Chapter 2
Strategy

Chapter Outline

Organization-Environment Interface

Organizations operate in a dynamic environment; external and internal forces are continually changing. To use a sports metaphor, both the playing field and the rules of the game are constantly being revised for organizations. Products that were popular yesterday may be obsolete today; reliable customers who were satisfied last week may buy from a competitor this week, and last month's suppliers may have gone out of business.

Strategy is defined as the combination of plans to achieve a desired objective and the methods of implementing them. To use another sports metaphor, a strategy is a game plan. Strategy has generally been used in a military context to refer to the coordinated action plans a military unit intends to use to defeat its enemy. The deployment of troops, the timing of the attack, and the means of deception are all part of military strategy.

To survive in a dynamic environment, organizations must be prepared to diagnose their opportunities and revise their strategies. Choosing the right strategy usually makes the difference between success or failure. But good strategies depend on good alignment and implementation; new strategies require corresponding changes throughout the organization.

Visions, Missions, and Strategy

An effective organization begins with a ***vision*** that explains what it must do to be successful and a ***mission*** that identifies what it should become. Organizations are created for a purpose and they function more effectively when all stakeholders have a clear understanding of the organizations' vision, mission, and strategy.

Vision. An organization is formed when someone has a vision or idea about the kind of product or service the company ought to create. Even nonprofit organizations have a shared understanding of what the organization is trying to accomplish or how it will improve the lives of people. The vast majority of organizations are started as small family-run businesses by a founder who has such a vision. Even large corporations were once started as small companies with a vision of a founder. Effective organizations depend on the existence of a powerful shared vision that evolves and is refined through wide participation. Effective organizations usually have a written vision statement that defines success for the company and the pursuit of this image effectively motivates people to work. It is the power of a shared vision that usually inspires and unites people more than the charisma of a leader. A vision statement should be realistic and credible, well articulated and easily understood, appropriate, ambitious, and responsive to change. It should orient the group's energies and serve as a guide to action. It should also be consistent with the organization's values. A vision should challenge and inspire the group to achieve its mission.

Mission. Visions become translated into organizational missions that describe what the organization is designed to accomplish. Missions are similar to visions; but while visions are broad, general statements of purpose, mission statements are more specific. Written mission statements help to focus the energies and efforts of their members by answering such questions as questions: Why does our organization exist? What business are we in? What values will guide us? Organizational goals and objectives are usually derived from the mission statement and are even more specific. While mission statements are not measurable, goals and objectives ought to be.

Strategy. Strategy is about winning and succeeding. In a business organization, strategy is about profits; it explains how the firm plans to make money now and in the future. A good strategy helps it to remain profitable and continue to grow. Firms that have a sustained competitive advantage are able to provide above-average profits for their investors; while firms that do not have a sustained competitive advantage or that are not competing in an attractive industry earn at best only average profits and seldom survive. Strategies are also important to non-profit companies, such as hospitals, universities, and government agencies. Every organization needs to have a strategy that is consistent with its mission and it needs to be revised as needed. Most current organizations adopt one of these strategies:

1 ***Cost leadership***: being the low-cost producer

2 ***Differentiation:*** being an innovative leader with a unique product or service

3 ***Focus***: selling a special product or service within a limited segment of a market.

These strategic decisions, which are explained at the end of the chapter, have a profound impact on the effectiveness and survival of an organization and they also have an impact on its internal structure and processes. An organization's structure needs to match its strategic mission. If management makes a significant change in the organization's strategy, the structure will need to be modified to accommodate and support the change. Four ***grand strategies*** have been identified that summarize the tactical direction most organizations are taking:

1 A ***growth strategy*** attempts to increase the level of the organization's operations through increased sales revenues, more employees, or greater market share. This can be achieved through expanding the current operations or through acquisitions and mergers.

2 A ***stability strategy*** is characterized by an absence of significant changes, which means that the organization continues to serve its same market and customers while maintaining its market

share.

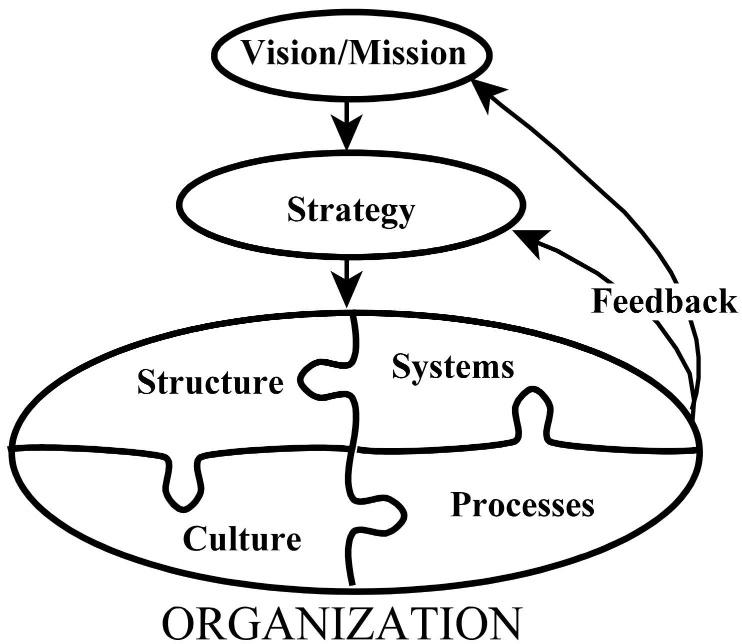
3 A ***retrenchment strategy*** involves reducing the size of the organization by scaling back its operations, reducing its work force, or selling less profitable product lines. This strategy is often selected in response to intense foreign competition.

4 A ***combination strategy*** occurs when an organization is simultaneously pursuing two or more of the strategies above. This strategy is quite common since many companies trim less-profitable product lines so they can grow by focusing on more profitable lines.

Structure, Systems, Culture, and Processes

The events that transpire within an organization are a consequence of its mission and strategy as illustrated in Exhibit 2.1. If we want to make organizations more effective, we need to understand what happens in them; we must know what to look for and how to recognize the essential characteristics. Knowing what to look for involves an understanding of four organizational characteristics: structure, systems, culture, and processes.

