



# Towards an Integrative Theory of Organizational Success and Failure: Previous Research and Future Issues

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**Abstract.** This paper provides a survey of research to develop and empirically test of a holistic model of organizational success and failure in entrepreneurial organizations at different stages of growth. It builds upon previous work by Flamholtz (1995) to develop a model of organizational success and failure and by Flamholtz et.al. to assess the models validity empirically (Flamholtz and Aksehirlı, 2000; Flamholtz, 2001; Flamholtz and Hua, 2002A, 2002B). The initial model proposes that there are six key factors or “strategic building blocks” of successful organizations, and the six key variables must be designed as a holistic system, which has been termed “The Pyramid of Organizational Development”.

**Keywords:** strategy, organizational development, infrastructure, financial performance and organizational success.

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## 1. Background

In recent years, most industries throughout the world have witnessed successes and failures of seemingly similar companies. Organizations such as Microsoft, Southwest Airlines, Nike and Wal-Mart become dominant forces in their industries while other comparable organizations such as Apple Computer, People Express, LA-Gear, and K-Mart have experienced difficulties and decline after a period of promising initial growth (Flamholtz & Randle, 1998).

The result is an increased need for a better understanding of the management of organizational growth and the determinants of success and failure over the long term. More specifically, why do some organizations continue to be successful over the long term while others, with equally promising starts, experience difficulties and even failure?

To help answer this question, Flamholtz (1995) presented a framework entitled the “Pyramid of Organizational Development” that identified six key “strategic building blocks” of successful organizations. Subsequently,

Flamholtz et.al., have engaged in a program of empirical research to assess the validity of the model and various hypotheses and implications derived from it.

The next section provides a review of the key aspects of the framework relevant to this research. The third section will survey the empirical research which has been conducted to date to assess the validity of various hypotheses derived from the framework. Finally, the implications of this research for theory and practice will be considered in the final section.

## **2. The Theoretical Framework**

The framework consists of four key parts: 1) a “strategic organizational development” model, 2) a life cycle model, 3) a model of the levels of strategic organizational development required at each stage of growth, and 4) a framework for the dysfunctional consequences which occur when suboptimal strategic organizational development occurs. These are described, in turn, below.

### **2.1. The Model for Strategic Organizational Development**

The initial premise or hypothesis underlying this framework is that organizations must perform certain tasks to be successful at each stage of their growth. The six key tasks of strategic organizational, all of which have been supported by previous research are:

- Identification and definition of a viable market niche (Aldrich, 1979; Brittain and Freeman, 1980; Freeman and Hannan, 1983),
- Development of products or services for the chosen market niche (Burns & Stalker, 1961; Midgley, 1981),
- Acquisition and development of resources required to operate the firm (Pfeffer & Salancik, 1978; Brittain & Freeman, 1980; Carroll & Yangchung, 1986),
- Development of day-to-day operational systems (Starbuck, 1965),
- Development of the management systems necessary for the long-term functioning of the organization (Child & Keiser, 1981; Tushman et.al., 1985),

- Development of the organizational culture that management feels necessary to guide the firm (Peters & Waterman, 1982; Walton, 1986).

Each of these key tasks will be discussed in detail below.

### 2.1.1. Identification of Market Segment and Niche

The first challenge for a new venture in organizational survival or success is to identify a market need for a marketable service or product. The chances of organizational success are enhanced to the extent that the firm is successful in this step (Flamholtz, 1995).

The challenge is not merely in identifying the market but also, if possible, to capture a “market niche,” a relatively protected place that would give the company sustainable competitive advantages. Failing to define a niche or mistakenly abandoning the historical niche can cause an organization to experience difficulties and even failure. The process of identifying the market involves the development of a strategic market plan to identify potential customers and their needs and the creation of a competitive strategy (Flamholtz, 1995).

### 2.1.2. Development of Products and Services

The second challenge or strategic building block involves the development of products and/or services. This process can also be called “productization,” which refers to the process of analyzing the needs of customers in the target market, designing the product and developing the ability to produce it (Flamholtz & Randle, 2000). For a production firm this stage involves the design and manufacturing phases, whereas for a service firm, this stage involves forming a system for providing services to the customers (Flamholtz & Randle, 2000).

The success this stage is highly related to the previous critical task, proper definition of the market niche (Flamholtz, 1995). Unless a firm fully understands the needs of the market, it cannot satisfy those needs in productization.

