

Among concepts in the field of management in the past 50 years, perhaps none has been written about or debated more than strategy. Chandler (1962), whose pioneering comparative analysis of four companies we reviewed in Chapter 1, appears to have been the first to apply the strategy concept to the business environment, a concept he likely adapted from his connection with teaching at a military college (Freedman, 2013). Books by Drucker (1964) and Ansoff (1965) created a dramatic rise in the interest in business strategy in the 1960s that has never declined. Since then, consulting companies and publications seem to generate new tools and frameworks every year. As a result, the field of strategy has created a “dizzying sequence of grand ideas, the appearance of gurus . . . [a] proliferation of management fashions and fads . . . with cacophony and inconsistency” (Freedman, 2013, p. 561). It is no wonder that many executives find themselves overwhelmed with strategy concepts and advice. Some observers remark that “it is a dirty little secret that most executives don’t actually know what all the elements of a strategy statement are, which makes it impossible for them to develop one” (Collis & Rukstad, 2008, p. 84). If you are hesitant in approaching this topic, you are not alone.

This chapter will introduce foundational ideas and concepts about strategy. This overview is by its nature a selective one specifically for those new to organization design. Strategy can be a difficult concept, full of complex theories and dense writings. Our goal here will not be to convert you into a corporate strategy officer, but to instead, provide enough information so that you can use the organization’s strategy decisions as a launching point for the remainder of the organization design. This overview will help you (1) understand why strategy is a compelling concept for design practitioners, (2) recognize when an organization does or does not have a strategy that is agreed upon by a leader or design team, (3) identify what kind of strategy the organization has, and (4) begin to formulate ideas about how the strategy should impact the rest of the design.

## Learning Objectives

In this chapter you will learn

- Why strategy is important for organization design.
- Definition of strategy and types of generic strategies.
- Key concepts in strategy.
- New perspectives on strategy that are important for a design practitioner to know.

## WHY STRATEGY IS AN IMPORTANT CONCEPT FOR ORGANIZATION DESIGN

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Strategy is at the top of the STAR model for a reason. By providing the starting point for the organization's required capabilities (and thus the design criteria as you recall from Chapter 2), strategy has an influence on nearly every other design decision. Specifically, strategy is important for designers for four reasons:

- 1. Strategic clarity and agreement are required for effective design.** “If the strategy is not clear, or not agreed upon by the leadership team, there are no criteria on which to base other design decisions” (Galbraith, Downey, & Kates, 2002, p. 3). Without strategic clarity, it will be almost impossible to gain agreement on the prioritized organizational capabilities reviewed in the previous chapter. If a leadership team does not agree on the strategy, it will be difficult to make design decisions affecting organizational structure, key metrics, or required skills of employees to deliver on the strategy. In these cases, it is worth investing additional time up front in strategy development before beginning on the remainder of the design.
- 2. Different strategies require different designs.** To reemphasize a point from Chapter 1, “[T]here is no one-size-fits-all organization design that all companies—regardless of their particular strategy needs—should subscribe to” (Galbraith, 2002, p. 14). Just because Nordstrom and Banana Republic are both in the apparel industry and Nike and Adidas are shoe manufacturers does not mean that they should have identical organization designs. Understanding and facilitating organization design thus requires an understanding of how and why strategy has an impact on the design.
- 3. Organization design can be a strategic advantage.** If an organization can master a new capability and embed it into its organization design faster or more effectively than a competitor, it can achieve a strategic advantage. Nike's digital capabilities were given strategic focus in 2010 in its digital sports division (Galbraith, 2014b). That capability is visible in its Nike+ sensors embedded in running shoes and in its online NikePlus.com community, which sets Nike apart from competitors that do not offer these features. Unique organization designs can differentiate an organization or help it achieve operating efficiencies that competitors cannot easily replicate.
- 4. Organization design can facilitate strategy execution.** Some experts believe that strategies can be copied, but what distinguishes a company's success is its ability to execute on that strategy. As we have seen, many problems with strategy execution can be traced to poor design. Knowledge of strategy can help an organization designer identify creative ways to embed that strategy into each element of the STAR model.

## WHAT IS STRATEGY?

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Consider these classic and recent definitions of strategy offered by well-respected strategic thinkers:

- “Strategy can be defined as the determination of the basic long-term goals and objectives of an enterprise, and the adoption of courses of action and the allocation of resources necessary for carrying out these goals.” (Chandler, 1962, p. 13)
- “Strategy is about positioning an organization for sustainable competitive advantage. It involves making choices about which industries to participate in, what products and services to offer, and how to allocate corporate resources. Its primary goal is to create value for shareholders and other stakeholders by providing customer value.” (De Kluyver & Pearce, 2003, p. 1)
- “A company’s strategy is management’s action plan for running the business and conducting operations.” (Thompson, A. A., Jr., Strickland, & Gamble, 2008, p. 3)
- “The dynamics of the firm’s relation with its environment for which the necessary actions are taken to achieve its goals and/or to increase performance by means of the rational use of resources” (Ronda-Pupo & Guerras-Martin, 2012, p. 182)

Not surprisingly, in its history, the field of strategy has included many different definitions and schools of thought. Ronda-Pupo and Guerras-Martin (2012) have studied 91 different definitions of strategy in the first 46 years of the field, noting that “the lexicon of strategic management is internally inconsistent and tends to be confusing” (p. 162). Hambrick and Fredrickson (2001) remark that “[s]trategy has become a catchall term used to mean whatever one wants it to mean” (p. 49). Mintzberg (1987; Mintzberg, Ahlstrand, & Lampel, 1988) observes that there are five definitions or perspectives on what strategy means:

**Strategy is a plan:** We often describe a strategy as a consciously identified path and set of actions. In this definition, strategy is seen as a planning activity that occurs before actions take place. You might have a strategy for getting to work when there is bad weather or a traffic accident that makes your typical route a poor choice.

**Strategy is a ploy:** Strategy can be a threat of a proposed move in order to draw out the behavior of a competitor or opponent. A poker player might bluff to get a competitor to withdraw. A company may publicly state that it has no interest in acquiring a smaller rival in order to discourage a bidding war.

**Strategy is a pattern:** Strategy can be something observed in hindsight whether the actions were intended consciously as a plan or not. In this sense, we can distinguish “*deliberate*” strategies, where intentions that existed previously were realized, from “*emergent*” strategies, where patterns developed in the absence of intentions” (Mintzberg, 1987, p. 13). We might infer a company’s strategy from the actions it takes.

**Strategy is a position:** Strategy can be defined in relationship to other competitors within an industry segment or environment. A company might decide to position itself as a provider to the market niche of urban apartment dwellers or environmentally conscious car buyers.

**Strategy is a perspective:** Finally, strategy can be a worldview, or a company's internal identity and way of perceiving the external world. SOLO eyewear had a mission to help one million people see again in developing countries through a sustainable business model of people, planet, and profit (Schroeder & Denoble, 2014). A compelling vision and laudable goal helped to create a loyal following. Leinwand and Mainardi (2016) write that IKEA's identity "to create a better everyday life for the many people" (p. 22) translates into how they see every aspect of home design.

Scholars make a distinction between corporate strategy and business strategy (Hrebiniak, Joyce, & Snow, 1988; Porter, 1987). A corporate (also called company-wide) strategy is the answer to the overarching question, "What business should we be in?" or as Porter (1987) puts it, "What makes the corporate whole add up to more than the sum of its business unit parts" (p. 43). It might describe the diversification strategy of Berkshire Hathaway, whose subsidiaries include companies in unrelated industries such as Duracell, See's Candies, and Helzberg Diamonds. A business strategy (also called competitive strategy) describes how each of those individual separate businesses compete in their own industries. In this chapter, we will concentrate more on strategy in the latter circumstances.

