CHAPTER 11

Organizational Transformations: Birth, Growth, Decline, and Death

Learning Objectives

Organizations that successfully carve out a niche in their environments so that they can attract resources (such as customers) face a series of problems in their struggle for growth and survival. This chapter examines the organizational change and transformation problems that occur over the life cycle of an organization. Entrepreneurs and managers who understand the forces that lead to the birth of organizations, that influence how they grow and mature over time, and that eventually may cause their decline and death will be able to change their organization's strategy and structure to increase its effectiveness and chances of survival.

After reading this chapter you should be able to:

1. Appreciate the problems involved in surviving the perils of organizational birth and what actions founders can take to help their new organizations survive.
2. Describe the typical problems that arise as an organization grows and matures, and how an organization must change if it is to survive and prosper.
3. Discuss why organizational decline occurs, identify the stages of decline, and describe how managers can work to prevent the failure and even the death or dissolution of an organization.

The Organizational Life Cycle

Why do some organizations survive and prosper while others fail and die? Why do some organizations have the ability to manage their strategies, structures, and cultures to gain access to environmental resources while others fail at this task? To answer these questions, researchers suggest we need to understand the dynamics that affect organizations as they seek a satisfactory fit with their environment.[1] It is commonly believed that organizations experience a predictable sequence of stages of growth and change over time: the **organizational life cycle.**

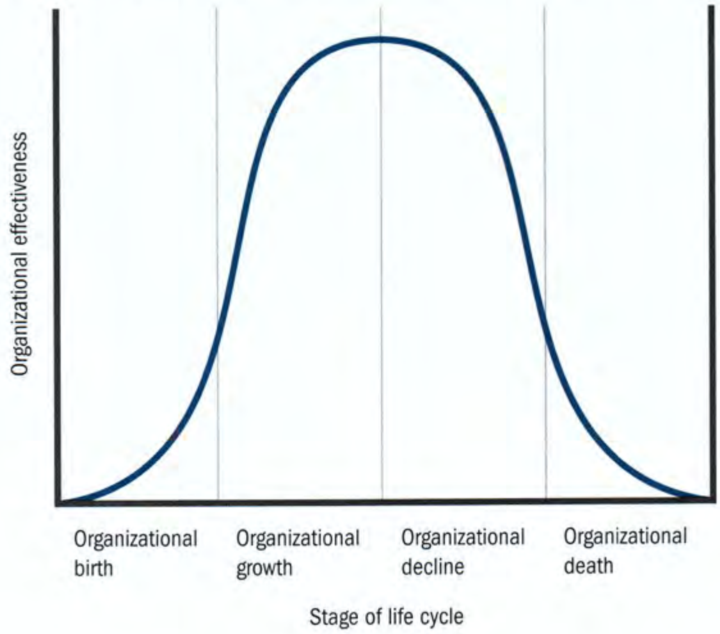
Organizational life cycle A sequence of stages of growth and development through which organizations may pass.

The four principal stages of the organizational life cycle are birth, growth, decline, and death (see Figure 11.1).[2] Organizations pass through these stages at different rates, and some do not experience every stage. Moreover, some companies go directly from birth to death without enjoying any growth if they do not attract customers or resources. Some organizations spend a long time in the growth stage, and many researchers have identified various substages of growth through which an organization must navigate. There are also substages of decline. Some organizations in decline take corrective action, change quickly, and turn themselves around.

The way an organization can change in response to the problems it confronts determines whether and when it will go on to the next stage in the life cycle and survive and prosper or fail and die. Each stage is examined in detail here.

Figure 11.1 A Model of the Organizational Life Cycle

Organizations pass through these four stages at different rates, and some do not experience every stage.



Organizational Birth

Entrepreneurs
People who recognize and take advantage of opportunities to use their skills and competences to create value.

Organizational birth
The founding of an organization: a dangerous life cycle stage associated with the greatest chance of failure.

Liability of newness
The dangers associated with being the first in a new environment.

Organizations are born when people called **entrepreneurs** recognize and take advantage of opportunities to use their skills and competences to utilize resources in new ways to create value.[3] Michael Dell found a new way to market low-priced computers to customers: mail order. Liz Claiborne took advantage of a growing niche in the women's clothing market—business attire for women. Dell and Claiborne saw an opportunity to create value (for computer users and businesswomen), and they both seized the opportunity to found an organization that could produce lower priced products—PCs and business attire—than the competition.

