JOMO KENYATTA UNIVERSITY OF AGRICULTURE & TECHNOLOGY

SCHOOL OF OPEN, DISTANCE & eLEARNING

IN COLLABORATION WITH

SCHOOL OF HUMAN RESOURCE MANAGEMENT

ENTREPRENEURSHIP AND PROCUREMENT DEPARTMENT

HPS 2304 STRATEGIC MANAGEMENT

P.O. Box 62000, 00200

Nairobi, Kenya

HPS 2304 STRATEGIC MANAGEMENT

Course description

Introductory overview of strategic management , the hierachy of management, the strategic management concepts, strategic managers and decisions, SWOT analysis, strategy formulation, necessity of a business strategy, competitive analysis, generic business strategies, developing and maintaining competitive advantage, international competitive strategies, strategy implementation and control, strategy evaluation, structuring, resource allocation, strategic aspects of purchasing and supplies.

Course aims

Build Learners' capacity to integrate technical and business knowledge to help one succeed as a strategic manager in a dynamic global business environment.

Learning outcomes

By the end of this course, the learner should be able to:-

1. Develop analytical skills and acquire decision making tools for dealing with complex management problems at various levels in an organization.

2. Describe the relationship between different strategies, the organization structure in a dynamic world.

3. Develop a framework of analysis that enables them to identify the central issues and problems in complex, comprehensive cases, and to suggest alternative courses of action

Instruction methodology

Class lecturers, Assignments and exercises,Group discussions

Course Text Books

1. Pearce / Robinson, (2009), Strategic Management, Formulation, ImplementationAnd Control, 10th, ISBN 978=-81-317-1925-1

2. Jay B. Barney, William S. Hesterly, (2009), Strategic Management And Competitive Advantage: Concepts And Cases,ISBN 978-81-203-3377-2

3. J. David Hunger, Thomas L. Wheelen, (2007), Essentials of Strategic Management, 4th Ed, McGraw Hill Irwin, Boston, USA.ISBN 978-81-203-3234-8

4. Fred R. David (2006), Strategic Management: Concepts and Cases, 12th ISBN 978-81-203-3566-0

Reference Textbooks

1. R.M SrivastaveDivya Nigam, (2007), Corporate Strategic ManagementISBN 81-8398-190-9

2. Jay B. Barney, (2009), Gaining and Sustaining Competitive Advantage, 3ND Ed ISBN 978-81-7758-777-7

3. Melissa A. Schilling (2008), Strategic Management of Technological Innovation, 2nd , ISBN 978-0-07-066712-9

4. AzharKazmi (2009), Strategic Management and Business Policy, 3rd ISBN 978-0-07-026363-8

5. Thomas L. Wheelen, J. David Hunger, KrishRangarajan, (2009), Concepts In Strategic Management And Business Policy, 9th , Pearson Ed , New Delhi India,978-81-775-8191-1

Reference Journals

1. International Journal of Applied Strategic Management. ISSN print: 1755-8913

2. Journal of Strategy and Management. ISSN: 1097-0266

3. Technology Analysis and Strategic Management Journal. ISSN : 1465-3990

Course Journals

1. Strategic Management Journal. ISSN-10: 1133495230

2. International Journal of Strategic Management. ISSN: 1555-2411.

3. Academy of Strategic Management Journal. ISSN: 1939-6104

Assessment information

The module will be assessed as follows;

- CATs/Assignment/Presentation 30 %
- Final Examination 70 %
- **Total 100%**

Contents

LESSON 1

Introduction to strategic management

By the end of this chapter, the learner should be able to define, identify, explain, describe and discuss the following:

1. Different terms as used in strategic management
2. Concepts and techniques of strategic management
3. Features of Strategy
4. Roles of strategy
5. Strategic management process
6. Levels of management

1.1. Definition of terms:

1. **Strategy** :regarded as a unifying idea which links purpose and action (Collin white) or combination of competitive moves and business approaches that managers employ to please customers ,compete successfully and achieve organizational objectives(Thompson /Strickland) or the set of actions through which an organization by accident or design develops resources and uses them to deliver services or products in a way users find valuable (Adrian /Alison).
2. **Strategic management:** refers to the managerial process of forming a strategic vision ,setting objectives ,crafting strategy and then overtime initiating whatever corrective adjustment in the vision ,objectives ,strategy and execution are deemed appropriate.

1.2. The concepts and techniques of strategic management:

1. Resource: something that an organization owns ,controls or has access to on a semi-permanent basis e.g. money and physical objects.
2. Customers: the people or other organizations that pay for the organizations services or products

3. Users: the people or other organizations who actually use an organizations products or services
4. Stakeholders: people with an interest in an organizations success ,failure or activities and therefore a desire to influence behavior .
5. Business model: deals with whether the revenue cost profit economics of its strategy demonstrate the viability of the enterprise as a whole.
6. Strategic vision: this a roadmap of a company's future.
7. Company's mission :typically focused on its present business scope.
8. Objectives: are organizations performance target the results and outcome it wants to achieve.

1.3. Features of Strategy

1. Strategy is Significant because it is not possible to foresee the future. Without a perfect foresight, the firms must be ready to deal with the uncertain events which constitute the business environment.
2. Strategy deals with long term developments rather than routine operations, i.e. it deals with probability of innovations or new products, new methods of productions, or new markets to be developed in future.
3. Strategy is created to take into account the probable behavior of customers and competitors. Strategies dealing with employees will predict the employee behavior.

Strategy is a well defined roadmap of an organization. It defines the overall mission, vision and direction of an organization. The objective of a strategy is to maximize an organization's strengths and to minimize the strengths of the competitors.

Strategy, in short, bridges the gap between "where we are" and "where we want to be". The strategy statement of a firm sets the firm's long-term strategic direction and broad policy directions. It gives the firm a clear sense of direction and a blueprint for the firm's activities for the upcoming years. The main constituents of a strategic statement are as follows:

1.4. Strategic Intent

An organization's strategic intent is the purpose that it exists and why it will continue to exist, providing it maintains a competitive advantage. Strategic intent gives a picture about what an organization must get into immediately in order to achieve the company's vision. It motivates the people. It clarifies the vision of the vision of the company. Strategic intent helps management to emphasize and concentrate on the priorities. Strategic intent is, nothing but, the influencing of an organization's resource potential and core competencies to achieve what at first may seem to be unachievable goals in the competitive environment. A well expressed strategic intent should guide/steer the development of strategic intent or the setting of goals and objectives that require that all of organization's competencies be controlled to maximum value.

Strategic intent includes directing organization's attention on the need of winning; inspiring people by telling them that the targets are valuable; encouraging individual and team participation as well as contribution; and utilizing intent to direct allocation of resources. Strategic intent differs from strategic fit in a way that while strategic fit deals with harmonizing available resources and potentials to the external environment, strategic intent emphasizes on building new resources and potentials so as to create and exploit future opportunities.

1.5. Mission Statement

Mission statement is the statement of the role by which an organization intends to serve it's stakeholders. It describes why an organization is operating and thus provides a framework within which strategies are formulated. It describes what the organization does (i.e., present capabilities), who all it serves (i.e., stakeholders) and what makes an organization unique (i.e., reason for existence). A mission statement differentiates an organization from others by explaining its broad scope of activities, its products, and technologies it uses to achieve its goals and objectives. It talks about an organization's present (i.e., "about where we are"). For instance, Microsoft's mission is to help people and businesses throughout the world to realize their full potential. Wal-Mart's mission is "To give ordinary folk the chance to buy the same thing as rich people." Mission statements always exist at top level of an organization, but may also be made for various organizational levels. Chief executive plays a significant role in formulation of mission statement. Once the mission statement is formulated, it serves the organization in long run, but it may become ambiguous with organizational growth and innovations. In today's dynamic and competitive environment, mission may need to be redefined. However, care must be taken that the redefined mission statement should have original fundamentals/components. Mission statement has three main components-a statement of mission or vision of the company, a statement of the core values that shape the acts and behaviour of the employees, and a statement of the goals and objectives.

1.5.1. Features of a Mission

1. Mission must be **feasible and attainable**. It should be possible to achieve it.
2. Mission should be **clear** enough so that any action can be taken.
3. It should be **inspiring** for the management, staff and society at large.
4. It should be **precise** enough, i.e., it should be neither too broad nor too narrow.
5. It should be **unique and distinctive** to leave an impact in everyone's mind.
6. It should be **analytical**,i.e., it should analyze the key components of the strategy.
7. It should be **credible**, i.e., all stakeholders should be able to believe it.

1.5.2. Vision

A vision statement identifies where the organization wants or intends to be in future or where it should be to best meet the needs of the stakeholders. It describes dreams and aspirations for future. For instance, **Microsoft's vision** is "to empower people through great software, any time, any place, or any device." **Wal-Mart's vision** is to become worldwide leader in retailing. A vision is the potential to view things ahead of themselves. It answers the question "where we want to be". It gives us a reminder about what we attempt to develop. A vision statement is for the organization and it's members, unlike the mission statement which is for the customers/clients. It contributes in effective decision making as well as effective business planning. It incorporates a shared understanding about the nature and aim of the organization and utilizes this understanding to direct and guide the organization towards a better

purpose. It describes that on achieving the mission, how the organizational future would appear to be.
An effective vision statement must have following features-

1. It must be **unambiguous.**
2. It must be **clear**.
3. It must **harmonize** with organization's culture and values.
4. The dreams and aspirations must be **rational/realistic.**
5. Vision statements should be **shorter** so that they are easier to memorize.

In order to realize the vision, it must be deeply instilled in the organization, being owned and shared by everyone involved in the organization.

1.6. Goals and Objectives

A goal is a desired future state or objective that an organization tries to achieve. Goals specify in particular what must be done if an organization is to attain mission or vision. Goals make mission more prominent and concrete. They co-ordinate and integrate various functional and departmental areas in an organization. Well made goals have following features-

1. These are **precise and measurable.**
2. These look after c**ritical and significant** issues.
3. These are **realistic and challenging**.
4. These must be achieved within a **specific time** frame.
5. These include both **financial as well as non-financial components.**

Objectives are defined as goals that organization wants to achieve over a period of time. These are the foundation of planning. Policies are developed in an organization so as to achieve these objectives. Formulation of objectives is the task of top level management.
Effective objectives have following features-

1. These are not single for an organization, but multiple.
2. Objectives should be both short-term as well as long-term.
3. Objectives must respond and react to changes in environment, i.e., they must be flexible.
4. These must be feasible, realistic and operational.

1.7. The strategic management process

The strategic management process means defining the organization's strategy. It is also defined as the process by which managers make a choice of a set of strategies for the organization that will enable it to achieve better performance. Strategic management is a continuous process that appraises the business and industries in which the organization is involved; appraises it's competitors; and fixes goals to meet all the present and future competitor's and then reassesses each strategy. Strategic management process has the following four steps:

- **Environmental Scanning** - Environmental scanning refers to a process of collecting, scrutinizing and providing information for strategic purposes. It helps in analyzing the internal and external factors influencing an organization. After executing the environmental analysis process, management should evaluate it on a continuous basis and strive to improve it.
- **Strategy formulation** - it is the process of deciding best course of action for accomplishing organizational objectives and hence achieving organizational purpose. After conducting environmental scanning ,managers formulate corporate , business and functional strategies. Strategy implementation- this implies the strategy work as intended for putting the organization's chosen strategy into action. It includes designing the organizational structure, , distributing resources , developing decision making process , and managing human resources.
- **Strategy Evaluation and control** – this is the final step of strategic management process. The key es activities are: appraising internal and external factors, measuring performance and taking corrective actions. These components are steps that are carried, in chronological order, when creating a

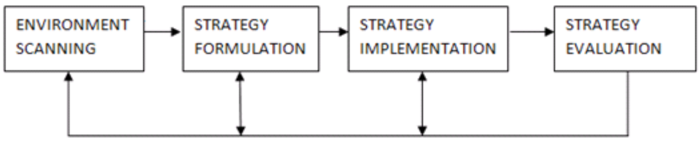

Figure 1.1: Components of Strategic Management Process

new strategic management plan. Present businesses that have already created a strategic management plan will revert to these steps as per the situation's requirement, so as to make essential changes.

- **Strategic management** is an ongoing process. Therefore, it must be realized that each component interacts with the other components and that this interaction often happens in chorus.

  The use of strategic planning as a tool in management of businesses dates back to 1970"s, when many large firms adopted a formalized top-down strategic planning model. Under this model, strategic planning became a deliberate process in which the top executives periodically would formulate the firm's strategy, then communicate it down the organization for implementation. As a tool the strategic planning refers to the several action alternatives that can be put in place to put a firm into an envisaged future position. In brief the strategic planning starts with a vision of where the firm would want to be in future. Below is a flowchart model which summarizes the process strategic planning:

$$
\begin{array}{c}
Vision \\
\downarrow \\
Mission \\
\downarrow \\
Objectives \\
\downarrow \\
Situation Analysis \\
\downarrow \\
Strategy Formulation \\
\downarrow \\
Implementation \\
\downarrow \\
Control
\end{array}
$$

This process is most applicable to strategic management at the business unit level of the organization. For large corporations, strategy at the corporate level is more concerned with managing a portfolio of business. For example, corporate level strategy involves decisions about which business units to grow, resource allocation among the business units, taking advantage of synergies among the business units, and merger and acquisitions. In the process outlined here, “company” or “firm” will be used to donate a single-business unit of a diversified firm.

1.7.1. Mission

A company’s mission is its reason for being. The mission often is expressed in the form of a mission statement, which conveys a sense of purpose to the employees and project a company image to customers. In the strategy formulation process, the mission statement sets the mood of where the company should go.

1.7.2. Objectives

Objectives are concrete goals that the organization seeks to reach, for example, an earnings growth target. The objectives should be challenging but achievable. They also should be measurable so that the company can monitor its progress and make corrections as needed.

1.7.3. Situation Analysis

Once the firm has specified its objectives, it begins with its current situation to devise a strategic plan to reach those objectives. Changes in the external environment often present new opportunities and new ways to reach objectives. An environmental scan is performed to identify the available opportunities. The firm also must know its own capabilities and limitations in order to select the opportunities that it can pursue with a higher probability of success. The situation analysis therefore involves an analysis of both the external and internal environments. The external environment has two aspects: the macro- environment that affects all firms and a micro-environment that affects only the firms in a particular industry. The macro-environmental analysis includes political, economic, social, and technological factors and sometimes is referred to as a PESTEL analysis. An important aspect of the micro-environmental analysis is the industry in which the firm operates or is considering operating. Michael Porter devised a five forces framework that is used for industry analysis. Porter's 5 forces include barriers to entry, customers, suppliers, substitute products, and rivalry among competing firms. A situational analysis can generate a large amount of information, much of which is not particularly relevant to the strategy formulation. To make the information more manageable, it is sometimes useful to categorize the internal factors of the firm as strength and weaknesses, and the external environmental factors as opportunities and threats. Such an analysis often is referred to as a SWOT analysis.

1.7.4. Strategy Formulation

Once a clear picture of the firm and its environment is in hand, specific strategic alternatives can be developed. While different firms have different alternatives depending on their situation, there also exist generic strategies that can be applied across a wide range of firms. Michael Porter identified cost leadership, differentiation, and focus as three generic strategies that may be considered when defining strategic alternatives. Porter advised against implementing a combination of these strategies for a given product; rather, he argued that only one of the generic strategy alternatives should be pursued.

1.7.5. Implementation

The likely strategy will be expressed in high-level conceptual terms and priorities. For effective implementation, it needs to be translated into more detailed policies that can be understood at the functional level of the organization. The expression of the strategy in terms of functional policies also serves to highlight any practical issues that might not have been visible at a higher level. The strategy should be translated into specific policies for functional area such as:

- Marketing
- Research and development
- Procurement
- Product
- Human resources
- Information systems

In addition to developing functional policies, the implementation phase involves identifying the required resources and putting in place the necessary organizational changes.

1.7.6. Control

Once implemented, the results of the strategy need to be measured and evaluated, with changes made as required to keep the plan on track. Control systems should be developed and implemented to facilitate this monitoring. Standards of performance are set, the actual performance measured, and appropriate action taken to ensure success.

1.7.7. Dynamic Continuous Process

The strategic management process is dynamic and continuous. A change in one component can necessitate a change in the entire strategy. As such, the process must be repeated frequently in order to adapt the strategy to environmental changes. Throughout the process the firm may need to cycle back to a previous stage and make adjustments.

1.7.8. Drawbacks of this Process

The strategic planning process outlined above is only one approach to strategic management. It is best suited for stable environments. A drawback of this top-down approach is that it may not be responsive enough for rapidly changing competitive environments. In times of change, some of the more successful strategies emerge informally from lower levels of the organization, where managers are dealing with customers on a day-to-day basis.
Another drawback is that this strategic planning model assumes fairly accurate forecasting and does not take into account unexpected events. In an uncertain world, long-term forecasting cannot be relied upon with a high level of confidence. In this respect, many firms have turned to scenario planning as a tool for dealing with multiple contingencies.

1.8. THE SWOT analysis

Swot analysis is a simple Framework for generating strategic alternatives from a situation analysis. It is applicable to either the corporate level or the business unit level and frequently appears in marketing plans. SWOT (sometimes referred to as TOWS) stands for Strength, Weaknesses, Opportunities and Threats. The SWOT framework was described in the late 1960"s by Edmund P. Learned, C. Roland Christiansen, Kenneth Andrews, and William D. Guth in Business Policy, Text and Case **(Homewood, IL: Irwin,1969)**. The general Electric Growth Council used this form of analysis in the 1980's. Because it concentrates on the issues that potentially have the most impact, The SWOT analysis is useful when a very limited amount of time is available to address a complex strategic situation. The following diagram shows how SWOT analysis fits into a strategic situation analysis.
Situation Analysis

$$\begin{array}{cc} Internal Analysis & External Analysis \\ Strengths Weaknesses & Opportunities Threats \end{array}$$

1.8.1. Levels of management or Management hierarchy

Top Management

Includes:

1. Board of directors

2. Managing director
3. General managers

Functions:

1. Determining of goals or objectives
2. Policy framing
3. Formulation of strategic plans
4. Mobilization of resources
5. Motivating personnel
6. Coordinating and communicating
7. Controlling of operations

Middle Management

Includes:

1. Department managers
2. Section officers

Functions:

1. Runs detailed activities of the organization
2. Cooperate for smooth functioning of the organization
3. Coordinating between different parts
4. Build up efficient staff
5. Build company spirit

Lower Management

Includes:

1. Supervisor

2. Foremen

Functions:

1. Planning the day-to-day work

2. Issue instructions to workers and supervise

3. Provide on the job training

4. Solve worker's problems

5. Maintain discipline among workers

1.9. Role of Strategy

The role of carefully formulated strategies is quite significant in all types of organizations-business or non- business, public sector or private sector, large or small, in developed or underdeveloped countries. The following are the roles of strategy:

1. **Framework for operational planning** - Strategy provides the framework for plans by channeling operating decisions and often predefining them. They provide more consistent framework for operational planning.

2. **Clarity in direction of activities** - Strategies focus on direction of activities by specifying what activities are to be undertaken for achieving organizational objectives more clear and specific.

3. **Increase organizational effectiveness** - The concept of effectiveness is that the organization is able to achieve its objectives within the given resources. Thus , for effectiveness, it is only necessary that resources are put to the best of their efficiency but also that they are put in a way which ensures their maximum contribution to organizational objectives.

4. **Personnel satisfaction** - Strategy contributes towards organizational effectiveness by providing satisfaction to the personnel of the organization. In organizations where formal strategic management process is followed, people are more satisfied by definite prescription of their roles thereby reducing role conflict and role ambiguity. If the decisions are systematized in the organization, everyone knows how to proceed, how to contribute towards organizational objectives, where the information may be available, who can make decisions and so on. •

1.10. Benefits of Strategic Management

Studies have revealed that organizations following strategic management have outperformed those that do not. Strategic planning ensures a rational location of resources and improves coordination between various divisions of the organization. Strategic management helps managers think ahead and anticipate problems before they occur.

The main benefit of the planning is the continuous dialogue about the organization's future between the hierachical levels in the organization. In short, the most highly rated benefits of strategic management are:

1. Clarity of strategic vision for the organization
2. Focus on what is strategically important tot the organization
3. Better understanding of the rapidly changing business environment.

These benefits can be broadly elaborated as follows:

1. Strategy formulation enhances the company's ability to prevent problems.
2. The company is able to focus its scarce resources on the best available alternatives.
3. It enhances understanding of the company operating environment hence being able to allocate resources more effectively and efficiently.
4. It enables continuity of the organization e.g. long term strategic plans enables a company to focus on future performance of the firm.

5. Strategic management reduces the chances of resistance among the implementers of strategic decisions.

6. Strategic management enhances the focusing of the organizations activities towards achieving the overall onjectives of the firm.

7. It sets parameters against which the success or failure of a company can be measured.

1.11. Risks in Strategic Management

Managers must be trained to avoid three types of unintended negative consequences involved in strategy formulation and implementation.

1. The time that managers spent on the strategic management process may have negative impact on the operations of the firm. Managers must therefore be trained to minimize the amount of time spent in the strategic management process.

2. If the formulators of the strategy are not intimately involved in the implementation there may be a gap hence not able to achieve the intended result. Therefore strategy formulators must be actively involved in the implementation process. If not involved the subordinates must be trained on how to implement the strategy effectively.

Strategic managers must be trained to anticipate disappointments and how to respond effectively to them.

Revision Questions

Example ✎. Describe the features of Strategy

Solution:
Strategy is Significant because it is not possible to foresee the future. Without a perfect foresight, the firms must be ready to deal with the uncertain events which constitute the business environment.
Strategy deals with long term developments rather than routine operations, i.e. it deals with probability of innovations or new products, new methods of productions, or new markets to be developed in future.
Strategy is created to take into account the probable behavior of customers and competitors. Strategies dealing with employees will predict the employee behavior.
□

EXERCISE 1. ✍ Describe the roles of strategy

EXERCISE 2. ✍ Describe the strategic management process

EXERCISE 3. ✍ Describe the levels of management

LESSON 2

Strategy implementation

By the end of this chapter, the learner should be able to define, identify, explain, describe and discuss the following:

1. Strategic Implementation
2. Requirements for Strategic Implementation
3. Strategy implementation and structure

Strategy implementation has been defined as 'the process by which strategies and policies are put into action through the development of programs, budgets, and procedures'. The implementation of strategy directly or indirectly connects to all functions of management. Thus it is fundamental to follow a holistic approach when analyzing and assessing complex issues of strategy implementation.

2.1. The importance of strategy implementation phase

In spite of all the energy and resources spent in the pursuit of the wonderful strategy, it is surprising to consider how little effort is dedicated towards its implementation. Most managers stumble in the implementation stage. A current economic survey found that a discouraging 57 percent of firms failed at carrying out strategic initiatives over the past three years, according to their senior operating executives.

2.2. Difficulties

One major source of difficulty encountered in implementing strategy comes from the fact that, in most organizations, the pre-strategy decision-making processes are heavily political in nature. Strategy presents elements of rationality which are disruptive to the historical culture of the organization and threatening to the political process. A natural organizational reaction is to struggle against the disruption of the historical culture and power structure, rather than confront the challenges posed by the environment. This reaction has been widely observed during the introduction of strategic planning into business firms A no less important difficulty is that the introduction of strategic planning triggers conflict between the historical profit making activities (for example serving the community in NGOs) and the new creative activities. Organizations usually do not have the capability, the capacity or the motivational systems to act and to think strategically. Finally organizations generally have limited information about themselves and their environment which is necessary for effective strategic planning. They also have no managerial talents capable of the formulation and implementation strategy (Ansoff, 1988). Hunger and Wheelen (2003) stress that a good strategy can result in a disaster through poor strategy implementation, therefore strategy formulation and strategy implementation should be considered as two sides of the same coin. Allison and Kaye (2005) claim that there are two main obstacles facing the effective implementation of the strategy:

- The difficulty of transformation big ideas into particular steps.
- The difficulty of protecting the focus that was accomplished through the planning process.

They address the first difficulty by developing annual operating plans, and address the second one by assessing the plan and setting up regular monitoring of the plan.

2.3. Strategy implementation framework

Okumus (2003) reviewed the literature in strategy implementation; his work can be concluded as the following: One of the most cited implementation frameworks was proposed by Waterman et al., (1980) which was derived from their research and consultancy work.
These writers argued that successful strategy implementation is fundamentally attending to the relationship between the following seven elements:

- Strategy
- Structure
- Systems
- Style
- Staff

- Skills
- Subordinate goals.