### 2.1.3. Acquiring Resources

Success in identifying a market niche and productization will create increased demand for a firm’s products or services. Consequently, the resources of the

firm will be spread very thin (Flamholtz, 1995). The organization will require additional physical, financial and human resources. This is the point at which the entrepreneur/s should start thinking about the long-term vitality of the firm and procure all the necessary resources to survive the pressure of current and future increase in demands (Flamholtz & Randle, 2000).

#### 2.1.4. Development of Operational Systems

The fourth critical task is the development of basic day-to-day operational systems, which include accounting, billing, collection, advertising, personnel recruiting and training, sales, production, delivery and related systems (Flamholtz, 1995). Entrepreneurial companies tend to quickly outgrow the administrative systems available to operate them. Therefore, it is necessary to develop sufficient operational systems, on time, to build a successful organization. In contrast, large established companies might have developed overly complicated operational systems. In this case, the success of the organization depends on the reengineering of operational systems (Flamholtz, 1995).

#### 2.1.5. Development of Management Systems

The fifth step is to develop the management systems, which is essential for the long-term viability of the firm (Flamholtz & Randle, 2000). Management systems include systems for planning, organization, management development and control. Planning systems involve planning for the overall development of the organization and the development of scheduling and budgeting operations. It includes strategic planning, operational planning and contingency planning (Flamholtz, 1995). The mere existence of planning activities does not indicate that the firm has a planning system. A planning system ensures that planning activities are strategic and ongoing.

Organizational structure involves the ways in which people are organized and activities are coordinated. As with the planning activities success depends, not on the mere existence of a structure, but on the match between the structure and business strategy (Flamholtz, 1995).

The process of planned development of the current and future managers is Management Development Systems. Control systems is the set of processes (budgeting, goal setting) and mechanisms (performance appraisal) that would encourage behavior that would help achieve organizational objectives (Flamholtz, 1995).

### 2.1.6. Developing Corporate Culture

Just as people have personalities, organizations have cultures, which are composed of shared values, beliefs and norms. Shared values refer to the importance the organization attaches to the aspects of product quality, customer service, and treatment of employees. Beliefs are the ideas that the people in the organization hold about themselves and the firm. Lastly, the norms are the unwritten rules that guide interactions and behavior (Flamholtz, 1995).

### 2.1.7. The Model as a Whole

A second premise or hypotheses is that each of these tasks must be performed in a stepwise fashion in order to build a successful organization. Taken together, then, these six tasks lead to a hierarchical model of organizational development (Exhibit 1 on page 302).

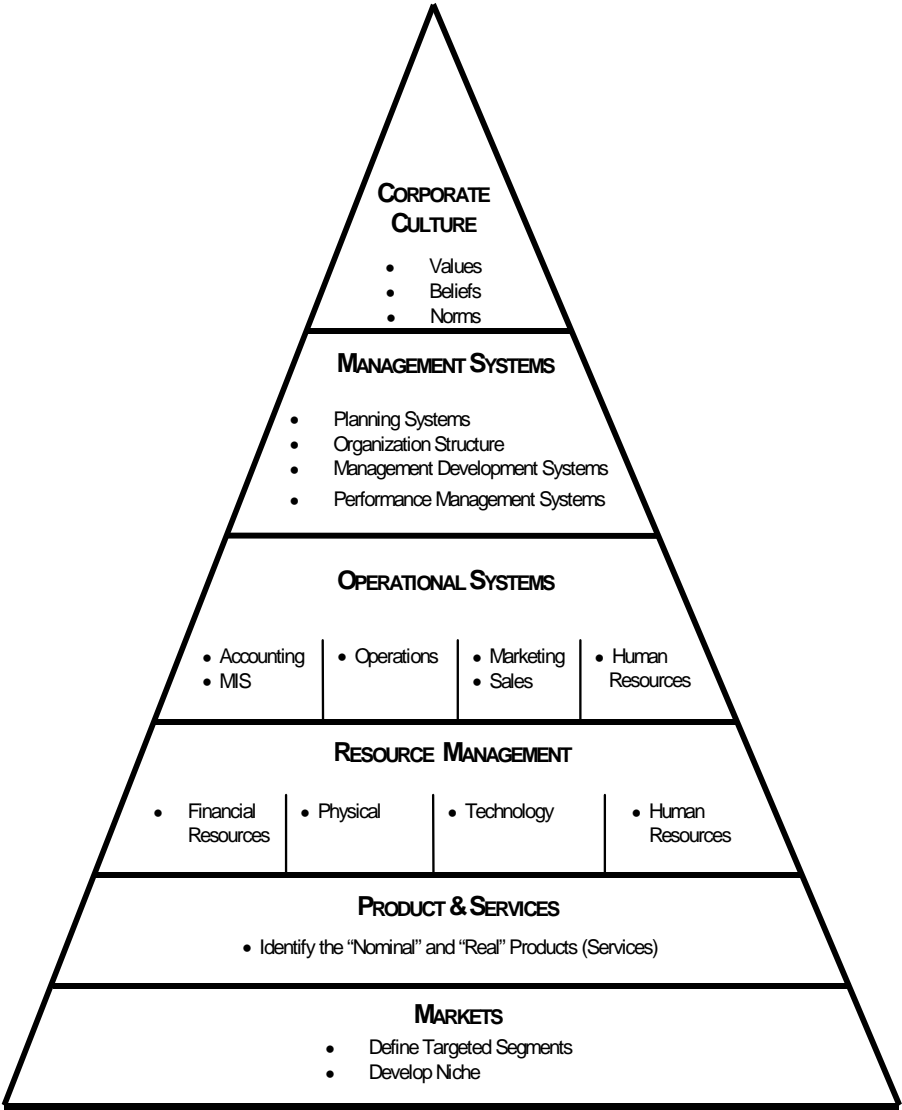
Similar hierarchical views are present in the previous literature. Woodward discussed a similar relation between market niche and product, and structure and culture. In addition, Chandler's (1962) book, "Strategy and Structure," suggests that a firm's structure follows from its long-term strategy.

