CHAPTER TWO
STRATEGY, ORGANIZATION DESIGN, AND EFFECTIVENESS

CHAPTER OVERVIEW

This chapter explains the types of goals that organizations pursue and the competitive strategies to reach those goals. There is an overview of strategic management, followed by frameworks for determining strategic action. Several approaches are then explored for measuring organizational effectiveness.

CHAPTER OUTLINE

Managing by Design

Before reading the chapter, students will give their opinions on the following statements:

- A company's strategic intent or direction reflects managers' systematic analysis of organizational and environmental factors.
- The best business strategy is to make products and services as distinctive as possible to gain an edge in the marketplace
- The best measures of business performance are financial.

The Role of Strategic Direction in Organizational Design

The primary responsibility of top management is to determine an organization's goals, strategy, and design, therein adapting the organization to a changing environment. Direction setting begins with an assessment of opportunities and threats in the environment and an evaluation of internal strengths and weaknesses. Then the company can determine its mission, goals and strategies. Organizational design reflects the way goals and strategies are implemented. This is the role of organization theory. Consider how organization design is affected by the choice of goals and strategy. New goals and strategy are often selected based upon environmental needs, and then the top management attempts to redesign the organization to achieve those ends. Performance measurements feed back into the internal environment, so that past performance of the organization is assessed by top management in setting new goals and strategies for the future.

ASSESS YOUR ANSWER
A company's strategic intent or direction reflects managers' systematic analysis of organizational and environmental factors.
ANSWER: *Agree.* The best strategies come from systematic analysis of

organizational
strengths and weaknesses combined with analysis of opportunities and
threats in the environment. Careful study combined with experience enable top
managers to decide on specific goals and strategies.

Organizational Purpose

Purpose may be referred to as the overall goal or mission. Different parts of
the organization establish their own goals to help the organization achieve its
overall purpose.

Strategic Intent

Strategic Intent means that all the organization's energies and
resources are directed toward a focused, unifying, and compelling
overall goal. Three aspects of strategic intent include:

Mission

The **official overall** goal for an organization is its **mission**. The
mission describes the organization's vision, its shared values and
aspirations, and its reason for existence.

Competitive Advantage

Competitive advantage refers to what sets the organization apart
from others and provides it with a distinctive edge for meeting
customer or client needs in the marketplace.

IN PRACTICE
Walgreens

Rather than just selling prescriptions, Walgreens is redefining its strategic
intent to become a broad health care provider. It began by opening
pharmacies in hospitals and assisted living facilities and by offering flu shots
and other immunizations in its stores. Then, the company established Take
Care Health Clinics to provide basic health services. Walgreens is buying two
firms that operate health care centers at large corporations.

Core competence

Core competence is something the organization does especially
well in comparison to its competitors.

Operative Goals

Operative goals designate the ends sought through operating
procedures and describe specific measurable outcomes in the short
run. These goals concern overall performance, resource, market,
employee development, productivity, and innovation and change.
- *Overall performance* goals may be expressed in terms of

profitability, delivery of service, growth, or volume. Jelly Belly Candy Company has a goal of increasing sales by 25 percent by 2010.

- *Resource* goals pertain to the acquisition of needed material and financial resources. Honda Motor Company may have the resource goal of obtaining high-quality auto parts at low cost.
- *Market* goals relate to the market share or market standing. Canada's Mega Bloks Inc. achieved its market goal of doubling its share of the toy building block market.
- *Employee development* goals pertain to the training, promotion, safety, and growth of workers.
- *Productivity* goals concern the amount of output achieved from available resources.
- *Innovation and change* goals pertain to internal flexibility and readiness to adapt to unexpected changes in the environment.

The Importance of Goals

The mission or official goals provide **legitimacy** to stakeholders. In contrast, operative goals provide **employee direction and motivation**, **decision guidelines**, and **criteria of performance**.

A Framework for Organizational Strategies and Design

A **strategy** is a plan for interacting with the competitive environment to achieve organizational goals. Goals define where the organization wants to go and strategies define how the organization will get there.

