

## MANAGING LEVERS OF ORGANIZATION DESIGN TO ENHANCE SMES' LONGEVITY: An Agenda for Further Research.

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### **DEBATING POINTS:**

1. What relationships exist between the owner/entrepreneur, SME organizational design, and SME longevity?
2. What is the role that organizational design can play to affect SME survival and, in particular, business risk perception?
3. What kind of policies can be taken (e.g. by SMEs and other institutions supporting them) in order to improve small business longevity through proper organization design investments?

### **ABSTRACT**

SME success is often primarily linked to the personal traits of entrepreneurs and *vice versa*. In terms of SME failure, most of the literature, research and popular press, seems focused on individual factors, such as those related to the owner/entrepreneur's profile and behavior, or contextual factors like those associated with relationships between the firm and its own stakeholders, especially on the competitive and financial systems arenas.

That said, some scholars have emphasized the relevance of organizational design for SME longevity, though there seems to be little inter-relating of the two sides. This paper examines the relationships between owner/entrepreneur attributes and organization design and infrastructure in an attempt to gain a clearer understand of SME longevity and failure. It examines critical issues in appropriateness and comprehensiveness of organizational design, control and decision-making flexibility and risk perception. It concludes that these linkages are not well understood and may lead to unhelpful misdiagnoses of small business failure. It consequently suggests a research agenda based on a structural analysis and modeling using the system dynamics approach.

### **1. Entrepreneurial traits and SME longevity: an ‘imperfect’ binomial relationship?**

SME success is often primarily linked to the personal traits of entrepreneurs. On the other side, entrepreneurial success is commonly identified with SME success. In this regard, factors like the entrepreneur’s need of achievement (McClelland D., 1961), internal locus of control (Brockhous R., 1982), tolerance for ambiguity, and risk taking propensity (Burns P., 2001) have been considered as main determinants of entrepreneurial behavior, as well as business success or failure.

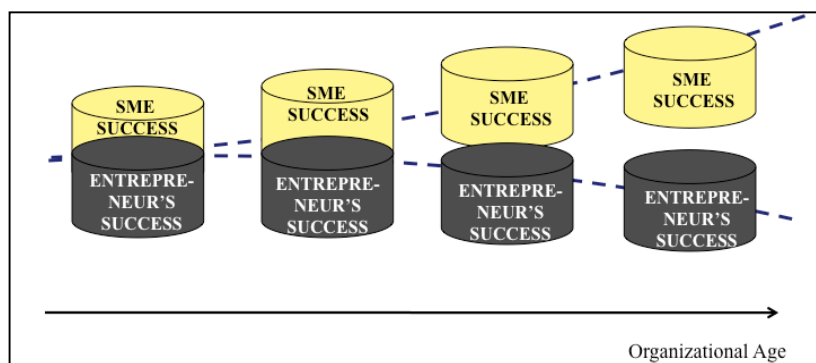
Conversely, it has been recognized that the success of owner/entrepreneurs may differ from the success and longevity of their enterprises (Cantner et al, 2011). In fact, a business can be successful but – for a variety of reasons – its owner/entrepreneur may decide to leave the firm and sell it (Battisti - Okamuro 2010); or, rather, an owner/entrepreneur can feel intrinsically rewarded by the popularity achieved through the business, but the firm cannot rely on an organization that will allow it to continue operations in the long run, regardless the personal and emotional involvement of the entrepreneur.

Empirical evidence demonstrates that SME success and continuity are only imperfectly overlapped with the success of owner/entrepreneurs. This ‘imperfect’ binomial relationship between the two concepts tends to become more evident when the process of aging for an enterprise reveals a lack of consistency in the organization design.

Figure 1 shows how the more a firm approaches its maturity (in terms of elapsed time from startup) the more most of the factors affecting its success tend to decouple from those merely associated with the owner/entrepreneur's personal success.

The purpose of this paper is to outline a research agenda covering the topic of SME survival and longevity through the perspective of organizational design and of its effects on both entrepreneurial quality and business performance.

Our thesis is that the drive, ambition, personal contacts, knowledge, and other skill set of the owner/entrepreneur are not sufficient to guarantee SME longevity. On the other hand, we claim that it is simplistic to attribute the causes of SME failure to the inadequacies in the entrepreneur and even to his/her illegal or corrupt behavior. The longevity of SMEs strongly depends also on the design and establishment of the various dimensions of their organizational infrastructure intended to inform and support the efforts of the owner/entrepreneur, with the aim to impact company performance.



**Figure 1: Diverging patterns of SME and entrepreneur's success factors over SME aging process.**

We also claim that this topic has not been adequately analyzed by empirical research yet. The focus of research agendas on SME failure seems mostly devoted to individual factors (such as those related to the owner/entrepreneur's profile and behavior) or contextual factors (such as those

associated with relationships between the firm and its own stakeholders, especially on the competitive and financial systems arenas).

Maybe one of the reasons for this apparent lack of research attention to the organizational design issues as a determining factor for SME longevity or demise, relates to the implicit hypothesis that a focus on an organizational design investment policy would not be appropriated in this context, due to the costs and rigidities that such investments might generate. On the other side, it is possible to observe that organizational infrastructure is not only made up by formal systems. Further, particularly in SMEs, the informal – or unwritten – components of organization design (such as those related to planning, performance appraisal and rewards, career, delegation/authority and responsibility) may play a significant role to address the entrepreneur's efforts towards the desired goals or to filter and affect their possible inadequacies in the interest of company survival and continuity over time.

Basing on such a perspective, the following sections of this paper will be devoted to an analysis of main research contributions on the role of organizational design in affecting business longevity, particularly in the context of small-medium and family-owned firms.

Such analysis will provide us with the basis to outline a research agenda in order to better frame a causation approach underlying the recognition of main factors determining SME bankruptcies, and sustaining their own longevity.

