EMERGENT PARTNERS

ORGANIZATIONAL STRUCTURE IN PRIVATELY-HELD COMPANIES

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Proper organizational hierarchy and a good organizational chart are just as important for small businesses as they are for large, international companies. Without good organizational structure, assigning responsibility over critical business processes can be difficult and create management issues for senior leadership. A lack of structure also leads to individual positions being loosely defined resulting in employees losing focus on the most important aspects of their jobs.

How do companies determine what their organizational structure should look like and what the responsibilities of each position should be? Once this is determined, how do they successfully implement organizational changes while limiting the interruption of business activities while minimizing negative effects on employee morale?

WHY ORGANIZATIONAL STRUCTURE IS IMPORTANT

The first step to creating good organizational structure is understanding why it is important. Good organizational structure provides numerous benefits for companies.

Distribution of Authority

Organizational structure enables the distribution of authority for decision making by creating a defined hierarchy. A business owner or small group of senior managers cannot effectively make all decisions for the company. Centralizing all decision making decreases the ability of the organization to handle minor exceptions that inevitably arise during the delivery of products or services. It also slows down adaptability to minor fluctuations in the client or customer delivery model.

Centralization creates a situation where decision making gets bottlenecked with senior management, which only gets worse as an organization grows. Decentralizing decision making, which includes assigning and defining specific responsibility for decision making to certain employees, allows senior management to easily hold employees accountable for the performance of critical business functions. This gives key employees ownership of certain tasks providing motivation to complete those tasks successfully. It also makes managing those functions much less difficult for senior management because they can focus on a few key employees for critical interactions.

Establishing Hierarchy

In addition to defining the distribution of authority, establishing a clear hierarchy for all employees provides other benefits.

- Defines a suitable number of management levels.
- Provides the vehicle for defining individual roles taking into consideration how each role will be managed.

Defining roles and levels of management offers a unique benefit to smaller organizations where some managers will have hands-on responsibilities in addition to managing employees. Clear definitions of these types of roles and their place in the hierarchy helps these individuals properly manage both their individual duties and those who report to them.

Segregating Duties

Segregation of duties is important in all companies. Even though small, privately-held companies usually operate with a smaller staff, it is still important not to consolidate too many critical responsibilities under a single individual. A good organizational structure provides the visibility to determine which duties need to be segregated. Once this has been accomplished, responsibilities can be broken out effectively between individuals while remaining under the appropriate management. For example, the handling of cash and the reconciliation of cash accounts represent areas of small businesses where there is a significant risk of fraud. While it makes sense to consolidate these responsibilities under one function such as accounting, both responsibilities and their oversight cannot be assigned to a single individual. With a good organizational structure in place, a company can determine where and how to segregate these duties resulting in more secure operations of the business.

Communication

Markets today experience constant change. The more effectively an organization communicates both internally and externally, the better it will be equipped to respond positively to changes creating a competitive advantage in the market. Good organizational structure is critical for effective communication. Organizational structure and a hierarchy for management clearly define how information should flow through the company.

Defined channels of communication provide several key benefits.

- They assist with keeping management and associated functions on task by directing relevant information to the right organizational functions.
- Defined communication channels reduce instances where irrelevant information is received by functions of the business. This means that individuals do not have to decide on their own which information is relevant reducing the chance that relevant information is overlooked and not properly communicated.
- Lastly, defined communication channels make communication easier for senior management by reducing the number of individuals in the organization they have to directly communicate with.

Differentiating Business Functions

Different functions of the business require different forms of management. There are also functions of the business that need to be under different management to prevent potential mismanagement and fraud. For example, business development should not fall under the same direct management as accounting and finance since employees in each function are managed using different motivations. Salespeople are interested in making sales, while accountants are interested in performing certain technical tasks. There are also fraud and mismanagement concerns. When individuals compensated based on performance are allowed to influence how that performance is measured, it is inevitable that issues will eventually arise. Good organizational structure allows senior management to effectively differentiate business functions in the overall best interests of the business and place those functions under management that is going to help them thrive.