Organizational birth, the founding of an organization, is a dangerous stage of the life cycle and associated with the greatest chance of failure. The failure rate is high because new organizations experience the **liability of newness**—the dangers associated with being the first to operate in a new environment.[4] This liability is great for several reasons.

Entrepreneurship is an inherently risky process. Because entrepreneurs undertake *new* ventures, there is no way to predict or guarantee success.[5] Entrepreneurs bear this uncertainty because they stand to earn potentially enormous returns if their businesses take off. Much of the time, however, entrepreneurs make mistakes in judgment or planning, and the result is organizational death.[6]

A new organization is fragile because it lacks a formal structure to give its value-creation processes and actions reliability and stability. At first, all its activities are performed by trial and error; organizational structure emerges gradually as decisions are made about what roles, rules, and SOPs should be implemented. Eventually, for example, it may become clear that one manager should handle money coming in from customers (accounts receivable), another should control money being paid out to suppliers (accounts payable), and another should obtain new accounts. But at first, in a new organization, the structure is in the mind of the founder; it is not formalized in a chart or a set of rules. The structure is flexible and responsive, allowing the organization to adapt and continually improve its routines to meet the needs of its environment.

A flexible structure can be an advantage when it allows the organization to change and take advantage of new opportunities, but it can also be a disadvantage. A formal structure provides stability and certainty by serving as the organization's memory.

Structure specifies an organization's activities and the procedures for getting them done. If such procedures are not written down, a new organization can literally forget the skills and procedures that made it successful. A formal structure provides an organization with a firm foundation from which to improve on existing procedures and develop new ones.[7]

Another reason why organizational birth is a dangerous stage is that conditions in the environment may be hostile to a new organization. Resources, for example, may be scarce or difficult to obtain because many established organizations are competing for them.

Developing a Plan for a New Business

One way in which entrepreneurs can address all these issues is through the crafting of a business plan that outlines how they plan to compete in the environment. Table 11.1 lists the steps in the development of a business plan.

Planning for a new business begins when an entrepreneur notices an opportunity to develop a new or improved good or service for the whole market or for a specific market niche. For example, an entrepreneur might notice an opportunity in the fast-food market to provide customers with healthful fast food, such as rotisserie chicken served with fresh vegetables or burritos made with organic ingredients. This is what the founders of the Boston Market and Chipotle restaurant chains did.

The next step is to test the feasibility of the new product idea. The entrepreneur conducts as thorough a strategic planning exercise as possible, using SWOT analysis, the analysis of organizational strengths and weaknesses and environmental opportunities and threats. Potential threats might be that KFC will decide to imitate the idea and offer its customers rotisserie chicken, which KFC did after Boston Market identified the new market niche. The entrepreneur should conduct a thorough analysis of the external environment (see Chapter 3) to test the potential of a new product idea and must be willing to abandon an idea if it seems likely that the threats and risks may overwhelm the opportunities and returns. Entrepreneurship is always a very risky process, and many entrepreneurs become so committed to their new ideas that they ignore or discount the potential threats and forge ahead—only to lose their shirts.

If the environmental analysis suggests that the product idea is feasible, the next step is to examine the strengths and weaknesses of the idea. At this stage the main strength is the resources possessed by the entrepreneur. Does the entrepreneur have access to an adequate source of funds? Does the entrepreneur have any experience in the fast-food industry, such as managing a restaurant? To identify weaknesses, the entrepreneur needs to assess how many and what kind of resources will be necessary to establish a viable new

TABLE 11.1 Developing a Business Plan

1. Notice a product opportunity, and develop a basic business idea
   Goods/services
   Customers/markets
2. Conduct a strategic (SWOT) analysis
   Identify opportunities
   Identify threats
   Identify strengths
   Identify weaknesses
3. Decide whether the business opportunity is feasible
4. Prepare a detailed business plan
   Statement of mission, goals, and financial objectives
   Statement of strategic objectives
   List of necessary resources
   Organizational timeline of events

venture—such as a chain of burrito restaurants. Analysis might reveal that the new product idea will not generate an adequate return on investment. Or it might reveal that the entrepreneur needs to find partners to help provide the resources needed to open a chain on a sufficient scale to generate a high enough return on investment.