## **2. Organizational design and business longevity.**

Different scholars have emphasized the relevance of organizational design for SME longevity. In particular, Adizes (1999, chapters, 13, 14, 15) remarks how an important cause of aging for enterprises lies in a lack of alignment between the structure of responsibilities, the structure of authority, and the structure of rewards (p. 307). The concept of functionality of organization structure is stressed as a main factor affecting organization's entrepreneurship. Adizes also

underlines how the capability of an organization to solve problems depends on the strength and consistency of its own mechanisms impacting on three main sources of energy, i.e.: coalesced authority, power, and influence.

Adizes interprets *authority* as the right to make a decision. In the initial stages of business life-cycle (which he calls “infancy” and “adolescence”), the founder retains all decision-making authority.

When the firm grows, an authority delegation process should start in order to keep the organizational system and its boundaries under control.

*Power* is recognized by Adizes as another important source of energy an organization should build up and mobilize – consistently with other sources of energy – in order to solve problems. He defines power as the capability to punish or reward.

The third source of energy for an organization is referred to *influence*, i.e.: a person’s capability to cause people to act without having to invoke authority or power.

The interplay between coalesced authority, power, and influence defines what Adizes calls *authorance*, i.e. all the energy management uses to cause behavior to occur.

Another interesting contribution in establishing the principle of consistency between organizational system design and business survival in different life-cycle stages can be seen in Brown (2008). The author analyzes the way twelve organizational variables should change when the firm goes through different development stages. Analyzed variables are the following:

1. *organizational design*, which includes: structural systems, human resource systems, information systems, reward systems, work design, political systems, and organizational culture (Cummings – Worley, 2005);
2. *recruiting*, including the definition of roles and responsibilities, candidate profiling and sourcing, applicant screening, and compensation packaging guidelines;
3. *training & development*, i.e. those systems devoted to the development of workforce performance and leadership;

4. *performance management*, i.e. the continuous process of identifying, measuring, and developing individual and group results; this includes: planning, coaching, appraisal, and improvement;
5. *compensation and incentives*, i.e. pay and rewarding systems;
6. *trust*;
7. *communication*;
8. *alignment*, i.e. identifying whether there are any competing priorities, opposing viewpoints or communication breakdowns, primarily referred to the executive team and the CEO's mind.
9. *teamwork*;
10. *organizational learning & knowledge management*;
11. *innovation*;
12. *change management*.

Lack of attention towards organizational design and its fit with the crucial needs that each evolutionary stage of the firm implies may prejudice corporate longevity.

The concept of corporate longevity refers to the organization's capability to continuously renew itself, i.e. to align its own internal actions with the conditions of external environments. Corporate longevity is a measure of organization's ability to sustain its continuity (Montuori, 2000).

It has been emphasized by Kvee (2009) that organizational renewal can take two different forms, i.e.: *first-order renewal*, and *second-order renewal*. The first one relates to those firms operating in relatively stable and benign environments, often related to market niches. The so-called *dwarf businesses* (Bianchi – Winch 2005), having an internal change adapting their own strategic resources to the gradual changes of the industries where they operate, provide good examples of physiological patterns of organizational development in this field.

The second one relates to sustained self-renewing firms that have sharply mutated from an original state to respond or to react to a changing and dynamic environment.

In relation to the second form of organizational renewal, Kvee (2009, p. 29) has identified a set of key principles of self-renewing organizations, i.e.:

- *managing internal rate of change*, i.e. aligning organizational resources and capabilities with external opportunities and challenges, to positively affect performance;
- *optimizing self-organizing*. This principle encourages the idea of delegating decision making to the lowest possible level of the organization to maximize capabilities of scope throughout the organizational levels. In such systems, order arises from the interaction agents who share information, take actions, and continuously adapt each other, by taking into consideration emerging phenomena;
- *synchronizing concurrent exploitation-exploration*. Exploitation is needed to pursue short-term order, structure, and stability. Exploration is needed to experiment with new ideas, paradigms, and technologies, to create discontinuities.

### **3. Organizational design, business risk perception and company survival.**

Wertzel and Jonsson (1989) have pointed out the relevance of organization design in affecting business decline. The two authors defined organizational decline as a state when businesses “fail to anticipate, recognize, avoid, neutralize or adapt to external or internal pressures that threaten the organization’s long-term survival” (p. 95). Based on this definition, they sketched a model of stages of organizational decline. Such model is outlined through five main stages, i.e. 1) blinded, 2) inaction, 3) faulty action; 4) crisis; 5) dissolution.

The first three stages imply that a distorted or lacking business *risk perception* may originate failures in anticipating or detecting pressure toward entropy could emerge. Consequently, lack,

delayed or unfocused corrective or proactive action could give rise to faults, which could eventually lead to crisis and business demise.

Le Roux *et al* (2006) also emphasize the role reduced and biased risk perceptions may play in affecting business decline, due to a lack of organizational design consistency. On this regard, the authors remark how entrepreneurs often ignore the likelihood that a substantial competition will be encountered. Overestimation of product demand rates, misconception of delays and lack of understanding feedback relationships between causes and effects linking relevant variables, are often sources of imperfect reasoning, wrong decision-making, and the failure of business ideas. Many entrepreneurs may also fail because their businesses lack the necessary strategic resources (e.g. capacity, knowledge, salesforce, image).

A consequence of this phenomenon is an increased perceived self-efficacy (i.e. ability to effectively accomplish the intended actions and to attain the expected targets) and augmented perceived control, which may generate a feeling of invulnerability in the entrepreneur. Particularly when strategic decision-making is focused into the hands of the single owner-entrepreneur or on a restricted group of collaborators (often belonging to the same business-owning family), when weak signals of change and discontinuity or undetected strategic opportunities in the competitive, social or financial system depend only from 'gut feeling' and entrepreneurial experience, the company may run the risk to suffer from unexpected crises. This is particularly true when the firm's structural or operational growth rise at a sustained rate, though the company still remains small, family-owned, and with an autarchic decision making profile.