Promoting Complimentary Business Functions

Grouping similar or complimentary tasks under single management points creates consistency and allows for more effective management of business functions. Good organizational structure makes this possible. For example, a business has two complimentary service offerings that are delivered in similar ways and paired together in most situations. Traditional structure would dictate that the business have two direct managers who oversee the delivery of each service offering. However, instead of both of those managers reporting to senior management, they can report to another manager reporting to senior management. The additional layer of management allows a single individual to focus the majority of their efforts on growing both service offerings and managing how they complement each other. This allows the two service offerings to get the combined management attention they need without overloading the direct responsibilities of senior management.

Attracting and Maintaining Talent

The potential for growth and advancement is an important aspect of employee morale and retention. When there is a defined organizational structure and hierarchy in place, it provides a clear path for employees to potentially advance in the organization. This is important for attracting and retaining a talented workforce. Employees are motivated when they can see a clear path for how they can grow in the organization. They are also more likely to stay with an organization long term because they feel they are in a situation where they can keep their careers from becoming stagnant. Being able to offer long-term opportunity and communicate that opportunity to employees creates a significant competitive advantage for small, privately-held companies.

THE COMPONENTS OF GOOD ORGANIZATIONAL STRUCTURE

What constitutes good organizational structure in a small, privately-held company? Good organizational structure should help the business accomplish several goals.

Differentiate Critical Areas of the Business

Business functions that require different management structures or have different management objectives should be separated when possible. Breaking out management of business development and accounting is a good example. Another would be breaking out the management of different product or service offerings because there is a difference in how they are provided to the customer.

Combine Complimentary Areas of the Business

The combination of complimentary areas of the business can make management of the organization more effective by streamlining capabilities. An example is adding layers of management in certain places to make certain functions easier for senior management to oversee. Another example is combining business functions that are highly complementary and require similar management structures such as combining supply chain under general operations.

Structure the Coordination of Efforts between Critical Areas of the Business

All areas of the business interact in some way. Good organizational structure should define how these areas interact and create a hierarchy for managing that interaction. Since communication is a key part of this interaction, it should also define how these areas of the business communicate with each other.

Establish a Clear Hierarchy

A good organizational structure should provide a clear hierarchy for management from senior management to the most basic level of employee while maintaining a reasonable number of management levels.

Distribute Management Responsibilities

In a small, privately-held company that is growing quickly, it is easy for managers to become overloaded with responsibilities reducing their ability to manage key functions of the business effectively. Management functions must be strategically grouped so that they can be distributed as evenly as possible among the management team.

Provide Avenues for Employee Growth

Even employees at the lowest level of the organization need to have potential paths for growth and advancement. The hierarchy established within a good organizational structure should include positions of logically increasing responsibility wherever possible to encourage employees to stay and grow with the organization.

Be Flexible and Adaptable

Companies and the markets they are in are constantly changing. A good organizational structure leaves room for growth and should not be too rigid or compartmentalized as to limit flexibility to compensate for changes in the business.

Properly Segregate Duties

Segregation of duties is important in all companies. Even though small, privately-held companies usually operate with a smaller staff, it is still important to not consolidate too many critical responsibilities under one individual. For example, allowing the manager of the finance and accounting department to be responsible for the movement of cash as well as the completion of bank reconciliations can open up the business to potential fraud. Reconciliation responsibilities need to be assigned to a different employee or adequate approval controls need to be put in place.

Job Descriptions as a Component of Organizational Structure

A critical component of good organizational structure is formal descriptions of individual positions and their duties. Employees who work for small, privately-held companies tend to perform several tasks at once which are sometimes not directly related. In an unstructured environment where positions and tasks are not well defined, employees run the risk of taking on additional tasks that they feel are important for them to handle. This creates a couple of situations that are detrimental to the business even if there is an organizational hierarchy in place.

Most employees usually do not have the overall view of the organization that senior management does meaning that it can be difficult for them to see where the key tasks they perform effect the entire organization. When they are allowed to take on tasks individually, the potential exists for them to deviate from those key tasks reducing the positive impact they have on the business. Formally defining employee tasks allows management to place employees in situations where their skills will have the most positive impact on the business as a whole and help those employees maintain proper focus. As the business evolves over time and key tasks change, in a defined environment management has control over where new tasks are assigned or how tasks evolve.

