

Chapter **7** Creating and Managing Organizational Culture

Learning Objectives

In this chapter, the concept of organizational culture is examined. Culture is discussed in terms of the values and norms that influence employees' behavior and bond them to the organization and determine how they perceive and interpret the environment and act in ways to give an organization a competitive advantage. The global dimension of culture is also examined, and the problems that organizations experience when they expand globally and encounter different kinds of values and norms is addressed.

After studying this chapter you should be able to:

1. Differentiate between values and norms, understand the way culture is shared by an organization's members, and why organizations have different types of culture.
2. Describe how individuals learn culture both formally (that is, the way an organization intends them to learn it) and informally (that is, by seeing what goes on in the organization).
3. Identify the four building blocks or foundations of an organization's culture that account for cultural differences among organizations.
4. Understand how an organization's culture, like its structure, can be designed or managed.
5. Discuss an important outcome of an organization's culture: its stance on corporate social responsibility.

What Is Organizational Culture?

Previous chapters have discussed how the most important function of organizational structure is to *control*—that is, coordinate and motivate—people within an organization. In **Chapter 1**, we defined **organizational culture** as the set of shared values and norms that control organizational members' interactions with each other and with suppliers, customers, and other people outside the organization. Just as an organization's structure is designed to achieve competitive advantage and promote stakeholder interests, an organization's culture can be used to increase organizational effectiveness.¹ This is because organizational culture controls the way members make decisions, the way they interpret and manage the organizational environment, what they do with information, and how they behave.² Culture thus affects an organization's performance and competitive position.

What are organizational values, and how do they affect behavior? **Values** are general criteria, standards, or guiding principles that people use to determine which types of behaviors, events, situations, and outcomes are desirable or undesirable. The two kinds of values are terminal and instrumental (see **Figure 7.1**).³ A **terminal value** is a desired end state or outcome that people seek to achieve. Organizations might adopt any of the following as terminal values, that is, as guiding principles: excellence, responsibility, reliability, profitability, innovativeness, economy, morality, quality. Large insurance companies,

Organizational culture

The set of shared values and norms that control organizational members' interactions with each other and with people outside the organization.

Values

General criteria, standards, or guiding principles that people use to determine which types of behaviors, events, situations, and outcomes are desirable or undesirable.

Terminal value

A desired end state or outcome that people seek to achieve.

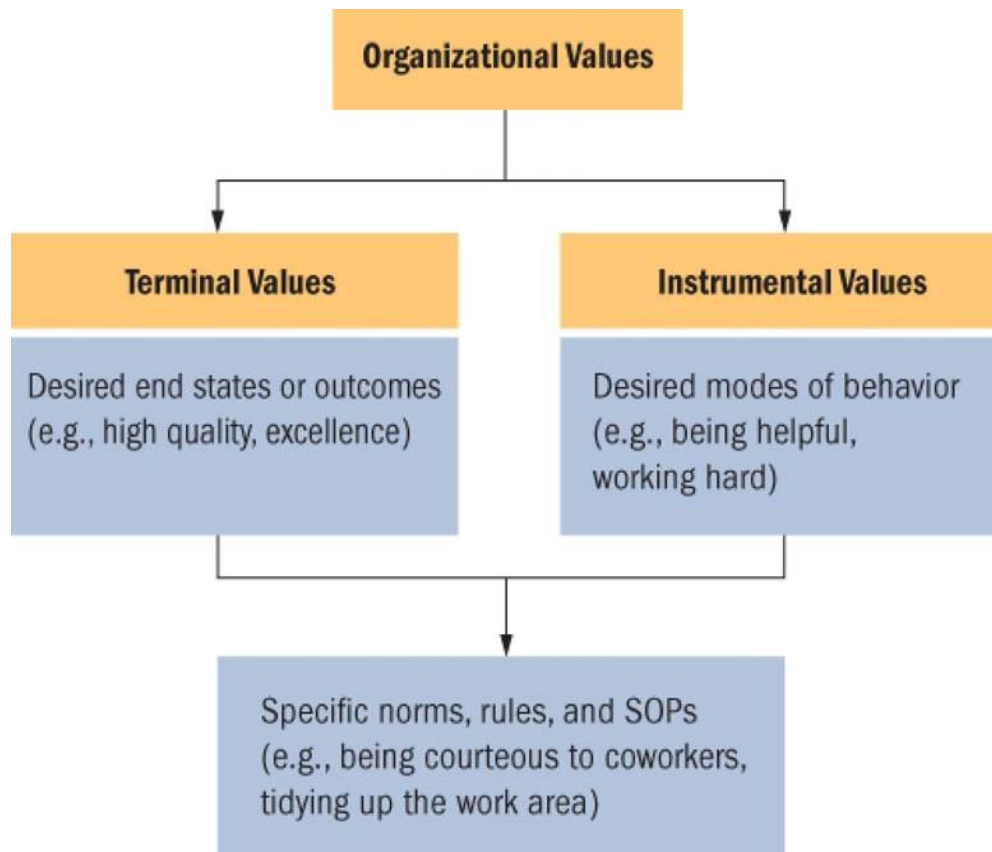


Figure 7.1 Terminal and Instrumental Values in an Organization's Culture

for example, may value excellence, but their terminal values are often stability and predictability because the company must be there to pay off policyholders' claims.

An **instrumental value** is a desired mode of behavior. Modes of behavior that organizations advocate include working hard, respecting traditions and authority, being conservative and cautious, being frugal, being creative and courageous, being honest, taking risks, and maintaining high standards.

Instrumental value

A desired mode of behavior.

An organization's culture thus consists of the end states that the organization seeks to achieve (its *terminal values*) and the modes of behavior the organization encourages (its *instrumental values*). Ideally, instrumental values help the organization achieve its terminal goals. Indeed, different organizations have different cultures because they possess different sets of terminal and instrumental values. For example, a computer software and hardware company like Google and Apple whose cultures emphasize the terminal value of innovativeness may attain this outcome through encouraging the development of instrumental values of being creative, taking risks, sharing new product ideas, and cooperating with other team members. That combination of terminal and instrumental values leads to an entrepreneurial culture. As Apple's CEO Steve Jobs commented, "You need a very product-oriented culture, even in a technology company. Lots of companies have tons of great engineers and smart people. But ultimately, there needs to be some gravitational force that pulls it all together."⁴ That compelling force is provided by the type of control—the form of coordination and motivation—that results from an organization's culture.

In some organizations, however, values and norms that emphasize creative "out-of-the-box" thinking may be inappropriate. For example, a parcel delivery company like UPS or FedEx that desires stability and predictability to reduce costs may emphasize caution, attention to detail, speediness, and conformity to work rules and standard operating procedures (SOPs). The result will be a conservative culture—the gravitational force that guides UPS, as **Organizational Insight 7.1** describes. FedEx has imitated UPS's approach. For example to save high-priced gasoline, FedEx uses a GPS positioning system to instruct its drivers on the most

efficient ways to drive their routes. For example, they turn right at intersections when possible to reduce delivery time and distance; no doubt UPS uses a similar system.

Terminal values can often be found by studying an organization's mission statement and official goals, which tell organization members and other stakeholders what kinds of values and ethical standards it wishes its members to use in their decision making. So that members understand instrumental values—that is, the styles of behavior they are

expected to follow as they pursue desired end states—an organization develops specific norms, rules, and SOPs that embody its instrumental values. In **Chapter 4**, we defined **norms** as standards or styles of behavior that are considered acceptable or typical for a group of people. The specific norms of being courteous and keeping the work area clean and safe, for example, will develop in an organization whose instrumental values include being helpful and working hard.

Norms

Standards or styles of behavior that are considered acceptable or typical for a group of people.



Organizational Insight

7.1 UPS Says There Is a Right Way to Deliver Parcels

United Parcel Service (UPS) controls more than three-fourths of the U.S. ground and air parcel service, delivering over 10 million packages a day in its fleet of 150,000 trucks.⁵ It is also the most profitable company in its industry. UPS employs over 250,000 people, and since its founding as a bicycle messenger service in 1907 by James E. Casey, UPS has developed a culture that has been a model for competitors such as FedEx and the U.S. Postal Service.

From the beginning, Casey made efficiency, economy, and thrift the company's terminal values and loyalty, humility, discipline, dependability, and intense effort the key instrumental values that UPS employees should adopt. UPS has always gone to extraordinary lengths to develop and maintain these values and associated norms in its workforce, not least because UPS started out as an employee-owned company.

First, its operating systems from the top of the company down to its trucking operations are the subject of intense scrutiny by the company's 3,000 industrial engineers. These engineers are constantly on the lookout for ways to measure outputs and behaviors to improve efficiency; for example, they time every part of an employee's job. Truck drivers, for example, are instructed in extraordinary detail on how to perform their tasks: They must step from their truck with their right foot first, fold their money face up, carry packages under their left arm, walk at a pace of 3 feet per second, and slip the key ring holding their truck keys over their third finger.⁶ Male employees

are not allowed to have beards. All employees must be carefully groomed, and they are instructed on how to deal with customers. Drivers who perform below average receive visits from training supervisors who accompany them on their delivery routes and teach them how to raise their performance level. Not surprisingly, as a result of this intensive training and close behavior control, UPS employees internalize the company's strong norms about the appropriate ways to behave to help the organization achieve its values of economy and efficiency.

Its search to find the best set of output controls leads UPS to constantly develop and introduce the latest in IT into the company's operations, particularly its materials management operations. In fact, today UPS offers a consulting service to other companies in the area of global supply chain management. Its goal is to teach other companies how to pursue its values of efficiency and economy, values that the company has been pursuing for the last 100 years as a result of the values of its founder.



Many of the most powerful and crucial values of an organization are not written down. They exist only in the shared norms, beliefs, assumptions, and ways of thinking and acting that people within an organization use to relate to each other and to outsiders and to analyze and deal with problems facing the organization. Members learn from one another how to interpret and respond to various situations in ways that are consistent with the organization's accepted values. Eventually, members choose and follow appropriate values without even realizing they are making a choice. Over time, they internalize the organization's values and the specific rules, norms, and SOPs that govern behavior; that is, organizational values become part of members' mindsets—people's own values systems—and affect their interpretation of a situation.⁷ Once again, this is why the cultures of different companies can diverge so widely.

Organizational culture is based on relatively enduring values embodied in organizational norms, rules, SOPs, and goals. People in an organization draw on these cultural values when making decisions and acting upon them, and when dealing with ambiguity and uncertainty inside and outside the organization.⁸ The values in an organization's culture are important shapers of members' behavior and responses to situations, and they increase the reliability of members' behavior.⁹ In this context, *reliability* does not necessarily mean consistently obedient or passive behavior; it may also mean consistently innovative or creative behavior as in the case of Google and Apple, or consistently attentive, cautious, and speedy behavior as in the case of UPS or FedEx.¹⁰ However, it can also mean totally unethical behavior.

Arthur Andersen, the disgraced, now-defunct accounting firm, was well known for its insistence that its employees abide by its rigid, constraining rules of behavior. Its employees had to wear dark blue suits, black shoes, and in some branches the managers insisted those shoes be the lace-up type or employees were told off. It also had in place an extensive and thorough MBO system and employees' performance was continually evaluated. Its values were based on obedience to company rules and norms, respect for partners, and the importance of following its well-established rules and SOPs. On the surface, the firm's demand that its employees follow its cultural values and norms would seem sound practice for a company whose business depends on the accurate measurement and accounting of the resources used by its clients. Accounting is a relatively precise science, and the last thing an accounting company needs is for its employees to practice "creative accounting."

Small wonder, then, that the business world was astounded in the early 2000s when it became clear that some of Arthur Andersen's most senior partners had been instructing their subordinates to overlook or ignore anomalies in its client books to obtain large consulting fees in order to maintain the clients' business, and to shred documents that revealed its unethical and illegal dealings with Enron before government regulators could examine them, which led to its collapse.

The paradox is that Arthur Andersen's values were so strong that they led subordinates to forget the "real" ethics of what they were doing and they followed its "distorted" ethics. Apparently, Arthur Andersen's culture was so strong it had an almost cult-like effect on its members, who were afraid to question what was going on because of the enormous status and power the partners wielded—and the threat of sanction if anyone disobeyed the rules.

Differences in Global Values and Norms

The values and norms of different countries also affect organizational culture. Indeed, differences between the cultures of different countries that arise because of differences in their national values and norms help reveal the powerful effect of organizational culture on behavior.¹¹ For example, today global outsourcing is a major organizing method that companies use to reduce costs, which obviously requires managers and employees in different countries to coordinate their actions. However, one recent study found that differences in culture are a major problem in getting coordination to work.

Cultural differences such as diverse communication styles, different approaches to completing tasks, different attitudes toward conflict, and different decision-making styles are major factors that hamper coordination in outsourcing relationships that require contact between people from different countries.

To get a feel for the effects of these differences in cultural values and norms on organizational behavior, consider what happened when a U.S. and a Mexican company attempted to cooperate in a joint venture. After much negotiation, Pittsburgh-based Corning Glass and Vitro, a Mexican glassmaking company, formed a joint venture to share technology and market one another's glass products throughout the United States and Mexico. They formed their alliance to take advantage of the opportunities presented by the North American Free Trade Agreement (NAFTA), which opened up the markets of both countries to one another's products. At the signing of the joint venture, both companies were enthusiastic about the prospects for their alliance. Managers in both companies

claimed they had similar organizational cultures. Both companies had a top-management team that was still dominated by members of the founding families; both were global companies with broad product lines; and both had been successful in managing alliances with other companies in the past. Nevertheless, two years later Corning Glass terminated the joint venture and gave Vitro back the \$150 million it had given Corning for access to Corning's technology.¹²

Why had the venture failed? The cultures and values of the two companies were so different that Corning managers and Vitro managers could not work together. Vitro, the Mexican company, did business the Mexican way, in accordance with values prevailing in Mexican culture. In Mexico, business is conducted at a slower pace than in the United States. Used to a protected market, Mexican companies are inclined to sit back and make their decisions in a "very genteel," consensual kind of way. Managers typically come to work at 9 *a.m.*, spend two or more hours at lunch, often at home with their families, and then work late, often until 9 *p.m.* Mexican managers and their subordinates are also intensely loyal and respectful to their superiors; the corporate culture is based on paternalistic, hierarchical values; and most important decision making is centralized in a small team of top managers. This centralization slows decision making because middle managers may come up with a solution to a problem but will not take action without top-management approval. In Mexico, building relationships with new companies takes time and effort because trust develops slowly. Thus personal contacts that develop slowly between managers in different companies are an important prerequisite for doing business in Mexico.

Corning, the American company, did business the American way, in accordance with values prevailing in American culture. Managers in the United States take short lunch breaks or work through lunch so they can leave early in the evening. In many U.S. companies, decision-making authority is decentralized to lower-level managers, who make important decisions and commit their organization to certain

courses of action. U.S. managers like to make decisions quickly and worry about the consequences later.

Aware of the differences in their approaches to doing business, managers from Corning and from Vitro tried to compromise and find a mutually acceptable working style. Managers from both companies agreed to take long working lunches together. Mexican managers agreed to forgo going home at lunchtime, and U.S. managers agreed to work a bit later at night so they could talk to Vitro's top managers and thus speed decision making. Over time, however, the differences in management style and approach to work became a source of frustration for managers from both companies. The slow pace of decision making was frustrating for Corning's managers. The pressure by Corning's managers to get everything done quickly was frustrating for Vitro's managers. Corning's managers working in Mexico discovered that the organizational cultures of Vitro and Corning were not so similar after all, and they decided to go home. Vitro's managers also realized it was pointless to prolong the venture when the differences were so great.

Corning and countless other U.S. companies that have entered into global agreements have found that doing business in any other country is different from doing business at home. U.S. managers living abroad should not expect to do business the U.S. way. Because values, norms, customs, and etiquette differ from one country to another, managers working abroad must learn to appreciate and respond to those differences.

Because many mergers fail due to the fact that differences between organizational cultures can be so great, companies that acquire other companies, even U.S. companies, such as Microsoft, Google, and Oracle, use seasoned teams of "merger culture" experts who take the steps necessary to blend the cultures of the merged companies. Likewise, some companies recognize beforehand that their cultures are so different that a merger would be impossible. For example, Microsoft contemplated merging with another leading global software company, German-based SAP. But after their top managers began negotiations, it became clear that despite the advantages of the merger, their two cultures were so different they could never successfully merge their skills and resources to create more value. Similarly, when Google sought to acquire Groupon in 2010 for \$6 billion,

Groupon's top managers decided they wanted to maintain their own culture and grow the company their own way, as we discussed in Chapter 1.

In sum, there are many ways in which culture can inspire and facilitate the intense kind of personal and team interactions that are necessary to develop organizational competences and obtain a competitive advantage. First, cultural values are important facilitators of mutual adjustment in an organization. When shared cultural values provide a common reference point, employees do not need to spend much time establishing rapport and overcoming differences in their perceptions of events. Cultural values can smooth interactions among organizational members. People who share an organization's values may come to identify strongly with the organization, and feelings of self-worth may flow from their membership in it.¹³ Employees of companies like Google, Southwest Airlines, and Groupon, for example, seem to value their membership in the organization and are committed to it.

Second, organizational culture is a form of informal organization that facilitates the workings of the organizational structure. It is an important determinant of the way employees view their tasks and roles. It tells them, for example, if they should stay within established rules and procedures and simply obey orders or whether they are allowed to make suggestions to their superiors, find better or more creative ways of performing their roles, and feel free to demonstrate their competency without fear of reprisal from their peers or superiors.

This is not trivial. One of the most common complaints of employees and junior managers in organizations is that although they know certain tasks or roles could be accomplished better and should be performed in different ways, their organization's values and norms do not permit them to advise or question their superiors up the organizational hierarchy. They feel trapped, become unhappy, and often leave an organization, causing high turnover. To mitigate this problem, some companies like GE, Google, and Microsoft have open lines of communication to the CEO that bypass the immediate superior. These companies also go out of their way to develop values of equity and fairness that demonstrate their commitment to reward employees who work toward organizational goals, rather than behaving in their own self-interest. GE even has a name for the managers who are out for themselves—"Type 4" managers—and based on feedback from subordinates, these managers are routinely asked to leave to make room for those who can develop empowered, motivated subordinates. GE's work practices demonstrate its values to its members.

How Is an Organization's Culture Transmitted to Its Members?

The ability of an organization's culture to motivate employees and increase organizational effectiveness is directly related to the way in which members learn the organization's values. Organizational members learn pivotal values from an organization's formal socialization practices and from the stories, ceremonies, and organizational language that develop informally as an organization's culture matures.

Socialization and Socialization Tactics

Newcomers to an organization must learn the values and norms that guide its existing members' behavior and decision making.¹⁴ Can they work from 10 *a.m.* to 7 *p.m.* instead of from 8 *a.m.* to 5 *p.m.*? Can they challenge the opinions of their peers and superiors or should they simply listen and remain silent? Newcomers are outsiders, and only when they have learned and internalized an organization's values and act in accordance with its rules and norms will they be accepted as insiders.

To learn an organization's culture, newcomers must obtain information about cultural values. They can learn values indirectly, by observing how existing members behave and inferring what behaviors are appropriate and inappropriate. From the organization's perspective, however, the indirect method is risky because newcomers might observe and learn habits that are *not* acceptable to the organization. From the organization's perspective, the most effective way for newcomers to learn appropriate values is through **socialization**, which, as we saw in **Chapter 4**, is the process by which members learn and internalize the norms of an organization's culture.

Socialization

The process by which members learn and internalize the values and norms of an organization's culture.

Van Maanen and Schein developed a model of socialization that suggests how organizations can structure the socialization experience so newcomers learn the values that the organization wants them to learn. In turn, these values influence the role orientation that the newcomers adopt.¹⁵ **Role orientation** is the characteristic way in which newcomers respond to a situation: Do they react passively and obediently to commands and orders? Are they creative and innovative in searching for solutions to problems?

Role orientation

The characteristic way in which newcomers respond to a situation.

Van Maanen and Schein identified 12 socialization tactics that influence a newcomer's role orientation. The use of different sets of these tactics leads to two different role orientations: institutionalized and individualized (see **Table 7.1**).¹⁶ An *institutionalized role orientation* results when individuals are taught to respond to a new context in the same way that existing organizational members respond to it. An institutionalized orientation encourages obedience and conformity to rules and norms. An *individualized role orientation* results when individuals are allowed and encouraged to be creative and to experiment with changing norms and values so an organization can better achieve its values.¹⁷ The following list contrasts the tactics used to socialize newcomers to an institutionalized orientation with those tactics used to develop an individualized orientation.

1. **Collective vs. Individual.** Collective tactics provide newcomers with common learning experiences designed to produce a standardized response to a situation. With individual tactics, each newcomer's learning

experiences are unique, and newcomers can learn new, appropriate responses for each situation.

2. **Formal vs. Informal.** Formal tactics segregate newcomers from existing organizational members during the learning process. With informal tactics, newcomers learn on the job, as members of a team.
3. **Sequential vs. Random.** Sequential tactics provide newcomers with explicit information about the sequence in which they will perform new activities or occupy new roles as they advance in an organization. With random tactics, training is based on the interests and needs of individual newcomers because there is no set sequence to the newcomers' progress in the organization.
4. **Fixed vs. Variable.** Fixed tactics give newcomers precise knowledge of the timetable associated with completing each stage in the learning process. Variable tactics provide no information about when newcomers will reach a certain stage in the learning process; once again, training depends on the needs and interests of the individual.

Table 7.1 How Socialization Tactics Shape Employees' Role Orientation

Source: G. R. Jones, "Socialization Tactics, Self-Efficacy, and Newcomers' Adjustments to Organizations," *Academy of Management Review* 29 (1986); pp. 262-279.

Tactics That Lead to an Institutionalized Orientation	Tactics That Lead to an Individualized Orientation
Collective	Individual
Formal	Informal
Sequential	Random
Fixed	Variable
Serial	Disjunctive
Divestiture	Investiture

5. Serial vs. Disjunctive.

When serial tactics are employed, existing organizational members act as role models and mentors for newcomers. Disjunctive processes require newcomers to figure out and develop their own way of behaving; they are not told what to do.

6. **Divestiture vs. Investiture.** With divestiture, newcomers receive negative social support—that is, they are ignored or taunted—and existing organizational members withhold support until newcomers learn the ropes

and conform to established norms. With investiture, newcomers immediately receive positive social support from other organizational members and are encouraged to be themselves.

When organizations combine the tactics listed in [Table 7.1](#), some evidence indicates that they can influence an individual's role orientation.¹⁸ Military-style socialization, for example, leads to an extremely institutionalized orientation. New soldiers are placed in platoons with other new recruits (*collective*); are segregated from existing organizational members (*formal*); go through preestablished drills and learning experiences (*sequential*); know exactly how long this will take them and what they have to do (*fixed*); have superior officers who are their role models (*serial*); and are treated with zero respect and tolerance until they have learned their duties and “gotten with the program” (*divestiture*). As a result, new recruits develop an institutionalized role orientation in which obedience and conformity to organizational norms and values are the signs of success. New members who cannot or will not perform according to these norms and values leave (or are asked to leave), so that by the end of the socialization process the people who stay are clones of existing organizational members.

No organization controls its members to the extent that the military does, but other organizations do use similar practices to socialize their members. Arthur Andersen, discussed earlier, had a very institutionalized program. Recruits were carefully selected for employment because they seemed to possess the values that Arthur Andersen's partners wanted—for example, hard working, cautious, obedient, and thorough. After they were hired, all new recruits attended a six-week course at its training center outside Chicago, where they were indoctrinated as a group into Arthur Andersen's way of doing business. In formal eight-hour-a-day classes, existing organizational members served as role models and told newcomers what was expected of them. Newcomers also learned informally over meals and during recreation what it meant to be working for Arthur Andersen. By the end of this socialization process, they had learned the values of the organization and the rules

and norms that govern the way they are expected to behave when they represented Andersen's clients. This effort to create an institutionalized role orientation worked well until its unethical, greedy partners, seeking to maximize their returns at the expense of other stakeholders, took advantage of its strong culture to lead its employees astray.