Empirical evidence of the relevance of such principles for business survival has been provided by the research conducted by Miller and Friesen (1984), and by Kvee (2009). In particular, Kvee, based her analysis on a group of case-studies available from the SMEs literature (De Geus, 1999; O'Hara, 2004; Van Driel, 2004) on long-lived firms.



Free and Macintosh (2008) have particularly remarked the relevance of the principle of consistency in organizational design in relation to the issue of risk perception as a vital component characterizing business survival. Though their study refers to a very large firm, such as Enron, their reasoning can suggest useful thoughts also for smaller firms.

In particular, Free and Macintosh remark how a common approach in analyzing Enron's demise has been associated with lack of ethics and the absence of any controls. On the contrary, they remark that the Enron's control regime comprised all the most important elements typically profiling an organization's design, ranging from the formalization of tasks to formalized processes, from performance management and bonus systems to codes of ethics, and so on. The problem was related to their internal consistency and their aptitude as a system to feed a sustainable growth strategy and to prevent that radical cultural shifts caused by individual key-players' behavior would have affected the business survival.

In this regard, the authors remark how Enron's corporate culture took "all the characteristics of a combative Wall Street trading organization and ultimately compromised formal controls and espoused values" (p. 366). From 1996, when Mr. Skilling was appointed as Enron's CEO, a radical change in the business culture was generated, and even strengthened by deep changes in organization design. The company strategy field was shifted from exploiting physical pipeline and gas exploration business to expanding energy trading expertise into a range of new commodities to sustain intensive earnings growth. This implied an almost exclusive focus of attention on short-term earnings.

Recruitment and orientation rituals, performance targets (stock options), information reporting procedures ("market-to-market" accounting), compensation plans, the organization structure design played consistent roles in deeply embedding the values underlying the new company culture which led to unsustainable growth and bankruptcy. In other words, Enron's organization system's design

was not able to perceive and counteract the dangers that such a cultural shift determined by the new CEO would have implied for the firm.

More specifically, the so-called *peer review committee* – that ruled performance management – was a main source of fear and greed in employees and managers. It encouraged the spontaneous constitution of “fiefdoms” of loyal employees who gravitated towards powerful players for protection. Such system provided a strong mechanism for preventing the emergence of subcultures in the firm. Therefore, while the business culture was a main factor affecting organizational design, this last in turn reinforced culture again, according to a pattern that eventually led to failure.

A very tight organization structure enabled quick decision-making and execution, but prevented any kind of control or debate on actions made. Also, a high fragmentation of work was a major organizational cause of lack of risk perception: supervisors were used to parcel out subtasks to a number of subordinate employees, thereby impeding each of them a through understanding of the purpose and scope of fulfilled activities (Cohan, 2002, p. 287).

In reference to the Enron case, Cohan (2002) also stresses the importance of organizational design factors as main determinants of the company’s failure. In particular, he focuses on the concept of ‘information blockage’. The ability of company managers to counteract flexibly adverse market and financial phenomena was thwarted since information was blocked from or distorted by the board. According to the “law of diminishing control”, the larger an organization becomes, the weaker its ability to control over its actions will be if the only control and strategic decisions will continue to be exercised from the top (Downs, 1966).

An important part of this ‘information blockage’ is played by the low inclination of Enron’s people to report bad news, at different levels of the company’s hierarchy. Even though the company was experiencing rising difficulties in sustaining its aggressive strategies, nobody was inclined to admit or report them. Communication and rewards systems discouraged such behavior and, eventually, it was even difficult for people to distinguish to what extent business risk was offset by concrete

failure. “Adverse situations are usually open-ended; that is, poor performance seldom can be established conclusively ... and one may just want to hold on to one’s salary and perquisites for as long as possible... There is likely to be distortion in the flow of information if various cognitive biases are in operation, and hence, fewer danger signs will be reported up to the hierarchy as ‘relevant’” (Cohan, 2002, p. 280 and 282).

Related to risk perception and information blockage, Currall and Epstein (2003) provide another important contribution towards an in-depth analysis of the deep causes of Enron’s bankruptcy. They stress the concept of organizational trust fragility and its dynamics as main determinants for such failure. The two authors define trust as “the decision to rely on another party under a condition of risk ... Risk, therefore, creates an opportunity for trust (p. 193-194)”. The authors also distinguish different typical evolutionary phases of trust in an organization; such phases go through: 1) building trust; 2) maintaining trust; 3) destroying trust. At an early stage, trust is portrayed at zero level since the parties lack information about the trustworthiness of the other part. Since this information is gradually provided, trust-building actions are taken. Therefore, trust grows until it begins to level off (maintenance stage). At this stage, trust maintains relatively constant, until actions from any party are taken to erode it. If trust-destroying events occur and if parties are informed and aware of them, the level of trust falls sharply to a negative value (distrust stage).

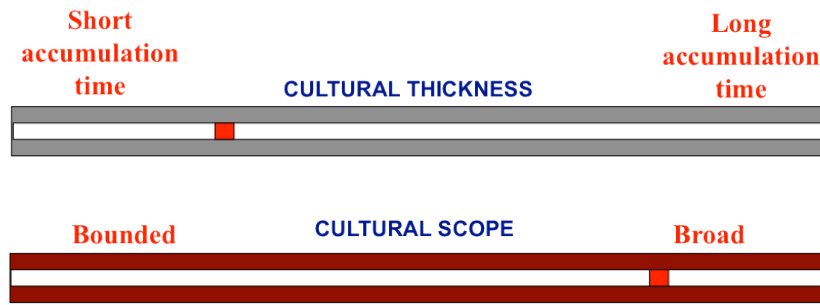
Applied to this model, an interesting analysis of trust dynamics in Enron is attempted by the authors. They demonstrate how a distortion in provided information and the consolidated positive business image generated an excessive trust in different stakeholders towards the firm: investor community, employees, customers, members of local community and government regulators, and auditors were all inclined not to change their own expectations of further financial performance improvement by the firm, in spite of the symptoms of crisis that financial markets gave.