Porter's Competitive Forces and Strategies

Industry forces determine a company's position vis-à-vis competitors:

The Threat of New Entrants creates pressure for organizations to hold down prices or increase investment. **The Power of Suppliers** means that large suppliers can charge higher prices, limit service and quality, and shift costs to customers. **The Power of Buyers** can force down prices, demand better quality or service, and drive up costs. **The Threat of Substitutes** for a company's product or service reflects changes in cost, new technologies, and social trends that affect buyer loyalty. **Rivalry among Existing Competitors** is influenced by the preceding four forces, cost and product differentiation.

HOW DO YOU FIT THE DESIGN?
Your Strategy/Performance Strength
As potential manager, what are your strengths concerning strategy formulation and implementation? To find out, think about *how you handle challenges and*

issues in your school work or job. Managers with *implementer* strengths tend to work on operative goals and performance to make things more efficient and reliable. Managers with the *formulator* strength push toward out-of-the-box strategies and like to think about mission, vision, and dramatic breakthroughs. Both styles are essential to strategic management and organizational effectiveness.

Michael Porter introduced a framework describing four competitive strategies. To use this model, managers evaluate two factors: competitive advantage and competitive scope. Whether the organization competes on a broad or narrow scope determines the selection of strategies. **Low-cost leadership** strategy involves techniques for excelling at cost reduction and efficiency, with broad competitive scope. **Differentiation** strategy strives to create and market unique products by innovative product characteristics and advertising. Focus strategies concentrate on a narrow market or buyer group. The company tries to achieve either a **focused low-cost** or a **focused differentiation** advantage within a narrowly defined market.

[Use **WORKBOOK** activity here.]

IN PRACTICE
Apple

Although Apple is a small player in the cell phone market, the innovative technology of the iPhone, combined with creative marketing, convinced many consumers that they needed a phone that gives them easy access to the Internet, digital music and video, and mobile social networks.

ASSESS YOUR ANSWER
The best business strategy is to make products and services as distinctive as possible to gain an edge in the marketplace.

ANSWER: *Disagree.* Differentiation, making the company's products or services distinctive from others in the market, is one effective strategic approach. A low cost leadership approach can be equally or even more effective depending on the organization's strengths and the nature of competition in the industry.

Miles and Snow's Strategy Typology

Raymond Miles and Charles Snow assume that managers form strategies congruent with the external environment. There must be a fit among internal organization characteristics, strategy, and the external environment. Four strategies can be developed. The **prospector** strategy involves innovation, taking risks, seeking out new

opportunities and growth. The **defender** strategy may involve retrenchment, beyond just stability, by seeking to keep current customers without innovation or growth. The **analyzer** strategy lies between the prospector and defender by efficiently maintaining a stable business for current product lines, while at the same time innovating to develop new product lines. Finally, the **reactor** approach is to respond in an ad hoc manner to environmental threats and opportunities, without a long-range plan.

BOOK MARK
The Strategy Paradox: Why Committing to Success Leads to Failure
(And What to Do About It)
by
Michael E. Raynor

Strategies that have the greatest chance of success also have the highest probability of failure. Managers can implement strategies that deliver superior results while minimizing exposure: *Anticipate the Future and Formulate Strategic Options; Decide on Strategic Actions and Manage Chosen Options.* This approach puts uncertainty at the center of the strategic decision-making process.

How Strategies Affect Organization Design
Design must support the firm's competitive approach. For example, if the organization uses the low-cost leadership or defender strategy, the design is for efficiency whereas if the organization uses the differentiation or prospector strategy, the design calls for a learning structure with strong horizontal coordination.

Other Factors Affecting Organization Design
In addition to strategy affecting organization design, other contingency factors **environmental stability, workflow technology, size and life cycle, and corporate culture** must *fit* as well.

Assessing Organizational Effectiveness

Organizational *effectiveness* is the degree to which an organization realizes its multiple goals. *Efficiency* is the amount of resources used to produce outputs (ratio of inputs to outputs). Effectiveness is often difficult to measure in organizations, especially those that are large, diverse, and fragmented.

