Capabilities and Organizational Design
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When firms succeed, it is often because they possess distinct organizational capabilities. Such organizations figure out how to do something that no other organization can do - either because they do something totally different, or because they are simply the best at delivering a certain quality at the lowest possible cost.

Organizational capabilities are the organizational analogue to individual skills; just as some people are better at playing the piano than others, or have unique combinations of skills, some organizations consistently stand out from their competitors. They can take many forms: firms with distinctive capabilities might consistently be more innovative than others, have the most efficient distribution systems, deliver consistently better customer service, or produce goods with fewer defects and greater reliability than anyone else.

Such capabilities can be a sustainable basis for value creation advantages, provided they are carefully nurtured and maintained by the firm’s leaders. Capability-based advantages are distinct from resource advantages, which derive from resources or assets that you control and others do not. (Examples of resource advantages include brand reputation, patents and an installed base of users.) Firms can and do have both capability- and resource-based advantages.

Knowing that your organization has one or more distinctive capabilities, however, is different from knowing how to scale them, or adapt to change. Yet a critical aspect of driving growth for your venture is understanding how your initial success can be repeated (at high volumes), how it can be strengthened and improved, and how it can be protected from imitation by rivals. If your “special sauce” comes down to the unique chemistry that three member of your team have with each other, it is exceedingly unlikely that you will be able to manage growth. Similarly, if you do not understand how your organization’s capabilities come about, you are more likely to make mistakes when adapting to change.

Hiring smart people is not sufficient for establishing a capability-
based advantage. A competitive advantage that is built exclusively on the superior skills of employees is a tenuous advantage, and perhaps no advantage at all, since it walks out the door every night. And because they can walk out the door, the skilled employees may capture much of the advantage they create.

The answer to leveraging capability, instead, lies in organizational design. By thinking carefully about how you structure and run your organization, you have the potential to deliver on a capability-based advantage where the whole is greater than the sum of its parts. Moreover, you have the opportunity that build a sustainable business that thrives and grows, without being dependent for its success on the skills of particular individual contributors.

This note discusses the central challenge in building organizations—balancing coordination and motivation—and introduces a model for assessing alignment in organizational design.

**Coordination and Motivation**

Before turning to a framework for analyzing organizational design, take a few minutes to consider the miracle that is modern organizations.

Imagine that you want to be in the business of creating and selling fine dining experiences, with gourmet food and first-rate service. Making this happen requires an ability to coordinate a myriad of tasks: chopping, roasting, frying, saucing and plating the food, seating patrons, taking their orders, filling their water and wine glasses, serving the food, attending to special needs, preparing checks and processing credit cards. You could try to do that by yourself, but to do so would be to give up the gains from specialization: someone who chops vegetables all day will get more done than someone who moves from chopping to frying to plating to serving. So you will have a chef, a prep cook, a fry cook, a maitre d’, servers, a bartender, a sommelier, etc.

Now, however, you have a new challenge: you have to get all of these people to work together effectively, and to work to the best of their ability in their roles. If you have ever visited a restaurant kitchen during the dinner rush (or watched enough reality TV cooking shows), you have a flavor for how challenging this can be.

What does an experienced chef have to do in the kitchen to put an order of “Sweetbreads, morels, snap peas & ramps” on your plate 15-20 minutes after you ordered it, and still make a profit at $29 a plate?

The most obvious challenge in the kitchen is coordination: a
million moving parts, all trying to get to one final end, which is the plate. Coordination means the right people doing the right thing at the right time, without wasteful duplication. When coordination fails in a kitchen, the food is overcooked, it arrives late, or they forget to put the sauce on the side. When it fails at an airline, bags are lost, planes are delayed, people miss their connections.

But chefs have another responsibility as well: maintaining individual motivation. An effective head chef not only needs to ensure that the cook at the grilling station knows what needs to be grilled when, she also has to make sure that it is cooked just right—and only the grill cook can do that. The fry cook has to keep doing his job even when others do things wrong, work harder when the rush is at its peak, and keep going even when he has had too much to drink the night before. Why would either of them want to ensure that the diner has an exquisite experience, if their rewards are the same when the diner’s experience is just average? If the members of the kitchen are insufficiently motivated—if the fry cook goes out to smoke a cigarette during the rush—the kitchen won’t live up to its potential. In the worst case, the restaurant will end up on a Gordon Ramsay’s Kitchen Nightmares.