Effective strategic implementation requires the follows:

1. Organizational structure appropriateness.
2. Sound leadership of the company.
3. Effective motivational system
4. Annual objectives
5. Functional strategies
6. Clear budget
7. Detailed action plan

In addition to the above requirements one the important factor is Communicating Strategy. The communication channels must be open and frequent enough to allow free consultation and exchange of ideas for clarity. Strategy must be clearly understood for it to be accurately implemented. Communication provides employees with general guidance to make decision.

2.4. Strategy & Structure

Definition of Organizational Structure:
This is the diagrammatical representation of the various levels of authority and how that authority flows within the organization. It also depicts the interrelationships between the functional units and operational systems of the organization. The structure can either facilitate or inhibit strategy implementation, and as Chandler says: Changes in strategy ultimately lead to changes in the organization's structure.

2.4.1. Types of organizational structure

1. Functional
2. Geographical
3. Divisional

4. Customer-based
5. Matrix

Functional Structure

The most widely used structure is the functional or centralized type because this structure is the simplest and least expensive of the seven alternatives. A functional structure groups tasks and activities by business function such as product/operations, marketing, finance/accounting, R&D, and computer information systems. It has the following advantages: Besides being simple and inexpensive, a functional structure also promotes specialization of labor, encourages efficiency, minimizes the need for an elaborate control system, and allows rapid decision-making. Some disadvantages of a functional structure are that it forces accountability to the top, minimizes career development opportunities, and is sometimes characterized by low employee morale.

The Divisional Structure

The divisional or decentralized structure is the second most common type used by international/multinational businesses/corporations. The divisional structure can be organized in one of four ways: by geographic area, product or service, customer, or process. With a divisional structure, functional activities are performed both centrally and in each separate division. A divisional structure has some clear advantages. First, and perhaps foremost, is accountability. Other advantages of the divisional structure are that it creates career development opportunities for managers, allows local control of local situations, leads to a competitive climate within an organization, and allows new businesses and products to be added easily. However, it has some disadvantages as well. Perhaps the most important limitation is that a divisional structure is costly.

A divisional structure by **geographic area** is appropriate for organizations whose strategies need to be tailored to fit the particular needs and characteristics of customers in different geographic regions. A division structure by **product** is most effective for implementing strategies when specific products or services need special emphasis.

A division structure by **process** is similar to a functional structure, because activities are organized according to the way work is actually performed.

2.4.2. The Matrix Structure

It is the most complex of all designs because it depends upon both vertical and horizontal flows of authority and communication. It can result in higher overhead because it creates more managerial positions. It also creates dual lines of budget authority, dual sources of reward and punishment, shared authority, and dual reporting channels. Its advantages are that project objectives are clear, there are many channels of communication, workers can see visible results of work, and projects can be shut down easily.

2.4.3. An assessment of Organizational Structure

- No structure is appropriate for all situations.
- Appropriate structure may change as the organization develops.
- Examples require structure change: Introducing new strategy, having problems in achieving its objectives, leadership changes.

2.4.4. Symptoms of an ineffective of Organizational Structure

According to P. Drucker, these are some of the symptoms of ineffective organizational structure:

- Too many management levels make cooperation and communication difficult
- Too many meetings attended by too many.
- Too much attentions are given to resolve interdepartmental conflict.
- Excessive decision making at top management

2.4.5. Evolution of organizational structure:

Alfred D. Chandler proposed the following:
Changing strategy.
Administrative problems leading to decline performance. Revised structure subsequent return to economic health. Chandler also made suggestion as to when Structural adjustments should happen? When there is:

- Market expansion.

- Product line diversification.
- Vertical integration.

2.4.6. Relationship between strategy and Organizational Structure

The process of matching structure to strategy is complex and should be undertaken with a thorough understanding of:

- The historical development of the organizational structure.
- The requirements of the organization's environment and technology.
- The political relationships that might be affected.
- Organizational Culture
- Organizational Leadership
- Different skill requirements for different strategies
- Strategy and Motivational systems
- Deployment of Resources through Budgeting
- Development of functional Strategies

Important to note

- Organizational reward system influence the entire organizational climate.
- Organizational rewards include all types of rewards, tangible and intangible.
- **Budgeting:** Is the process of allocating resources to be employed to achieve objectives.
- Budget should be directly linked to strategy implementation.
- Functional Strategies describe the methods and means at functional level to achieve corporate strategies and business unit strategies.

- **More insights into the relationship between strategy and structure**

Just to help you gain more understanding of the connection between strategy and structure, below are some captions of what other researchers and consultants think, and say to questions frequently asked by students of strategy about this topic:

- **Strategy Follows Structure, Structure Supports Strategy**

"***Strategy and structure are married to each other. If you change one you have to change the other".***

For too long, structure has been viewed as something separate from strategy. Revising structures are often seen as ways to improve efficiency, promote teamwork, create synergy or reduce cost. Yes, restructuring can do all that and more. What has been less obvious is that structure and strategy are dependent on each other. You can create the most efficient, team oriented, synergistic structure possible and still end up in the same place you are or worse. Why? Because Strategy follows structure, structure supports strategy!

- **The Connection between Strategy and Structure**

Structure is not simply an organization chart. Structure is all the people, positions, procedures, processes, culture, technology and related elements that comprise the organization. It defines how all the pieces, parts and processes work together (or don't in some cases). This structure must be totally integrated with strategy for the organization to achieve its mission and goals. Structure supports strategy. If an organization changes its strategy, it must change its structure to support the new strategy. When it doesn't, the structure acts like a bungee cord and pulls the organization back to its old strategy. Strategy follows structure. What the organization does defines the strategy. Changing strategy means changing what everyone in the organization does.

When an organization changes its structure and not its strategy, the strategy will change to fit the new structure. Strategy follows structure. Suddenly management realizes the organization's strategy has shifted in an undesirable way. It appears to have done it on its own. In reality, an organization's structure is a powerful force. You can't direct it to do something for any length of time unless the structure is capable of supporting that strategy.

- **A Science Fiction and Real World Example**

Let's look at an imaginary example using the human body. Suppose science figured out how to create a living tissue arm to replace one's existing arm that could perform 300% better in strength, responsiveness and dexterity. The strategy here is to restructure the body with this super arm so it can do more. The scientists successfully replace an existing arm with this new super arm.

What will happen? The rest of the body remains as it was before. So the heart, circulation system, nervous system and brain are still structured to support a regular arm. This new arm requires more and faster blood flow, faster neuron responses in the brain and so on to support its functions. Over time, the super arm will evolve back into a regular arm because the rest of the body cannot support its enhanced capabilities. For this science fiction example to work, scientist would need to restructure the entire human body, not just one part of it.

What happens when you restructure sales channels resulting in large sales increases but nothing is changed in order processing, customer support, engineering or manufacturing? You end up with a lot of unhappy customers because the company can't deliver on its promise. How many times have we seen something like this happen? Or what happens when you add a new offering that goes to a new target customer? Maybe a company has a sales force that sells to small businesses and lower management in larger organizations. They add a new offering that is targeted at top executives. The existing sales force / sales channels cannot effectively sell to that new target. This has happened just a few too many times. And, of course, what happens when a firm makes a major push to upgrade its quality and service without improving everything in the organization that supports products and service? Disaster. Plain and simple.

2.5. Strategy is the Structure

The sum total of how an organization goes about its work is its strategy. Structure and strategy are married to each other. When a company makes major changes, it must carefully think out every aspect of the structure required to support the strategy. That is the only way to implement lasting improvements. Every part of an organization, every person working for that organization needs to be focused on supporting the vision and direction. How everything is done and everything operates needs to be integrated so all the effort and resources support the strategy.

It takes the right structure for a strategy to succeed. Management that is solely focused on results can have a tendency to direct everyone on what they need to do without paying attention to the current way the organization works. While people may carry out these actions individually, it is only when their daily way of working is integrated to support strategy that the organization's direction is sustainable over time.

2.5.1. Implementing Change As Important As Strategy Itself

During the last 27 years, we've worked with organizations in over 30 industries to help them find more ways to increase sales, growth rates and market share. Improving existing strategies and creating new strategies that can spur exceptional growth reflect our firms main mission. But, over the years, we began to notice that some clients were not successful in implementing new strategies. That is what led us to look deeper into the cause behind this. The question we posed was, "Does your company's DNA structure support your strategy?" Top management can't just send out a proclamation about a new strategy, direction and vision and expect everyone to follow it. To implement such a strategic shift requires a complete change within the organization itself. The organization's DNA has to be rebuilt or its existing DNA structure will cause the new strategy to fail and revert back to the old strategy. And that will happen without top management's involvement.

Leadership and people issues turn out to be much more important than we may have realized. On the surface, everyone talks about the importance of people and leadership but too often, management puts this on the back burner when the heat's on to deliver quarterly results or meet the guidance. Structure is strategy. That's why we realized our focus on increasing our client's revenue had to be balanced by an equal focus on implementing change. We didn't want to leave clients with reports that weren't implemented or worse implemented through directives that ultimately failed. So many years ago we became project managers for our client's implementation efforts to insure that their new strategies designed to increase revenue actually rang the cash register.

You can't improve strategy, increase revenue, even enhance the performance of a sales force without addressing the structural, people, cultural, communication, measurement and leadership aspects of the organization or at least that part of the organization you are changing. Strategy and structure are married to each other.

A decision to change one requires an all out effort to change the other. But that structural change must be well thought out and based on a thorough cause and effect analysis. You don't just change a structure to change it. You have to make sure the changes will support that strategy. At the same time, you don't just implement a better leadership and engagement approach in a company or alter the organizational chart without evaluating how that is going to affect the firm's ability to carry out its current strategies.

Which comes first strategy/structure, if strategy then why?

And if structure then why? Strategy always comes first. What is the purpose of a structure? Why does the structure exist? What result is the structure intended to produce? Creating a structure just to create a structure serves no purpose and requires the expenditure of money without any thought about a return. Strategy defines what customers and markets an organization serves, what they are offering those markets, what makes them different and better than their competition, how they will offer this at an attractive price that they can make a profit at and much more. You have to know what you are offering, who you are offering it to and why you are offering it to them before you can create a supporting structure to carry out these strategies. Once you have created that structure, you then have to closely monitor both the strategy and the structure over time. If you make any adjustments in the strategy, you need to adjust the structure to support those changes. If you discover that something needs to be improved in the structure, you need to carefully consider whether those improvements will help or hinder the firms ability to execute its strategy.

Many firms work on improving their people, systems, organization, culture and more. This is a good thing because they want to always be the best at what they do and that means continuous improvement. Too often, this is done without considering its affect on strategy and that's where some firms get into trouble. Continuous improvement in how well things are done has to go hand in hand with continuous improvement in strategy.

How can they (Strategy & Structure) mismatched when both depend on each other? While they are connected and dependent on each other, they can be separately and independently controlled. Top management can decide to change strategy and also decide to not make any changes to structure. Or they could revamp structure but not change strategy. I have seen both occur during my experience as a management consultant. When you change one, it will change the other because of the dependent relationship. That's where companies get into trouble. They change one and don't realize how it will alter the other. Then the other one changes and in a way that hurts them. Here's a simple, classic and all too common example. Suppose a company has a strategy to deliver superior customer service. Every part of their firm has been developed to do this consistently. This strategy has resulted in their having an image of offering great service and support. Then profit margins get squeezed due to competitors actions and the company responds by laying off employees and shrinking some departments. They think they can do this without it affecting their service image. Usually, they are wrong because their service slips (the structure side) due to the change in strategy (making cost reduction a higher priority than service).

What is the contribution of the Organization structure to strategy implementation?

The structure of the organization will determine if the strategy can even be implemented and under what conditions the organization can deliver the strategy. Structure is everything that makes up the organization including it's people, leadership, infrastructure, capital, technology and more. It's all the parts and pieces that make up the organization and what it does. If an organization changes its strategy and starts implementing it, the success of this endeavor depends on the structure. You can't successfully implement a strategy the existing structure doesn't support. The implementation of strategy starts by reconfiguring the structure so it will support the new strategy. That may involve creating new departments, hiring people with expertise the organization now lacks, upgrading the skills and attitudes of everyone working for the organization, changing the organization chart, accessing more capital, developing new technology and software, changing physical facilities by either increasing or decreasing them, developing new methods of logistics and distribution if appropriate and so much more. A classic example of this issue is now confronting Best Buy. You may have read about the problems Best Buy, the electronics retailer, is now facing with large losses and having to address severe competition from Amazon, Walmart and Costco among others. Their recent press releases talk about matching the prices the other retailers charge.

The challenge for Best Buy is that first it has to decide what it wants to be and what strategies will help it move in that direction. It seems to be toying with implementing a low price strategy. The problem is that it can't just cut its prices to match these major competitors because it won't make any money. All it will end up doing is churning dollars but not increasing profits. The reason for this has everything to do with Best Buy's structure as compared to Walmart, Costco and Amazon. These three competitors are completely structured to deliver low prices and make a profit. All three of them succeed very well at doing this. For example, one of the reasons Walmart can consistently offer low prices across the board is because they eliminated an entire distribution channel between the manufacture and their stores. They did this by developing their own logistics and distribution system which is probably the best in the world. Both the efficiency of this system and the elimination of the profit an outside distributor would build into its prices gives Walmart an edge with their landed cost.

For Best Buy to pursue a low cost strategy, it takes more than just lowering prices. They have to restructure their company and develop a distribution and logistics system like their competitors that can lower their total landed cost of product to their stores. That would require a huge investment on their part. If they don't do that and lower their prices, they may increase their revenue but won't make a profit off it.

Further, they would be making a huge investment just to match competitors who are already world class at delivering low prices. They aren't going to be able to beat those prices and they are taking a huge risk just to see if they could and get people to buy. You can see that for Best Buy to pursue a low price strategy would require a huge investment, restructuring and risk. Whenever an organization changes its strategy, it has to identify all the elements within its structure that must change to support that strategy. Otherwise, the strategy is doomed.

How often does a company or an organization change their strategies?

Every company is different, every market is different, every situation is different so there is no single right answer to this question. Check out 100 companies and you will find 100 different answers to your question. Here is the more relevant point. Companies shouldn't change their strategy just to change it or because they feel they had their current one for too long or because they see other companies changing theirs. There is no right or wrong number of times to change a strategy. Some companies have essentially kept the same strategy for decades with only minor adjustments. Others seem to change their strategies every few years. And then there are those that think a new year means a new strategy. Normally the later don't last. Companies should keep their existing strategies when they work. That means they are producing good results satisfying both shareholders and customers and are holding their own against a changing competitive landscape. You change a strategy only when you have to or it makes sense to adjust to what you see happening in the future. Strategy is the primary way that companies adjust to change or fail to adjust to change. It's how they keep their firms aligned with their marketplace and help them get an edge over their competition. If what a firm has works, no need to change it.

If it's not working or it looks like new developments are going to change the playing field, then altering strategy is a good idea. More often than not, the problem is with companies that change their strategies too often.

That is because they haven't done a good job of figuring out who they are in the market and are not willing to commit to a well thought out, long term approach for their firm. Every company is different, every market is different, every situation is different so there is no single right answer to this question. Check out 100 companies and you will find 100 different answers to your question.

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Why does the structure of an organization follow the development of the organization strategy, rather than the strategy following the development of the structure?

We all know the age old question, which came first the chicken or the egg. For that question, the argument can go either way. In the case of strategy, there is only one choice. For an organization to be successful in achieving its goals, it must have the right strategy. Strategy defines who the organization's markets and customers are, what they want and need, what types of products and services will be offered to satisfy them, how to make, distribute, market and sell its offerings and how the organization will go about doing all that in a profitable way. The how includes everything from how it is made, who makes it, how it is distributed, what sales channels are used, how the market buys or acquires the product and service, how the firm differentiates itself from competition and alternative solutions and so much more. So strategy defines what business you are in, who you serve, how you serve your markets, and how you do this in a way that gets enough customers to buy from you a profitable price. There is no way to know what structure an organization needs until it defines its strategies. The organization structure including capital, people, infrastructure, assets, systems and so on can only be known once the strategy is known.

For example, if you decide that you are going to be a virtual company using other firms to manufacture, distribute, and provide customer service, then you obviously don't need to build a manufacturing plant, logistics system, customer service center, call service center and all the administrative support people and systems necessary to run these. You can set up in a small office with a small staff of key people because everything else is outsourced. On the other hand, if you go back to the birth of Federal Express which grew out of a college thesis, the company's strategy was based on the ability to deliver packages "absolutely positively overnight." That was it's core strategy and that strategy encompassed it's understanding of who it's market was, what they needed and were willing to pay a profitable price to get and how it was going to do all this. Since nothing existed already to deliver such an amazing promise (at the time), the entire infrastructure to do this had to be built from scratch. That meant they had to create their own airline, with their own planes and distribution centers and trucks and local facilities to deliver on the promise. I believe the initial funding for Federal Express was over $200 million to make this happen. Their strategy detected the organization structure they needed to achieve it. Reflect on all this for a moment. If you don't have a strategy, how in the world can you know what type of organization structure you are going to need? While strategy and structure are indeed married to each other, it's always strategy that must lead the charge.

What impact will it have on a company is there isn't a strategy, structure and system?

The short answer is that the company will go out of business very rapidly. No business can exist without a strategy. Regardless of its structure and systems or the lack thereof, a business must have a strategy that defines what market and customers it is serving, what product or service it is offering that market, how it gets people to buy what it offers and how it does all this in such a way as to make a profit. You have to answer those questions to even have a business. Without it, you're just sitting at home playing Frisbee with the dog.

2.6. How Strategy Shapes Structure

(W. Chan Kim and Renée Mauborgne , HAVARD BUSINESS REVIEW 2009)

When executives develop corporate strategy, they nearly always begin by analyzing the industry or environmental conditions in which they operate. They then assess the strengths and weaknesses of the players they are up against. With these industry and competitive analyses in mind, they set out to carve a distinctive strategic position where they can outperform their rivals by building a competitive advantage. To obtain such advantage, a company generally chooses either to differentiate itself from the competition for a premium price or to pursue low costs. The organization aligns its value chain accordingly, creating manufacturing, marketing, and human resource strategies in the process. On the basis of these strategies, financial targets and budget allocations are set.

The underlying logic here is that a company's strategic options are bounded by the environment. In other words, structure shapes strategy. This "structuralist" approach, which has its roots in the structure-conduct-performance paradigm of industrial organization economics1, has dominated the practice of strategy for the past 30 years. According to it, a firm's performance depends on its conduct, which in turn depends on basic structural factors such as number of suppliers and buyers and barriers to entry. It is a deterministic worldview in which causality flows from external conditions down to corporate decisions that seek to exploit those conditions. Even a cursory study of business history, however, reveals plenty of cases in which firms' strategies shaped industry structure, from Ford's Model T to Nintendo's Wii. For the past 15 years, we have been developing a theory of strategy, known as blue ocean strategy, that reflects the fact that a company's performance is not necessarily determined by an industry's competitive environment.2 The blue ocean strategy framework can help companies systematically reconstruct their industries and reverse the structure-strategy sequence in their favor. Blue ocean strategy has its roots in the emerging school of economics called endogenous growth3, whose central paradigm posits that the ideas and actions of individual players can shape the economic and industrial landscape. In other words, strategy can shape structure. We call this approach "reconstructionist." While the structuralist approach is valuable and relevant, the reconstructionist approach is more appropriate in certain economic and industry settings. Indeed, today's economic difficulties have heightened the need for a reconstructionist alternative. The first task of an organization's leadership, therefore, is to choose the appropriate strategic approach in light of the challenges the organization faces. Choosing the right approach, however, is not enough. Executives then need to make sure that their organizations are aligned behind it to produce sustainable performance. Most executives understand the mechanics of making the structuralist approach work, so this article will focus on how to align an organization behind the reconstructionist approach to deliver high and sustainable performance.

2.6.1. What Is the Right Strategic Approach for Your Business?

There are three factors that determine the right approach: the structural conditions in which an organization operates, its resources and capabilities, and its strategic mind-set. When the structural conditions of an industry or environment are attrac-

tive and you have the resources and capabilities to carve out a viable competitive position, the structuralist approach is likely to produce good returns (see the exhibit “Choosing the Right Strategic Approach”). Even in a not-so-attractive industry, the structuralist approach can work well if a company has the resources and capabilities to beat out the competition. In either case, the focus of strategy is to leverage the organization’s core strengths to achieve acceptable risk-adjusted returns in an existing market.
But when conditions are unfavorable and they are going to work against you whatever your resources and capabilities might be, a structuralist approach is not a smart option. This often happens in industries characterized by excess supply, cutthroat competition, and low profit margins. In these situations, an organization should adopt a reconstructionist approach and build a strategy that will reshape industry boundaries.

Remark. Blue Ocean Strategy is about re-defining the industry value curve and identifying value innovation. The aim is to move the firm away from direct competition with other firms in the industry and to instead to create a "new" industry in which the value offering is so differentiated from competitors, that those competitors tactics and manoeuvring is no longer (directly) relevant. Thus, the analogy is that the current market is too competitive and that the ocean is bloodied by the aggressive competition (which erodes profitability, firms coalesce around the same dominant value curve and only look for small incremental improvements, etc..). Blue Ocean Strategy moves the firm into clear, blue waters.

Revision Questions

Example ✐. Explain the requirements for Strategic Implementation

Solution: for revision □

EXERCISE 4. ✍ Explain the strategy implementation and structure

LESSON 3

Strategy and organizational culture/ corporate culture

By the end of this chapter, the learner should be able to define, identify, explain, describe and discuss the following:

1. Organization culture
2. Corporate culture
3. Characteristics of organization culture

Culture refers to the values and patterns of belief and behavior that are accepted and practiced by the members of a particular organization. As we look into this topic it is important to take the following into mind:

- Organizational culture changes as environment changes.
- The founder and Top management shape the org. culture.
- Change in strategy requires change in culture.

Organizational culture includes the norms, values and beliefs that organizational members share **(Schneider, 1990)**, and is shaped by opinion leaders, history, and by work that is valued and rewarded in the company. It is also cognitive in nature, and serves to give employees a sense of identity about themselves, their coworkers, and the company. Research has shown that a strong corporate culture can give a company a powerful advantage over its competitors, especially in highly competitive and commodity-like markets **(Kotter and Heskett, 1992; Burt et al., 1994)**. Culture pervades every level of a company, including the shared beliefs held by top managers regarding how they should manage themselves, their subordinates, and the company **(Lorsch, 1986)**. Culture may stem from the strong influence of a company's founder(s) (Herb Keller at Southwest Airlines is a good example), but may also be influenced by its relationship and experiences with the firm's external environment, e.g., needs of key customers, competitive environment, etc. **(Greenberg and Baron, 2000)**.

3.1. Types of Organizational Cultures

There are various types of organizational or corporate cultures. Their classification can be summarized into the following:

- Strong versus Weak cultures
- Positive versus Negative cultures
- Healthy Versus Unhealthy cultures
- Flexible versus Rigid cultures

Remark. Read more on each of these types of cultures to discover their characteristics and how each impacts on strategy implementation.

3.1.1. Why Build a Strong and Effective Culture? Because:

- Organizational culture is a system of Shared values (what is important) and Beliefs (how things work)
- Organizational culture shapes a firm's People, Organizational structures and Control systems
- Organizational culture produces behavioral norms
- Culture sets implicit boundaries – Dress, Ethical matters and the way an organization conducts its business
- Culture acts as a means of reducing monitoring costs
- Effective culture must be cultivated, encouraged and fertilized. It must be maintained through storytelling and rallies or pep talks by top executives

3.1.2. Corporate Culture can be supported through motivating with Rewards and Incentives

Rewards and incentive systems have the following merits

- Powerful means of influencing an organization's culture
- Focuses efforts on high-priority tasks

- Motivates individual and collective task performance
- Can be an effective motivator and control mechanism Potential downside of rewards and incentives
- Subcultures may arise in different business units with multiple reward systems
- May reflect differences among functional areas, products, services and divisions
- Shared values may emerge in subculture in opposition to patterns of the dominant culture
- Reward systems may lead to information hoarding, working at cross purposes

3.1.3. Creating effective reward and incentive programs

- Objectives are clear, well understood and broadly accepted
- Rewards are clearly linked to performance and desired behaviors
- Performance measures are clear and highly visible
- Feedback is prompt, clear, and unambiguous
- Compensation “system” is perceived as fair and equitable
- Structure is flexible; it can adapt to changing circumstances

3.1.4. Corporate Leadership

The leader is an individual who is able to influence the attitudes and opinion of others. The leader must have a clear vision. Developing and maintaining a strong, positive culture which is supportive to strategy implementation requires strong leadership. The leader must do the following in addition to having a clear vision:

- Communicate that vision
- Build a strong political base
- Allocate resources appropriately and adequately

- Provide support and counseling to staff
- Encourage free sharing of ideas and experience throughout the implementation process

Revision Questions

Example ✐. what do you understand by Characteristics of organization culture

Solution: for revision □

EXERCISE 5. ✍ Explain what is meant by Corporate culture

LESSON 4

Strategy evaluation and strategic control

By the end of this chapter, the learner should be able to define, identify, explain, describe and discuss the following:

1. Strategy evaluation
2. Strategic control
3. Nature of control
4. Evaluation and control within an organization

Strategy evaluation involves "examining how the strategy has been implemented as well as the outcomes of the strategy" (Coulter, 2005, p. 8). This includes determining whether deadlines have been met, whether the implementation steps and processes are working correctly, and whether the expected results have been achieved. If it is determined that deadlines are not being met, processes are not working, or results are not in line with the actual goal, then the strategy can and should be modified or reformulated.

