

## CASE STUDY

# Managerial discretion and structures in organizations: The case of Addis Ababa, Ethiopia

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**Abstract:** Due to the turbulent of business environment, complexity of managing human resource and volatility of customer needs, it is a formidable managerial task to design structures which will be suitable to meet such requirements and free to exercise course of action for managerial discretion. However, in most of the case the structure type that can be designed and implemented in many organizations are to the interest of stakeholders and owners. Research also shows that the latitudinal action of management staffs and autonomous decisions are a theme of discussion in managerial discretion. The researcher used a conceptual study of both a qualitative and quantitative approach coupled with case study for this study. The aim of this paper therefore is to assess the applicability of managerial discretion that suite to organization structures, and based on the study, the research findings show that organizations that have managed by owner-manager has less experienced managerial discretion, and thereby came to conclude that managers who are free to choose course of action have led to company success than those company which managed by owner-manager.

**Keywords:** managerial discretion, structure, organization, course of action, contemporary, latitude

## 1 Introduction

The perspective of managerial discretion with respect to structure of an organization has a great place in contemporary management thinking as a latitude of action & a free course of action performed by professional managers would able to drive an organizations to better position in competitive environment and exceed customer expectation. However, in most of the case it is less likely to experience managerial discretion in many of the organizations, except with Share Companies.

In line with this, to exercise managerial discretion understanding the organization set up is essential and better equip with the formation of company; however forms of a company is different from country to country. As stated by Negussie Tadesse<sup>[1]</sup>: “the major forms of business organization in US are: the sole proprietorship, Partnerships, Limited Partnerships, Corporations, Limited liability Companies and Limited Partnerships. In UK, the two major categories of companies are public and private companies. German law provides for

two principal categories of business organizations: the Aktien gesellschaft/AG which is equivalent to the US Corporation and the Gesellschaft mitbeschränkter Haftung/GmbH or limited liability company. The French Commercial Code also provides four forms of Commercial companies: General Partnerships, Limited Partnerships, Limited Liability Companies and Public Limited Companies.”

However, in Ethiopian context the most types of organizations are Sole proprietorships, Private Limited Company (PLC) & Share Company. Among these the two companies which recognized by law are Private limited company and Share company. For instance, out of 9897 companies registered the number of private limited companies is 9504 (about 96%), whereas the number of the share companies is only 393 (about 4%)<sup>[1]</sup>.

On browsing Ministry of Trade website ([www.mot.gov.et](http://www.mot.gov.et)), to form and establish Sole proprietorship a single person share is required, whereas for Private Limited Company it requires 2–5 shareholder and for Share Company it requires more than 5 shareholders. Based on my practical work experiences and exposures for the last 29 years in different organizations, an organization; like, Sole proprietorships and PLC predominantly have owner-manager structure which implies almost all major decisions are taken by owners. Hence, there is no chance of getting decision by other managers and this prevents to exercise managerial discretion.

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Whereas, Share Company has a different setting in which shareholders nominate board of directors and then the organization set up can be designed to fill managerial positions, accordingly managers will staff remaining employees. Based on the context of business environment, customer requirements and functions of an organization, this share company would be able to introduce either a simple or complex structures.

Hence exercising free course of actions is a major problem in an organization, the purpose of this research paper therefore is to examine literature parts in the area, identifying the gaps on exercising managerial discretion and then recommend on how an organization able to utilize such course of actions.

## 2 Theoretical review

### 2.1 Managerial discretion

For past many years and till now the central theme of exercising managerial discretion with respect to organizations objectives has been a conflicting issue as there is an argument of how managers meet stakeholders interest vis-à-vis excelling its role independently. From more than two decades of this article writer personal experience, insight and observation as a manager in different organizations, it is unlikely to get managers to choose their course of action, and even to the extent that owners/shareholders are unaware of the theoretical implication of managerial discretion on the performance of an organization.

On this regard, there are numerous scholars' articles and research which are written about managerial discretion, and as Phillips *et al.*<sup>[2]</sup> stated "for several decades, a central question in the literature on business strategy and organizations has been the degree to which managers are free to choose courses of action and whether these choices bring about intended outcomes."

Though the latitude of actions differ from organization to organization, the involvement of top management in decision process is inevitable. In this respect, on exercising managerial discretion we can perceive that whether an organization's form and fate sit totally outside the control of its top managers, completely within their control, or, more typically, somewhere in between Finkelstein & Boyd<sup>[3]</sup>.

Researchers have made various explanations about managerial discretion in relation to firms. According to Fama & Jensen (1983b), Jensen & Meckling (1976), cited in Cho<sup>[4]</sup> high levels of discretion encourage managers to appropriate wealth from other stakeholders and thereby impair firm performance. They argue that firms should limit managerial discretion.