Exhibit 2.1: Designing Effective Organizations



Structure. Structure refers to the fixed relationships of the organization, such as how jobs are assigned to departments, who reports to whom, and how the jobs and the departments are arranged in an organizational chart. The structure of an organization has a large influence on the behavior of people and the effectiveness of the organization. Poorly structured organizations can create confusion and wasted effort. Even highly motivated people cannot overcome the effects of an ineffective structure. The impact of different organizational structures on profitability and effectiveness are examined in chapter 15.

Systems. Systems refer to the patterned activities that keep an organization operating. As explained in chapter 1, the most important systems are the procurement, production, disposal, human resource, adaptive, and managerial subsystems.

Culture. Organizational culture refers to the system of shared values and beliefs that influence worker behavior. Each organization creates its own distinctive culture much like people have distinctive personalities. This culture is based on the values that seem to be widely shared among members of the organization and they are reflected in the rituals and ceremonies that are held, the traditions that are celebrated, and the stories and myths that are circulated among workers. In times of uncertainty, an organization's culture guides the behavior of members and creates a sense of stability and direction.

Processes. Organizational processes refer to the interactions among members of the organization. Some of the major organizational processes are the human resource functions of recruiting and staffing that provide the right people in the right jobs at the right time. Other important organizational processes include communication, decision-making, leadership, and power. A major consideration in designing an effective structure is providing for these processes to be accomplished efficiently. For example, effective methods for collecting and communicating useful information need to be integrated within the organizational structure.

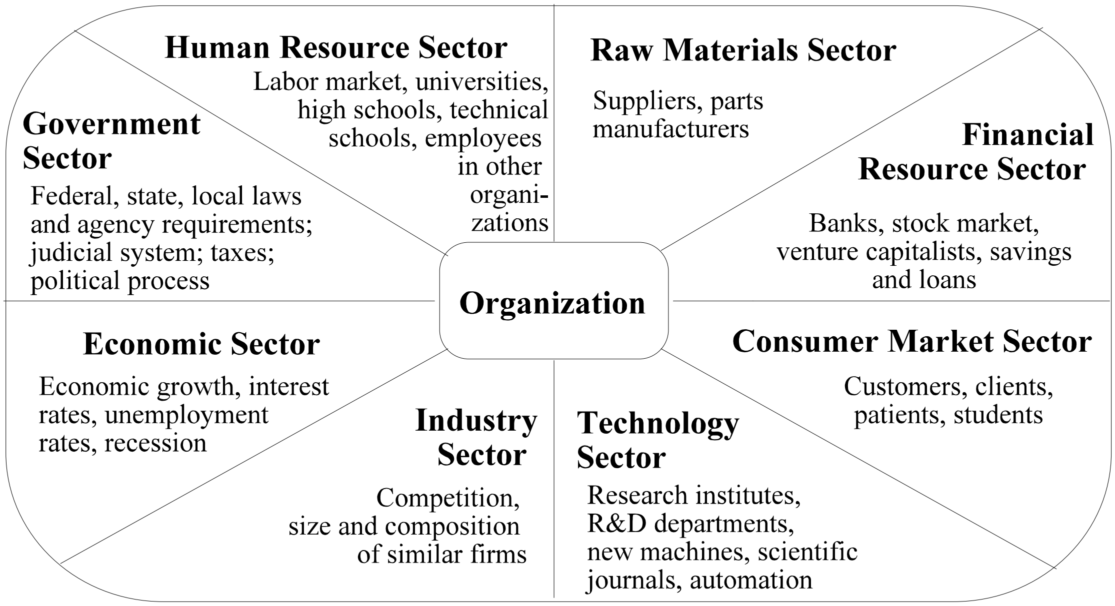
Environmental Sectors

All organizations are required to interact with their environment. Organizations depend on the environment to provide the necessary resources and to consume its products. The products must be acceptable to society, and the organization needs to obtain a favorable exchange so that it can recycle the products and convert them into new resources.

The existence of an organization can be threatened by public disapproval. Organizations can be terminated or drastically restricted if society disapproves of the organization's products, the way they are produced, or the organization's failure to comply with social expectations, such as safety requirements, environmental pollution standards, tariff agreements, and other legal requirements. The environment of tobacco companies, for example, has become increasingly hostile because of adverse scientific research, changing social customs, and anti-smoking laws.

In a broad sense, an organization's environment is infinite and includes everything outside the organization. It is more useful, however, to focus on specific elements that influence it, called the organization's ***domain***, which can be divided into sub-environments or *sectors* that contain similar elements.[1] Each sector represents an important segment of the environment that has the potential for influencing the survival and effectiveness of the organization. Eight of the most important sectors are shown in Exhibit 2.2.[2] In strategic planning, a firm would want to examine each of these sectors to discover any competitive advantages it could adopt or weaknesses it should avoid.

EXHIBIT 2.2 The Environmental Sectors of an Organization



1. *Human resources sector*. The human resources sector includes the labor market and all the sources from which potential employees may be obtained, including employment agencies, universities, technical schools, and other educational institutions. Employees can also be pirated from other organizations.

2. *Raw materials sector*. Raw materials must be obtained from the external environment. These materials include everything from paper and students for a university, patients for a hospital, iron ore for a steel mill, and insecticide for a farm. The raw materials sector for the auto industry includes a large number of suppliers and parts manufacturers.

3. *Financial resources sector*. Money is an essential input for most organizations and an especially crucial input for a new company. The financial resources sector includes places where needed money can be obtained, such as banks, savings and loan institutions, stock markets, and venture capitalists.

4. *Consumer markets*. The outputs produced by the organization must be consumed by customers who purchase the goods and services. This market sector includes the customers, clients, and potential users of the organization's products and services. For example, hospitals serve patients, schools serve students, supermarkets supply homemakers, airlines move travelers, and government agencies serve the public.

5. *Technology sector*. Technology is the use of available knowledge and techniques to produce goods and services. The technology sector includes scientific research centers, universities, and the research and development efforts of other organizations that contribute to new production techniques and the creation of new knowledge.