After conducting a thorough SWOT analysis, if the entrepreneur decides that the new product idea is feasible, the hard work begins: developing the actual business plan that will be used to attract investors or funds from banks. Included in the business plan should be the same basic elements as in the product development plan: (1) a statement of the organization's mission, goals, and financial objectives; (2) a statement of the organization's strategic objectives, including an analysis of the product's market potential, based on the SWOT analysis that has already been conducted; (3) a list of all the functional and organizational resources that will be required to implement the new product idea successfully, including a list of technological, financial, and human resource requirements; and (4) a timeline that contains specific milestones for the entrepreneur and others to use to measure the progress of the venture, such as target dates for the final design and the opening of the first restaurant.

Many entrepreneurs do not have the luxury of having a team of cross-functional managers to help develop a detailed business plan. This obviously is true for solo ventures. One reason why franchising has become so popular is that potential entrepreneurs can purchase and draw on the business plan and experience of an already existing company, thereby reducing the risks associated with opening a new business.

In sum, entrepreneurs have a number of significant challenges to confront and conquer if they are to be successful. It is not uncommon for an entrepreneur to fail repeatedly before he or she finds a venture that proves successful. It also is not uncommon for an entrepreneur who establishes a successful new company to sell it in order to move on to new ventures that promise new risks and returns. An example of just such a entrepreneur is Wayne Huizenga, who bought many small waste disposal companies to create the giant WMX waste disposal company, which he eventually sold. A few years later Huizenga took control of Blockbuster Video and, by opening and buying other video store chains, turned Blockbuster Video into the biggest video chain in the United States, only to sell it in 1994. A historical example of an entrepreneur who transformed the steel industry is presented in Organizational Insight 11.1.

Organizational Insight 11.1

Andrew Carnegie and Entrepreneurship

Andrew Carnegie was born in Scotland in 1835; he was the son of a master hand-loom weaver who, at that time, employed four apprentices to weave fine linen tablecloths.[8] His family was well-to-do, yet ten years later they were living in poverty. Why? Advances in weaving technology had led to the invention of steam-powered weaving looms that could produce large quantities of cotton cloth at a much lower price than was possible through hand-loom weaving. Hand-loom weavers could not compete at these low prices and Carnegie's father was put out of business. In 1848, his family, like hundreds of thousands of other families in Europe at this time, decided to emigrate to the United States to find work and survive.

The Carnegies settled near Pittsburgh, where they had relatives, and the father continued to weave tablecloths and sell them door to door, making around $6 dollars a week. His mother, who had come from a family of cobblers, took in shoes for repair and made around $4 a week. Carnegie found a job as a "bobbin boy," replacing spools of thread on power looms in a textile factory; he took home $1.20 for a 60-hour week.

Once his employer found out he could read and write, a rare skill at this time, he became a bookkeeper for the factory. In his spare time he became a telegraph messenger and learned telegraphy. He began to deliver telegrams to Tom Scott, a top manager at the Pennsylvania Railroad, who came to appreciate Carnegie's drive and talents. Scott made him his personal telegrapher for the astonishing sum of $35 a week. Carnegie was now 17. Only seven years later, when he was 24, he was promoted to Scott's job, as superintendent of the Western Division of the railroad. At 30, he was offered the top job of superintendent of the whole railroad! Carnegie had other ambitions, however. During his time at the railroad he had invested cleverly in railroad stock and was now a wealthy man, with an income of $48,000 a year, of which only $2,800 came from his railroad salary.

While a manager at the railroad, Carnegie had made his name by continually finding ways to use resources more productively to reduce costs and increase profitability. His company's stock price had shot up—which explains why he was offered the railroad's top job. Carnegie saw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an opportunity to apply his cost-cutting skills in the backward steel industry. Carnegie had noticed U.S. railroads' growing demand for steel as they built new U.S. railways rapidly in the 1860s. At that time, steel was made using small-batch production, an expensive, labor-intensive process we discussed in Chapter 9, and the steel produced cost $135 a ton.[9]

In searching for ways to reduce the steel-making costs, Carnegie was struck by the fact that many different companies performed each of the different operations necessary to convert iron ore into finished steel products. One company smelted iron ore into "pig iron"; another company then transported the pig iron to other companies that rolled the pig iron into bars or slabs. Many other companies then bought these bars and slabs and made them into finished products such as steel rails, nails, wire, and so on. Intermediaries who bought the products of one company and then sold them to another connected the activities of these different companies. The many exchanges, or "handoffs," involved in converting iron ore into finished products greatly increased operating costs. At each stage of the production process steel had to be shipped to the next company and reheated to allow it to become soft enough to work on. Moreover, these intermediaries were earning large profits for providing this service, which also raised the cost of the finished products.