### Sustainable Competitive Advantage

One of the core concepts that has captivated strategists has been that of developing a "sustainable competitive advantage" (for a history and overview, see N. Hoffman, 2000). On this subject, among scholars of strategy in the last several decades, perhaps none is more cited or well known than Michael Porter. It is a fair assumption that virtually every student of strategy since 1996 has been assigned Porter's classic article, "What Is Strategy?" that appeared in the *Harvard Business Review* that year. For Porter, strategy is about "the general principles of creating and sustaining competitive advantage" (Magretta, 2012, p. 93). This means being different—not trying to mimic others or copy a competitor but to find a unique path to stand out in a lasting way. In other words, "A company can outperform rivals only if it can establish a difference that it can preserve" (Porter, 1996, p. 62). How is a company to stand out and perform better than the competition? Porter explains that

Competitive advantage grows fundamentally out of value a firm is able to create for its buyers that exceeds the firm's cost of creating it. Value is what buyers are willing to pay, and superior value stems from offering lower prices than competitors for equivalent benefits or providing unique benefits that more than offset a higher price. (1985, p. 3)

A company that finds a competitive advantage will be more profitable than competitors because it will operate at lower cost or have the ability to charge a premium price to customers because of the value that is provided.

If you look around your home and ask yourself why you purchased any given item or service, it's likely that the answer will effectively boil down to one of those two reasons. Perhaps you chose the item because it was less expensive, and you

judged the competitors to be essentially equal in features. You determined that one brand of stapler or copy paper or orange juice is as good as its alternatives, and you chose the one that cost the least. Or, perhaps you chose the product or service because it was different or unique. You chose premium coffee because you like the taste better, your top-of-the-line flat screen TV because it had unique features, or the more expensive dry cleaner that offers faster service. You were willing to pay more in these instances rather than only evaluating cost. For those companies, your decision criteria formed the basis of their competitive advantage over the alternatives that you did not select.

### Activity Systems and Strategic Trade-offs

In Porter's classic 1996 article, he articulated two key principles to define the essence of strategy, including activity systems and strategic trade-offs.

#### Strategy Rests on Unique Activities

Porter writes that “[t]he essence of strategy is in the activities—choosing to perform activities differently or to perform different activities from rivals” (Porter, 1996, p. 62). In this sense, being different and unique is central to strategy. Most companies that produce a product or service must do similar things such as product development or design, manufacturing and production, service delivery, sales, finance, and marketing. If every company did these activities in exactly the same way, there would be little difference between them. If a company can discover how to manufacture a product at a lower cost, however, that lower cost can be passed on to the customer in terms of lower prices and the company can gain an advantage over a competitor. Or, if a company has a superior product design process that provides an attractive set of new features that no other competitor can match, they also have an advantage. Porter explains:

Ultimately all differences between companies in cost or price derive from the hundreds of activities required to create, produce, sell, and deliver their products or services, such as calling on customers, assembling final products, and training employees. . . . Activities, then, are the basic units of competitive advantage. Overall advantage or disadvantage results from all of a company's activities, not only a few. (Porter, 1996, p. 62)

Activities are grouped together in activity systems, and when the entire activity system is oriented toward a particular goal, competitive advantage can result. A single activity (lower-cost manufacturing) can provide an advantage, but a sustainable advantage comes from organizing a series of activities into a system that is more difficult for competitors to copy.

Consider the example of Southwest Airlines. Ask most people what Southwest's strategy is, and most will come up with some version of “low cost.” But that simple label fails to capture the myriad of activities internally to Southwest that allows them to maintain a cost advantage. Southwest does not just replicate everything that United Airlines does but charge less for the service—to do so would be to settle for lower profitability. Instead, Southwest is able to offer lower prices by also making other choices that decrease costs, such as offering more limited service (no meals, no seat assignments, no baggage transfers to other airlines, no connections). While this has changed somewhat in recent years, Southwest

initially chose a smaller lower-cost airport location outside of major hub cities (e.g., Chicago Midway instead of Chicago O'Hare). Using the same fleet of 737 aircraft has meant that Southwest can have standardized training, and pilots and crew members do not have to be limited to only the aircraft they are trained to work. Maintenance costs are lower because spare parts inventory from panels to bolts to coffee pots will all fit every plane, improving the efficiency of maintenance crews. Fast gate turnaround times and efficient boarding practices keep planes flying (when they are making money, versus standing on the ground) and allow more departures per day. In short, everything Southwest does in its major activity system is in the service of providing lower costs to customers. Perhaps another competitor could come along and do the same thing as Southwest by engaging in a few of these activities—charging similarly low prices and offering limited service routes. Other competitors, however, have had difficulty replicating the entire activity system that gives Southwest a unique advantage.

### Strategy Requires Trade-offs

Listen to many business executives articulate their strategies, and you may hear some version of “We want to offer the highest-quality product at the lowest cost with the best customer service.” This is misguided, in Porter's view. He advises that “a strategic position is not sustainable unless there are trade-offs with other positions” (1996, p. 68). He points to what happened with Continental Airlines (now United Continental Holdings) in the mid-1990s when it decided to compete with Southwest by launching a service called Continental Lite. It offered low prices (one popular incentive invited customers to bring a friend on the flight and be charged only a penny more), no meals, and the same routes. But by maintaining its full-service routes, frequent flier program, and travel agent incentives, it was not able to reduce its costs as Southwest had. Eventually it cut frequent flier benefits and travel agent costs, angering both constituencies. The company's CEO resigned in 1994 and the Continental Lite service was discontinued in 1995 at what is estimated to have cost \$140 million (Bryant, 1995).

Porter's view is that “[a] sustainable strategic position requires trade-offs” (1996, p. 68). This means that companies accept the idea that they cannot meet all needs of all customers, and they must make deliberate decisions not to pursue certain types of customer or market. Magretta (2012) describes how the Swedish furniture designer IKEA chose to target price-conscious customers with less expensive furniture designs. IKEA chooses not to design and sell luxury goods or hand-constructed dining tables. Customers agree to the trade-off of assembling the furniture themselves, packing it in their own vehicles, and with almost no individualized sales assistance. Trade-offs are important for three reasons, Porter (1996) writes:

1. “Inconsistencies in image or reputation” (p. 68) arise without trade-offs, because customers will be confused about the mixed messages. If a company is trying to lead the market with a lower-cost product, it will be challenging to convince new customers that a high-end offering is worth the price. If IKEA added an expensive leather sofa to its line with the ability to select among 50 color options, or if Gucci created a \$30 sports watch, customers would likely react negatively to the discrepancy with the rest of the company's products.
2. Different strategies require different product configurations, different equipment, and different management systems. Without trade-offs,

these different strategies dramatically increase complexity. IKEA's manufacturing line that is organized to build modular furniture for self-assembly would not be suitable for the leather sofa.

3. Without trade-offs and a clear signal, employees can be confused about priorities. If IKEA introduced a custom-built set of kitchen cabinets that were made to order, employees from designers to procurement to manufacturing would need to stop and rethink how to cope with the offering that goes against the processes used for the rest of the company's product lines. This requires different employee behavior and a different set of skills.

Magretta (2012) concludes that "if there is one important takeaway message, it is that strategy requires choice. . . . Trade-offs play such a critical role that it's no exaggeration to call them strategy's linchpin" (p. 121).

## TYPES OF STRATEGY

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In this section, we will examine different formulations of types of strategy that scholars have observed. We will cover three strategy frameworks: Porter's generic strategies, Treacy and Wiersema's value disciplines, and Miles and Snow's strategy typology.

As we will see in later chapters, it is important for the organization designer to be able to identify the type of strategy that an organization is adopting in order to be able to disseminate the implications of that choice throughout the rest of the design and ensure alignment.

### Porter's Generic Strategies

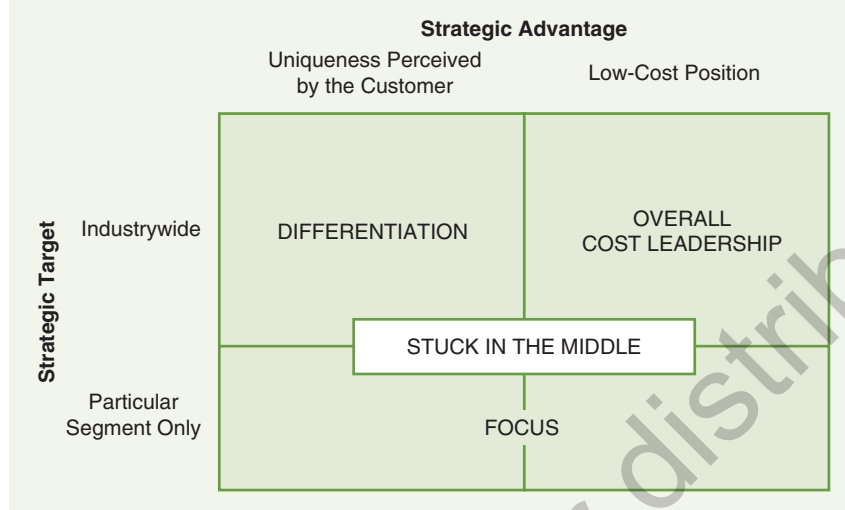
Porter (1980, 1985) explains that there are three generic strategies from which companies can choose: cost, differentiation, and focus, a typology that Campbell-Hunt (2000) called "unquestionably among the most substantial and influential contributions that have been made to the study of strategic behavior in organizations" (p. 127). As we have seen, Porter has noted that a company must choose one of these strategies to the exclusion of the other two, writing that "sometimes the firm can successfully pursue more than one approach as its primary target, though this is rarely possible" (1980, p. 35), a point that has generated considerable attention (see Figure 3.1).