Should an organization encourage an institutionalized role orientation in which newcomers accept the status quo and perform their jobs in keeping with the commands and orders they are given? Or should an organization encourage an individualized role orientation in which newcomers are allowed to develop creative and innovative responses to the jobs that the organization requires of them? The answer to this question depends on the organization's mission. A financial institution's credibility and reputation with clients depend on its integrity, so it wants to have control over what its employees do. It needs to adopt a strong socialization program that will reinforce its cultural values and standardize the way its employees perform their activities to develop a good reputation for honesty and reliability. So developing an institutionalized orientation is in the best interests of financial organizations such as Bank of America and insurance companies such as State Farm.

One danger of institutionalized socialization lies in the power it gives to those at the top of the organization to manipulate the situation. A second danger can lie in the sameness it may produce among members of an organization. If all employees have been socialized to share the same way of looking at the world, how will the organization be able to change and adapt when that world changes? When confronted with changes in the organizational environment (for example, a new product, a new competitor, or a change in customer demands), employees indoctrinated into old values will be unable to develop new values that might allow them to innovate. As a result, they—and thus the organization—cannot adapt and respond to the new conditions.

An organization whose mission is to provide innovative products for customers should encourage informal random experiences from which individuals working on the job gain information as they need it. By all accounts, many Internet companies such as Google, Groupon, and Amazon.com rely on individualized socialization

tactics and allow members to develop skills in areas that capitalize on their abilities and interests.¹⁹ These companies take this approach because their effectiveness depends not on standardizing individual behavior but on innovation and the ability of members to come up with new and improved solutions to Internet-related problems—such as Amazon.com’s push in the 2000s to seek new ways to generate revenues to offset its rising operating costs. For example, it started a consultancy group to sell its IT skills to any interested organizations—something suggested by lower-level employees—and it is now moving quickly to take advantage of opportunities in cloud computing. In the 2010s it is using its strong values and norms to support its rapid entry into many new kinds of virtual markets to sell an increasing range of products. In every market, employees know how they should work to meet its goals because they are “Amazonians.” In this way an organization’s socialization practices not only help members learn the organization’s cultural values and the rules and norms that govern behavior, but they also support the organization’s mission by strengthening them over time.

Stories, Ceremonies, and Organizational Language

The cultural values of an organization are often evident in the stories, ceremonies, and language found in the organization.²⁰ At Southwest Airlines, for example, employees wearing costumes on Halloween, Friday cookouts with top managers, and managers periodically working with employees to perform basic organizational jobs all reinforce and communicate the company's collaborative culture to its members.

Organizations use several types of ceremonial rites to communicate cultural norms and values (see [Table 7.2](#)).²¹ *Rites of passage* mark an individual's entry to, promotion in, and departure from the organization. The socialization programs used by the army, in colleges, and in companies like 3M and Microsoft, which recognize their most creative people with special job titles, plaques, and so on, are rites of passage; so too are the ways in which an organization grooms people for promotion or retirement. *Rites of integration*, such as shared announcements of organizational success, office parties, and company cookouts, build and reinforce common bonds between organizational members. *Rites of enhancement*, such as awards dinners, newspaper releases, and employee promotions, publicly recognize and reward employees' contributions.

Triad Systems, a computer company founded in Livermore, California, used many ceremonies to integrate and enhance its organizational culture. Every year in its annual trade show its managers gave out awards to recognize employees for excellent service. With much hoopla the *Grindstone Award* was awarded to "individuals who most consistently demonstrate initiative, focus, dedication, and persistence"; the *Innovator Award* to those who "conceive and carry out innovative ideas"; and the *Busting the Boundaries Award* to "those who work most effectively across departmental and divisional boundaries to accomplish their work."²² The

goal of Triad's awards ceremony is clear—to develop organizational folklore that supports work teams and builds a productive culture. Giving praise

Table 7.2 Organizational Rites

Type of Rite	Example of Rite	Purpose of Rite
Rite of passage	Induction and basic training	Learn and internalize norms and values
Rite of integration	Office Christmas party	Build common norms and values
Rite of enhancement	Presentation of annual award	Motivate commitment to norms and values

and recognition builds a community of employees who share similar values and promotes the development, across functional groups, of a common corporate language that bonds people together and so better coordinates their activities.

Organizational stories and the language of an organization are important media for communicating culture. Stories (whether fact or fiction) about organizational superstars provide important clues about cultural values and norms. Such stories can reveal the kinds of behaviors that the organization values and the kinds of practices the organization frowns on. Studying stories and language can reveal the values that guide behavior.²³ Because language is the principal medium of communication in organizations, the characteristic phrases that frame and describe events provide important clues about norms and values.

The concept of organizational language encompasses not only spoken language but how people dress, the offices they occupy, the company cars they drive, and how they formally address one another. In Google, Facebook, and many other high-tech organizations, casual dress is the norm, but in investment banks like Goldman Sachs, and luxury department stores like Neiman Marcus and Saks, expensive, well-tailored clothing is the order of the day.

Many organizations have technical languages that facilitate mutual adjustment between organizational members.²⁴ At 3M, inside entrepreneurs have to emphasize the relationship between their product and 3M's terminal values to push ideas through the product development committee. Because many 3M products are flat—such as sanding and grinding discs, Post-it notes, and thin plastics—the quality of flatness embodies 3M's terminal values, and flatness is often a winning theme in 3M's corporate language—it increases a new product's chance of getting funded. At Google, employees have developed a shorthand language of technical software phrases to describe company-specific communication problems. Technical languages are used by the military, by sports teams, in hospitals, and in many other specialized work contexts. Like socialization practices, organizational language, ceremonies, stories, and even detailed books of organization-specific rules help people learn the ropes and the organization's cultural values. Take the example of SiteROCK, profiled in [Organizational Insight 7.2](#) .



Organizational Insight

7.2 SiteROCK's Military Management Culture

The high-tech, dot-com culture is not usually associated with the values and norms that characterize the military. However, managers of the thousands of dot-coms that went belly up in the early 2000s might have benefited from some military-style disciplined values and norms. Indeed, a few dot-coms that survived the shakeout did so because their managers used military-style rules and SOPs to control their employees and ensure high performance. One of these companies is SiteROCK, based in Emeryville, California, whose COO, Dave Lilly, is a former nuclear submarine commander.

SiteROCK is in the business of hosting and managing the websites of other companies and keeping them up and running and error free. A customer's site that goes down or runs haywire is the major enemy. To maximize the performance of his employees and to increase their ability to respond to unexpected online events, Lilly decided he needed to develop an institutionalized role orientation and develop a comprehensive set of rules and standard operating procedures to cover all the major known problems.²⁵ Lilly insisted that every problem-solving procedure be written down and codified. SiteROCK now has over 30 thick binders listing all the processes and checklists that employees need to follow when an unexpected event happens. Their job is to try to solve the problem using these procedures.

Moreover, again drawing from his military experience, Lilly instituted a "two-man" norm: Whenever the unexpected happens, each employee must immediately tell a coworker and the two should attempt to solve the problem

together. The goal is simple: Develop strong norms of cooperation to achieve the quick resolution of a complex issue. If the existing rules don't work, then employees must experiment, and when they find a solution, the solution is turned into a new rule to be included in the procedures book to aid the future decision making of all employees in the organization.

At SiteROCK, these written rules and SOPs have resulted in values that lead employees to achieve high levels of customer service. Because the goal is 100% reliability, detailed blueprints guide planning and decision making, not seat-of-the-pants problem solving, which might be brilliant 80% of the time but result in disaster the rest of the time. Before SiteROCK employees are allowed in the control room each day, they must read over the most important rules and SOPs. And at the end of a shift they spend 90 minutes doing paperwork that logs what they have done and states any new or improved rules that they have come up with. Clearly, SiteROCK has developed a company-specific testament that symbolizes to employees the need for sustained, cooperative effort.



Managerial Implications Analyzing Organizational Culture

1. Study the culture of your organization, and identify the terminal and instrumental values on which it is based to assess how they affect organizational behavior.
2. Assess whether the goals, norms, and rules of your organization are effectively transmitting the values of the organizational culture to members. Identify areas for improvement.
3. Examine the methods your organization uses to socialize new members. Assess whether these socialization practices are effective in helping newcomers learn the organization's culture. Recommend ways to improve the process.
4. Try to develop organizational ceremonies to help employees learn cultural values, to enhance employee commitment, and to bond employees to the organization.

Finally, organizational symbols often convey an organization's cultural values to its members and to others outside the organization. In some organizations, for example, the size of people's offices, their location on the third floor or the thirty-

third floor, or the luxury with which they are equipped are symbols that convey images about the values in an organization's culture. Is the organization hierarchical and status conscious, for example, or are informal, participative work relationships encouraged? In the 1990s, GM's executive suite on the top floor of their giant Detroit headquarters was isolated from the rest of the building and open only to top GM executives. A private corridor and stairway linked top managers' offices to the private elevators connected to their heated parking garage.

Sometimes, the very design of the building itself is a symbol of an organization's values. For example, Walt Disney hired famed Japanese architect Arata Isozaki to design the Team Disney Building, which houses Disney's "imagineering unit," in Orlando, Florida. This building's contemporary and unusual design featuring unusual shapes and bright colors conveys the importance of imagination and creativity to Walt Disney and to the people who work in it. Many organizations such as Google, Facebook, and Apple have followed this approach and designed futuristic office campuses to inform employees that their main task is to think ahead and predict changes in the organizational environment.

Where Does Organizational Culture Come From?

Now that you have seen what organizational culture is and how members learn and become part of an organization's culture, some difficult questions can be addressed: Where does organizational culture come from? Why do different companies have different cultures? Why might a culture that for many years helped an organization pursue its corporate mission suddenly harm the organization? Can culture be managed?

Organizational culture develops from the interaction of four factors: the personal and professional characteristics of people within the organization, organizational ethics, the property rights that the organization gives to employees, and the structure of the organization (see [Figure 7.2](#)). The interaction of these factors produces different cultures in different organizations and causes changes in culture over time. The way in which people's personal characteristics shape culture is discussed first.

Characteristics of People within the Organization

The ultimate source of organizational culture is the people who make up the organization. If you want to know why cultures differ, look at their members. Organizations A, B, and C develop distinctly different cultures because they attract, select, and retain people who have different values, personalities, and ethics.²⁶ People may be attracted to an



Figure 7.2 Where an Organization's Culture Comes From

organization whose values match theirs; similarly, an organization selects people who share its values. Over time, people who do not fit in leave. The result is that

people inside the organization become more and more similar, the values of the organization become more and more parochial, and the culture becomes more and more distinct from that of similar organizations.

The founder of an organization has a substantial influence on the organization's initial culture because of his or her personal values and beliefs.²⁷ Founders set the scene for the later development of a culture because they not only establish the new organization's values but hire its first members. Presumably, the people selected by the founder have values and interests similar to the founder's.²⁸ Over time, members buy into the founder's vision and perpetuate the founder's values in the organization.²⁹ An important implication of this "people make the place" view of organizational culture is that the culture of an organization can be strengthened and changed over time by the people who control and lead it.³⁰

The growth of Google provides a good illustration of the important role a company's founders play in developing shared cultural values that establish a strong organizational culture.

Google was founded in 1995 when two Stanford graduate computer science students collaborated to develop a new kind of search engine technology. They understood the limitations of existing search engines and by 1998 they developed a superior engine that they felt was ready to go online. They raised \$1 million from family, friends, and risk-taking "angel" investors to buy the hardware necessary to connect Google to the Internet.

At first, Google answered 10,000 inquiries a day, but in a few months it was answering 500,000, 3 million by the fall of 1999, 60 million by the fall of 2000, and in the spring of 2001 it reached 100 million per day. In the 2000s, Google has become the leading search engine, and it is one of the top five most used Internet companies. Rivals like Yahoo and Microsoft are working hard to catch up and beat Google at its own game.

Google's explosive growth is largely due to the culture of entrepreneurship and innovation its founders cultivated from the start. Although by 2011 Google had grown to over 26,000 employees worldwide, its founders claim that it still maintains a small company feel because its culture empowers its employees, which it calls staffers or "Googlers," to create the best software possible. Brin and Page created Google's entrepreneurial culture in several ways.

From the beginning, lacking space and seeking to keep operating costs low, Google staffers worked in "high-density clusters." Three or four employees, each equipped with a high-powered Linux workstation, shared a desk, couch, and chairs that were large rubber balls and worked together to improve its technology. Even when Google moved into more spacious surroundings at its "Googleplex" headquarters building, staffers continued to work in shared spaces. Google also designed its building so that staffers are constantly meeting one another in Google's funky lobby, in the Google Café where everyone eats

together, in its state-of-the-art recreational facilities, and in its "snack rooms" equipped with bins packed with cereals, candy, yogurt, carrots, and of course - make-your-own cappuccino. They also created many social gatherings of employees such as a TGIF open meeting and a twice-weekly outdoor roller hockey game where staffers are encouraged to bring down the founders.

All this attention to creating what just might be the "grooviest" company headquarters in the world did not come about by chance. Brin and Page knew that Google's most important strength would be its ability to attract the best software engineers in the world and then to motivate them to perform well. Common offices, lobbies, cafés, and so on bring staffers into close contact with one another, develop

collegiality, and encourage them to share their new ideas with their colleagues and constantly improve its search engine technology and find new ways to grow the company—hence Google Chrome, Voice, Docs, and the many other applications it provides its users today. The freedom Google gives its staffers to pursue new ideas is a clear signal of its founders' desire to empower them to be innovative and to look off the beaten path for new ideas. Finally, recognizing that staffers who innovate important new software applications should be rewarded for their achievements, Google's founders also gave them stock in the company, which effectively makes staffers its owners as well.

Organizational Ethics

Many cultural values derive from the personality and beliefs of the founder and the top-management team and are in a sense out of the control of the organization. These values are what they are because of who the founder and top managers are. Google founder Larry Page, who became its CEO in 2011, is a workaholic who often works 14 hours a day. His terminal values for Google are excellence, innovation, and high quality and safety, and the instrumental values he advocates are hard work, creativity, and attention to detail. Page expects employees to put in long workdays because he requires this level of commitment from himself, and he expects them to do everything they can to promote innovation, quality, and safety because this is what he does. Employees who do not buy into these values leave Google, and those who remain are spurred by organizational norms to stay on the job, stick with the task, and go out of their way to help others solve problems that will help the organization.

An organization can, however, consciously and purposefully develop some cultural values to control members' behavior. Ethical values fall into this category. As discussed in [Chapter 2](#), organizational ethics are the moral values, beliefs, and rules that establish the appropriate way for organizational members to deal with one another and with the organization's stakeholders (see [Figure 7.3](#)).



Figure 7.3 Factors Influencing the Development of Organizational Ethics

In developing cultural values, top managers must constantly make choices about the right or appropriate thing to do. IBM, Dell, or Sears, for example, might wonder whether they should develop procedural guidelines for giving advance notice to employees and middle managers about impending layoffs or store closings. In the past, companies have been reluctant to do so because they fear employee hostility and apathy. In 2010, Toyota and other car makers decided to recall several of its vehicles because problems with sticking brake pedals had caused wrecks that resulted in serious harm to passengers. Similarly, a company has to decide whether to allow its managers to pay bribes to government officials in foreign countries where such payoffs are an illegal yet accepted way of doing business. In such

situations, managers deciding on a course of action have to balance the interests of the organization against the interests of other stakeholder groups.³¹

To make these decisions, managers rely on ethical instrumental values embodied in the organization's culture.³² Such values outline the right and wrong ways to behave in a situation in which an action may help one person or stakeholder group, but hurt another.³³ Ethical values, and the rules and norms they embody, are an inseparable part of an organization's culture because they help shape the values that members use to manage situations and make decisions.

One of top management's main responsibilities is to ensure that organizational members obey the law. Indeed, in certain situations top managers can be held accountable for the conduct of their subordinates. One of the main ways in which top managers can ensure the legality of organizational behavior is to create an organizational culture that instills ethical instrumental values so that members reflexively deal with stakeholders in an ethical manner. Many organizations do act illegally, immorally, and unethically and take few steps to develop ethical values for their employees to follow. **Organizational Insight 7.3** describes how Guidant put company interests above customers' health and above the law.



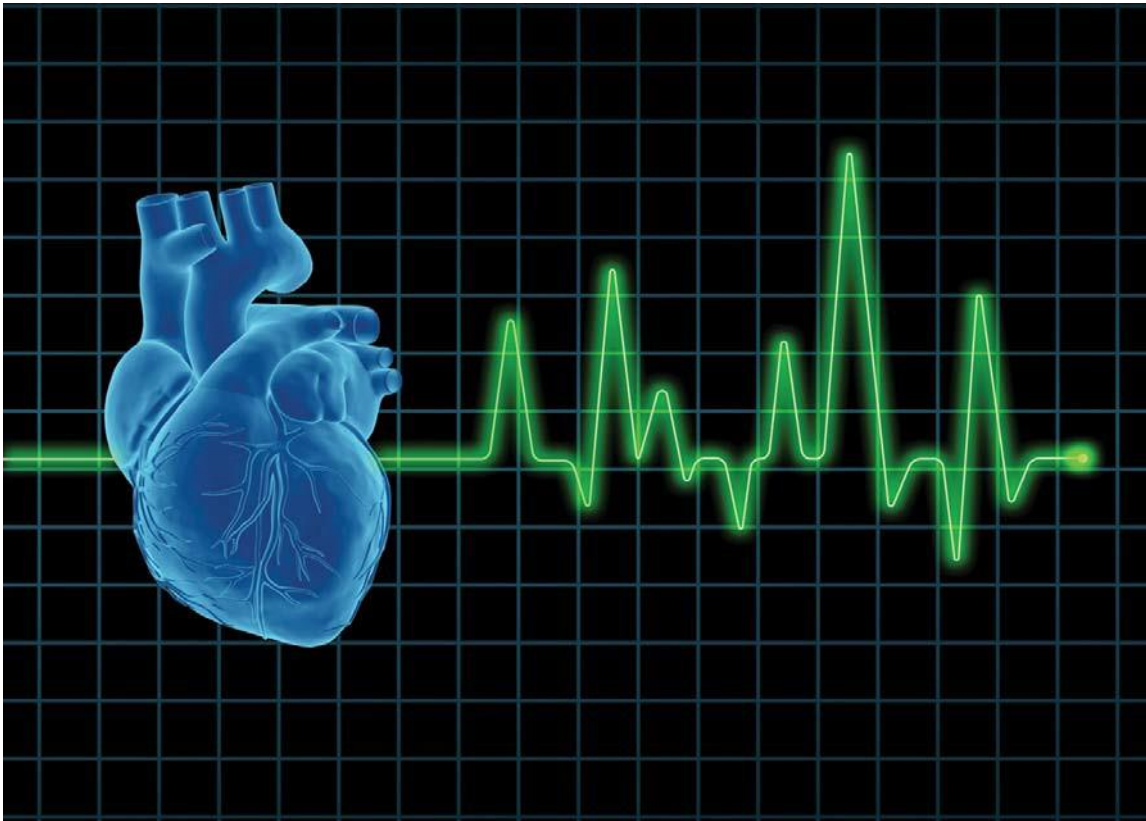
Organizational Insight

7.3 Has Guidant Solved Its Ethical Problems?

In 2005, Guidant Corporation, a maker of medical cardiac devices, revealed that many of its defibrillators had an electrical defect that might cause them to fail when needed to interrupt an erratic and possibly fatal heart rhythm. Guidant was forced to recall more than 100,000 implantable heart devices, including three models of defibrillators with similar electrical flaws that were tied to at least seven patient deaths.

One of the most troubling aspects of the recall came into view when it was revealed that Guidant had known about the electrical problem for at least three years after two physicians in Minneapolis, Dr. Maron and Dr. Hauser, told the company about the problem. They urged Guidant to alert physicians about the device defect so they could check their patients and implant new models. Guidant made no effort to communicate the problem to physicians nationwide, or to the Food and Drug Administration (FDA), which has a clear procedure for when a company should make a legal written declaration about known problems with a medical product. When the company failed to act on their message and take their advice, the physicians contacted other physicians and the *New York Times*. The resulting story and outcry quickly forced Guidant to reveal the problem with its devices and communicate the problem to physicians nationwide.

In the ensuing investigation, a panel of medical experts came to the conclusion that Guidant had deliberately kept its faulty cardiac



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devices on the market without considering the medical impact and had knowingly failed to alert doctors and patients when the devices started to malfunction. Once legal proceedings were started against the company, internal documents further revealed that a consultant to Guidant had informed the company's top executives that he believed it had a clear ethical obligation to inform physicians about heart device defects and he urged the company to begin a recall process, informing them that their decision to withhold such data was highly questionable. He also noted that Guidant had a clear conflict of interest that would naturally lead it (and other companies) to disclose product failures only when necessary. So, if a tragedy occurred—which it did—Guidant's actions would be viewed in the worst possible light possible; it is always in a company's best interest to expose its dirty laundry.

This proved true when Guidant faced a product liability lawsuit filed in Texas by patients who received Guidant defibrillators and then faced a federal lawsuit in Minnesota that claimed the company had acted criminally when it knowingly sold potentially flawed defibrillators. Guidant had to pay hundreds of millions in damages to patients, and after intense negotiation with the Justice Department, it reached an agreement to plead guilty to two “misdemeanors” that related to problems concerning the completeness and accuracy of its filings with the FDA and to pay a \$296 million fine—the largest ever imposed upon a medical device company.

In 2010, however, responding to ongoing criticism by the Minneapolis physicians who first revealed the problem that the fine was not enough to punish the company for its criminal actions, a federal judge in Minnesota rejected the plea agreement. The judge said that the deal did not hold Guidant sufficiently accountable for its criminal conduct in knowingly selling potentially flawed defibrillators and that prosecutors should have sought probation for Guidant and its new owner, Boston Scientific. Possible criminal charges against the executives who had orchestrated the cover-up were also suggested by some parties.

While on probation, the company would be required to take certain steps to ensure such unethical and illegal behavior did not happen again, such as by putting in place strict new ethical communication guidelines, an ethics ombudsman to take charge of the decision about when to communicate product defects, and charitable activities by Guidant to improve medical care among minority patients. The company announced it would support such steps and that by 2011 it would put in place the performance programs necessary to ensure its managers would never make such unethical and illegal decisions again.

Personal and professional ethics (see Chapter 2) also influence how a person will act in an organization, so an organization's culture is strongly affected by the people who are in a position to establish its ethical values. As we saw earlier, the founder and top managers of an organization play a particularly important role in establishing ethical norms and values—for better or worse. As an example of a worst-case scenario, consider the behavior of Beech-Nut's top managers in the early 1980s. Beech-Nut, the maker of baby foods, was in financial trouble as it strived to compete with Gerber, the market leader. To lower costs, Beech-Nut's top managers entered into an agreement with a low-cost supplier of apple juice concentrate to save the company over \$250,000 a year.

Soon, one of Beech-Nut's food quality specialists became concerned about the concentrate that he believed was not made from apples alone but contained large quantities of corn syrup and cane sugar. He brought this information to the attention of top managers but, obsessed with the need to lower costs, they ignored it and the company continued to produce and sell its product as pure apple juice. Eventually, investigators from the U.S. Food and Drug Administration (FDA) confronted Beech-Nut's top managers with evidence that the concentrate was adulterated. The top managers issued denials and quickly shipped the remaining stock of apple juice to the market before their inventory could be seized.³⁴

The specialist who had questioned the purity of the apple juice had resigned from Beech-Nut but decided to blow the whistle on the company. He told the FDA that top managers knew about the problem with the concentrate and eventually the company pleaded guilty to charges that it had deliberately sold adulterated juice. It was fined millions of dollars, its top managers were also found guilty and sentenced to prison terms, and consumer trust in Beech-Nut products plummeted, as did Beech-Nut stock. The company was taken over by Ralston Purina, which is today a division of Nestlé, a company well known for following the ethical values in its organizational mission and culture.

Property Rights

The values in an organization's culture reflect the ethics of individuals in the organization, of professional groups, and of the society in which the organization exists. The values in an organization's culture also stem from how the organization distributes **property rights** : the rights that an organization gives to its members to receive and use organizational resources.³⁵ Property rights define the rights and responsibilities of each inside stakeholder group and cause the development of different norms, values, and attitudes toward the organization. **Table 7.3** identifies some of the property rights commonly given to managers and the workforce.

Property rights

The rights that an organization gives to its members to receive and use organizational resources.