6. *Industry sector*. An industry encompasses all the organizations in the same type of business,

most of whom act as competitors to an organization. The size of the industry and the number of other competing firms create a unique industry sector for each organization. An industry dominated by one or two major corporations, such as heavy-equipment-manufacturing, is much different from an industry characterized by hundreds of small companies, such as the fast-food industry.

7. *Economics sector*. Organizations are not isolated from economic conditions. The success and effectiveness of an organization is influenced by the health of the overall economy and by such factors as whether the economy is expanding or contracting. Some of the most important aspects of this sector include economic growth, unemployment rates, recessions, inflation rates, and the rate of investment.

8. *Government sector*. The government sector includes all the federal, state, and local laws plus the regulatory agencies that administer these laws, and the judicial system that resolves disputes. This sector also includes the political system and political action committees and lobbyists who try to change the laws and obtain favorable legislative treatment.

Boundary-Spanning Roles

Because of uncertainty about the environment, organizations create a series of buffering departments to help them absorb the impact of the environment. An organization can be viewed as a technical core surrounded by departments that buffer the organization.[3] The purpose of these buffering departments is to protect the organization and help it adapt to an uncertain environment. The goal of buffer departments is to make the technical core as stable as possible so it can function efficiently. Examples of buffering departments are shown in Exhibit 2.3.

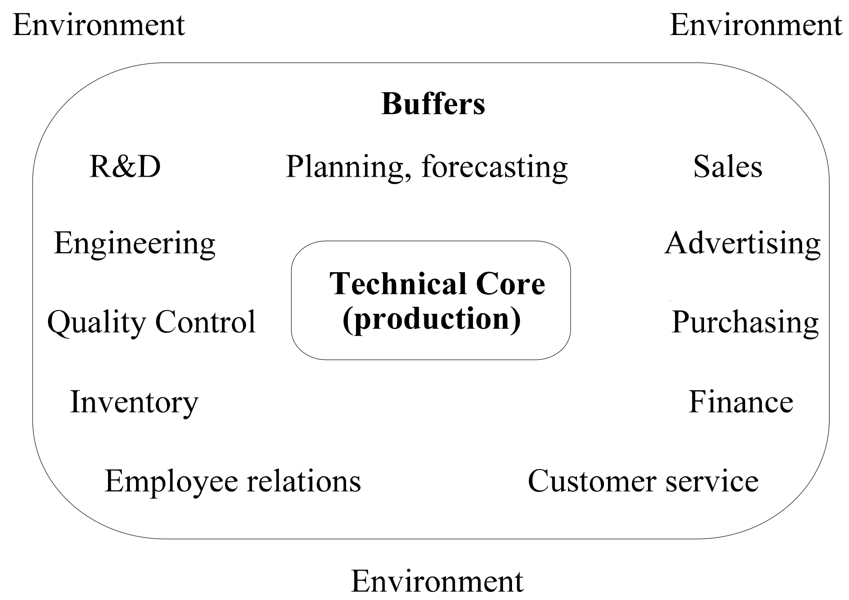
The activities of buffering departments are called ***boundary-spanning roles*** because they link and coordinate the organization with key elements in the environment. They serve two major purposes: (1) to gather and process information about environmental changes; and (2) to represent the organization to the environment. By communicating information between the environment and the organization, plans and activities can be coordinated and uncertainty can be reduced. This information helps the organization adapt to the environment or prepare to change the environment if needed.

Environmental Uncertainty

All organizations function in an uncertain environment, but the uncertainty is much greater for some organizations than others. Reducing this uncertainty may be important to an organization's effectiveness and survival.

Complexity and Stability. When the environment is uncertain managers have difficulty predicting external changes and they have to make decisions with insufficient information. Producing viable products requires good information about such things as consumer interests and the availability of resources. Uncertainty also increases the risk of failure and makes it difficult to compute the costs and probabilities associated with different decisions.

EXHIBIT 2.3 Boundary-Spanning Roles That Buffer an Organization



Organizational uncertainty is determined by two dimensions: complexity and stability, as shown in Exhibit 2.4.[4] ***Environmental complexity*** concerns the number of external elements relevant to an organization. In a simple environment, the organization interacts with only a small number of external elements. For example, a family-operated chicken farm that sells most of its eggs to one food chain has a very simple environment. In a complex environment, however, the organization must interact with a large number of diverse external elements. Automobile companies, for example, interact with hundreds of parts suppliers located in many different countries plus hundreds of dealerships scattered throughout the world. Furthermore, they interact with countless elements in the human resources sector in acquiring new employees plus dozens of agencies from the government sector.

How rapidly the environment changes is called ***environmental stability*** and it is stable when it remains relatively unchanged for several years. Some organizations enjoy a very stable environment, such as lead pipe manufacturers whose pipe and connecting joints have remained virtually unchanged for many years. Other organizations have a very unstable environment, such as the electronics industry whose products may become obsolete overnight because of technological advances and new scientific discoveries. The actions of competitors and the unpredictability of the market also contribute to making the electronics industry a very unstable environment.

Reducing Uncertainty. Because uncertainty threatens organizational survival and reduces its effectiveness, organizations use a variety of strategies to reduce environmental uncertainty. Most of these efforts focus on gaining greater control over environmental resources. The first two strategies listed here, however, involve internal changes within the organization.

EXHIBIT 2.4 Framework for Evaluating Environmental Uncertainty

ENVIRONMENTAL COMPLEXITY

ENVIRONMENTAL STABILITY	**Simple**	**Complex**
Stable	**Simple + Stable = Low Uncertainty** *Examples:* Soft drink bottlers, beer distributors, container manufacturers, agricultural farms, auto repair shops.	**Complex + Stable = Low Moderate Uncertainty** *Examples:* Universities, hospitals, insurance companies, government agencies
Unstable	**Simple + Unstable = High Moderate Uncertainty** *Examples:* Software companies, fashion clothing, music industry, toy manufacturers	**Complex + Unstable = High Uncertainty** *Examples:* Airline companies, oil companies, computer firms, aerospace firms, auto industry

Source: Adapted from Duncan, R., "Characteristics of Organizational Environments and Perceived Environmental Uncertainty," *Administrative Science Quarterly,* vol. 17 (1972): 320.