It should be noted that the pyramid shape does not imply that the key tasks are carried out independently. All six tasks are vital for the health of the firm, and must occur simultaneously. However, the relative emphasis on each task or level of the Pyramid will vary according to the organization's stage of growth (Flamholtz, 1995), as noted below.

Another hypothesis is that the top four levels of the pyramid, which form the "infrastructure" of the firm, are less susceptible to imitation (Flamholtz, 1995) and, accordingly, provide the basis for long-term sustainable competitive advantage. Thus, although competition between firms takes place at all levels, long-term sustainable advantage is primarily found at the top three levels.

EXHIBIT 1

The Six Key Building Blocks of Successful Organizations:  
Pyramid of Organizational Development



## 2.2. Strategic Organizational Development at Different Stages of Growth

The emphasis that should be given to each task differs depending on the size of the firm. Organizations experience developmental problems if their infrastructure is not consistent with their size. The parallel relationship with size and organizational structure leads to an organizational life cycle model that complements the Organizational Development Pyramid (Flamholtz, 1995), as shown in Exhibit 2 below.

### EXHIBIT 2

#### Stages of Growth

Stage	Description	Critical Development Areas	Approximate Size (sales: US\$)	
			Manufacturing Firms	Service Firms
I	New Venture	Markets and products	Less than \$1million	Less than \$0.3 million
II	Expansion	Resources and operational systems	\$1 - \$10 million	\$0.3 - \$3.3 million
III	Professionalisation	Management systems	\$10 - \$100 million	\$3.3 - \$33 million
IV	Consolidation	Corporate culture	\$100 - \$500 million	\$33 - \$167 million

As seen in Exhibit 2, each stage of growth is viewed as having a set of critical developmental tasks. For example, the critical tasks at Stage I are markets and products, while at Stage III the critical task is the development of management systems.

### 2.3. Dysfunctional Consequences of Suboptimal Strategic Organizational Development

In this framework presented above, strategic organizational development equilibrium occurs when there is a fit between the organization's strategic development of the six key building blocks of organizational success and its size or stage of development. When this fit does not occur, the organization will experience a variety of "organizational growing pains". These growing pains are symptoms of organizational distress and an indication of the need to change, if the organization wants to continue to operate successfully.

#### 2.3.1. The Classic Growing Pains

Based upon our experience in working with a wide variety of organizations, we have identified ten classic symptoms of organizational growing pains (Flamholtz, 1995) and (Flamholtz & Randle, 2000). These growing pains, which are summarized in Exhibit 3 and described below, were derived from observations and assessments conducted with a wide variety of organizations (different sizes and industries).

#### EXHIBIT 3

##### Ten Classic Growing Pains

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1. People feel that "there are not enough hours in the day."
  2. People spend too much time "putting out fires."
  3. People are not aware of what other people are doing.
  4. People lack understanding about where the firm is headed.
  5. There are too few good managers.
  6. People feel that "I have to do it myself if I want to get it done correctly."
  7. Most people feel that "our meetings are a waste of time."
  8. When plans are made, there is very little follow-up, so things just don't get done.
  9. Some people feel insecure about their place in the firm.
  10. The organization continues to grow in sales but not in profits.
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1. People feel that there are not enough hours in the day.