Carnegie also noticed that the steel produced by British steel mills was of a higher quality than the steel made in U.S. mills. The British had made major advances in steel-making technology, and U.S. railroads preferred to buy their steel rails. Carnegie made frequent trips to Britain to sell U.S. railroad stock. On one trip he saw a demonstration of Sir Henry Bessemer's new "hot blasting" method for making steel. Bessemer's famous process made it possible to produce great quantities of higher-quality steel continuously, as a process, not in small batches. Carnegie instantly realized the enormous cost-saving potential of the new technology. He rushed to become the first steel maker in the United States to adopt it.[10]

Carnegie sold all his stocks and invested his capital to create the Carnegie Steel Company, which was the first low-cost Bessemer steel-making plant in the United States. Determined to retain the profit that intermediaries were making in his business, he also decided his company would perform all the steel-making operations necessary to convert iron ore into finished products. For example, he constructed rolling mills to make steel rails next to his blast furnace so that iron ore could be converted into finished steel products in one continuous process.

Carnegie's innovations led to a dramatic fall in steel-making costs and revolutionized the U.S. steel industry. His new production methods reduced the price of U.S. steel from $135 a ton to $121, yet his company was enormously profitable, with a profit margin between 35% and 50%. Most of his competitors could not compete with his low prices and were driven out of business. He plowed back all his profits into building his steel business and constructed many new low-cost steel plants. By 1900, his company became the leading U.S. steel maker, and he was one of the richest men in the world.

A Population Ecology Model of Organizational Birth

The way in which Carnegie transformed the U.S. steel industry is a story about how and why the number and nature of companies in an industry changes over time. **Population ecology theory** seeks to explain the factors that affect the rate at which new organizations are born (and die) in a population of existing organizations.[11] A **population of organizations** comprises the organizations that are competing for the *same* set of resources in the environment. All the fast-food restaurants in Houston, Texas, constitute a population of restaurants that compete to obtain environmental resources in the form of dollars that people are willing to spend on to obtain food conveniently. Apple, Dell, HP, Lenovo, Acer, and the other PC companies constitute a population of organizations that are seeking to attract environmental resources in the form of dollars that consumers are willing to spend on personal computing. Different organizations within a population may choose to focus on different **environmental niches,** or particular sets of resources or skills. Today, as mobile computing devices become more possible, all these companies are competing against the

Population ecology theory
A theory that seeks to explain the factors that affect the rate at which new organizations are born (and die) in a population of existing organizations.

Population of organizations
The organizations that are competing for the same set of resources in the environment.

Environmental niches
Particular sets of resources.

leader, Apple, that was dominating the market in 2011 with its iPhone and iPad devices. To fight back, Nokia teamed with Microsoft to offer new mobile devices based on the Windows 8 operating system, and other companies have teamed with Google to develop mobile devices based on software platforms such as Android and Gingerbread.

Number of Births

Population density
The number of organizations that can compete for the same resources in a particular environment.

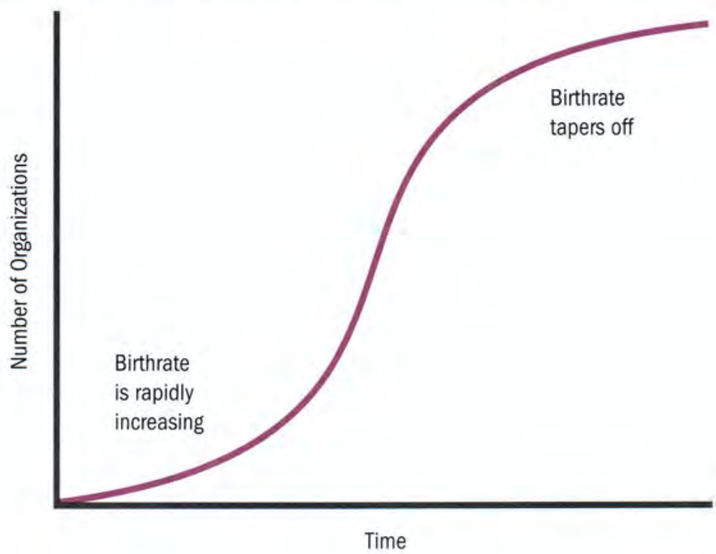
According to population ecology theory, the availability of resources determines the number of organizations in a population. The amount of resources in an environment limits **population density**—the number of organizations that can compete for the same resources in a particular environment.[12] Population ecology theorists assume that growth in the number of organizational births in a new environment is rapid at first as organizations are founded to take advantage of new environmental resources, such as dollars that people are willing to spend on mobile personal computing (see Figure 11.2).[13]

Two factors account for the rapid birthrate. The first is that as new organizations are founded, there is an increase in the knowledge and skills available to generate similar new organizations—such as companies that are eager to adopt Google's free mobile software platforms. Also, many new organizations are founded by entrepreneurs who leave existing companies to set up their own companies using the competences they have learned by working in those companies. Many new companies have been founded by people who left pioneering organizations such as Xerox, Microsoft, IBM, and Google. For example, eBay was founded by Pierre Omidyar, who left Microsoft to use his skills to develop its auction software platform.