1. *Changing the organizational structure*. As the environment becomes more complex, the organization needs more buffering departments and boundary spanners. In a stable environment, the internal structure can be centralized and can operate according to fixed rules and procedures. When the environment is unstable, however, the organization's structure must be informal, decentralized, and coordinated by the efforts of many individuals whose specific responsibility is to facilitate this control.

2. *Planning and forecasting*. Organizations can increase their capacity to respond to an unstable environment by forecasting environment changes and creating contingency plans. Planning can soften the adverse impact of external shifts. Organizations that have unstable environments frequently create separate planning departments to help the organization adapt successfully. For example, economic forecasting may not change the economy any more than weather forecasting can change the weather. However, a good economic forecast may be as helpful to organizational planning as a weather forecast is for scheduling a company picnic. An interesting paradox regarding economic forecasts is that their accuracy increases as the environment becomes more stable, but their usefulness increases as the environment becomes more unstable. Although forecasts in an unstable environment are not as accurate, they are nevertheless more useful because they identify the important contingencies and the relationships between them and forecasts can always be updated.

3. *Mergers and acquisitions*. An effective method of controlling environmental resources is to buy a controlling interest in an upstream or downstream company that serves as a supplier or consumer. If there is uncertainty about the source of a crucial raw material, this uncertainty can be removed by buying the supplier. For example, steel companies have acquired iron and coal mines, and soft drink manufacturers have acquired bottle makers. A similar method of controlling environmental resources is through joint ventures and contracts that create a legal and binding relationship between two or more firms. In a joint venture, organizations share the risks

and costs associated with large projects. Contracts are designed to provide long-term security for both the supplier and the consumer of raw materials by tying the consumer and the supplier to specific amounts and prices. For example, McDonald's Corporation will sometimes acquire an entire crop of potatoes to be certain of its supply of french fries.

4. *Cooptation*. ***Cooptation*** is any strategy of bringing outside people into the organization and making them feel obligated to contribute because of their organizational involvement. Cooptation occurs when leaders of important environmental sectors are brought into the organization by having them serve on an advisory committee or a board of directors. Cooptation explains why organizations in more uncertain environments tend to have larger boards of directors—a larger board can reduce uncertainty to a greater degree.[5] Some organizations reduce their resource uncertainty by creating a formal linkage called an interlocking directorate in which the members of the board of directors of one company sit on the board of directors of another company. These individuals influence the policies and decisions of each organization in ways that guarantee their cooperation. Another form of cooptation is to recruit executives from another interdependent organization. For example, companies in the aerospace industry hire retired generals and executives from the Department of Defense to help them obtain better information about technical specifications and to improve their chances of obtaining defense contracts.

5. *Public relations and advertising*. Organizations spend enormous amounts of money to influence consumer tastes and public opinion. Advertising and public relations activities are designed to reduce uncertainty by providing a stable demand for the company's outputs or a constant level of inputs. Press reports and other news media shape the company's image in the minds of suppliers, customers, and government officials. Hospitals, for example, have begun to advertise their services to attract more patients.

6. *Political activity*. Since government legislation and agency enforcement can exert such a powerful influence on organizations, many of them spend a considerable amount of money on lobbyists and political action committees. These individuals strive to protect the interests of the organization by making members of governing bodies aware of the interests of the organization and the consequences of a proposed bill. Many organizations have formed trade associations for similar purposes, such as the National Association of Manufacturers. By pooling their resources, organizations expect the associations to have a larger voice in lobbying legislators, influencing new regulations, developing public relations campaigns, and blocking unfair competition.

7. *Illegal activities*. Although it is wrong, many organizations resort to illegal activities to control environmental uncertainty. Scarce environmental resources and pressures to succeed, especially from top managers, often lead managers to behave in illegal ways. Some examples of illegal behaviors include payoffs to foreign governments, illegal political contributions, promotional gifts, illegal kickbacks, price fixing, illegal mergers, franchise violations, refusals to bargain in good faith with a union, and espionage in market development and innovations.

Although organizations usually try to adapt to the environment, some try to change and control the environment. This is especially true of large organizations that command large resources. The environment is not fixed. Organizations can adapt when necessary, but they can also neutralize or alter a problematic sector in the environment. Although the potential of significantly influencing the environment is small when organizations act alone, a group of organizations can make a noticeable change within the environment when they act in concert.

Developing a Strategy

Organizations create generic strategies to help them survive in a dynamic and competitive environment. These generic strategies generally share several important characteristics:

< They identify the mission and goals the organization is striving to achieve.
< They have a long-term focus that extends beyond the immediate time horizon.
< They define the action plans the organization intends to follow to achieve its mission and goals.
< They explicitly recognize the impact of the external environment, especially the reactions of competitors.

An organization's strategy determines the direction it will go and serves to coalesce the energies of many people and departments in a unified effort. Good strategies help organizational leaders make consistent and effective decisions. They also communicate expectations and coordinate the actions of the members. For example, decisions about product quality and where they will be marketed are important strategic decisions. An organization that decides to produce high quality products and compete in the markets of highly industrialized nations is pursuing a much different strategy than a company that decides to produce inferior products and sell them in underdeveloped countries. Such was the case with the Korean company, Daewoo Group, which decided to focus its markets in the third world because of criticism regarding its poor quality and poor after-sales service.[6]