People feel they can work 24 hours a day, seven days a week and still not get all the required work done. When employees believe that they are being endlessly overworked morale problems can occur. People may simply decide they can no longer operate under these conditions and may leave the organization. This will result in significant turnover costs and replacement costs related to recruiting, selecting, and training new people.

2. People spend too much time “putting out fires”.

This means that people are faced with an almost endless series of crises or “fires.” Examples of “putting out fires” problems are easy to find.

“Fires” or crises were so prevalent at one \$50 million manufacturing company in the U.S. that 33 managers began to refer to themselves as “fire fighters”, and senior management rewarded middle management for their skills in handling crises. When it became apparent that managers who had been effective in “fire prevention” were being ignored, some of them became “arsonists” to get senior management’s attention.

3. People are not aware of what other people are doing.

This creates a situation in which people and departments do whatever they want to do and say that the remaining tasks are “not our responsibility”. Constant bickering between people over responsibility for things not getting done may ensue.

4. People lack understanding about where the firm is headed.

Employees may complain that “the company has no clear direction”. When insufficient communication is combined with rapid changes, employees may begin to feel anxious. If anxiety increases to the point where it becomes unbearable, employees may begin leaving the firm. It should be noted that turnover of this kind could be very costly to the company.

5. There are too few good managers.

Although the organization may have many people who hold the title of “manager”, it may not have *good* or effective managers. Rapid growth at Apple Computer led Steven Jobs to bring in “professional managers” to help manage the company because it had not developed a cadre of managers as it grew. However, this led to the inevitable culture clash, and to Jobs’ resignation.

6. People feel that “I have to do it myself to get it done correctly”.

Increasingly, as people become frustrated by the difficulty of getting things done in an organization, they come to feel that “if I want to get something done correctly, I have to do it myself”. Operating under this mindset departments become isolated from one another and teamwork becomes minimal.

7. Most people feel “our meetings are a waste of time”.

Unfortunately, at many companies, meetings have typically no planned agendas, and often they have no designated leader. As a consequence, the meetings become a free-for-all, tend to drag on interminably, and seldom result in decisions.

Other complaints about meetings involve lack of follow-up on decisions that are made. Meetings are also ineffective if people ignore the goals that have been set or fail to monitor their progress toward these goals.

8. When plans are made, there is very little follow-up so things just don't get done.

Recognizing that the need for planning is greater than in the past, a CEO may introduce a planning process. People go through the motions of preparing business plans, but the things that were planned just don't get done. In some cases, there is no follow-up because the company has not yet developed systems adequate to monitor its goals. In other cases, follow-up does not occur because personnel have not received proper training in setting, monitoring, and evaluating goals.

9. Some people feel insecure about their place in the organization.

Sometimes the Board has become anxious about problems facing the organization and has therefore hired a “heavy-weight” manager from outside. This action may have been accompanied by the termination of one or more current managers. Employees begin to wonder if whether they will be the next to “get the axe”. In an attempt to protect themselves, they keep their activities secret and do not “make waves”. This results in isolation and a decrease in teamwork. When anxiety becomes too high, it may result in morale problems, turnover, or a very political environment.

10. The organization continues to grow in sales but not in profits.

If all the other growing pains are permitted to exist, this final symptom may emerge. In some instances, sales continue to increase while profits remain flat,

so that the company is succeeding in only increasing its workload. In the worst cases, sales increase while overall profits decline.

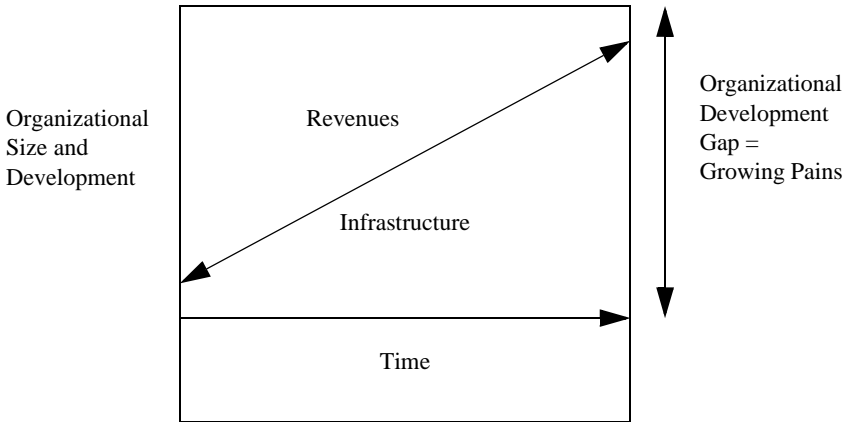
This set of classic growing pains are not only problems in and of themselves, we believe that they are symptoms of a deeper problem, and a “signal” or warning that the organization needs to make a fundamental change in its infrastructure, as explained below. Although it is tempting to look at growing pains from a binary (“yes” or “no”) perspective, as we shall explain below it is more useful to view them on a continuum, i.e., the degree to which they exist in a particular organization.