A synthesis of the role played by organizational design mechanisms and specifically by information disclosure and risk perception on trust and decision-makers’ behavior can be made by using the

conceptual framework provided by Simons (1994 and 2000, chapter 13). Management control systems play an important role in affecting the analyzed phenomena. Management control is defined by the author as “the formal, information-based routines and procedures used by managers to maintain or alter patterns in organizational activities” (p. 170). Simons describes management control as a system comprising four main sub-systems, i.e.: 1) beliefs; 2) boundary; 3) diagnostic control, and 4) interactive control systems. The first two provide the context for the other two. They define, respectively, the core values and the risks to be avoided. The last two sub-systems are respectively focused on critical performance variables monitoring (according to feedback control mechanisms) and on strategic uncertainties surveillance (according to feed-forward mechanisms). If we apply such conceptual framework to the Enron case, and we refer to the first two subsystems (i.e.: beliefs and boundary) we may specifically identify two groups of “levers of control” that are usually managed by the board and affect the other decisions in organizational design.

If we refer to the *belief system*, such levers can be defined as: “cultural thickness” and “cultural scope”. The first one sets the time, and therefore the continuity, with which the dominant values have been accumulating into the corporate culture. The second one sets the scope (broad vs. bounded) of corporate culture, i.e. the extent of which the dominant values accepted by the organization are identical for all the people working in the company or, rather, several sub-cultures exist (though not significantly differing each other), or even there are completely different cultures (fig. 2-a).

This leads to a set of linked questions: *Is culture creation and change a spontaneous and ungoverned process, or the board and business key-actors affecting corporate beliefs? To what extent do such beliefs affect organizational mechanisms ruling the attribution of roles and responsibilities, rewards and career processes, planning and control, information, reporting, etc.? To what extent are they strengthened or smoothed by such organization mechanisms?*



**Figure 2-a: Span of values profiling the belief system.**

If we refer to the *boundary system*, two more levers can be identified, i.e. strategic space focus and strategic space definition. The two levers are complementary attributes of the same concept (fig. 2-b). A boundary system defines the areas of business activity and the limits and rules managers must observe in taking decisions. Referred to this concept, a business strategic space can be bounded or broad, meaning that boundaries to the field of activities are narrow or wide, respectively, so that more or less freedom is given to managers. At the same time, for instance, a ‘broad strategic space’ focus might either be characterized by a clear or undefined or a blurred strategic space definition. In the first case, though the boundaries for managers’ activities might be broad, the rules underlying their actions would be well defined, in order to avoid manager abuses or inconsistencies in decision making.

In the Enron case, a very broad strategic space was matched with an undefined strategic space definition, leading to aggressive volume-oriented commercial strategies and risky operations. All company actors considered such an approach as straightforward, since the corporate culture was very strong, though very young, in terms of accumulation time. This was another anomaly in the design of the governance system of the firm. Such anomaly was due to the fact that the CEO established rewards, careers and information reporting systems that discouraged any kind of action against the dominant values that had been forced into the firm by the CEO.



**Figure 2-b: Span of strategic space profiling the boundary system.**

If we move from the belief and boundary systems, overarching the other two subsystems of management control, to the role that the levers of organization design (Simons, 2000; 2005) have played in the Enron case, we may observe that the *time to report failure*, and therefore risk perception, were delayed by a:

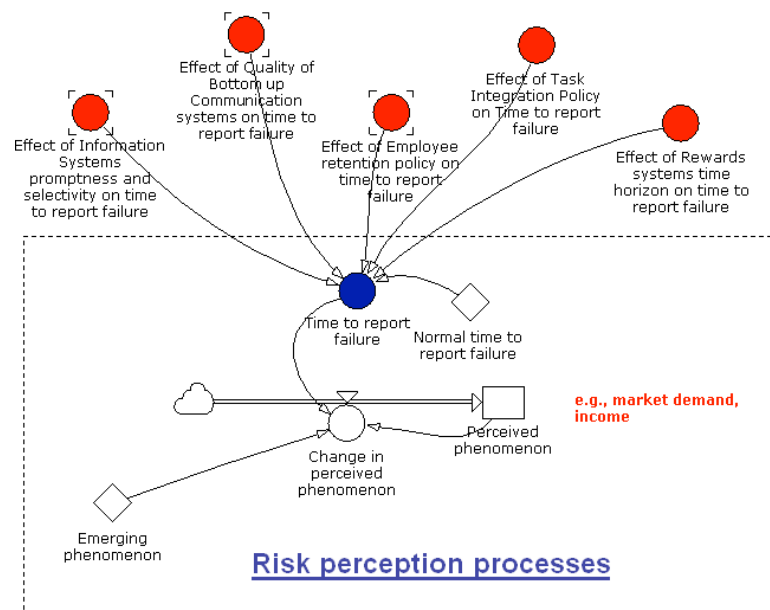
1. short-term oriented and unclear employee retention policy,
2. blurred responsibility and bottom-up communication system,
3. short-term reward system,
4. unselective and unfocused information support, which was lagged, distorted and unable feed actions aimed to prevent failure and detect opportunities,
5. fragmented distribution of tasks in the organization structure.