Both management and employees are involved in strategy evaluation, because each is able to view the implemented strategy from different perspectives. An employee may recognize a problem in a specific implementation step that management would not be able to identify.

The strategy evaluation should include challenging metrics and timetables that are achievable. If it is impossible to achieve the metrics and timetables, then the expectations are unrealistic and the strategy is certain to fail.

4.1. The Meaning and Nature of Control

There is no consensus in the literature regarding the definition of control or control system. Perspectives range from broad conceptualizations where management control is seen as everything that managers do to achieve the goals of the organization, to narrow definitions concerning specific aspects of the accounting system (**Anthony, 1995; Machin, 1988; Nandan, 1996**). This may also reflect disagreement regarding the appropriate discipline into which the study of management control systems most appropriately belongs.

Traditionally, management control systems were defined as those formal, systematically developed, organization-wide, data handling systems, which are designed to facilitate the management control process **(Machin, 1988)**. This conceptualization tended to be very much accounting-based, with management control being seen as synonymous with management accounting. However, in a services-driven rather than manufacturing driven economy, conceptualizing control in terms of accounting becomes problematic. The relevant costs to be controlled shift from what are termed engineered costs to managed and committed costs **(Anthony, 1995)**. The problem with managed costs in the difficulty of predicting or forecasting the outcome of a certain level of cost incurred, and traditional accounting-based systems are not effective in measuring the output of managed costs.

As a result, the study of management control systems is now evolving into a study of those formal and informal systems that help individuals control what they do with themselves and other resources. Controls are intended to guard against the possibility that people will do something the organization doesn't want them to do or fail to do something they should do. **Lowe and Machin (1988)** approach the role of management control systems as enabling specific and specialized resources within the organization to be harnessed effectively in line with organizational purpose. However, they note (p.26) a problem in that organizational purpose is rarely clearly defined: "In an organization whose purpose includes the stated and the unstated, the explicit and the implicit, perhaps in contradiction and conflict in some cases, how can one design and develop a coherent, effective management control system". Anthony defines management control as the process by which managers assure that resources are obtained and used effectively and efficiently in the accomplishment of the organization's objectives (1995).

Controls prescribe a set of activities for dealing with situations as they arise. **Anthony and Govindarajan (1995)** propose that the formal management control process can be broken down into distinct stages: strategic planning, budget preparation, performance measurement and analysis, and performance evaluation and compensation. Others discuss a hierarchy of control, ranging from strategic control that focuses on the overall strategic direction of the firm to annual plan control, profitability control, and operational efficiency control **(Anthony and Govindarajan, 1995; Morris, Pitt and Honeycutt, 2000)**. **Tannenbaum (1968)** defines management control as any process in which a person or group or organization determines or intentionally affects what another person, group or organization will do. Tannenbaum developed a model of control termed a control cycle. Starting with the simplest of situations, whereby an individual controller wishes to influence the behavior of an individual controllee, he defines each of the elements between the original intention of the controller and the eventual feedback of the resulting behavior. Other research introduces the influence of social interaction, the importance of informal communication, and the role of self-control in the control process **(Dalton and Lawrence, 1971)**. **Nandan (1996)** incorporates informal and social processes, where management control is approached as a broadly defined set of strategies and mechanisms designed and implemented to co-ordinate and control loosely coupled units located in time and space.

Further research has identified four basic strategies of control: simple control, technological control, bureaucratic/administrative control and concertive/cultural control **(Cirka, 1997)**. Simple control is the direct personal supervision exercised by the owner over his subordinates. Technological control deals with the technological techniques used in production processes. Bureaucratic and administrative control covers the formal rules, procedures and policies used in hierarchical organizations. Concertive or cultural control deals with the control brought about by shared values, norms and the conformance to the beliefs of social system. Control strategies can be further grouped into behavior, output and input control **(Cirka, 1997)**. Behavior control focuses on regulating the activities of organizational members through operating procedures and personal evaluation. Input control regulates the inputs to the organization based on considerations regarding the most appropriate inputs for attaining the desired state. Output controls set targets for and measure achievement. An additional classification of control practices focuses on whether they arise from conscious managerial efforts or from informal mechanisms which emerge through the spontaneous interactions of workers over time. Lastly, **Machin (1988)** proposes that the field of management control includes four spectra:

- The managerial output, ranging from concrete items such as units of production to abstract outcomes such as effective co-ordination.
- The information used to measure success ranging from objective numbers to subjective linguistic data
- The philosophy of management, ranging from autocratic ordering to partici-

pative assistance to goal achievement.

- The system mode ranging from feedback control facilitating retrospective performance evaluation to feed forward control providing advice and assistance to the subordinate.

4.2. The Evolution of Control Within the Organization

Management control systems tend to evolve with the organization. Organizational structures typically start as simple forms where the owner/entrepreneur exercised personal centralized authority reinforced by close personal supervision. The owner/entrepreneur exercises the planning and control without formal structures or systems. With the development of larger and more complex organizations seeking greater economies of scale, control comes to be exercised through a bureaucracy. Standardization of work is introduced along with the formal programming of behavior. Responsibility for behavioral control and control of output is delegated to individuals according to their level within the hierarchy. An important issue for the theory of management control is that the development of bureaucracy and the resultant hierarchical structures brought with it a greater need for management. But as organizations move away from hierarchies to flatter structures, the need for managers and management control lessens.

Robert Schwartz (1985) refers to "whole person organizations" where he argues that with the move away from the industrial age, with its specialization and repetitive tasks, to a more creative high tech information age, the whole person is required to do the job, not just the arms and legs. The difficulty is that no one knows how to control an environment in which everybody is urged to be themselves, which leads to a paradox in that contemporary organizations risk failure if they let everybody run free uncontrollably, but they also risk stagnation and ultimate demise if they don't free up the creative talents of their employees.

Contingency theory posits that the appropriate organizational structure is dependent upon the contingencies of size, technology and the external environment. To the extent that organizational design is dependent on the external environment, it is dependent on the amount of uncertainty inherent in that environment. As the environment becomes more complex and dynamic, uncertainty increases and the appropriate organizational structure changes. Moreover, the choice of organizational structure is closely linked to the management control strategy, such that the level of uncertainty then has implications for the choice of control strategy. **Van de Ven and Delbecq (1988)** found that as task uncertainty increased, co-ordination by programming and hierarchical means was substituted by horizontal communication channels. **Lawrence and Lorsch (1967)** suggest that dynamic environments tend to lead to adaptation facilitated by less formal controls. Galbraith (1975) argues that the greater the uncertainty, the greater the amount of information that needs to be processed. He discusses the implications of an increasing information load for the design of management control systems. After exhausting all the procedural and formative control methods, management is eventually confronted with two alternatives in dealing with information overload. The first alternative deals with moving away from functionally defined units to project or task focused units. The second deals with improving communication flows through greater horizontal interaction. The effectiveness of formal controls may be limited in situations of uncertainty, while the use of social or informal means becomes more appropriate. Social standards and group interactions rather than formal control systems are often said to explain much of the behavior found within organizations. To be effective, management control must therefore embrace an analysis of social standards and interactions. Control over the human inputs into the organization is increasingly being recognized as complementary to or as a substitute for formal control over behavior and outputs. This philosophy is embraced in the theory of Indirect controls, Unobtrusive controls and Control by **Ritual (Cirka, 1997).**

These processes do not aim to program behavior directly but bring about appropriate informal or social forces for actions. The traditional approach to management control has been criticized by social physiological researchers as neglecting motivation and interpersonal behavior. **McKenna (1988)** uses motivational theory to investigate the motivational implications of management control. Emmanuel and Otley note that attempts to control behavior represent a complex and ill understood activity because it involves attempts to control self-controlling human beings **(Cirka, 1997)**. The control process assists in ensuring "the minimization of idiosyncratic behavior and the promotion of conformity in accordance with explicit plans" **(McKenna, 1988).** One approach to control is close supervision, where parameters are set for the amount of discretion that can be exercised by subordinates. However, close supervision is considered to be less desirable from a motivational point of view. Another approach to control is procedural control or formalization, which refers to controlling behavior through policies and plans designed to prescribe correct or expected action.

Formalization facilitates greater delegation through structuring work therefore it lessens the need for close supervision. It is also asserted that greater individual effort follows delegation since it permits a higher degree of individual freedom, discretion and control. Goal congruence is facilitated in these circumstances. The downside to delegation is that it causes managers in different departments to develop their own departmental identities and philosophies. Their decisions become increasingly based on departmental rather than organizational goals and a parochial outlook makes co-ordination more difficult. Formalization and procedural control may promote minimally acceptable behavior rather than effective behavior. Procedural controls demand rigid and conformist behavior and are considered to be inappropriate for conditions of innovation and a rapidly changing environment (McKenna, 1988). McKenna (1988) proposes that firm hierarchical and procedural methods of control may not be most appropriate forms. A control system that facilitates autonomy among subordinates in an environment where group acceptance and equitable rewards prevail is highly recommended in turbulent conditions as it is more effective in enhancing organizational adaptability and responsiveness. However, the challenge is the development of an organizational environment or culture that supports greater autonomy. **Thomas (1988)** investigates the area of self-control and its use in the organization to improve overall organizational control. He analyses the uses of the term self-control in the literature and argues that the term is often mistaken with what is essentially social control. More specifically, he distinguishes self-direction, where the individual exercises discretion over his own behavior that may or may not be conducive to the achievement of organizational goals (and he/she does not necessarily adopt these goals as his/her own), from self-control, where the individual internalizes the organizations goals and values. He concludes that, in the absence of this internalization, one must resort to administrative and social control. **Richbell (1988)** investigates the potential that increased participation has for increasing management control. He argues that increased participation may increase overall control as a result of "the potential to create attitudes of involvement and commitment to the organization" (1988, p.169). Individuals will feel more responsibility for carrying out decisions in which they have been involved, enhancing control at both group and individual level. Richbell states that while participation may offer the possibility of increasing control over uncertainty in the human resources area, its potential for increasing control over other organizational behavior is limited.

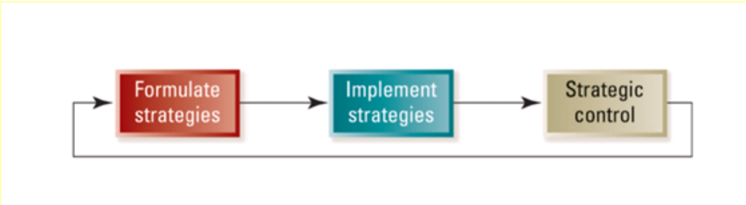
4.3. Approaches to Control

There are two major approaches to strategic control, namely:

- Traditional control system
- Contemporary control system

4.3.1. Traditional Approach to Strategic Control

Traditional control system - Involves lengthy time lags, often tied to the annual planning cycle. It is a "Single-loop" learning control system which compares actual performance to a predetermined goal. It is based largely on the feedback approach. Little or no action is taken to revise strategies, goals and objectives until the end of the time period as the diagram below depicts.



Traditional approach is sequential and consists of the five simple steps below:

- Strategies are formulated
- Top management sets goals
- Strategies are implemented
- Performance is measured against the predetermined goal set
- Corrective measures are taken

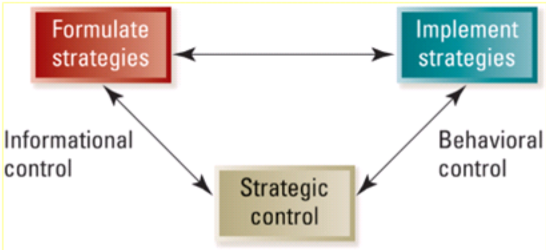
It is appropriate when

- There is a stable and simple environment

- Goals and objectives can be measured with certainty
- There is little need for complex measures of performance

4.3.2. Contemporary Approach to Strategic Control

Contemporary control system continually monitors the environments (internal and external), identifying trends and events that signal the need to revise strategies, goals and objectives. The diagram below shows the interdependency between the major steps in strategic management cycle.



It reveals that the relationships between strategy formulation, implementation and control are highly interactive. There are two different types of control:

- Informational control
- Behavioral control

- **Informational control**

Informational control is concerned with whether or not the organization is "doing the right things" while **Behavioral control** is concerned with whether or not the organization is "doing things right" in the implementation of its strategy. Both types of control are necessary conditions for success.

Informational Control deals with internal environment and external strategic context. The key question here is, "Do the organization's goals and strategies still 'fit' within the context of the current strategic environment?" Two key issues are - Scan and monitor external environment (general and industry), and continuously monitor the internal environment.

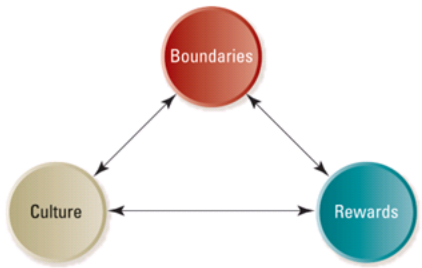
There exists a sharp contrast between the two approaches in terms of Informational Control. According to the Traditional approach understanding of the assumption base is an initial step in the process of strategy formulation whereas the Contemporary approach views Information control as part of an ongoing process of organizational learning that updates and challenges the assumptions underlying the firm's strategy.

- **Behavioral Control**

Behavioral control is focused on implementation processes and procedures — doing things right. It is based on three key control "levers":

- Culture
- Rewards
- Boundaries

Behavioral Control is majorly concerned with balancing Culture, Rewards, and Boundaries. The contrast between the two approaches in this case is that Traditional approach emphasizes comparing outcomes to predetermined strategies and fixed rules while Contemporary approach emphasizes a balance between Culture, Rewards and Boundaries as per the diagram below.



The first two components of this tripartite relationship have been discussed in the above sections. Boundaries will be briefly discussed below.

4.3.3. Characteristics of Effective Contemporary Control Systems

Control system must focus on:

- Constantly changing information identified by managers as having potential strategic importance
- Data important enough to demand frequent and regular attention from operating managers at all levels of the organization.

Data and information generated by the control system is being interpreted and discussed in face-to-face meetings of Superiors, Subordinates, and Peers

- Control system as a key catalyst for ongoing debates on
- Underlying data
- Assumptions
- Action plans

4.3.4. Setting Boundaries and Constraints

The aim must be to focus efforts on strategic priorities. Short-term objectives must be Specific and measurable, have Specific time horizon for attainment, be Achievable, but challenging and Provide proper direction, but be flexible when faced with need to change Short-term action plans should be also specific, implementable, and individual managers held accountable for implementation of action plans.
Rule-based controls are most appropriate in firms with the following characteristics

- Stable and predictable environments
- Largely unskilled and interchangeable employees
- Consistency in product and service is critical
- Risk of malfeasance is extremely high

Guidelines
Can set spending limits and range of discretion, and also Can specify proper relationships with customers and suppliers.
Evolving from Boundaries to Rewards and Culture
Organizations should strive to have boundaries internalized through a system of rewards and incentives coupled with a strong culture. In addition to these:

- Hire the right people (already identify with the firm's dominant values)
- Train people in the dominant cultural values
- Have managerial role models
- Reward systems clearly aligned with organizational goals and objectives

4.3.5. Business-Level Strategy and Strategic Control:

Firms competing on the basis of cost must implement

- Tight cost controls
- Frequent and comprehensive reports to monitor costs associated with outputs
- Highly structured tasks and responsibilities
- Incentives based on explicit financial targets, rather than innovation and creativity Firms competing on the basis of differentiation must implement
- Employ experts who can identify crucial elements of intricate, creative designs and marketing decisions
- Support for collaboration and cooperation among specialists and functional managers
- Behavioral performance measures and intangible incentives and rewards

4.3.6. Corporate-Level Strategy and Strategic Control

Key issue is the need for independence versus interdependence Cost strategies and unrelated diversification require:

- Less need for interdependence
- Reward and control systems to focus more on financial indicators

Differentiation or related diversification require:

- Intense need for tight interdependencies among functional areas and business units
- Sharing of resources is critical
- Synergies are more important than cost leadership
- Heavy use of behavioral performance indicators

4.3.7. Relationships Between Control and Business-Level and Corporate-Level Strategies Role of Corporate

Governance Corporate governance is responsible for the creation of relationship among the shareholders, the management (led by the Chief Executive Officer) and the board of directors or Separation of Owners (Shareholders) and Management. Shareholders (investors) have a limited liability, participate in the profits of the enterprise but with limited involvement in the company's affairs. Board of directors, who are elected by shareholders have a judicial obligation to protect shareholder interests. Agency Theory poses a few problems for corporate governance:

- Goals of principals and agents may conflict
- Difficulty or expensive for the principal to verify what the agent is actually doing
- Hard for board of directors to confirm that managers are actually acting in shareholders interests
- Managers may opportunistically pursue their own interests
- Principal and agent may have different attitudes and preferences toward risk

Governance Mechanisms should align the Interests of Owners and Managers. There are two primary means of monitoring behavior of managers:

1. Having committed and involved board of directors who can:
    - Be active, critical participants in setting strategies
    - Evaluate managers against high performance standards
    - Take control of succession process
    - Director independence
2. Shareholder activism – giving the the shareholders the:
    - Right to sell stock
    - Right to vote the proxy

- Right to sue for damages if directors or managers fail to meet their obligations
- Right to information from the company
- Residual rights following company's liquidation

Reward and compensation agreements can also be powerful in align the Interests of Owners and Managers:

- Align rewards of all employees (including rank and file as well as executives) to the long-term performance of the corporation
- Allow creation of executive wealth that is reasonable in view of the creation of shareholder wealth
- Measurable and predictable outcomes that are directly linked to the company's performance, which are market oriented, easy to understand by investors and employees and fully disclosed to investing public and approved by shareholders.

Revision Questions

Example ✐. Analyze the Strategy evaluation

Solution: for revision □

EXERCISE 6. ✍ Analyze the Strategic control

EXERCISE 7. ✍ Analyze the Nature of control

EXERCISE 8. ✍ Analyze the Evaluation and control within an organization

LESSON 5

Strategy formulation and strategic analysis tools

By the end of this chapter, the learner should be able to define, identify, explain, describe and discuss the following:

1. Strategy formulation process
2. Value chain analysis
3. Porters value chain models
4. Different strategic analysis tools

5.1. Introduction

Strategy Formulation

1. **Organizational Mission and Objectives** - these provide direction for other aspects of the process.

2. **Environmental analysis** - It takes into account the external factors. Includes collection of relevant information from the environment, interpreting its impact on the future organizational working, and determining what opportunities and threats are offered by the environment.

3. **Corporate analysis** -it takes into account the internal factors which are critical for the success of the present or future business of the organization and then evaluating these factors whether they are contributing in a positive way or in a negative way. A positive contribution is strength while a negative contribution is a weakness.

4. **Identification of alternatives** - environment analysis and corporate analysis taken together will specify the various alternatives for strategy. Usually this process will bring large number of alternatives. Therefore, criteria should be set up to evaluate each alternative. Normally the criteria are set in the light of organizational mission and objectives.

5. **Choice of alternative** - Choice is determining the acceptable alternative among the several which fit with the organizational objectives.

Implementation

This is the way of putting the selected strategy into action. Choice of the strategy is mostly analytical and conceptual while implementation is operational or putting into action. Strategic management does not occur in a vacuum i.e. it is influenced by many factors that may affect the success of the firm.

The two main factors that require an in-depth analysis when analyzing the situation are:

1. Industry
2. Competition

- **Industry analysis** - is the process of surveying or analyzing the industry within which business exists with the aim of understanding how to fix yourself in the industry.
- **Competition analysis** - refers to closely monitoring the competition, the competitors, the competitive advantages as well as the core competences that are required to succeed in that industry.

Exercise. When designing the strategies, strategic managers require a thorough understanding of industry and competition areas, and to better understand these, managers must ask:

What are the boundaries of the industry?

Exercise. What is the structure of the industry?

Exercise. Which firms are our main competitors?

Exercise. What are the major determinants of competition in that industry?

NOTE: Answers to these four questions will provide a basis for thinking when formulating appropriate strategies or making choices.

5.1.1. Activities Incorporated by Industry and Competition analysis

Industry and competition analysis incorporate the following activities:

1. Defining and choosing the boundaries of the industry and the company markets.

2. Understanding the structure of the industry.
3. Analyzing the forces of competition.
4. Determining the key success factor in the industry.
5. Performing competitive intelligence analysis.
6. Interpreting competitive signals.
7. Identifying opportunities and threats.

- Defining and Choosing the Boundaries of the Industry and the Company Markets

  Defining the industry requires a focus on the customer needs and expectation. It involves identifying:

  - Customer segments within the industry
  - Customer needs and purchasing patterns
  - Technology to be used to meet these needs and expectations.

- Understanding the Structure of the Industry

  This involves paying attention to the following:

  - Barriers to entry or exit.
  - The level of product differentiation.
  - The level of concentration i.e. the number of competitors and the extent of competition.
  - Economies of scale i.e. the ability of the business to produce a variety of products and still achieve the economies

- Analyzing the forces of competition

  This involves analyzing the five forces of Porter's model. According to Michael Porter, in his book **"Competitive Advantage",** analyzing the level of competition involves an understanding of five major forces that determine the level of competition within an industry.

5.2. Competitor analysis and competitive advantage

5.2.1. Analyzing Competitors

Analyzing key competitors allows an entrepreneur to:

- Avoid surprises from existing competitors' new strategies and tactics.
- Identify potential new competitors and the threats they pose.
- Improve reaction time to competitors' actions.
- Anticipate rivals' next strategic moves.

5.2.2. Techniques of analysis:

- Monitor industry and trade publications.
- Talk to customers and suppliers.
- Listen to employees, especially sales representatives and purchasing agents.
- Attend trade shows and conferences.
- Study competitors' literature and "benchmark" their products and services.
- Get competitors" credit reports.
- Check out the local library.
- Use the World Wide Web to learn more about competitors.
- Visit competing businesses to observe their operations

5.2.3. Competitive Profile Matrix

Once you do a successful competitor analysis, then you can build a competitive profile matrix. These are simple tools that allow a business owner to evaluate his company against major competitors on the key success factors in that market, which can lead to quick update of your knowledge of competitors. The following may form key areas for the matrix:

- Major competitors

- Cost structure
- New competitors
- Competitors' key strategies
- Strengths and weaknesses
- Customers' view
- Read trade publications
- Ask customers and suppliers
- Talk to employees
- Attend trade shows
- Buy their products

5.2.4. Competitive Advantage

A firm gains a competitive advantage when it is able to do what it is doing better than its competitors. This can be achieved by defining the firm's core competencies, creating the companies' core competencies, Market segmentation and Positioning

Core competencies

Core competencies a unique set of capabilities that a company develops in key operational areas that allow it to vault past competitors. Creating your company's core competencies may rotate around understanding customer characteristics such as buying of goods, for example, increase or decrease purchases.

Market segmentation

Carving up the mass market into smaller, more homogeneous units and then attacking each segment with a specific marking strategy.

Positioning

This involves influencing customers' perceptions to create the desired image for the business and its goods. This can be sometimes achieved through knowledge management, which is described as the practice of gathering, organizing, and disseminating the collective wisdom and experience of a company's employees for the purpose of strengthening its competitive position. Knowledge management involves taking inventory of the special knowledge the people in the company possess organizing that knowledge and disseminating it to those who need it.

5.2.5. Analysis of Core Competencies

Core competencies are the capabilities that are vital for the competitive well-being of the organization. They are collective skills e.g. of how to coordinate and integrate special production skills of technologies. Significant resources must be put into acquiring them. Core competencies support all business aspects. Barney ,in his VRIO framework of analysis, proposes four questions to evaluate a firm's competencies:

- Value : Does it provide consumer value and competitive advantage?
- Rareness : Do other competitors posses it?
- Imitability : Is it costly for others to imitate?
- Organization : Is the firm organized to exploit the resource?