Traditional Effectiveness Approaches

Traditional approaches to measuring effectiveness look at different parts of the organization and measure indicators connected with outputs, inputs, or internal activities.

Goal Indicators

The **goal approach** measures effectiveness by evaluating the extent to which output goals are achieved. This is a logical approach because organizations do try to attain certain levels of output, profit, or client satisfaction. It is more productive to measure effectiveness using operative goals than using official goals (mission) which are more abstract and difficult to measure.

Resource-Based Approach

The **resource-based approach** evaluates the ability of the organization to obtain valued resources from the environment. Thus it looks at the input side of the transformation process. This approach is useful when other indicators of performance are difficult to obtain. Indicators of system resource effectiveness include dimensions such as bargaining position, ability to correctly interpret properties of the environment, maintenance of internal day-to-day activities, and ability to respond to environmental changes.

Internal Process Approach

The **internal process approach** evaluates effectiveness by examining internal organizational health and economic efficiency. An evaluation of human resources and their effectiveness is important. Indicators of effectiveness include a strong, adaptive corporate culture and positive work climate, operational efficiency, undistorted horizontal and vertical communication, and development of employees.

The Balanced Scorecard Approach to Effectiveness

The **balanced scorecard** combines several indicators of effectiveness into a framework, balancing financial measures with operational measures relating to a company's success factors. The balanced scorecard considers four effectiveness categories. The *financial perspective* reflects a concern that activities contribute to improved financial performance. *Customer service indicators* measure how customers view the organization, customer retention, and customer satisfaction. *Business process indicators* focus on production and operating statistics. The *potential for learning and growth* focuses on managing resources and human capital. Effectiveness results from how well these elements are aligned, so that individuals, teams, and departments work to attain specific goals that help the organization achieve high performance and fulfill its mission.

ASSESS YOUR ANSWER
The best measures of business performance are financial.

ANSWER: *Disagree.* If you can have only one type of measure of business performance, it might have to be financial. But diverse views of performance, such as using the balanced scorecard, have proven to be more effective than financials alone, because managers can understand and control the actions that cause business effectiveness. Financial numbers alone provide narrow and limited information.

Design Essentials

- Organizations exist for a purpose. Top managers decide the organization's strategic intent, including a specific mission to be accomplished. Operative goals designate specific ends sought through actual operating procedures.
- Two other aspects related to strategic intent are competitive advantage and core competence.
- Strategies may include any number of techniques to achieve the stated goals. Two models for formulating strategies are Porter's competitive forces and strategies and the Miles and Snow strategy typology.
- Assessing organizational effectiveness reflects the complexity of organizations as a topic of study. Organizations must perform diverse activities well—from obtaining resource inputs to delivering outputs—to be successful.
- No approach is suitable for every organization, but each offers some advantages that the others may lack. A recent approach to measuring effectiveness is the balanced scorecard approach.

LECTURE ENHANCEMENT

STAKEHOLDER OR CONSTITUENCY APPROACH

The stakeholder or constituency approach to determining goals and effectiveness is based on the organization identifying the stakeholders of the organization and their respective measures for determining the organization's effectiveness (See Chapter 1). Each group has different criteria, or goals, which it feels that organization should be addressing. Once the various criteria or goals are defined, the organization must determine how to balance conflicting demands and prioritize which goals to address. One method is to determine the power of each constituent group and the relative importance of the effectiveness criteria of that group. Remember that the stakeholder groups may have power over the organization by virtue of ability to provide or deny critical resources.

The relative importance of the effectiveness criteria is the degree to which the constituent group feels the goals are important to them. By mapping both the power for the stakeholder group and importance of effectiveness criteria, the organization can analyze its stakeholder environment. Have students determine an organization about which they can collect information from at least a small sampling of several groups of stakeholders.