The first four factors define corresponding organizational design *drivers* of performance, related to what Simons defines as *span of support*. Such concept refers to the help that managers are expected to receive from (and give to) others to achieve their goals.

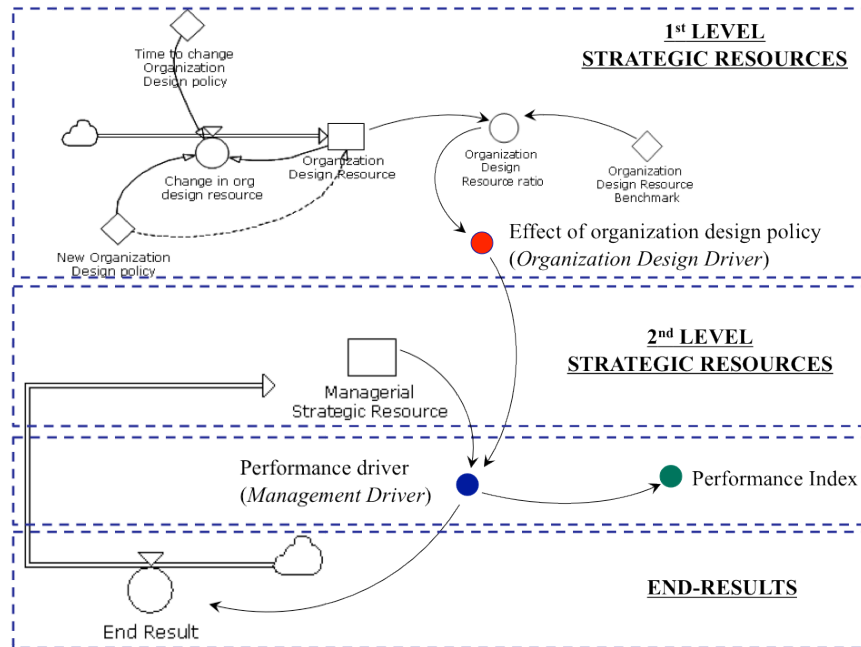
The fifth factor defines organizational design drivers related to what Simons defines as *span of influence*, i.e. the width of the net that an individual casts in collecting data, probing new

information, and attempting to influence the work of others. This encourages information sharing and interaction.

Organization design *drivers* of performance affect *management drivers*, i.e. those performance drivers that often cannot be improved by only increasing the company endowment of strategic resources available to managers (e.g. information systems, people, databases, etc.) (Bianchi, 2012). The productivity of such resources is affected by what we can define as *first level* (or “meta”) strategic resources. These resources relate to the organization setting where individual resources deployed by managers can transfer to the business system their own potential. In the Enron case, a performance driver related to risk perception processes could be measured in terms of “time to report failure”. Such variable affects the change in an information strategic resource, such as perceived demand, for instance (fig. 3-a and 3-b).



**Fig. 3-a: A generic model describing ‘organizational design’ drivers impacting on “time to report failure” (management driver)**



**Fig. 3-b: A dynamic performance management view of the impact of organizational design resources and drivers on management performance and (2<sup>nd</sup> level) strategic resource dynamics**

Though Enron was a conglomerate company, a number of similarities can be detected if we compare this business case with many sudden failures of SMEs caused by the changes in the behavior of single influential players, such as their owner/entrepreneurs. This often relates to changes on their personal goals and inclinations, for instance implying behaviors characterized by:

- a rising interest and involvement in politics and a disengagement in the business activities, without any strategy for delegating strategic decision making;
- a lack of awareness of emerging gradual phenomena (e.g. related to the competitive system) that could threaten the company's survival, and which could be properly perceived by



improving the capability of the organization system to foster communication, and reporting bad news or threats by the employees to the owner;

- an increasing and obsessive search for individual prestige through an aggressive and disordered exploitation of the company name and resources, without an advantage for the firm;
- an orientation towards short-term or sectoral goals (e.g. production or R&D, irrespective of the financial implications);
- an inclination to involve and appoint as company managers people from the same business-owning family, irrespective from their abilities and inclinations to properly carry out their office.

Dramatic corporate bankruptcies are usually framed through a behavioral perspective, often focusing ethical issues and violations of laws. Such focus is more on individual or restricted group behavior, rather than also on the underlying organizational causes.

This is not only common practice when large business failure scandals are studied (e.g. Enron, Parmalat), but also when smaller enterprise bankruptcies are discussed. The causes of the illegal behavior of entrepreneurs and other key-business decision makers tend to be linked to single factors such as: individual greed, lack of social responsibility, missing company rules, loose accounting techniques, and a large variety of variables pertaining to the sociological and psychological dimensions of observed phenomena. In other cases, the causes of dramatic failures are also associated with managerial (or 'technical') errors in setting up competitive or financial strategies (e.g. too aggressive price reductions, product portfolio proliferation, underinvestment, product quality decline).

Though such factors can be relevant in showing the effects of investigated phenomena, they may not be able enough to fully explain them. In fact, the causation approach underlying their own recognition as main factors for analyzing corporate bankruptcies is not capable to foster a deep and

systemic understanding of the organizational reasons leading to undesired (and often unexpected) pathologies.

A higher level of inference in analyzing the link of causal factors leading to the observed phenomena should be related to *organization design*, i.e. to “the system of accountability that defines key positions in an organization and legitimates the rights of these positions” (to set goals, receive information, and influence the work of others) (Simons R., 2005).

#### **4. Organizational design policies and SME longevity: on the causations between the entrepreneurial profile and SME performance.**

Organization design is associated with the setting of structures and mechanisms which may outline transparent rules in various fields, such as: authority lines, roles and responsibility areas, resource acquisition, resource development and allocation, information, communication, coordination, accountability, career and reward/incentive systems.

