

Chapter 01 Introduction

Essay Questions

1. What are three components of organizational architecture? Which one is most important to the success of the firm?

The three components of organizational architecture are the assignment of decision rights, the reward system, and the performance-evaluation system. The success of a firm depends on the successful interaction all three of these components.

*AASCB: Communication
Bloom's: Knowledge*

2. Enron was clearly a company riddled with fraud and excess; its conduct drove it into bankruptcy. The text argues that individual behavior was not at the core of Enron's problems. What were the problems with this corporation from an organizational architecture point of view?

Enron delegated an extraordinary amount of decision rights to lower-level employees. However, Enron lacked effective oversight and review of decisions made by these employees. The performance evaluations for the internal risk management group were based in part on the recommendations of the individuals making the deals that risk management was supposed to monitor. The legal staff was decentralized to individual business units making them too eager to ensure that their unit met performance targets. Finally, Enron offered high-powered incentives tied to short term performance measured by near-term earning growth. This encouraged excessive risk taking.

*AASCB: Communication
Bloom's: Comprehension*

3. DHL, a successful European company, is attempting to overcome various legal problems in order to enter the US market in overnight package delivery. Its two major competitors would be FedEx and UPS. As DHL looks to set up a US subsidiary, it wishes to benchmark its organizational architecture. What should it do?

DHL should realize that a successful organizational architecture is more than a collection of good ideas or good parts. A successful organization should be carefully coordinated to align individuals' incentives with the firm's goals. DHL's organizational architecture has survived in a European legal and regulatory environment. In contrast FedEx and UPS architectures' have survived under the US legal system in the market for overnight delivery. There is no single "best" organizational form for all firms in all external legal and market environments. Instead the best organizational form for a firm depends critically on its current business environment. DHL should be aware of possible unintended side-effects from changing one component of organizational architecture without considering its effects on the parts of organizational architecture.

AASCB: Reflective Thinking
Bloom's: Comprehension

4. What are some of the ways in which risky borrowers cheated on housing loans?

Borrowers overstated their income and claimed "liar loans." Fraudulent borrowers would recruit people to apply for more liar loans, provide unreliable home appraisals, purchase homes at the lower prices from the sellers and pocket the difference.

AASCB: Communication
Bloom's: Knowledge

5. What was the main reason for "liar loans" to proliferate?

The incentives to mortgage brokers were such that, the more loans they generate, greater is their compensation. Obviously, the mortgage brokers had no incentive to go behind the scenes to check the viability of repayment.

AASCB: Communication
Bloom's: Knowledge

6. Is there a relationship between a CEO's retirement and the R&D expenses in a firm?

There is. In many instances, a CEO reduces R&D expenses a few years before retirement. This boosts earnings in these selected years. If the CEO's bonuses is linked to earnings, then the CEO retires with a big package from reduced R&D, while the firm suffers in the long run due to a failure of keeping up with innovation.

AASCB: Communication
Bloom's: Knowledge

7. Explain why the top executives of Societe Generale are more likely to blame than Jerome Kerviel?

Kerviel had been playing the markets for over a year and several red flags were ignored by the Bank managers. The supervisors accepted Kerviel's trades without much difficulty. The managers were ready to go along, as long as Kerviel was not making any money for himself, and as long as his activities were creating some benefit for the system. The managers had embraced a system of risk taking. It is their irresponsibility primarily, that behooved Kerviel to behave the way he did.

AASCB: Analytical
Bloom's: Knowledge

8. How can good management practices be useful in a global economy?

The example of Tianjin Optical & Electrical Communication Group in China and its collaboration with Motorola comes to mind. Tianjin was a failing company. But with the adoption of US telecommunications quality-control and management practices, it has succeeded. Joint ventures such as these are likely to be useful if the foreign companies adopt US management tools, in terms of supervision, control and rewards.

AASCB: Communication
Bloom's: Comprehension

Multiple Choice Questions

9. The key to organizational architecture is:

- A. assignment of decision rights, reward structure and evaluation systems
- B. the methods of rewarding (paying) top management
- C. a complicated structure of performance evaluation systems
- D. the initial establishment of golden parachutes for top management

AASCB: Analytical
Bloom's: Knowledge

10. The authors argue that successful corporations assign decision rights in ways that:

- A. effectively link decision-making authority with good information.
- B. structure moneymaking tools for all employees.
- C. eliminate the potential for fraud completely.
- D. rely on monitoring and evaluation for all creativity.

AASCB: Reflective Thinking
Bloom's: Comprehension

11. The example of Enron shows that:

- A. selection of people is the key to organizational success or failure.
- B. large incentives are the keys to getting people moving in a corporation.
- C. business success is possible in a regulatory environment.
- D. organizational structure is extremely important in business success.

AASCB: Analytical
Bloom's: Application

12. Many economics texts discuss the question "Which markets should a firm enter?" This text focuses on the following question:

- A. How should the firm price its products?
- B. Who are the firm's competitors?
- C. How should the firm be internally structured?
- D. What mix of inputs – labor and capital – is most efficient?

AASCB: Communication
Bloom's: Comprehension

13. In the textbook, there is an example of a software firm in which the managers provided a financial incentive to get rid of software bugs. The result was that software writers added more bugs into the software. This example shows that:

- A. financial incentives should never be used.
- B. most employees are very corrupt.
- C. incentives can create perverse effects.
- D. high-tech firms are unique.