Table 7.3 Common Property Rights Given to Managers and the Workforce

Managers' Rights	Workforce Rights
Golden parachutes	Notification of layoffs
Stock options	Severance payments
Large salaries	Lifetime employment
Control over organizational resources	Long-term employment
Decision making	Pension and benefits
	Employee stock ownership plans
	Participation in decision making

Shareholders have the strongest property rights of all stakeholder groups because they own the resources of the company and share in its profits. Top managers often have strong property rights because they are given large amounts of organizational resources, such as high salaries, the rights to large stock options, or golden parachutes, which guarantee them large sums of money if they are fired when their company is taken over. Top managers' rights to use organizational resources are reflected in their authority to make decisions and control organizational resources. Managers are usually given strong rights because if they do not share in the value that the organization creates, they are unlikely to be motivated to work hard on behalf of the organization and its other stakeholders.

An organization's workforce may be given strong property rights, such as a guarantee of lifetime employment and involvement in an employee stock ownership plan (ESOP) or in a profit-sharing plan. Most workers, however, are not given very strong property rights. Few are given lifetime employment or involved in ESOPs, though they may be guaranteed long-term employment or be eligible for bonuses. Often workers' property rights are simply the wages they earn and the health and pension benefits they receive. Workers' rights to use organizational resources are reflected in their responsibilities in the level of control they have over their tasks.

The distribution of property rights has a direct effect on the instrumental values that shape employee behavior and motivate organizational members.³⁶ Attempts to limit employees' benefits and reduce their rights to receive and use resources can often result in hostility and high turnover. However, establishing a company-wide stock option plan, as Google did, and encouraging employees to use organizational resources to find better ways of serving customers can foster commitment and loyalty, as at companies like Southwest Airlines and Microsoft.

The distribution of property rights to different stakeholders determines (1) how effective an organization is and (2) the culture that emerges in the organization. Different property rights systems promote the development of different cultures because they influence people's expectations about how people should behave and what they can expect from their actions. The power of property rights over people's expectations is apparent in a situation that occurred at Apple Computer in the 1990s—something that is hard to believe happened given its spectacular success today.

For its first ten years in operation, Apple had never had a layoff, and employees had come to take job security for granted as they worked hard to further the company's incredible early success. Although no written document promised job security, employees believed they were appreciated and possessed an implicit property right to their jobs. Imagine, then, what happened in 1991 when Apple announced the first layoffs in its history and several thousand middle- and lower-level personnel were

terminated to reduce costs. Employees were dumbfounded: This was not how Apple treated its employees. They demonstrated outside Apple headquarters for several weeks. What effect did the layoff have on Apple's culture? It destroyed the belief that Apple valued its employees, and it destroyed an organizational culture in which employees had been motivated to put forth effort above and beyond their formal job descriptions. At Apple, employee loyalty

turned into hostility. By 2011, after having received record salaries and bonuses, Apple once again has a committed workforce and hopefully will never again have to lay off employees.

Kodak, Dell, AT&T, and many other large companies that have recently laid off large numbers of employees are in the peculiar position of needing increased commitment from those who remain in order to turn their businesses around. Can they reasonably expect this? How can they encourage it? Perhaps they can give remaining employees property rights that will engender commitment to the organization. That task is the responsibility of top managers.

Top Management and Property Rights

Top managers are in a strong position to establish the terms of their own employment, their salary and benefits packages, and their termination and pension benefits. Top managers also determine the property rights received by others and thus determine what kind of culture will develop in an organization. The core competences of Apple and Google, for example, depend on their employees' skills and capabilities. To gain employee commitment, these organizations reward their functional experts highly and give them very strong property rights. Apple has a position called "Apple Fellow," which gives top programmers the right to work on any project in the corporation or start any new project that they find promising. Both corporations reward important employees with large stock options. Thousands of people who joined Microsoft in the 1970s and 1980s and Google in the 1990s and 2000s, for example, are today multimillionaires as a result of stock options they received in the past. It is not difficult to imagine how committed they are to the organization. Companies do not hand out stock options because they are generous, however; they do so because they want to encourage terminal values of excellence and innovation and instrumental values of creativity and hard work. And they also want to prevent their best people from leaving to found their own firms or go to work for their competitors! In 2010, Google increased the rewards of its employees by 10% across the board and handed out other bonuses to stop them from leaving and joining competitors like Facebook and Amazon.com.

Does giving stronger property rights to lower-level production line or staff workers produce a culture in which they are committed to the organization and motivated to perform highly? The introduction of an employee stock option plan at Bimba Manufacturing, which makes aluminum air cylinders in Monee, Illinois, had dramatic effects on employee behavior and the culture of the organization. Bimba's owner, Charles Bimba, decided to sell the company to its employees by establishing an ESOP. He kept 10% of the shares; the other 90% he sold to employees. Some of the employees' money came from an already existing profit-sharing plan; the rest was borrowed from a bank. Changes in the company since the ESOP was

introduced have been dramatic, and the orientation of the workforce to the organization has totally changed.

Previously, the company had two groups of employees: managers who made the rules and workers who carried them out. Workers rarely made suggestions and generally just obeyed orders. Now, cross-functional teams composed of managers and workers meet regularly to discuss problems and find new ways to improve quality. These teams also meet regularly with customers to better meet their needs. Because of the incentives provided by the new ESOP, management and workers have developed new working relationships based on teamwork to achieve excellence and high quality. Each team hires its own members and spends considerable time socializing new employees in the new culture of the organization. The new cooperative spirit in the plant has forced managers to relearn their roles. They now listen to workers and act as advisers rather than superiors.

So far, changing the company's property rights system has paid off. In the 2000s Bimba has become an industry leader in providing pneumatic and hydraulic air cylinders; it has prospered and workers have repaid the loan they took out to finance the employee stock purchase. The ESOP totally changed Bimba's culture and the commitment of its workforce. In the words of one worker, it led to "an intense change in the way we look at our jobs."³⁷ Bimba's experience demonstrates how changing the property rights system can change organizational culture by changing the instrumental values that motivate and coordinate employees. The need for close supervision and the use of rigid rules and procedures to control behavior is no longer needed at Bimba because coordination is achieved by teams of employees who value cooperation and are motivated by the prospect of sharing in the profits created by the new work system.

Can Property Rights Be Too Strong?

As the Bimba story suggests, the value and level of a person's behavior and performance are, in part, a consequence of the rights the person is given. Sometimes, however, employees can be given property rights that are so strong that the organization and its employees are actually harmed over time. A well-known example of this situation occurred at IBM in the 1990s. Over the years IBM developed a very conservative culture in which employees had strong rights, such as the implicit promise of lifetime employment. As a result, according to former CEO Lou Gerstner, IBM employees had become cautious and noninnovative. Gerstner claimed that the organization protected IBM employees so well that they had no motivation to perform, to take risks, or to rock the boat. He suggested that the property rights of IBM employees were too strong.

It is easy to understand how property rights can become too strong. [Chapter 5](#) discussed how people in bureaucracies can come to believe they own their positions and the rights that go with them. When this happens, people take steps to protect their rights and resist attempts by others to wrest their rights away. The result is conflict, internal power struggles, and a loss of flexibility and innovation as the organization loses sight of its mission because its members are preoccupied with their own—not the organization's—interests. Property rights, therefore, must be assigned on the basis of performance and in a discriminating way. Managers must continually evaluate and address this difficult challenge.

Gerstner took steps to change IBM's property rights system and create an entrepreneurial culture by distributing rewards including salary and promotion based on performance and eliminated employees' expectations of lifetime employment. To create a certain kind of culture, an organization needs to create a certain kind of property rights system. In part, organizational culture reflects the values that emerge because of an organization's property rights system.

Organizational Structure

We have seen how the values that coordinate and motivate employees result from the organization's people, its ethics, and the distribution of property rights among various stakeholders. The fourth source of cultural values is organizational structure. Recall from **Chapter 1** that *organizational structure* is the formal system of task and authority relationships that an organization establishes to control its activities. Because different structures give rise to different cultures, managers need to design a certain kind of organizational structure to create a certain kind of organizational culture. Mechanistic structures and organic structures, for example, give rise to totally different sets of cultural values. The values, rules, and norms in a mechanistic structure are different from those in an organic structure.

Recall from **Chapter 4** that *mechanistic structures* are tall, highly centralized, and standardized, and *organic structures* are flat and decentralized and rely on mutual adjustment. In a tall, centralized organization, people have relatively little personal autonomy, and desirable behaviors include being cautious, obeying superior authority, and respecting traditions. Thus mechanistic structure is likely to give rise to a culture in which predictability and stability are desired end states. In a flat, decentralized structure, people have more freedom to choose and control their own activities, and desirable behaviors include being creative or courageous and taking risks. Thus an organic structure is likely to give rise to a culture in which innovation and flexibility are desired end states.

An organization's structure can promote cultural values that foster integration and coordination. Out of stable task and role relationships, for example, emerge shared norms and rules that help reduce communications problems, prevent the distortion of information, and speed the flow of information. Moreover, norms, values, and a common organizational language can improve the performance of teams and task forces. It is relatively easy for different functions to share information and trust one

another when they share similar cultural values. One reason why product development time is short and the organization is

flexible in product team structures and matrix structures is that the reliance on face-to-face contact between functional specialists in teams forces those teams quickly to develop shared values and common responses to problems.

Whether a company is centralized or decentralized also leads to the development of different kinds of cultural values. In some organizations, it is important that employees do not make decisions on their own and their actions be open to the scrutiny of superiors. In such cases, centralization can be used to create cultural values that reinforce obedience and accountability. For example, in nuclear power plants, values that promote stability, predictability, and obedience to superior authority are deliberately fostered to prevent disasters.³⁸ Through norms and rules, employees are taught the importance of behaving consistently and honestly, and they learn that sharing information with supervisors, especially information about mistakes or errors, is the only acceptable form of behavior.³⁹

Conversely, by decentralizing authority, an organization can establish values that encourage and reward creativity or innovation. At 3M, employees are informally encouraged to spend 15% of their time working on personal projects. The founders of Hewlett-Packard established the “H-P Way,” a decentralized approach to organizing that gives employees the right and obligation to access equipment and resources so they can be creative and conduct their own research informally, outside of their normal job responsibilities. In both these companies, the organizational structure produces cultural values that tell members it is all right to

be innovative and to do things in their own way, as long as their actions are consistent with the good of the organization.

In sum, organizational structure affects the cultural values that guide organizational members as they perform their activities. In turn, culture improves the way structure coordinates and motivates organizational resources to help an organization achieve its goals. One source of a company's competitive advantage is its ability to design its structure and manage its culture so there is a good fit between the two. This gives rise to a core competence that is hard for other organizations to imitate. However, when companies fail to achieve a good fit, or when structural changes produce changes in cultural values, problems start to occur.

Can Organizational Culture Be Managed?

Managers interested in understanding the interplay between an organization's culture and the organization's effectiveness at creating value for stakeholders must take a hard look at all four of the factors that produce culture: the characteristics of organizational members (particularly the founder and top managers), organizational ethics, the property rights system, and organizational structure. To change a culture can be very difficult because those factors interact, and major alterations are often needed to change an organization's values.⁴⁰ To change its culture, an organization might need to redesign its structure and revise the property rights it uses to motivate and reward employees. The organization might also need to change its people, especially its top-management team. Keeping in mind the difficulty of managing organizational culture, let's look at how Microsoft's original culture evolved as a result of the interaction of the four factors.

First, Bill Gates's personal values and beliefs and his vision of what Microsoft could achieve from employees' creativity and hard work formed the core of Microsoft's culture, with its terminal values of excellence and innovation. After its initial success was established by its MS-DOS and Microsoft Word platforms, Microsoft began to attract the best software engineers in the world. Gates was therefore in a position to select those people who bought into his values and who could perform at the level that he and his managers required. Over time, norms based on the need for individual initiative (to enhance the instrumental values of creativity and risk taking) and for teamwork (to enhance cooperation) emerged, and Microsoft built one of the first campus-like headquarters complexes to promote the development of an informal atmosphere in which people could interact and develop strong working bonds.

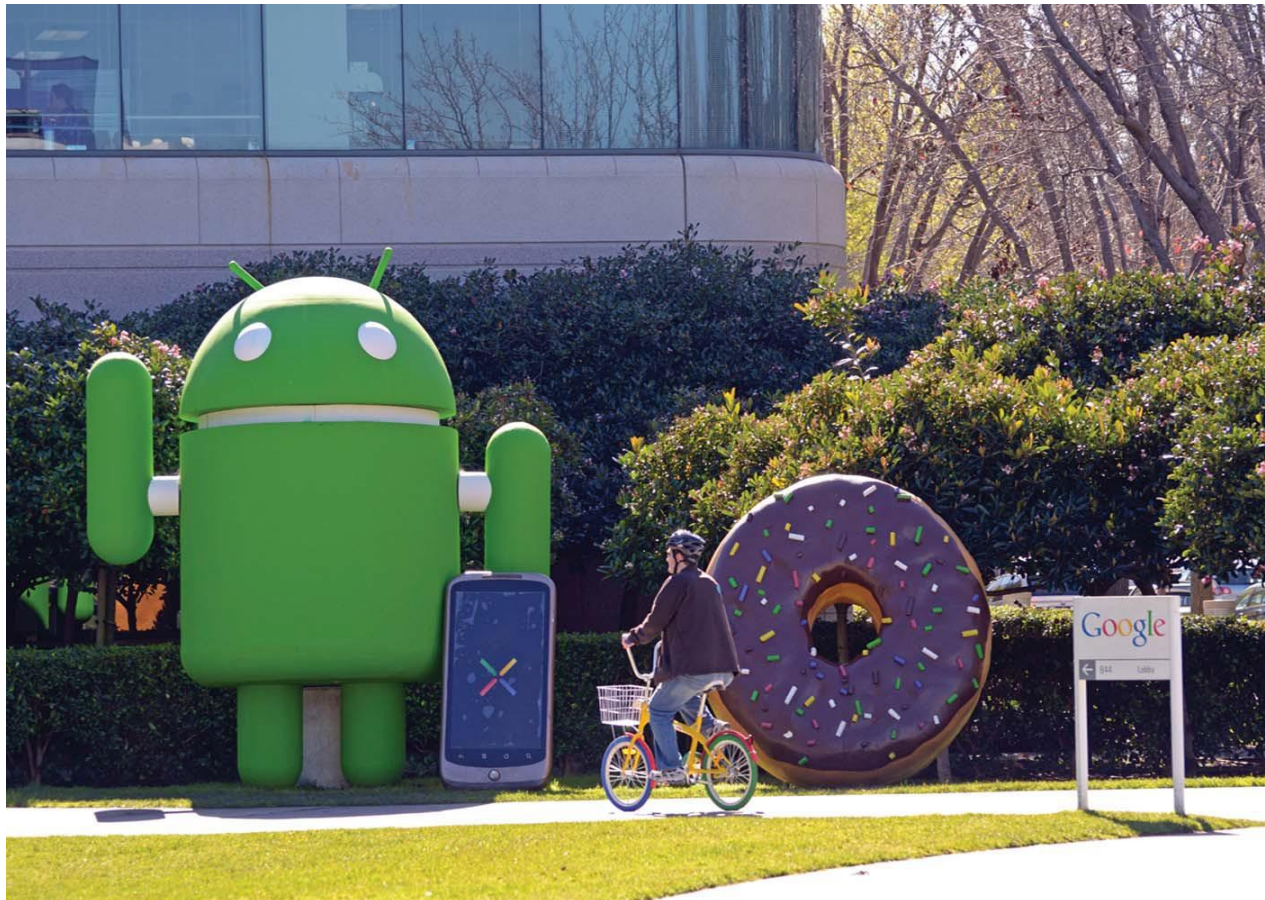
Gates designed an organic structure for Microsoft and kept it as flat and decentralized as possible by using small teams to coordinate work activities. This design encourages risk taking and creativity. He also used a product team structure to reinforce a collaborative atmosphere and norms of “team spirit.” Gates also established a culture for innovation by rewarding successful risk taking and creativity with strong property rights. Thousands of key employees received stock options, for example. Furthermore, Microsoft offered high-quality pensions and benefits and never had to lay off employees until the 2000s. Finally, the company has a history of behaving ethically toward its employees and customers (even if not toward its competitors). Microsoft’s people, its structure, its property rights, and its ethics interact and fit together to make up Microsoft’s culture.

Compare Microsoft’s culture to the one Louis Gerstner, IBM’s former CEO, had to change to turn around the failing company. IBM had a conservative, stable culture produced by property rights tied not to performance but to employee longevity in the organization, and a tall, centralized structure that promoted obedience and conformity. The people attracted to and retained by this IBM culture were those who liked working in a stable environment where they knew their place, who accepted the status quo, and who did not mind that the culture limited their opportunities to innovate or be creative. Although there was a match among the factors producing IBM’s culture, the culture did not serve the company well. Because its cultural values emphasized stability, IBM was unable to adapt to changes in the environment, such as changes in technology and customer needs, and it almost failed in the early 1990s.

Can a company maintain a creative, entrepreneurial culture as it grows? Microsoft has not been able to maintain its dynamic and freewheeling culture as it has grown and has encountered many motivational and coordination problems. As a result, many analysts believe Microsoft has missed many opportunities, made many mistakes, and consequently has been overtaken by companies like Google and Facebook. However, by 2010 Google’s rapid growth had also resulted in high employee turnover and its new CEO Larry Page, who took over in 2011, was having

to work hard to maintain its entrepreneurial culture. In 2011, Microsoft also was striving to maintain its dominance in the PC software market and make advances into mobile computing and to prevent the development of inertia and complacency in the company.

To prevent an organization's culture from changing in ways that reduce effectiveness as the organization grows, top managers must continually redesign its structure to offset the control problems that occur with large size and complexity.⁴¹ As just noted, these problems arise even within high-performing organizations such as Microsoft, Google, and Apple, which is why understanding organizational theory and design is such an important issue.



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A company's culture can change over time as it grows. Despite its success, Google has had to work hard to maintain its entrepreneurial culture over the years.



Managerial Implications Designing Organizational Culture

1. Try to identify the source of the values and norms of your organization's culture and analyze the relative effects of people, ethics, property rights, and structure on influencing organizational culture.
2. Use this analysis to produce an action plan for redesigning the culture of the organization to improve effectiveness.
3. Be sure that the action plan takes all four factors into consideration, because each one affects the others. Changing one factor alone may not be sufficient to change organizational culture.
4. Make the development of ethical organizational values one of your major priorities.

Social Responsibility

One very important consequence of the values and norms of its culture is an organization's stance with regard to social responsibility. The term *social responsibility* refers to a manager's duty or obligation to make decisions that nurture, protect, enhance, and promote the welfare and well-being of stakeholders and society as a whole. Many kinds of decisions signal an organization's interest in being socially responsible (see [Table 7.4](#)).

Approaches to Social Responsibility

The strength of an organization's commitment to social responsibility ranges from low to high (see [Figure 7.4](#)).⁴² At the low end of the range is an **obstructionist approach**. Obstructionist managers choose not to behave in a socially responsible way. Instead, they behave unethically and illegally and do all they can to prevent knowledge of their behavior from reaching other organizational stakeholders and society at large. Managers at the Mansville Corporation adopted this approach when evidence that asbestos causes lung damage was uncovered. Managers at Beech-Nut who sought to hide evidence about the use of corn syrup in their apple juice also adopted this approach. The managers of all these organizations chose an obstructionist approach. The result was not only a loss of reputation but devastation for their organizations and for all stakeholders involved.

Obstructionist approach

The low end of the organization's commitment to social responsibility.

Defensive approach

An approach indicating a commitment to ethical behavior.

A **defensive approach** indicates at least a commitment to ethical behavior.

Defensive managers stay within the law and abide strictly within legal requirements,

Table 7.4 Forms of Socially Responsible Behavior

Managers are being socially responsible and showing their support for their stakeholders when they:
<ul style="list-style-type: none"> • Provide severance payments to help laid-off workers make ends meet until they can find another job. • Provide workers with opportunities to enhance their skills and acquire additional education so they can remain productive and do not become obsolete because of changes in technology. • Allow employees to take time off when they need to and provide health-care and pension benefits for employees. • Contribute to charities or support various civic-minded activities in the cities or towns in which they are located. (Target and Levi Strauss both contribute 5% of their profits to support schools, charities, the arts, and other good works.) • Decide to keep open a factory whose closure would devastate the local community. • • Decide to keep a company's operations in the United States to protect the jobs of American workers rather than move abroad. • Decide to spend money to improve a new factory so that it will not pollute the environment. • Decline to invest in countries that have poor human rights records. • Choose to help poor countries develop an economic base to improve living standards.

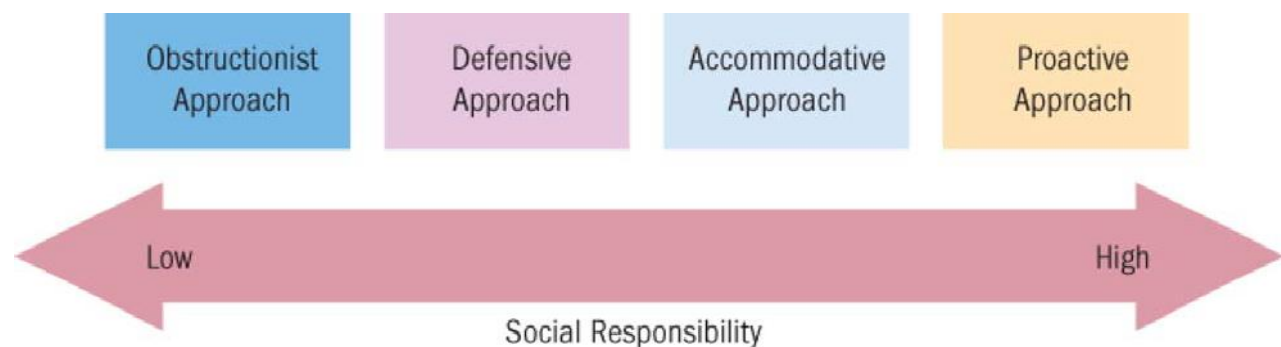


Figure 7.4 Approaches to Social Responsibility

but they make no attempt to exercise social responsibility beyond what the law dictates. Managers adopting this approach do all they can to ensure that their employees behave legally and do not harm others. But when making ethical choices, these managers put the claims and interests of their shareholders first, at the expense of other stakeholders.

The very nature of a capitalist society—in which managers' primary responsibility is to the owners of the corporation, its shareholders—probably encourages the defensive response. Some economists believe that managers in a capitalistic society should always put stockholders' claims first, and if these choices are not acceptable to other members of society and are considered unethical, then society must pass laws and create rules and regulations to govern the choices managers make.⁴³ From a defensive perspective, it is not managers' responsibility to make socially responsible choices; their job is to abide by the rules that have been legally established. Thus defensive managers have little active interest in social responsibility.

An **accommodative approach** is an acknowledgment of the need to support social responsibility. Accommodative managers agree that organizational members ought to behave legally and ethically, and they try to balance the interests of different stakeholders against one another so the claims of stockholders are seen in relation to the claims of other stakeholders. Managers adopting this approach want to make choices that are reasonable in the eyes of society and want to do the right thing when called on to do so.

Accommodative approach

The acknowledgment of the need to support social responsibility.

Managers taking a **proactive approach** actively embrace the need to behave in socially responsible ways, go out of their way to learn about the needs of different stakeholder groups, and are willing to use organizational resources to promote the interests not only of stockholders but of the other stakeholders. Such companies—HP, The Body Shop, McDonald's, Johnson & Johnson—are at the forefront of campaigns for causes such as a pollution-free environment, recycling and conservation of resources, minimizing or avoiding the use of animals in drug and cosmetic testing, and reducing crime, illiteracy, and poverty.

Proactive approach

Managers who actively embrace the need to behave in socially responsible ways, go out of their way to learn about the needs of different stakeholder groups, and are willing to use organizational resources to promote the interests not only of stockholders but of the other stakeholders.

Why Be Socially Responsible?