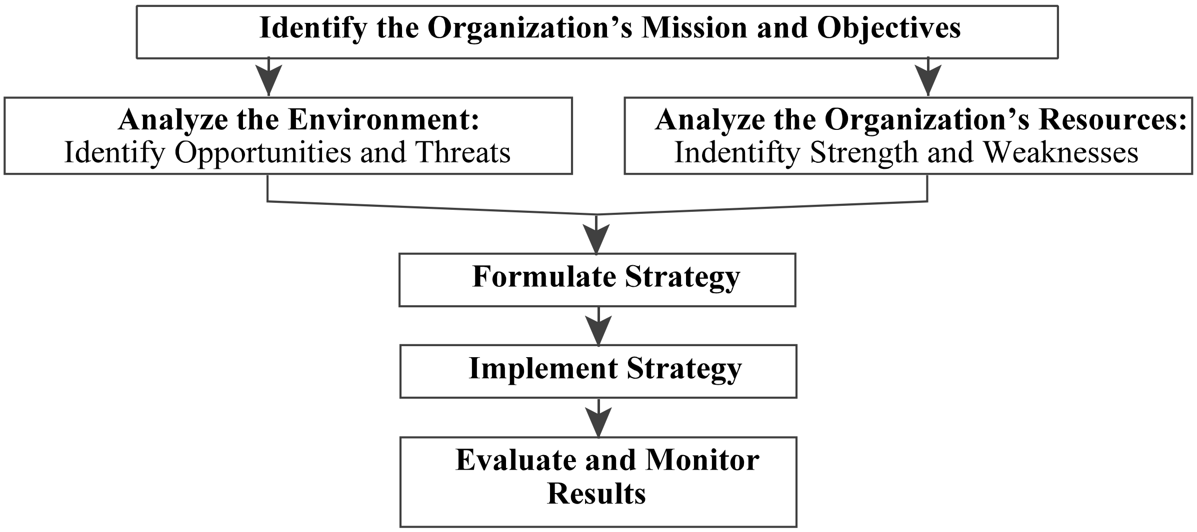
Strategic Management Process

A good strategy contains a shared vision about the company's mission and a coordinated set of action plans to help members know how to overcome opposition. The strategic management process consists of six steps as illustrated in Exhibit 2.5.

1 The first step is to identify the organization's mission and decide "What business are we in?" This step forces management to carefully identify the scope of its products or services. Sometimes it is just as important to know what businesses they do not want to pursue as what they do want to pursue.

2 The second step is to analyze the environment and identify opportunities it wants to pursue and threats it wants to avoid. This process, called ***environmental scanning***, involves anticipating and interpreting changes in the environment and usually requires screening diverse information to detect emerging trends. There is some evidence indicating that companies that scan the environment achieve higher profits and revenue growth than companies that don't.

Exhibit 2.5: Strategic Management Process



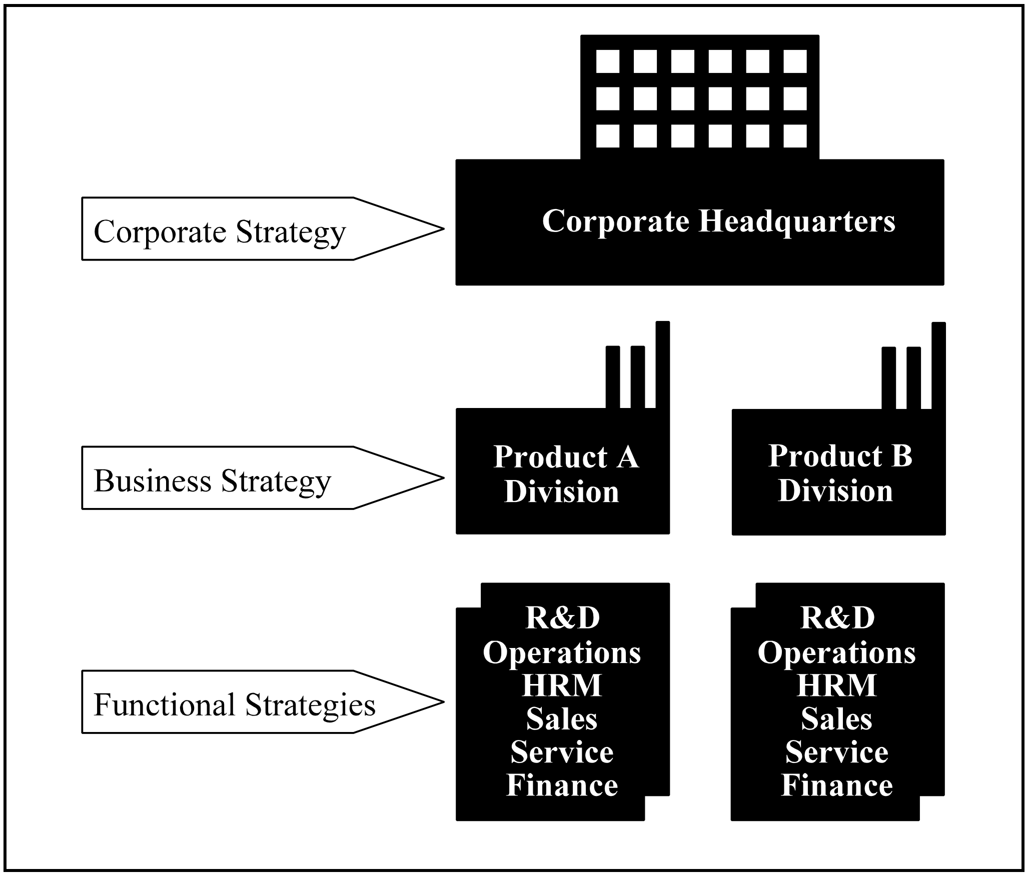
3 The third step is to analyze the organization's resources and identify it's strengths and weaknesses. What are it's skills and abilities? What unique knowledge and patents does it possess? Has it been successful at developing new and innovative products or services? What is its reputation for quality? Unique skills or resources that give an organization a competitive edge are called its ***core competency***. Conversely, those resources that an organization lacks or activities that the firm does not do well are its weaknesses.

4 The fourth step is to combine the external and internal analyses and formulate an overall generic strategy for the organization to follow plus functional strategies for each organizational function, as illustrated in exhibit 2.6. These functional strategies need to be aligned with the generic strategy so that the entire organization is acting in concert.

5 The fifth step is implementation. Even good strategies must be implemented properly or they will not succeed. Good implementation usually requires competent leaders who have the foresight and vision to know which direction to pursue and the confidence and trust of the members to encourage their involvement.

6 The sixth step is to evaluate and monitor the organization's results and maintain its competitive advantage. Long-term success with any strategy requires that the advantage be sustainable. That is, it must withstand both the actions of competitors and the evolutionary changes in the industry. This is a difficult challenge since technology is continually changing, customer preferences are not stable, and competitors frequently try to imitate successful organizations.