### Cost Leadership

A company enjoys a cost-leadership advantage if it can find ways of operating at a lower cost than competitors. A cost-leadership strategy can work in two ways. First, it can result in higher than average profits even when the company charges generally the same as competitors, because the company's costs are lower and thus its profits will be higher. Second, the company can charge less than competitors and attract more price-sensitive customers, maintaining higher profits by selling more volume. The sources for this advantage can vary depending on the industry, but commonly involve the following:

- Economies of scale (bulk purchasing to reduce costs from suppliers or volume manufacturing, which reduces the cost per unit manufactured)

**Figure 3.1 Porter's Generic Strategies**



Source: Adapted from Porter, M. E. (1980). *Competitive strategy: Techniques for analyzing industries and competitors*. New York, NY: Free Press, p. 39. Retrieved from [https://commons.wikimedia.org/wiki/File:Michael\\_Porter%27s\\_Three\\_Generic\\_Strategies.svg](https://commons.wikimedia.org/wiki/File:Michael_Porter%27s_Three_Generic_Strategies.svg), licensed under CC BY-SA 3.0 <https://creativecommons.org/licenses/by-sa/3.0/deed.en>

- More efficient uses of facilities such as manufacturing (perhaps designing products specifically for ease of manufacturing)
- More productive employees (due to more efficient processes) or lower-cost labor (shifting work to lower-cost locations)
- Low overhead costs or cost management in areas such as marketing and information technology
- More efficient uses of raw materials (less waste in the manufacturing process) or using less expensive raw materials
- Outsourcing or vertical integration to take advantage of the capabilities of other companies and thus reduce costs
- Using the Internet or lower-cost distribution channels to sell directly to customers and eliminate a salesforce, distributors, or dealers

Most companies want to be efficient and will look for cost reductions periodically regardless of strategy. A cost-leadership strategy as its primary objective, however, aligns managers and employees to the goal of aggressively examining all internal sources of cost and pursuing cost reductions throughout the organization. A company might invest resources in technology that show real-time inventory levels or automatically package and ship orders from a warehouse. The same can occur with companies that offer services instead of products, making service calls more efficient and thus increasing profitability by performing more services in the same amount of time as a competitor. A low-cost-leadership position can often be sustained by continued reinvestment in efficiencies, new equipment, or new facilities (Porter, 1980).



## Differentiation

The second generic strategy is that of differentiation. A differentiation strategy seeks to gain advantage by offering something that no one else offers, and thus can command a premium price. However, creating uniqueness comes at a cost, perhaps in research and development, additional staff, costly raw materials, and more. Differentiation will be profitable only when the premium price that is charged is higher than the cost incurred to create the differentiation (Porter, 1985). Differentiation can take many forms:

- Additional or better features not offered by competitors (a different size, flavor, or color; a new capability such as Internet connectivity; unique, attractive, or specialized design)
- Product quality (premium materials, better reliability, better taste)
- Services that set the company apart (personal assistance or consulting, free installation support or training, free upgrades, overnight delivery, available spare parts, a comprehensive set of services or one-stop shop)
- Removal of something buyers do not want (packaging materials; worry or fear such as in the case of lost computer files; high fructose corn syrup, trans fats, dyes, chemicals, or fragrance)
- Location, delivery, or distribution channel (many locations that offer local convenience, the ability to purchase or maintain an account online, online help or chat)
- Enhancing value to buyers (lowering buyers' costs, saving their time)
- Perceptions of image or reputation (exclusivity, brand recognition and image, technological superiority)

Some features that differentiate a product or service provide an advantage only temporarily, until a competitor can add the same feature (if Tide creates a lemon-scented laundry detergent, then Wisk can do the same relatively quickly). An enhanced feature is not a differentiator if customers do not want it, and it is not profitable if it costs a great deal to invest in the differentiator but customers are not willing to pay extra for it. The differentiation can provide a sustainable competitive advantage as long as competitors cannot duplicate it, customers still desire it, and they perceive that a company has it.

## Focus

The third generic strategy is a focus strategy. A focus strategy targets a specific market niche or customer type. Jitterbug, a cell phone provider, targets seniors with simple software on their smartphones, easy to read larger screens, and pre-installed apps that store medical history or dial urgent care with the touch of a button. Law Tigers is a professional association of injury lawyers who specialize in motorcycle accident litigation. Golf Channel shows only programming related to the sport of golf. By focusing on a specific target market, these companies narrow their customer base (to seniors, motorcycle riders, golf enthusiasts) but thereby seek to outperform other companies within that market by specializing. Many

companies might target specific market segments, but as Porter notes, for a focus strategy to be effective, “the target segments must either have buyers with unusual needs or else the production and delivery system that best serves the target segment must differ from that of other industry segments” (1985, p. 15). Companies that use a focus strategy hope to demonstrate to customers that they have additional expertise gained by focusing on the target customer segment. They try to show that other companies do not understand the customer and have lost focus with their wider target market.

A focus strategy has two variations—the same two that we have reviewed above—cost and differentiation, and the same principles apply to reduce costs or enhance differentiation. This can be especially desirable as a strategy for smaller businesses that do not have the resources to compete on a large scale against bigger competitors. Thus, focus can be a starting strategy as the business grows. A boutique consulting firm may decide to specialize in consulting on marketing for regional food and beverage companies, leaving McKinsey to consult with globally recognized brands. One requirement for a focus strategy is to identify true differences in the needs of the target customer segments. In addition, there is always the risk that the larger competitors will develop their own segmented brands to compete in the focused market.

### Treacy and Wiersema’s Value Disciplines

In 1993 (and later expanded in 1995), Treacy and Wiersema articulated their value disciplines approach to strategy, arguing that “no company can succeed today by trying to be all things to all people” (1995, p. xii) and that “to choose a value discipline . . . is to define the very nature of a company” (p. 32). They argued that in earlier decades, customers made choices based on quality or price or some combination, but their observations showed that customers were making more complex buying decisions based on convenience, their customer experience, and postsales service and support. Industry leaders, they wrote, succeeded by focusing on a specific type of customer value. Some customers are more price sensitive than others and seek a no-frills experience, others are willing to pay more for the best product, and still others want their needs met in a customized way with a total solution. They label these three value disciplines as *operational excellence*, *product leadership*, and *customer intimacy*.

Treacy and Wiersema found that top companies were able to “change what customers valued and how it was delivered, then boosted the level of value that customers expected” (1993, p. 84). As they observed market leaders in different industries, they found four rules that seemed to govern the leaders’ success:

Rule 1: Provide the best offering in the marketplace by excelling in a specific dimension of value.

Rule 2: Maintain threshold standards on other dimensions of value.

Rule 3: Dominate your market by improving value year after year.

Rule 4: Build a well-tuned operating model dedicated to delivering unmatched value (1995, pp. 21–25)

They point out that based on Rule 2, “choosing one discipline to master does not mean that a company abandons the other two, only that it picks a dimension

of value on which to stake its market reputation” (1995, p. xii). Savvy customers know what they are doing, they point out. Customers who expect an exceptional experience at Nordstrom know that they are likely to pay more for the service, but not irrationally so. Customers who want low prices at Walmart know that personal service is unlikely, but still expect time waiting in line to be reasonable.