When employees have the individual ability to take on new tasks, there can also be a negative effect on overall employee morale. When an individual or small group of overzealous employees take over a disproportionate share of the overall work, negative perceptions among other employees are created. Formally defining employee roles allows management to ensure that key tasks are spread out among employees and that each employee has the opportunity to maximize their positive contribution to the business based on their individual skills and capabilities.

The first step of defining organizational structure is taking an objective look at the business starting with how it provides products or services. Does this delivery require individuals or small teams? Are support staff required? Is there an aspect of continuing customer service after product or service delivery? How these questions are answered determines the basis for the company's organizational structure.

If product or service delivery requires teams of employees, then an effective organizational structure should include individual team managers as well as managers for groups of teams. If product or service delivery involves individuals, then a single manager over those individuals may be the most effective solution.

In a situation where support staff are required, effective delivery may mean that support teams report to different managers, but roll up to managers that are responsible for delivery teams. There may also be the need to contract third parties who need to be supervised by a different management structure altogether.

When defining organizational structure, the amount and level of available resources needs to be taken into account.

How much can a company legitimately spend filling out an organizational chart without affecting overall profitability?
This is perhaps the most significant challenge facing small companies that are trying to devise and implement organizational structure. **Adding personnel can be beneficial, but only if the business is going to see a quantifiable benefit from those additions.**

Compensation packages are important to consider as well.
Additional personnel that are added who have more performance-based pay plans can help offset cost increases with production.

Another question to consider is whether or not the current market can support the level of talent required for a new or proposed position.
If a position requires a certain skill set that is not prevalent in the existing available talent pool, finding and retaining employees in that position is going to be significantly more time consuming and expensive. In cases like this, the value that the skill set in question is going to bring to the organization needs to be scrutinized. **There are times when it is better to deviate from an ideal structure in favor of one that is going to support easily attainable talent at an acceptable cost.**

Organizational Structure based on Business Goals

Business strategy and goals must be factored into organizational structure.

Is the company being prepared for rapid growth?
If so, organizational structure needs to be created to support that growth.

Will the company grow through acquisition?
Whether growth by acquisition is in a single industry or multiple industries, organizational structure needs to be adaptable.

Does the business owner want to keep the organization small and remain heavily involved in daily operations?
In this case, organizational structure should have as few layers as possible to avoid separating the owner from daily activities.

Is the company going to be prepared for a potential sale?
If company strategy is to eventually sell, then organizational structure should be created accordingly. One aspect of this could be to isolate the owners from daily activities to reduce the company's dependence on individuals who will eventually leave the organization after a sale.

As the organizational structure is defined, the roles within that structure should be defined as well. When defining individual roles, there are several things to consider.

Capabilities of Existing Employees

When evaluating the capabilities of existing employees, there are a few questions that need to be answered.

What are employees who are already working for the company capable of?

Can existing employees take on additional or different responsibilities and still positively contribute to the organization?

What is the overall tolerance for existing employees to handle change and how drastic of a change can they handle?

When defining or changing organizational structure, companies should try and maintain existing employees, especially employees with long tenure, whenever possible. Understanding the capabilities of current employees helps to decide who will be able to stay and evolve with the company as well as what position employees who stay will be best suited for.

Departure from Existing Norms

When changes in responsibilities represent a significant deviation from existing norms, they are more difficult for individuals to respond to and take a longer time to implement. Sometimes these significant deviations are necessary because of the growth and evolution of the business. In these cases, only the most adaptable and flexible employees need to be placed in roles that are significantly changing. However, when creating new roles or redefining existing roles, the differences between the new and the old must be minimized as much as possible and clearly documented and communicated in a new written job description.

Availability of Required Skills

Individual roles that are designed around individual highly talented employees instead of designed to fill a need in an organizational process, can be difficult to hire for. The ability to find replacements with similar skills must always be considered. The reality of available, qualified individuals and the amount of compensation the company will be able to support to attract those individuals must be taken into consideration. A better exercise is to determine if the job is really necessary and if the position is a value add to the organization.

