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Corporate Strategy and Structure: Some Current Considerations

Alfred D. Chandler, Jr.

Almost thirty years ago, as a relatively young historian, I developed an interest in the beginnings and evolution of modern large-scale business organizations—in how and why they altered their operating structures. Historically administrators rarely change their daily routine or alter positions of power except under the strongest pressures. Therefore a look at how the largest and most successful industrial corporations reshaped their internal structure would be of interest to historians, sociologists, and even economists. I had no intention of producing a book for managers, but shortly after publication of *Strategy and Structure*, I received a request from the Mitsubishi Enterprises to translate the study into Japanese as well as from other companies for reports and documents cited. Clearly the book was of interest to managers and students of management.

My interest in business organization had started with my dissertation and my first book, a study of the work and writings of my great grandfather, Henry V. Poor, the editor of the weekly *American Railroad Journal*, in the 1850s, and *Poor's Manuals of Railroads*, after the Civil War. Poor's name lives on today as one-half of Standard and Poor's, the providers of business information and comparative bond ratings. Through Poor's writings I watched the beginnings, week by week, of the nation's first big businesses. Central to these developments was the creation of the first large managerial hierarchies in the American business world. This interest in business organization received a boost when, even before the book on Poor had been published, I was invited to the Naval War College in Newport, Rhode Island, to develop and teach a course for senior captains on the "basics of national strategy." Although I knew little about the subject, I found the invitation appealing because I had spent five years during the war in the lower naval ranks. At the War College I had the good fortune to meet William Reitzel of the Brookings Institution. Reitzel was as interested in government and military organization as I was in the structure of business. We soon made tentative plans to collaborate on a book that would examine, through detailed case studies, major structural changes in large-scale organizations. Upon returning to the Massachusetts Institute of Technology where I had been teaching history since 1950, I began a preliminary study of structural changes in large American corporations. I found that the most fundamental change was a move from a centralized, functionally departmentalized structure (the U Form, as economists later termed it) to a multi-divisional one with a corporate office and a number of product or geographic divisions (the M Form). Among the most important innovators who adopted the M Form were E.I. Du Pont de Nemours and Company, General Motors Corporation, Standard Oil of New Jersey (now Exxon), and Sears Roebuck and Company.

When I began research in the archives of these companies, I had assumed, following the conventional wisdom of the day, that divisionalization was a re-

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sponse to the need to decentralize decision-making, a need arising from the increasing size of the enterprise. Too many decisions were being made at the top and too few delegated to middle managers. Although the new structure was found to be the result of a need to relieve the overload in decision-making at the top, it was due, not so much to the larger size of the enterprise *per se*, but to the increasing diversity and complexity of decisions that senior managers had to make. The need arose when the enterprise began to operate in a number of geographic areas or in a number of related product markets. Decisions at Du Pont increased rapidly after its diversification into several new industries. Top-level decision-making at General Motors differed from that at Ford Motor Company precisely because Ford concentrated on the mass production and distribution of a single model, while General Motors made and sold many different lines of automobiles, trucks, parts, and accessories. Standard Oil of New Jersey operated in many more foreign markets than did any other American oil company. At Sears the overload was sharply increased when, under General Robert Wood's guidance, the country's largest mail-order house became one of its leading retail chains as well. Much the same was true for other leading industrial enterprises that adopted the multidivisional structure in the years before 1960.

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The records of these companies also reveal how management procedures, including the existing structure of the enterprise shaped policies, frequently of holding back proposed changes in strategy. Just as basic reorganizations in structure came only after a sharp crisis (serious financial losses at Du Pont and General Motors; a series of smaller related crises over a much longer period of time at Standard Oil and Sears Roebuck), so too, did the initial changes in strategy in these companies come only after a massive shift in their markets. At Du Pont the first try at diversification was a limited response to the loss of government orders for military propellants in 1918. The full-blown development of that strategy came from a search for peacetime uses for facilities and personnel that had been vastly increased to meet the demands for ammunition, first of the Western Allies and then the United States government, during the First World War. For Jersey Standard, increasing concentration and expansion in overseas markets was a direct response to the Supreme Court decision in 1911, which broke up the original Standard Oil Company into a large number of independently operating firms. This decision by the Court permitted the successor company, Standard Oil of New Jersey, to sell in only a few northeastern states. At Sears the move into chain stores, located in and near urban areas, was a reaction to the diminution of its basic rural mail-order market, as agricultural income declined sharply when agriculture became a minor sector in the American economy in terms of income and productivity. For General Motors, a new company in a new industry, there was, of course, no long-established strategy to be changed.