### 2.3.2. Nature and Causes of Organizational Growing Pains

Growth, though essential to organizations over the long term, creates its own set of problems: the growing pains described above. These growing pains are symptoms that something has gone wrong in the growth and development of a business enterprise. They are a symptom of organizational distress, and an early warning or leading indicator of future organizational difficulties, including financial difficulties.

Growing pains indicate that the “infrastructure” of an enterprise (i.e., the internal operational and management systems it needs at a given stage of growth) has not kept up with its size, as measured by its revenues. For example, a business with \$200 million (U.S.) in revenues may only have an infrastructure to support the operations of a firm with \$50 million in revenues, or one-fourth its size. This type of situation typically occurs after a period of growth, sometimes quite rapid growth, where the infrastructure has not been changed to adjust to the new size and complexity of the organization. The result, as shown in Exhibit 4 (page 308), is an “organizational development gap,” (that is, a gap between the organization’s actual infrastructure and that required at its current size or stage of development) which produces the growing pains.

EXHIBIT 4  
Organizational Development Gap



As a rule of thumb, whenever an organization doubles in size (as measured by its revenues), it is essentially a different company and requires a new infrastructure to support its operations. If the infrastructure has not been adjusted to reflect the increased size a variety of classic growing pains will be experienced.

Growing pains can and do occur in organizations of all sizes, including the largest industrial enterprises. However, they are most characteristic of early stage entrepreneurial companies, even in those organizations where revenues exceed \$1 billion. Although growing pains are the result of organizational success (i.e., successful development of a market and product), they can lead to great difficulties and even foreshadow failure. For example, Osborne Computers, a pioneer in the portable “personal” (micro) computer business, achieved \$100 million in revenues after being in business for only two years, but went into bankruptcy in year three!

### 3. Empirical Research to Assess the Validity of the Framework

To assess the validity of the framework presented above and to provide empirical support for its proposed implications, Flamholtz et.al. have been engaged in a program of empirical research. In the following section, the empirical research to date to test the model's predictive validity and its related hypotheses will be summarized.

#### 3.1. Strategic Organizational Development and Financial Performance

Flamholtz and Aksehirli (2000) proposed a link between the organizational success model and the financial success of organizations. To test this hypothesized relationship, they analyzed financial and non-financial information relevant to the hypothesized model for eight pairs of companies in different industries. Each company was evaluated in terms of the six key strategic building blocks, and scores were assigned to indicate the degree of the organization's development. Average Return on Equity was used as an indicator of financial performance. Using the Friedman Two-way Analysis of Variance and a regression analysis, they found a statistically significant relationship between the proposed model of organizational success and financial performance.

The major implication of this research is that it provides empirical support for the use of the Pyramid Model as a managerial tool, as we proposed in the previous section.

#### 3.2. Strategic Organizational Development and Financial Performance: Additional Evidence

In addition, Flamholtz and Hua (2002A) report the results of an empirical test of the hypothesized relationship regarding financial success and the degree of development of six key variables (or "strategic building blocks") included in the organizational development pyramid within a *single* firm. The research site was a U.S.-based, medium-sized industrial enterprise. The company is a parts manufacturer for industrial, truck, and other automotive businesses. It is a supplier of parts for such companies as Ford Motor Company, Navistar, and Dana Corporation.

To assess this issue, they compared divisional data the degree of organizational development with divisional "EBIT" (earnings before interest and taxes), a classic measure of financial performance for 18 divisions. Specifically, they ran a regression between: 1) the degree to which each division was perceived as being developed on the six key strategic building

blocks as a whole (i.e., the average pyramid development score), and 2) EBIT. This regression was statistically significant. This result supports the hypothesis of a relationship between the degree of strategic organizational development and the financial performance of organizations.