### Operational Excellence

The operational excellence value discipline means “providing customers with reliable products or services at competitive prices and delivered with minimal difficulty or inconvenience” (Treacy & Wiersema, 1993, p. 84). Companies pursuing an operational excellence approach appeal to customers based on lower prices or convenient, hassle-free service. Costco, for example, has fewer products than most large stores, and does not invest in the ambience of its facilities, which are typically warehouses with huge shelves and industrial lighting. With aggressive supplier negotiations and ruthless product selection, Costco carries and prices items that are popular and where savings can be passed on to the customer. Too many items would contribute too much complexity, which would cost more to organize and operate, so few items and bulk purchasing creates cost effectiveness and simplicity. Operational excellence implies that companies will focus on end-to-end process controls, from sales to supply chain to service, rooting out waste and seeking constant improvement. Companies that are successful in this approach often have standard, simple practices, process checks and monitoring, and management and rewards systems that reinforce process compliance and efficiency.

### Product Leadership

Product leadership means “offering customers leading-edge products and services that consistently enhance the customer’s use or application of the product, thereby making rivals’ goods obsolete” (Treacy & Wiersema, 1993, p. 85). Product leadership companies seek innovation and creative development of new products, new features for existing products, or new ways to use products. Product leaders recognize that success comes from the next innovation, so they concentrate on effective research and development processes and the ability to launch new products into the market and capitalize on product success. They may have any number of new innovations in the portfolio pipeline, and often must balance where to invest resources and where to winnow the portfolio to pursue the breakthrough product. Google, for example, regularly tests and launches new products beyond its initial Search product that have resulted in such innovations as Google Earth, Google Analytics, and Google AdSense (Maxwell, 2009). Further investments in renewable energy or driverless car innovations may or may not pan out, but such projects are the hallmark of a product leadership strategy that rewards experimentation and seeks the next big thing. Product leadership companies are not afraid to create an innovation that may even make the company’s own products obsolete, knowing that if they do not, a competitor could.

### Customer Intimacy

Customer intimacy refers to “segmenting and targeting markets precisely and then tailoring offerings to match exactly the demands of those niches” (Treacy & Wiersema, 1993, p. 84). Companies pursuing a customer intimacy strategy are

not trying to push the latest product or undercut competitors on cost, but instead to build long-term customer loyalty by seeking to understand their customers at such a level of depth that they can design a total solution for them. At Home Depot, for example, clerks do not simply point out that plumbing repair parts are located on aisle 14, but instead they will go to great lengths to inquire about the problem the customer is experiencing and to demonstrate the repair process with the customer in the store. In Hemp's (2002) narrative about his week-long trial as a room service waiter at the Ritz-Carlton, he observes that at the Ritz, customer intimacy is a passion. "If a housekeeper notices that a guest has moved the desk in her room to get a better view out the window, the housekeeper might log that observation on a guest-recognition slip so that the furniture would be arranged accordingly on the guest's next visit" (p. 54). Customer-intimate companies invest heavily in understanding customers and their problems, and in training employees on how to interact with customers to build customer loyalty. A company that chooses this approach "must display the confidence to charge more, because it knows it is worth every dime" (Treacy & Wiersema, 1995, p. 142).

Table 3.1 summarizes the three value disciplines.

### Miles and Snow's Strategy Typology

Miles and Snow's (1978) pioneering study concerned the process of organizations' adaptation to their environments. By studying companies in four different industries—college textbook publishing, electronics, food processing, and hospitals—they found that organizations tended to demonstrate one of four different strategic approaches, or types of organizational adaptation.

#### Defenders

Defenders are companies that presume a narrow and relatively stable market and that seek to improve the efficiency of their operations. They compete primarily on the basis of price, quality, or service, and given that the market is not constantly changing, they can direct their attention to price reductions and quality

**Table 3.1 Comparing the Value Disciplines**

	Operational Excellence	Product Leadership	Customer Intimacy
Source of Competitive Advantage	Beat competitors on price	Innovation in product with better features, benefits, and functionality	Build relationships and repeat business through superior customer partnerships
How to Maintain the Advantage	Internal cost control; process efficiency; waste reduction	Investment in research and development; product launch processes	Monitor customer preferences and trends; customer feedback that drives improvements
Rewards	Process compliance and efficiency	Experimentation and innovation	Customer satisfaction
Key Internal Processes	Supply chain	Research and development	Sales and customer support

improvements for existing products. The objective of a Defender is not to develop new products or seek new markets but maintain a position within an existing market and seek to provide a full range of services to clients within that market. Growth occurs from extending existing products within the same market, cautiously and incrementally. With an emphasis on stability and efficiency, most Defenders exhibit operations that are formalized, controlled, and prescribed.

### Prospectors

Prospectors see their environment with opposite characteristics from Defenders. A Prospector sees a flexible and dynamic environment and defines their market broadly. This requires the Prospector to regularly innovate and extend its product lines, developing new products and seeking new market segments for growth. A Prospector must monitor industry activity, customer preferences, and competitive behavior to ensure that it is positioned for future trends. As an example, Miles and Snow refer to Star Electronics, a company with 20 different divisions, each of which “is relatively free to explore any product, market, or technological development which might lead to an improved version of its present product line or to new markets” (1978, p. 56). Prospectors differentiate themselves through innovation and bringing their products to market before competitors can (Miles & Snow, 1986).

### Analyzers

If Defenders and Prospectors are at two ends of a continuum, Miles and Snow (1978) write, then Analyzers try to combine the strengths of both strategies. An Analyzer might have a mix of stable products and ones that are changing or developing, seeking growth in depth of market penetration and through product development. Unlike Prospectors, Analyzers are not likely to be first to market, but instead follow the lead of the Prospectors. There is a balance of emphasis on tight controls and efficiencies and new innovations and continued effectiveness, but the balance must not swing too widely in either direction. Because they operate in both stable markets and changing ones, they aim to develop formal and controlled internal practices for their stable markets and hone their ability to replicate innovations in changing markets. Thus, the Analyzer succeeds through finding the right mix of new products and current ones, new markets and existing customers, efficiency and effectiveness, stability and flexibility.

### Reactors

It is a misnomer to call the Reactor profile a strategy compared to the other three types, as it may be better labeled as the lack of a strategy (Parnell & Wright, 1993). Miles and Snow (1978) write that the Reactor “lacks a set of consistent response mechanisms that it can put into effect when faced with a changing environment” (pp. 81–82) likely because it has no strategy, has not been able to link strategy throughout the organization’s other structures and processes, or it stubbornly holds to an approach that is no longer viable. Reactors may see the need for change but are somehow unable to execute the necessary actions to adapt successfully.

Table 3.2 summarizes the three strategy frameworks we have reviewed. See the box following Table 3.2 for a discussion of how these strategies have been adapted to global organizations.

**Table 3.2 Three Strategy Frameworks**

Porter's Generic Strategies	Treacy and Wiersema's Value Disciplines	Miles and Snow's Strategy Typology
<ul style="list-style-type: none"> <li>• Low cost</li> <li>• Differentiation</li> <li>• Focus</li> </ul>	<ul style="list-style-type: none"> <li>• Operational excellence</li> <li>• Product leadership</li> <li>• Customer intimacy</li> </ul>	<ul style="list-style-type: none"> <li>• Defenders</li> <li>• Prospectors</li> <li>• Analyzers</li> <li>• Reactors</li> </ul>

## GLOBAL STRATEGIES

You may have noticed that the generic strategy frameworks we have studied do not explicitly address strategy variations for global organizations. Companies that operate in multiple countries often have different approaches to strategy in those countries for different reasons. Beverages and snack foods, for example, display great variation due to food preferences and tastes around the world. For example, Pepsi's Mirinda brand of carbonated beverages is only available outside the United States, and the Walkers brand of potato chips is marketed primarily in the United Kingdom (whose flavors include sweet chili chicken). Many global companies have specific brands only available in certain markets. While Coca-Cola is available around the world, Coca-Cola also markets the Del Valle brand of orange juice available in Latin America and the Ciel brand of bottled water in Mexico. To take into account the complexity of global strategy, there have been many attempts to create a generic strategies approach for global competition (see Rugman & Verbeke, 1993, 2006).

Companies that operate in more than one country generally display one of three broad international strategy types (Bartlett, 1986; Inkpen & Ramaswamy, 2005). Global companies have to consider two requirements: the degree of integration or scale efficiency across countries, and the degree of local responsiveness and flexibility needed.