5.2.6. Using resources to gain competitive advantage:

Arguing that a company's sustained competitive advantage is primarily determined by his resource endowments; Grant proposes a five steps, resource - based approach to strategy analysis:

1. Identify and classify the firm's resources in terms of strengths and weaknesses. C
2. ombine the firm's strengths into different capabilities and core competencies .
3. Appraise the profit potential of these capabilities and competencies.

4. Select the capability that best exploits the firm's capabilities an competencies related to external opportunities.

5. Identify resource gaps and invest in upgrading weaknesses.

5.2.7. Tests to identify core competencies:

- Provide potential access to a wide variety of markets.
- Makes a significant contribution to perceived customer benefits of the end-product
- Makes it difficult for a competitor to copy.

To produce a list of core competencies, an organization must consider its capabilities and any gaps that need to be plugged.

5.2.8. Guidelines for core competencies:

An organization should have 5-6 core competences The embedded skills that breed the next generation of competitive products should not be bought or rented on outsourcing deals. Any outsourcing must be treated with care.

- **Deliver core products:**

  Core products embody the core competencies and are the components that add to the value of the end products.

- **Value chain analysis;**

  Value Chain Analysis is another framework or tool that is used to diagnose or understand the internal environment of a business or a production system.

The internal environment is the final step in gathering information for the Environmental Analysis. It consists of identifying resources and capabilities (in the form of the value chain), finding competencies, and determining what competitive advantages (hopefully sustainable) the organization has. The internal environmental assessment, along with the external evaluation (macro and micro environment) already completed will provide all the information needed for the final SWOT Analysis.

5.2.9. Resources Capabilities, Competencies, Tangible Assets, Intangible Assets and Organizational Capabilities:

Resources, capabilities, and competencies should be evaluated with respect to goals, strategy, and the vision statement of the organization. Not every RC&C needs to be included in the evaluation – only those that will eventually lead to a competitive advantage. For example, you have a top-notch janitorial staff, but unless you have a cleaning service, it really does not help your competitive position. The following lists will help identify what types of RC&C items that need to be considered. A few examples are listed.

- **Resources and capabilities**
  1. Physical -. Plants, Equipment, Natural resources
  2. Human - Managerial Know-how, Talented key employees, Friendly staff
  3. Intellectual - Specialized knowledge, Collective learning, Cutting edge technological knowledge
  4. Intangible - Patents and copyrights, - Brand name - Customer loyalty
  5. Skills - Proven ability to introduce new products, Expertise at providing consistently good customer service, Ability to create "lean" value chain
  6. Organizational - Proprietary technology, Cash, Strong network of suppliers, Well organized, effective, efficient management structure, Alliances, partnerships, cooperative or joint ventures

- **Inbound Logistics**

Inbound logistics covers everything that has to do with the obtaining, purchasing, storing, distributing (internally), and managing raw inputs, components, materials, and services. Some examples would be JIT systems, inspection processes, advanced receiving systems, EDI (electronic data interchange) systems, inventory control, and SCM (supply chain management).

- **Operations**

Operations consist of all the processes, assets, and costs of turning raw materials into a final product or service. Facilities (and maintenance), workers, designers, quality assurance, environmental protection, equipment, and assembly processes would be included in the evaluation of Operations.

- **Outbound Logistics**

Outbound logistics encompasses all of the resources, capabilities, and processes required to distribute the final product or service. Examples of outbound logistic items are warehousing, packaging, shipping, delivery vehicles (and maintenance), order picking, finished goods inventory control, distributor and customer supply chain management (CRM – customer relationship management).

- **Sales and Marketing**

Sales and Marketing is considered everything associated with marketing the product or service. The sales force, personal selling, advertising, promotion, market research, web site, and dealer or distributor support are a few examples of Sales and Marketing.

- **Service**

Service is associated with providing assistance to the customer. Some Service examples are installation, warranty work, maintenance, complaints, questions, repair, and technical assistance.

- **Competencies**

Competencies are accomplished by evaluating the organization's resources and capabilities and benchmarking as discussed in the sections below.
Points to note:

- The term value chain describes a way of looking at business as a chain of activities that transform inputs into outputs that adds customer's value.
- Value chain analysis attempts to understand how a business creates customer value by examining the contributions of different activities within the business to the customer value.

– Competitive possibilities open to an organization can be discerned from a resource audit which is assessed for efficiency and effectiveness. - Efficiency – measure of how well the resources are being used e.g. profitability, capacity, use and the yield gained from that capacity. - Effectiveness – assessment of how well the resources are allocated to those activities which are the most competitively significant within the value chain (distribution)

5.3. The aim of value chain analysis

A model can be used to assess activity by activity, the degree of effectiveness of resource use and efficiency in the value chain.
The aim is to identify areas of potential improvements.

5.3.1. Porter's Value Chain Model

This model classifies activities into:

- Primary activities – contribute to getting the goods or service one step closer to the customers.
- Secondary activities – support the primary activities

- **Primary Activities**
  - Inbound logistics – All processes associated with receiving, storing and disseminating inputs to the production process for the product or service.
  - Operations – All processes associated with transforming the inputs into outputs.
  - Outbound logistics – All activities concerned with distributing the products or services to the customers.
  - Sales & Marketing – Activities which provide opportunities for the potential customer to buy the product or service and offer inducements to do so e.g. advertising, pricing, tendering etc.
  - Services – All processes concerned with the provision of service as part of the deal struck with the customers e.g. repairs, maintenance, spare parts supply, product upgrades, training, installation etc.

- **Secondary activities**
  - Administration and Infrastructure – The tasks that comprise general management, planning, legal services, quality management, office administration etc.
  - Human Resource Management - Activities associated with recruiting training, developing, appraising, promoting and rewarding personnel.
  - Product/Technology development – Activities that relate to developing the technology of the product or service and the processes that produce it and the processes that ensure the management of the organization, e.g. IS , development of new product /service designs.
  - Procurement – Activities that support the procurement of inputs for all of the activities of the value chain e.g. Procurement of IS, raw materials etc.
- **Portfolio analysis**

This is sometimes referred to as Product Portfolio Analysis and requires that a company must continuously evaluate its businesses in order to determine how to allocate resources to different units as products. This is because some business units may be too weak hence making losses or eating on the profits of others. Strategic managers can use various models/ tools in evaluating their business/ products.
An example tool is the Boston Consulting Group (BCG) tool matrix, which is 2x2 matrix.
It classifies businesses, products or divisions according to the present market share and the future growth of the market.
The intention of the matrix is to distinguish between the cash generators and the cash consumers
The model uses the analogy in the following diagram.

5.3.2. The BCG Growth-Share Matrix

The BCG Growth-Share Matrix is a portfolio planning model developed by Bruce Henderson of the Boston Consulting Group in the early 1970’s. It is based on the observation that a company’s business units can be classified into four categories based on combinations of market growth and market share relative to the largest competitor, hence the name "growth-share". Market growth serves as a proxy for industry attractiveness, and relative market share serves as a proxy for competitive

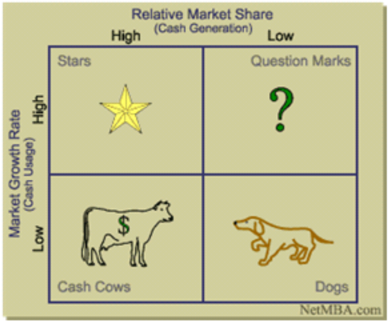


Figure 5.1: BCG Growth-Share Matrix

advantage. The growth-share matrix thus maps the business unit positions within these two important determinants of profitability.

BCG Growth-Share Matrix

This framework assumes that an increase in relative market share will result in an increase in the generation of cash. This assumption often is true because of the experience curve; increased relative market share implies that the firm is moving forward on the experience curve relative to its competitors, thus developing a cost advantage. A second assumption is that a growing market requires investment in assets to increase capacity and therefore results in the consumption of cash. Thus the position of a business on the growth-share matrix provides an indication of its cash generation and its cash consumption.

Henderson reasoned that the cash required by rapidly growing business units could be obtained from the firm's other business units that were at a more mature stage and generating significant cash. By investing to become the market share leader in a rapidly growing market, the business unit could move along the experience curve and develop a cost advantage. From this reasoning, the BCG Growth-Share Matrix was born.

The four categories are:

- Dogs - Dogs have low market share and a low growth rate and thus neither generate nor consume a large amount of cash. However, dogs are cash traps because of the money tied up in a business that has little potential. Such businesses are candidates for divestiture.

- Question marks - Question marks are growing rapidly and thus consume large amounts of cash, but because they have low market shares they do not generate much cash. The result is a large net cash comsumption. A question mark (also known as a "problem child") has the potential to gain market share and become a star, and eventually a cash cow when the market growth slows. If the question mark does not succeed in becoming the market leader, then after perhaps years of cash consumption it will degenerate into a dog when the market growth declines. Question marks must be analyzed carefully in order to determine whether they are worth the investment required to grow market share.

- Stars - Stars generate large amounts of cash because of their strong relative market share, but also consume large amounts of cash because of their high growth rate; therefore the cash in each direction approximately nets out. If a star can maintain its large market share, it will become a cash cow when the market growth rate declines. The portfolio of a diversified company always should have stars that will become the next cash cows and ensure future cash generation.

- Cash cows - As leaders in a mature market, cash cows exhibit a return on assets that is greater than the market growth rate, and thus generate more cash than they consume. Such business units should be "milked", extracting the profits and investing as little cash as possible. Cash cows provide the cash required to turn question marks into market leaders, to cover the administrative costs of the company, to fund research and development, to service the corporate debt, and to pay dividends to shareholders. Because the cash cow generates a relatively stable cash flow, its value can be determined with reasonable accuracy by calculating the present value of its cash stream using a discounted cash flow analysis.

Under the growth-share matrix model, as an industry matures and its growth rate declines, a business unit will become either a cash cow or a dog, determined soley by whether it had become the market leader during the period of high growth.
While originally developed as a model for resource allocation among the various business units in a corporation, the growth-share matrix also can be used for resource allocation among products within a single business unit. Its simplicity is

its strength - the relative positions of the firm's entire business portfolio can be displayed in a single diagram.

5.3.3. Limitations

The growth-share matrix once was used widely, but has since faded from popularity as more comprehensive models have been developed. Some of its weaknesses are:

- Market growth rate is only one factor in industry attractiveness, and relative market share is only one factor in competitive advantage. The growth-share matrix overlooks many other factors in these two important determinants of profitability.
- The framework assumes that each business unit is independent of the others. In some cases, a business unit that is a "dog" may be helping other business units gain a competitive advantage.
- The matrix depends heavily upon the breadth of the definition of the market. A business unit may dominate its small niche, but have very low market share in the overall industry. In such a case, the definition of the market can make the difference between a dog and a cash cow.

While its importance has diminished, the BCG matrix still can serve as a simple tool for viewing a corporation's business portfolio at a glance, and may serve as a starting point for discussing resource allocation among strategic business units.

5.4. Benchmarking and Balance Scorecard;

5.4.1. Benchmarking

Benchmarking may be done on several levels: industry, primary competition, and prior performance. Although many books focus primarily on cost, benchmarking may also be accessed through efficiency and effectiveness. Some examples of efficiency benchmarking might be number of defective widgets produced; hours of downtime for machine X; or number of days from sale to delivery. Efficiency types of measures should be used in conjunction with standard financial measures of benchmarking such as days in inventory or asset turnover ratios. As a part of benchmarking capabilities against the competition, weighted chart is used, as not all competencies are as important as others are. An example for the pet store is given below:

Resource/Capability	Rare	Valuable	Non-substitutable	Non-imitable	Exploitable
Owner's knowledge	Yes	Yes	Yes	Yes	Yes
Financial resources	No	Somewhat	Yes	Yes	Somewhat
Location	Yes	Yes	No	Somewhat	Somewhat
Marketing skills	No	Yes	Somewhat	Yes	Somewhat
Hiring skills	Somewhat	Yes	Yes	Yes	Yes
Customer Service	Yes	Yes	No	No	Yes

5.4.2. Balanced Scorecards

This refers to a set of measurements unique to a company that includes both financial and operational measures. It gives managers a quick, and yet a comprehensive picture of a company's overall performance.

Four Perspectives are covered:

• Customer: How do customers see us?

• Internal Business: At what must we excel?

• Innovation and Learning: Can we continue to improve and create value?

• Financial: How do we look to shareholders?

Revision Questions

Example ✎. Describe Porters value chain models.

Solution: for revision □

EXERCISE 9. ✍ Discuss the Strategy formulation process

LESSON 6

Competitive advantage of a company

By the end of this chapter, the learner should be able to define, identify, explain, describe and discuss the following:

1. Core competencies and competitive advantage
2. Porter's generic strategies
3. Competitive strategies

6.1. Core competencies and competitive advantage

In order to understand the above concepts defining a few common terms may be necessary.

Resources: These are organization's assets and are thus the basic building blocks of the organization. They include physical assets such as plant, equipment and location ;human assets in terms of the number of employees and their skills; and organizational assets such as culture and reputation.

Capabilities: Refer to a corporation's ability to exploit its resources. They consist of business processes and routines that manage the interaction among resources to turn inputs into outputs e.g. a company's marketing ability can be based on the interaction among its marketing specialists.

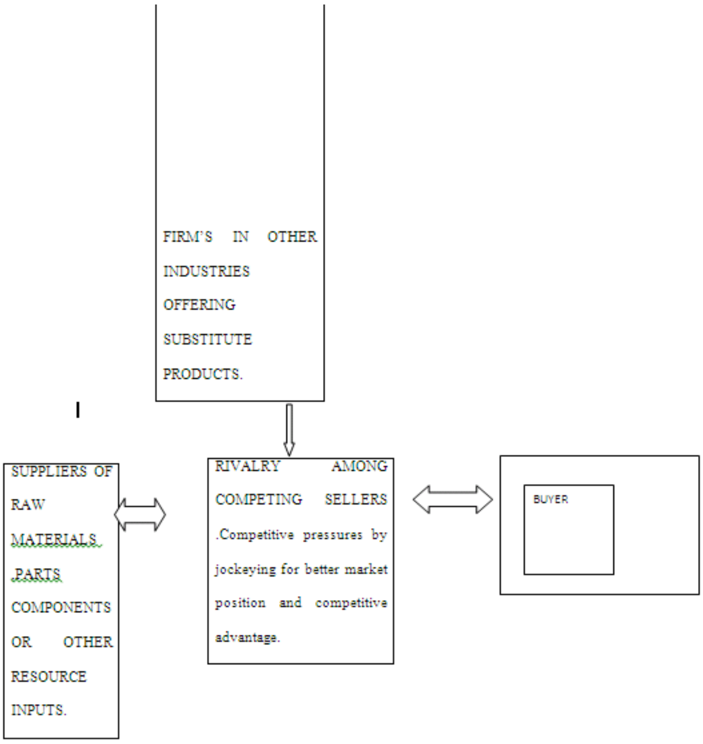
A competency: Is a cross-functional integration and coordination of capabilities. For example a competency in new product development in one division of a corporation may be the consequence of integrating management of information systems capabilities.

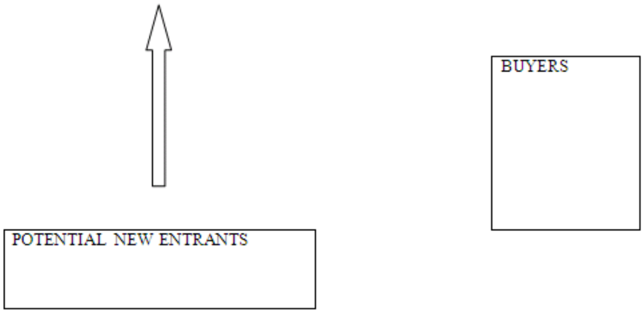
Core competency: Is a collection of competencies that crosses divisional boundaries , is widespread within the corporation and is something that the corporation can do exceedingly well. A company has **competitive advantage** whenever it has an edge over rivals in attracting customers and defending against competitive forces. For example providing buyers with what they perceive as superior value – a good product at a low price.

6.2. Competitive forces and generic strategies;

Competitive forces: Porter of Harvard business school has convincingly demonstrated ,the state of competition in an industry in a composite of five competitive forces:

1. The rivalry among competing sellers in the industry.
2. The potential entries among competitors.
3. The market attempts of companies in other industries to win customers over their own substitute products.
4. The competitive pressures stemming from supplier- seller collaboration and bargaining.
5. The competitive pressures stemming from seller – buyer collaboration and bargaining.





The rivalry among competing sellers: The strongest of the five competitive forces is usually the jockeying for position and the buyer favor that goes on among rival sellers of a product or service. In some industries, the cross- company rivalry is centered on price competition –competing to offer buyers the best (lowest) price is typical among internet retailers and the sellers of such standard commodities as nails plywood, sugar, printer paper ,and gasoline. Regardless of the industry, several common factors seem to influence the tempo of cross-company rivalry:

1. Rivalry intensifies as the number of competitors increases and as competitors become more equal in size and capability.

2. Rivalry is usually stronger when the demand for the products is growing slowly .

3. Rivalry is more intense when industry conditions tempt competitors to use price cuts or other competitive weapons to boost unit volume.

4. Rivalry is stronger when customers' cost to switch brands are low.

5. Rivalry is stronger when one or more competitors are dissatisfied with their market position and launch moves to bolster their standing at the expense of the rivals.

6. Rivalry increases in proportion to the size of the playoff from a successful strategic move.

7. Rivalry tends to be more vigorous when it costs more to get out of the business than to stay in and compete.

8. Rivalry become more volatile and unpredictable the more diverse competitors are in terms of their visions , strategic intents , objectives , strategies , resources ,and countries of origin.

9. Rivalry increases when strong companies outside the industry acquire weak firms in the industry and launch aggressive , well-funded moves to transform their newly acquired competitors into major market contenders.

The potential entry of new competitors: New entrants to a market bring new production capacity, the desire to establish a secure place in the market , and sometimes substantial resources with which to compete. Just how serious the competitive threat of entry is in a particular market depend on two classes of factors: Barriers to entry and the expected reaction of incumbent firms to new entries. A barrier to entry exists wherever it is hard for a new comer to break into the market or economic factors put a potential entrant at a disadvantage relative to its competitors. There are several types of entry barriers:

- Economies of scale
- Cost and resource disadvantages independent of size
- Learning and experience curve effect
- Inability to match the technology and specialized know-how of firms already in the industry .
- Brand preferences and customer loyalty
- Capital requirements
- Access to distribution channels
- Regulatory policies
- Tariffs and international trade restriction

Competitive pressures from substitute products: Firms in one industry are quite often in close competition with firms in another industry because their respective products are good substitutes. The producers of eyeglasses compete with the makers of contact lenses and with eye specialists who perform lesser surgery to correct vision problems. The presence of readily available and attractively priced substitutes creates competitive pressure by placing a ceiling on the prices and industry can charge for its products without giving customers an incentive to switch to substitutes and risking sales erosion. The availability of substitute inevitably invites customers to compare quality , features ,performance ,ease of use and other attributes as well as prices.

Competitive pressure stemming from supplier bargaining power and supplier seller collaboration: Whether supplier – seller relationships represent a weak or strong competitive force depends on whether suppliers can exercise sufficient bargaining power to influence the terms and conditions of supply in their favor , and the extent of supplier – seller collaboration in the industry. The suppliers to a group of rival firms are a strong competitive force whenever they have sufficient bargaining power to put certain rivals at a competitive disadvantage based on the prices they can command , the quality and performance of the items they supply, or the reliability of their deliveries.

Competitive pressures stemming from buyer bargaining power and seller buyer collaboration: Whether seller – buyer relationships represent a weak or strong competitive force depends on whether buyers have sufficient bargaining power to influence the terms and conditions of sale in their favor and the extent and competitive importance of seller buyer strategic partnerships in the industry. Buyers are a strong competitive force when they are able to exercise bargaining leverage over price ,quality service or other terms of sales. Even if buyers do not purchase in large quantities or offer a seller important market exposure or prestige , they may still have some degree of bargaining leverage in the following circumstances:

- If buyers costs of switching to competing brands or substitutes are relatively low.
- If the number of buyers is small or if a customer is particularly important to a seller
- If buyers are well informed about sellers' products ,prices , and costs.
- If buyers pose a credible threat of integrating backward into the business of sellers.
- If buyers have discretion in whether and when they purchase the product.

6.3. Competitive Strategies

A Competitive strategy is about being different. It means deliberately choosing to perform activities differently or perform different activities than rivals to deliver a unique mix of value (Michael E. Porter). The essence of strategy lies in creating tomorrow's competitive advantages faster than competitors mimic the ones you possess today. Gary Hamel & Prahalad C.K.)

6.3.1. Porter's generic competitive strategies

We shall consider competitive strategy by using Porter's three generic strategies as the fundamental choices, and then adding various competitive tactics. Michael Porter (1980, 1985) has proposed three generic strategies that provide good starting point for strategic thinking:

1. Overall cost leadership
2. Differentiation
3. Focus

6.3.2. Overall cost leadership

Cost leadership: Is a lower- cost competitive strategy that aims at the broad mass market and requires aggressive construction of efficient scale facilities , vigorous pursuit of cost reduction from experience tight cost and overhead control , avoidance of marginal customer accounts and cost minimization in areas like R&D , service , sales force , advertising. Because of its lower costs , the cost leader is able to charge a lower price for its products than its competitors and still make satisfactory profit. Although it may not necessarily have lowest costs in the industry, it has lower cost than its competitors. Some companies successfully following this strategy are Wal- mart , Dell (computers) ,Alamo (rental cars). Having a lower- cost position also gives a company or business unit a defense against rivals. Its lower costs allow it to continue to earn profits during times of heavy competition. Its high market share means that it will have high bargaining power relative to its suppliers (because it buys in large quantities). Its low price will also serve as a barrier to entry because few new entrants will be able to match the leader's cost advantage. As a result, cost leaders are likely to earn above- average returns on investment

- Involves appealing to a broad section of the market by providing products or services at the lowest price.
- This requires being the overall low-cost provider of the products or services (e.g. Hyundai among automobile manufacturers)
- Implementing this successfully requires continual exceptional efforts to reduce costs without excluding product features and services that buyers consider essential.

6.3.3. Differentiation

- Appeals to a broad section of the market offering differentiation features that make customers willing to pay premium prices e.g. superior technology, quality, prestige, special features, service, convenience etc. (e.g. Lexus)
- Success with this type of strategy requires differentiation features that are hard or expensive for competitors to duplicate.
- Sustainable differentiation usually comes from advantages in core competencies, unique company resources or capabilities, and superior management of value chain activities.

6.3.4. Focus

Focus can be looked at in two different ways:

1. Price (cost) focus – A market niche strategy , concentrating on a narrow customer segment and competing with the lowest prices, which again requires having lower cost structure than competitors.
2. Differentiation focus – A second market niche strategy, concentrating on a narrow customer segment and competing through differentiation features (e.g. a high- fashion women's clothing boutique in Nairobi)
    - Best- cost provider strategy
    - This is not one of Porter's basic three strategies, though it is mentioned by a number of other writers.

- It is a strategy of trying to give customers the best cost/ value combination, by incorporating key good-or-better product characteristics at a lower cost than competitors.
- It is a mixture or hybrid of low-price and differentiation, and targets a segment of value- conscious buyers that is usually larger than a market-niche, but smaller than a broad market. (e.g. Honda, Nokia and Toyota)

6.3.5. Other Competitive Tactics

Although a choice of one of the generic competitive strategies discussed provides the foundation for a business strategy, there are many variations and elaborations. Among these are various tactics that may be useful. In general, tactics are shorter in time horizon and narrower in scope than strategies. • There are two types of competitive tactics :

1. Time tactics
2. Market location tactics

- **Time tactics**

Involves when to enter a market or make a strategic move. This is often as important as what move to make. We often talk of :

1. First-mover – The first to provide a product or service.
2. Second-mover – Also known as rapid followers.
3. Late-mover –Wait-and-see.

- **Market location tactics**

When and how to enter and/or defend. These fall conveniently into offensive and defensive tactics.

1. Offensive tactics- Are designed to take market share from a competitor.
2. Defensive tactics- Attempt to keep a competitor from taking away some of our present market share.

Offensive tactics

1. Frontal Assault – going head- to – head with the competitor, matching each other in every way. To be successful, the attacker must have superior resources and be willing to continue longer than the company attacked.

2. Flanking Manoeuvre – Attacking a part of the market where the competitor is weak.

3. Encirclement – Usually evolves from the previous two. It involves encircling and pushing over the competitor's position in terms of greater product variety and/ or serving more markets.

4. Bypass Attack – Attempting to cut the market out from under the established defender by offering a new, superior type of produce that makes the competitor's product unnecessary or undesirable.