Another question concerned the thresholds of strategic organizational development for profitability of individual companies or operating units. Specifically, they wanted to identify potential “benchmarks” of organizational development to serve as guideposts for developing the six key strategic building blocks. Stated differently: What are the levels of strategic organizational development required for profitability and superior profitability in companies?

They found that all of the six divisions with strategic organizational development scores greater than 3.0 were profitable. In contrast, for the nine divisions with strategic organizational development scores less than 3.0, six were profitable and three were “unprofitable” (i.e., negative EBIT).

This study has implications for the level of strategic organizational development required for optimal profitability. One major implication of this study is, that it provides additional empirical support for the use of the Pyramid model as proposed earlier in this article. Another major managerial implication of this study is that there is a high (in this study 100%) probability of profitability for organizations with Pyramid scores greater than 3.0. Similarly, it also suggests that there is a 33% chance of being unprofitable for organizations with Pyramid scores less than 3.0. While a level of development of 3.0 seems to be the threshold for being profitable, most organizations want to achieve superior financial performance.

### 3.3. Corporate Culture and Financial Performance

In addition to the overall tests of the strategic organizational development model, there has also been an empirical test of the effects of corporate culture on financial performance (Flamholtz, 2000). “Corporate culture” is one of the six key building blocks included in the Pyramid framework. It is also hypothesized to be the critical developmental factor at Stage IV (see Exhibit 2).

Previous authors (Kotter and Heskett, 1992) have suggested that culture has an impact on financial performance. Unlike previous studies, which have only examined the effects of culture on financial performance using cross-sectional data, Flamholtz (2000) did a study of the impact culture has on financial performance in a single organization.

The study involved developing statements describing the core values of the desired culture of the company as a whole, as well as determining the extent to which the divisions’ culture was consistent with the stated desired

culture. This was measured by using a survey with a Likert scale (Flamholtz, 2000). This data was then used as an input to address the question concerning the impact of corporate culture on financial performance. The hypothesis was that the greater the degree of agreement of the divisional culture with the overall desired corporate culture, the greater financial performance. Financial performance was measured as EBIT.

The results, using a regression analysis, indicate that there is a statistically significant relationship between culture and financial performance (measured by 'EBIT,' or earnings before interest and taxes). Thus these results provide support for the previously hypothesized relationship between culture and financial performance, with significant implications for management theory and practice.

One of the major implications concerns the potential sources of competitive advantage. One of the hypotheses is that the top four levels of the pyramid, which form the "infrastructure" of the firm, are less susceptible to imitation (Flamholtz, 1995), and, accordingly, provide the basis for long-term sustainable competitive advantage. Culture is one of the key components of organizational infrastructure, and if there are demonstrable differences in culture across business units, which are associated with differences in profitability, this provides support for the notion that organizations compete not only in products and markets but in infrastructure as well.

#### 3.4. Infrastructure and Competitive Advantage

One of hypotheses presented above is that the top four levels of the pyramid, which form the "infrastructure" of the firm, are less susceptible to imitation (Flamholtz, 1995), and, accordingly, provide the basis for long-term sustainable competitive advantage. At present there is no published research on this issue. However, Flamholtz and Hua with the assistance of Aksehirli (2003) have conducted research on this issue. They have found empirical support for this hypothesis.

The major implication of this study is that it challenges the convention paradigm of strategy, which focuses almost exclusively upon external forces. The research by Flamholtz, Hua, and Aksehirli (2003) indicates that competitive advantages can occur within "the black box" systems internal to an organization.

#### 3.5. Growing Pains and Financial Performance

As discussed above, when an organization grows it will almost inevitably experience a classic set of "growing pains". These growing pains are

“symptoms” that something has gone wrong in the process of strategic organizational development, and an “early warning” of significant future problems. More specifically, strategic organizational development equilibrium occurs when there is a fit between the development of the six key building blocks of organizational success and the organization’s size or stage of development (Flamholtz, 1995). When this fit does not occur, the organization will experience a variety of “organizational growing pains”.

Flamholtz and Hua (2002B) performed an empirical test of the hypothesized relationship between “organizational growing pains” and corporate financial performance. They also addressed the question: are there benchmark levels of growing pains which might be used to predict which organizations will be profitable versus those which are likely to be unprofitable? Previous to this research, the hypothesized relationship between growing pains and performance in previous literature has been conceptual in nature; in contrast, this study presents some very specific “benchmarks” for growing pains in relation to successful organizational financial performance.