Several advantages are argued to result when managers and organizations behave in a socially responsible manner. First, workers and society benefit directly because organizations (rather than the government) bear some of the costs of helping workers. Second, it has been said that if all organizations in a society were socially responsible, the quality of life as a whole would be higher. Indeed, several management experts have argued that the way organizations behave toward their employees determines many of a society's values and norms and the ethics of its citizens. It has been suggested that if all organizations adopted a caring approach and agreed their responsibility is to promote the interests of their employees, a climate of caring would pervade the wider society.⁴⁴ Experts point to Japan, Sweden, Germany, the Netherlands, and Switzerland as countries where organizations are very socially responsible and where, as a result,

crime and unemployment rates are relatively low, the literacy rate is relatively high, and sociocultural values promote harmony between different groups of people. Other reasons for being socially responsible are that it is the right thing to do and companies that act responsibly toward their stakeholders benefit from increasing business and see their profits rise.⁴⁵

Given these advantages, why would anyone quarrel over the pursuit of social responsibility by organizations and their managers? One issue that comes up is that although some stakeholders benefit from managers' commitment to social responsibility, other stakeholders, particularly shareholders, may think they are being harmed when organizational resources are used for socially responsible

courses of action. Some people argue that business has only one kind of responsibility: to use its resources for activities that increase its profits and thus reward its stockholders.⁴⁶

How should managers decide which social issues they will respond to and to what extent their organizations should trade profits for social gain? Obviously, illegal behavior should not be tolerated; all managers and workers should be alert to its occurrence and report it promptly. The term **whistle-blower** is used to refer to a person who reports illegal or unethical behavior and takes a stand against unscrupulous managers or other stakeholders who are pursuing their own ends.⁴⁷ Laws now exist to protect the interests of whistle-blowers, who risk their jobs and careers to reveal unethical behavior. In part, these laws were enacted because of the experiences of two engineers at Morton Thiokol who warned that the *Challenger* space shuttle's O-ring gaskets would be adversely affected by cold weather at launch.⁴⁸ Their warnings were ignored by everyone involved in the headlong rush to launch the shuttle. As a result, seven astronauts died when the *Challenger* exploded shortly after launch in January 1986. Although the actions of the engineers were applauded by the committee of inquiry, their subsequent careers suffered because managers at Morton Thiokol blamed them for damaging the company's reputation and harming its interests. A new set of rules designed to encourage employees to come forward and report unethical and illegal behavior is discussed in **Organizational Insight 7.4** .

Whistle-blowing

Informing (by an employee) an outside person or agency, such as a government agency or a newspaper or television reporter, about an organization's (its managers') illegal or immoral behavior.

Another way in which managers can ascertain whether they are acting socially responsibly is to apply ethical standards and values. Managers' own ethics influence their behavior, and their own values strongly influence whether they will take a proactive approach to social responsibility. An organization's code of ethics, usually printed in its annual reports and mission statements, also influences how conscientiously managers seek to support the interests of all their stakeholders. Some organizations, like Johnson & Johnson, view the company's code of ethics as the only policy to follow when an ethical dilemma is evident, and they allow this code to govern their choices. Other organizations pay lip service to the organization's ethical code and, as a result, managers facing a moral dilemma seek to protect their own interests first and worry later about how other stakeholders will be affected.⁴⁹ When such managers talk about protecting the organization, what they are really talking about is protecting their own interests: their jobs, bonuses, careers, and abilities to use organizational resources for their own ends.

Evidence suggests that managers who behave socially responsibly will, in the long run, most benefit all organizational stakeholders (including stockholders). It appears that socially responsible companies, in comparison with less responsible competitors, are less risky investments, tend to be somewhat more profitable, have a more loyal and committed workforce, and have better reputations, which encourage stakeholders (including customers and suppliers) to establish long-term

business relationships with them.⁵⁰ Socially responsible companies are also sought out by communities, which encourage such organizations to locate in their cities and offer them incentives such as property-tax reductions and the construction of new roads and free utilities for their plants. Thus there are many reasons to believe that, over time, strong support of social responsibility confers the most benefits on organizational stakeholders (including stockholders) and on society at large.



Organizational Insight

7.4 New SEC Rules Offer Whistle-blowers

Large Rewards

In the 2000s, there have been many revelations of wrongdoing by financial executives, such as those that led to the subprime mortgage financial crisis, and about Ponzi schemes involving investment fund managers such as Bernie Madoff, who stole tens of millions from investors, and finally many cases of insider trading against such people as billionaire hedge fund manager Raj Rajaratnam, who in 2011 was convicted on all counts of illegally using inside information to make tens of millions in profit.

Given the increasing evidence of widespread fraud, and the increasing propensity of managers to behave unethically and eventually lead them to act illegally, the Securities and Exchange Commission (SEC) decided to approve regulations that would encourage whistle-blowers—other executives or subordinates who know about such activities—to come forward and report unethical and illegal actions to the SEC

In 2011, the SEC passed rules that would allow whistle-blowers who report corporate fraud or other misconduct to the government to gain up to 30% of the money recovered from the successful prosecution of illegal financial dealings by people or companies. The whistle-blower program was

mandated by the financial overhaul law, the Dodd-Frank Act, passed in 2010. These rules were passed despite widespread opposition from large U.S. companies such as AT&T, FedEx, Google, and Target. These companies argued that whistle-blowers should first have to tell their companies about unethical or illegal actions by other managers that would allow them to correct problems before informing the SEC. However, supporters of whistle-blowers say requiring them to report wrongdoing first would discourage them because it makes them subject to punitive actions from their own companies, many of which have been known in the past to find ways to harm people who inform on their own organizations.

Nevertheless, the new rules state that even if employees report potential wrongdoing to their company, the SEC will officially designate them as whistle-blowers so that they are eligible for awards providing they give the SEC the same information within 120 days. They will even



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receive these rewards if they choose to remain with their organizations after providing such information. SEC Chairperson Mary Schapiro said, “Although companies’ internal compliance programs play an extremely valuable role in preventing fraud, the new rules strike a balance between encouraging whistle-blowers to pursue internal compliance when appropriate and give them the option to go directly to the SEC. It is the whistle-blower who is in the best position to know which route is best to pursue.”

Supporters of the new rules argue that whistle-blowers can be an effective line of defense against corporate wrongdoing, such as Bernard Madoff’s multibillion-dollar fraud over nearly two decades that continued despite warnings the SEC received from at least two whistle-blowers. Under the new program, for example, if an insider at Goldman Sachs had given the SEC information leading to its \$550 million civil fraud settlement with Goldman over its marketing of sub-prime mortgage securities, that person could have collected up to \$165 million.

Clearly, the SEC’s new rules for its whistle-blower program offer employees a powerful financial incentive to report potential misconduct in their companies directly to the government. The whistle-blower provision came on top of the requirements of the 2002 Sarbanes-Oxley Act, which mandated that organizations create effective internal compliance programs to learn about potential wrongdoing but which many companies have chosen to ignore.

Summary

Organizational culture exercises a potent form of control over the interactions of organizational members with each other and with outsiders. By supplying people with a toolbox of values, norms, and rules that tell them how to behave, organizational culture is instrumental in determining how they interpret and react to a situation. Thus an organization's culture can be a source of competitive advantage. **Chapter 7** has made the following main points:

1. Organizational culture is a set of shared values that provide organizational members with a common understanding of how they should act in a situation.
2. There are two kinds of organizational values: terminal (a desired end state or outcome) and instrumental (a desired mode of behavior). Ideally, instrumental values help the organization to achieve its terminal goals.
- 3.

Organizational culture affects organizational effectiveness because it can (a) provide an organization with a competitive advantage, (b) improve the way an organizational structure works, and (c) increase the motivation of employees to pursue organizational interests.

4. Culture is transmitted to an organization's members by means of (a) socialization and training programs and (b) stories, ceremonies, and language used by members of the organization.
5. Organizational culture develops from the interaction of (a) the characteristics of organization members, (b) organizational ethics, (c) the property rights distributed among the people in the organization, and (d) organizational structure.

6. Different organizational structures give rise to different patterns of interaction among people. These different patterns lead to the formation of different organizational cultures.
7. Social responsibility is an organization's moral responsibility to stakeholder groups affected by the organization's actions. There are four stances on social responsibility, and they have very different implications for organizational behavior.

Discussion Questions

1. What is the origin of organizational culture? Why do different organizations have different cultures?
2. How do newcomers learn the culture of an organization? How can an organization encourage newcomers to develop (a) an institutionalized role orientation and (b) an individualized role orientation?
3. In what ways can organizational culture increase organizational effectiveness? Why is it important to obtain the right fit between organizational structure and culture?
4. "An organization should always adopt a broad stance on social responsibility." Explain why you agree or disagree with this statement.

Organizational Theory in Action

Practicing Organizational Theory

Developing a Service Culture

Form groups of three to five people and discuss the following scenario:

You are the owner/managers of a new five-star resort hotel opening up on the white sand beaches of the western coast of Florida. For your venture to succeed, you need to make sure that hotel employees focus on providing customers with the highest-quality customer service possible. You are meeting to discuss how to create a culture that will promote such high-quality service, encourage employees to be committed to the hotel, and reduce the level of employee turnover and absenteeism, which are typically high in the hotel business.

1. What kinds of organizational values and norms encourage employees to behave in ways that lead to high-quality customer service?
2. Using the concepts discussed in this chapter (for example, people, property rights, and socialization), discuss how you will create a culture that promotes the learning of these customer service values and norms.
3. Which factor is the most important determinant of the kind of culture you expect to find in a five-star hotel?

The Ethical Dimension #7

The chapter discussed how Arthur Andersen's organizational culture had become so strong that some of its partners and their subordinates began to act unethically and pursue their own short-run interests at the expense of other stakeholders. Many employees

knew they were doing wrong but were afraid to refuse to follow orders. At Beech-Nut, the company's ethical values completely broke down: Managers joked about harming stakeholders.

1. Why is it that an organization's values and norms can become too strong and lead to unethical behavior?
2. What steps can a company take to prevent this problem, to stop its values and norms from becoming so inwardly focused that managers and employees lose sight of their obligations to their stakeholders?

Making the Connection #7

Identify an organization that has been trying to change its culture. Describe the culture that it is trying to alter. Why is this culture no longer effective? How has the organization tried to bring about change? How successful has it been?

Analyzing the Organization: Design Module #7

In this module, you will analyze the culture of your organization, discuss the characteristic ways in which members act, and its stance on social responsibility.

Assignment

1. Do managers and employees use certain words and phrases to describe the behavior of people in the organization? Are any stories about events or people typically used to describe the way the organization works? (*Hint:* Look at the company's Web page.)
2. How does the organization socialize employees? Does it put them through formal training programs? What kind of programs are used, and what is their goal?
3. What beliefs and values seem to characterize the way people behave in the organization? How do they affect people's behavior?
4. Given the answers to the first three questions, how would you characterize the organization's culture and the way it benefits or harms the organization? How could the culture be improved?
5. Can you find a written statement of the organization's stance on social responsibility? Are there stories in the press about the company? If there are, what do they say?

Case for Analysis A Tale of Two Cultures

In an attempt to give Southwest Airlines a competitive advantage based on low-cost, high-quality service, CEO Herb Kelleher developed terminal and instrumental values that made Southwest's culture the envy of its competitors. Southwest managers and employees alike are committed to the success of the organization and do all they can to help one another and to provide customers with excellent service (a terminal value). Four times a year, Southwest managers work as baggage handlers, ticket agents, and flight attendants so they get a feel for the problems facing other employees. An informal norm makes it possible for employees to gather with Kelleher every Friday at noon in the company's Dallas parking lot for a company cookout.

Southwest keeps the organization as flat and informal as possible, and managers encourage employees to be creative and to develop rules and norms to solve their own problems. To please customers, for example, employees dress up on special days like Halloween and Valentine's Day and wear "fun uniforms" every Friday. In addition, they try to develop innovative ways to improve customer service and satisfaction. All employees participate in a bonus system that bases rewards on company performance, and employees own over 22% of the airline's stock. The entrance hall at company headquarters at Love Field in Dallas is full of plaques earned by employees for their outstanding performance. Everybody in the organization cooperates to achieve Southwest's goal of providing low-cost, high-quality service.

The culture of excellence that Southwest has created seems to be working to its advantage. Southwest increased its operating routes and profits every year and is the most profitable airline flying today.

Contrast Southwest's CEO and culture with that of Value Line, Inc. Jean Buttner, publisher of the *Value Line Investment Survey*, fashioned a culture that the company's employees apparently hated. In her attempt to reduce costs and improve efficiency, she created instrumental values of frugality and economy that poisoned employees' attitudes toward the organization. Employees were told to sign in by 9 *a.m.* every day and sign out when leaving. If they faked their arrival or departure time, they could be terminated. Because at Value Line messy desks were regarded as signs of laziness or "unproductivity," Buttner required department managers to file a "clean surfaces report" every day, certifying that employees did tidy up their desks.⁵¹ Salary increases were also kept as small as possible and the company's bonus and health plans were under tight rein.

How have these values paid off? Many highly trained professional workers left Value Line because of the hostile atmosphere produced by these "economical" values and by work rules that devalued employees. Also, this turnover generated discontent among the company's customers, who began to complain. So bad did feelings between employees and Buttner become that employees reportedly put up a notice on their bulletin board that criticized Buttner's management style and suggested that the company could use some new leadership. Buttner's response to this message from a significant stakeholder group was to remove the bulletin board. Clearly, at Value Line no culture of cooperation between managers and employees exists.

Discussion Questions

1. List the reasons why Southwest's and Value Line's cultures differ so sharply.
2. Could Value Line's next CEO copy Southwest's culture?

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Chapter 8

Organizational Design and Strategy in a Changing Global Environment

Learning Objectives

Finding the right strategy to respond to changes taking place in the environment (such as changes in the needs of customers or actions of competitors overseas) is a complex issue facing managers. In a changing global environment it is easy to make mistakes, and managers must constantly monitor their strategies and structures to make sure they are working effectively both at home and abroad.

After reading this chapter you should be able to:

1. Identify the ways managers can use functional-level strategy to develop core competences that allow an organization to create value and give it a competitive advantage.
2. Explain how the way managers combine their organization's distinctive competences can create a successful business-level strategy that allows them to compete for scarce resources.
3. Differentiate among the corporate-level strategies companies can use to enter new domains where they can continue to grow and create value.
4. Appreciate the importance of linking strategy to structure and culture at each level—functional, business, and corporate—to increase the ability to create value.
5. Understand how global expansion strategies allow an organization to seek new opportunities to take advantage of its core competences to create value for stakeholders.

Strategy and the Environment

As we discussed in [Chapter 1](#), an organization's **strategy** is a specific pattern of decisions and actions that managers take to use core competences to achieve a competitive advantage and outperform competitors.¹ An organization develops a strategy to increase the value it can create for its stakeholders. In this context, value is anything that satisfies the needs and desires of organizational stakeholders. Stockholders want a company to set goals and develop an action plan that maximizes the long-run profitability of the company and the value of their stock. Customers are likely to respond to a strategy based on the goal of offering high-quality products and services at appropriate prices.

Strategy

The specific pattern of decisions and actions that managers take to use core competences to achieve a competitive advantage and outperform competitors.

Through its strategy, an organization seeks to use and develop core competences to gain a competitive advantage so it can increase its share of scarce resources in its environment. Recall that core competences are skills and abilities in value-creation activities, such as manufacturing, marketing, or R&D that allow a company to achieve superior efficiency, quality, innovation, or customer responsiveness. An organization that possesses superior core competences can outperform its rivals. Organizational strategy allows an organization to shape and manage its domain to exploit its existing core competences and develop new competences that make it a better competitor for resources.

Core competences

The skills and abilities in value-creation activities that allow a company to achieve superior efficiency, quality, innovation, or customer responsiveness.

McDonald's, for example, uses its existing core competences in the production of fast food such as burgers and fries to provide fast food for the breakfast segment of the fast-food domain. By investing in food-testing facilities, McDonald's developed R&D competences that led to the development of breakfast items (such as the Egg McMuffin, burritos, and a variety of coffees and fruit drinks) that could be produced quickly. By using its existing core competences in new ways, and by developing new competences, McDonald's continuously creates new breakfast foods that contribute greatly to its revenues and profit. Similarly, Google developed its software engineering skills in search engine technology to expand its domain into email, document management, and mobile applications including instant purchase payment by smartphone in June 2011.

The more resources an organization can obtain from the environment, the better able it is to set ambitious long-term goals and then develop a strategy and invest resources to create core competences to allow it to achieve those goals. In turn, improved competences give an organization a competitive advantage, which allows the organization to attract new resources—for example, new customers, highly

qualified employees, or new sources of financial support. **Figure 8.1** shows this cyclical value-creation process.

Sources of Core Competences

The ability to develop a strategy that allows an organization to create value and outperform competitors is a function of an organization's core competences. The strength of its core competences is a product of the specialized resources and coordination abilities that it possesses and other organizations lack.²

Specialized Resources

Two kinds of resources provide an organization with core competences that give it a competitive advantage: functional resources and organizational resources.

Functional resources are the skills possessed by an organization's functional personnel. The skills embedded in Google's many different software engineering teams constitute its single biggest functional resource. The quality of 3M's many different R&D groups is the source of its continued growth. Procter & Gamble's expertise in new product development is its greatest functional resource.

Functional resources

The skills possessed by an organization's functional personnel.

To be a source of competitive advantage, however, it is not sufficient that an organization has high-quality functional resources; these resources must also be

unique or special

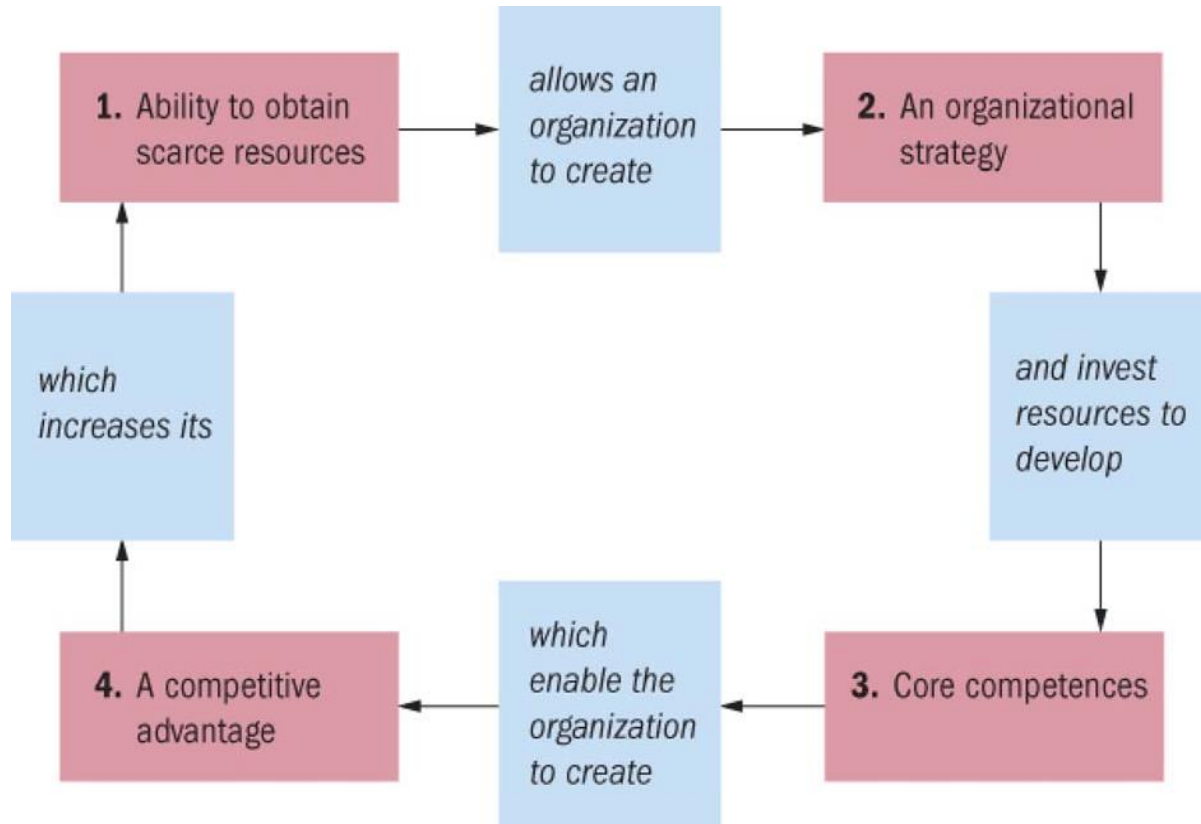


Figure 8.1 The Value-Creation Cycle

Ample resources, a well-thought-out strategy, and distinctive competences give an organization a competitive advantage, which facilitates the acquisition of still more resources.

and difficult to imitate—to be *core competences*.³ For example, Google’s claim to uniqueness rests in the breadth and depth of the software talent it possesses. But suppose a rich competitor like Microsoft or Facebook comes along and tries to hire Google’s best engineers, or DuPont lures away 3M’s scientists. If that were to happen, those companies’ claims to uniqueness would disappear (and top researchers do frequently move to other organizations). So to maintain its long-term

competitive advantage, an organization needs to protect the source of its functional competences. That is why Google gives its best people strong property rights, including stock options that make them owners of the company, and why 3M is well known for its generous long-term employment policies.

Organizational resources are the company-specific skills and competence that give an organization a competitive advantage. They include the skills of a company's top-management team, the vision of its founder or CEO, and the possession of valuable and scarce resources such as land, capital reserves, and plant equipment. They also include intangibles such as a company's brand name and its corporate reputation.⁴ Like functional resources, to provide a competitive advantage, organizational resources must be unique or difficult to imitate. When organizations can hire away one another's managers, or when any organization can buy the most advanced computer-controlled manufacturing technology from Hitachi or Caterpillar, organizational resources are not unique and do not give an organization a competitive advantage. However, brand names, like Coca-Cola and Toyota, and reputations, such as Google's and Microsoft's, are organizational resources that are unique and difficult to imitate. Obtaining those resources would entail buying the whole company, not just hiring away individual managers.

Organizational resources

The attributes that give an organization a competitive advantage such as the skills of the top-management team or possession of valuable and scarce resources.

Coordination Abilities

Another source of core competences is **coordination ability**, an organization's ability to coordinate its functional and organizational resources to create the most value. Effective coordination of resources (achieved through the control provided by organizational structure and culture) leads to a competitive advantage.⁵ The control systems that an organization uses to coordinate and motivate people at the functional and organizational levels can be a core competence that contributes to the organization's overall competitive advantage. Similarly, the way an organization decides to centralize or decentralize authority or the way it develops and promotes shared cultural values increases its effectiveness and allows the organization to manage and protect its domain better than its competitors can protect theirs. Google and Microsoft design their structures and cultures around small teams to coordinate activities in a way that facilitates the rapid development and launch of new products.

Coordination ability

An organization's ability to coordinate its functional and organizational resources to create maximal value.

An organization's ability to use its structure and culture to coordinate its activities is also important at the functional and organizational levels.⁶ The way an organization coordinates people and resources within functions determines the strength of its core competences. For example, several organizations have access to fast-food production technology (a functional resource) similar to the advanced coffee machines that McDonald's uses, but none has been able to imitate the rules, SOPs,

and norms that make its production operations so efficient. Competitors have been unable to duplicate the way McDonald's coordinates people and resources that enables it to produce its fast food so efficiently and reliably.

Similarly, at the organizational level, the ability to use structure and culture to coordinate and integrate activities across departments or divisions gives some organizations a core competence and thus a competitive advantage. For example, the success of 3M and Procter & Gamble can be explained in part by their ability to develop integrating mechanisms that allow their marketing, product development, and manufacturing departments to combine their skills to develop a constant stream of innovative products. Similarly, PepsiCo's success stems in part from its sharing of resources among its different divisions (Pepsi-Cola, Frito-Lay, and so on).