Though the different variables impacting on organizational design are quite heterogeneous, and often ruled by a multitude of policy makers in larger firms, they primarily affect organizational behavior and decision-making. For instance, the different possible ways incentive and career systems are structured (e.g.: short *vs.* long term; monetary *vs.* non-monetary; input *vs.* output *vs.* outcome measure orientation), the extent to which information tends to be shared among different decision makers involved in a same business process, the depth and width of organizational hierarchy, the speed and frequency of communication systems, the criteria underlying budgeting and resource allocation processes and performance evaluation, are likely to encourage or to discourage certain patterns of behavior carried out by the business actors. So, different conduct profiles in an organization – e.g. transparent/collaborative or deceptive, trust or distrust, building slacks or sharing resources, searching for symptomatic rather than for fundamental solutions to

problems, using a harvesting, divesting, or investing perspective in managing resources – can be substantially affected by organizational design policies.

The investments associated with such policies are likely to develop a set of *first level* (or *meta*) strategic resources providing the organizational context, affecting the logics according to which managerial decisions aimed to build up and deploy specific (*second level*) strategic resources will be carried out. So, for instance, in order to be able to build up capacity or to retain human capital (*second level* strategic resources), an organization may need a set of information, communication, performance management systems, and an organization structure (*meta* resources) that may foster the acquisition and deployment of the former resources, with a view to generating an impact on competitive drivers and end-results.

Since the mix of variables impacting on organization design is quite diverse, very rarely do even larger firms have explicit policies aimed at building up what we can call *meta* strategic resources, according to a consistent strategy.

A missing organizational investment policy may generate problems in coordinating the behavior of different decision makers in a company, particularly when a firm experiences fast growth or crisis patterns originated by sudden external factors:

*What is the role of organizational design in affecting decision-making and behavior in SMEs?*

*Is it possible to consider organizational design as a 'first level' bundle of strategic resources whose setting, mix, consistency, and relative weight of different variables constituting it, significantly affects the success and survival of SMEs?*

*How can concretely organizational design policies contribute to SME performance and longevity?*

*To what extent the formal components of organizational design should weight over the informal ones in SMEs? How should the informal components (e.g. rewards systems) be designed to ensure their evidence, transparency and reliability?*

As remarked in the previous sections of this paper, often the analyses of SME crises are deeply associated with individual factors (e.g., ethical or professional attributes, or psychological traits of the owner-entrepreneur), or contextual/social factors (e.g., relationships between a family business and different groups of people belonging to the business-owning family), or even competitive factors. Although such non-organizational factors can be very useful to frame the net of events leading to crises and unsustainable growth, they may not be fully supportive to explain the deep causes underlying the demise of SME organizations. Such deep causes should be searched in the inability of the firm (as an organizational system) to overcome inconsistencies and problems arising from the behavior of individual decision makers, i.e. of stakeholders both operating inside and outside the organizational context.

Not only in large businesses, but also in smaller firms the organizational setting should provide a context to transform and coordinate into a consistent ‘formula‘ the individual energies coming from different players and various tangible and intangible resources, with a view to add value to them. So, even a micro-business should not be totally identified with its owner/manager.

On the other hand, unsustainable growth and sudden crisis phenomena affecting smaller firms are often caused and framed by a too bounded and oversimplifying causation approach. Therefore, it is not uncommon that a firm is identified with its key-players (e.g. the owner/entrepreneur), and its own performance is deeply affected by individual behavior and personal traits. For instance, SME success is often associated with the capabilities of its founder and a bounded number of decision makers supporting him or her. But...

*Is that a sound basis to sustain business development and lifelong existence?*

An approach that tends to overlay the performance of a firm with the traits and behavior of single individuals (although those who cover important roles) runs the risk of confusing the organization with the individual, and thereby exposing the lifelong existence of the firm to the personal events that may affect the life of its key-players.

The sustainability of business success (even for a micro-firm) can be properly assessed if one considers the company ability to design a consistent organization system that fosters the exploitation of key-players' individual attributes, adds value on them, and neutralizes those individual behaviors which may challenge the future of the company itself.

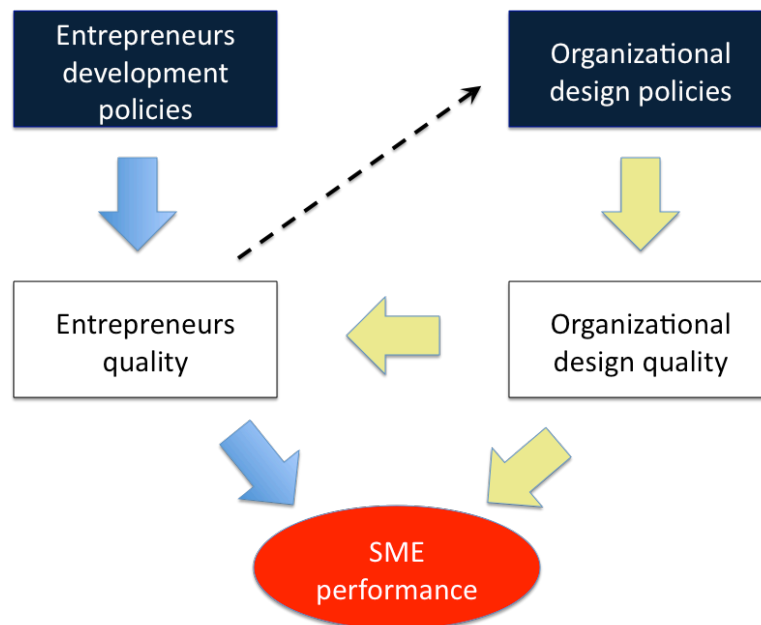
Though the size and scope of SMEs, in terms of key-decision areas and domains, might suggest that organizational design investment policies are not a relevant topic in such contexts, also because it usually implies the establishment of formal structures and mechanisms that might over-bureaucratize a smaller firm, such policies are also relevant in SMEs. In fact, the specific complexity of SMEs (Bianchi, 2002) requires organizational structures and mechanisms that allow them to deal with a number of factors which – if improperly focused in a governance perspective – may give rise to crisis. Among such specific complexity factors in smaller firms, it is possible to mention the entrepreneur's aptitudes to delegate, to settle clear boundaries between the firm and the business-owning family, to perceive properly the business risk, to perceive business growth rates sustainability and the related financial, capacity and market implications, to balance appropriately the short with longer terms, financial with non-financial measures in performance evaluation, to perceive trade-offs between a subsystem (e.g. R&D) and another one (e.g. financial) in the firm, etc. Often, such factors deeply characterize a small business profile, so that its success or crisis can be strongly associated with the capability to primarily support and improve entrepreneurs' aptitudes and – through them – to foster business success.