5. Guerrilla Warfare – using a " hit and run" attack on a competitor, with small, intermittent assaults on different market segments.

Defensive tactics

1. Raise Structural Barriers – Block avenues that challengers can take in mounting an offensive move.

2. Increase Expected Retaliation - Signal challengers that there is threat of strong retaliation if they attack.

3. Reduce Inducement for Attack – e.g. lower profits to make things less attractive. Keeping prices very low gives a new entrant little profit incentive to enter.

6.4. The product life cycle;

Product life-cycle management (or PLCM) is the succession of strategies used by business management as a product goes through its life-cycle. The conditions in which a product is sold (advertising, saturation) changes over time and must be managed as it moves through its succession of stages.
Product life-cycle (PLC) Like human beings, products also have a life-cycle. From birth to death, human beings pass through various stages e.g. birth, growth, maturity, decline and death. A similar life-cycle is seen in the case of products. The

product life cycle goes through multiple phases, involves many professional disciplines, and requires many skills, tools and processes. Product life cycle (PLC) has to do with the life of a product in the market with respect to business/commercial costs and sales measures. To say that a product has a life cycle is to assert three things:

- Products have a limited life,
- Product sales pass through distinct stages, each posing different challenges, opportunities, and problems to the seller,
- Products require different marketing, financing, manufacturing, purchasing, and human resource strategies in each life cycle stage.

The four main stages of a product's life cycle and the accompanying characteristics are:

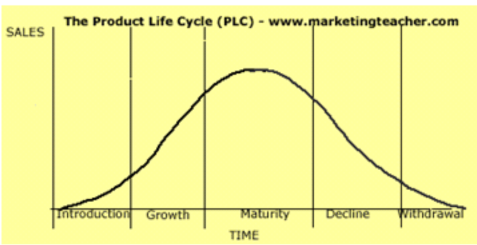
1. **Market introduction stage**
    - costs are very high
    - slow sales volumes to start
    - little or no competition
    - demand has to be created
    - customers have to be prompted to try the product
    - makes no money at this stage
2. **Growth stage**
    - costs reduced due to economies of scale
    - sales volume increases significantly
    - profitability begins to rise
    - public awareness increases
    - competition begins to increase with a few new players in establishing market
    - increased competition leads to price decreases

3. **Maturity stage**

    - costs are lowered as a result of production volumes increasing and experience curve effects
    - sales volume peaks and market saturation is reached
    - increase in competitors entering the market
    - prices tend to drop due to the proliferation of competing products
    - brand differentiation and feature diversification is emphasized to maintain or increase market share
    - Industrial profits go down

4. **Saturation and decline stage**

    - costs become counter-optimal
    - sales volume decline
    - prices, profitability diminish
    - profit becomes more a challenge of production/distribution efficiency than increased sales



6.4.1. Lessons of the PLC

It is claimed that every product has a life period, it is launched, it grows, and at some point, may die. A fair comment is that – at least in the short term – not all products or services die. Jeans may die, but clothes probably will not. Legal services or medical services may die, but depending on the social and political climate, probably will not.
Limitations

The PLC model offers some degree of usefulness to marketing managers, in that it is based on factual assumptions. Nevertheless, it is difficult for marketing management to gauge accurately where a product is on its PLC graph. A rise in sales per se is not necessarily evidence of growth. A fall in sales per se does not typify decline. Furthermore, some products do not (or to date, at the least, have not) experience a decline. **Coca Cola and Pepsi** are examples of two products that have existed for many decades, but are still popular products all over the world. Both modes of cola have been in maturity for some years. Another factor is that differing products would possess different PLC "shapes". A fad product would hold a steep sloped growth stage, a short maturity stage, and a steep sloped decline stage. A product such as Coca Cola and Pepsi would experience growth, but also a constant level of sales over a number of decades. It can probably be said that a given product (or products collectively within an industry) may hold a unique PLC shape, and the typical PLC model can only be used as a rough guide for marketing management. This is why its called the product life cycle. The duration of PLC stages is unpredictable. It is not possible to predict when maturity or decline will begin. Strict adherence to PLC can lead a company to misleading objectives and strategy prescriptions.

6.5. Asset Allocation, Diversification, and Rebalancing

Even if you are new to investing, you may already know some of the most fundamental principles of sound investing. How did you learn them? Through ordinary, real-life experiences that have nothing to do with the stock market. For example, have you ever noticed that street vendors often sell seemingly unrelated products - such as umbrellas and sunglasses? Initially, that may seem odd. After all, when would a person buy both items at the same time? Probably never - and that's the point. Street vendors know that when it's raining, it's easier to sell umbrellas but harder to sell sunglasses. And when it's sunny, the reverse is true. By selling both items- in other words, by diversifying the product line - the vendor can reduce the risk of losing money on any given day. If that makes sense, you've got a great start on understanding asset allocation and diversification. This publication will cover those topics more fully and will also discuss the importance of rebalancing from time to time.

Asset Allocation

Asset allocation involves dividing an investment portfolio among different asset categories, such as stocks, bonds, and cash. The process of determining which mix of assets to hold in your portfolio is a very personal one. The asset allocation that works best for you at any given point in your life will depend largely on your time horizon and your ability to tolerate risk.

- **Time Horizon** - Your time horizon is the expected number of months, years, or decades you will be investing to achieve a particular financial goal. An investor with a longer time horizon may feel more comfortable taking on a riskier, or more volatile, investment because he or she can wait out slow economic cycles and the inevitable ups and downs of our markets. By contrast, an investor saving up for a teenager's college education would likely take on less risk because he or she has a shorter time horizon. Risk

- **Tolerance** - Risk tolerance is your ability and willingness to lose some or all of your original investment in exchange for greater potential returns. An aggressive investor, or one with a high-risk tolerance, is more likely to risk losing money in order to get better results. A conservative investor, or one with a low-risk tolerance, tends to favor investments that will preserve his or her original investment. In the words of the famous saying, conservative investors keep a "bird in the hand," while aggressive investors seek "two in the bush."

Risk versus Reward

When it comes to investing, risk and reward are inextricably entwined. You've probably heard the phrase "no pain, no gain" - those words come close to summing up the relationship between risk and reward. Don't let anyone tell you otherwise: All investments involve some degree of risk. If you intend to purchases securities - such as stocks, bonds, or mutual funds - it's important that you understand before you invest that you could lose some or all of your money. The reward for taking on risk is the potential for a greater investment return. If you have a financial goal with a long time horizon, you are likely to make more money by carefully investing in asset categories with greater risk, like stocks or bonds, rather than restricting your investments to assets with less risk, like cash equivalents. On the other hand, investing solely in cash investments may be appropriate for short-term financial goals.

Investment Choices

While the SEC cannot recommend any particular investment product, you should know that a vast array of investment products exists - including stocks and stock mutual funds, corporate and municipal bonds, bond mutual funds, lifecycle funds, exchange traded funds money market funds, and U.S. Treasury securities. For many financial goals, investing in a mix of stocks, bonds, and cash can be a good strategy. Let's take a closer look at the characteristics of the three major asset categories.

- **Stocks** - Stocks have historically had the greatest risk and highest returns among the three major asset categories. As an asset category, stocks are a portfolio's "heavy hitter," offering the greatest potential for growth. Stocks hit home runs, but also strike out. The volatility of stocks makes them a very risky investment in the short term. Large company stocks as a group, for example, have lost money on average about one out of every three years. And sometimes the losses have been quite dramatic. But investors that have been willing to ride out the volatile returns of stocks over long periods of time generally have been rewarded with strong positive returns.

- **Bonds** - Bonds are generally less volatile than stocks but offer more modest returns. As a result, an investor approaching a financial goal might increase his or her bond holdings relative to his or her stock holdings because the reduced risk of holding more bonds would be attractive to the investor despite their lower potential for growth. You should keep in mind that certain categories of bonds offer high returns similar to stocks. But these bonds, known as high-yield or junk bonds, also carry higher risk.

- **Cash** - Cash and cash equivalents - such as savings deposits, certificates of deposit, treasury bills, money market deposit accounts, and money market funds - are the safest investments, but offer the lowest return of the three major asset categories. The chances of losing money on an investment in this asset category are generally extremely low. The federal government guarantees many investments in cash equivalents. Investment losses in non-guaranteed cash equivalents do occur, but infrequently. The principal concern for investors investing in cash equivalents is inflation risk. This is the risk that inflation will outpace and erode investment returns over time.

Stocks, bonds, and cash are the most common asset categories. These are the asset categories you would likely choose from when investing in a retirement savings program or a college savings plan. But other asset categories - including real estate, precious metals and other commodities, and private equity - also exist, and some investors may include these asset categories within a portfolio. Investments in these asset categories typically have category-specific risks. Before you make any investment, you should understand the risks of the investment and make sure the risks are appropriate for you.

6.5.1. Why Asset Allocation Is So Important

By including asset categories with investment returns that move up and down under different market conditions within a portfolio, an investor can protect against significant losses. Historically, the returns of the three major asset categories have not moved up and down at the same time. Market conditions that cause one asset category to do well often cause another asset category to have average or poor returns. By investing in more than one asset category, you'll reduce the risk that you'll lose money and your portfolio's overall investment returns will have a smoother ride. If one asset category's investment return falls, you'll be in a position to counteract your losses in that asset category with better investment returns in another asset category. The Magic of Diversification. The practice of spreading money among different investments to reduce risk is known as **diversification**. By picking the right group of investments, you may be able to limit your losses and reduce the fluctuations of investment returns without sacrificing too much potential gain.

In addition, asset allocation is important because it has major impact on whether you will meet your financial goal. If you don't include enough risk in your portfolio, your investments may not earn a large enough return to meet your goal. For example, if you are saving for a long-term goal, such as retirement or college, most financial experts agree that you will likely need to include at least some stock or stock mutual funds in your portfolio. On the other hand, if you include too much risk in your portfolio, the money for your goal may not be there when you need it. A portfolio heavily weighted in stock or stock mutual funds, for instance, would be inappropriate for a short-term goal, such as saving for a family's summer vacation.

How to Get Started

Determining the appropriate asset allocation model for a financial goal is a complicated task. Basically, you're trying to pick a mix of assets that has the highest probability of meeting your goal at a level of risk you can live with. As you get closer to meeting your goal, you'll need to be able to adjust the mix of assets. If you understand your time horizon and risk tolerance - and have some investing experience - you may feel comfortable creating your own asset allocation model. "How to" books on investing often discuss general "rules of thumb," and various online resources can help you with your decision. For example, although the SEC cannot endorse any particular formula or methodology, the Iowa Public Employees Retirement System offers an online asset allocation calculator. In the end, you'll be making a very personal choice. There is no single asset allocation model that is right for every financial goal. You'll need to use the one that is right for you.

Some financial experts believe that determining your asset allocation is the most important decision that you'll make with respect to your investments - that it's even more important than the individual investments you buy. With that in mind, you may want to consider asking a financial professional to help you determine your initial asset allocation and suggest adjustments for the future. But before you hire anyone to help you with these enormously important decisions, be sure to do a though check of his or her credentials and disciplinary history.

The Connection Between Asset Allocation and Diversification

Diversification is a strategy that can be neatly summed up by the timeless adage "Don't put all your eggs in one basket." The strategy involves spreading your money among various investments in the hope that if one investment loses money, the other investments will more than make up for those losses.

Many investors use asset allocation as a way to diversify their investments among asset categories. But other investors deliberately do not. For example, investing entirely in stock, in the case of a twenty-five year-old investing for retirement, or investing entirely in cash equivalents, in the case of a family saving for the down payment on a house, might be reasonable asset allocation strategies under certain circumstances. But neither strategy attempts to reduce risk by holding different types of asset categories. So choosing an asset allocation model won't necessarily diversify your portfolio. Whether your portfolio is diversified will depend on how you spread the money in your portfolio among different types of investments.

6.5.2. Diversification and innovation;

- **Diversification**

A diversified portfolio should be diversified at two levels: between asset categories and within asset categories. So in addition to allocating your investments among stocks, bonds, cash equivalents, and possibly other asset categories, you'll also need to spread out your investments within each asset category. The key is to identify investments in segments of each asset category that may perform differently under different market conditions. One of way of diversifying your investments within an asset category is to identify and invest in a wide range of companies and industry sectors. But the stock portion of your investment portfolio won't be diversified, for example, if you only invest in only four or five individual stocks. You'll need at least a dozen carefully selected individual stocks to be truly diversified. Because achieving diversification can be so challenging, some investors may find it easier to diversify within each asset category through the ownership of mutual funds rather than through individual investments from each asset category. A mutual fund is a company that pools money from many investors and invests the money in stocks, bonds, and other financial instruments. Mutual funds make it easy for investors to own a small portion of many investments. A total stock market index fund, for example, owns stock in thousands of companies. That's a lot of diversification for one investment! Be aware, however, that a mutual fund investment doesn't necessarily provide instant diversification, especially if the fund focuses on only one particular industry sector.

If you invest in narrowly focused mutual funds, you may need to invest in more than one mutual fund to get the diversification you seek. Within asset categories, that may mean considering, for instance, large company stock funds as well as some small company and international stock funds. Between asset categories, that may mean considering stock funds, bond funds, and money market funds. Of course, as you add more investments to your portfolio, you'll likely pay additional fees and expenses, which will, in turn, lower your investment returns. So you'll need to consider these costs when deciding the best way to diversify your portfolio.

- **Options for One-Stop Shopping - Lifecycle Funds**

To accommodate investors who prefer to use one investment to save for a particular investment goal, such as retirement, some mutual fund companies have begun offering a product known as a "lifecycle fund." A lifecycle fund is a diversified mutual fund that automatically shifts towards a more conservative mix of investments as it approaches a particular year in the future, known as its "target date." A lifecycle fund investor picks a fund with the right target date based on his or her particular investment goal. The managers of the fund then make all decisions about asset allocation, diversification, and rebalancing. It's easy to identify a lifecycle fund because its name will likely refer to its target date. For example, you might see lifecycle funds with names like "Portfolio 2015," ***"Retirement Fund 2030," or "Target 2045."***

6.5.3. Changing Your Asset Allocation

The most common reason for changing your asset allocation is a change in your time horizon. In other words, as you get closer to your investment goal, you'll likely need to change your asset allocation. For example, most people investing for retirement hold less stock and more bonds and cash equivalents as they get closer to retirement age. You may also need to change your asset allocation if there is a change in your risk tolerance, financial situation, or the financial goal itself. But savvy investors typically do not change their asset allocation based on the relative performance of asset categories - for example, increasing the proportion of stocks in one's portfolio when the stock market is hot. Instead, that's when they "rebalance" their portfolios.

6.6. Rebalancing

Rebalancing is bringing your portfolio back to your original asset allocation mix. This is necessary because over time some of your investments may become out of alignment with your investment goals. You'll find that some of your investments will grow faster than others. By rebalancing, you'll ensure that your portfolio does not overemphasize one or more asset categories, and you'll return your portfolio to a comfortable level of risk.
For example, let's say you determined that stock investments should represent 60% of your portfolio. But after a recent stock market increase, stock investments repre-

sent 80% of your portfolio. You'll need to either sell some of your stock investments or purchase investments from an under-weighted asset category in order to reestablish your original asset allocation mix. When you rebalance, you'll also need to review the investments within each asset allocation category. If any of these investments are out of alignment with your investment goals, you'll need to make changes to bring them back to their original allocation within the asset category. There are basically three different ways you can rebalance your portfolio: You can sell off investments from over-weighted asset categories and use the proceeds to purchase investments for under-weighted asset categories. You can purchase new investments for under-weighted asset categories. If you are making continuous contributions to the portfolio, you can alter your contributions so that more investments go to under-weighted asset categories until your portfolio is back into balance. Before you rebalance your portfolio, you should consider whether the method of rebalancing you decide to use will trigger transaction fees or tax consequences. Your financial professional or tax adviser can help you identify ways that you can minimize these potential costs. Stick with Your Plan: Buy Low, Sell High - Shifting money away from an asset category when it is doing well in favor an asset category that is doing poorly may not be easy, but it can be a wise move. By cutting back on the current "winners" and adding more of the current so-called "losers," rebalancing forces you to buy low and sell high.

- **When to Consider Rebalancing**

You can rebalance your portfolio based either on the calendar or on your investments. Many financial experts recommend that investors rebalance their portfolios on a regular time interval, such as every six or twelve months. The advantage of this method is that the calendar is a reminder of when you should consider rebalancing. Others recommend rebalancing only when the relative weight of an asset class increases or decreases more than a certain percentage that you've identified in advance. The advantage of this method is that your investments tell you when to rebalance. In either case, rebalancing tends to work best when done on a relatively infrequent basis.

6.7. Innovation.

Companies' growth agendas rest upon tried and true strategies, tactics and other best practices that are "proven" to drive results. And why shouldn't they be? They've worked in the past and are often associated with the success of the core business. The problem is that these strategies and tactics can often be misaligned to the unique market, technology, or organizational requirements for realizing future opportunities and breakthrough innovations .Through understanding innovation lifecycles, it becomes possible to address the following questions:

- Which products, services and technologies are most vulnerable to competitive disruption?
- Where are the greatest opportunities for breakthrough innovation and growth?
- What specific growth strategies are appropriate across the portfolio?
- What organizational strategies – leadership, structure, processes, and metrics – best support businesses, products, and services at different points across their maturity?

6.8. S-curves

S-curves visually depict how a product, service, technology or business progresses and evolves over time. S-curves can be viewed on an incremental level to map product evolutions and opportunities, or on a macro scale to describe the evolution of businesses and industries. On a product, service, or technology level, S- curves are usually connected to "market adoption" since the beginning of a curve relates to the birth of a new market opportunity, while the end of the curve represents the death, or obsolescence of the product, service, or technology in the market. Usually the end of one S-curve marks the emergence of a new S-curve – the one that displaces it (e.g., video cassette tapes versus DVDs, word processors versus computers, etc.). Some industries and technologies move along S-curves faster than others. High tech S-curves tend to cycle more quickly while certain consumer products move more slowly.

6.9. Lifecycles and Market Adoption

The Lifecycle model suggests that market adoption reflects a bell curve that tracks to customer/consumer adoption of a new technology, product or service. First come the "early adopters" who are interested in testing out and trying something new. After the early adopters come targeted market beachheads that represent segments with specific needs that become reference points for other segments.

The technology then moves from custom solutions for specific segments to mass manufacturing and distribution of standardized products for the mass market. From there, the market matures. This is when late adopters who are adverse to "risk" begin purchasing the tried and true solutions. Competitiveness becomes almost entirely based on incremental improvements and economies of scale.

A simple example of these dynamics comes from the "typewriter" industry. The advent of the manual typewriter was a true breakthrough. But then came the IBM Electric from "outside" the industry, displacing the manual technology and creating a new "electric typewriter" industry. The word processor followed, driving IBM's business into obsolescence. And then of course then computer, Microsoft's Word and desktop printing represents the latest S-curve. This begs the question as to what will come next. Breakthrough innovations that represent bold new S-curves are rarely created and driven by industry incumbents.

For example, of the ten leaders in the semiconductor industry in 1955, only two were left in 1975 General Electric & RCA. And in 1952 there were 85 US television manufacturers. Today there is one - Zenith. By understanding where your company, businesses, products, services and technologies fall on the lifecycle, you can work with these patterns to avoid obsolescence and leverage them to your strategic advantage.

Failure Points

So why do organizations fail to identify emerging S-Curve threats and opportunities, let alone transition from one curve to the next? The causes are simple. Getting it right is challenging. The top reasons for missing S-Curve shifts include:

- Not focusing on or investing in the new technologies or applications
- Not effectively defending an existing business and technology
- Not effectively creating new markets and technologies to recreate the business

- Cultural inertia that hinders the ability to play two games at once (e.g., managing the existing business while investing in and driving the new)
- Lack of Industry Foresight, Customer Insight, or the organizational support and processes (Strategic Alignment) required for superior Execution

6.10. Lifecycle Innovation Strategies

For mature technologies, products, or services, incremental innovation can help extend life and drive differentiation and growth. Incremental innovation is not a new business creation strategy per se, but a method of sustaining growth in the core business by:

- Adding minor features and functionality to create greater variation and options
- Tweaking existing technology to create the "next iteration" of products Incremental innovation thrives in structured environments characterized by continuous product and process improvement. While incremental innovation is important to sustaining revenue growth within an S-Curve, jumping

S-Curves involves creating or driving disruptive innovations. Bold and less predictable, these strategies can include:

- Creating new-to-the-world customer value (e.g., cell phones, microwaves, televisions)
- Displacing existing ways of delivering value (digital photography vs. silver halide, inkjet and LaserJet printers vs. typewriters) As a growth strategy, such disruptive innovation can focus on cannibalizing an existing business or creating new businesses altogether.

By understanding the innovation dynamics within your existing market space, you can:

- Know when incremental vs. discontinuous innovation is required
- Selectively cannibalize existing products and services to avoid obsolescence and enable greater growth

- Consciously manage organizational processes, metrics and alignment to support the kind of innovation that will lead to growth.

6.11. Organizational Strategies

Leadership within organizations that possess a spectrum of products, services and technologies across the lifecycle can be a formidable challenge. The very structures and processes that drive success in mature businesses (e.g., highly standardized and efficient) are often inflexible and lead to ***failure*** in emerging businesses. It is critical to align the right structures, processes, metrics, leadership and people to the maturity level of the respective business unit, function, or team. Organizations that reside at the beginning and ends of the S-Curve must be managed differently from those squarely in the middle. Mature businesses require optimization. Emerging ventures – and mature businesses in need of reinvention – require a different operating model, one characterized by experimentation, flexibility and learning. Some of the critical differences in organizational strategy and culture typically include:

- Optimization Focused (Mature Businesses)
  - Meet current customer needs
  - Exploit what you know
  - Analyze and plan
  - Stick to your knitting
  - Live by process and structure
- Innovation Focused (Emerging Businesses)
  - Anticipate future customer needs
  - Explore what you don't know
  - Hypothesize and learn
  - Reward experimentation
  - Allow freedom and flexibility

The critical message is this: *organizational requirements for success differ across each lifecycle phase.* With this understanding, it becomes possible to intentionally and strategically design organizations to manage portfolios of businesses (or product lines) in ways that minimize the problems that arise from a "one size fits all" approach.

Revision Questions

Example ✐. Explain the Porter's generic strategies

EXERCISE 10. ✍ Explain the Competitive strategies

LESSON 7
Managing strategic change

By the end of this chapter, the learner should be able to define, identify, explain, describe and discuss the following:

1. Change management
2. Targets of change management
3. Different models of change management

7.1. An overview of change management

Before we get into discussing strategic change, it may be relevant to have an overview of change management in general. Organizations are constantly changing, often as a result of events which affect the status quo, such as process improvements, the introduction of new technology, organizational restructuring or mergers. The greatest challenge for organizations implementing such change is to achieve the cultural or behavioral change that is often required to achieve the planned benefits, even when it is recognized that change is required. Behavioral change in organizations does not just happen. Typically, change will only occur if an initiative has direction, leadership, very clear goals and benefits for its key stakeholders; and of course, all of these are communicated well and in a timely manner. For it to be successful, change management needs to be practiced for some time, to ensure sustainability. Lasting cultural change will only be achieved by creative planning, skilful communication and by developing a coherent change strategy that will drive, achieve and sustain real change.

7.2. Three important principles are central to managing change:

- Change management is not the goal in itself: it is a means to an end, and the end is an improvement in an organization's performance. It is about effectively managing a process that will lead to an environment where an improvement in performance are realized.
- The "targets" of change must play an active role in realizing the change: Successful Change projects will identify and communicate the vision, letting the

employees know they are expected and empowered to play an active role in realizing the planned benefits.

- An organization's employees are their greatest asset: potentially, they are also the greatest challenge. For a vision to become reality, those at the "coal-face" must believe in the project and have the desire to achieve it.

There are many strategies and techniques to support Change Management, particularly those aimed at impacting the values, attitudes and habits that we as individuals demonstrate while we are at work. The fundamentals of change are contained within five key steps.

7.3. Change Management & Benefits Planning

Before launching a project, the team should conduct the following:

- Benefits Identification : The early identification and agreement of the benefits and in particular the outcomes that the change program is to produce is essential.

- Executive Sponsorship: sponsors must communicate and drive strategic business objectives. Gaining effective sponsorship and leadership is the first step in the change to be implemented.

- Readiness Assessment: An assessment of the readiness of the organization to adopt the changes required will enable a realistic implementation plan to be developed.

- Benefit realization planning :Having identified the benefits of the program it is important to detail the plan to show all the key actions and responsibilities to achieve the required change and realize the planned benefit

- Resistance Management: A major obstacle to successful Change Management is employee resistance at any level, typically due to: lack of awareness about the change, fear of change, fear of losing control. It is essential to identify and manage all stakeholder groups to minimize resistance and build support.