1. List all major stakeholders of the organization.
2. Determine the amount of power each has with respect to the organization, preferably by interviewing the top management team.
3. Find out from key stakeholders what effectiveness criteria are more important; then determine for a particular effectiveness criterion (e.g., market share, customer service), its importance to each stakeholder group.
4. Place stakeholder group in appropriate place on model.

ANALYSIS OF STAKEHOLDER POWER & IMPORTANCE

High Power of Stakeholder Group Over Organization

1. High Power Low Importance	2. High Power High Importance
3. Low Power Low Importance	4. Low Power High Importance

DISCUSSION QUESTIONS

1. Discuss the role of top management in setting organizational direction.

ANSWER: The primary responsibility of top management is to determine an organization's goals, strategy, and design. Top management must assess the opportunities and threats in the environment and the internal strengths and weaknesses of the organization. Based on this assessment, the duty of top management is then to formulate the overall mission and goals of the organization. The design of the organization should be based on the mission and goals. The perspective of top management is needed in this process, especially since managers can interpret the environment differently and develop different goals. This interpretation can have a dramatic impact on organization success.

2. How might a company's goals for employee development be related to its goals for innovation and change? To goals for productivity? Can you discuss ways these types of goals might conflict in an organization?

ANSWER: Employee development may be seen as a prerequisite for innovation or productivity. Goals for innovation and change may spark different approaches by different employees, leading to conflict. Similarly, implementation for productivity may be approached so differently by different employees that it would lead to conflict. Such conflict, if in the form of constructive disagreement, can be healthy for determination of the best path.

3. What is a goal for the class for which you are reading this text? Who established this goal? Discuss how the goal affects your direction and motivation.

ANSWER: Students may volunteer that a personal goal is to pass the class with a grade of "C" or better in order to fulfill degree requirements. Challenge students to evaluate how such a goal could be reformulated in order to offer motivation that would elevate effort to measurable but realistic objective. Ask students to state the likely goals the instructor has for the class, and how those goals would affect their direction and motivation. There is no "right" answer to this question, but make sure students have the message that goals can, in part, determine behavior.

4. What is the difference between a goal and strategy as defined in the text? Identify both a goal and a strategy for a campus or community organization with which you are involved.

ANSWER: Operative goals include performance goals, resource goals, market goals, employee development goals, productivity goals, and goals

for innovation and change. The official goal is sometimes referred to as the mission or formally stated definition of the business outcome the organization is trying to achieve – its reason for existence. In contrast, a strategy is the organization's plan for achieving its goals. The goal of Beta Gamma Sigma might be to increase the number of paying members by 15% in two semesters, while a strategy for achieving that goal might be aggressive communication to business students about Beta Gamma Sigma's purpose.

5. Discuss the similarities and differences in the strategies described in Porter's competitive strategies and Miles and Snow's typology.

ANSWER: Similarities include that Porter's differentiation strategy and Miles and Snow's prospector strategy both call for learning orientations with a flexible, decentralized structure. Both have strong capability in research, and values employee creativity, risk-taking and innovation. Additional similarities are that Porter's low-cost leadership strategy and Miles and Snow's defender strategy have an efficiency orientation with centralized authority and tight cost control. Differences are that Miles and Snow's analyzer strategy moves in a new direction from Porter's strategies by balancing the other two main approaches (prospector and defender) into one strategy, while Porter has no "combination strategy" that balances the differentiation and low-cost leadership approaches. Furthermore, Miles and Snow have one category, the reactor, that has no clear approach whatsoever, which is not an option in Porter's approaches.

6. Do you believe mission statements and official goal statements provide an organization with genuine legitimacy in the external environment? Discuss.

ANSWER: One important function of a mission statement is to state the reason for the existence of the organization which provides outsiders with a sense of the organization's purpose. Official goals identify the purpose and legitimize the organization for employees, clients, government and other important external groups. Official goals typically are abstract and therefore run the risk of being perceived by some outsiders as "apple pie" statements that sound good but do little to shape the actual organization. Official goals are in harmony with the mission and provide a rationale or reason for the organization to exist. Many students comment that such statements offer genuine legitimacy only to the extent that they actually go beyond "public relations" to guide decision making. Therefore, the genuine legitimacy provided may come more from the overall implementation of the mission along with the organization's goals and strategies than from the piece of paper on which the mission is written for outsiders to read.