To study whether there is a statistically valid predictive relationship between growing pains and EBIT, they calculated a regression equation based upon these two variables. The results of this statistical test indicate that there is a statistically significant relationship between growing pains as a predictor of EBIT. This means that growing pains are a predictor of financial performance or the “bottom line” (EBIT).

An analysis of the relationship between specific growing pains scores and financial performance was also conducted to determine benchmark levels of “safe” versus “unsafe” growing pains. The results suggest that there appears to be a maximum level of growing pains beyond which organizational financial health is at risk. This suggests that there is a “maximum healthy growing pains score” to provide the highest probability of success, and confirms that there do appear to be threshold levels of growing pains which might be used to predict which organizations will be profitable versus those which are likely to be unprofitable.

The data derived from this study provide empirical support for the notion that growing pains have an impact on financial performance, and that there are threshold levels of growing pains that are “unsafe” or “unhealthy” for future financial performance. The results of the analysis suggest that there is a (very strong) statistically significant relationship between growing pains and financial performance.

The major implication of this research is that there appears to be a maximum level of growing pains beyond which organizational financial health is at risk. Specifically, the maximum “healthy” level of growing pains appears to be “32”. This means that to optimize the chances of being profitable an organization ought to keep its growing pains score less than 32 (Flamholtz and Randle 2000).



#### **4. Summary of the Framework's Implications**

Several implications can be derived from the framework described above. These are summarized below:

1. The initial premise or implication from this framework is that organizations must perform certain tasks to be successful at each stage of their growth.

2. A second premise is that each of these tasks must be performed in a stepwise fashion in order to build a successful organization.

3. Another implication is that the top four levels of the pyramid, which form the "infrastructure" of the firm, are less susceptible to imitation (Flamholtz, 1995), and, accordingly, provide the basis for long-term sustainable competitive advantage.

4. Each stage of growth is viewed as having a set of critical developmental tasks. For example, the critical tasks at Stage I are markets and products, while at Stage III the critical task is the development of management systems.

5. Strategic organizational development equilibrium occurs when there is a fit between the organization's strategic development of the six key building blocks of organizational success and its size or stage of development. When this fit does not occur, the organization will experience a variety of "organizational growing pains". These growing pains are symptoms of organizational distress and an indication of the need to change, if the organization wants to continue to operate successfully.

##### **4.1. Implications for Management, Boards, Auditors and Researchers**

The proposed model and empirical research findings presented above have significant implications for management theory and practice. The specific implications of each individual research study have been stated above. However, this section examines the broader implications of the model and research as a whole for management, boards, auditors, and researchers.

###### **4.1.1. Strategic Organizational Development and Financial Performance.**

The data derived from the set of empirical studies surveyed above provides an indication that the proposed model of strategic organizational development

does have an impact on financial performance. This has important implications for management theory and practice. It is one thing to assert that organizational development is a significant factor of organizational success and quite another to be able to demonstrate that the effective management of these variables can enhance profitability.

Managers can have confidence in using the framework to assess the strategic development of their companies as well as to plan for its future development. This suggests that the strategic planning process ought to be based upon the pyramid as a “strategic lens” for the development of organizations. Although all six functions that make up the pyramid should be managed successfully in order to achieve good financial performance, practitioners can incorporate the organizational life cycle model to decide which tasks to emphasize at each stage of growth.

Another implication for management is the fact that the organizations are competing at each level of the pyramid. Since markets can be easily entered and products can be easily copied, the real competition goes on at the top four levels of the pyramid. This is the area where organizations can develop sustainable competitive advantages.

#### 4.1.2. Corporate Culture and Financial Performance.

The data derived from the set of empirical studies surveyed above provides an indication that the corporate culture does have an impact on financial performance. This has important implications for management theory and practice. It is one thing to assert that corporate culture is a significant factor of organizational success and quite another to be able to demonstrate that the effective management of this variable can enhance profitability.

One of the major implications concerns the potential sources of competitive advantage. One of the hypotheses is that the top four levels of the pyramid, which form the “infrastructure” of the firm, are less susceptible to imitation (Flamholtz, 1995), and, accordingly, provide the basis for long-term sustainable competitive advantage. The data indicate that there is a statistically significant relationship between culture and financial performance (measured by ‘EBIT’, or earnings before interest and taxes). Thus these results provide support for the previously hypothesized relationship between culture and financial performance.

Culture is one of the key components of organizational infrastructure, and since there are demonstrable differences in culture across business units, which are associated with differences in profitability, this provides support for the notion that organizations compete not only in products and markets but in infrastructure as well. Culture, then, is a potential source of competitive advantage, and, in turn, differential financial performance.