7.3.1. Execution and Implementation

Once the project has been launched, the project should conduct the following 4 key execution steps.

- Communications Plan: If staff understand what the change is and why it's required, how to implement the change becomes far less of an issue. It is critical to develop carefully structured communications plans and mechanisms to inform staff about the Change program and how it will affect them.

- Implement the Change Management Plan: It is imperative to monitor the actions within the Change Management plan, continuously assessing progress and if necessary revising the plan accordingly.

- Education & Training Plan: A key element of the Change Management plan is Education & Training, where the aim is to provide the employees in the organization with the skills, tools & techniques required for them to perform their role effectively as the changes are being implemented.

- Active Resistance Management: By actively listening and monitoring feedback on the planned changes during implementation, to identify any areas where resistance is being encountered.

7.4. Reinforcing Change

Once the change program is underway, there are three further steps focused upon sustaining the change.

- **Measuring Benefits:** Measuring the benefits delivered by the program assessing the progress achieved against the benefits and the outcomes identified at the start.

- **Identify Gaps and Manage Resistance**: If the some of the anticipated benefits have not been realized this may be because of gaps in the actions undertaken or unexpected resistance. Identification of gaps and resistance enables the identification of corrective actions to reinforce the change.

- **Reinforcing Change:** Having achieved the new behaviors, process, practices etc, it is all too common for organizations to slip back to operating and behaving along the original familiar lines.

On a regular basis, monitor the organizational performance relative to the goals of the Change Management project, developing where appropriate corrective actions to reinforce the desired changes.

7.4.1. Triggers and drivers of change

Change is something that presses us out of our comfort zone. It is destiny- filtered, heart grown, faith built. Change is for the better or for the worst, depending on where you view it. Change has an adjustment period, which varies on the individual. It is uncomfortable, for changing from one state to the next upsets our control over outcomes. The human experience consists of matching our capabilities against the challenges we face. A sense of balance, is maintained in our lives when Ability/willingness is equal to danger/opportunity. We seek this kind of balance because it makes us feel that things are predictable and thus easier to manage. Change occurs when this balance is disrupted. There are two ways the status quo can be disrupted:

7.4.2. Positive change or Negative change

Positive Change when people believe their capabilities exceed a challenge, they generally feel positive because the outcome is not only desirable but expected (for example the birth of a child.) When the reverse is true, people feel negative not only because the outcome is undesirable, but also because such situations lack predictability. Negative Change when most people find it is extremely uncomfortable to face situations filled with the unknown because of the loss of predictability. We are attracted to situations that are familiar because they allow us the feeling of being in control.

7.5. Forces for Change:

Two opposing forces influence change in an organization:
One that **drives** for change and one that resist. One of the following forces may affect an organization. Driving forces initiate change and Resisting forces act against the driving to keep it going. They are usually external or internal.
Source of **funding** a group may fear new ideas and reduced or increased and may prefer to do things the way they have always been done. The interests and needs of the group functions the same way as before. Membership is increasing or dropping.

Members have different views of the group's purpose. When projects or programs are evaluated, a need to change is identified.

7.5.1. Change process

Conceptually, the change process starts with an awareness of the need for change. An analysis of this situation and the factors that have created it leads to a diagnosis of their distinctive characteristics, and an indication of direction in which action needs to be taken. Possible courses of action can then be identified and evaluated, and a choice made of the preferred action.

7.5.2. Change models:

The best known change models are those developed by Lewin (1951), Beckhard (1969), and Beer et al (1990).

- **Lewin's model**

  1. Unfreezing - altering the stable equilibrium which supports existing behaviors and attitudes. This process must take account of the inherent threats change presents to people and the need to motivate those affected to attain the natural state of equilibrium by accepting change.
  2. Changing - developing new responses based on new information.
  3. Refreezing - stabilizing the change by introducing the new responses into the personalities of those concerned.

Lewin also suggested a methodology for analyzing change which he called‘ ‘field force analysis.’

1. Analyze the restraining or the driving forces that will affect the transition to the future state.
2. Asses which of the driving or restraining forces are critical.
3. Take steps both to increase the critical driving forces and to decrease the critical restraining forces.

- **Beckhard's model**

According to Beckhard change program should incorporate the following:

1. Set goals and define the future state or organizational conditions desired after the change.

2. Diagnose the present condition in relations to these goals.

3. Define the transition state activities and commitments required to meet the future state.

4. Develop strategies and action plans for managing this transition in the light of an analysis of the factors likely to affect the introduction of change.

- **Beer et al's model**

Beer and his colleagues prescribed six steps to effective change , which concentrate on what they call task alignment – reorganizing employees roles , responsibilities and relationships to solve specific business problems in small units where goals and tasks can be clearly defined. The aim of following the overlapping steps is to build a self – reinforcing cycle of commitment, coordination and competence.

1. Mobilize commitment to change through the joint analysis of problems.

2. Develop a shared vision of how to organize and manage to achieve goals such as competitiveness.

3. Foster consensus for the new vision , competence to enact it , and cohesion to move it along .

4. Spread revitalization to all departments without pushing it from the top – don't force the issue , let each department find its own way to new organization.

5. Institutionalize revitalization through formal policies ,systems and structures.

6. Monitor and adjust strategies in response to problems in the revitalization process.

7.6. The role of the management

Management's responsibility (and that of administration in case of political changes) is to detect trends in the macro environment as well as in the microenvironment so as to be able to identify changes and initiate programs. It is also important to estimate what impact a change will likely have on employee behavior patterns, work processes, technological requirements, and motivation. Management must assess what employee reactions will be and craft a change program that will provide support as workers go through the process of accepting change.

The program must then be implemented, disseminated throughout the organization, monitored for effectiveness, and adjusted where necessary. Organizations exist within a dynamic environment that is subject to change due to the impact of various change such as evolving technologies. To continue to operate effectively within this environmental turbulence, organizations must be able to change themselves in response to internally and externally initiated change. However, change will also impact upon the individuals within the organization.

Effective change management requires an understanding of the possible effects of change upon people, and how to manage potential sources of resistance to that change. Change can be said to occur where there is an imbalance between the current state and the environment.

Revision Questions

Example ✎. How does Change Management work?

Solution: Change management is a procedural based process. It starts with the detections of a change trigger and ends with the implementation of a new strategy within the organization. □

EXERCISE 11. ✍ Identify and explain different models of change management

LESSON 8

Strategic change - aligning strategy and the organization

By the end of this chapter, the learner should be able to define, identify, explain, describe and discuss the following:

1. Competitive strategy
2. Aligning competitive strategy and organization
3. Strategic alignment and the external environment

8.1. Importance of Alignment

In this section, a vision of what an innovative company looks like is offered so that a manager knows what has to be done if his or her company is going to become more innovative than it is now. Becoming more innovative means increasing the rate at which new products and services that customers value are successfully brought to market each year. Success means bringing them to market on time, within budget, and at prices that make them profitable within an acceptable period of time. We build on the four key elements of an organization (formal organization, work, people, and informal organization) introduced in the last section, but here we focus on how they must be aligned with the company's strategy and with each other. An important question to ask is *What kind of formal organization, work, people, and informal organization would be required for alignment with a competitive strategy that emphasizes innovation?*

In the figure above, the arrows show three forms of alignment. First, is what can be called horizontal alignment **(Baird and Meshoulam, 1988)** – the extent to which the four organizational elements are mutually supportive and work together (the outer arrows). For example, does the company's culture support the formal structure and are employee skills aligned with the tasks performed? The second form of alignment has been called vertical alignment **(Baird and Meshoulam, 1988)** – the extent to which the four organizational elements are aligned with the company's competitive strategy (the inner arrows in the figure). Finally, the third form of alignment is represented by the single vector arrow in the figure and represents the

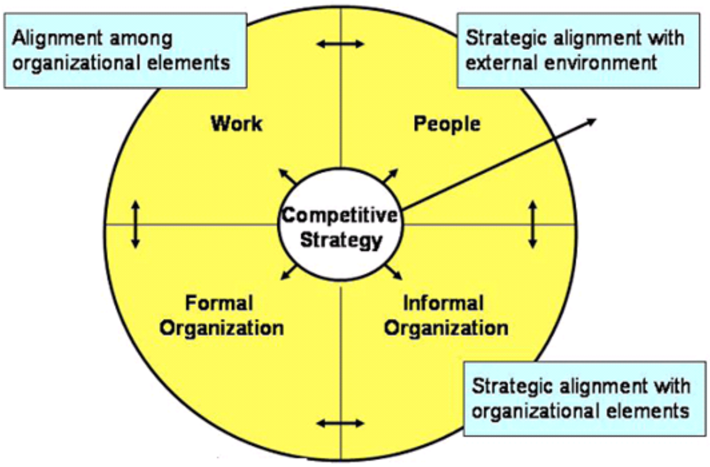


Figure 8.1: Alignment and Innovation

alignment between the company's competitive strategy and the external environment (discussed in Section 3.2). The fact that there are so many types of alignment is a strong indication of just what an important role alignment plays in innovation and change, and how challenging it is to achieve and maintain it **(Wright and Snell, 1998)**.

8.2. Competitive Strategy

As alluded to previously, a change in competitive strategy is likely if the firm faces stagnant or shrinking profit margins, no pricing power, loss of customers, etc. In response to such signals, the firm may adopt a competitive strategy that includes increasing the number of new products successfully introduced, entering more markets, and finding new revenue sources. Being more innovative in this way requires being open to ideas from previously untapped sources inside and outside of the company, and designing a firm that responds quickly and flexibly to the ideas that represent opportunities for potential revenue growth (Blumentritt, 2004).

Strategy is about making choices, and top management needs to be as clear as possible about the rationale for making them. Firms can compete on price or differentiation (Porter, 1980; 1985). In the latter case, firms differentiate their products in order to avoid competing solely on price. Non-price attributes include reputation, brand, superior product performance, and service. Top management also must choose what products, customers, and market segments to serve. Innovation should reinforce the basis on which the firm chooses to compete, i.e., price or differentiation. Ideally, innovation enhances a core competence that permits the firm to surpass its competition on dimensions that its customers value.

Many SMEs have difficulty competing on price alone. Even if they can match the prices of their foreign or domestic competitors, operating margins may be razor thin. Using innovation to improve operational efficiency can help firms that choose to compete on price, but we believe that innovation will serve firms better if they focus on the development and introduction of new products and services, especially if they can earn a price premium and higher margins **(Weerawardena and McColl-Kennedy, 2002)**. Innovation is essential to prevent erosion of strategic assets, market position, and product commoditization.

Top management is responsible for articulating the company's competitive strategy and how innovation will serve this strategy. Companies can focus innovation on products, processes and markets (e.g., new ways to serve customers). They also can focus on incremental or radical innovation (McAdam et al., 2000; Weerawardena and McColl-Kennedy, 2002). Incremental innovation modestly improves a firm's products or processes or fine-tunes its business model, e.g., how it creates value for its customers. Radical innovation significantly improves existing products and services or replaces them with new ones. Radical innovation occurs less frequently than incremental innovation in part because most firms don't have the technical and human resources required for radical innovation, and don't accept or aren't prepared for the risks and uncertainty associated with it. The magnitude of change required to foster radical innovation in companies with little experience in being innovative is probably beyond what they can handle in a relatively short time, e.g., one to three years. The type of change discussed in this guide is similar to what Nadler and Tushman (1989) call "frame bending". Change of this type is proactive so there is sufficient time for generative learning. It may require major changes in elements of all four quadrants, but still emphasizes continuity of leadership and building on existing strengths. A change strategy is essential so that companies can judge how far they have to move and what degree of change is realistic, given their current capabilities.

Top management is also responsible for other decisions that affect the nature of innovation within the firm. For example, what sources of new revenue should the firm pursue in the next five years? What is an appropriate mix or portfolio of innovation

Figure 8.2: Designing for Innovation

projects? Will the firm be a technology leader or follower? What type of innovation will the firm do in-house versus partner or outsource? Each of these decisions and those mentioned above affect the configuration of formal organization, work, people, and informal organization that supports them most effectively. Innovation is not a competitive strategy in itself, but can enhance any competitive strategy once the strategy has been articulated. If the strategy involves increasing the rate at which new products or services are introduced, then innovation can impact the firm in multiple ways. Innovation can enhance how a firm conducts day-to-day operations, increase the rate at which all employees generate ideas for new products and services, and facilitate quick and efficient commercialization of new products.

The first principle for designing an organization is to assure that the four essential elements of the firm are aligned with its competitive strategy. Alignment means that each element consistently supports the competitive strategy and mutually reinforces other elements (Porter, 1996). For example, a firm that wants to differentiate itself from competitors by regularly refreshing its product line needs to align all elements to support this capability. All four elements discussed below should be designed to encourage all employees to generate ideas for product and process improvement and for new products and services. The sub-section on formal organization focuses on the design of an organization to manage day-to-day operations as well as the design of cross-functional product development teams, which are temporary structures that are created to manage the design and development of new products and services.

The remaining three elements, work, people, and the informal organization, should be designed to facilitate operation of both of these types of formal organization structures.

8.3. Formal Organization

No structure is optimal for all firms; it depends on the firm's strategy and its products. Guidelines to assure the best fit between a specific strategy, products, and structure are beyond the scope of this report. For more information on this subject, we suggest readers look at Mintzberg (1992) or Nadler and Tushman (1997). However, we can offer guidelines to encourage the maximum generation of ideas from all employees at every organizational level within a company. Guidelines for the design of the formal organization to maximize generation of ideas are presented below. Similar guidelines for other elements are covered in later subsections.

First of all, reduce the number of levels in the company by broadening the responsibility of employees at each level. Flat structures allow employees to see "the big picture" and minimize distortion by reducing the levels through which communications must pass. Flat structures also encourage an "open door policy" where employees have easy access to top management. This helps employees to be able to contact people in other functions directly without going through and/or clogging other channels. It should be noted that the individuals with the most formal authority aren't necessarily the most knowledgeable on a certain subject. Employees should be permitted to seek advice from those who have authority based on knowledge as well as position. Second, share information with employees at all levels (e.g., financial, marketing, production) by publishing newsletters or using other communication channels. Make sure that everyone is on the same page. Also, minimize symbols or signals of status differences so that some employees don't feel less valued than others. In order to encourage teamwork and idea sharing, it is important that employees feel equal with their peers.

Third, create ad hoc collateral structures for brainstorming or problem-solving. These structures include task forces, forums, retreats, etc. The more diverse the membership, the greater the chances are for creative idea generation. Representatives of different functions can generate ideas for new products and services by filling in the "white spaces" between functions (Prahalad and Hamel, 1994). Internal (within the firm) networks among creative personnel for idea or information sharing can be created formally or allowed to develop informally. External networks between the firm and its customers and suppliers, or members of other firms can be supported financially or membership in them encouraged, e.g., Open Source software. Next, codify and capture learning generated from ad hoc collateral structures and from product development teams. This can be done by devoting time at the end of major project milestones or at project completion to reflect on what has been learned, taking notes, storing them in digitized format and organizing information for easy retrieval when similar problems arise in the same or future teams.

Also, teams that recently completed projects can meet with teams that are just starting projects to share lessons learned. Activities like these assure that learning is not lost, and mistakes are not repeated. Next, develop a measurement system that tracks critical project activities and valued outcomes. As the adage goes, management tends to gets what it measures. It also gets what it rewards. Thus, develop a reward system that is linked to what is measured and valued by management.

Rewards and incentives can be tangible in the form of monetary bonuses, or they can be less tangible in the form of recognition, promotions, or empowerment. The objective is to make sure that rewards are linked to behaviors that you'd like to see increase. For example, engineering, manufacturing and marketing personnel have little incentive to cooperate on product development projects if the reward system is based only on achieving function-based goals. Similarly, if the reward system is based only on achieving short-term goals, then project personnel will not act in the long-term best interest of the project. (See section 3.6.4 for more information on rewards and incentives.) Tools such as 360º performance reviews can be used to measure and track employees' performance in relation to strategic goals (Curtis, 1996). 360º performance reviews evaluate employee performance from all perspectives including bosses, peers, subordinates, customers, etc. This type of review gives managers a more accurate picture of the employee's progress towards goals and also helps to determine how the employee should be rewarded, or reprimanded.

Day-to-day operations.

The formal organization should be structured to receive orders from customers, and produce and deliver products and services to them in the most efficient and effective manner. This requires assigning tasks to functions, and determining relationships

between functions so that products and information follow the shortest, least ambiguous and nonredundant path, and decision-making is made by persons who are closest to relevant information and required response (Nadler and Tushman, 1997). If your company is small, then perhaps every employee knows all of your customers and can identify unmet or emerging needs. If not, and you have a function-based structure, you already know some of the risks of organizing this way (i.e., functions promote efficiency, but often at the cost of flexibility, see section 3.3)
. A customer- or product-based structure may encourage greater customer focus, but it may not be realistic for SMEs because too few customers or products generate enough sales volume to justify this type of structure (Mosey, 2005). In function-based structures, personnel in marketing, manufacturing, engineering, etc. often have difficulty thinking beyond their own function. Cross-functional teams can help overcome this myopia. They are better at identifying customer needs, especially if they visit customers and observe how they use the firm's current products or services and gather ideas on what new or improved products or services might better serve their needs.

Specialization within functions is necessary in any company, but it has a potential downside. It can foster inertia, myopic thinking, divergent interests, turf battles, etc. Cross-functional teams are an effective way to overcome these risks. They focus energy and shorten lines of communication during their relatively brief existence. If managed properly, cross-functional teams can use divergence as a source of creativity, thereby transforming a potential liability into a valuable asset. Managing teams properly includes assigning the right mix of people, giving the team leader enough authority to deal effectively with function managers, and using appropriate metrics to measure and reward performance (Duck, 1993). Depending on the urgency, strategic importance, and technical challenges of the product, some or all team members may need to be assigned full-time to the team. They also may need to be assigned some physical space for collaboration.

Product development. Innovation in terms of new product or service development (NPD/NSD) requires a different structure than one designed for day-to-day operations (Oliva and Kallenberg, 2003; Tushman and Nadler, 1986). Information flows and decision-making are very different for these two types of activities. Cross-functional teams are important supplements to the firm's structure (de Jong and Vermeulen, 2003; Mosey, 2005; Rangaswamy and Lilien, 1997). Such teams are created to design and develop a new product or service and are disbanded when that task is completed. Because these two structures are designed for such different purposes, their leaders may face potential conflict. Leaders of traditional functions are usually more influential than leaders of cross-functional teams, especially when the latter are developing incremental product improvements. However, leaders of cross-functional teams may (should) have greater influence than leaders of functions when radical products are being developed. The latter may have considerable difficulty adjusting to this situation. Product complexity, type of innovation, or urgency (e.g., narrow window of opportunity) also affects the need for some or all team members to be dedicated full-time to NPD/NSD projects. These projects require high enough frequency and intensity of interaction among members to justify full-time dedication. This high level of interaction may also justify co-locating team members, i.e., common work space. This may not be an issue for SMEs that have only a single facility. Even then, it's surprising how rapidly interaction among personnel from key functions declines when they are out of sight or sound of each other (Allen, 1977). Further, research indicates that projects that are staffed full-time by a few members are completed much sooner than those without full-time members (de Jong and Vermeulen, 2003).

If the firm already uses the idea generation practices discussed in the previous section, employees who are assigned to cross-functional teams will bring these practices with them. These practices will be useful for identifying ideas for new products and processes. However, the primary purpose of cross-functional teams is to select the most promising ideas (screen them against business criteria), and commercialize them (meet product performance, budget and time targets). Even in small companies, top management can easily lose touch with other managers and workers. These employees can offer a rich pool of ideas for new products. This pool can be tapped, however, through one- or two-day special purpose retreats at which junior people are given an opportunity to present their ideas directly to senior managers. Product development teams can generate ideas too, of course, by visiting customer sites and watching how customers use the company's products or, in general, how they perform their work (Gebauer, et al., 2005; Hartlaub, 1994; Royal, 2005). Product development teams are primarily used for transforming ideas into commercial products. This process includes developing working prototypes, cost estimates (machinery, tools, ramp-up), sourcing decisions, market tests, etc. Early involvement of people who are responsible for these activities assures they will be allies rather than adversaries.

The NPD process can be divided into stage-gates (Cooper, 1995). A typical set of stages includes idea generation, preliminary investigation (market testing), business case (pay-back criteria), development, test, and launch. Gates are screens and reviews that include articulated milestones and exit criteria that products must successfully pass before moving on to the next gate. Following all stage-gates conscientiously increases the success of new product introductions from about 50% to 80% (Griffin, 1997).

8.4. Work

Work refers to activities that add value to a company's products and services. These activities may be physical (doing) or mental (e.g., planning, deciding, problem-solving). They can be bundled and assigned to individuals or teams. There are a number of ways that managers can design work so that employees both "grow" in their jobs and, at the same time, help the company to reach its goals.

One assumption we make, based on past research, is that employees who are satisfied, engaged, and committed will be much more valuable to the company. One of the first goals when designing jobs should be to give people broad responsibilities that expose them to a variety of areas within the company (i.e., cross-training). Having open job boundaries can also help employees to help coworkers and to see the interrelatedness of tasks. Exposing employees to a broad variety of duties and jobs gives them the opportunity to learn from one another and be creative, coming up with totally new ideas, or even better ways of doing the same job.

Jobs need to be challenging enough so that people are stimulated to think about their connectedness to other jobs and are willing to improvise when useful. Similar to the formal organization, work can also be divided into day-to-day and product development activities. Whether you are talking about shop floor or professional employees, there are certain job characteristics that can make jobs more satisfying to employees, which in turn leads to higher employee productivity and customer satisfaction (Vogt, 2005). These characteristics include skill variety, task identity and significance, autonomy and feedback (Hackman and Oldham, 1976; Katz, 2005). The following table describes each of these characteristics.

8.4.1. Characteristic Description

- Skill variety - the breadth of knowledge, skills and abilities needed to complete the job.
- Task identity - the extent to which the employee sees a whole job through from start to finish.
- Task significance - the employee's appreciation of the job's importance and interrelatedness to the rest of the company.
- Autonomy - the employee's freedom to perform the job independently within certain rules and guidelines.
- Feedback - constructive information about the employee's performance on the job, intended to help the employee learn from past experiences and improve their performance.

On the level of day-to-day operating activities, the above-mentioned characteristics can help Shop-floor employees to improve operational efficiency. For instance, skill variety and task significance can be achieved through job rotation in which employees are moved from job-to-job in order for them to better understand each task. This can help to develop employees' knowledge about the tasks being performed, which can stimulate idea generation and can also help improve efficiency because employees will be able to fill-in for others when they are absent from work. Further, research shows that employees who see the importance of their work within the company are more likely to help promote the company's strategy and goals (Boswell and Boudreau, 2001).
Similarly, for product development activities, the above-mentioned characteristics can help members of cross-functional development teams to work better together. The development of cross-functional teams brings together people from different specialties in order to solve problems. The interaction required between functions in order to solve problems challenges all team members to learn more about each function, stimulating skill variety. The conglomeration of different knowledge, skills and abilities fosters idea generation among the team. Once ideas are generated and the decision is made to develop them, the employees who are best equipped to handle the given issue (such as engineering, marketing, finance, etc.) should be given

the autonomy to creatively solve the problem within boundaries. It may be helpful to eliminate titles so that all team members are on a level playing field based on knowledge rather than formal rank.

It is also possible to give all team members very general titles to imply broad and shared responsibilities. Timely feedback should be given in order to help team members learn from mistakes and improve their performance.

8.4.2. People

People often get channeled by their own specialties and have a myopic vision of work done by others in the company. As mentioned above, however, it is important that employees see the importance and interrelatedness of their tasks compared with the tasks of others. Managers must ask themselves whether all their employees understand and appreciate what other people do. If not, there can be unnecessary conflicts, inefficiencies, etc. For example, manufacturing and design people often conflict because of status differences (design usually has higher status). Status parity helps to bridge the gap in their communication and unite them for a common purpose (Susman and Dean 1992).

Further, does the company have enough specialized and well-trained personnel to perform the required duties? It is important that employees are well-trained and able to perform their tasks properly. When hiring new employees, you must make sure that they "fit" with the culture of the firm. For instance, if your firm is focusing on becoming more innovative, new and current employees should believe that innovation is beneficial and be willing to contribute to NPD/NSD efforts (see section 3.6.3 for more details). Further, is your firm able to participate in research and development (R&D)? If you do not possess or cannot hire enough of such people full-time, some of them may be contracted to serve temporarily as consultants.