Although many functional and organizational resources are not unique and can be imitated, an organization's ability to coordinate and motivate its functions and departments is difficult to imitate. It might be possible to buy the functional expertise or technical knowledge of 3M or Google, but the purchase would not include access to the practices and methods that either organization uses to coordinate its resources. These intangible

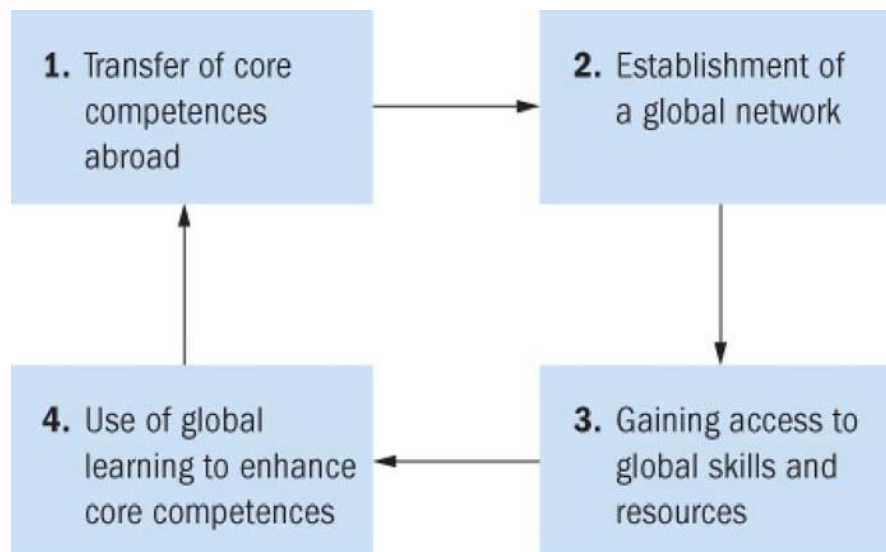


Figure 8.2 The Creation of Value through Global Expansion

practices are embedded in the way people interact in an organization—in the way organizational structure and culture control behavior—and they make these companies more successful than their rivals.

Global Expansion and Core Competences

Expanding globally into overseas markets can be an important facilitator of the development of an organization's core competences. **Figure 8.2** summarizes four ways in which global expansion allows an organization to create value for its stakeholders.

Transferring Core Competences Abroad

Value creation at the global level begins when an organization transfers a core competence in one or more of its functions to an overseas market to produce cheaper or improved products that will give the organization a low-cost or differentiation advantage over its competitors in that market. For example, Microsoft, with its competence in the production of technologically advanced software, takes this differentiation advantage and produces software tailored to the needs of consumers in different countries. As a result of the transfer of its core competences abroad, over 60% of Microsoft's revenue comes from overseas sales.

Establishing a Global Network

Generally, when an organization decides to transfer its competences abroad, it locates its value-creation activities in countries where economic, political, and cultural conditions are likely to enhance its low-cost or differentiation advantage. It then establishes a global network—sets of task and reporting relationships among managers, functions, and divisions that link an organization's value-creation activities around the world. To lower costs, an organization may locate its value-creation functions in the countries in which production costs—the costs of raw materials, unskilled or skilled labor, land, and taxes—are lowest. To lower costs, a video game company like Nintendo or Sony may perform its assembly operations in one country and its design operations in another, have its headquarters in a third country, and buy its inputs and raw materials from still other countries. To link these far-flung activities, the organization creates a global network.

Gaining Access to Global Resources and Skills

An organization with a global network has access to resources and skills throughout the world. Because each country has unique economic, political, and cultural conditions, different countries have different resources and skills that give them a competitive advantage. So, for example, a U.S. organization is likely to benefit from establishing itself in countries with low-cost or differentiation core competences so that it can gain access to and learn how to develop these competences. If organizations in one country have an R&D competence, it would pay a U.S. company to establish operations in that country to gain access to the competence. Japan, for example, still leads the world in lean manufacturing based on its efficient and high-quality production skills, and U.S. companies such as Xerox, Ford, and Caterpillar established operating divisions in Japan to learn these skills.

Using Global Learning to Enhance Core Competences

Organizations set up their global operating network to gain access to knowledge that will allow them to improve their core competences. The access to global resources and skills that a global network provides allows an organization to find new ways to improve its effectiveness. After an organization learns a new functional skill in one country, for example, it can transfer it to its domestic base to enhance its core competences. It can then transfer its enhanced competences to all of its overseas operations to increase its competitive advantage abroad. For example, after World War II, the founders of Toyota, Panasonic, and other Japanese companies came to the United States to learn American production and marketing methods, which they then took back to Japan. The engineers who founded Toyota studied GM's and Ford's production techniques and took what they had learned back to Japan, where they improved on it and adapted it to the Japanese environment. As a result, Japanese companies obtained a competitive advantage over U.S. companies.

Of course, certain dangers are associated with outsourcing important functional competences to companies abroad. First, a company risks losing control of its core skills and technology by sharing it with a partner company abroad; and if its partner then works to improve on these skills, it may become a strong competitor in the future. Second, and related, if a company outsources a functional activity, it will no longer be investing resources to improve its skills in that activity—so it is giving away a potential source of future competitive advantage. For these reasons, organizations need to consider carefully which skills and competences they should

nurture and protect and which they should allow other companies to perform for them to reduce their costs.

Four Levels of Strategy

An organization should match its strategy and structure so it can create value from its functional and organizational resources. But where is an organization's strategy created, and by whom? Strategy is formulated at four organizational levels—functional, business, corporate, and global—by the managers at each level. An organization's ability to create value at one level is an indication of its ability to manage the value-creation process at the other levels.

Functional-level strategy is a plan of action to strengthen an organization's functional and organizational resources, as well as its coordination abilities, to create core competences.⁷ 3M and HP, for example, invest heavily to improve their skills in R&D and product design, and P&G and Coca-Cola invest heavily to devise innovative approaches to marketing.

Functional-level strategy

A plan of action to strengthen an organization's functional and organizational resources, as well as its coordination abilities, in order to create core competences.

To strengthen their technical and human resources, functional managers train and develop subordinates to ensure the organization has skills that match or exceed the skills of its competitors. Another part of the functional managers' job is to scan and

manage the environment surrounding their particular function to ensure that they,

and managers at all levels, understand changes that may affect the way the organization operates.

R&D functional managers, for example, need to understand the techniques and products of their rivals. R&D functional managers at car companies routinely buy competitors' cars and strip them down to their component parts to study the technology and design that went into their manufacture. Taking this information, they can imitate the best aspects of competitors' products. It is also the job of R&D experts to scan other industries to find innovations that may help their company. Innovations in the computer software and microchip industries, for example, are important in product development in the car industry. If all of the functional managers in an organization monitor their respective functional environments and develop their functional resources and abilities, the organization will be better able to manage the uncertainty of its environment.⁸

Business-level strategy is a plan to use and combine an organization's functional core competences to position it so it has a competitive advantage in its domain or segment of its industry.⁹ Mercedes-Benz takes its skills in R&D and positions itself in the luxury segment of the car market where it competes with Lexus and BMW. Coca-Cola uses its marketing skills to defend its niche against PepsiCo—an ongoing battle.

Business-level strategy

A plan to combine functional core competences in order to position the organization so that it has a competitive advantage in its domain.

Business-level strategy is the responsibility of the top-management team (the CEO and vice presidents in charge of the various functions). Their job is to decide how to position the organization to compete for resources in its environment. CBS, NBC, and ABC, for example, compete with Fox, CNN, and HBO and hundreds of other TV channels to attract viewers (customers). Programming is the key variable that these companies can manipulate. They rely on functional experts in their news, documentary, comedy, and soap opera departments (among others) to scan the environment and identify future viewing trends so they can commission programs that will give them a competitive advantage. Because all of the TV networks are doing this and trying to outguess their rivals, programming is a complex and uncertain process.

Corporate-level strategy is a plan to use and develop core competences so the organization not only can protect and enlarge its existing domain but can also expand into new domains.¹⁰ Mercedes-Benz used its competences in R&D and product development to enter the household products and aerospace industries. Coca-Cola took its marketing skills and applied them globally in the soft-drinks industry.

Corporate-level strategy

A plan to use and develop core competences so that the organization can not only protect and enlarge its existing domain but can also expand into new domains.

Corporate-level strategy is the responsibility of corporate-level managers—the top-management team of a multibusiness organization. Their responsibility is to take the value-creation skills present in an organization’s divisions and combine them to improve the competitive position of each division and of the organization as a whole. Corporate strategists strive to find ways to merge and use the resources of every division to create more value than could be obtained if each division operated alone and independently. For example, Honda took its strengths in engine production developed first in its motorbike and car divisions and then applied them to produce high-quality engines for products such as jet skis, pressure washers, and lawn mowers.

Finally, **global expansion strategy** involves choosing the best strategy to expand into overseas markets to obtain scarce resources and develop core competences as discussed earlier. How does strategy at each level advance the goal of creating value? **Organizational Insight 8.1** describes how Samsung used these strategies to create value; then we discuss each level of strategy and its effects on organizational design in the remainder of this chapter.

Global expansion strategy

A plan that involves choosing the best strategy to expand into overseas markets to obtain scarce resources and develop core competences as discussed above.



Organizational Insight

8.1 Samsung's Success Is Based on Many Strategies

In the 2000s, Samsung Electronics, based in Seoul, Korea, became the second-most profitable global technology company after Microsoft.¹¹

Samsung accomplished this when its pioneering CEO Lee Kun Hee decided to develop and build functional competences first in low-cost manufacturing, second in R&D, and then into the production of new products to compete globally. Samsung competes principally in the global consumer electronics industry. In the 1990s, its engineers studied how the Japanese companies Sony and Panasonic innovated new products. Then, its engineers copied Japanese technology and used their manufacturing skills to make low-priced versions of the products that they could sell at lower prices than the Japanese.

Samsung then decided to use its new competences to enter and compete in the mobile phone industry and develop a business-level strategy to make lower-cost phones than global giants Nokia and Motorola, and by 2011 it was the second biggest global competitor in this market. Samsung also entered the semiconductor industry in which it worked to make the lowest-cost memory chips; here too it



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used its functional skills to become the global cost leader by pursuing a low-cost strategy. The company also entered other digital-product markets such as cameras, printers, and storage devices, where it has rapidly gained market share because of its functional- and business-level strategies.

At the level of corporate strategy, Samsung's goals were to increase its profitability by creating value by transferring its competences in product development and manufacturing by entering new industries and producing new products. Its strategy was successful and profitable, but it was not playing in the same league as Sony, for example. Sony could charge premium prices for its leading electronics and continuously plow back profits into the R&D needed to make more advanced state-of-the-art electronics.

CEO Hee decided to adopt new strategies that would allow his company to compete head-to-head with Japanese and European electronics companies

and make it a global technology leader. Samsung's goal was not to copy technology innovated by Sony, Matsushita, Phillips, and Nokia but for its engineers to develop the R&D skills necessary to rapidly innovate leading-edge technologies, such as LCD displays, to create products such as mobile computing devices more advanced than those of its competitors. Within a decade, Samsung became the leading supplier of advanced flash memory chips and LCD screens, premium-priced products that it sold to other global electronics makers, including Japanese flat-screen TV makers such as Sony!¹² By 2010 Samsung had also become second in the market to Apple in terms of sales of smartphones and tablet computers, and it has become one of the most innovative electronics makers in the world.

Functional-Level Strategy

The strategic goal of each function is to create a core competence that gives the organization a competitive advantage. Earlier, we noted how McDonald's production and marketing functions give the organization unique core competences. No competitor can match the efficiency of McDonald's production process, and no competitor has developed the brand-name reputation that McDonald's enjoys.

An organization creates value by applying its functional skills and knowledge to inputs and transforming them into outputs of finished goods and services. To gain a competitive advantage, an organization must be able to perform functional activities **(1)** at a *lower cost* than that of its rivals so it can charge *lower prices* for its good and services; or **(2)** in a way that allows it to *differentiate* its products from those of its rivals, by giving them unique qualities that customers desire, so it can charge higher or *premium* prices.¹³

Strategies to Lower Costs or Differentiate Products

Any function that can lower the cost at which a product is produced or can differentiate a product adds value to the product and to the organization.

Table 8.1 summarizes the ways in which different organizational functions can advance the goal of value creation.

The manufacturing function can lower the costs of production by pioneering the adoption of the most efficient production methods, such as computer-controlled flexible

Table 8.1 Low-Cost and Differentiation Advantages Resulting from Functional-Level Strategy

Value-Creating Function	Source of Low-Cost Advantage	Source of Differentiation Advantage
Manufacturing	<ul style="list-style-type: none"> • Development of skills in flexible manufacturing technology 	<ul style="list-style-type: none"> • Increase in product quality and reliability
Human resource management	<ul style="list-style-type: none"> • Reduction of turnover and absenteeism 	<ul style="list-style-type: none"> • Hiring of highly skilled personnel • Development of innovative training programs
Materials management	<ul style="list-style-type: none"> • Use of just-in-time inventory system/ computerized warehousing • Development of long-term relationships with suppliers and customers 	<ul style="list-style-type: none"> • Use of company reputation and long-term relationships with suppliers and customers to provide high-quality inputs and efficient distribution and disposal of outputs
Sales and marketing	<ul style="list-style-type: none"> • Increased demand and lower production costs 	<ul style="list-style-type: none"> • Targeting of customer groups • Tailoring products to customers
		<ul style="list-style-type: none"> • Promoting brand names
Research and development	<ul style="list-style-type: none"> • Improved efficiency of manufacturing technology 	<ul style="list-style-type: none"> • Creation of new products • Improvement of existing products

manufacturing systems. Because manufacturing skills and competence can improve product quality and reliability, manufacturing can also contribute to product differentiation.¹⁴ Toyota, for example, leads the world in lean manufacturing techniques, which both reduce production costs and increase quality by lowering the number of defects. Manufacturing thus gives Toyota vehicles a low-cost advantage and a differentiation advantage.

On the input side, the human resource management (HRM) function can lower costs by designing appropriate control and reward systems to increase employee motivation and reduce absenteeism and turnover.¹⁵ HRM can contribute to differentiation by selecting and hiring high-quality employees and managers and by running innovative training programs. The use of employee stock ownership plans, the linking of pay to performance for different job categories, and the development of flexible work hours are all ways in which the HRM function can advance the cause of value creation. Xerox, Google, Nvidia, and other companies have developed sophisticated HRM systems for selecting and training their employees.

The role of materials management on both the input and the output sides is also crucial. Just-in-time inventory systems and computerized warehousing reduce the costs of carrying and shipping inventory. Purchasing managers' skills in developing long-term links with suppliers and distributors and in fostering an organization's reputation can lead to a low-cost or differentiation advantage.¹⁶ Suppliers who trust an organization may offer more favorable payment terms or be more responsive to the organization when it needs more or different types of inputs in a hurry. The quality of a company–supplier relationship can also affect the quality of inputs. A supplier has more incentive to invest in specialized equipment to produce higher-quality inputs if it trusts the organization.¹⁷ Highly skilled purchasing negotiators may also be able to strike good contract terms with suppliers.

VF Company, the clothes manufacturer that makes Lee and Wrangler jeans, has developed a low-cost core competence on the output side of the value-creation

process. VF Company has a state-of-the-art inventory control system. A computer network links its manufacturing and distribution plants directly to its retail customers. When a Walmart customer buys a pair of VF jeans, for example, a record of the sale is transmitted electronically from Walmart to a VF warehouse, which restocks the retailer within five days. When a specified number of garments have been shipped from the VF warehouse, a reorder is automatically placed with the manufacturing plant. This system allows the VF organization to maintain a 95% in-stock rate (the industry average is 70%) and reduce lost sales for the retailer and manufacturer.

At the output end of the value-creation process, the expertise of sales and marketing contributes directly to a low-cost or differentiation advantage. A core competence in marketing can lower the cost of value-creation activities. Suppose a marketing department devises an online advertising campaign that significantly increases product sales and so the organization's market share steadily rises. When the organization expands production to meet increased customer demand, it will obtain manufacturing economies of scale and so production costs will fall. Panasonic and LG have a low-cost advantage because their marketing and sales efforts have developed global markets whose enormous size enables the companies to produce huge volumes of a product at lower and lower unit costs.

Marketing and sales help differentiate products because they tell customers about why one company's products are better than another's. They target customer groups and discover, analyze, and transmit to the product development and R&D departments the needs of customers so those functions can design new products to attract more customers.¹⁸ A core competence in marketing can allow an organization quickly to discover and respond to customer needs. This speed gives the organization's products a differentiated appeal. Coca-Cola, Philip Morris, and Campbell's Soup are all known for innovative marketing that constantly promotes their brand names and protects their domains from competitors.

Research and development can also contribute significantly to an organization's value-creation activities.¹⁹ R&D can reduce costs by developing cheaper ways of making a product. Skills in R&D have allowed Japanese companies to develop low-cost, flexible manufacturing

techniques that Xerox, HP, and other U.S. manufacturers are copying. A core competence in R&D that results in the improvement of existing products or the creation of new products gives an organization a strong competitive advantage through differentiation. Intel's creation of faster and improved microchips is an example of incremental product improvement. Graphics chip technology developed by Nvidia and AMD is leading to ever more advanced graphics, gaming, video, and 3D movie capabilities on new generations of mobile computing devices. All makers of smartphones, laptops, tablets, and game consoles, and so on, rush to modify their products to use the new state-of-the-art chip; otherwise, they fear, their products are likely to lose their differentiated appeal.

Functional-Level Strategy and Structure

Every function in an organization can develop a core competence that allows an organization to perform value-creation activities at a cost lower than its rivals or that allows it to create clearly differentiated products, such as Google's. One goal of an organization is to provide its functions with the resources and the setting they need to develop superior skills and expertise. Thus organizational structure and culture are very important to the development of functional-level strategy. We first consider structure.

The strength of a function's core competence depends not only on its skills and resources, but also on its ability to coordinate the use of its resources. An organization's coordination abilities are, in turn, a product of its structure.²⁰ In **Chapter 4**, we discussed Lawrence and Lorsch's findings about how the degree of functional differentiation in the production, sales, and R&D departments within an organization, and the extent of integration among them directly affect organizational performance. In effective organizations, each of the three departments develops an orientation specific to its functional tasks and develops its own ways of responding to its particular functional environment.

According to contingency theory, an organization's design should permit each function to develop a structure that suits its human and technical resources. We continue to follow the contingency theory approach as we examine how to design a structure that allows the R&D, manufacturing, and sales functions to develop core competences.²¹ **Figure 8.3** summarizes the characteristics of structures that support the development of core competences by those three functions.

Successful innovation depends on the ability of R&D experts to apply their skills and knowledge in creative ways and to combine their activities with new technologies to produce superior differentiated products. The structure most conducive to the development of functional abilities in R&D is a flat decentralized structure in which

mutual adjustment among teams is the main way of coordinating human and technical resources. This is the kind of setting that Google has developed. In such an organic structure, functional norms and values based on self-control and team control are likely to emerge, and a core competence in R&D is likely to emerge and strengthen over time.

What sort of structure supports the development of a core competence in production? Traditionally, the manufacturing function has used a tall hierarchy in which decision making is centralized and the speed of the production line controls the pace of work.²² Standardization is achieved through the use of extensive rules and procedures, and the result of these design choices is a mechanistic structure. Has such a structure led to a core competence in manufacturing for U.S. companies? If we compare U.S. and Japanese manufacturing companies' competences today, we see that U.S. companies still lag behind, although they have made major advances in the last decade. What do the Japanese do differently? The manufacturing function in Japanese companies has always had a more organic structure than the manufacturing function in U.S. companies: It is flatter, more decentralized, and relies more on mutual adjustment.

A core competence based on coordination abilities in sales is another important source of competitive advantage that should be planned for in an organization's strategy. Typically, the sales function uses a flat, decentralized structure to coordinate its activities because incentive pay systems, rather than direct supervision by managers, are the primary control mechanism in sales settings.²³ Salespeople are generally paid on the basis of how much they sell, and information about customer needs and changing customer requirements is relayed

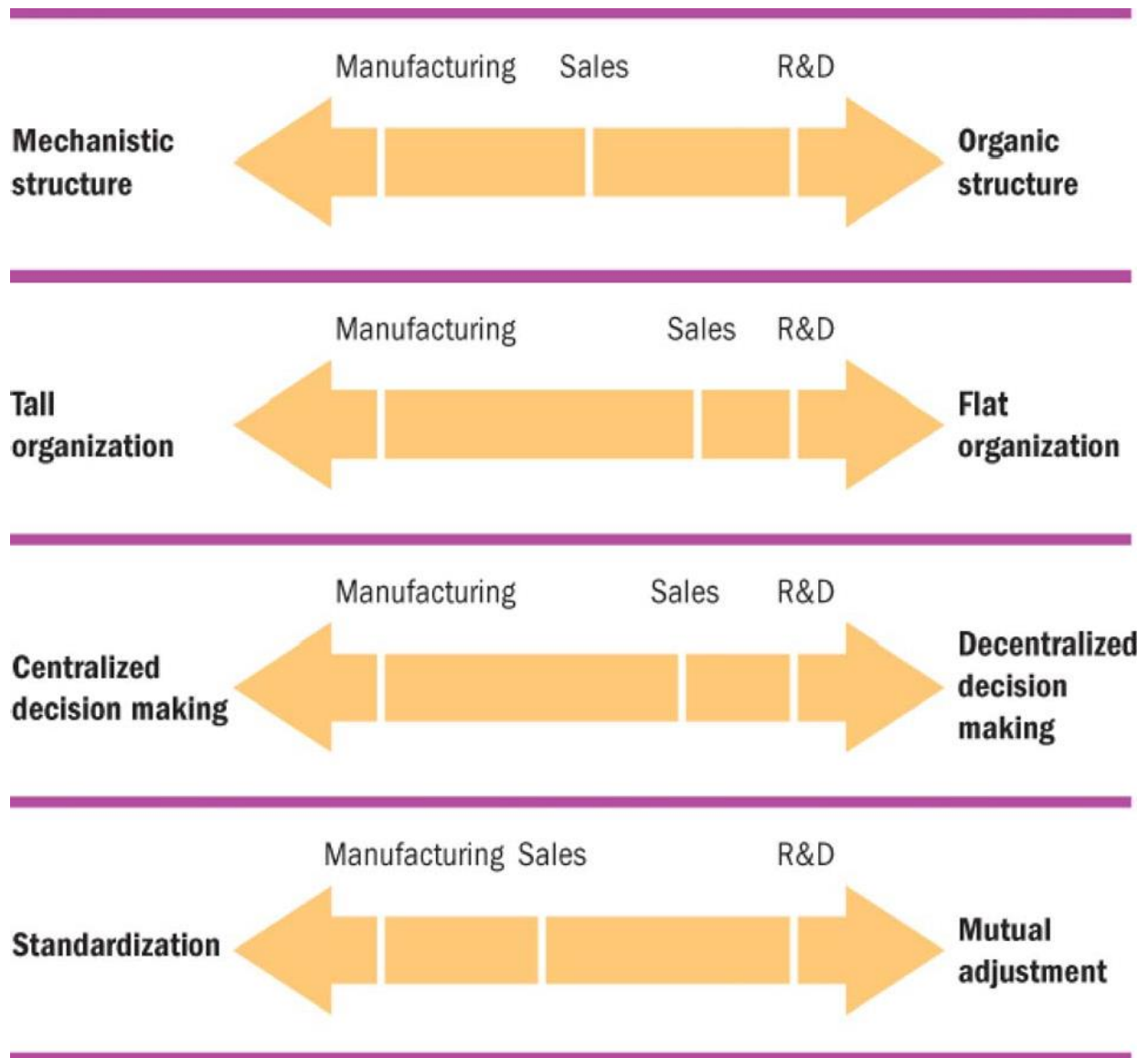


Figure 8.3 Structural Characteristics Associated with the Development of Core Competences in Production, Sales, and Research and Development

to the salespeople's superiors through a standardized reporting system. Because salespeople often work alone, mutual adjustment is relatively unimportant. Thus the structure of the sales function is likely to be relatively mechanistic, compared to that used by the R&D function, but not as mechanistic as that used by manufacturing.

In some sales settings, however, a differentiated appeal to customers is necessary. Luxury department stores such as Nordstrom and Neiman Marcus do not use incentive compensation. In such settings, the last thing the organization wants to do is encourage a standardized hard sell to customers. Instead, it wants salespeople to develop competence in a sales technique based on a courteous, personalized, customer-oriented approach.

The same strategic considerations shape the structure of other organizational functions—accounting, human resources, materials management, and so on. The coordination abilities of each function reflect the skill with which managers design the functional structure to suit the resources the function uses in its value-creation activities. The greater the organization's skills at coordinating functional resources, the stronger are the core competences the organization develops and the greater is its competitive advantage.