#### 4.1.3. Growing Pains and Financial Performance.

In addition, as we have seen, organizational growing pains can directly influence financial performance or the so-called “bottom line”. As a result, management needs: 1) to understand the nature and causes of growing pains, 2) to have a method of measuring them, 3) a template to assess their severity, and 4) a strategy for managing them.

Variations exist, but it is clear that organizations of all sizes and types experience some growing pains. Severity of these problems can be affected by the rate of growth experienced by the organization. Managers of rapidly growing companies of any size or type must learn to recognize organizational growing pains and take steps to alleviate them so that their organizations can continue to operate successfully. The payoff will be reduced growing pains and an increased likelihood of a positive “bottom line”.

What should an organization do to minimize or avoid the problems associated with growing pains? Most entrepreneurs are always concerned with the risk of failure if revenues are insufficient to cover expenses. However, many ignore the equally damaging risks of choking on their own rapid growth. To avoid the problems accompanying hyper-growth, a company must have an infrastructure that will absorb that growth. If a company anticipates rapid growth, then management must invest in building the required infrastructure *before* it is actually necessary. It is very difficult, and sometimes impossible, to “play catch-up” with organizational infrastructure. Some companies, such as Starbucks Coffee, Compaq Computer, and PacificCare had a strategy of having their infrastructure in place prior to their explosive growth and reaped the benefits of this investment. In contrast, Boston Markets, Osborne Computers, and MaxiCare, did not have their infrastructure in place prior to explosive growth and all three have experienced bankruptcy. Thus the ideal strategy for a firm that anticipates rapid growth is to build an infrastructure sufficient for the size of the organization it anticipates becoming, prior to actually reaching that size.

This strategy of building the infrastructure prior to growth is not merely appropriate for large companies, but for relatively small entrepreneurship as well. For example, several years ago, the author met with the president of a U.S. service firm specializing in insurance-based benefit programs for executives when the firm had approximately \$3 million in annual revenues. At that time, the author of this article advised the CEO that it was probably premature to build the infrastructure to the extent that was being contemplated. However, the CEO indicated that he wanted his firm to grow to \$50 million in revenue within five years. He then proceeded to invest in building the infrastructure of his company before it was actually necessary. This was a wise move, because the company actually grew to more than \$65 million in revenue within five years.

Given the research findings about growing pains cited above, it appears that growing pains can be used as leading indicators of future financial performance. The U.S. Federal Reserve monitors leading indicators of economic activity to predict the direction of GNP and inflation. Similarly, growing pains might be used as leading indicators of future changes in organizational financial performance. In addition, our findings concerning the maximum level of growing pains in relation to the levels of profitability are, at a minimum, suggestive of the need to control or at least minimize growing pains.

Since growing pains can be measured and we have shown that they are clearly linked to financial performance, it would be useful to report growing pains to the Board. This would be done on a comparative basis across time. Independent auditors might also find this information useful as a signal to look for organizational problems. These findings also have implications for Boards of Directors and external auditors. Recent experiences in the U.S., with Enron, Waste Management, and other publicly traded enterprises suggest the need for improved methods of control (Flamholtz, 1996; Nilsson and Olve, 2001). There are complex issues involving the balance of power among management, Boards, and auditors not only in the U.S., but throughout Europe and Asia as well (Hooghiemstra and Van Manen, 2002). What is required are tools that can help identify potential problems *before they occur*.

#### 4.2. Future Research

From an academic perspective, the results reported here are preliminary but promising. The results of the research surveyed here represent the first attempt in the empirical analysis of Organizational Development Pyramid framework and should be supplemented with further studies. It would be valuable for future research to replicate the current study, not only in North American environment but in Europe and Asia as well.

This paper also suggests that the level of strategic organizational development, as well as the level of growing pains, can be used to estimate the future financial success of the firm. Although the results reported here are promising, it remains for future research to examine this phenomenon with a longitudinal study using time series analysis.

#### 4.3. Conclusion

The Organizational Development Pyramid framework can be a promising tool in predicting the future performance of the companies. In combination with stages of growth, the Organizational Development pyramid can be used to

assess a company's success in fulfilling the critical tasks for each stage of growth. In addition, as we have seen, organizational growing pains can directly influence financial performance or the so-called "bottom line".

This framework offers the basis of a different paradigm of organizational success and failure for organizations at different stages of growth, from new entrepreneurships to established companies. Although the research is not definitive, it offers some promising findings and opens the way to new questions.

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