Structure thus had as much impact on strategy as strategy had on structure. Only because the changes in strategy came chronologically before those of structure, (and perhaps also because an editor at MIT Press talked me into changing the title to *Strategy and Structure*), does it appear that my work concentrates more on how strategy defines structure than on how structure affects strategy. My goal from the start had been to study the complex interconnections in a modern industrial enterprise between structure and strategy, and an ever-changing external environment.

Although the pioneering firms I examined have had their ups and downs since they adopted the new structure, all of them still use it. Indeed by the Second World War most industrial enterprises that were expanding into new geographic- or related product markets adopted similar structures. The senior managers of area or product divisions who had the responsibility for market share and profit were given full control of functional activities like production, sales, purchasing, and research and development essential to carrying out such responsibilities. The top managers in the corporate office monitored the operating divisions and, on the basis of the divisions' performances and estimates of changing markets and technologies, planned for future production and distribution and allocated resources to implement these plans.

The new institutional structure was no panacea for corporate success. The firms I examined, as well as others, have had persistent problems in defining the relationship between the corporate center and the operating divisions and among the divisions themselves. At Du Pont, for example, the divisions became powerful baronies that often went their own way, mostly

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escaping any strong oversight. At General Motors, on the other hand, the corporate office, particularly its financial executives and staff, exercised strong, probably too strong, authority over the divisions. In these and other diversified firms the introduction of profit centers within the divisions has confused responsibility and accountability. Nevertheless, half a century after the restructuring, Du Pont is still the nation's largest chemical company, General Motors and Exxon the world's largest automobile and oil companies respectively, and Sears, one of the nation's largest retail marketing firms. Their overall profit records for the decades since their initial reorganizations have been enviable.

The new structure had a significant impact on strategy. By reducing the overload at the top, it encouraged managers to adopt strategies for long-term growth by moving into new geographic and product markets. Managers were much less reluctant to diversify or to go abroad when they could administer new business simply by creating new divisions. Many soon realized that they had developed capabilities within their existing production, distribution, or research activities that gave them competitive advantages abroad as well as in related industries. For example, the capabilities created in the development and production of rayon permitted Du Pont to become the nation's most efficient producer and to obtain a near-monopoly on moisture-proof cellophane, produced in much the same manner as rayon but sold to very different markets. In the same way, by the 1940s Du Pont's Textile Fiber Department had adopted a policy of development of new products that made their own existing lines, and therefore substantial existing facilities, obsolete. Nylon replaced rayon; orlon took markets from nylon, and dacron from orlon. Better to have the company use its own resources to improve product and process than to leave this opportunity to competitors.

Similar strategies were developed by other divisions at Du Pont and by other chemical companies. Food, drug, and other producers of name brand, packaged consumer products, makers of electrical and electronic equipment, and a wide variety of machinery companies were able to use internal capabilities to provide a competitive edge in related product markets. So, too, the expansion of oil, metal, and machinery companies overseas was facilitated by the adoption of a multi-divisional area structure comparable to that of Standard Oil of New Jersey. Indeed, the constant expansion into new geographic- and product markets based on existing functional capabilities became an even more dynamic force for the continuing growth of modern industrial firms in the years following the Second World War.

The very success of these strategies of growth, facilitated by the multi-divisional structure, created new challenges. Competition intensified as American companies moved into Europe, and European and Japanese companies moved into the United States, and the companies of one industry moved into the markets of another. As overall capacity increased, that of individual enterprises became underutilized. Costs rose, prices fell. With declining returns in the industries in which they operated, the top managers of many companies, particularly American companies, turned to a new strategy of growth. They began to move into other industries that appeared to have greater profit potential, even though their existing capabilities gave them little or no competitive advantage. Since they did not have the capability to build their own facilities and to hire their own personnel, they entered distant or unrelated businesses by acquiring them or occasionally merging with them.

Acquisition of unrelated businesses almost became a mania.