Functional-Level Strategy and Culture

The development of functional abilities that lead to core competences is also a result of the culture that emerges in a function or department. Recall from **Chapter 7** that organizational culture is a set of shared values that organizational members use when they interact with one another and with other stakeholders. What is the importance of culture for a functional-level strategy? A competitor can easily imitate another organization's structure, but it is very difficult for a competitor to imitate another organization's culture, for culture is embedded in the day-to-day interactions of functional personnel. Culture is very difficult to control and manage, let alone imitate or copy, so a company that has an effective culture has an important source of competitive advantage.²⁴



Managerial Implications Functional- Level Strategy

1. As a member or manager of a function, identify the functional resources or coordination abilities that give your function a core competence. Having identified the sources of your function's core competence, establish a plan to improve or strengthen them, and create a set of goals to measure your progress.
2. Study your competitors and the methods and practices they use to control their functional activities. Pick your most effective competitor, study its methods, and use them as a benchmark for what you wish to achieve in your function.
3. Analyze the way your functional structure and culture affect functional resources and abilities. Experiment to see whether changing a component of structure or culture can enhance your function's core competence.

The reason is that the coordination abilities that stem from an organization's culture emerge gradually and are a product of many factors: an organization's property rights system, its structure, its ethics, and the characteristics of its top-management

team. Because these factors can be combined in many different ways, reproducing another organization's culture is difficult.

To develop functional abilities and produce a core competence, it is necessary to choose the property rights, functional structure, and functional managers that seem most likely to enhance a function's coordination ability. We just saw that R&D uses a flat, decentralized structure and small teams to create norms and values that emphasize teamwork and cooperation. There are other ways in which an organization can build a culture to reinforce those norms and values. Employees can be given strong property rights, including job tenure and a share in the organizational profits; and an organization can recruit people who share its terminal values and socialize them to its functional instrumental values.²⁵ Apple and Google deliberately create an entrepreneurial culture by using small teams to socialize IT specialists to their instrumental values of hard work and cooperation; the same is true in biotech companies like Amgen and Genentech.

In sum, to create value at the functional level, the organizational strategy must allow and encourage each function to develop a core competence in lowering costs or differentiating its products from those of competitors. The sources of core competences lie in the resources an organization embeds in each function, and in the abilities of functional experts to take advantage of and coordinate those resources. To gain a competitive advantage, an organization needs to design its functional structure and culture to provide a setting in which core competences develop. The more a function's core competence is based on coordination abilities embedded in the way people in the organization interact, the more difficult it is for competing organizations to duplicate the core competence and the greater is the organization's competitive advantage.

Business-Level Strategy

The challenge of a business-level strategy is for an organization to take the core competences created by its functions and combine them to take advantage of opportunities in the environment to create value. Strategic managers at the business level select and manage the domain in which the organization uses its value-creation resources and coordination abilities to obtain a competitive advantage.²⁶ For example, core competences in three functions—production, marketing, and materials management—jointly give McDonald’s a competitive advantage over rivals such as Burger King and

Wendy’s. Obtaining a competitive advantage is important because, as we noted in **Chapter 3**, organizations in the same environment (e.g., fast food) are in competition for scarce resources—customers. Any organization that fails to devise a business-level strategy to attract customers is at a disadvantage vis-à-vis its rivals and in the long run is likely to fail. Thus the organization needs a business-level strategy that does both of the following: (1) selects the domain the organization will compete in and (2) positions the organization so it can use its resources and abilities to manage its specific and general environments in order to protect and enlarge that domain.

Strategies to Lower Costs or Differentiate Products

We have seen that the two basic ways in which an organization can create value are by reducing the cost of its value-creation activities and by performing those activities in a way that gives its products a differentiated appeal. Business-level strategy focuses on selecting the domain in which an organization can take advantage of its functional-level core competences. In the 2000s, for example, Chipotle has successfully chosen its domain—making high-quality customized burritos—and designed its materials management system to give it access to organic food products that it efficiently transforms in its restaurants into high-quality fast food. Its stock has soared in value because customers enjoy the way its resources create a tasty product they value.

Recall from **Chapter 3** that the organizational domain is the range of goods and services that the organization produces to attract customers and other stakeholders. Once an organization has chosen its domain, it has two bases on which it can position itself to compete with its rivals. It can use its skills in low-cost value creation to produce for a customer group that wants low-priced goods and services. This plan is called a **low-cost business-level strategy**. Or it can use its skills at differentiation to produce for a customer group that wants and can afford differentiated products that command a high or premium price. This plan is called a **differentiation business-level strategy**.²⁷ Walmart and Target, for example, specialize in selling low-price clothing to customers who want or can afford to pay only a modest amount for their attire. Neiman Marcus and Saks Fifth Avenue specialize in selling high-priced clothing made by exclusive designers to wealthy customers who want prestige or status.

Low-cost business-level strategy

A plan whereby an organization produces low-priced goods and services for all customer groups.

Differentiation business-level strategy

A plan whereby an organization produces high-priced, quality products aimed at particular market segments.

Both Walmart and Neiman Marcus are in the retail clothing industry but have chosen different domains in which to compete. They have decided to sell different products to different groups of customers. In essence, Neiman Marcus and Saks have chosen a business-level strategy based on core competences in differentiation in order to charge a premium price, and Walmart and Target have chosen a business-level strategy based on core competences in low-cost value-creation activities in order to charge a low price.

To compete successfully, an organization must develop a low-cost or differentiation strategy to protect and enlarge its domain. An organization can also attempt to pursue both strategies *simultaneously* and produce differentiated products at low cost.²⁸ Doing so is extremely difficult and requires an exceptionally strong set of core competences. McDonald's is an organization that has successfully pursued both strategies simultaneously. McDonald's has developed a unique brand-name reputation by means of sophisticated marketing and has developed low-cost skills in

its manufacturing and distribution functions. Moreover, McDonald's has used many of the interorganizational strategies discussed in [Chapter 3](#) to pursue both strategies simultaneously. It has formed strategic alliances with suppliers and obtains bread, rolls, and restaurant fittings (tables, chairs, lights, and so on) from companies with which it has long-term contracts or in which it has a minority ownership interest. McDonald's uses franchising to maintain the reliability and efficiency of its retail outlets and owns many of the sources of its inputs, such as vast ranches in Brazil on which it raises large herds of cattle.

Over time, an organization has to change its business-level strategy to match changes in its environment. New technological developments, foreign competitors, and changes in customer needs and tastes may all affect the way an organization tries to compete for resources.

[Focus on New Information Technology: Amazon.com, Part 5](#) describes how changes in IT affected the company's choice of business-level strategy.



Focus on New Information Technology

Amazon.com, Part 5

Before the advent of online bookstores, competition among bookstores was limited at best. The market was essentially divided between two kinds of competitors: (1) large bookstore chains such as Barnes & Noble and Borders whose stores, often located in malls or large shopping strips, offered customers the latest lines of best-selling books and (2) independent bookstores, both those that are large and offer a huge selection of books to customers in major cities, and the small specialized bookstores found in most cities in the United States. The large bookstore chains used their huge purchasing power to negotiate low prices with book publishers, and they pursued a low-cost strategy, often offering price discounts. Bookstores that offered a large selection of books (compared to the chains) or that specialized in some way pursued a differentiation strategy. Thus the different kinds of bookstores were not in competition, and all were able to make comfortable profits.

Jeff Bezos's idea of using the Internet to sell books online made it possible to develop a *simultaneous* low-cost and differentiation strategy and thus outperform existing bookstore competitors. First, on the differentiation side, the ability of a computerized online catalog to both describe and make available to customers every book in the English language offered customers a selection that could not be rivaled even by the largest bookstores in cities like New York and San Francisco. Second, on the low-cost side, his use of IT technology to interface inexpensively with book publishers, distributors, and customers allowed him to offer these customers books at discounted prices, and to get them quickly to customers as well.

Small wonder, then, that this new low-cost/differentiation strategy gave Amazon.com a competitive advantage over its rivals. Many small and large stand-alone bookstores have exited the market; the large chains responded by opening up book superstores and by going online themselves. However, they have not repeated Amazon.com's success story; in fact, bookstore chain Borders went bankrupt in 2011 and Barnes & Noble was in big trouble. Why? Amazon.com has over 125 million customers in its database and over 65% of its business is from repeat customers.²⁹ In the 2010s its share price has once again soared to record highs because investors believe it has the core competences and business-level strategy that will continue to make it the online place to shop in the years ahead.

As Amazon.com's strategy suggests, organizations have to defend, protect, and continuously improve the sources of their competitive advantage if they are to control their environment successfully in the long run. Industry leaders such as Amazon, Google, Toyota, and McDonald's have so far sustained their competitive advantage by maintaining, improving, or rebuilding their functional-level resources and abilities. Amazon, for example, constantly updates its IT, such as its moves into eBooks using its Kindle reader, streaming video, and, most recently the remote storage of customers' library of music and videos on its cloud computing servers that allows them to access their library anywhere using any kind of electronic device. McDonald's was forced to find new ways to differentiate its fast-food offerings to compete against sandwich chains, salad bars, and coffee shops and has enjoyed remarkable success because it can offer customers similar kinds of products at a much lower cost.

Focus Strategy

Another business-level strategy is the focus strategy—specializing in one segment of a market and focusing all of the organization’s resources on that segment.³⁰ KFC specializes in the chicken segment of the fast-food market; Tiffany specializes in the high-price luxury segment of the jewelry market; Rolls-Royce focuses on the highest price segment of the car market—a customized Rolls-Royce Phantom convertible costs over \$500,000.

Business-Level Strategy and Structure

The value that an organization creates at the business level depends on its ability to use its core competences to gain a competitive advantage. This ability is a product of the way the organization designs its structure.³¹ An organization pursuing a differentiation business-level strategy generally confronts design choices different from those faced by organizations pursuing a low-cost strategy. **Figure 8.4** summarizes the differences.

The competitive strengths of an organization with a differentiation strategy come from functional skills that give the organization's products unique or state-of-the-art features that distinguish them from the products of competitors. An organization pursuing a differentiation strategy has to be able to develop products quickly because only if it gets its products to customers ahead of its competitors can it exploit its differentiation

Strategy	Number of Market Segments Served	
	Many	Few
Low cost	●	
Focused low cost		●
Differentiation	●	
Focused differentiation		●

Figure 8.4 Types of Business-Level Strategy

advantage. Close cooperation between functions is likely to be required to bring new products to market quickly. For example, R&D, marketing, manufacturing, and product development must be able to communicate easily and adjust their activities to one another smoothly to speed the development process. All these factors make it likely that an organization pursuing a differentiation strategy has an organic structure. An organic structure permits the development of a decentralized, cross-functional team approach to decision making, which is the key to speedy new product development.

A low-cost strategy is associated with the need for close control of functional activities to monitor and lower the costs of product development.³² Manufacturing and materials management become the central functions for an organization pursuing a low-cost strategy. The other functions (R&D, marketing, and so on) tailor their skills to achieve the goal of producing a low-cost product. A speedy response to market changes is not vital to the competitive success of a low-cost organization. Often, because product development is so expensive, such an organization waits to develop a new or improved product until customers clearly demand it. The low-cost organization generally imitates the differentiator's product and always remains one step behind to keep costs low. Consequently, a mechanistic structure is often the most appropriate choice for an organization pursuing a low-cost strategy (see **Figure 8.5**). Centralized decision making allows the organization to

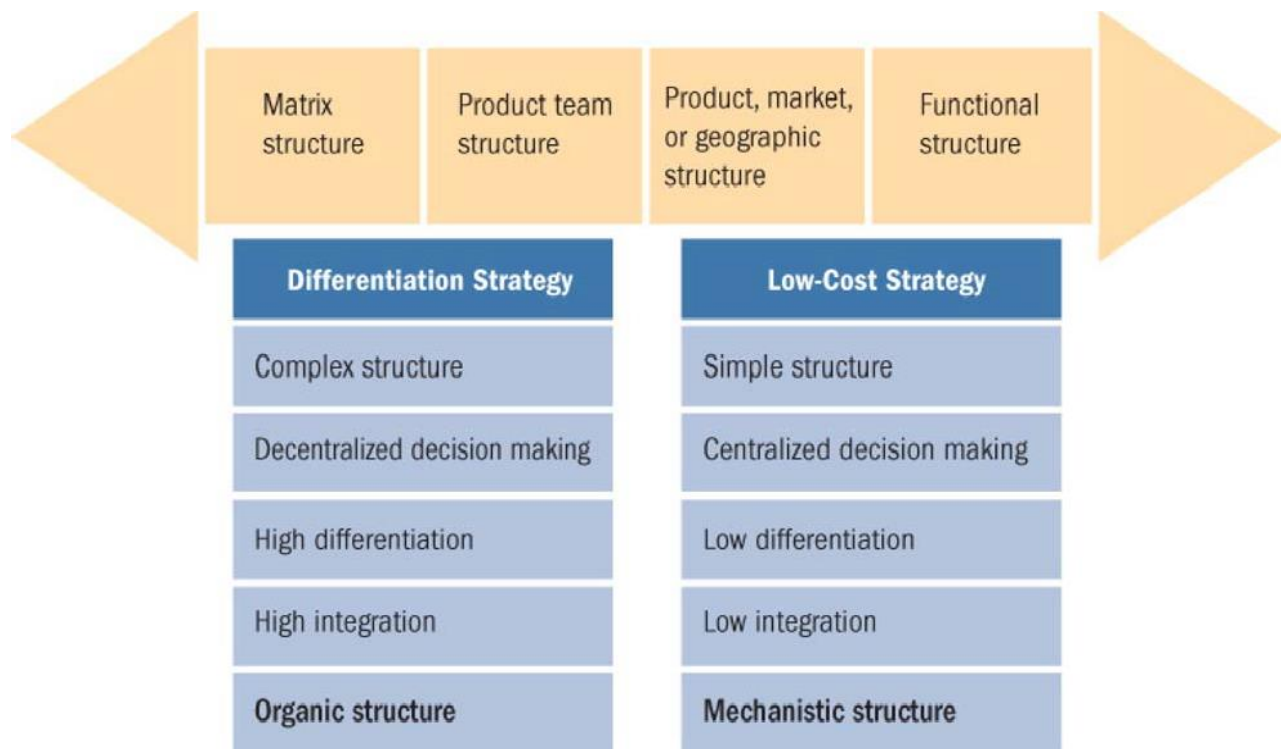


Figure 8.5 Characteristics of Organizational Structure Associated with Business-Level Differentiation and Low-Cost Strategies

maintain close control over functional activities and thus over costs. Also, because there is no pressing need to respond quickly or innovatively, a mechanistic structure provides sufficient coordination to meet the demands of the competitive domain.

Further evidence for the match between differentiation strategy and organic structure, and the match between low-cost strategy and mechanistic structure, comes from contingency theory. Recall from [Chapter 4](#) that contingency theory suggests that organizations in uncertain, rapidly changing environments require a greater degree of differentiation and integration than do organizations in more stable environments.³³ Because differentiators generally compete in a complex, uncertain environment where they need to react quickly to rivals' actions, and

because low-cost companies usually compete in slow-moving environments, contingency theory suggests that effective differentiators will have greater differentiation and integration than low-cost companies have. Given that organizational structures with extensive differentiation and integration are costly to operate, contingency theory implies that low-cost companies should use the simplest structure possible because it will help to keep down the cost of value creation.³⁴

In addition to examining the relationship between business-level strategy and organic and mechanistic structures, we can look at the relationship between strategy and the types of organizational structure discussed in **Chapter 6** : functional, divisional, and matrix structures. From a strategy perspective, three factors affect an organization's choice of a structure to create a competitive advantage for itself:

1. As an organization produces a wider range of products, it will need greater control over the development, marketing, and production of these products.
2. As an organization seeks to find new customer groups for its products, it will need a structure that allows it to serve the needs of its customers.
3. As the pace of new product development in an industry increases, an organization will need a structure that increases coordination among its functions.

Organizations following a low-cost strategy typically focus on producing one product or a few products to reduce costs. BIC Corporation, for example, produces only a few disposable razors for both men and women. A low-cost company does not face the problems of dealing with a wide range of products or with many customer groups. Moreover, low-cost companies are not leaders in product development. Because they are imitators, they do not have the problems of coordinating the activities of different functional groups. For all these reasons, low-cost companies generally adopt the simplest structure that is consistent with their strategy. Normally, a functional structure (one in which people are grouped by common skills

or use of similar resources) is sufficient to coordinate the core competences of a low-cost organization.

By contrast, differentiators typically produce a wide range of products to suit the needs of different groups of customers. Also, to the degree that competition between differentiators is based on the development of new and innovative products (a situation found in the car and personal computer industries), differentiators need a structure that allows functional experts to cooperate so they can quickly develop and introduce new products. For these reasons, differentiators are likely to adopt a more complex structure. If the pressing need is to handle a wide range of products, a product structure (in which products are grouped into separate divisions served by the same set of support functions) is the appropriate choice. If handling different groups of customers is the key to success, a market structure or a geographic structure (in which functional activities are grouped to best meet the needs of different types of customers) will best fit the differentiator's needs. A product team structure or a matrix structure (in which product development is coordinated by teams of cross-functional specialists) can be adopted when rapid product development and speedy response to competitors are the keys to competitive advantage.

All of those structures can provide an organization with the ability to coordinate functional and organizational resources to create a core competence. Intel, the microchip maker, has decided that the only way to maintain its lead in the industry is to produce several generations of microchips at the same time. So it has established a product team structure in which teams of research and development specialists work side by side to plan the chips of the future.³⁵

To summarize, an organization must match its business-level strategy to the organizational structure that allows the organization to use its functional and organizational resources to create a competitive advantage. A top-quality R&D department is useless unless an organization has a structure that coordinates R&D activities with a marketing department that can correctly forecast changes in customer needs and a product development department that can translate research and marketing findings into commercial products. Choosing the right structure has major payoffs for an organization by helping create a low-cost or differentiation advantage at the business level. As Organizational Insight 8.2 discusses, organizations sometimes lose control over their structures, and then they have to reorganize in radical ways to regain their competitive advantage.

Business-Level Strategy and Culture

Organizational culture is another major determinant of the ability to use functional and organizational resources effectively. The challenge at the business level is to develop organization-wide values, and specific norms and rules, all of which allow the organization to combine and use its functional resources to the best advantage. Over time, different functions may develop different subunit orientations, which impede communication and coordination. But if the various functions share values and norms, communication and coordination problems can be overcome. If managers in different functions can develop common ways of dealing with problems, an organization's competitive advantage will be enhanced.

How does the culture of a low-cost organization differ from that of a differentiator? Organizations pursuing a low-cost strategy must develop values of economy and frugality.³⁸ Frequently, specific norms and rules develop that reflect the organization's terminal and instrumental values. For example, when Ken Iverson was CEO of Nucor, a leading low-cost steel products maker, he operated the company in a frugal, careful way. Top managers at Nucor worked in small unpretentious corporate offices with few of the trappings of luxury. They drove their own cars to work, flew economy class, and on business trips shared rooms in hotels to reduce costs.

The functions within a low-cost organization are likely to develop goals that reflect the organization's values of economy. Marketing views its job as finding the most efficient ways of attracting customers. R&D sees its role as developing new products that offer the greatest potential return for the smallest investment of organizational resources.

In low-cost organizations, a common "language" and a code of behavior based on low-cost values develop. In a differentiator, by contrast, the need to be different from competitors and to develop innovative products puts product development or

marketing at center stage. Values that promote innovation and responsiveness to customers, stories of products that became winners or of winning products that were not developed, and boosting the status of employees who create new products all make organizational members aware of the need to be the first or the best.³⁹ Cultural values of innovation, quality, excellence, and uniqueness help a differentiator implement its chosen strategy, and they become a source of competitive strength.

An insight into the way culture can influence a company's business-level strategy occurred when, after considerable negotiations, pharmaceutical company American Home Products (AHP) announced it would buy Monsanto, another large pharmaceutical and chemical company, for \$33 billion. Analysts applauded the merger, believing it would provide important differentiation and low-cost advantages for the combined firm. Specifically, the merged companies would have a much broader product range, and the merger would eliminate expensive duplication of production facilities, leading to major cost savings.

Analysts were therefore shocked when the two companies later announced that the merger was off because it was not in the best interests of shareholders. Why? AHP has a culture characterized by a short-term focus on bottom-line profits. Its managers are cost conscious and only want to invest in products that have a short-term payoff. Monsanto, in contrast, has a long-term orientation. It is driven by a desire to produce innovative new products, many of which may not pay off except in the long run. Thus it has strong values



Organizational Insight

8.2 Why Companies Need to Change Their Global Structures and Strategies

After a decade of profitable growth, Avon suddenly began to experience falling global sales in the mid-2000s both at home and in developing markets abroad.³⁶ After several months visiting the managers of its worldwide divisions, Andrea Jung, Avon's CEO, decided that Avon had lost the balance between centralization and decentralization of authority; managers abroad had gained so much authority to control operations in their respective countries and world regions that they had made decisions to benefit their own divisions, and these decisions had hurt the performance of the whole company. Specifically, Avon's operating costs were out of control, and it was losing both a low-cost and a differentiation advantage. Avon's country-level managers from Poland to Mexico ran their own factories, made their own product development decisions, and developed their own advertising campaigns. And these decisions were often based on poor marketing knowledge and with little concern for operating costs because their goal was to increase sales as fast as possible.

Also, when too much authority is decentralized to managers lower in an organization's hierarchy, these managers often recruit more and more managers to help them build their country "empires." The result was that Avon's global hierarchy had exploded—it had risen from 7 levels to 15 levels of managers in a decade as tens of thousands of extra managers were hired around the globe! Because Avon's profits were rising fast, Jung and her top management team had not paid enough attention to the way

Avon's organizational structure was becoming taller and taller—and how this was taking away its competitive advantage.

In 2006, Jung woke up from this nightmare: She had to confront the need to lay off thousands of managers and restructure the hierarchy. She embarked on a program to take away the authority of Avon's country-level managers and to transfer authority to regional and corporate headquarters managers to streamline decision making and reduce costs. She cut out seven levels of management and laid off 25% of Avon's global managers in its 114 worldwide markets. Then, using teams of expert managers from corporate headquarters, she embarked on a detailed examination of all Avon's functional activities, country by country, to find out why its costs had risen so quickly and what could be done to bring them under control. The duplication of marketing efforts in countries around the world was one source of these high costs. In Mexico, one team found that country managers' desire to expand their empires led to the development of a staggering 13,000 different products! Not only had this caused product development costs to soar, it had led to major marketing problems, for how could Avon's Mexican sales reps learn about the differences among 13,000 products—and then find an easy way to tell customers about them?

In Avon's new structure the focus is now on centralizing all new major product development; Avon develops over 1,000 new products a year, but in the future although the input from different country managers would be used to customize products to country needs in terms of fragrance, packaging, and so on, R&D would be performed in the United States. Similarly, in the future the goal is to develop marketing campaigns targeted toward the average "global" customer but



Almond Chu © Dorling Kindersley

that can be easily customized to any country by using the appropriate language or changing the nationality of the models used to market the product, for example. Other initiatives have been to increase the money spent on global marketing, which had not kept pace with its rapid global expansion to increase differentiation and a major push to increase the number of Avon ladies in developing nations to attract more customers. By 2011, Avon recruited another 400,000 reps in China alone!³⁷

Country-level managers now are responsible for managing this army of Avon reps and for ensuring that marketing dollars are being directed toward the right channels for maximum impact. However, they no longer have any authority to engage in major product development or build new manufacturing capacity—or to hire new managers without the agreement of regional- or corporate-level managers. The balance of control has changed at Avon, and Jung and all her managers are now firmly focused on making operational decisions that lower its costs or increase its differentiation advantage in ways that serve the best interests of the whole company—and not just the country in which its cosmetics are sold.



Managerial Implications Business-Level Strategy

1. Managers in each function should understand their function's contribution to the organization's low-cost advantage or differentiated appeal. Members of a function should examine their interactions with members of other functions to see if they can devise new ways of reducing costs or develop a differentiated appeal.
2. Managers should act like entrepreneurs and always be on the lookout for new opportunities to protect and enlarge the domain of their organization. They must continually experiment to see whether they can enlarge the existing organizational domain, find new uses for existing products, or develop new products to satisfy customer needs.
3. Managers must always evaluate whether the current organizational structure and culture are congruent with the organization's business-level strategy. If they are not, managers should move quickly to make changes that can improve their competitive position.

of innovation and excellence. Managers at these companies came to realize it was impossible to harmonize these different cultures and driving values. They foresaw that potential low cost and differentiation advantages might be wiped out by politics and infighting between managers of these two companies. It was just not worth the risk to go ahead with the merger.