How will you solve this challenge? Most likely, your solution will be to build a formal organization, in this case a restaurant. Organizations are one particular means of coordinating and motivating people’s activity; markets are another. What distinguishes organizations and markets is how they accomplish the needed coordination and motivation. Organizations coordinate and motivate people’s activity through authority: the fry cook focuses on frying because that’s what you tell him to do, and because if he doesn’t, he will likely lose his job.

Markets, by contrast, accomplish coordination and motivation through voluntary, mutually beneficial exchange: the butcher sells meat to you, and you buy from her, because you both feel better off doing so. As economists since Adam Smith have taught us, well-functioning markets are wonderfully efficient coordination devices. But as Nobel-prize winning economists Ronald Coase and Oliver Williamson explained, they only function well under certain conditions (e.g., when contracts can be specified and enforced), and the failures of markets can make organizations a superior means of coordinating and motivating action.

It is hard to imagine that the exchanges in a restaurant kitchen can be accomplished through market mechanisms. Instead, the challenge for the leader is how to use her authority to accomplish the needed coordination and motivation. Organizational design is the key lever. For this we turn to the PARC model, introduced by Saloner, Shepard...
The PARC Model

Whether you are building a new firm, or leading an established company, the question for you as a strategic leader is simple: how does the design of the organization affect your ability to deliver superior capabilities, and sustain those capabilities over time?

Thinking about this question is complicated by the fact that extensive research shows that there is no single right organizational design. Every organization is unique, with different policies, practices, and cultures. Even among highly successful organizations in the same industry, there are striking differences in how firms work. Goldman Sachs and Morgan Stanley are probably more similar to each other than they are to Google, but anyone who has worked at both places will tell you that they are still very different.

With so much potential variety, and so many possible “right” answers, it is tempting to throw up your hands and say that it is not worth thinking about. However, this would be a mistake. It will lead you to make organizational choices without reflecting on why you are making those choices.

What you need is a framework for making sense of the seeming chaos, for thinking systematically about the building blocks of organizations, and about how these elements interact with each other and the firm’s strategy. We will use the PARC framework, which is one of many quite similar frameworks for analyzing organizational design, including David Nadler’s “congruence model,” McKinsey’s 7S model, etc.

PARC is an acronym for the key elements of organizational design identified in the model: People, Architecture and Routines, and Culture. These are the main elements that you want to focus on when trying to understand how an organization works and assessing the degree of organizational and strategic alignment.

Understanding the organization

Some simple questions will help you get a better picture of the organization:

People

1. What knowledge, skills, and training do employees bring to the firm?
2. What motivates the employees to work? Are they primarily interested in money, do they emphasize the meaning of their work, or do they value the community of their fellow employees?

3. What are their expectations? How does the firm fit into their career or life plans?

Architecture and Routines

1. How is the formal organization (organizational chart) structured? Are tasks organized by function, product, or customer? How does the grouping compare to other firms in the industry? How is work coordinated?

2. Is the organizational hierarchy flat, or are there many layers?

3. How are employees compensated? Do they receive a share of profits (directly or indirectly)?

4. What is the typical decision-making process? How many people are involved? Is authority delegated or centralized in the organization?

5. Are jobs defined very narrowly, or do people cover a wide range of tasks? Are tasks combined in the same way as at competitors?

6. Is there a lot of teamwork?

7. How does knowledge and information flow? Is the network of informational ties in the firm very fragmented? Do some people act as central hubs or brokers in the network?

Culture

1. What are the fundamental values of people in the organization?

2. What assumptions and beliefs about the world do employees share?

3. Is there a lot of agreement among employees about what is important and how the world works? Are these values and beliefs strongly held?

Critical Tasks The final element of the PARC model is the set of critical tasks that the organization needs to accomplish in order to succeed. Critical tasks are the activities that the firm absolutely has to perform in order to deliver on its competitive advantage. Critical tasks are therefore the link between your strategy and your
organization: they are how the strategy is translated into what needs to get done, and how, by the organization.