Exhibit 2.6: Levels of Strategy and Organization Structure



Writing Mission Statements

A mission statement explains the essence of an organization – why it exists, what it wants to be, who it serves, and why it should continue. It is based on the organization's assumptions about its purpose, its values, its distinctive competencies, and its place in the world. Although there are no commonly accepted guidelines for writing mission statements, the following elements are usually found in most carefully crafted statements:

1 A *purpose statement*: This statement explains what the organization seeks to accomplish and why it deserves the commitment of members and support of the public. Purpose statements try to answer such questions as "How is the world going to be different?" and "What is going to change?" and "How will things be better?"

2 The *business statement*: This statement identifies the organization's business activities or functions, such as to produce and transport alfalfa (for a ranch) or to construct affordable housing for first-time home owners (for a construction firm).

3 *Values statements*: These statements explain which values and beliefs the members of the organization hold in common and endeavor to practice. Some of the most common values statements include a commitment to quality service, innovation, diversity, creativity, honesty, integrity, and personal development.

The characteristics of a useful mission statement include:

1 It should identify the purposes of the organization clearly enough that measurable objectives can be derived from them. A clear formulation of the firm's objectives will enable progress toward them to be measured.

2 It should differentiate the firm from other companies in the industry and establish its individuality and uniqueness.

3 It should define the business – in other words, the activities and programs – that the company wants to be in.

4 It should identify and explain the firm's relationships and obligations to all relevant stakeholders.

5 It should explain how it will contribute to society and the betterment of people well enough to be exciting and inspiring.

A segment of Hewlett-Packard's mission statement illustrates these characteristics:

> Hewlett-Packard Company designs, manufactures, and services electronic products and systems for measurement, computing, and communication used by people in industry, business, engineering, science, medicine, and education.
>
> HP's basic business purpose is to accelerate the advancement of knowledge and improve the effectiveness of people and organizations. The company's more than 25,000 products include computers and peripheral products, electronic test and measurement instruments and systems, networking products, medical electronic equipment, instruments and systems for chemical analysis, handheld calculators and electronic components.[7]

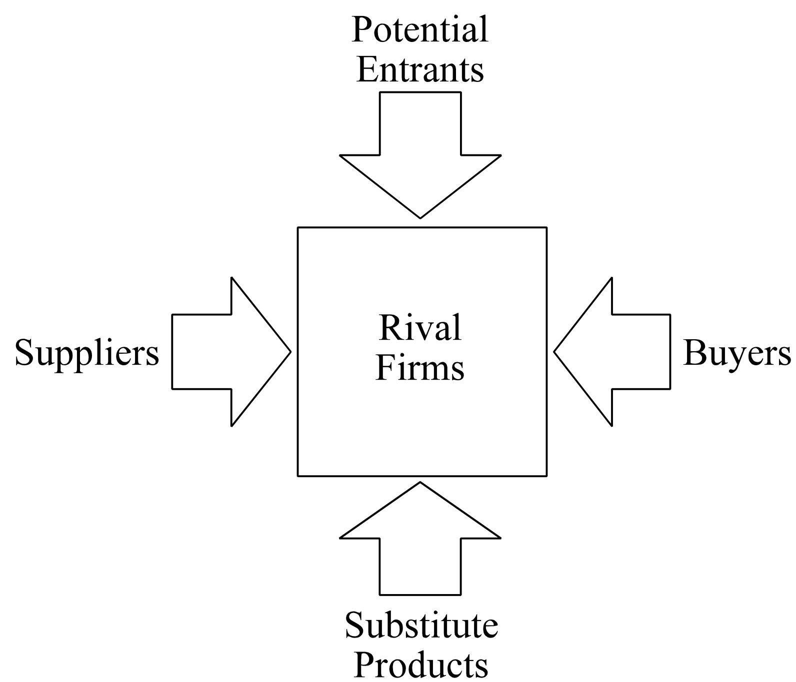
Analyzing the Environment

We live in a world that has become a global economy. Virtually every nation participates in the production and consumption of goods and services that move around the globe crossing economic, cultural, and political boundaries. Globalization has encouraged international integration. For example, financial resources from one country may be used to buy natural resources from another country and be manufactured in still another country and distributed worldwide. But it has also led to intense competitive pressures for companies everywhere in the world. These conditions force global companies to think seriously about the strategies required to sustain their competitive advantage.

One strategy model focuses on helping firms identify their competitive niche in the external environment by selecting a profitable industry and competing effectively in it. The ***industrial organization model***, or I/O model, suggests that the conditions and characteristics of the external environment are the primary determinants of successful strategies that will help firms earn above-average profits.[8]

Industry Analysis. Firms face the challenge of finding the most attractive industry in which to compete. Because most firms are assumed to have equal access to similar resources that are mobile across companies, competitiveness generally can be increased only when they find the industry with the highest profit potential and learn how to use their resources to formulate and implement the strategy required by that industry. Michael Porter has developed a ***five forces model of competition*** that identifies the major environmental forces of an industry analysis, as illustrated in exhibit 2.7.[9] This five forces model suggests that an industry's profit potential is a function of the interactions among these five forces. Organizations can use this analysis to examine an industry's profit potential and to establish a defensible competitive position given the industry's structural characteristics. The five forces are suppliers, buyers, rival firms, product substitutes, and the threat of new entrants.

Exhibit 2.7: The Five Force Model



Source: Adapted from Michael Porter, *Competitive Strategy*, (New York: Free Press, 1980), p. 4.

1 *Suppliers*. Firms depend on their suppliers for materials to which they provide added value. The power of suppliers depends on such factors as how many suppliers are available, whether there are satisfactory substitute supplies, and whether a supplier might choose to integrate forward, such as a bakery deciding to open its own retail outlet.

2 *Buyers*. Firms seek to maximize their revenues, while buyers want to purchase goods at the lowest possible price. The power of buyers increases when there are many competing products, when the products are similar, or when only one or a few buyers purchase the entire output.

