, whose comparison to the achieved performance provides the evaluation of division's success, are not reliable enough. If insufficiently sophisticated methods and wrong evaluations and forecasts are used to draft a business plan, if business plans do not contain some relevant elements, if transfer prices are determined in the wrong way, and if allocation of mutual expenditures to divisions is wrong, then these plans will be defective. Such business plans will not be a reliable support for the control and coordination of the divisions' work. Top management will soon realize that they cannot rely on business plans to control the divisions' work, so instead through performance standardization, they will control the divisions' work by means of direct monitoring. This will destroy the autonomy of divisions and turn divisional model into a centralized organization.

On the other hand, it is often the case in divisionalized companies that an excessive development, formalization and bureaucratization of strategic business planning system happen. In that case, planning and controlling units, dealing with drafting of business plans both in divisions and at the company top, are dramatically widened, and they increase the number of employees as well as their own importance. These units use more and more sophisticated methods in drafting the plans, they require the managers to submit more and more information which they process and, as a result, they produce more and more documents, both in paper and electronic. But, this is still not the worst thing. The worst thing is that the process of strategic planning, and especially the process of business planning, becomes more an intellectual exercise than a real process of orienting the company and its divisions' business operations. Gradually, the strategic and business plans become excessively developed, over precise, with too many information, unclear and hard to understand

to divisional managers. Strategic and business planning becomes its own goal. For a company it becomes more important that it has strategic and business plans than that they are realistic and usable in the practice of company management. This is a typical example of the anomaly characteristic of bureaucratization, which is called “goal and means substitution”, when the means become its own goal. The consequence is bureaucratization of the entire company, its loss of flexibility and all the advantages of divisionalization. We could say that there is also a third type of mistakes in the implementation of performance standardization in divisionalized company, although such type of mistake could sooner be ascribed to the problems in delegation of authority. Namely, in some companies, strategic and business plans are adequately drafted and represent a solid foundation for coordination and control of divisions’ work, but they are not followed. The strategic company top or divisional management simply does not use the business plans in running the company business operations or divisions. The strategic company top can, for the purpose of increasing their operative influence on the work of divisions, disregard the business plans and impact the divisions’ work even outside of the business plans’ framework. The company top justifies this by alleged poor quality of the business plans or by a change in circumstances comparing to when these plans were drafted. On the other hand, divisional management can do the same. Striving to increase its autonomy, divisional management can take actions that surpass the framework of the approved business plan. In both cases, the problem is not so much in the business plans per se, as it is in management’s, conscious or unconscious, disregarding and avoidance of their implementation.

Conclusion

Aside from being attractive, the divisional model of organizational structure is also a very risky model. This type of organizational structure has many advantages. It enables flexibility and entrepreneurship even to large companies, which is a very challenging task. Divisional model offers alternative to large companies in comparison to bureaucratic organizational model; hence, it is very

popular and it has always a positive connotation. But, on the other hand, divisional organizational model carries some risks. It is a highly complex model of organization, whose design and implementation require vast knowledge and rich experience. The mistakes in designing and implementation of divisional structure lurk from all sides. Still, the most prominent risks of divisional model are linked to its three key dimensions: structuring of divisions and centralized functions; delegation of authority; and system of coordination and control based on performance standardization. The first mistake that can be made while designing a divisional model may occur already in the first stage: in determining the very divisions. Divisions as the basic organizational units must be set up in such a way that there is no, or at least no significant, interdependence and transactions among them. Only a pooled interdependence should exist among divisions. On the other hand, a mistake can also be made in creating of centralized functions if they are selected in a wrong way or if too little or too many functions are centralized at the corporate top. The second mistake can be made while establishing a fine division of authority between the corporate management and the divisional management. This delegation of authority should follow a strategic management – operative management direction. This is, of course, easy to say, but in practice it is difficult to establish a precise division between strategic and operative decisions. Even when it is well established, this division of authority between the corporate management and the divisional management is prone to being disrupted during its implementation. Then an unwholesome imbalance of authority and responsibility occurs, either by the company top starting to get involved in divisions’ business operations (which happens more often), or by divisional managers starting to overtake the strategic decisions-making (which happens rarely). The third risk in designing and implementation of a divisional model lies in the mechanism of coordination and control of the divisions. This mechanism is the performance standardization, and it is operationalized through the system of strategic and business planning. The risk that a divisional model carries in itself consists of strategic and business planning being either underdeveloped, of poor quality and ineffective or excessively developed,

formalized and bureaucratized. Having all this in mind, it is possible that, even though effective, strategic and, especially, business planning are disregarded in practice by company or divisional managers. All three described groups of mistakes in divisional model designing lead to loss of all its advantages and, of course, poor performance of a divisionalized company.

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Nebojša Janićijević

is a Full Professor at the Faculty of Economics, University of Belgrade, where he teaches courses in the field of organization, human resources management and change management to students at undergraduate, graduate and doctoral studies. So far, as an author and coauthor he published several books, and among them "Organizational Change Management", "Organizational Culture and Management" and "Enterprise Organization". He published a number of articles in foreign and domestic academic journals, and participated in many international scientific conferences. He was three times at study stays at U.S. universities as a receiver of fellowship of Fulbright Program. He is a member of the European Group for Organizational Studies (EGOS) and the European Academy of Management (EURAM). Nebojša Janićijević is a consultant for leading domestic companies in the field of organizational restructuring and human resources management.