The perception towards managerial discretion has been a point of argument for quite for many years, Phillips *et al.*<sup>[5]</sup> also noted "stakeholders' reaction to orientation may be quite varied: a manager with a narrow orientation – say focused on financiers – might be in a position of high discretion vis-a-vis those financiers (or at least a subset of them), but at the cost of additional constraints from consumers or employees. A manager with a broad orientation might find less discretion from any individual stakeholder group, but more in the aggregate across stakeholders." However, this paper points out these two scenarios (narrow & broader orientation) are still debating and a point of argument.

In addition Phillips *et al.*<sup>[5]</sup> depicted that managerial discretion at a given time may be high or low and are associated with the manager's choice of orientation. In the context implied by most extant stakeholder theoretic studies, let us assume managers with high discretion are initially more likely to choose a broad orientation, using their latitude to address all stakeholders' interests. This may have the effect of catalysing an increase in managerial discretion perhaps due to higher levels of trust. High discretion may also mean that managers have greater freedom to choose to focus on a narrower group of stakeholders (*e.g.* shareholders, consumers or employees), which may then reduce aggregate discretion in future periods as under attended stakeholders react.

Alternatively, low discretion may derive from a single powerful stakeholder group (*e.g.* financiers) demanding a narrow orientation toward their interests or, in contexts characterized by powerful regulatory/civil society institutions. In this case, we are likely to find a combination of low discretion with broad orientation which will create a rather different dynamic. This presents a great deal of complexity in the possible combinations of levels of managerial discretion and orientation. This combinational complexity is only increased by the dynamic and recursive addition of stakeholders-responses to managers-orientations, influencing future levels of both stakeholder-specific and aggregate discretion.

Hambrick & Finkelstein<sup>[6]</sup> under the title "Upper Echelons Theory: The Organization as a Reflection of its Top Managers": stated that organizational outcomes-strategic choices and performance levels-are partially predicted by managerial background characteristics, and organizational outcomes-both strategies and effectiveness-are viewed as reflections of the values and cognitive bases of powerful actors in the organization, which are top managers.

Theodore 2017 (cited in Wangrow *et al.*, 2014) indicated that managerial discretion plays a role in organizational outcomes such as the diversity of organizational

performance, commitment to predetermined activities or even compensation of the chief executive.

According to Wangrow & Schloemer<sup>[7]</sup>, though generally viewed in the management literature as an opportunity for executives to positively affect performance and increase value, the literature in finance and economics argues that managerial discretion represents a cost to shareholders from potential opportunism or other self-serving behaviors.

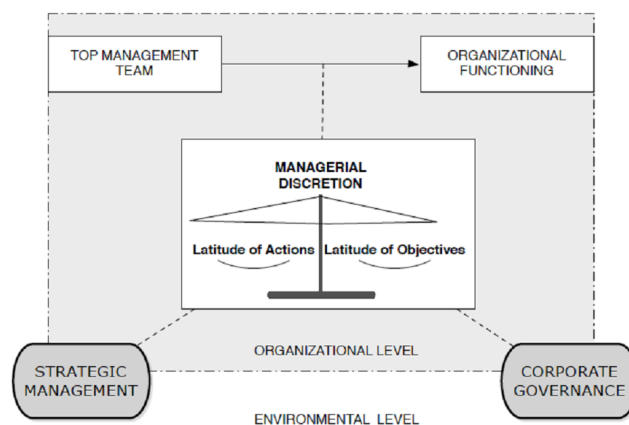
March and Simon 1958 also argued that executives engage in rational human choice and that, because of executives' limited cognitive capacities relative to the complexities of the problems faced by individuals and organizations, simplifying processes are required to capture the main features of problems facing their organizations. Additionally, executives' bounded rationality and aspiration levels, combined with implications of organizations existing as social institutions, influence executives' decisions and their organizations' actions.

Theodore *et al.*<sup>[8]</sup> further noted that "managerial discretion stresses the constraints, on which discretion to act is inside the 'zone of acceptance' of the more controlling parties, especially those who control critical resources and contingencies. While during strategy implementation process, managers in organizations need resources and contingencies managed by others that may influence the success of strategy implementation."

Besides, as stated on Figure 1 below managerial discretion can't function in open system rather it encompasses various factors like; top management functions which has a direct link to organizational functions, and in organization function context there are strategic management & corporate governance that could make an impact at organizational & environmental level. So to exercise managerial discretion there are should not be an imbalance of latitude of objectives & latitude of actions in which top management of an organizations will aspire from strategic management point of view so that it can inculcate the role of corporate governance in an organization.