3 *Rival firms*. Competition among rivals is stimulated when one or more firms identifies an opportunity to improve their market position or when they feel competitive pressures. Since the firms in an industry are mutually dependent on each other, a competitive advance by one (such as frequent flyer mileage in the airline industry) usually precipitates corresponding moves by all of the others. Rivalry is especially strong when most of the firms are equally balanced and feel a need to distinguish themselves, when the market is not expanding and firms fear a loss of market

share, and when the products are not unique and can be easily replaced.

4 *Substitute Products.* Firms compete against other firms that offer substitute products. Therefore, substitute products place an upper limit on the prices firms can charge since substitutes will be used whenever the price of the product exceeds the price of the substitute. The threat of substitute products is strong when customers can easily switch to the substitute and when the substitute's quality is high and its costs are low. For example, Nutrasweet is a substitute for sugar, since they perform similar functions, and the price of Nutrasweet provides an upper limit on the price of sugar.

5 *New entrants*. New entrants threatens existing competitors by providing additional production capacity. Unless there is a corresponding increase in the demand for additional production there will likely be price cuts and a corresponding loss of revenues and profits for all firms. Existing competitors try to develop barriers to new entrants, while new entrants seek markets where the barriers are relatively weak. Some of the most challenging entry barriers are inefficient economies of scale for new entrants (small operations do not benefit from large production runs), unrecognized product differentiation (customers are not familiar with the new product), insufficient starting capital (significant funds are needed for a firm's initial resources in physical facilities and inventory), limited access to distribution channels (new firms do not have established relationships with distributors), and historical cost disadvantages (the established competitors have already acquired the most favorable locations, proprietary product technology, and favorable access to raw materials).

Competitor Analysis. In addition to analyzing the overall industry, firms also need to analyze each company with which they directly compete. This assessment, called a ***competitor analysis***, is especially critical for firms facing one or a few powerful competitors. In the airline industry, for example, each airline is vitally interested in what other airlines are doing. Are they changing their routes or prices, are they purchasing new planes or increasing their work force, and are they providing new or improved services or benefits?

Successful companies perform a competitor analysis for each competing firm in their industry. This analysis involves examining each competitor's future objectives, current strategy, assumptions, and capabilities. The kinds of questions involved in this analysis are:[10]

1 Future objectives: How do our goals compare to our competitors' goals? What will we emphasize in the future? What is our attitude and the attitudes of others toward risk?

2 Current strategy: How are we currently competing? Does this strategy support changes in the competitive structure?

3 Assumptions: Do we assume the future will be volatile or stable? Are we operating under a status quo or are we advancing? What assumptions do our competitors hold about the industry and about themselves?

4 Capabilities: What are the strengths and the weaknesses of each competitor? How do we rate compared to our competitors?

An effective competitor analysis requires gathering needed information and data, referred to as

competitor intelligence. Information needs to be obtained about each competitor's customers, distribution channels, marketing, sales, advertising, finances, operations, organizational structure, research and development, and strategic plans. Analysts have an obligation to obtain this information in ways that are ethical. Stealing drawings or documents, eavesdropping, and trespassing are unethical and illegal methods of collecting information. However, techniques that are generally considered both legal and ethical include (a) obtaining publicly available information, such as court records, help-wanted ads, annual reports, financial reports of publicly held corporations, and Uniform Commercial Code filings, and (b) attending trade fairs and shows to obtain brochures and advertisements, view their exhibits, and listen to discussions about their products.

The morality of several intelligence-gathering techniques is highly questionable even if they are technically legal, such as paying someone to serve as an impostor (such as a student, a management consultant, or a reporter) to obtain inside information, conducting job interviews for jobs that don't exist in hopes that a competitor's employees will apply and volunteer inside information, hiring a competitor's key employees to obtain knowledge about technological innovations, and purchasing a competitor's trash to obtain documents and other inside information. As a general rule, information-gathering techniques ought to respect the right of competitors not to reveal information about their products, operations, and strategic intentions that they do not want divulged. When evaluating the ethics of such cases, the Golden Rule should serve as a useful moral guideline.

Analyze the Firm's Resources

Although strategy focuses mostly on the external environment, internal conditions within each organization also play a major role in strategy formulation and implementation. This view is referred to as the ***resource-based theory of the firm*** and it provides a very different focus on the sources of competitive advantage. According to Jay Barney, the person most frequently credited for the resource-based view, sustained competitive advantage results from the ownership and control of resources that are rare, valued by the market, non-tradable, non-substitutable, and difficult or impossible to imitate.[11] Such resources include physical assets, intangible resources, and organizational capabilities.

Resources and Capabilities. Some organizations are able to achieve a sustained competitive advantage and earn above-average profits because they possess unique resources or they have capabilities that provide a competitive edge and cannot be easily imitated. Many inputs into the firm's production process might act as unique resources, such as capital equipment, the skills of individual employees, patents, venture capital, and talented managers. These resources are often categorized into human resources, physical resources, and organizational capital resources.

This capability is usually referred to as its ***distinctive competence*** or ***core capability***. An illustration of a distinctive resource that is rare, non-substitutable, and virtually impossible to imitate is Walt Disney's animated characters. Although competitors have attempted to develop their own sets of animated characters, Mickey Mouse, Donald Duck, and other Disney characters are well recognized, very distinctive, and highly admired. Furthermore, Disney has exploited its capability to use these resources in producing universal and timeless entertainment in both animated films and theme parks. For Disney, this capability represents a distinctive competence.

Having a clear understanding of what is its distinctive competence is crucial when an organization is considering a diversification strategy. If the new diversification is able to leverage an existing skill base the organization will likely achieve high performance. But if the diversification requires acquiring a significantly different skill and knowledge set, it will be less likely to achieve high performance.

Organizational Structure. Many strategies have failed because the organization's structure, control systems, and reward systems were not adequately designed to implement the strategies. The vital relationship between strategy and organizational structure has been recognized at least since 1920 when DuPont and General Motors implemented innovative multidivisional structures that created separate product divisions. Each product division acted like an independent profit center. These multidivisional structures were needed to match the strategic changes in the organizations due to their size, managerial control, and reward systems.