IMPLEMENTING ORGANIZATIONAL STRUCTURE

Once an organizational structure has been properly defined, it must be properly implemented. This implementation must not interfere with how the company provides its products or services. Business interruption can very easily negate the positive effects of implementing something new. The best plan for implementation depends on a few things.

How large is the organization?

Small organizations or those without a complicated hierarchy could implement a new structure at all levels at one time. Larger organizations may want to implement changes in phases saving the most critical functions for last to minimize the chance that unforeseen events will drastically effect the business.

How much of a change is going to be involved for existing employees?

Existing employees will need the opportunity to adapt to the new structure. If there is going to be a significant change from previous norms, there needs to be a good plan in place and additional training planned to help them adapt.

What is an acceptable timeframe for implementation?

Changes may need to occur instantaneously or it may be possible to phase them in over time. Regardless of the timeframe, implementation timing and deadlines need to be carefully planned.

How are employees going to respond?

Individuals are usually resistant to change. However, some individuals embrace it. When making changes in organizational structure, there will be both positive and negative reactions. Employees may have issues with responsibilities being added or taken away or they may not react well to having new oversight over their work where there was limited oversight before. Some employees may respond positively because they feel changes increase their impact on the company's success or that the expansion of duties allows them grow in the organization. Regardless of whether positive or negative, employee response must be considered and planned for.

COUNTERING NEGATIVE EFFECTS ON THE BUSINESS AND EMPLOYEE MORALE

Inevitably, changes to organizational structure will create some negative effects. How the organization counters these effects will determine how much business interruption ends up occurring.

Reduction in the Ability to Provide Products and Services

Providing products or services to customers or clients is the most important thing that a company does. Any changes to the organization should be carefully planned to eliminate or significantly minimize negative effects on product or service delivery. Phasing in changes in duties and management can help in situations where changes are going to be significant. Also, the creation of temporary redundancies or controls can help as well. This may mean more work for employees and make the initial phases of the implementation more difficult, but the increased effort is always worthwhile when it comes to effective delivery to customers or clients.

Reduction of Employee Productivity and Morale

Changes in duties can have negative effects on employee performance and morale whether duties are added or taken away. Additional duties can make employees feel overloaded. Fewer duties can make them feel inadequate. Changes in general tend to make employees uneasy. When making changes to organizational structure and job duties, it is always important to effectively communicate the rationale behind the changes. Employees must understand and be shown how changes in organizational structure and job duties are beneficial for both the company and them, otherwise it will be difficult them to embrace the change.

Regarding specific job duties, phasing in additional duties when possible can help in situations where duties are being added. The availability of additional tools to improve the efficiency of completing more standardized tasks can help as well. When reducing employee duties, making them realize how important the core tasks that remain are to the organization can instill a sense of pride and help with potential performance issues.

For key employees, allowing them to have some input in the changes helps boost morale. When employees are a part of the process for defining their roles, they will take ownership of the changes and work hard to promote them.

FAMILY BUSINESSES

Businesses where there is significant involvement from several members of the same family create unique challenges when making changes to the organization. Typically, family businesses have several key deficiencies.

Lack of Standards

Family businesses can lack standards in a variety of ways. Exceptions for family members that do not apply to employees can exist in company policies, processes, compensation, and strategy. A lack of standards can also extend to organizational structure when family members are allowed to define their own roles within the company.

Communication

Issues with communication can have significant effects on family businesses. Differences in communication between family members and employees create problems with how information is distributed throughout the company. Problems can exist with communication between family members due to unresolved family issues. Additionally, problems with relationships between family members can be devastating to how a company operates. This can have adverse effects on both daily management and overall strategy.

Favoritism

Families favoring themselves over employees, regardless of qualifications or job performance, creates significant morale issues within a family business. Promoting or placing individuals in management positions because they are family members and not because they are qualified for the position also creates issues with morale and can lead to ineffective management of the company. Ultimately, this ineffective management can translate into poor customer or client service and employee dissatisfaction.