What can deduce from the above description & diagram is that the theme of managerial discretion can be hampered by both latitude of objectives & actions, and these in turn would be influenced by factors at organizational and environmental level. Hence for free course of actions, managers shall get a room and freedom to integrate all those factors so that they are able to meet organizational objectives.

To this effect, nowadays companies are increasingly focusing on human capital as it is a driving force for success; this is highly attributed to professional managers who aspire for free course of action and autonomous decision by them. Hence, organizations shall give an



Notes: Adapted from Ponomareva & Umans, 2015: An Integrative View on Managerial Discretion: A Study of a Russian Firm in Transition, p.4

**Figure 1.** Managerial discretion: framework of analysis

emphasis to discretionary behavior as those managers and employ that have free course of actions would able to perform more and do their job in a better way. This notion is also augmented by scholars Hambrick & Finkelstein<sup>[9]</sup> as managerial discretion refers to the latitude of options that CEOs have when making strategic choices.

## 2.2 Organizational structure with respect to managerial discretion

### 2.2.1 Organization structure

Theories of managerial discretion revealed that structure of an organization influences the pattern of latitude of actions and course of actions exercised by managements which in turn have an impact on performance of an organization. Due to this reason reviewing organization structure has a paramount importance for this study. Accordingly, as Buchanan & Huczynski<sup>[10]</sup> state organization structure is the formal system of task and reporting relationships that control, coordinate and motivate employees to work together to achieve organizational goals. The purpose of organization structure is, first, to divide up organizational activities and allocate them to sub-units; and second, to coordinate and control these activities so that they achieve the aims of the organization.

Rediate<sup>[11]</sup> cited in Hanover Research (2010), stated that organizational structure is a tool for aligning the company's workforce and strategies with their intended result. At the root of any design effort is flexibility. A successful end result creates work flows, incentives, and reporting/decision making structures that best support a company's strategic mission while allowing the company to adapt quickly to unforeseen events.

Ahmady, Mehrpour & Nikooravesh<sup>[12]</sup>, cited in Minterzberg (1972) stated that organizational structure is the framework of the relations on jobs, systems, operating process, people and groups making efforts to achieve

the goals. Organizational structure is a set of methods dividing the task to determined duties and coordinates them.

### 2.2.2 Common type of organization structure

Managerial discretion has a great link with strategic direction and thereby to structure of an organization, to this extent managerial discretion is shaped by internal organizational factors such as powerful factions inside the firm, firm demographics, and resource availability<sup>[7]</sup>. Besides, as Murugan 2005<sup>[13]</sup> states the major types of organization structures are, line organization, functional organization, line and staff organization, project organization and matrix organization. From these types of structures, in case of Ethiopia-Addis Ababa; line organization/simple structure, functional organization/bureaucracy, line and staff organization and matrix organization are commonly implemented in most of Sole proprietorship, Private Limited Company & Share Company.

For instance, the typical characteristics of organizations structures are explained by Robinsons 2016 as **Simple structure** in which it is a structure characterized by a low degree of departmentalization, wide spans of control, authority centralized in a single person, and little formalization, and **Bureaucracy** type of structure is an organizational structure with highly routine operating tasks achieved through specialization, very formalized rules and regulations, tasks that are grouped into functional departments, centralized authority, narrow spans of control, and decision making that follows the chain of command, and **Matrix structure** is an organizational structure that creates dual lines of authority and combines functional and product departmentalization.

In line with these, the course of action to exercise managerial discretion is highly attributed to prevailing organization structures. To this extent from my practical experience in various organizations; the managerial discretion of autonomous and latitudinal decisions are more commonly exercised in an organization structure of Share Companies, whereas it is unlikely to get managerial discretion with an autonomous managerial decision in the structure of Private Limited Companies. Instead, a lot of intervention, nepotism, favoritism and inexperienced management staffs hinder a course of action to exercise managerial discretion at Private Limited Company.

## 3 Methodology of the study

Since there is resource scarcity on getting theoretical review on conceptual research article on the topic of managerial discretion, for the purpose of this study it employed mixed studies review of systematically reviewing literature and combining quantitative with qualitative re-

search are used. The quantitative part is attributed to questionnaire to supplement the qualitative part of the study. However, methodologically it would be vital to employ qualitative type of study and as Butler & Surace<sup>[14]</sup>, cited in (Eisenhardt, 1989; Hesse-Biber and Leavy, 2011; Yin, 2009) stated the qualitative study based on multiple case studies was chosen as the method of this study. The author has taken three organizations to conduct case studies as “the purpose of the case study research is to get an in-depth understanding about the complexity of at least one case” Stake 1995<sup>[15]</sup>. Hence, in order to investigate and understand the existing problem an exploratory research design supplemented with personal insight and observation are used.