- **Multinational organization:** A company that requires a high degree of local responsiveness but has low integration across countries is a multinational organization, operating on an independent country-by-country basis. It might produce different products for different geographies depending on unique local requirements, regulations, or consumer preferences. This strategy is also preferred when shipping or customs costs might be prohibitive.
- **Global organization:** A global organization displays high integration and scale efficiency but low local responsiveness. The same product may be produced and sold globally with very minor deviations from the standard. There may be centralized activities such as manufacturing to take advantage of cost benefits, with local sales or marketing units physically close to customers.
- **Transnational organization:** "In contrast to the multinational strategy that seeks to maximize responsiveness to local demands and the global strategy that seeks to maximize scale efficiency at the cost of flexibility, the transnational approach attempts to synthesize the salient benefits of both approaches without many of the disadvantages associated with either" (Inkpen & Ramaswamy, 2005, p. 69).

A company may locate manufacturing in one country to take advantage of costs and a research and development facility in another to take advantage of local expertise. This strategy requires a high degree of coordination across groups, which we will address in more detail in Chapter 5 in the context of global operating models.

For global companies, Porter (1986) modifies his three generic strategies approach to five, to include (1) global cost leadership; (2) global

differentiation; and (3) global segmentation, “serving a particular industry segment worldwide” (p. 47). These first three strategies apply to companies whose geographic scope of strategy is a global one. He includes two other strategies for companies whose scope is country centered: (4) protected markets, “seeking out countries where market positions are protected by host governments” (p. 47) and (5) national responsiveness, where there may be a high degree of uniqueness in a particular country even though the industry is global.

### Stuck in the Middle

All three sets of authors warn of the dangers of not selecting a defining central and consistent strategy. Porter (1980) writes that “the firm failing to develop its strategy in at least one of the three directions—a firm that is ‘stuck in the middle’—is in an extremely poor strategy situation” (p. 41). Similarly, Treacy and Wiersema (1995) write that “not choosing means ending up in a muddle . . . steering a rudderless ship, with no clear way to resolve conflicts or set priorities” (p. 45). Reactors in the Miles and Snow (1978) typology are “inconsistent and unstable” and “will at some point be forced to move . . . to one of the other three types” (p. 154).

Profitability suffers for stuck-in-the-middle companies as a result of their refusal to choose. They are unable to focus on a specific market, losing the battle on cost with other low-cost rivals, and lacking a differentiated product or service. “Achieving cost leadership and differentiation are also usually inconsistent, because differentiation is usually costly” (Porter, 1985, p. 18). Such a strategy can rarely be successful, Porter writes, but only if competitors are also stuck in the middle or if a unique proprietary technology is developed that allows both cost reduction and differentiation at the same time.

The stuck-in-the-middle paradigm has provoked considerable debate. Some agree that too much specialization in one strategy domain can be easy to imitate or that it might leave a company with a myopic view of the competition that limits them from seeking potential innovations (Miller, 1992; Salavou, 2015). But others see examples of successful companies that have bridged multiple strategies. Treacy and Wiersema (1993) acknowledge that “a few maverick companies have gone further by mastering two” of the value disciplines (p. 86), pointing to Toyota’s product leadership and operational excellence, and the office supply company Staples’s operational excellence and customer intimacy. Salavou (2015) points out that hybrid strategies, as distinct from stuck-in-the-middle strategies, allow shades of gray between the fixed options suggested by earlier models.

Some of the research on hybrid strategies has found that combinations of low cost and differentiation can provide advantages that are more difficult for competitors to copy. The issue may be one of intent and strategy consciousness. In tests of Miles and Snow’s (1978) typology, Parnell and Wright (1993) and Parnell (1997) found that companies that had an unsystematic strategy and as “reactors” found

themselves stuck in the middle were less successful than companies that intentionally balanced multiple strategic forms. These authors concluded that “low cost and differentiation are not mutually exclusive” (Parnell, 1997, p. 178) and that “businesses can successfully compete with combination strategies” (Parnell & Wright, 1993, p. 32). Faulkner and Bowman (1992) and Parnell (2006) both point out that a more effective lens on strategy may be to examine how companies compete to deliver *perceived customer value* through combinations of the various dimensions. Kim and Mauborgne (2009) argue that in highly competitive industries, a “reconstructionist” strategic approach makes sense whereby a company can redefine an industry in pursuit of both differentiation and low cost.

## KEY CONCEPTS

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Here we will review several key concepts in the strategy literature that have been widely popular or influential and that are instructive for the organization designer: five forces, core competencies, blue ocean strategy, and the strategy canvas. Each of these concepts will help a designer understand the basis of an organization’s strategic priorities and how it intends to execute that strategy.

### Porter’s Five Forces Model

Porter points out that to effectively analyze competition and strategy, one must understand the underlying economic structure of an industry (Porter, 1979, 1980, 2008). Certainly, the choice of strategy within that industry is critical, but the factors that contribute to the industry’s competitive environment strongly influence how profitable the competitors can be. He argues that “the first fundamental determinant of a firm’s profitability is industry attractiveness” (1985, p. 4) and that five forces make up the industry’s economic structure. Where those competitive forces are intense, profitability is decreased, and where the competitive forces are weaker, profitable returns are more attractive. By analyzing the average industry return on invested capital, Porter (2008) points out that some industries such as soft drinks and pharmaceuticals have a relatively high profitability compared to the average, whereas airlines, hotels, and book publishing have relatively low profitability. The objective of the corporate strategist, then, “is to find a position in the industry where his or her company can best defend itself against these forces or can influence them in its favor” (Porter, 1979, p. 137) to achieve profits that are higher than the industry average. Understanding the five forces can help an organization designer appreciate the underlying rationale for a company’s strategic position and why strategic change (and in turn a change to its organization design) might be necessary.

The five forces recast an understanding of a company’s competitive environment with a more complete set of factors. We intuitively understand that companies in the same industry compete with one another (Coca-Cola and Pepsi, Southwest and American Airlines, United Parcel Service and FedEx). But this is only one dimension of what shapes the profits and competitive environment of each of those companies. Airline companies compete for profits with alternative forms of transportation as well as with suppliers Airbus and Boeing (airplane manufacturers), who would inevitably desire to be paid more for their planes, and pilot unions that would also like for employees to share in the profits. FedEx’s profitability is not only influenced by how much business it gains over UPS, but by how much it pays



for its trucks and the drivers who operate them. Direct competition among rivals is, as we will see, only part of the story that determines a company's profitability.

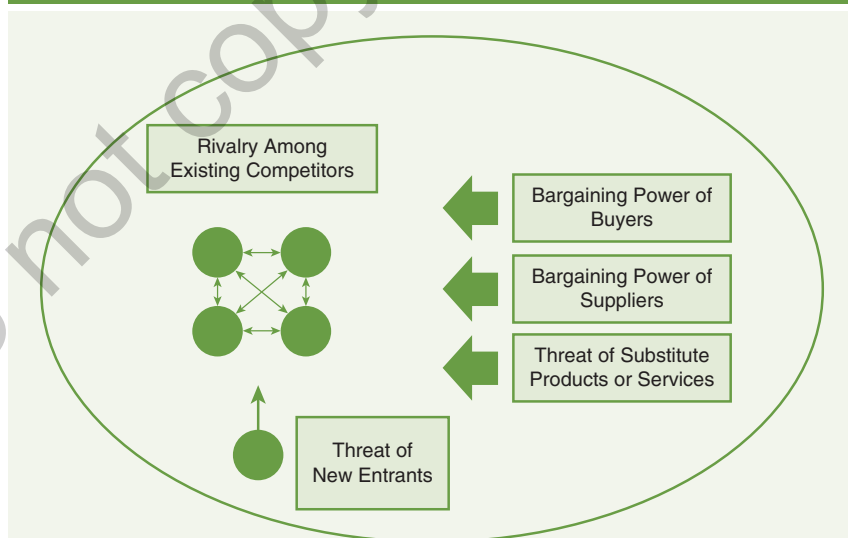
The five forces are not equally impactful in any given industry, and "the most salient force is . . . not always obvious" (Porter, 2008, p. 80). Porter gives the example of Kodak and Fuji, who competed as intense rivals between each other. The biggest threat to their profitability was not the other company but the growth of digital photography and competitors such as Apple. Moreover, underlying industry dynamics can and do change, sometimes rapidly, making any analysis of the five forces temporary. (For a detailed explanation of the five forces beyond this selective overview, consult Porter, 1979, 1980, 2008; see Figure 3.2.)