An organizational culture that promotes norms and rules that increase effectiveness can be a major source of competitive advantage. In [Chapter 7](#) , we saw how organizations deliberately shape their culture to achieve their goals. Google and 3M, for example, promote innovation by establishing norms and rules that enable employees to move to positions where their talents are most valuable to the organization.

Recall, too, that organizational structures are chosen because of their effect on culture. Organic structures foster the development of cultural values of innovation and quality. In contrast, mechanistic structures foster economical values that focus attention on improving existing rules and SOPs, not finding new ones. Low-cost companies that seek to develop Japanese-style lean production systems will find a mechanistic structure useful because it focuses all efforts on improving existing work procedures.

In sum, organizational culture is another important factor shaping an organization's business-level strategy for improving its value-creation skills. As technology changes, as new products and markets come into being, and as the environment changes, an organization's culture likewise will change. Like organizational structure, the way in which organizational culture supports an organization's strategy for value creation can also be a source of competitive advantage. That is one reason why managers are increasingly trying to develop a strong global company culture to increase organizational effectiveness.

Corporate-Level Strategy

An organization that cannot create more value in its current domain often tries to find a new domain in which to compete for resources. Corporate-level strategy involves a search for new domains in which to exploit and defend an organization's ability to create value from the use of its low-cost or differentiation core competences.⁴⁰ Corporate-level strategy is a continuation of business-level strategy because the organization takes its existing core competences and applies them in new domains. If an organization takes marketing skills developed in one domain and applies them in a new domain, for example, it can create value in that new domain. When Philip Morris took marketing skills developed in the tobacco industry, applied them to Miller Brewing, and made Miller Lite the market leader, it created value for Miller's customers and for Philip Morris's shareholders. Now

we look in detail at how vertical integration and diversification, two important corporate-level strategies, can help an organization create value.

Vertical Integration

An organization pursuing a strategy of **vertical integration** decides that it will establish—or take over and buy—operations to make some of its own inputs and become its own supplier (backward vertical integration) or dispose of or distribute its own outputs (forward vertical integration).⁴¹ By doing so it now controls the production of some of its inputs or the disposal of its outputs (see **Figure 8.6**). As an illustration, **Figure 8.7** shows a soft-drink company that enters new domains that overlap its core domain so it can use, enhance, or protect its low-cost or differentiation value-creation skills.

Vertical integration

A strategy in which an organization takes over and owns its suppliers (backward vertical integration) or its distributors (forward vertical integration).

How does vertical integration allow an organization to use or enhance its core competences in value creation? An organization that supplies its own inputs and/or disposes of its own outputs may be able to keep for itself the profits previously earned by its independent suppliers and distributors. Moreover, production cost savings often arise when an organization owns its suppliers because, for example, inputs can now be designed so they can be assembled at a lower cost. Also, because it now controls the

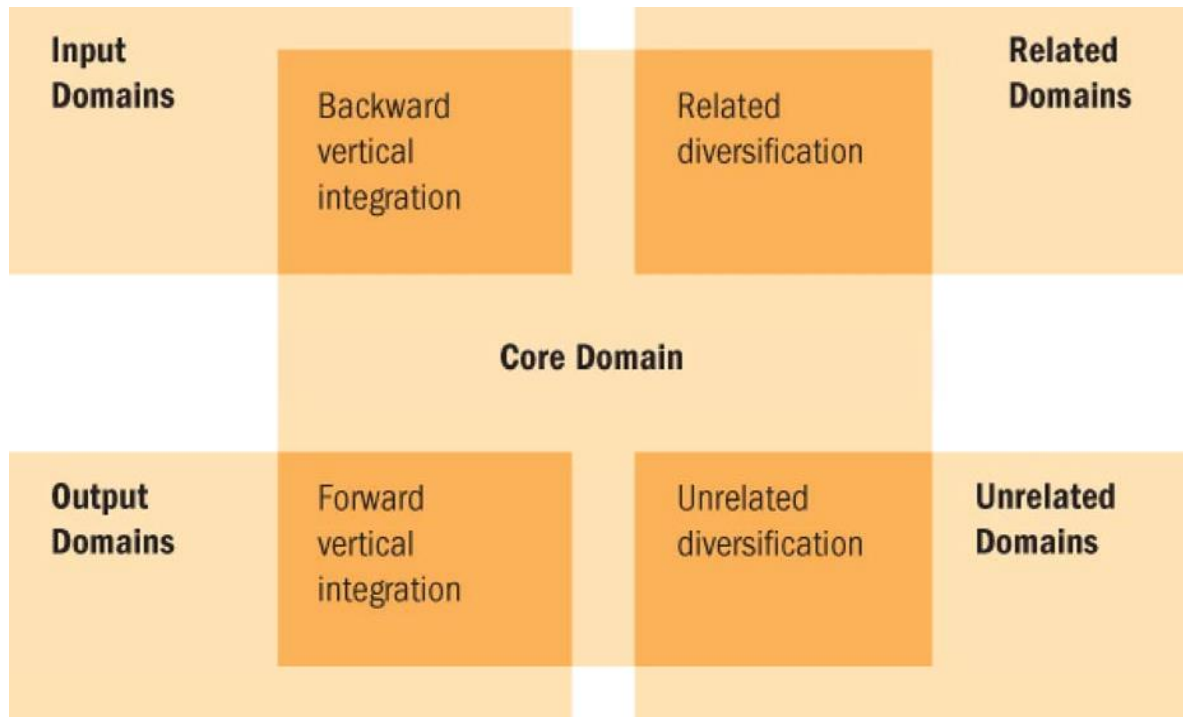


Figure 8.6 Corporate-Level Strategies for Entering New Domains

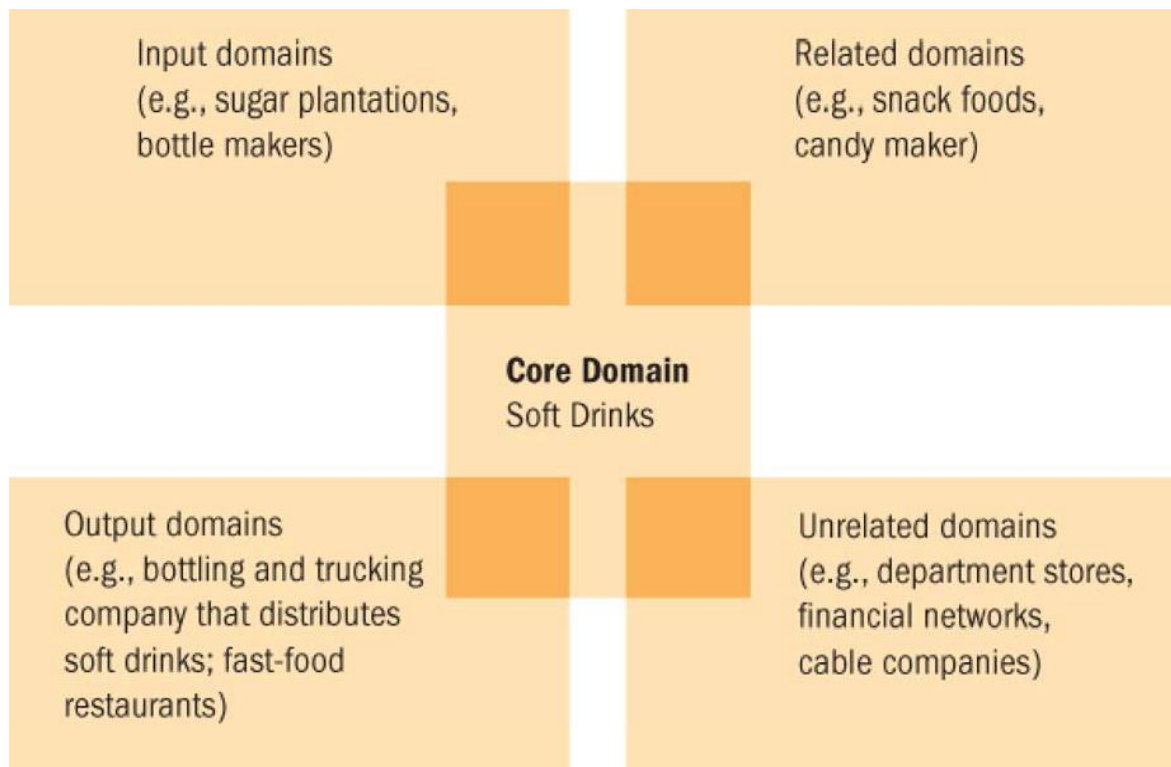


Figure 8.7 Soft-Drink Company's Corporate-Level Strategies for Entering New Domains

reliability and quality of inputs, this can save an organization a great deal of money if products eventually have to be repaired under guarantee.

An organization can call attention to its uniqueness by making its products different from those of its rivals. One way to do this is by making the inputs that make a product unique, that is, by using forward vertical integration. Coca-Cola, for example, has sole control over how the Coke formula is made, so Coca-Cola tastes like no other cola drink. Controlling inputs also helps the organization control quality, which confers uniqueness on a product. Rolls-Royce carefully tends the flocks of sheep from which it obtains the leather for its car upholstery: The sheep are kept in enclosures without barbed wire and are protected so the leather has no flaws and blemishes. Finally, taking over a supplier by vertical integration avoids problems that result when there are only a few suppliers in an industry who may try to take advantage of an organization by, for example, raising the prices of inputs or reducing their quality. Using backward vertical integration to control the way a product is distributed can also result in a low-cost or differentiation advantage. Radio Shack, for example, makes most of its own store brand products so it receives all the profit from both making and selling Radio Shack electronic merchandise—often at high prices.

Control of overlapping input and output domains enhances an organization's competitive advantage in its core domain and creates new opportunities for value creation. But an organization also needs to look at the bureaucratic costs associated with owning its suppliers and distributors.⁴² An organization needs to evaluate whether minority ownership, strategic alliances, and other interorganizational strategies are viable alternatives to vertical integration.⁴³ The value-creation advantages of vertical integration can often be obtained by creating

strategic alliances with independent suppliers and distributors, and by doing so an organization avoids the bureaucratic costs associated with owning its suppliers or distributors. The more an organization pursues vertical integration the larger it becomes, and the bureaucratic costs associated with managing the strategy rise sharply because of communication and coordination problems and the simple fact that managers are expensive to employ. Too much vertical integration can be a strategic mistake. Thus managers must be careful to make design choices about organizational structure and culture that will enhance and support such a strategy.

Related Diversification

The strategy of **related diversification** involves an organization entering a *new* domain in which it can use one or more of its existing core competences to create a low-cost or differentiated competitive advantage in that new domain. When Honda entered the small-car and lawn-mower markets, for example, it entered new domains in which it could use its strong functional competences in engine design and manufacture that it had developed in its core domains, motorbikes and cars, to achieve a differentiation advantage.

Related diversification

The entry into a new domain that is related in some way to an organization's domain.

Unrelated Diversification

Whenever an organization enters a new domain to take advantage of an opportunity to use any of its core competences in a way that can lower costs or create uniqueness, it creates value through related diversification. When a company pursues unrelated diversification, it enters new domains that have nothing in common with its core domain. The value created by **unrelated diversification** comes from taking advantage of one specific core competence: a top-management team's ability to operate a set of organizations in concert more effectively than if each of the organizations were controlled by separate top-management teams.⁴⁴

Unrelated diversification

The entry into a new domain that is not related in any way to an organization's core domain.

Suppose a retail organization's top-management team has developed unique skills in economizing on bureaucratic costs by designing and managing organizational structure. If the team sees an organization in some new domain—for example, fast food—that is being managed inefficiently and is not making the best use of its resources, team members may see an opportunity for their organization to expand into this new domain and create value there. If the top-management team takes over the inefficient organization, restructures its operations, reduces bureaucratic costs, and increases its profitability, it has created value that did not previously exist in the fast-food organization.

An organization that takes over inefficient companies and restructures them to create value is pursuing a strategy of unrelated diversification. For example, companies like GE and United Technologies seek out underperforming companies and restructure them; they sell off unprofitable divisions and only keep those that can be reorganized to operate profitably. Indeed, designing an efficient organizational structure is an important part of unrelated diversification because companies that perform poorly often do so because they have high bureaucratic costs.

Corporate-Level Strategy and Structure

The appropriate organizational structure must be chosen at the corporate level to realize the value associated with vertical integration and related and unrelated diversification. In general, as we discussed in [Chapter 6](#) , for organizations operating in more than one domain, a multidivisional structure is the appropriate choice (see [Figure 6.6](#)). The use of self-contained operating divisions supported by a corporate headquarters staff provides the control the organization needs to coordinate resource transfers between divisions so core competences can be shared across the organization. There are a few variants of the multidivisional structure. Each is suited to realizing the benefits associated with either unrelated or related diversification.

Conglomerate Structure and Unrelated Diversification

Organizations that pursue a strategy of unrelated diversification attempt to create value by acquiring underperforming businesses, restructuring them, and then managing them more efficiently. This strategy frees corporate managers, the top management team of the parent organization, from day-to-day involvement in the running of its various divisions, that is, the companies the organization owns. After the restructuring, corporate management's only role is to monitor each division's performance and intervene to take selective action when necessary. Organizations with a strategy of unrelated diversification are likely to use a conglomerate structure.

Conglomerate structure

A structure in which each business is placed in a self-contained division and there is no contact between divisions.

As **Figure 8.8** shows, in a **conglomerate structure**, each unrelated business is a self-contained division. Because there is no need to coordinate activities between divisions, only a small corporate headquarters staff is needed. Communication is from the top down and occurs most often on issues that concern bureaucratic costs, such as decisions about the level of financial expenditure necessary to pursue new value-creation opportunities. The conglomerate Hanson Trust, for example, operated with a corporate staff of only 120 people to oversee its more than 50 divisions; it operated primarily through rules

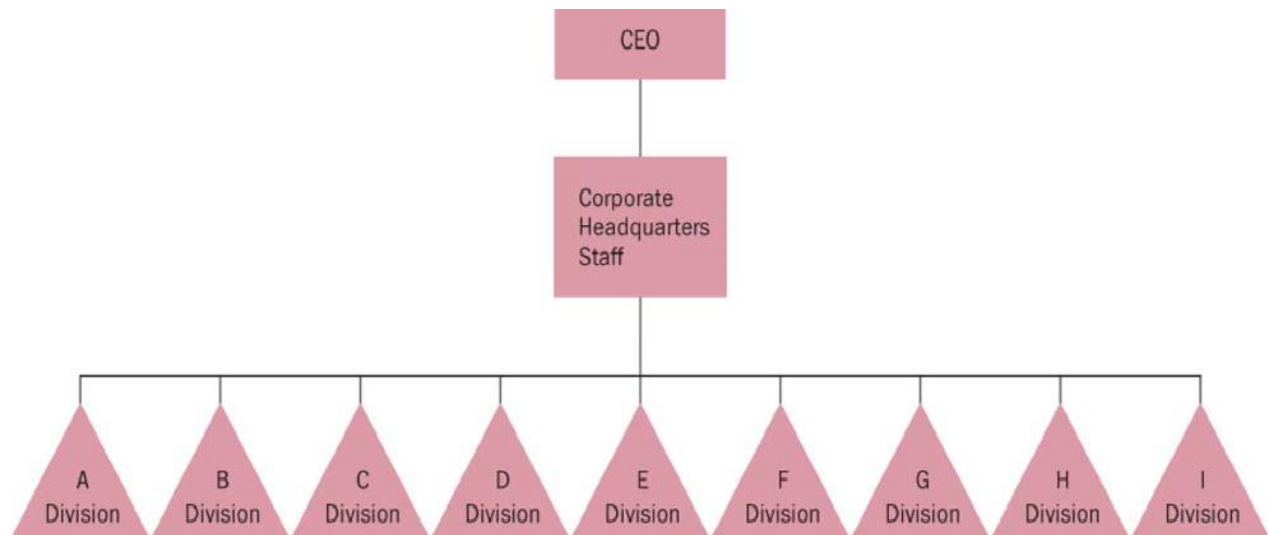


Figure 8.8 Conglomerate Structure

A structure in which each business is placed in a self-contained division and there is no contact between divisions.



Organizational Insight

8.3 UTC Continuously Improves Operating Rules in Its Different Businesses

United Technologies Corporation (UTC), based in Hartford, Connecticut, owns a wide variety of companies that operate in different businesses and industries. Some of the companies it owns are more well known than UTC itself, such as Sikorsky helicopters, the aircraft engine and component maker Pratt & Whitney, Otis elevators, Carrier air conditioning, and Chubb, the security and lock maker.⁴⁶

In the 2000s, UTC has been one of the most profitable companies in the world and the reason, so its CEO George David claims, is its commitment to developing a program of innovative rules and operating processes to continuously increase quality. UTC's program originated when it had a major problem in its Otis elevator division, and David assigned one of its leading engineers, Yuzuru Ito, to head a team of Otis engineers to find out why it performed so poorly. Under Ito's direction they created a set of "process" techniques that involve all employees—managers, designers, production workers—who had produced the elevator to analyze why the elevators were malfunctioning and then develop improved operating rules and procedures to solve the problem. This intensive study led to a total redesign of the elevator, and when their new and improved elevator was launched worldwide it met with great success.

After this success David decided the best way to increase UTC's profitability was to find ways to make the managers in all its diverse businesses focus on improving operating rules. He convinced Ito to take responsibility for

championing the development of UTC's quality program, which is known as *Achieving Competitive Excellence*, or ACE. ACE is a set of rules and procedures used by employees from the shop floor to top managers to analyze systematically all aspects of the way a product is made to find ways to improve quality and reliability,



Vladislav Gajic/Shutterstock.com

to lower the costs of making the products, and especially to find new rules to make the next generation of a particular product perform better, in other words to encourage technological innovation.

David makes every employee in every function and at every level take responsibility for achieving the incremental, step-by-step gains from improved rules and procedures that can result in innovative products, built with ever-increasing quality and efficiency that can put a company on the path to dominating its industry. David calls these techniques “process

disciplines,” and he has used them to improve the performance of *all* UTC companies. In the decade since he took control, he has quadrupled UTC’s earnings per share and its stock price has boomed and it has become one of the best-performing stocks in the 2010s.⁴⁷

that controlled bureaucratic costs. Hanson Trust had a rule that required a corporate executive to approve any expenditure over \$3,000.⁴⁵ Beyond this, it made little attempt to intervene in the affairs of the operating divisions. United Technologies, discussed in Organizational Insight 10.3, offers an interesting example of how a company can develop operating rules and SOPs across its different businesses to increase performance.

Structures for Related Diversification

An organization pursuing a strategy of related diversification tries to obtain value by sharing resources or by transferring functional skills from one division to another—processes that require a great amount of coordination and integration.

Related diversification requires lateral communication between divisions as well as vertical communication between divisions and corporate headquarters. As a result, integrating roles and teams of functional experts are needed to coordinate skill and resource transfers. Coordination is complicated because divisions may fight for resources and may not wish to share information and knowledge unless they are equitably rewarded for doing so. Imagine the coordination problem that arises when an organization has hundreds of divisions such as GE or GM.

If related diversification is to provide the gains comparable to those obtained from unrelated diversification, a much larger corporate headquarters staff is required to coordinate interdivisional activities, and much more managerial time and effort is needed.

When the coordination problem becomes very severe, a multidivisional matrix structure is used to increase integration (see [Figure 6.12](#)). As we saw in [Chapter 6](#), this structure provides the coordination between the divisions and corporate headquarters that allows for the transfer of skills and the sharing of resources around the organization. It gives top-level functional, divisional, and corporate managers the opportunity to meet in teams to plan the organization's future strategy.

The bureaucratic costs associated with managing related diversification (whether in a multidivisional structure or a matrix multidivisional structure) are much greater than those associated with vertical integration or unrelated diversification.⁴⁸

Considerably more communication and coordination are needed to create value from related diversification than from the other corporate-level strategies.

Bureaucratic costs increase as the size of the corporate staff and the amount of time that both divisional and corporate managers spend in coordinating with other divisions increase. In contrast, the bureaucratic costs associated with unrelated diversification are likely to be low because there is no need to coordinate resource transfers between divisions—the divisions do not exchange anything.

Corporate-Level Strategy and Culture

Just as a move to a more appropriate organizational structure can reduce bureaucratic costs, so can a move to a more appropriate organizational culture. Cultural values and the common norms, rules, and goals that reflect those values can greatly facilitate the management of a corporate strategy. For example, Hanson Trust, which pursued a strategy of unrelated diversification, put most value on economy, cost cutting, and the efficient use of organizational resources. Divisional managers at Hanson Trust could not spend large amounts of money without the approval of corporate executives. Knowing that their performance was scrutinized closely, their actions were shaped by corporate values tied to bottom-line result.

By contrast, suppose an organization is pursuing a strategy of related diversification. What kinds of values, norms, and rules are most useful in managing the strategy? Because the creation of value from related diversification requires a large amount of coordination and integration, norms and values that emphasize cooperation between divisions are important. This type of culture lowers the costs of exchanging resources and is likely to feature a common corporate language that the various divisions can use in their dealings with one another. Each division will have its own culture, but the corporate culture can overcome differences in divisional orientation, just as at the business level an organization's culture can overcome differences in functional orientation.

At 3M and Procter & Gamble (P&G), for example, corporate values of innovation and entrepreneurship are passed on in the stories that organizational members use to frame significant corporate events. New employees are socialized to the innovative culture and learn the corporate language from their interactions with other employees. In choosing which divisional managers will be promoted to the corporate headquarters staff, 3M and P&G also send their members a clear message about the kinds of values and behaviors associated with career success—actions that lead to innovative new products.

Thus different cultures help organizations pursue different corporate-level strategies. An organization needs to create a culture that reinforces and builds on the strategy it pursues and the structure it adopts. In an organization that has a conglomerate structure, in which there is no connection between divisions, it would be pointless to develop a common corporate culture across divisions because the managers in the different divisions would not know one another. A multidivisional matrix structure, in contrast, does support the development of a cohesive corporate culture because it permits the rapid interchange of ideas and the transfer of norms and values around the organization. In sum, as we saw in [Chapter 7](#) , corporate culture is an important tool that organizations can use to coordinate and motivate employees.

As at the business level, the interorganizational strategies discussed in [Chapter 3](#) are an important means of increasing the value an organization can create through its corporate strategy. Interorganizational strategies increase value by allowing the organization to avoid



Managerial Implications Corporate-Level Strategy

1. To protect the organization's existing domains and to exploit the organization's core competences to create value for stakeholders, managers should carefully analyze the environment.
2. To distinguish between a value-creation opportunity and a value-losing opportunity, managers should carefully evaluate the benefits and costs associated with entering a new domain.
3. As part of this analysis, managers should weigh the benefits and costs of various strategies for entering the domain—for example, takeover of an existing company, versus establishing a new organization, versus using a strategic alliance such as a joint venture.
4. No matter which corporate strategy managers pursue, as the organization grows, managers must be careful to match their organization's structure and culture to the strategy they are pursuing.

the bureaucratic costs often associated with managing a new organization in a new domain. As the number of an organization's divisions increases, for example, the bureaucratic costs associated with managing interdivisional activities increase. Interorganizational strategies such as strategic alliances may allow an organization to obtain the gains from cooperation between divisions without experiencing the costs.

Suppose two organizations establish a joint venture to produce a range of products in a domain that is new to both of them. Each organization contributes a different skill or resource to the venture. One provides low-cost manufacturing skills; the other, differentiated R&D and marketing skills. By establishing the joint venture, they have avoided the bureaucratic costs that would be incurred if one organization took over the other or if either organization had to internally coordinate the new resource transfers necessary to make the new venture work. Similarly, the gains from vertical integration can often be realized through minority ownership or long-term contracts, which avoid the need to own the supplier or distributor. An organization that can use an interorganizational strategy to enter and compete in a new domain can often secure the benefits of the diversification and integration strategies without incurring bureaucratic costs.