The second factor accounting for the rapid birthrate in a new environment is that when a new kind of organization is founded and survives, it provides a role model. The success of the new organization makes it easier for entrepreneurs to found similar new organizations because success confers legitimacy, which will attract stakeholders. Fast-food restaurants, for example, were a relatively untested kind of organization until McDonald's proved their ability to attract resources in the form of customers. Entrepreneurs watched McDonald's create and succeed in the U.S. fast-food market and then imitated McDonald's by founding similar companies, such as Burger King and Wendy's. McDonald's became a U.S. institution, gave the population of fast-food organizations legitimacy, and allowed them to attract stakeholders such as customers, employees, and investors. Today, fast food is taken for granted in most countries around the world, especially China, where rising wages are allowing its one billion citizens to enjoy fast food, especially fried chicken from KFC. Similarly,

Figure 11.2 Organizational Birthrates over Time

According to population ecology theory, the rate of birth in a new environment increases rapidly at first and then tapers off as resources become less plentiful and competition increases.



Groupon, the leader in the online deals that pioneered selling discounted services and goods, spawned imitators such as LivingSocial and is facing growing competition from companies such as Facebook and Google.

Once an environment is populated with a number of successful organizations, the organizational birthrate tapers off (see the S-shaped curve in Figure 11.2).[14] Two factors work to decrease the rate at which organizations are founded. First, births taper off as the availability of resources in the environment for late entrants diminishes.[15] Companies that start first, like McDonald's or Groupon, have a competitive edge over later entrants because of first-mover advantages. **First-mover advantages** are the benefits an organization derives from being an early entrant into a new environment. They include customer loyalty, a recognized brand name, and the best locations for new businesses like restaurants. Latecomers enter an environment that is partially depleted of the resources that they need to grow. Investors, for example, become increasingly reluctant to lend money to new startups because their chances of survival in an already competitive environment are poor unless they can somehow discover and find a way to attract resources. Similarly, the best managers and workers prefer to work in organizations that have established reputations and offer secure employment opportunities.

First-mover advantages
The benefits an organization derives from being an early entrant into a new environment.

The second factor that decreases the birthrate is the difficulty of competing with existing organizations for resources.[16] Potential entrepreneurs are discouraged from entering an industry or market because they understand that the larger the number of companies already competing for resources, the more difficult and expensive the resources will be to obtain. To obtain new customers, new companies may need to overspend on advertising or innovation, or they may need to reduce their prices too much. Moreover, existing companies may band together and make it very hard for new companies to enter the market. They may engage in collusion, agreeing (illegally) to set their prices at artificially low levels to drive new rivals out of an industry, or they may erect barriers to entry by investing heavily in advertising so it is very expensive for new companies to enter the market.

Survival Strategies

Population ecologists have identified two sets of strategies that organizations can use to gain access to resources and enhance their chances of survival in the environment: (1) r-strategy versus K-strategy and (2) specialist strategy versus generalist strategy.

R-STRATEGY VERSUS K-STRATEGY Organizations that follow an **r-strategy** are founded early in a new environment—they are early entrants. Organizations that follow a **K-strategy** are founded late—they are late entrants.[17] The advantage of an r-strategy is that an organization obtains first-mover advantages and has first pick of the resources in the environment. As a result, the organization is usually able to grow rapidly and develop skills and procedures that increase its chance of surviving and prospering. Organizations that follow a K-strategy are usually established in other environments and wait to enter a new environment until the uncertainty in that environment is reduced and the correct way to compete is apparent. For example, Samsung, HTC, and Motorola did not enter the smartphone industry until Apple demonstrated the huge global market potential for smartphones and their applications. Sometimes these organizations then take the skills they have established in other environments and use them to develop effective products that allow them to compete with organizations following the r-strategy. In 2011, for example, Apple claimed Samsung's new smartphones and tablets were simply imitations of its own mobile devices, and Apple sued Samsung, which countersued, and a battle was raging between them.

r-strategy
A strategy of entering a new environment early.