### Threat of New Entrants

A highly profitable industry can attract new businesses that wish to capture some of the profits for themselves. As Porter (2008) notes, this is especially true when competitors can use their size and scale to expand from a related industry. For example, Pepsi expanded into the bottled water market in 1994 with its Aquafina brand, and Coca-Cola responded in 1999 by introducing Dasani. Both companies could leverage their substantial distribution networks, well-known brands, and existing bottling facilities to take market share from competitors such as Evian. Consider what it would take for you to enter the same bottled water industry without those same resources. Several barriers to entry would exist, such as extensive capital requirements to purchase or build a bottling plant, brand recognition of existing competitors that put your unknown label at a disadvantage, and the lack of distribution channels to get your product to consumers. You would lack the same economies of scale that Pepsi has and would need to charge more.

In other industries, the threat of new entrants is kept low because of switching costs. Switching costs refer to the tangible and intangible costs in changing a buyer and supplier relationship. While it does not cost a consumer more to change

Figure 3.2 Porter's Five Forces



from Dasani to Aquafina, it might cost a consumer to switch from an iPhone to an Android in time setting up the device, moving music files or contacts, and learning how to use the features. All of these entry barriers deter new companies from entering the existing market, leading to higher profitability in the industry. The Internet and mobile phone apps reduce barriers to entry by providing direct access to consumers (instead of traditional distribution channels such as brick-and-mortar stores) and reducing costs (such as a sales force) (Porter, 2001).

### **Bargaining Power of Buyers**

The second force is the negotiating ability of the buyer to extract price concessions or enhanced services from suppliers. If buyers can easily change to another supplier, then suppliers will be forced to keep prices low to retain the business. Consider the shipping and package delivery industry. Amazon.com has been able to negotiate lower shipping costs from UPS not only because the online retailer is a large customer but because Amazon could easily switch to another delivery company. This has made for stagnant profit margins at UPS in recent years and pushed the company to look for internal operating efficiencies (Stevens, 2014). Moreover, the threat of backward integration (such as Amazon.com creating its own shipping division) will frustrate UPS's attempts to raise prices. Buyers also hold power when the products they purchase are not unique or they spend a lot with the supplier and have an incentive to monitor costs, and thus have negotiating leverage.

### **Bargaining Power of Suppliers**

A third force is the negotiating ability of the supplier, the flip side of the previous force. If the supplier has a unique product that is highly differentiated or in short supply, the supplier will retain more profits and charge higher prices to the buyer (who has nowhere else to turn). Microsoft holds negotiating power as a dominant supplier of its operating system, giving personal computer manufacturers few alternatives. With a number of PC companies in the market, consumer buyers have a lot of choices, forcing manufacturers to keep prices low to win customers, but they are also unable to extract price concessions from Microsoft. Thus, PC companies are caught in the middle between two powerful forces.

If a buyer has high switching costs, they will be more dependent on a supplier. For example, if a company has trained all of its employees how to use a particular piece of leased manufacturing equipment, they may be loath to switch suppliers of that equipment and invest in costly retraining on new machinery. When consumers have long-term cell phone contracts that require them to stay with the supplier or pay a substantial fee, the power of switching costs explains why even unhappy customers stay with their provider. It also explains why some cell phone providers offer to buy out contracts to encourage customers to switch (reducing switching costs).

On the other hand, if switching costs are low, then buyers can easily change to another supplier and reduce the supplier's negotiating leverage. A company that has an exclusive arrangement for rental cars with one company but who could easily switch to another brand reduces the bargaining power of the car supplier.

### **Threat of Substitute Products or Services**

The threat of alternative products or services is a fourth force that shapes an industry's competitive environment. "A substitute performs the same or a similar function as an industry's product by different means" (Porter, 2008, p. 84). Some

substitutes are easily identifiable because they are almost exact reproductions of a company's product (i.e., they do the same thing). Netflix and Redbox both competed with brick-and-mortar video rental companies; Apple's iPhone became a substitute for film cameras, other digital cameras, and digital video recorders; and Uber became a substitute for hailing a taxi. A movie theater that is a short drive from my house might compete as a direct rival with other theaters that may be slightly farther away on price or customer experience. I might be willing to patronize another theater if the other theater was less expensive, if its seats were more comfortable, or if it offered better popcorn.

However, consider that the competition is broader than just other movie theaters and that substitutes are not always exact. I have a number of entertainment choices on a Saturday evening (including watching live theater, staying at home, or attending a sporting event). The movie theater entertainment experience has a large number of threats of substitute products beyond movies. This is what keeps admission prices stable even where only a single theater exists for hundreds of miles. There may be no other theater to act as competition, but there are plenty of substitute entertainment options to compete with. Because there are virtually no switching costs for substitute entertainment (it does not cost me anything to make the substitute choice), theaters do not just compete with each other, they compete with all other possible ways to spend your leisure time.

In addition, consider what happens when theatergoers do not feel inclined to substitute or when substitutes do not fulfill the same requirements. When the only way to see the popular Broadway play *Hamilton* was to buy a scarce ticket to the New York theater production, there were no other substitutes for theatergoers that wanted the unique experience. The threat of substitution of another Broadway show was lower. Producers were able to raise the base ticket price to \$849, a figure they arrived at by studying the resale ticket market (Paulson, 2016).

Porter warns that "strategists should be particularly alert to changes in other industries that may make them attractive substitutes when they were not before" (Porter, 2008, p. 85). When Nomacorc developed a synthetic substitute for real cork in wine bottles, the plastics manufacturer was able to use the innovation to take significant market share from cork makers (Magretta, 2012). New technologies can quickly provide substitutes.

### Rivalry Among Existing Competitors

Rivalry is probably the most intuitive of the five forces to understand and is often the most visible in price wars. When Delta drops the price of an airline ticket to earn business, United and Southwest feel pressured to act in kind. As Porter (1979) writes, "[R]ivalry among existing competitors takes the familiar form of jockeying for position—using tactics like price competition, product introduction, and advertising slugfests" (p. 142). In a city where there are a fixed number of hotel rooms, hotel chains have a perishable product (because last night's unsold hotel room has no value) and will be pressured to keep prices low to lure customers. They may need to offer enhanced features such as a free breakfast, airport shuttle services, or late check-out to distinguish themselves from other chains. When competitors are roughly equal in size and growth is slow, the rivalry is likely to be intense and price competition can be destructive to profitability.

Analysis of Porter's Five Forces can help an organization designer understand why a company might be responding to its competitive environment with a strategic shift. Porter (1985) explains that

from a strategic standpoint, the crucial strengths and weaknesses are the firm's posture vis-à-vis the underlying causes of each competitive force. Where does the firm stand against substitutes? Against the sources of entry barriers? In coping with rivalry from established competitors? (p. 29)

The five forces might explain why a company adds a new division to diversify and enter a profitable new market or why it wants to set up a new manufacturing unit to reduce the reliance on a supplier. With knowledge of this rationale, the organization designer will be in a better position to identify how the organizational structure, processes, rewards, and people practices can enhance this competitive positioning.

### Core Competencies

In contrast to the positioning-based view of strategy described in the five forces model that sees strategy as a company's relationship with its environment, there is an alternative perspective that looks inside the company. That is, it sees the company's internal capabilities as being the most important resource for a company's success and development of capability as critical for strategy. (This perspective, called the resource-based view of the firm, is generally traced to the pioneering work of economist Edith Penrose, 1959). This point of view has given rise to the concept of "capabilities-based competition" (Stalk, Evans, & Shulman, 1992, p. 57) or "core competencies" (Hamel & Prahalad, 1994; Prahalad & Hamel, 1990). Prahalad and Hamel (1990) write that "the real sources of advantage are to be found in management's ability to consolidate corporatwide technologies and production skills into competencies that empower individual businesses to adapt quickly to changing opportunities" (p. 81). A successful strategy long term, they write, is more about developing and using core competencies over time than any short-term winning product strategy.