The author uses a longitudinal study of 25 years real life work experiences (as personal observation), in which by working as a management team of performing managerial tasks so that it is being an opportunity to exercise latitudinal action. By using non-probability (convenience) sampling techniques, the structured close-ended and unstructured open-ended questionnaires (which breakdown into 5 majority categorized questions) were designed, administered and distributed to 120 top Private Limited Companies who led by owner-manager that situated on dispersed location in the city. From these companies, the sample is taken from a total of 254 respondents that works as senior managers who are led by owner-mangers. Due to accessibility of data, researcher took those samples by targeting to business firms which engaged on freight logistics, garment factories and retailers. Since the population is low (254 respondents), a census of the entire population was taken. In addition to those companies, to avoid biases a sample of 55 Share Company's; in which each two management staffs (with a total of 110 respondents, that is the entire population) also taken in which they were not working as owner-manager. In total, the author distributed a questionnaire to 175 Private and Share Companies which have 364 senior managers and management staffs (from 1350 total number of employees). This implies it has a total response rate of 100%.

## 4 Results and discussions

After the data is gathered it is analyzed by using Excel spreadsheet. As summarized on [Table 1](#) above, organization structures that hamper course of action have a significant point (93.41%), those who don't have latitude of actions on making autonomous decision accounts 15.11%, on the other hand 81.87% responds that managerial discretion is less experienced in owner-manager's company than Share company's, besides 88.19% responded favoritism, nepotism, mala-administration and intervention are at-

**Table 1.** Climate models used

S.N.	Type of Questions	Yes (%)	No (%)
1	As a manager do you think that organization structures hamper course of action?	93.41	6.59
2	As an executive of business do you have latitude of actions on making autonomous decision which enable to meet company objectives?	15.11	84.89
3	Do you think that owner-manager company's /PLC/ is less experienced to managerial discretion than Share companies?	81.87	18.13
4	Do you think companies lead by owner-managers are attributed to favoritism, nepotism, mala-administration and intervention?	88.19	11.81
5	Do you believe that positive discretion behavior has an impact to organizational performance?	94.78	5.22

tributed owner-managers companies and lastly 94.78% states positive discretion behavior has an impact to organizational performance.

The implication of the above analysis indicates organizations have to pave way for free course of action and management shall exercise managerial discretion autonomously so that it drives organizational success. This paper also identifies companies which lead by owner-manager type businesses are highly attributed to nepotism, maladministration and favoritism, and a lot of intervention has been made by such inexperienced owner-managers relatives which in turn drives them to poor competitiveness, and in addition such companies in which their structure are designed to hamper course of action are less experienced for managerial discretion and also decisions that are solely made by owner-manager are less effective than those companies who exercise free course of action on managerial discretion.

This finding also supported by such theory that positive discretionary behavior has a good impact to organizational performance, besides the flexibility that managers must manage things in the most appropriate would be a result of free course of action in managerial discretion.

## 5 Conclusion and implication for future research

Regarding managerial discretion for several decades, a central question in the literature on business strategy and organizations has been the degree to which managers are free to choose courses of action and whether these choices bring about intended outcomes. On the contrary, there is a point of discussion that high levels of discretion encourage managers to appropriate wealth from stakeholders and thereby impair firm performance, which argue that firms should limit managerial discretion. However, theoretical part of this paper identifies simple/line structure is attributed to an organizational structure in which characterized by a low degree of departmentalization, wide spans of control, authority centralized in a single person, and little formalization are hindering management to exercise managerial discretion.

Since the dynamic nature of business environment requires a professional and talented manager, organizations structures shall introduce flexibility and underpin man-

agement staff by giving autonomous decision for managers. On compromising latitude of actions and latitude of objectives managerial discretion can be affected by organization and external level as well. On this regard, the conflict of interest through stakeholders; like owners, finance on one side and managers (those who run the business) on the other hand shall be harmonized for the success of the company as long as all are on the same page.

Hence, at a concluding remark since the central question on theoretical part of literatures focuses on the degree to which managers are free to choose courses action or exercise managerial discretion and whether these choices bring about intended outcomes, the management strategic decisions therefore have to be making autonomous decision to meet company objectives.

In addition, both hypothetically and the data that has been collected indicates those managers who are free to choose course of action, having a room for discretionary behavior, broader in their orientation and did their job in latitude have led to company success than those company which managed by owner-manager which hamper course of action. At last, even if there are plenty of chances on getting literatures on managerial discretion, it is unlikely to find a case study specific to this research topic. Hence, this research article will contribute for business owners to investigate the reason of why they are unfamiliar to exercise course of actions by managers and able to assess the result of introducing managerial discretion. In addition, it will be a point of discussion to conduct future research and contribute to research gaps; like, by undertaking a hypothesis study of the relationship between managerial discretion and organization performance.

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