Family Issues

Most family businesses lack protections from issues within the family. This is because considerations in management structure, redundancy of duties, or standardizations have not been made. Events such as divorce, personal financial crises, and health issues have the potential to cause irreparable damage to the business, especially if adequate exit strategies are not in place for key family members.

These key deficiencies with family businesses make defining and implementing changes in organizational structure very difficult. What is best for the business is not always best for members of the family. When some family members are perceived to benefit more from changes than others, rifts in the family can be created causing undesirable personal situations that can take away a focus on properly running the business.

So how can a family business implement necessary changes to organizational structure? There are several things to consider.

What is Best for the Business is Best for the Family

Family members need to understand that a family business does not exist solely to serve them as individuals. While employment within a family business can be a privilege for family members, it should never be expected. Members of the family need to understand that a successful family business is more important to the family than a failing business that provides certain family members paychecks.

For a close knit family, the successful business will provide benefits for all, regardless of whether or not everyone is directly employed by or involved with the business. Individual family members may not approve of how changes in organizational structure affect them, but the improvements to the business will eventually be far more beneficial.

Perception is a Driving Factor

Successfully managing a company involves successfully managing perceptions. This is more difficult in a family business. Family members have preconceived perceptions based on the family environment and existing relationships. Older siblings sometimes do not take well to being replaced by or having to report to younger siblings. Immediate family members may expect preferential treatment over extended family members. Spouses may expect preferential treatment over in-laws and even senior management or have an unfounded sense that they are indispensable to the business because of their relationship to the family.

To successfully implement changes in organizational structure, preconceived perceptions have to be addressed.

For instance, within a family business there is a situation where a family member has been placed in a position that they have held for a long period of time. This family member is going to have the perception that they are the best person possible to fill that position regardless of their record of performance or capabilities. If it is necessary to move that family member from their position as part of the design and implementation of a new organizational structure, this perception must be changed.

With certain individuals, highlighting their ineffectiveness in the position or how the position has evolved beyond their skills may be the proper motivation for changing their perception. This is a negative approach, but they might not have been able to see these issues because they were wrapped up in performing their regular duties. A more positive approach could be focusing on perceived benefits for them and the company by making the changes. Another positive approach could be to build up the importance of their new duties to the success of the company. The best approach depends on the personalities of the individuals involved.

A Well-Run Organization Requires Standardization

Family members cannot always receive preferential treatment or be given special concessions simply because they are family members.

Company policies must apply to everyone regardless of whether or not they are a member of the family. Business processes must apply to family members the same as they do for employees. If a family member has certain way of doing things, that way needs to be incorporated into a standardized process for everyone if possible. If standardization is not possible or there is a better process that can be implemented, then the family member must adapt to what is best for the company.

Compensation packages must also be as consistent as possible across the organization. It could be devastating for morale if employees were to find out that compensation packages were grossly skewed in favor of family members.

Standardization of strategy is important as well. Strategy should be focused on growing the company, not growing opportunity for individual members of the family.

CONCLUSION

Regardless of the size or goals of an organization, organizational structure is important to the organization's success. Structures can be simple or complex depending on what the business currently needs and what it is predicted to need in the future.

Devising a good organizational structure requires many important considerations to be made. Once a structure has been determined, it is critical that it is implemented smoothly with minimal interruption to the business.

Countering negative effects on the business and employee morale is critical, especially in situations involving family businesses.

Devising and implementing effective organizational structure provides significant rewards in productivity, adaptability, and the effective use of talent creating unique competitive advantages for small businesses.

[Add something about making tough decisions and considering first the health of the business and its goals.]

ABOUT THE AUTHORS

Maurice Nassar is the Managing Partner for Emergent Partners. He has served in a variety of positions for companies both large and small in management and as a business consultant. Formerly the Chief Financial Officer for a privately-held, international company, he was responsible for building the processes and infrastructure which led to exceptional growth. Throughout his career he has developed the business model and methodologies that Emergent Partners uses to help businesses improve their operations and succeed in their respective markets.

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