By the late 1960s growth through acquisition of enterprises in distant or unrelated businesses had almost become a mania. Where in 1965 there were just over 2,000 mergers, by 1969 there were over 6,000. The number dropped back to 2,861 by 1973. During the period 1963-1972 close to three-fourths of the assets acquired through merger and acquisition were for product diversification, and one-half of these were in unrelated products. For the period 1973-1977, one-half of all assets acquired through merger and acquisition were in unrelated industries.

This rapid expansion into distant or unrelated businesses put an enormous strain on the multi-divisional structure. It led to a breakdown of communication between top management at the corporate office and the operating management in the divisions. It did so for two reasons. First, the top managers often had little specific knowledge of, or experience with, the technological processes and markets of many of the businesses they had acquired. Second, acquisition of many more divisions created a decision-making overload in the corporate office. Whereas before the Second World War the corporate offices of large, diversified, international enterprises rarely managed more than ten di-

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visions, and the largest only twenty-five or so, by 1969 many companies were operating as many as forty divisions, some even more. For example, that same year the corporate offices of Borg-Warner, General Electric, and Bendix—all firms whose products had a rather distant relationship with one another—administered thirty-seven, forty-six, and fifty-three divisions, respectively. Among the conglomerates—enterprises that grew wholly by acquisition of companies in unrelated industries—Gulf & Western administered thirty-five, Textron thirty-two, Walter Kidde fifty-five, and Litton seventy. Moreover, because these divisions operated production, marketing, purchasing, and research facilities on a world-wide basis, many were as large in terms of assets and employees as most of the war enterprises described above.

The increase in the number of divisions administered and the wide variety of businesses in which they operated created an overload even more daunting than that at Du Pont and others among the pioneering companies before the invention of the multi-divisional form. Where the earlier overload resulted in the innovation of the multi-divisional structure, that of the 1960s led only to an increase in the number of executives in the corporate office. Divisions were grouped together, administered by group vice-presidents, who often had their own subordinate line and staff executives.

Top managers in the corporate office no longer had the time to make and maintain personal contacts with the heads of the operating divisions. Nor did the senior executives have the product-specific experience so necessary in the evaluation of proposals and the monitoring of the performance of their operating managers. Instead they had to rely on impersonal statistical data to carry out those critical tasks. As Thomas Johnson and Robert Kaplan have made clear in their recent study, *Relevance Lost: The Rise and Fall of Managerial Accounting*, such data had become far less relevant than the information systems devised and used by corporate officers to carry out comparable functions in the 1920s and 1930s. The overload was not so much due to lack of information but from its quality and from the inability of senior managers to evaluate it. Top managers began to lose the competence essential to maintaining a unified enterprise whose whole is more than the sum of its parts. The resulting weakness in management led to a rash of selling off of divisions and subsidiaries. In 1965 the ratio of divestitures to acquisition and mergers was about one to eleven. By 1969 the number of acquisitions and mergers had soared above 6,000, and the ratio was a little more than one to eight; by 1970 it was one to two and a half. For the years 1974 through 1977 there was one divestiture to every two mergers and acquisitions.

The unprecedented number of mergers and acquisitions, followed by as unprecedented a number of divestitures, gave rise to a new financial business—the buying and selling of companies. Before the acquisitions binge of the late 1960s, almost no investment banking house had a merger and acquisitions department. Very soon such specialized departments became a bank's largest money makers.

In the 1970s and 1980s, restructuring was a major activity in American industry as a way to undo the unbridled diversification of the earlier years and at the same time to permit American firms to meet continuing intensive competition. The goal of most restructuring efforts was to end the separation between top and operating managers by reducing the number of divisions and by concentrating on products and processes in which a firm's production, marketing, and research capabilities were strongest. Such restructuring was most successful where it was done as part of long-term strategic planning. It has been far less successful where the initiative has come from investment banks, financiers, speculators, and managers eager for short-term profits.

Although the reshaped enterprises use a wide variety of organizational arrangements, the underlying structure has remained much the same. The relationships between the corporate office, the operating divisions, and between and within divisions vary from company to company and industry to industry. Nearly all operating units—divisions or subsidiaries—are responsible for a set of closely related product lines or a geographical area, while the corporate office is responsible for monitoring the performance of the operating units and for allocating resources for long-term development of the enterprise as a whole. The basic organizational structure of American business enterprises in today's capital-intensive, technologically advanced industries in many ways bears great similarity to the one I had described earlier.

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