One way of thinking of the necessary knowledge and skill sets held by your employees is by considering the concept of human capital. Human capital is composed of the knowledge, skills and abilities that people possess at hiring and then build-up over time through education, training, experience, etc. (Becker, 1993). Thus, a firm's reserves of human capital are largely determined by the individual characteristics of its employees. Managers can enhance the human capital in their company via two broad means: by hiring practices for new employees and with training of current employees. Because employees differ in their technical skills and work-related experience, they will have differing capacities to contribute to a firm's innovation and growth. Those who can't contribute or are unwilling to learn how to contribute must leave the company. Without sufficient human capital the company will be unable to effectively leverage the physical capital (e.g., plant and equipment) that it commands. SME managers should carefully consider whether their company's human capital has the requisite knowledge, skills and ability to be competitive and to achieve the levels of growth desired. Human capital can be enhanced by education and training programs that focus on developing growth paths for employees.

One way to do this is to introduce a pay-for-knowledge system (pay employees for what they know and contribute rather than only for performing a fixed set of tasks). Employees can learn a variety of tasks (breadth) or learn one task in great depth. The most valuable employees develop a "T-shaped" profile, e.g., breadth across a variety of areas and depth in one area (Leonard-Barton, 1995). Education and training sessions also can focus on promoting the value of inquiry, i.e., suspend judgment, experiment, collect data and let the data speak for itself (Thomke, 2003). Another way to promote inquiry is to encourage employees to confront problems with root cause analysis. Root cause analysis (i.e., the five whys) consists of asking the question "why?" at least five times (Senge et al., 1994), which should be sufficient to discover the root cause of most problems. Education and training sessions are ideal settings for promoting values and strengthening an innovation culture. The problem is that most SMEs don't have the in-house staff or time to devote to education and training that large companies have; nevertheless they can rely on consultants and local colleges and universities for this purpose.

Many states have programs to subsidize all or most of the cost of training SME employees, e.g., Pennsylvania has WEDNetPA (http://www.wednetpa.com/).

8.5. Informal Organization

Perhaps the most important component of the informal organization is the firm's culture. Organizational culture includes the norms, values and beliefs that organizational members share (Schneider, 1990), and is shaped by opinion leaders, history, and by work that is valued and rewarded in the company. It is also cognitive in nature, and serves to give employees a sense of identity about themselves, their coworkers, and the company. Research has shown that a strong corporate culture can give a company a powerful advantage over its competitors, especially in highly competitive and commodity-like markets (Kotter and Heskett, 1992; Burt et al., 1994). Culture pervades every level of a company, including the shared beliefs held by top managers regarding how they should manage themselves, their subordinates, and the company (Lorsch, 1986). Culture may stem from the strong influence of a company's founder(s) (Herb Keller at Southwest Airlines is a good example), but may also be influenced by its relationship and experiences with the firm's external environment, e.g., needs of key customers, competitive environment, etc. (Greenberg and Baron, 2000).

SME managers should note that some of these elements can be used to consciously shape a culture that will reinforce innovation. In order for innovative efforts to succeed, the firm's culture should be supportive of innovation. An innovation-supportive culture is one that values creativity and cooperation. There is a focus on teamwork, but individual initiative is also valued. An innovative culture supports idea generation and fairly evaluates each idea, no matter how outlandish it seems on the surface. Further, this type of culture also tolerates errors and even celebrates failures as long as lessons are learned. Thus, if an employee took the initiative to be innovative and failed, the person would still be rewarded for his or her efforts according to the formal rewards policy, as long as the employee (and the firm) learns from mistakes. Often times this means that adjustments will have to be made to the existing formal reward system that typically punishes failures and only rewards short-term performance. The reward system of an innovative firm should be based on innovative effort and evaluated on the basis of project milestones instead of a set period of time such as every three months.

Having heroes to emulate and success stories to share can encourage people to take innovative steps. In the words of Albert Einstein, one of the world's greatest minds, "Anyone who has never made a mistake has never tried anything new." An innovative culture should value experimentation and should understand that sometimes you'll need to "Fail early and often to succeed sooner" (Kelley, 2001). Employees should understand that learning from failures is often a key to success. Further, an innovative culture should seek to conquer barriers to innovation. Firms need to overcome "organizational antibodies" (Davila et al., 2006) that encapsulate and reject new ideas because of the "not-invented here" (NIH) syndrome and the "we've always done it that way" perspective. Moreover, people's perceptions can be barriers to innovation and must be overcome. Research shows that valence, expectancy and instrumentality often create a barrier to innovation (Gebauer et al., 2005). According to Vroom's (1964) expectancy theory, how much a person desires a reward (valence), the person's estimation of being able to achieve the reward (expectancy) and the person's belief that they will be rewarded (instrumentality) motivate a person to perform a certain activity.

In terms of innovation, many managers don't want to pursue innovation (low valence), believe that they will not be able to develop successful new products (low expectancy) and believe that even if they do develop successful new products they won't make enough money for the initiative to be worthwhile (low instrumentality). These beliefs provide a barrier to innovation because they convince managers that innovation is not worthwhile. These beliefs can be overcome by training in new product development methods, by successful innovation efforts even if modest, and by rewarding desired activities and outcomes.

Becoming innovative almost inevitably requires companies to change all four organizational elements. Prior to initiating change, the company's leaders should address "...the importance of making sure the cultural soil had been made ready before planting the seeds of change" (Garvin and Roberto, 2005: 112). This is because if they've created a culture that is generally receptive to change, then employees are more likely to understand why any new change is necessary, will be more emotionally committed to something new, and are more likely to faithfully execute the necessary steps (Garvin and Roberto, 2005). Also, employees in change-receptive environments are better able to let go of the competing, unsubstantiated views of the nature and extent of the problems facing their organization (Garvin and Roberto 2005).

This last statement illustrates one of the challenges posed by having a strong culture; that is, if a strategic change requires new ways of doing business, new attitudes, and new behaviors from employees, then it may be very difficult to change an existing culture to match the new strategy.

Also, Lorsch (1986) notes that managers can suffer from a type of "strategic myopia" that can inhibit strategic change. This myopia is related to the long-standing corporate culture and serves to guide decision-making based on the old ways of doing business. Hence, Lorsch (1986) calls culture the "invisible barrier to strategic change" since managers may not realize that their firm's culture is inhibiting their

ability to successfully change.
Culture is especially difficult to change when the other three organizational elements are aligned with it. Alignment among the four elements is desirable for sustainable change, but once alignment has been achieved, future change is less likely even when change triggers suggest that it is warranted. Mutual reinforcement has positive and negative implications for change.
Tushman and Nadler (1986) point out this paradox. Opinions vary as to which element should be changed first (Beer and Nohria, 2000), but there is consensus that no matter where you start, change in the other elements must follow quickly.

Revision Questions

Example ✐. what do you understand by the term competitive strategy

Solution: for revision □

EXERCISE 12. ✍ Discuss the Strategic alignment

LESSON 9

Triggers of change

By the end of this chapter, the learner should be able to define, identify, explain, describe and discuss the following:

1. Alignment of change
2. Change leadership
3. Main triggers of change
4. How to manage change in an organization

9.1. Change Triggers

- Lack of alignment
- Input from the environment
- Change in leadership
- Strategic choice

Events occurring both inside and outside your firm can create the need for change. First, legal, technological, and competitive changes in the external environment often necessitate some adaptation on the part of the firm to maintain fit with the environment. As we discussed in sections above, lack of alignment with the environment in which your firm operates may necessitate change in order to reestablish alignment. In those sections, we also highlighted the importance of being open to ideas and opportunities presented by partners, suppliers, or customers. This important input from the environment may generate initiatives requiring change (i.e., new products or services).

In addition to those triggers we discussed in earlier sections, change is often a byproduct of a change in leadership. Beckhard and Dyer (1983) point out that the entry or exit of a key family member is a trigger for change unique to family owned firms. A new leader may have different priorities than the previous leader. He or she may also have different strategic goals and unique perspectives that set the wheels of change in motion. But, an existing leader can also shift priorities or be inspired to

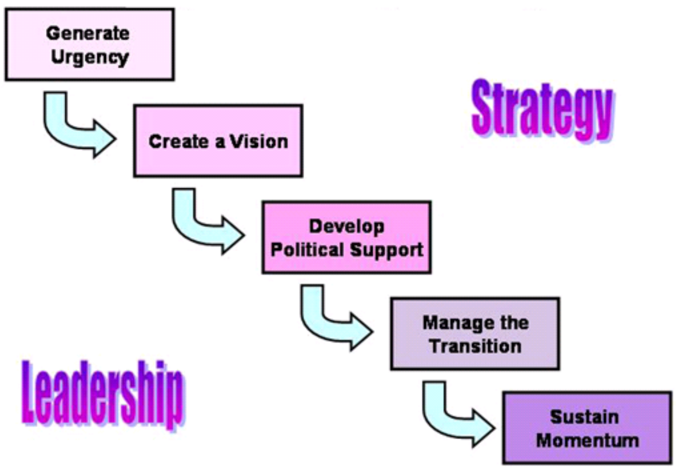


Figure 9.1: Implementing Change

make changes. Another important change trigger, then, is simply strategic choice on the part of existing leaders. Some ways this may occur are through strategic planning, interaction with customers, competitors, etc., and gut instinct that a new market or product is worth pursuing. This type of trigger is much more generative and proactive than reacting to the environment or working to maintain alignment. Regardless of which of these many triggers initiate the change process, there are several key activities that can facilitate a successful change implementation. We have organized these activities into a five-step change process that is discussed in the next section.

9.2. Implementing Change

Now that we've explained the reasons for change as well as what an innovative firm should look like, it's time to discuss how to implement change in your own company. Today's literature is overflowing with research and practical wisdom regarding successful initiation and management of organizational change efforts. Much of this research applies specifically to large organizational settings. Since there are many known differences between large and small companies, we find it unacceptable to believe that strategies for change management are identical for small and large firms alike (Gudmundson et al., 2003). Therefore, we draw from information

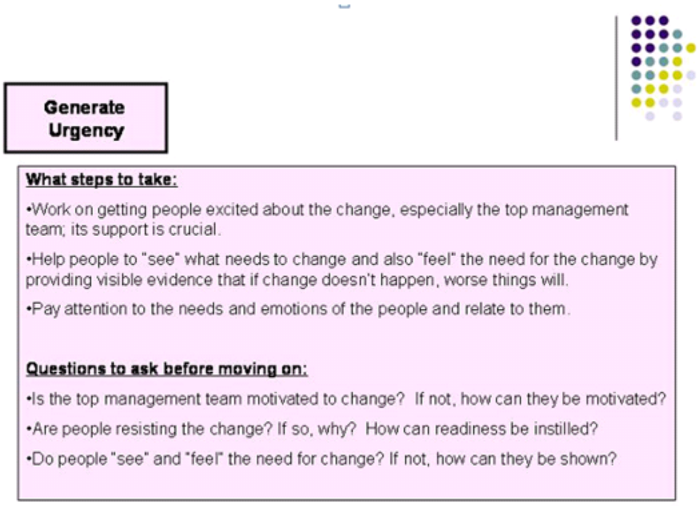


Figure 9.2: Generate Urgency

about both large and small firms, and, where possible, translate large-scale change practices into a smaller setting. The change process is often divided into logical steps or phases (Kotter and Cohen, 2002). These step-wise models provide a useful organizing framework, even if all steps are not necessary or if the order varies depending on the firm or the change initiative. We have analyzed many of these stage models and have generated a synthesized five-step change process applicable to strategic change. This process is a strategy for change, outlining the tasks and activities required for effective implementation. We have positioned this change process within the broader organizational context by highlighting two critical elements that influence the change strategy. First, the approach to change is heavily influenced by the broader strategic goals of the company. It is important that the approach for implementing change be aligned with, and contribute to, these broader strategic goals. Second, leadership is critical throughout the change process. The person who defines the firm's mission and values and articulates the firm's strategy (usually the CEO or president) must take ultimate responsibility for endorsing and communicating the change strategy to the rest of the company and ensuring that the steps in the process are accomplished.
According to Nadler and Tushman (1989) effective change seems to be backed by created energy. This means that the people who are leading the change focus on developing a sense of excitement in others, encouraging them to embrace change. Urgency helps to get people excited about embarking on change as it often shows

them that change is essential. Generating urgency involves recognizing the need for change, establishing a common view of its necessity, overcoming resistance to change, and fostering readiness. Generating urgency begins with recognizing the need for change. As we discussed earlier, there are many different ways that the need for change can be recognized (See section 3.2 and 3.4). After it is recognized, the creation of urgency helps to instill energy and initial momentum for a change effort (Jansen, 2004). Research shows that managers play a very important part in generating urgency. This urgency is often first recognized and communicated as a manager weighs the importance of various projects and assigns priorities and timelines to different initiatives (Dutton and Duncan, 1987; Ginsberg and Venkatraman, 1995).

Although change is often undertaken on many fronts, SMEs might not be able to tackle more than one change initiative at a time because of their lack of resources. In this case, it is important that managers choose carefully which project or projects to undertake. Even then, it is possible that some projects may need to be taken on sequentially rather than simultaneously. Urgency, then, is often communicated to employees indirectly based on which project is getting the manager's attention and commitment of resources. Once senior management has created the initial urgency, it is important to establish a common view that the change is needed, which often includes rallying support among members of the top management team (TMT).

In this guide the TMT is defined as the team formally charged with managing and leading the firm, such as the president, vice-president, etc. Support from the TMT is critical because its endorsement is needed not only for the initiative to continue, but also for its credibility. There must be substantial compelling evidence for change in order to gather TMT backing for the initiative. It is necessary to show both financial and non-financial evidence for change including current pain or pain that will occur if the change is not made. Kotter (1995b) suggests that at least 75% of the TMT must be in support of the change before moving on to generate urgency among the rest of the employees.

Nadler and Tushman (1989) point out that urgency and energy are emotional issues. Similarly, according to Kotter and Cohen (2002) people need to both see and feel the requirement for change before they are willing to accept it. Urgency is generated when people conclude that the status quo is worse than the time, energy and risk involved in changing (Kotter, 1995a). Energy can be created via participating in data collection and planning activities that alert workers to the firm's current circumstances (Nadler and Tushman, 1989) or by making some initial progress toward the change or generating a "buzz", even if participants have not yet fully endorsed the change (Jansen, 2004). Initial progress toward the change can instill a sense of attainability as well as the vigor to continue pursuing the change. Resistance to change can be a barrier to organizational change attempts. It encompasses a wide range of behaviors from passive resistance to active or even aggressive resistance. Determining the source of resistance (firm or individual) will help determine the appropriate course of action. At the firm level, Kotter (1995b) suggests that obstacles to change more often reside in the firm's structure such as in its performance appraisal or compensation system, which are not yet aligned with the desired new behaviors. At the individual level, Dent and Goldberg (1999) suggest that people do not necessarily resist change, but instead resist the loss of status, pay, or comfort associated with the status quo.

Kotter and Cohen (2002) suggest that leaders should pay attention to the needs of the employees and meet them at their level. This means that leaders will have to address the topics of complacency, self-protection, anger and pessimism in a very open and honest way that will not discourage employees from buying into the change. Reassuring statements should be made to employees to help them feel some level of security in the midst of change. However, it is important that management makes only promises that it can keep, such as providing training for new positions, doing its best to maintain employees, etc.

Resistance to change, however, can be minimized. For example, more and more, change agents are shifting from an emphasis on resistance to one of readiness for change (Armenakis et al., 1993; Jansen, 2000). Readiness considers the firm's capacity for making change and the extent to which individuals perceive the change as needed. They argue that change agents should be coaches and champions for change rather than monitors who expect, or react to signs of resistance. Creating readiness involves proactive attempts to influence employee beliefs, attitudes, and behavior. It focuses on establishing shared meaning of events and interpretation of circumstances.

Create a Vision

Creating a vision includes using the competitive strategy (discussed in section 3.4))“to visualize what the company should look like after the change, and aligning the four organizational elements with the strategy. The vision should include how the firm should organize and manage for competitiveness (Beer et al., 1990), and should specifically address its customers and strategic goals. Visions are very complex, take time to develop, and may require some background reading or information gathering before they are adequately articulated. This is serious work and may require help from a consultant. The vision should outline a realistic, credible and attractive future for the firm, including the results of the proposed change.

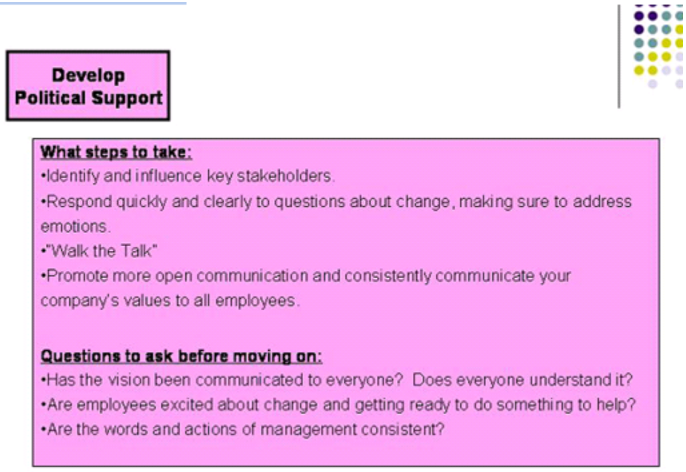
A good vision has certain characteristics. Fernald et al., (2005) propose that visions should be challenging and encourage firms to grow. Similarly, Nadler and Tushman (1989) maintain that visions should be rational, include stakeholders and value performance objectives, organizational structures and operating style. The vision should take into account the alignment of the four organizational elements of the formal organization, work, people and the informal organization (See section 3.4). Other important characteristics of good visions include clarity and attainability. A good vision should be able to be communicated in five minutes or less in order to keep it both meaningful and understandable (Kotter, 1995a).

In order to facilitate creating a vision, Kotter and Cohen (2002) and Tushman and Nadler (1986) suggest forming a transition team. This is not to be confused with the TMT. The transition team is formed specifically for the task of planning and implementing change, while the TMT is formally charged with running the firm.

The TMT and transition team may overlap substantially in membership, with the president or CEO leading the change effort as the "change leader". However, the transition team is often broader in representation, including managers of different functions and levels. Although everyone can't be a member of the transition team, many employees can be assigned to "action teams" to carry out change initiatives in their own work areas or departments. These action teams can include first-line supervisors and shop-floor employees. Broad participation in the change process is desirable; subject to the company's resource limitations. Although many names for transition teams exist, such as the transition management team, the steering committee and the guiding coalition, the goal of the team is the same—to successfully lead and manage the change effort. The transition team is composed of people who feel urgency for the change, are committed to the process and are widely respected for their knowledge and judgment. Team members should represent a broad cross-section of the company, be wellrespected and have either authority based on position or knowledge or both. Since team quality directly impacts the success of the change initiatives, it is imperative that the best employees are given the opportunity to participate (Sirkin et al., 2005).

The transition team should carry out its mission in a manner that is consistent with the values that it desires to see practiced in its vision of the future company. The transition team charged with creating a vision for the future must fully understand the firm's capabilities, be realistic in creating its vision, and yet inspire everyone to stretch these capabilities (Boswell and Boudreau, 2001). Similarly, the team should not begin to implement change until the change is considered in light of the firm's competitive strategy. As mentioned in section 3.4, it is imperative that the firm's competitive strategy be aligned with its external environment and organizational elements (O'Regan and Ghobadian, 2005). Kotter and Cohen (2002) also suggest a brainstorming session for teams that are having difficulty creating a vision. The suggestion is this: think about the firm from the perspective of the future — what is likely to change in the next few years? Tushman and Nadler (1986) assert that innovation requires change leaders who are not only visionary, but also able to make their visions become a reality. A change leader isn't the source of every good idea, but he or she quickly recognizes good ideas, endorses them, and provides adequate resources for their implementation.

Develop Political Support



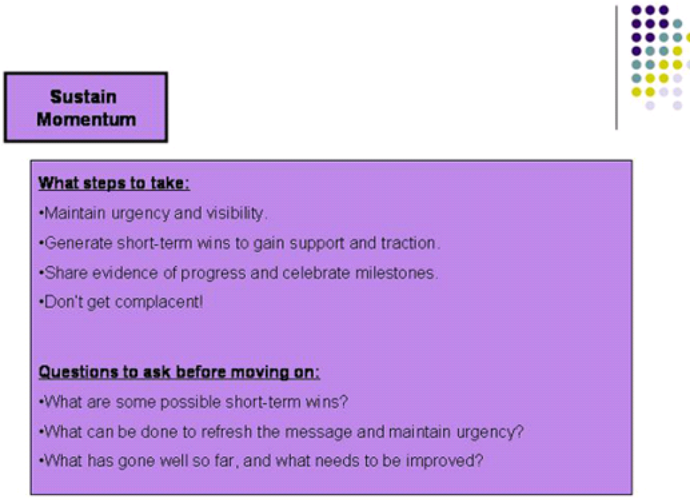
Implementing Change

Once a vision is created, political support and commitment must be developed. According to Kotter and Cohen (2002) the goal of this step is to get everyone involved in the change effort. In order to accomplish this goal, the vision must be spread and communicated so as to create sufficient awareness among constituents (Hansson and Klefsjo, 2003). One of the most influential ways that this is done is through "walking the talk." It is absolutely essential that key change leaders are true to the vision because research has found that the words and actions of persons with firm-based authority can either "make or break" the change effort (Blumentritt, 2004). For example, if your firm's new vision is to be innovative and open to the ideas of all employees, it is imperative that change leaders practice listening to new ideas and not shooting them down. In this example, the change leader's decision to listen to a new idea, even if it is outrageous, can speak volumes of credibility to employees. On the other hand, if the change leader chooses to outright reject the employee's idea in a way that is inconsistent with the vision, employees will have a hard time believing in the change effort.

In order to develop the necessary political support, key stakeholders must be identified and influenced. Influencing stakeholders includes generating urgency about the change and also getting them committed to the change effort itself. In order for change to succeed all questions must be answered. Everyone who has any stake in the company will have questions and the change leaders must address those questions clearly and quickly, addressing their emotions. For example, shareholders will be concerned about the value of their stocks, and it will be the change leaders' re-

sponsibility to reassure them that the firm will do its best not only to maintain but also increase company value. In this stage it is important to address the anxiety of those who will be experiencing the change the most (Kotter and Cohen, 2002).
They must understand the firm's motives for change as well as expected outcomes. During this step it is also crucial to ensure effective communication. Communication not only includes speeches given by leaders or mailbox memos, but consists of the daily words and actions of the change leaders. Change leaders must use every possible channel to communicate to employees while at the same time making sure that their words and actions are consistent with the vision (Kotter, 1995a). Leaders must show their conviction about the change initiative and their belief in its success. Stakeholders must be kept informed about any news pertaining to the change effort and its progress. Sirkin et al. (2005) claim that the change effort should be addressed at least three more times than is thought to be necessary.
Similarly, Duck (1993) suggests that change is finally starting to get through when the change leaders begin to get sick of talking about it. Further, it is possible that your firm may need to hire a few new employees for various reasons during the change process. If you choose to hire new employees it is critical that the new hires fit with the budding new innovative culture in order to maintain it (Kotter and Cohen, 2002). Blumentritt (2004) claims that most successful innovative change efforts succeed because of the people who are involved in making the change a reality.
Therefore, it is important to hire people who will help to take your company in the right direction. According to Blumentritt (2004) there are three main characteristics to look for when hiring a new person into an increasingly innovative culture: curiosity, talent and motivation. Curiosity is important because people who are curious generally ask a lot of questions and usually have a very creative mentality that helps to stimulate innovation. Likewise, talent is needed in order to understand how things work and finally motivation is necessary so that innovative efforts are not only devised, but also carried out to completion. In addition, you should also look for new hires that have diverse work experiences, education, demographics, knowledge, skills and abilities so as to bring new perspectives to the table. Newly hired employees can also bring excitement, which can help build support and energy for the change initiative.

Manage the Transition



Implementing Change

During this step, the groundwork that was laid in the first three steps, such as urgency generation, vision creation and political support development, comes into action and helps to provide a more smooth transition into change. This step consists of empowering people by removing obstacles to change, reassuring that change is possible, planning activities and commitments, and managing structures. Contrary to popular thought, empowerment is not just about giving people more power, but removing the obstacles that are preventing change (Kotter and Cohen, 2002). Indeed, giving employees additional power without first ensuring that they are capable of handling it may be detrimental (Duck, 1993).