7. Suppose you have been asked to evaluate the effectiveness of the

police department in a medium-sized community. Where would you begin, and how would you proceed? What effectiveness approach would you prefer?

> **ANSWER:** This question does not have a correct answer. It is designed to force students to think about the different approaches to effectiveness, to encourage them to apply more than one measure, and to try to apply them. Students will realize how difficult it is to use the goal approach or system resource approach alone. One solution to this question is to follow a procedure to identify indicator goals, system resources and internal process indicators. The measures can then be formulated into a combined approach to effectiveness. Students may also argue for the stakeholder approach since the police department is a social organization. The satisfaction of employees, city government, community members, minorities, and other groups, may be a good indicator of police department effectiveness; each of the stakeholders identified should be asked for indicators important to them, and then they should be asked to assess the department on the relevant indicator.

8. What are the advantages and disadvantages of the resource-based approach versus the goal approach for measuring organizational effectiveness?

> **ANSWER:** The advantage of the resource-based approach is that it can be used to evaluate effectiveness when organizations pursue different kinds of goals, if they are using similar resources. Organizations can be compared on the ability to acquire scarce and valued resources needed to provide products and services that will eventually enable them to realize their goals. The resource-based approach considered the organization in relationship to the external environment. The advantage of the goal approach is that it examines what the organization is trying to do, which in some respects is the preferred criterion of effectiveness. The goal approach becomes problematic when the effectiveness has to be measured for multiple goals, or when organizations are compared that pursue different goals, or when the only indicators are subjective. In these cases an accurate assessment may be difficult. Sometimes a combination of the system resource and goal approach is best. Both inputs and outputs can be evaluated. The two approaches can lead to a reasonably accurate measure of effectiveness.

9. What are the similarities and differences between assessing effectiveness on the basis of the balanced scorecard versus the stakeholder approach described in Chapter 1? Explain.

> **ANSWER:** The similarity is that both approaches incorporate inputs, internal processes, and outputs into determining goals and effectiveness. These approaches acknowledge that organizations do many things and serve various needs, both internal and external to the organization. The

differences reflect the focus for effectiveness. In the stakeholder approach, managers carefully balance the needs and interests of various *stakeholders* in setting goals and striving for effectiveness. The stakeholder approach integrates organizational activities by looking at what various stakeholders want. The satisfaction level of each stakeholder group can be assessed as an indication of performance and effectiveness. The balanced scorecard combines several indicators of effectiveness into a framework, balancing financial measures with operational measures relating to a company's success. The balanced scorecard considers four effectiveness categories: *financial perspective, customer service indicators, business process indicators,* and the *potential for learning and growth.* Effectiveness results from how well these elements are aligned.

10. A noted organization theorist once said, "Organizational effectiveness can be whatever top management defines it to be." Discuss.

ANSWER: This question can facilitate discussion of where goals come from and top management's role in the process. Generally speaking, students will agree with this statement. Managers define the goals of the organization and they define the extent to which the organization is performing well. These factors are not fixed or given from the environment. One of the important roles of management is to define goals and effectiveness, and these factors are then taken by other people at lower levels within the organization. Some students may disagree. Students may argue that society's view is paramount, and the organization should do what is best for the larger culture. This point of view reflects a constituency criterion, and can also be accepted as legitimate. Many managers working within organizations, however, would not accept this approach to effectiveness as superior to their own definition. Some students who disagree with the given statement may feel that managers often have too narrow a view of effectiveness, and that much as the students who had not yet read this chapter, managers may have thought of effectiveness as little more than goal attainment.