Strategies and structures must be aligned. An intended strategy has a substantial impact on how a firm is structured, which in turn affects its strategy. For example, a strategy that attempts to diversify responsibility for decision making by creating independent profit centers or autonomous work teams requires a multidivisional structure. However, a multidivisional structure would be highly inappropriate for a firm that had a strategy requiring central coordination and tight control. Likewise, a small firm following a single-business strategy requires a simple structure in which the owner-manager makes all major decisions and monitors all activities while the staff merely serve as an extension of the manager's authority. The competitive advantages of different organizational structures are discussed in the next chapter.

Formulating Strategy

Strategy formulation is not a systematic process that advances sequentially from one action plan or objective to another, although it is less chaotic in some organizations than others. Strategy formulation is a dynamic process that is evolutionary in nature and subject to change as external forces change. Since strategy focuses on the future and the future is uncertain, strategy needs to be flexible and ready to respond to revised conditions.

A popular approach to strategy development is the ***SWOT method*,** which stands for Strengths, Weaknesses, Opportunities, and Threats. Decision makers should examine the organization's competitive advantages relative to internal strengths and weaknesses, external opportunities and threats, and potential competitor actions. The SWOT approach to strategy formulation assumes that decision makers carefully analyze an organization's strengths, weaknesses, opportunities, and threats as they decide its future. This approach is a very proactive way to develop a strategy and it appears very clean and logical. However, it is not characteristic of the reactive way most organizational strategies develop.

Rather than creating a unified strategy based on a systematic analysis of the environment, most organizations formulate their strategies in response to problems. For example, a competitive threat, such as the sudden introduction of very inexpensive competing products, might first cause a company to reduce its price, then segment itself as a quality producer, then pursue a different product line, or finally seek to enter a different market.

Both proactive and reactive methods of strategy formulation are appropriate depending on the circumstances. In a stable environment, a proactive method can be used effectively to move the organization toward its long-term objectives. In an unstable environment, however, strategies need to be more flexible and responsive to change. There is a fine line between failing to proactively set the future course of the organization versus being inflexible and unable to reactively adapt to change.

Managers try to position their companies so that they can gain a relative advantage over their rivals. This positioning requires a careful evaluation of the competitive forces that dictate the rules of competition within the industry in which the organization operates. Michael Porter, one of the leading theorists in strategy formulation, has identified three approaches to maintain a competitive edge: cost leadership (being the low-cost producer), differentiation (having a unique product in a large market), and focus (having a unique product in a narrow market).[12]

Cost Leadership. Gaining a competitive advantage through cost leadership involves selling your products and services at a lower cost. This is usually achieved by technological innovations that improve the efficiency of operations or using low-cost labor that reduces the costs of production. Success with this strategy requires that the organization be the cost leader, not merely one of the contenders for that position. Furthermore, the products and services being offered must be perceived as comparable to or better than that offered by rivals. Companies that have used this strategy successfully include Southwest Airlines, Wal-Mart, and Canadian Tire.

Differentiation. A differentiation strategy involves providing unique products and services in ways that are widely valued by buyers. This can be achieved by providing exceptionally high quality, extraordinary service, innovative designs, technological capability, or an unusually positive brand image. Whatever attribute the company chooses to establish its uniqueness must be different from those offered by rivals and significant enough to justify its price premium. Exaggerated advertising claims and the customary hyperbole that borders on sheer deceit provide evidence that many firms rely on this strategy. Firms that have succeeded in finding a unique differentiating factor include Maytag on reliability, Mary Kay Cosmetics on distribution, and Nordstrom on customer service.

Focus Strategy. A focus strategy aims at either a cost advantage or a differentiation advantage in a narrow market segment. Companies that use this strategy select a defined segment of an industry, such as a particular product, a specific kind of end-use buyer, a defined distribution channel, or a limited geographical location, and target its strategy to serve them to the exclusion of others. The goal is to exploit a narrow segment of a market by appealing specifically to it. The success of a focus strategy may depend on how narrow the segment is. If the segment is too large, the strategy may suffer because of a lack of focus and uniqueness. But, an extremely small segment may limit a company's success until it expands to other segments.

Discussion Questions

1 What are the benefits that come from written mission statements? Write a mission statement for an organization or group with which you are affiliated or for your own personal life.

2 What makes some organizational environments more uncertain than others? Identify two contrasting organizations that have very different environments and describe their situations. Explain what the organization in the uncertain environment can do to reduce some of its uncertainty.

3 Explain the difference between these three strategies: cost leadership, differentiation, and focus. Describe a company where you have worked and explain which strategy it was using to compete. Also discuss how effectively you think it was following its strategy.

Notes

1. Richard L. Daft, *Organization Theory and Design*, 2nd ed. (Saint Paul, Minn.: West, 1986), chap. 2.

2. Ibid., pp. 49-55.

3. Ibid., pp. 59-66.

4. Ibid., p. 67.

5. Jeffrey Pfeffer, “Size and Composition of Corporate Boards of Directors: The Organization and Its Environment,” *Administrative Science Quarterly*, vol. 17 (1972), pp. 218-228.

6. Steve Glain, “Strategic Move: Daewoo Group Shifts Its Focus to Markets In the Third World,” *The Wall Street Journal*, October 11, 1993, p. A1.

7. Http://www.hp.com

8. Michael A. Hitt, R. Duane Ireland, and Robert E. Hoskisson, *Strategic Management: Competitiveness and Globalization*. (Minneapolis: West Publishing, 1995), Ch. 1.

9. Michael E. Porter, *Competitive Strategy: Techniques for Analyzing Industries and Competitors*. (New York: Free Press, 1980); Michael E. Porter, *Competitive Advantage*, (New York: Free Press, 1985).

10. Michael E. Porter, *Competitive Strategy: Techniques for Analyzing Industries and Competitors* (New York: Free Press, 1980), p. 49.

11. Jay B. Barney, Organizational Culture: Can it be a Source of Sustained Competitive Advantage?” *Academy of Management Review*, Nol. 11, (1986), pp. 656-665; Jay B. Barney, “Firm Resources and Sustained Competitive Advantage,” *Journal of Management,* vol. 17 (1991), pp. 99-120.

12. Michael E. Porter, *Competitive Advantage*, (New York: Free Press, 1985).