Consider that an innovative new product may help a company to differentiate itself from competitors, but what gave rise to the innovation in the first place? The organization likely made use of its unique skills and abilities in some aspect of product development. Apple's ability to design products with elegant and functional simplicity is at the root of many of its successful products, and is taught at its internal university (Chen, 2014). Color photocopiers and single-lens reflex cameras exist in two different industries, and Canon seeks to demonstrate how its products differ from Xerox or Nikon. To do that, Canon has been able to exploit its core competencies in precision mechanics and fine optics. Individual product lines may come and go, customer preferences change, and markets shift, but what remain consistent over time are a company's underlying skills and abilities.

Competencies transcend individual products and are "a bundle of skills and technologies rather than a single discrete skill or technology" (Hamel & Prahalad, 1994, p. 202). This means that core competencies are less about a single area such as product design, and more about how that product design exists in a web of functions that bring that design to the market, including manufacturing and marketing.

Companies should distinguish between core competencies and other activities that they may do well but which are not core. A core competence should pass three tests (Prahalad & Hamel, 1990, pp. 83–84):

1. A core competence provides potential access to a wide variety of markets. The competence should be extendable to other markets or

applications beyond the current or even obvious ones. If it is unlikely that the competence could be applied elsewhere, it is not likely to be core to the company.

2. A core competence should make a significant contribution to the perceived customer benefits of the end product. Even if customers cannot articulate the exact competence, they know that it forms one of the reasons behind why they chose the product or service. Customers may not know how Apple designs its products, but they know that product design and usability is a key benefit.
3. A core competence should be difficult for competitors to imitate. That is, if other competitors already have the competence as well, those skills are likely “table stakes” required as a minimum ability rather than differentiating the company. Over time, in fact, many core competencies are likely to become copied and routine for most competitors.

Many organizations can identify 20 to 30 activities that seem critical, but in reality, only five or six are likely to contribute to the company’s leadership position (Prahalad & Hamel, 1990). Hamel and Prahalad (1994) write that “other traps include mistaking assets and infrastructure for core competencies and an inability to escape an orthodox product-centered view of a firm’s capabilities” (p. 225). Once they are recognized, opportunities can be identified to extend existing competencies into current and new markets and to identify new competencies that will provide significant prospects in the future.

Galbraith and Lawler (1998) conclude that the core competencies concept reminds us that a company cannot succeed through imitation. “It must also develop new competencies so that it can create the next innovation. . . . What results is a constantly shifting strategy requiring multiple and combinable competencies,” they write, “very different from conventional thinking about sustainable advantage” (p. 2).

Organization designers can benefit from the concept of core competence in several ways. Companies that operate independent and isolated business units may be missing an opportunity to take advantage of core competencies that exist in other units, indicating opportunities to align structures and processes. Prahalad and Hamel (1990) point out that reward systems that encourage business unit independence may create competition rather than cooperation in the use of core competencies. Some organizations trace the company’s core competencies down to the individual employee level to ensure that the competencies are nurtured and retained, highlighting the people point of the star.

### Blue Ocean Strategies and the Strategy Canvas

The Ringling Bros. and Barnum & Bailey Circus held its first performance in New York in 1919 as a joint entity. With its trademark moniker, “The Greatest Show on Earth,” the circus has long been a feature of American culture, showcasing clowns and trained elephants and tigers. In the mid-1980s, however, the circus was performing poorly, and revenues were mediocre. Using Porter’s Five Forces language to explain the industry’s decline, there were plenty of substitutes for children more interested in video games, talented performers had supplier power, and audiences (buyers) felt increasingly wary about the use of animals.

What would possess a new entrant from wanting to enter this declining market? Enter Cirque du Soleil, founded by Guy Laliberté, to “reinvent the circus” (Kim & Mauborgne, 2015). Now with more than 40 original shows, Cirque du Soleil has entertained an astonishing 155 million audience members in dozens of countries with acrobats, unique stories, and exclusive music.

Kim and Mauborgne (2015) coined the term *blue ocean strategy* to describe what made Cirque du Soleil successful. They did not set out to duplicate existing competitors in an established market space. Instead, they redefined the market, creating a new type of circus experience more akin to a theater production. They redesigned the classic circus tent to create an upscale venue, eliminated costly and controversial animal acts, created intellectually stimulating storylines and characters threaded throughout the production, and designed lighting and music to enhance the visual production. They redefined the boundaries of the traditional circus market by creating something entirely new that was not exactly a circus, a concert, or a Broadway production, but all of those at once, appealing to adults as well as children.

Blue ocean strategies like this seek to reinvent the market. They make competitive analysis somewhat unnecessary, because no competitor precisely duplicates what the organization is doing. They “create and capture new demand, break the value-cost trade-off, and align the whole system of a firm’s activities in pursuit of differentiation *and* low cost” (Kim & Mauborgne, 2015, p. 18). A good blue ocean strategy has three characteristics: focus, to not compete on every dimension but selective ones; divergence, to create a new market space with differentiators that are not seen among competitors; and a compelling tagline, an authentic message that resonates with customers.

By contrast, red ocean strategies presume the boundaries around a given industry or market space and assume that competition occurs only within that market space. Red ocean strategies aim to “beat the competition, exploit existing

Red Ocean Strategy	Blue Ocean Strategy
Compete in existing market space	Create uncontested market space
Beat the competition	Make the competition irrelevant
Focus on existing customers	Focus on non-customers
Exploit existing demand	Create and capture new demand
Make the value-cost trade-off (Create greater value to customers at a higher cost or create reasonable value at a lower cost)	Break the value-cost trade-off (seek greater value to customers and low cost simultaneously)
Align the whole system of a firm's activities with its strategic choice of differentiation <b>or</b> low cost	Align the whole system of a firm's activities in pursuit of differentiation <b>and</b> low cost

Source: <http://www.comindwork.com/weekly/2016-06-13/productivity/red-ocean-strategy-vs-blue-ocean-strategy>

demand, make the value-cost trade-off, and align the whole system of a firm's activities with its strategic choice of differentiation *or* low cost" (Kim & Mauborgne, 2015, p. 18).

To assess the competitive environment and develop a blue ocean strategy, Kim and Mauborgne advise use of a concept they call the strategy canvas. The canvas "captures the current state of play in the known market space . . . [and] the offering level that buyers received across all these key competing factors" (Kim & Mauborgne, 2015, pp. 27, 29). Table 3.3 gives an example of the strategy canvas for Cirque du Soleil and the Ringling Bros. circus. By comparing the two companies on the dimensions important to buyers, we can see the *value curve*, or each company's comparative position on the points most critical for competition in that industry.

The Ringling Bros. and Barnum & Bailey value curve displays high value on areas where other circuses traditionally competed, such as animal shows. Notice the shaded dimensions at the end of the table, however. Cirque du Soleil competes in dimensions where traditional circuses have almost no competitive position. By adding entirely new dimensions to the competitive environment, Cirque du Soleil redefined market boundaries. When public appetite for animal shows decreased due to pressure from animal rights activists, ticket sales for Ringling Bros. shows waned. In May 2017, the Ringling Bros. circus closed permanently.

**Table 3.3 Cirque du Soleil Strategy Canvas**

Value Dimension	Cirque du Soleil	Ringling Bros. and Barnum & Bailey
Price	-	+
Star Performers	-	+
Animal Shows	-	+
Aisle Concessions	-	+
Multiple Show Arenas	-	+
Fun and Humor	0	0
Thrills and Danger	0	0
Unique Venue	++	-
Theme	++	-
Refined Watching Environment	++	-
Multiple Productions	++	-
Artistic Music and Dance	++	-

+ = advantage, 0 = neutral/equal, - = disadvantage

Source: Adapted from Kim, W. C., & Mauborgne, R. (2015). *Blue ocean strategy*. Boston, MA: Harvard Business Review Press, p. 43.

Every strategy canvas differs depending on the industry segment, but such a framework can help to guide a company's evaluation of its competitive position and potential strategic moves. Actions to create blue ocean strategies follow four categories (Kim & Mauborgne, 2015, p. 31):

1. **Reduce:** Which factors should be reduced well below the industry's standard?
2. **Eliminate:** Which of the factors that the industry takes for granted should be eliminated?
3. **Create:** Which factors should be created that the industry has never offered?
4. **Raise:** Which factors should be raised well above the industry's standard?