WORKBOOK ~ IDENTIFYING COMPANY STRATEGIES AND EFFECTIVENESS CRITERIA

The Workbook activity presents an opportunity to contrast different firms' goals and performance criteria. Students can refer back to the four effectiveness criteria. There is benefit in having several students research the same companies because there will be variation in the goals they select as being most important, and they may come to different conclusions on the strategies used. Furthermore, you will be better able to build on class consensus in subsequent class discussions.

Companies selected for the Internet search might include:

- three firms in the transportation industry such as Cummins, Harley-Davidson, and Mercedes Benz,
- three retailers such as Nordstrom's, Target, and Neiman-Marcus,
- three firms we've encountered in the text such as Xerox, Marriott, and 3M Corporation,
- three firms cited in the In Practice examples such as Apple, Walgreen's, and Cementos Mexicanos (Cemex).

A transparency made from the Power Point slide provided for this activity can be used for recording consensus on the three organizations selected for research.

CASE FOR ANALYSIS ~ THE UNIVERSITY ART MUSEUM

Ask students to assume the role of the dean in identifying the possible decisions before the next faculty meeting. They should generate two or three alternatives in answer to each of the first two questions. You can use the third question as the basis for class discussion.

1. What are the possible purposes of the University Museum?

> **ANSWER:** [a] It could serve as a laboratory for the graduate art history faculty and the doctoral students in the field; [b] it could serve as major "enrichment" for the undergraduate who is not an art history student, but wants both a liberal education and a counter-weight to the "bookish" diet fed to him in most courses; [c] it could serve the metropolitan community, including schools, outside the campus gates.

2. Who are or should be its customers?

> **ANSWER:** [a] The first purpose above would serve graduate students in professional training to be teachers of art history; [b] the second purpose above serve all undergraduates; [c] the third purpose above would serve the community and especially the teachers and students in public schools.

3. What implications for the structure of the museum, the qualifications of its director, and its relationship to the university follow from the above defined purposes and customers?

> **ANSWER:** The structure of the museum might include different positions and different qualifications for the people to fill those positions, depending on the purpose of the museum. The qualifications of the director might vary from more academic if the purpose is to serve as a laboratory for graduate faculty and students, to more marketing-oriented if the purpose is to serve the metropolitan community. Its relationship to the university will be close if the museum's program is integrated with the academic program; when their

purposes are mutually intertwined; personal relationships thrive along with financial interdependence. Its relationship to the university will be more limited to impersonal financial links if the museum abandons the faculty and its students for external groups. With independence between the departments, conceivably the seeds could even be planted for an "us" against "them" mentality to set in between the art history academicians and museum staff.

CASE FOR ANALYSIS ~ Airstar, Inc.

This case illustrates a company whose environment is becoming dynamic and chaotic while it tries to maintain internal stability and order. This presents you with an excellent opportunity to have the class apply the balanced scorecard model described in the text. Use the following three questions to guide the discussion and analysis.

1. Is it appropriate for the company to use an *internal* or *external* focus?
    Currently the company is still trying to use an internal focus to remain in control and be efficient. However, pressures of the market should be leading it to more of an external focus to survive and prosper.

2. Should the company emphasize *stability* or *flexibility*?
    The company wants to emphasize stability because that is the way things have always been done and where everyone is the most comfortable. This provides efficient and control. However, the market is demanding more flexibility requiring constant learning and change.

3. Based on your answers to the first two questions which approach should the company use?
    The company should use the analyzer approach as presented in the Miles and Snow typology. The analyzer tries to maintain a stable business while innovating on the periphery. The analyzer attempts to balance efficient production for current product or service lines with the creative development of new product lines.

WORKSHOP ~ The BALANCED SCORECARD AND ORGANIZATIONAL EFFECTIVENESS

This Workshop activity will help to bring alive the meaning behind the Balanced Scorecard approach to organizational effectiveness. Ask students to imagine that a company wants to assess how it is achieving two goals in each of the quadrants. What would be measured?   (Enter under "performance gauge" on table.) How would those goals be measured? (Enter in next column on table.) Where would the company get the information needed to conduct the measurement? (Enter under "source of data" on table.)