AASCB: Communication
Bloom's: Comprehension

14. If the market for a product improves with increases in both the market demand and the price, then the reaction of companies in that market:

- A. will be identical.
- B. will depend on the ability of the firm's economists to accurately estimate the supply and demand curve.
- C. will depend on whether or not the organization is attuned to market incentives.
- D. is dependent on the government regulatory mission.

AASCB: Analytic
Bloom's: Application

15. Economic Darwinism is when:

- A. organizational architecture is optimized.
- B. competition weeds out ill-designed organizations that fail to adapt.
- C. corporate mutations occur, like Enron.
- D. market benchmarks are employed.

AASCB: Communication
Bloom's: Knowledge

16. Fama and Jensen suggest that "the form of organization that survives in an activity is one that delivers the product demanded by customers at the lowest price while covering costs."

This is an example of:

- A. market and organizational efficiency.
- B. market and organizational equity.
- C. economic benchmarking.
- D. defective organizational architecture.

AASCB: Communication
Bloom's: Comprehension

17. The business practice of looking for a firm that has best practices in an area and then emulating those practices is called:

- A. organizational architecture.
- B. benchmarking.
- C. competitive markets.
- D. decision management.

AASCB: Communication
Bloom's: Knowledge

18. If the technology, the nature of competition, or the regulatory environment change in an industry, then:

- A. the appropriate organizational architecture will change too.
- B. a good organizational architecture is always able to cope with changes.
- C. organizational architecture is able to restore the former market environment.
- D. organizations are created by random events, just like markets.

AASCB: Reflective Thinking
Bloom's: Comprehension

19. Barings Bank failed because of:

- A. the free-rider problem.
- B. a lack of internal controls.**
- C. excessive reliance on benchmarking.
- D. downsizing of its matrix organizational architecture.

AASCB: Reflective Thinking
Bloom's: Knowledge

20. The term Darwinism is important because it indicates:

- A. the randomness of existing companies.
- B. surviving companies are the best in the *absolute* sense.
- C. the capability to transform as the external environment changes.**
- D. the existence of a higher intelligence that promotes success.

AASCB: Reflective Thinking
Bloom's: Comprehension

21. Economics provides a theory to explain:

- A. how successful business can be started.
- B. how managers can cheat and get away with it.
- C. how people make choices.**
- D. how to compete in the market.

AASCB: Reflective Thinking
Bloom's: Knowledge

22. *Business Week* sums up the failure of Enron to:

- A. September 11, 2001
- B. flawed organizational design**
- C. too much debt
- D. risky projects in India and the oil price hikes

AASCB: Reflective Thinking
Bloom's: Knowledge

23. According to the text, successful firms tend to set up:

- A. organizational architecture that is complex and decisions are "top-down".
- B. organizational architecture that is least expensive and decisions are "top-down".
- C. organizational architecture that links decision-making with decision rights
- D. decision-rights are reserved for the senior management

AASCB: Reflective Thinking
Bloom's: Application

24. Recent research on CEO behavior tells us that CEOs generally:

- A. increase the firm's R&D expenditure so as to boost earnings long before they retire.
- B. reduce the firm's R&D expenditure so as to boost earnings long before they retire.
- C. reduce the firm's R&D expenditure so as to boost earnings just before they retire.
- D. increase the firm's R&D expenditure so as to boost earnings just before they retire.

AASCB: Analytic
Bloom's: Knowledge

25. The Survival of the Fittest tells us:

- A. only the most innovative and adaptive firms are likely to survive competition.
- B. only the most innovative and adaptive firms are likely to attract more competition.
- C. only the least innovative and adaptive firms are likely to survive competition.
- D. only the most innovative and adaptive firms are likely to migrate to other products.

AASCB: Reflective Thinking
Bloom's: Knowledge

26. "Subprime mortgages" refer to:

- A. interest rates that are over and above the prime rate to risky borrowers.
- B. mortgages made to credit worthy borrowers at low interest rates.
- C. mortgages made to borrowers who do not usually qualify for loans.
- D. mortgage brokers making huge commissions on volume.

AASCB: Communication
Bloom's: Knowledge

27. Benchmarking means:

- A. blind copying
- B.** copying from the best so as to become better
- C. looking at yourself and telling others what to do
- D. looking at yourself and telling yourself you are the greatest

AASCB: Communication
Bloom's: Knowledge

28. Benchmarking may be a problem if:

- A. the current architecture is relatively unstable and proposed changes add huge benefits.
- B. the current architecture is relatively stable and proposed changes add huge benefits.
- C. the current architecture is relatively unstable and proposed changes add little benefits.
- D.** the current architecture is relatively stable and proposed changes add little benefits.

AASCB: Reflective Thinking
Bloom's: Knowledge

29. From Jerome Kerviel's actions in Societe Generale, we realize that in a business organization, managers may turn a blind eye to certain "red flags" from the system if:

- A. the managers themselves conduct certain illegal activities.
- B. the managers know that at some point these illegal activities will fail.
- C. the managers believe the no worker will unnecessarily expose himself or herself.
- D.** the managers embrace risk taking so long as it benefits the company.

AASCB: Reflective Thinking
Bloom's: Comprehension