## NEW TRENDS IN THINKING ABOUT STRATEGY

In the past several years, thinking about strategy has changed. Noting that more industries are operating in a hypercompetitive state (D'Aveni, 1994) where constant change is the norm, the idea of a sustainable competitive advantage is becoming a rarity (McGrath, 2013a, 2013b). S. L. Brown and Eisenhardt (1998) called

## TESTS OF STRATEGY FORMULATION

Synthesizing many of the recommendations in this chapter from strategy research, the following questions and principles can stimulate an evaluation of whether an organization has a robust enough strategy to create design criteria and guide a design effort.

<b>Principles of Strategy</b> (Markides, 2004)	<b>Elements of a Strategy</b> (Hambrick & Fredrickson, 2001)	<b>Questions to Ask to Test Strategy</b> (Hambrick & Fredrickson, 2001, p. 59)
<ul style="list-style-type: none"> <li>• Strategy must decide on a few parameters.</li> <li>• Strategy must put all our choices together to create a reinforcing mosaic.</li> <li>• Strategy must achieve fit without losing flexibility.</li> <li>• Strategy needs to be supported by the appropriate organizational context.</li> <li>• No strategy remains unique forever.</li> </ul>	<ul style="list-style-type: none"> <li>• Arenas: Where will we be active?</li> <li>• Vehicles: How will we get there?</li> <li>• Differentiators: How will we win in the marketplace?</li> <li>• Staging: What will be our speed and sequence of moves?</li> <li>• Economic logic: How will we obtain our returns?</li> </ul>	<ul style="list-style-type: none"> <li>• Does your strategy fit with what's going on in the environment?</li> <li>• Does your strategy exploit your key resources?</li> <li>• Will your envisioned differentiators be sustainable?</li> <li>• Are the elements of your strategy internally consistent?</li> <li>• Do you have enough resources to pursue this strategy?</li> <li>• Is your strategy implementable?</li> </ul>



this “competing on the edge,” noting that competition is becoming more uncontrolled, unpredictable, and often inefficient as companies regularly must fail before they find success. Thus, Reeves and Deimler (2011) concluded, adaptability is the new competitive advantage.

Many of these authors question the assumptions of the classic strategy frameworks and concepts that we have reviewed in this chapter and advocate for a view of strategy grounded in change. They point out that past ideas assumed relatively stable industries and markets which do not exist today, and that 5-year strategic planning horizons become obsolete almost as soon as the plans are created. As Reeves, Love, and Tillmanns (2012) put it, “[G]lobal competition, technological innovation, social feedback loops, and economic uncertainty combine to make the environment radically and persistently unpredictable. In such an environment, a carefully crafted classical strategy may become obsolete within months or even weeks” (p. 79). This perspective questions the need to engage in exhaustive strategic planning practices and highlights the need for a new approach to strategy.

Kotter (2012) concludes that previous definitions of strategy need to evolve. He writes that “strategy should be viewed as a dynamic force that constantly seeks opportunities” (p. 47), and McGrath (2013a) sees “the end of competitive advantage,” arguing for a series of short-term advantages that, taken together, keep a company in a leadership position. Product cycles of ramp up, sustainability, and decline occur with much more speed. Many companies find themselves in a difficult position having invested so much in a product that is rapidly declining; their only solution is to conduct a painful reactive restructuring. McGrath (2013b) advises that companies develop the ability to exit declining businesses as much as they need to recognize new areas of opportunity.

Reeves and Deimler (2011) describe four organizational capabilities that foster rapid adaptation:

1. The ability to read and act on signals of change. “In this environment, competitive advantage comes from reading and responding to signals faster than your rivals do, adapting quickly to change, or capitalizing on technological leadership to influence how demand and competition evolve” (Reeves, Love, & Tillmanns, 2012, p. 76).
2. The ability to experiment rapidly and frequently—not only with products and services but also with business models, processes, and strategies. McGrath (2013a) argues that this can be achieved by encouraging “intelligent failures” and an “experimental orientation” (p. 102).
3. The ability to manage complex and interconnected systems of multiple stakeholders. Whether they are suppliers, distributors, outsourced providers, or joint ventures, the ability to rapidly adapt requires a coordination and communication capability.
4. The ability to mobilize. For organization designers, this means creating flexible structures, teams, and decision rights practices that allow for flexibility in strategy execution. Leading adaptive businesses use their organization designs to their advantage and learn how to become “shape shifters” (McGrath, 2013a, p. 27), reconfiguring and morphing themselves as the opportunities require.

We will return to this perspective in Chapter 9 to examine how this focus on agile, flexible organizational strategies translates into changes in every point of the star.

## SUMMARY

An understanding of strategy can help a leader or organization designer identify ways to embed that strategy in the design and develop creative and innovative structures, processes, rewards systems, and people practices that differentiate the organization. Strategy has traditionally been seen as a sustainable competitive advantage, and we have reviewed three different strategy frameworks: Porter's generic strategies of low cost, differentiation, and focus; Treacy and Wiersema's value disciplines of operational effectiveness, product leadership, and customer intimacy; and Miles and Snow's strategy typology of Defenders, Prospectors, Analyzers, and Reactors. While originally most of these authors argued that companies must choose a single strategy or face limited success by being "stuck in the middle," some now argue that such an approach is possible (or even

preferable). We have also reviewed several critical concepts in strategy that are important for organization design. Porter's Five Forces explain how industries are economically structured and shape strategies in those industries. The concept of core competencies helps designers understand how nurturing an organization's competencies can create long-term future success. Blue ocean strategies explain how success can be found by redefining a market boundary beyond its traditional margins. Current themes in thinking about strategy concern speed and adaptability, as the timeframes for competitive advantages continue to shrink and erode. As we have seen, even a perfect strategy can fail without proper execution, and the organization's design is a major part of the ability to execute.

## QUESTIONS FOR DISCUSSION

1. Imagine that you're working with a group of executives at the start of an organization design project using the STAR model, and the conversation turns to strategy. Some say that strategy is a 5-year business plan, others argue that strategy is a set of high-level goals, another says that strategy is the method for getting to the vision of what we're trying to achieve. Everyone sitting around the table looks at you, and it's your big moment. One asks you, "In three sentences or less, how do you define strategy?"
2. In this chapter, we have focused on strategy as an umbrella concept that applies to an entire company. Yet, we know that organization design applies throughout an organization. How might you apply these concepts with other divisions inside a company, such as marketing, supply chain operations, customer service, or human resources? How might the ideas need to be adapted to that purpose?
3. It is evident that much has changed in the business world since many of the concepts in this chapter were originally developed, and scholars continue to debate these ideas. To what extent do the concepts such as generic strategies, value disciplines, five forces, and core competencies still apply today?

## FOR FURTHER READING

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Kim, W. C., & Mauborgne, R. (2015). *Blue ocean strategy*. Boston, MA: Harvard Business Review Press.

Miles, R. E., & Snow, C. C. (1978). *Organizational strategy, structure, and process*. New York, NY: McGraw-Hill.

Porter, M. E. (1979). How competitive forces shape strategy. *Harvard Business Review*, 57(2), 137–145.

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Porter, M. E. (2008). The five competitive forces that shape strategy. *Harvard Business Review*, 86(1), 78–93.

Prahalad, C. K., & Hamel, G. (1990). The core competence of the corporation. *Harvard Business Review*, 68(3), 79–90.

Treacy, M., & Wiersema, F. (1995). *The discipline of market leaders*. New York, NY: Basic Books

## EXERCISES

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1. Find two similar organizations that do the same thing (e.g., two companies that offer cell phones or services, two department stores, two car companies) and identify their different strategies.
2. Choose a well-known company and look at its website. Use some of the concepts in the chapter to identify that organization's strategy (what is its competitive advantage?). If you can find it out, try to locate its design, too. You might check the "About us" or "About the executive team" pages on the website.
3. The Appendix to this book contains an organization design simulation game involving a dice roll. Begin Part I of that activity now. Before you turn to the Appendix, roll a single six-sided die six times (the type of dice roll you would use in a board game) and keep track of your numbers in order. You will end up with a sequence like this: 4, 2, 3, 2, 5, 1. Duplicate numbers in your sequence are fine. Refer to the Appendix (Part I) to learn what your dice rolls mean for the type of organization you will create for this simulation exercise.

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