Though it is true, in principle, that better entrepreneurs may lead to better SMEs, it is not given for granted that – for instance – public policies aimed at supporting SMEs success, should have to be necessarily focused on entrepreneurs' development, rather than on supporting SME organizational design policies.

In other words, a conundrum emerges here:

- *is SMEs growth mostly affected by the development of entrepreneurs' aptitudes or – rather – can the latter be fostered through proper organizational structures, mechanisms and routines (which do not have to be necessarily formal) investment policies, that may allow the firm to address the behavior of its key-players?*
- *Can SME organizational design be considered as an indirect lever to train better entrepreneurs, i.e. leaders whose aptitudes can better respond to the need to ensure the firm a stronger autonomy, success and lifelong existence?*

Though it is not possible to find an absolute answer to the above questions, since both entrepreneurial and organizational design development policies can be functional for improving SME performance (figure 4), it is possible to remark that: a) external efforts aimed to sustain SME development and success should not be oriented only and (maybe even primarily) to single entrepreneurs, but might and should focus SMEs and their own organizational design investment policies as a target; b) improving the quality of organizational design is a means to improve the quality of entrepreneurs. In fact, designing proper organizational systems may affect entrepreneurial orientation and support change in personal traits, as an outcome of an organizational learning process. An improvement in entrepreneur's quality profile would, in turn, contribute to further develop proper organizational design policies leading to sustainable development in SME performance.



**Figure 4: Entrepreneurial development vs. organizational design policies: causalities in affecting performance.**

### **5. Managing levers of organizational design in SMEs.**

‘Levers of organization design’ implies a multitude of heterogeneous areas of intervention, having a major impact on the capability of a business to coordinate its own different subsystems. Managing organization design investment policies is not only a typical large business critical issue; it is also important for those SMEs facing internal and external change, not necessarily in terms of fast growth. Even gradual, i.e. inertial, change is likely to generate structural discontinuities in the long run in an organization, that often suddenly emerge in terms of lack of coordination, information, communication, accountability when the firm moves from a stage to another (e.g. in times of generational shifts in family businesses).

According to Simons (2000; 2005), levers of organization design, and related investments, are associated with four main spans, or domains:

1. control
2. support
3. influence
4. accountability.

*Span of control* defines the resources (people, funds, skills, information, contacts) directly under a manager's supervision. Relevant to span of control are, for instance: the vertical depth and horizontal width of organization structure, the extent to which decision-making processes tend to couple or decouple organization units.

*Span of support* refers to the help that managers are expected to receive from (and give to) others to achieve their goals. Relevant to span of support are, for instance, the following formal or informal systems:

- Rewards/incentives, i.e. their:
  - o short vs. long term orientation, and related implications on people inclination to report bad news and to distort emerging phenomena;
  - o financial vs. non-financial orientation;
  - o individual vs. group-based orientation, and related implications on people's inclination to collaborate with others.
- Career/human resource retention, i.e. their:
  - o short vs. long term orientation
  - o transparency of criteria;
- Education/training, i.e. the:



- intensiveness of related policies and relevance of such systems for business success.
- Responsibility, i.e. the:
  - transparency of roles and positions.
- Communication, i.e. their:
  - reliability, speed and coverage.
- Information, i.e. the:
  - Promptness, selectivity, quantity and mix of gathered information.
- Internal control transparency, i.e. the:
  - tightness and time span of performance evaluation metrics.
- Culture and beliefs, i.e. the:
  - Factors affecting values and trust dynamics.

*Span of influence* is the width of the net that an individual casts in collecting data, probing new information, and attempting to influence the work of others. This encourages information sharing and interaction. The concept of span of influence could be extended to a range of institutions and interest groups operating alongside business, specifically concerning SMEs (e.g. chambers of commerce, trade associations, political lobbying).

Relevant to span of influence are, for instance, related to:

- Integrating units (e.g. committees, task forces, second bosses, dotted lines of accountability, matrix design);
- Integration vs. fragmentation of tasks in organization design;
- Performance indicators/reporting systems (i.e., their promptness and aptitude to foster coordination).

*Span of accountability* defines the range of performance measures used to evaluate a manager's achievements.

Relevant to span of accountability are, for instance, related to:

- Scope of measures on which decision makers are made accountable;
- Weight of outcome measures on other measures.

Though Simons has primarily outlined the conceptual framework here described through the typical perspective of large and professionalized businesses, we claim here that the topic it underlies is also relevant for smaller firms.

Levers of organization design may indirectly affect in a significant way the performance, and hence the growth sustainability and long-term survival of SMEs. Understating their importance, based on the consideration that organization design policies are typical large business matters, provided that business decision makers do not formally take them, equals to ignore the effect that informal (together with formal) systems are likely to generate on performance. It is likewise saying that strategy or planning are only 'large business' issues, since many SMEs are not used to formally embody such practices in their own routines. On the contrary, it has been demonstrated that informal strategic planning and entrepreneurial learning are crucial for small business survival and growth.