For example, part of Volvo’s perceived quality advantage derives from designing cars with superior safety features. Discovering and inventing new technologies for preventing accidents and minimizing injuries is therefore a critical task for Volvo. By contrast, Toyota built its perceived quality advantage on producing highly reliable, defect-free cars. An ability to design and produce cars with a low defect rate is therefore a critical task for Toyota.

Figure 1 illustrates the interconnectedness of the various aspects of the PARC model.

Organizational Alignment and Capability

Organizational capabilities arise from and are sustained by well-aligned organizational designs. The value of the PARC model lies in giving you a framework for assessing the extent to which the organization is well aligned, and therefore reinforces the organization’s capabilities.

Alignment can be assessed along two dimensions. Specifically, an organization is well-aligned if:

• The elements of organizational design (People, Architecture and Routines, and Culture) are consistent with each other, and
• The elements of organizational design are aligned with the firm’s strategy, through their alignment with the firm’s critical tasks.

It is through the internal consistency of the elements of organizational design that the whole becomes greater than the sum of its parts. This is because organizations are integrated systems, where the performance of one component depends on the other components. The interaction of the different elements of organizational design is more important than the elements themselves. If the different components conflict with each other—are inconsistent or incongruent—the performance of the system as a whole will suffer. For example, people who do not like to be told what to do will not perform well in a command-and-control structure. Similarly, a strategy that requires real collaboration among people with different skills will be difficult to deliver in an organization that has rigid, narrow job definitions, and rewards people as individual contributors.

To return to our earlier example, a great chef uses a number of the elements of organizational design described in the PARC framework, and creates alignment between them.

• She hires prep cooks and sous-chefs with excellent cooking skills,
a passion for great food, and perhaps training from a culinary academy (People).

- Everyone in the kitchen has an assigned set of tasks – a division of labor (Architecture), and there is alignment between the skills of the people hired and the jobs they have to do.

- There is a control system, which in part takes the form of the chef calling out commands, checking the dishes before they go out, and yelling at people when things go wrong (Routines).

- When yelled at, people fix their mistakes without storming out (Culture).

- There is a formal hierarchy, with the chef at the top and prep cooks near the bottom (Architecture).

- There are routines for what happens when orders come in: the chef calls out “1 veal, 1 duck, 3 swine,” and everyone in the kitchen knows what to do in response. Prepped vegetables are thrown in boiling water; meat hits the pan. Plates are prepped and garnished. Waiters whisk them away.

- Motivation is encouraged through incentives (wages, the hope of moving up, and the fear of being fired on the spot) (Architecture).

- Effective chefs create a strong set of behavioral norms that shape how people interact with each other, how they are allowed to respond to stress, and how they feel about their work (Culture).

A well-run kitchen is one in which the elements of PARC align with each other to ensure effective coordination with high levels of motivation.

**Conclusion**

What you see in the kitchen is a microcosm of the even more complex coordination that is accomplished in organizations every day. In fact, what you see in the kitchen is a relatively simple form of coordination — it all takes place largely through face-to-face interaction, with people speaking to (or yelling at) each other. Running the restaurant as a whole is more difficult. While everything is going on in the kitchen, the front of the house is busy making sure guests are seated, water glasses are filled, and orders are taken in a timely fashion and communicated to the kitchen, etc.

Few if any of you will run a high-end restaurant, much less be the chef in the kitchen. The organizations you manage and lead
will in many cases be much larger and more complex – imagine the complexity of a modern airline. But no matter how large and complex the firm, the essential challenge for you is the same: how best to deliver coordination with high levels of motivation among everyone involved.

As you surely have experienced, this does not always happen. Meeting the joint challenge of coordination and motivation is one thing in a restaurant kitchen, or even in a small startup. Doing it in a large, complex organization is something else entirely. *The Office* may have exaggerated the pathologies of big firms, but it strikes a nerve because there is truth to it.

The good news, however, is that the elements of organizational design are powerful tools for accomplishing the challenge of optimizing coordination and motivation simultaneously. Attention to organizational design is important, because capability-based advantages reside in the elements of PARC, their alignment with each other and the firm’s Critical Tasks. In other words, a firm may have a competitive advantage because it has higher levels of internal consistency than its competitors. In addition, a firm may have a competitive advantage because it has made different, aligned choices about organizational design. By contrast, when leaders find themselves continually facing the same organizational problems, the root cause almost always lies in misalignment between the elements of PARC. In short, alignment is critical.