Further, Hansson and Klefsjo (2003) state that leaders need to drive the change effort by eliminating obstacles instead of just assigning new responsibility. The obstacles in this stage are often found in the formal and informal organization and could be people, processes, bureaucracy or just about anything else that has the potential to thwart the change initiative. Therefore, in this step it is important to ensure congruence between the change strategy and tasks. Empowerment is one way to ensure that the tasks performed are essential and that the essential tasks are performed. Thus, empowerment can surface in the form of releasing employees from nonessential daily tasks in order for them to participate in the change process. It is a good idea to estimate the additional time and effort that employees will need to devote in order to embrace the change. Sirkin et al. (2005) claim that the increase in an individual's work load should not exceed ten percent. They suggest that when change requires more than ten percent additional effort from employees, they are likely to resist the change altogether. In order to minimize the additional effort, it is likely that some old, non-value-adding activities, such as excessive paperwork, can be removed from the employee's job requirements to make certain that only essential tasks are being carried out.

Additionally, Kotter and Cohen (2002) believe that providing information is another form of empowerment. During this phase, it is important to maintain open and honest channels of communication between change leaders and stakeholders. Because the process of change can be grueling at times, people must be reminded that change is achievable. This can be done by communicating progress as well as announcing and celebrating victories. Jansen (2004) suggests that rather than communicating overall project progress, it is more motivating to focus on short term progress and interim events. Visible signs of progress and success help to build momentum and sustain long-term change efforts (Jansen, 2004). Similarly, Sirkin et al. (2005) believe that the length of time between reviews is an important factor of the initiative's success. They have observed that long projects that are reviewed frequently are more likely to succeed than short projects that are reviewed infrequently.

Another fundamental component of managing the transition is ensuring that both the formal and informal structures of the firm are consistent with the company's competitive strategy (as mentioned in section 3.4). Two key areas are especially important here:

1. processes supporting the generation of ideas and
2. human resource functions.

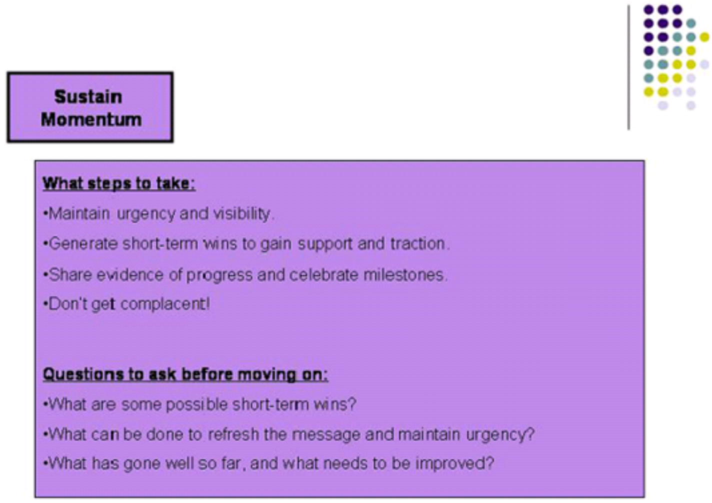
Blumentritt (2004) suggests three processes are necessary for supporting idea generation: processes for articulating and distributing ideas, processes for integrating ideas, and processes for managing the evaluation and development of ideas. Additionally, methods for submitting, integrating, and evaluating ideas should be put in place to facilitate the process. It is important to note that all stakeholders, whether employees, customers, suppliers or partners, should have the opportunity to share ideas. Second, it is important to make sure that the firm's human resource functions are consistent with the goals of the new vision (see section 3.4 for details). Firms often undergo a change process but disregard changing their reward systems, resulting in employees being punished instead of rewarded for performing new behaviors

(Kotter, 1995a; 1995b; Kotter and Cohen, 2002).

Since the goal of rewards and incentives is to encourage certain behaviors, it is important to ensure that your firm is encouraging the types of behaviors that it wants to see increase. The field known as strategic human resource management (SHRM) attempts to understand the challenge of motivating individual employees to pursue organizational strategic objectives. SHRM research is primarily focused on utilizing the human resource function to strategically support firms (Barney and Wright, 1998; Gratton et al., 1999; Schuler and Jackson, 1987; Ulrich and Lake, 1991). SHRM proponents suggest that managers should use the total system of HR tools available (e.g., recruiting, training and development, incentive systems, etc.) to motivate a firm's employees to work towards the firm's overall strategic needs. SHRM researchers argue for a more strategic view of human resources within the firm and have positively linked human resource practices with organizational performance (Huselid, 1995).

In order to facilitate alignment between strategic initiatives and employee behavior, many firms use the balanced scorecard approach to involve their employees with the firm's objectives. The balanced scorecard gives each employee a set of personally relevant criteria that he or she will be rewarded for meeting (Chow et al., 1997; Kaplan and Norton, 1992). Similarly, research on "line of sight" has shown that employees who are made aware of the significance of their contribution to the firm are more likely to participate in strategy-supporting behaviors (Boswell and Boudreau, 2001).

- **Sustain Momentum**



Implementing Change

Sustaining momentum is about keeping the change effort alive by continuing to generate urgency, pursue a vision, develop political support and manage the change transition. According to a study by Tushman and Nadler (1986) there is a common theme among many companies that were once highly successful and innovative - they actually get trapped by their own success. This is especially true in small and family-owned firms (Beckhard and Dyer, 1983). Thus, it is important for firms to focus on sustaining momentum for change. Following a Lewinian force field analysis, Jansen (2004) proposed terms for two competing forces during change: stasis- and change-based momentum. Stasis-based momentum describes the force for maintaining (or reverting to) the status quo. Change-based momentum is the force or energy for pursuing the change. Both forces exist within firms and during the change process.

Effective change management involves generating more energy for change than for maintaining the status quo. One of the most obvious ways to sustain change-based momentum in a change initiative is to create milestones by achieving short-term wins. Kotter and Cohen (2002) state that short-term wins are areas in which change has been successfully implemented. These “wins” encourage people that change is actually happening and reminds them that it is possible. Frey (2002) has employed small-scale pilot initiatives in working with small businesses. He points out that these successful pilots prove the viability of the change and show that it can be transplanted into other parts of the firm.

More broadly, small wins and interim progress help keep energy alive after the initial excitement of the project kickoff wears thin. Jansen (2004) found that employees reported higher momentum (feeling energized) following key events and evidence of interim progress. Another way to sustain momentum is to manage the social aspects of the change throughout the process. For example, key individuals in the firm supportive of the change initiative can be used as spokespeople and motivators during the change. Second, positive news about progress or change outcomes are best communicated in group settings, where interaction and enthusiasm can be shared. Conversely, negative information should be communicated in a less social setting. It is important to remember that even though excitement and enthusiasm can be quite contagious, so too can fear, anger, and resentment. Thus, managing the social energy of change is fast becoming a necessary tool for change leaders (Jansen, 2000). Once short-term wins have been made and people have seen the results, the firm is able to evaluate those results and, if necessary, make adjustments to the change plan (Hansson and Klefsjo, 2003).

This process helps to define the new firm as well as establish roots for the new organizational culture that is developing. Throughout implementation, consistent support is needed from the change leaders to not only successfully complete the change, but to also make sure it has lasting power. The change process is not complete until all aspects of the change have been fully incorporated into the firm. To avoid reverting to the status quo, leaders must make an active effort to legitimate and incorporate elements of the change into existing processes, procedures, and training.

Revision Questions

Example ✎. How can employees trigger change in an organization?

Solution: for revision □

EXERCISE 13. ✍ Explain the Main triggers of change

LESSON 10

Strategy follows structure, structure supports strategy

By the end of this chapter, the learner should be able to define, identify, explain, describe and discuss the following:

1. Strategy
2. Structure
3. Connection between strategy and structure

10.1. Strategy and structure are married to each other.

If you change one you have to change the other.
For too long, structure has been viewed as something separate from strategy. Revising structures are often seen as ways to improve efficiency, promote teamwork, create synergy or reduce cost. Yes, restructuring can do all that and more. What has been less obvious is that structure and strategy are dependent on each other. You can create the most efficient, team oriented, synergistic structure possible and still end up in the same place you are or worse. Strategy follows structure, structure supports strategy

10.2. The Connection between Strategy and Structure

Structure is not simply an organization chart. Structure is all the people, positions, procedures, processes, culture, technology and related elements that comprise the organization. It defines how all the pieces, parts and processes work together (or don't in some cases). This structure must be totally integrated with strategy for the organization to achieve its mission and goals. Structure supports strategy. If an organization changes its strategy, it must change its structure to support the new strategy. When it doesn't, the structure acts like a bungee cord and pulls the organization back to its old strategy. Strategy follows structure.
What the organization does defines the strategy. Changing strategy means changing what everyone in the organization does. When an organization changes its structure and not its strategy, the strategy will change to fit the new structure. Strategy follows structure. Suddenly management realizes the organization's strategy has

shifted in an undesirable way. It appears to have done it on its own. In reality, an organization's structure is a powerful force. You can't direct it to do something for any length of time unless the structure is capable of supporting that strategy.

10.2.1. A Science Fiction and Real World Example

Let's look at an imaginary example using the human body. Suppose science figured out how to create a living tissue arm to replace one's existing arm that could perform 300% better in strength, responsiveness and dexterity. The strategy here is to restructure the body with this super arm so it can do more. The scientists successfully replace an existing arm with this new super arm. What will happen? The rest of the body remains as it was before. So the heart, circulation system, nervous system and brain are still structured to support a regular arm. This new arm requires more and faster blood flow, faster neuron responses in the brain and so on to support its functions. Over time, the super arm will evolve back into a regular arm because the rest of the body cannot support its enhanced capabilities. For this science fiction example to work, scientist would need to restructure the entire human body, not just one part of it.

What happens when you restructure sales channels resulting in large sales increases but nothing is changed in order processing, customer support, engineering or manufacturing? You end up with a lot of unhappy customers because the company can't deliver on its promise. How many times have we seen something like this happen? Or what happens when you add a new offering that goes to a new target customer? Maybe a company has a sales force that sells to small businesses and lower management in larger organizations.

They add a new offering that is targeted at top executives. The existing sales force / sales channels cannot effectively sell to that new target. This has happened just a few too many times. And, of course, what happens when a firm makes a major push to upgrade its quality and service without improving everything in the organization that supports products and service? Disaster. Plain and simple.

10.3. Strategy is the Structure

The sum total of how an organization goes about its work is its strategy. Structure and strategy are married to each other. When a company makes major changes, it must carefully think out every aspect of the structure required to support the strategy. That is the only way to implement lasting improvements. Every part of an organization, every person working for that organization needs to be focused on supporting the vision and direction. How everything is done and everything operates needs to be integrated so all the effort and resources support the strategy. It takes the right structure for a strategy to succeed. Management that is solely focused on results can have a tendency to direct everyone on what they need to do without paying attention to the current way the organization works. While people may carry out these actions individually, it is only when their daily way of working is integrated to support strategy that the organization's direction is sustainable over time.

10.4. Implementing Change As Important As Strategy Itself

During the last 27 years, we've worked with organizations in over 30 industries to help them find more ways to increase sales, growth rates and market share. Improving existing strategies and creating new strategies that can spur exceptional growth reflect our firms main mission. But, over the years, we began to notice that some clients were not successful in implementing new strategies. That is what led us to look deeper into the cause behind this.

Does your company's DNA structure support your strategy? Top management can't just send out a proclamation about a new strategy, direction and vision and expect everyone to follow it. To implement such a strategic shift requires a complete change within the organization itself. The organization's DNA has to be rebuilt or its existing DNA structure will cause the new strategy to fail and revert back to the old strategy. And that will happen without top management's involvement. Leadership and people issues turn out to be much more important than we may have realized. On the surface, everyone talks about the importance of people and leadership but too often, management puts this on the back burner when the heats on to deliver quarterly results or meet the guidance. Structure is strategy.

That's why we realized our focus on increasing our client's revenue had to be balanced by an equal focus on implementing change. We didn't want to leave clients with reports that weren't implemented or worse implemented through directives that ultimately failed. So many years ago we became project managers for our client's implementation efforts to insure that their new strategies designed to increase revenue actually rang the cash register. You can't improve strategy, increase revenue, even enhance the performance of a sales force without addressing the structural, people, cultural, communication, measurement and leadership aspects of the organization or at least that part of the organization you are changing. Strategy and structure are married to each other. A decision to change one requires an all out effort to change the other. But that structural change must be well thought out and based on a thorough cause and effect analysis. You don't just change a structure to change it. You have to make sure the changes will support that strategy. At the same time, you don't just implement a better leadership and engagement approach in a company or alter the organizational chart without evaluating how that is going to effect the firms ability to carry out its current strategies.

10.4.1. Which comes first strategy/structure,if strategy then why?

and if structure then why? Great question Haresh. Strategy always comes first. What is the purpose of a structure? Why does the structure exist? What result is the structure intended to produce? Creating a structure just to create a structure serves no purpose and requires the expenditure of money without any thought about a return.

Strategy defines what customers and markets an organization serves, what they are offering those markets, what makes them different and better than their competition, how they will offer this at an attractive price that they can make a profit at and much more. You have to know what you are offering, who you are offering it to and why you are offering it to them before you can create a supporting structure to carry out these strategies.

Once you have created that structure, you then have to closely monitor both the strategy and the structure over time. If you make any adjustments in the strategy, you need to adjust the structure to support those changes. If you discover that something needs to be improved in the structure, you need to carefully consider whether those improvements will help or hinder the firms ability to execute its strategy.

Many firms work on improving their people, systems, organization, culture and more. This is a good thing because they want to always be the best at what they do and that means continuous improvement. Too often, this is done without considering its affect on strategy and that's where some firms get into trouble. Continuous improvement in how well things are done has to go hand in hand with continuous improvement in strategy.

10.4.2. How can they (Strategy & Structure) mismatched when both both depend on each other?

Excellent question Andy. While they are connected and dependent on each other, they can be separately and independently controlled. Top management can decide to change strategy and also decide to not make any changes to structure. Or they could revamp structure but not change strategy. I have seen both occur during my experience as a management consultant. When you change one, it will change the other because of the dependent relationship. That's where companies get into trouble. They change one and don't realize how it will alter the other. Then the other one changes and in a way that hurts them.

Here's a simple, classic and all too common example. Suppose a company has a strategy to deliver superior customer service. Every part of their firm has been developed to do this consistently. This strategy has resulted in their having an image of offering great service and support. Then profit margins get squeezed due to competitors actions and the company responds by laying off employees and shrinking some departments. They think they can do this without it affecting their service image. Usually, they are wrong because their service slips (the structure side) due to the change in strategy (making cost reduction a higher priority than service).

10.4.3. What is the contribution of the Organization structure to strategy implementation?

Really good question. Thanks for asking. The structure of the organization will determine if the strategy can even be implemented and under what conditions the organization can deliver the strategy. Structure is everything that makes up the organization including it's people, leadership, infrastructure, capital, technology and more. It's all the parts and pieces that make up the organization and what it does. If an organization changes its strategy and starts implementing it, the success of this endeavor depends on the structure. You can't successfully implement a strategy the existing structure doesn't support. The implementation of strategy starts by reconfiguring the structure so it will support the new strategy.

That may involve creating new departments, hiring people with expertise the organization now lacks, upgrading the skills and attitudes of everyone working for the organization, changing the organization chart, accessing more capital, developing new technology and software, changing physical facilities by either increasing or decreasing them, developing new methods of logistics and distribution if appropriate and so much more. A classic example of this issue is now confronting Best Buy. You may have read about the problems Best Buy, the electronics retailer, is now facing with large losses and having to address severe competition from Amazon, Walmart and Costco among others. Their recent press releases talk about matching the prices the other retailers charge.

The challenge for Best Buy is that first it has to decide what it wants to be and what strategies will help it move in that direction. It seems to be toying with implementing a low price strategy. The problem is that it can't just cut its prices to match these major competitors because it won't make any money. All it will end up doing is churning dollars but not increasing profits. The reason for this has everything to do with Best Buy's structure as compared to Walmart, Costco and Amazon. These three competitors are completely structured to deliver low prices and make a profit. All three of them succeed very well at doing this. For example, one of the reasons Walmart can consistently offer low prices across the board is because they eliminated an entire distribution channel between the manufacture and their stores. They did this by developing their own logistics and distribution system which is probably the best in the world. Both the efficiency of this system and the elimination of the profit an outside distributor would build into its prices gives Walmart an edge with their landed cost. For Best Buy to pursue a low cost strategy, it takes more than just lowering prices. They have to restructure their company and develop a distribution and logistics system like their competitors that can lower their total landed cost of product to their stores. That would require a huge investment on their part.

If they don't do that and lower their prices, they may increase their revenue but won't make a profit off it. Further, they would be making a huge investment just to match competitors who are already world class at delivering low prices. They aren't going to be able to beat those prices and they are taking a huge risk just to see if they could and get people to buy. You can see that for Best Buy to pursue a low price strategy would require a huge investment, restructuring and risk. Whenever an organization changes its strategy, it has to identify all the elements within its structure that must change to support that strategy. Otherwise, the strategy is doomed.

10.4.4. How often does a company or an organization change their strategies?

Every company is different, every market is different, every situation is different so there is no single right answer to this question. Check out 100 companies and you will find 100 different answers to your question. Here is the more relevant point. Companies shouldn't change their strategy just to change it or because they feel they had their current one for too long or because they see other companies changing theirs. There is no right or wrong number of times to change a strategy. Some companies have essentially kept the same strategy for decades with only minor adjustments.

Others seem to change their strategies every few years. And then there are those that think a new year means a new strategy. Normally the later don't last. Companies should keep their existing strategies when they work. That means they are producing good results satisfying both shareholders and customers and are holding their own against a changing competitive landscape. You change a strategy only when you have to or it makes sense to adjust to what you see happening in the future. Strategy is the primary way that companies adjust to change or fail to adjust to change. It's how they keep their firms aligned with their marketplace and help them get an edge over their competition.

If what a firm has works, no need to change it. If it's not working or it looks like new developments are going to change the playing field, then altering strategy is a good idea. More often than not, the problem is with companies that change their strategies too often. That is because they haven't done a good job of figuring out who they are in the market and are not willing to commit to a well thought out, long term approach for their firm. Every company is different, every market is different, every situation is different so there is no single right answer to this question. Check out 100 companies and you will find 100 different answers to your question. Here is the more relevant point. Companies shouldn't change their strategy just to change it or because they feel they had their current one for too long or because they see other companies changing theirs. There is no right or wrong number of times to change a strategy.

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10.4.5. Why does the structure of an organization follow the development of the organization strategy, rather than the strategy following the development of the structure?

You have asked the most important question of all. Thank you for posing this. We all know the age old question, which came first the chicken or the egg. For that question, the argument can go either way. In the case of strategy, there is only one choice. For an organization to be successful in achieving its goals, it must have the right strategy. Strategy defines who the organization's markets and customers are, what they want and need, what types of products and services will be offered to satisfy them, how to make, distribute, market and sell its offerings and how the organization will go about doing all that in a profitable way. The how includes everything from how it is made, who makes it, how it is distributed, what sales channels are used, how the market buys or acquires the product and service, how the firm differentiates itself from competition and alternative solutions and so much more. So strategy defines what business you are in, who you serve, how you serve your markets, and how you do this in a way that gets enough customers to buy from you a profitable price.

There is no way to know what structure an organization needs until it defines its strategies. The organization structure including capital, people, infrastructure, assets, systems and so on can only be known once the strategy is known. For example, if you decide that you are going to be a virtual company using other firms to manufacture, distribute, and provide customer service, then you obviously don't need to build a manufacturing plant, logistics system, customer service center, call service center and all the administrative support people and systems necessary to run these. You can set up in a small office with a small staff of key people because everything else is outsourced. On the other hand, if you go back to the birth of Federal Express which grew out of a college thesis, the company's strategy was based on the ability to deliver packages "absolutely positively overnight." That was it's core strategy and that strategy encompassed it's understanding of who it's market was, what they needed and were willing to pay a profitable price to get and how it was going to do all this.

Since nothing existed already to deliver such an amazing promise (at the time), the entire infrastructure to do this had to be built from scratch. That meant they had to create their own airline, with their own planes and distribution centers and trucks and local facilities to deliver on the promise. I believe the initial funding for Federal Express was over $200 million to make this happen. Their strategy detected the organization structure they needed to achieve it. Reflect on all this for a moment. If you don't have a strategy, how in the world can you know what type of organization structure you are going to need? While strategy and structure are indeed married to each other, it's always strategy that must lead the charge.

10.4.6. What impact will it have on a company is there isn't a strategy, structure and system?

The short answer is that the company will go out of business very rapidly. No business can exist without a strategy. Regardless of its structure and systems or the lack thereof, a business must have a strategy that defines what market and customers it is serving, what product or service it is offering that market, how it gets people to buy what it offers and how it does all this in such a way as to make a profit. You have to answer those questions to even have a business. Without it, you're just sitting at home playing Frisbee with the dog.

10.5. How Strategy Shapes Structure

By ***w. chan kim and renée mauborgne*** , Havard Business review 2009.

When executives develop corporate strategy, they nearly always begin by analyzing the industry or environmental conditions in which they operate. They then assess the strengths and weaknesses of the players they are up against. With these industry and competitive analyses in mind, they set out to carve a distinctive strategic position where they can outperform their rivals by building a competitive advantage. To obtain such advantage, a company generally chooses either to differentiate itself from the competition for a premium price or to pursue low costs. The organization aligns its value chain accordingly, creating manufacturing, marketing, and human resource strategies in the process. On the basis of these strategies, financial targets and budget allocations are set.

The underlying logic here is that a company's strategic options are bounded by the environment. In other words, structure shapes strategy. This "structuralist" approach, which has its roots in the structure-conduct-performance paradigm of industrial organization economics1, has dominated the practice of strategy for the past 30 years. According to it, a firm's performance depends on its conduct, which in turn depends on basic structural factors such as number of suppliers and buyers and barriers to entry. It is a deterministic worldview in which causality flows from external conditions down to corporate decisions that seek to exploit those conditions. Even a cursory study of business history, however, reveals plenty of cases in which firms' strategies shaped industry structure, from Ford's Model T to Nintendo's Wii. For the past 15 years, we have been developing a theory of strategy, known as blue ocean strategy, that reflects the fact that a company's performance is not necessarily determined by an industry's competitive environment.2 The blue ocean strategy framework can help companies systematically reconstruct their industries and reverse the structure-strategy sequence in their favor. Blue ocean strategy has its roots in the emerging school of economics called endogenous growth3, whose central paradigm posits that the ideas and actions of individual players can shape the economic and industrial landscape. In other words, strategy can shape structure. We call this approach "reconstructionist."

While the structuralist approach is valuable and relevant, the reconstructionist approach is more appropriate in certain economic and industry settings. Indeed, today's economic difficulties have heightened the need for a reconstructionist alternative. The first task of an organization's leadership, therefore, is to choose the appropriate strategic approach in light of the challenges the organization faces. Choosing the right approach, however, is not enough. Executives then need to make sure that their organizations are aligned behind it to produce sustainable performance. Most executives understand the mechanics of making the structuralist approach work, so

this article will focus on how to align an organization behind the reconstructionist approach to deliver high and sustainable performance. What Is the Right Strategic Approach for You?
There are three factors that determine the right approach: the structural conditions in which an organization operates, its resources and capabilities, and its strategic mind-set. When the structural conditions of an industry or environment are attractive and you have the resources and capabilities to carve out a viable competitive position, the structuralist approach is likely to produce good returns (see the exhibit “Choosing the Right Strategic Approach”). Even in a not-so-attractive industry, the structuralist approach can work well if a company has the resources and capabilities to beat out the competition. In either case, the focus of strategy is to leverage the organization’s core strengths to achieve acceptable risk-adjusted returns in an existing market.
But when conditions are unfavorable and they are going to work against you whatever your resources and capabilities might be, a structuralist approach is not a smart option. This often happens in industries characterized by excess supply, cutthroat competition, and low profit margins. In these situations, an organization should adopt a reconstructionist approach and build a strategy that will reshape industry boundaries.
NB: Blue Ocean Strategy is about re-defining the industry value curve and identifying value innovation. The aim is to move the firm away from direct competition with other firms in the industry and to instead to create a "new" industry in which the value offering is so differentiated from competitors, that those competitors tactics and manoeuvring is no longer (directly) relevant.
Thus, the analogy is that the current market is too competitive and that the ocean is bloodied by the aggressive competition (which erodes profitability, firms coalesce around the same dominant value curve and only look for small incremental improvements, etc..). Blue Ocean Strategy moves the firm into clear, blue waters. Personally, I believe that Kim & Mauborgne’s article "creating new market space" is a better account of their theory and is more useful in understanding their perspective. Or you could just buy the book.

Revision Questions

Example ✐. Describe the connection between strategy and structure

EXERCISE 14. ✍ Discuss the different strategic analysis tools