So, exploring and understanding the indirect impact that organization design policies generate on SME management processes, may shed some light on the causes behind the differences in performance between apparently similar SMEs on an operational viewpoint, and the sudden failure and bankruptcy of SMEs which might have previously shown an apparent good health.

*What kind of adjustments (if any) would the 'levers of organizational design', and related spans, need to be applied to smaller businesses? In particular, what kind of changes would be needed to this framework in order to embody specific small family business topics, e.g. for instance:*

*succession plans, the access of people from the business owning family to managerial positions, the lack of professional managers and the strict overlap between the three roles of entrepreneur, equity-owner, and manager? To what extent organization design policies may foster the gradual introduction of managers from outside the business owning family? What kind of fit should the levers of organization design portray in order to promote a cultural change in entrepreneurial aptitudes (e.g. those related to delegation, or to investment policies)?*

If we refer to the Italian context, both practice and academic research have only partially focused on this topic. However, there is a clear sign of a rising interest on it.

For instance, the Italian legislative system has introduced important innovations, concerning two relevant topics on the matter here discussed.

On the family business side, the Law n. 55/06 has disciplined the so-called “family pact”, i.e. a contract through which an entrepreneur transfers his or her company equity shares to one or more descendants.

Another relevant recent innovation is the legislative decree n. 231/2001. This decree has introduced for the first time into the Italian legal system a direct liability of companies for crimes committed by directors, executives, their subordinates and other subjects acting on behalf of the legal entity, when the unlawful conduct has been carried out in the interest of, or to the benefit of the company concerned. Companies shall not be considered liable pursuant to decree no. 231 if the following conditions exist:

1. the individual(s) who committed the crime acted in their own exclusive interest or in the interest of third parties not related to the company;
2. the managing body of the company has adopted and implemented a *compliance program* apt to prevent the misconducts sanctioned by the decree no. 231
3. an *ad hoc* internal body has been appointed by the management, to oversee the implementation and updating of the compliance program.

The prescribed minimum requirements for the compliance program are:

1. the identification of the *risk areas*, i.e. areas of the company processes where there is a possibility to commit the mentioned crimes;
2. the identification of procedures for regulating the decision-making process in risk areas, with respect to the crime prevention;
3. the management of financial resources for preventing the commission of crimes provided for by the decree no. 231;
4. obligations for each division of the company to inform and report to the *compliance officer*;
5. disciplinary sanctions to be inflicted to trespassers of the measures and procedures provided for by the compliance program.

The weight and scope of such innovations is significant, in terms of the potential contribution they may give to better guarantee the rights of different SME stakeholders towards a more “organizational–centric” (rather than only “individual–centric”) approach.

However, the need to preserve and exploit the advantages of individual creativity and the entrepreneurial approach on the one side and to balance it with a more professional organization, even in smaller businesses, cannot be only left to a legal discipline. In fact, law may only outline the framework under which the professionals who will support SMEs will have to operate. Moreover, such framework can also be partial or redundant, in respect to the goals that the legislator tries to pursue. Non-business specialists often outline legal frameworks; such frameworks are usually abstract depictions of business realities, whose principles should be concretely pursued by business professionals only.

Therefore, such innovations may disclose significant opportunities for SME experts to foster the longevity of smaller firms and their own better contributions to the different expectations of their stakeholders.

## **6. Investigating organizational design policies and SME longevity through a System Dynamics approach: an outline for future research.**

This paper has discussed the relationship between owner/entrepreneur characteristics and organizational design in SMEs. It has identified the need for great understanding and further research into this relationship and specifically how it impacts on risk perception and ultimately on company performance. In the short term, the success of any SME might be primarily influenced by the novelty or other features of the company's product and/or service offering and by the drive, ambition, and other skill set of the founding entrepreneur. However, strengths in all these do not guarantee the long-term survival and success of the enterprise. As has been surmised earlier, should the enterprise fail, it is often attributed to inadequacies in the entrepreneur and even to illegal or corrupt behavior. But here we have also considered how the design and establishment of the various dimensions of organizational infrastructure intended to inform and support the efforts of the owner/entrepreneur can also impact company performance and inadequacies here could ultimately be the reason for crisis.

It is contended that the relationship between the entrepreneur and the organizational infrastructure is not adequately understood. This means that not only might poor company performance, even crisis, be wrongly ascribed to entrepreneur inadequacy, but that key factors in organizational development be downplayed, even overlooked completely. This paper therefore advocates that a program of research in this area would be valuable in improving the longevity and long-term business performance by supporting the development of organizational infrastructures that optimally support the entrepreneur and any other senior decision-makers.

In order to achieve this, the relationships between organizational factor and the entrepreneur need to be characterized and how each of them impacts on company performance, especially in the longer term, investigated. The structural analysis and system behavior approach in system dynamics can be helpful in this effort. In fact, it can support an analysis of apparently different decisions regarding

levers of organization design according to a comprehensive framework that recognizes the value of investment, i.e., of strategic resource to various organization systems. Also, system dynamics supports an analysis of tradeoffs in time and decision loci associated with organization design policies. Finally it may allow one to link – though indirectly – the scope and intensiveness of organizational investment resources to their effects on the performance of fulfilled managerial processes, e.g. related to:

- risk perception;
- budget allocation;
- education and training;
- project launching & execution;
- resource building;
- workload execution;
- commercial.

It is suggested that case study analysis could play a central role in this. Initial analysis would be used to shed light on the critical inter-relationships in order to develop causal-loop diagrams and stock-flow structures to aid understanding. These could be developed into experimental models to further support understanding but also to test the perspective characterized above over a number of case-studies relating to mature SMEs. Cases where companies failed altogether could be particularly informative.

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