K-strategy
A strategy of entering an environment late, after other organizations have tested the water.

The difference between r-strategy and K-strategy is evident in the situation that emerged in the PC environment. In 1977, Apple Computer founded the PC market when it developed the Apple I. Other small companies quickly followed Apple's lead. Each of them pursued an r-strategy and developed their own unique PCs. Many of these companies were successful in attracting resources, and the population of PC companies grew quickly. IBM, the dominant seller of mainframe computers, realized the huge potential resources of the PC market. It adopted a K-strategy and moved to develop its own PC (based on Microsoft's MS-DOS operating system), which it introduced in 1981. IBM's ability to put its massive competences to work in the new environment and to take advantage of its brand name allowed IBM to become the dominant competitor. As MS-DOS became the industry standard, IBM drove most of the smaller r-strategists out of the PC market. Apple survived IBM's challenge by focusing its competences on satisfying the PC needs of academic and publishing customers. Then Steve Jobs returned and revolutionized the company, giving it a new "rebirth," and by 2011 Apple had become the most valuable global high tech company and Jobs was declared "CEO of the Decade."

Specialists
Organizations that concentrate their skills to pursue a narrow range of resources in a single niche.

Generalist
Organizations that spread their skills thinly to compete for a broad range of resources in many niches.

SPECIALIST STRATEGY VERSUS GENERALIST STRATEGY The difference between a specialist and a generalist strategy is defined by the number of environmental niches—or sets of different resources (customers)—for which an organization competes. Specialist organizations (or **specialists**) concentrate their competences and skills to compete for resources in a single niche—for example, smartphones. Generalist organizations (or **generalists**) use their well-developed competences to compete for resources in many or all niches in an environment—for example, smartphones, inexpensive cellphones, landline phones, netbooks, tablets, and so on.[18]

By focusing their activities in one niche, specialists are often able to develop core competences that allow them to outperform generalists in that niche. Specialists, for example, may be able to offer customers much better service than the service offered by generalists or, because they invest all their resources in a narrow range of products, they may be able to develop superior products. Nvidia, the leader in graphics chips, for example, invests all its resources to produce these state-of-the-art chips and does not invest resources to compete with Intel or AMD in making microprocessors or memory chips.

Generalists can often outcompete specialists when there is considerable uncertainty in the environment and when resources are changing so that niches emerge and disappear continually. Generalists can survive in an uncertain environment because they have spread their resources over many niches. If one niche disappears they still have others in which to operate. If a specialist's niche disappears, however, there is a much higher chance of organizational failure and death. In 2011 Nvidia was under increasing pressure as demand for desktop PCs and graphic chips fell sharply and its future now depends on the success of its Tegra mobile graphics chip.

Specialists and generalists normally coexist in many environments because generalists create the conditions that allow specialists to operate successfully.[19] Large department stores, for example, stock many different types of clothing but are only able to stock a limited amount of each type, for example, evening wear or sportswear. Given that customers often want more choices in clothing, specialty clothing stores that are able to offer an extensive selection of one type of clothing—for example, evening wear—can be successful, especially because they can charge a premium price for their selection of unique clothes. This is the opportunity for the entrepreneur even when there are powerful generalists around.

The Process of Natural Selection

The two sets of strategies—specialist versus generalist and r versus K—give rise to four strategies that organizations can pursue: r-specialist, r-generalist, K-specialist, and K-generalist (see Figure 11.3).[20]

Early in an environment, as a niche develops and new resources become available, new organizations are likely to be r-specialists—organizations that move quickly to focus on serving the needs of particular customer groups. Many new organizations grow and prosper, as did Apple. As they grow, they often become generalists and compete in new niches. While this is happening, however, K-generalists (usually the divisions or subsidiaries of large companies like IBM or GE) move into the market and threaten the weakest r-specialist organizations. Eventually, the strongest r-specialists, r-generalists, and K-generalists dominate the environment by serving multiple market segments and by pursuing a low-cost or differentiation strategy. Large companies, having chosen the K-generalist strategy, often create niches for new firms to enter the market, so K-specialists are founded to exploit the new market segments. In this way, generalists and specialists can coexist in an environment because they are *competing for different sets of resources.*

The early beginnings of the car industry provide a good example of this organizational birth process. The first car companies (such as Packard and Dusenberg) were small