Implementing Strategy across Countries

Global strategy can play a crucial role in strengthening a company's control over its environment. Companies can use four principal strategies as they begin to market their products and establish production facilities abroad: (1) a *multidomestic strategy*, oriented toward local responsiveness—a company decentralizes control to subsidiaries and divisions in each country in which it operates to produce and customize products to local markets; (2) an *international strategy*, based on R&D and marketing being centralized at home and all the other value-creation functions being decentralized to national units; (3) a *global strategy*, oriented toward cost reduction, with all the principal value-creation functions centralized at the lowest cost global location; and (4) a *transnational strategy*, focused so it can achieve both local responsiveness *and* cost reduction—some functions are centralized while others are decentralized at the global location best suited to achieving these objectives.

The need to coordinate and integrate global activities increases as a company moves from a multidomestic to an international to a global and then to a transnational strategy. For example, to obtain the benefits of pursuing a transnational strategy, a company must transfer its distinctive competences to the global location where they can create the most value and establish a global network to coordinate its divisions both at home and abroad. The objective of such coordination is to obtain the benefits from transferring or leveraging competences across a company's global divisions. Thus the bureaucratic costs incurred to solve communications and measurement problems that arise in managing transfers across countries to pursue a transnational strategy are much higher than those of pursuing the other strategies. The multidomestic strategy does not require coordination of activities on a global level because value-creation activities are handled locally, by country or world region. The international and global strategies fit between the other two strategies: Although products have to be sold and marketed globally, and hence global product transfers must be managed, there is less need to coordinate skill and resource transfers than for a transnational strategy.

The implication is that as companies change from a multidomestic to an international, global, or transnational strategy, they require a more complex structure, control system, and culture to coordinate the value-creation activities associated with implementing that strategy. In general, the choice of structure and control systems for managing a global business is a function of three factors:

1. The decision how to distribute and allocate responsibility and authority between managers at home and abroad so that effective control over a company's global operations is maintained
2. The selection of the organizational structure that groups divisions both at home and abroad in a way that allows the best use of resources and serves the needs of foreign customers most effectively
3. The selection of the right kinds of integration and control mechanisms and organizational culture to make the overall global structure function effectively

Table 8.2 summarizes the appropriate design choices for companies pursuing each of these strategies.

Table 8.2 Strategy-Structure Relationships in the International Environment

	Multidomestic Strategy	International Strategy	Global Strategy	Transnational Strategy
	Low	Need for Coordination		High
Vertical Differentiation Choices				
Levels in the hierarchy	Relatively flat	Relatively tall	Relatively tall	Relatively flat
Centralization of authority	Decentralized	Core competences centralized, others decentralized	Centralized	Simultaneously centralized and decentralized
Horizontal Differentiation	Global geographic structure	Global product group structure	Global product group structure	Global matrix or "matrix in the mind"
Integration				
Need for integrating mechanisms such as task forces and integrating roles	Low	Medium	Medium	High
Need for electronic	Medium	High	High	Very High

	Multidomestic Strategy	International Strategy	Global Strategy	Transnational Strategy
integration and management networks				
Need for integration by international organizational culture	Low	Medium	High	Very High
	Low	Bureaucratic Costs		High

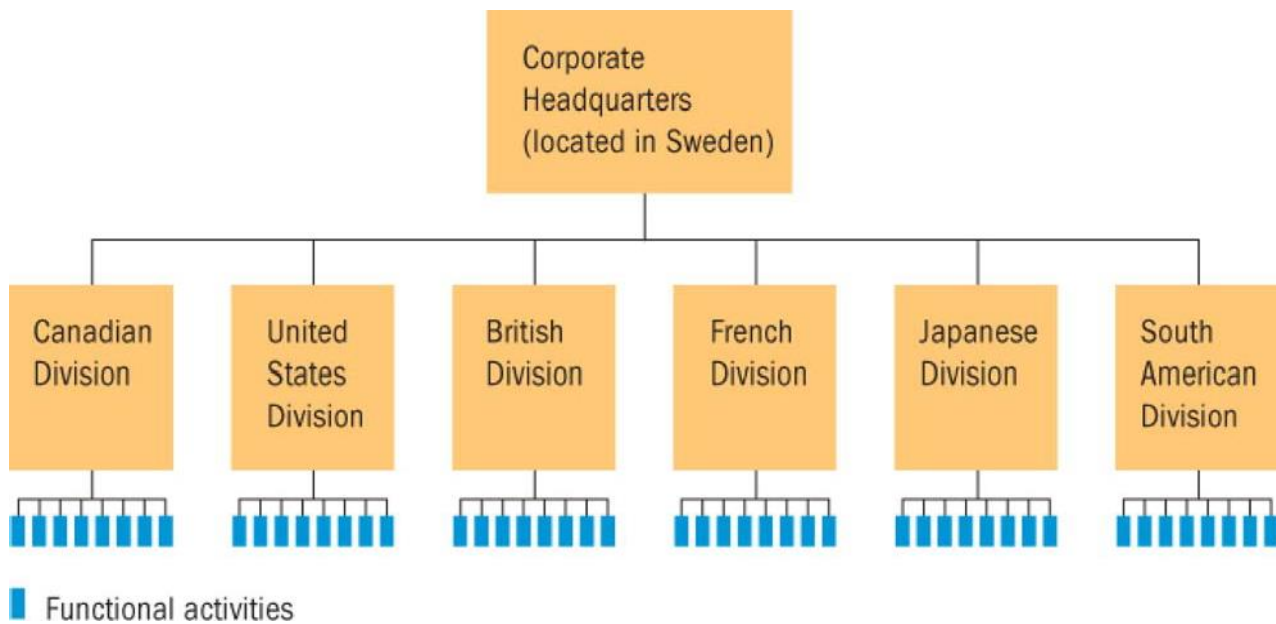


Figure 8.9 Global Geographic Structure

Implementing a Multidomestic Strategy

When a company pursues a multidomestic strategy, it generally operates with a global geographic structure (see [Figure 8.9](#)). When using this structure, a company duplicates all value-creation activities and establishes an overseas division in every country or world area in which it operates. Authority is then decentralized to managers in each overseas division, and they devise the appropriate strategy for responding to the needs of the local environment. Managers at global headquarters use market and output controls, such as return on investment, growth in market share, and operation costs, to evaluate the performance of overseas divisions. On the basis of such global comparisons, they can make decisions about capital allocation and orchestrate the transfer of new knowledge among divisions.

A company that makes and sells the same products in many different countries often groups its overseas divisions into world regions to simplify the coordination of products across countries. Europe might be one region, the Pacific Rim another, and the Middle East a third. Such grouping allows the same set of output and behavior controls to be applied across all divisions inside a region. Thus global companies can reduce communications and transfer problems because information can be transmitted more easily across countries with broadly similar cultures. For example, consumers' preferences regarding product design and marketing are likely to be more similar among countries in one world region than among countries in different world regions.

Because the overseas divisions themselves have little or no contact with others in different regions, no integrating mechanisms are needed. Nor does a global organizational culture develop because there are no transfers of skills or resources or transfer of personnel among managers from the various world regions. Historically, car companies such as GM, Volkswagen, and Ford used global-area structures to manage their overseas operations. Ford of Europe, for example, had little or no contact with its U.S. parent, and capital was the principal resource exchanged.

One problem with a global geographic structure and a multidomestic strategy is that the duplication of specialist activities across countries raises a company's overall cost structure. Moreover, the company is not taking advantage of opportunities to transfer, share, or leverage its competences and capabilities on a global basis: For example, it cannot apply the low-cost manufacturing expertise that has developed in one world region in another. Thus multidomestic companies lose the many benefits of operating globally.

Implementing International Strategy

A company pursuing an international strategy adopts a different route to global expansion. A company with many different products or businesses has the challenging problem of coordinating the flow of different products across different countries. To manage these

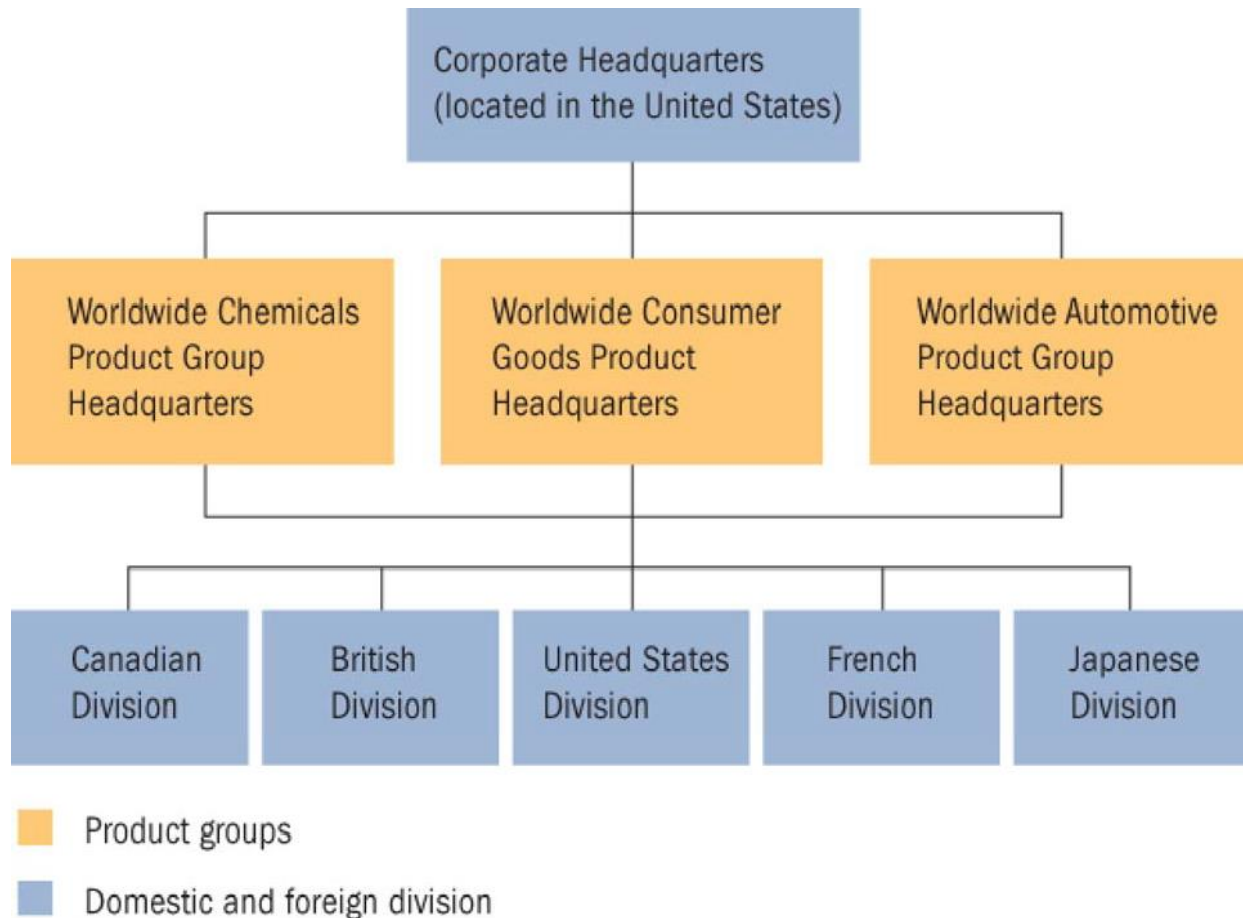


Figure 8.10 Global Product Group Structure

transfers, many companies use a global product group structure and create product group headquarters to coordinate the activities of both home and international divisions within each product group. Product group managers are responsible for organizing all aspects of value creation on a global level (see Figure 8.10).

This arrangement of tasks and roles reduces the transaction costs involved in managing handoffs across countries and world regions. However, managers abroad are essentially under the control of managers in the international divisions and if the number of levels of managers at the product group level becomes too great, corporate headquarters may lose control over company-wide decision making and product group and international division managers may compete for control of strategy making. The result is a loss of control, conflict, and a lack of cooperation. Many companies such as IBM and Citibank have experienced this problem. Very often, significant strategic control has been decentralized to overseas divisions. When cost pressures force corporate managers to reassess their strategy, and they decide to intervene, this frequently provokes resistance, much of it due to differences in culture—not just corporate, but country differences.

Implementing Global Strategy

When a company embarks on a global strategy today, it locates its manufacturing and other value chain activities at the global location that will allow it to increase efficiency and quality. In so doing, it has to solve the problems of coordinating and integrating its global activities. It has to find a structure that lowers the bureaucratic costs associated with resource transfers between corporate headquarters and its global divisions and provides the centralized control that a global strategy requires. The answer for many companies is also a global product group structure (see **Figure 8.10**).

Once again, the product groups coordinate the activities of home and overseas operations and decide where to locate the different functions at the optimal global location for performing that activity. For example, Philips has one worldwide product group responsible for coordinating the global R&D, manufacturing, marketing, and sales activities of the international divisions that make and sell its light bulbs. It has another worldwide group responsible for making and selling its medical equipment, and so on. The product group headquarters of its medical division and its R&D is located in Bothell, Washington. Manufacturing, however, is done in Taiwan, and the products are marketed and sold by each international division.

The product-group structure allows managers to decide how best to pursue a global strategy—for example, to decide which value-chain activities, such as manufacturing or product design, should be performed in which country to increase efficiency. Increasingly, U.S. and Japanese companies are moving manufacturing to low-cost countries such as China but establishing product-design centers in

Europe or the United States to take advantage of foreign skills and capabilities to obtain the benefits from this strategy.

Implementing Transnational Strategy

The main failing of the global product-group structure is that although it allows a company to achieve superior efficiency and quality, it is weak when it comes to responsiveness to customers because the focus is still on centralized control. Moreover, this structure makes it difficult for the different product groups to trade information and knowledge and to obtain the benefits from transferring, sharing, and leveraging their competences. Sometimes the potential gains from sharing product, marketing, or R&D knowledge between product groups are high, but so too are the bureaucratic costs associated with achieving these gains. Is there a structure that can simultaneously economize on these costs and provide the coordination necessary to obtain these benefits?

In the 1990s, many companies implemented a global matrix structure to simultaneously lower their global cost structures and differentiate their activities through superior innovation and responsiveness to customers globally. See **Figure 8.11** : On the vertical axis are the company's overseas divisions in the various countries or world regions in which it operates. Managers at the regional or country level control local operations. On the horizontal axis are the company's corporate product groups, which provide specialist services such as R&D, product design, and marketing information to its overseas divisions, which are grouped by world region. These might be the chemicals, consumer goods, and automobile product groups. Through a system of output and behavior controls, they then report to corporate product group personnel back in the United States and ultimately to the CEO or president. The heads of the world regions or country managers are also responsible for working with U.S. product group managers to develop the control and reward systems that will promote the transfer, sharing, or leveraging of competences that will result in superior performance.

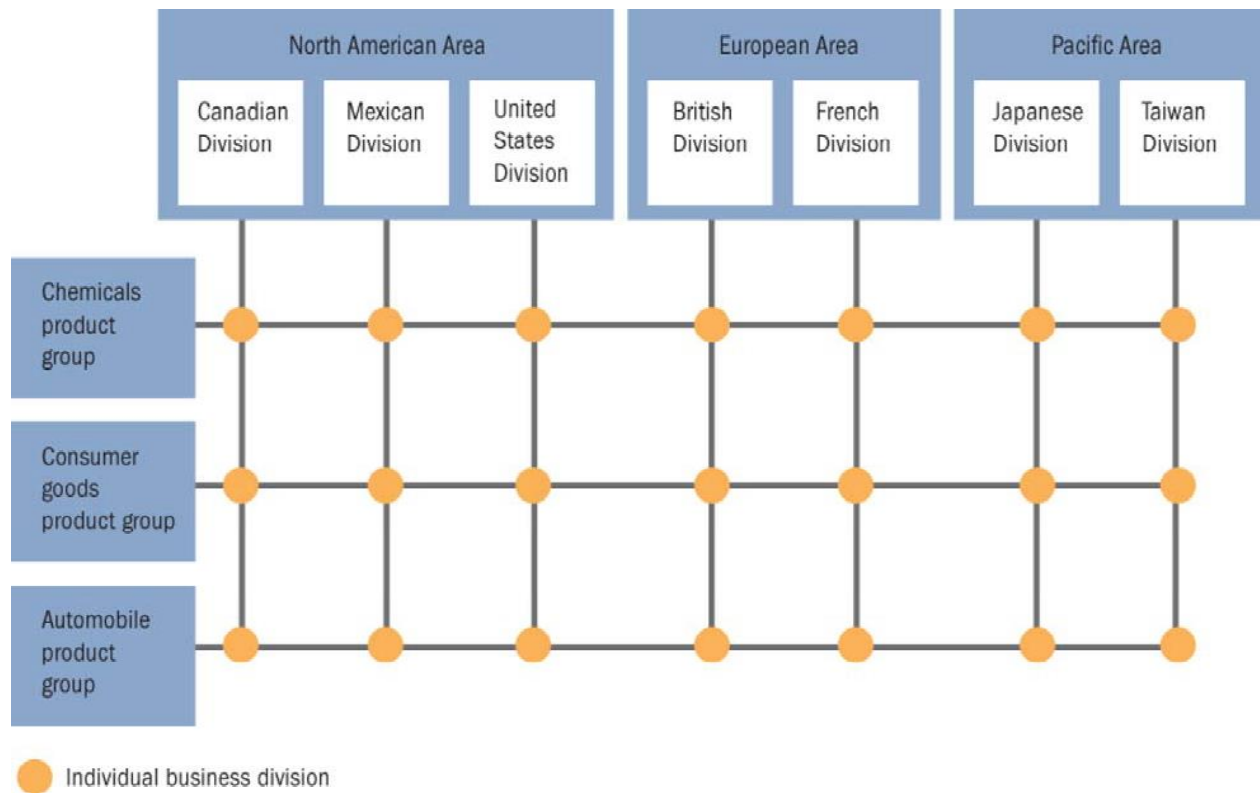


Figure 8.11 Global Matrix Structure

Implementing a matrix structure thus decentralizes control to overseas managers and provides them with considerable flexibility for managing local issues, but it can still give product and corporate managers in the United States the centralized control they need to coordinate company activities on a global level. The matrix structure can allow knowledge and experience to be transferred among geographic regions, among product groups, and among product groups and regions. Because it offers many opportunities for face-to-face contact between managers at home and abroad, the matrix facilitates the transmission of a company's norms and values and hence the development of a global corporate culture. This is especially important for a company with far-flung global operations for which lines of

communication are longer. Club Med, for instance, uses a matrix to standardize high-quality customer service across its global vacation villages.

Summary

Organizational strategy is a plan of action that an organization undertakes to create value. Organizations that do not continually set ambitious new goals and try to find effective means of reaching those goals are likely to be threatened by younger, more agile competitors in search of ways to seize resources for themselves. Consequently, organizational members at all levels in the organization—functional, business, corporate, and global—must develop their value-creation skills and abilities. Managers must manage the interrelationship of strategy (at all levels), structure, and culture to maximize the organization’s ability to manage, enhance, and protect its domain so it can create value to satisfy stakeholders. **Chapter 8** has made the following main points:

1. The value that an organization creates by means of its strategy is a function of how the organization positions itself in its environment so it can use its core competences to compete for resources.
2. An organization’s core competences are products of its functional and organizational resources and its coordination ability.
3. An organization must formulate strategy at four levels: functional, business, corporate, and global.
4. The goal of functional-level strategy is to create in each function a low-cost or differentiation competence that gives the organization a competitive advantage.
5. Functional structure and culture produce functional abilities that support the development of functional resources.
6. The goal of business-level strategy is to combine functional low-cost and differentiation competences to exploit opportunities in the organizational environment. Business-level strategy selects and manages the domain in which an organization uses its value-creation resources and coordination abilities.

7. The two main business-level strategies are low-cost business-level strategy and differentiation business-level strategy.
8. An organization chooses a structure and culture to develop coordination abilities that support its business-level strategy.
9. The goal of corporate-level strategy is to use and develop low-cost and differentiation competences so the organization can protect and enlarge its existing domain and expand into new ones.
10. Three main types of corporate-level strategy are vertical integration, related diversification, and unrelated diversification.
11. An appropriate corporate-level structure and culture can help reduce the bureaucratic costs of managing a strategy.
12. The four strategies that companies use to manage global expansion are a multidomestic strategy, an international strategy, a global strategy, and a transnational strategy. Each is associated with a different approach to value creation and a different set of organizational design problems.

Discussion Questions

1. How should an organization design its structure and culture to obtain a core competence in manufacturing and in research and development?
2. Pick an organization like a restaurant or a department store, and analyze how it might pursue a low-cost or a differentiation strategy.
3. What is the difference between a low-cost strategy and a differentiation strategy? How should a differentiated biotechnology organization and a low-cost fast-food organization design their structures and cultures to promote their respective competitive advantages?
4. Compare the competitive advantages enjoyed by a large restaurant chain, such as Steak and Ale or Red Lobster, and the sources of competitive advantages enjoyed by a small local restaurant.
5. Why would an organization choose a corporate-level strategy to expand its value-creation activities beyond its core domain? Discuss how an organization's structure and culture might change as the organization begins to enter new domains.
6. How and why do bureaucratic costs increase as a company goes from a multidomestic to an international to a global to a transnational strategy?

Organizational Theory in Action

Practicing Organizational Theory

What Kind of Supermarket?

Form groups of three to five people and discuss the following scenario:

You are a group of investors who are contemplating opening a new supermarket in your city. You are trying to decide what business-level strategy would provide your supermarket with a competitive advantage that would allow you to attract customers and outperform your prospective rivals.

1. List the supermarket chains in your city and identify their business-level strategies (for example, low cost, differentiation, or focus). Also, list any particular kinds of functional strengths or weaknesses that they might have (such as a great bakery or a lousy fish counter).
2. On the basis of this analysis, what type of business-level strategy do you think will best succeed in the local market? What will the specific elements of this strategy be? (For example: What kind of supermarket will it be? What kind of functional strengths will you try to develop? What kinds of customers will you aim for? What will you do to attract them?)

The Ethical Dimension #8

Bribery and corruption are common in some countries, and for people in those countries, they are a normal part of doing business. U.S. law bans any U.S. company from paying bribes to foreign officials or taking any steps to use illegal means to secure valuable foreign contracts or resources.

1. Why does the United States adopt this ethical and legal stance if people in the country accept bribery as the norm?
2. What could U.S. companies do to help reduce the incidence of bribery in these countries and promote ethical business practices?

Making the Connection #8

Find an example of an organization pursuing a business, corporate, or global expansion strategy. What kind of strategy is it pursuing? Why did it choose this strategy? How does the strategy create value? How does the strategy affect the organization's structure or culture?

Analyzing the Organization: Design Module

#8

This module focuses on the kinds of goods and services that your organization produces, the markets it competes in, and the kinds of strategies it uses to create value for its stakeholders.

Assignment

This assignment asks you to explore how your company creates value through its strategy and structure for managing the environment.

1. Briefly describe your organization's domain—that is, the goods and services it produces and the customer groups it serves.
2. What core competences give the organization a competitive advantage? What are the organization's functional-level strategies?
3. What is your organization's principal business-level strategy: low cost or differentiation? How successfully is the organization pursuing this strategy? In what ways does it need to improve its core competences to improve its competitive position?
4. In what ways do your organization's structure and culture match its strategy? Is there a good match? In what ways could the match be improved? Is the organization experiencing any problems with its structure?
5. Is your organization operating in more than one domain? If it is, what corporate-level strategies is it pursuing? How is it creating value from these strategies? Is it successful?
6. What kind of strategy is your organization pursuing in the international environment? What kind of structure does your organization use to manage this strategy?

Case for Analysis Schering-Plough Implements a New Global Strategy and Structure

One global company that found itself in trouble in the 2000s because of the way its structure and control systems were working was pharmaceutical maker Schering-Plough. In 2003, Schering was under pressures from many fronts. The Food and Drug Administration (FDA) was demanding a complete overhaul of its global manufacturing plants to increase and protect drug quality, and the patent on Claritin, its best-selling drug, was running out and it had few new products in the pipeline. Thus on both the quality and innovation dimensions, major sources of a differentiation advantage, the company's strategy was in trouble.

Schering-Plough's board of directors recruited Fred Hassan, a Pakistan-born Harvard MBA, to turn the company around. After meeting with hundreds of groups of managers and scientists, and visiting the company's operations around the globe, Hassan began to realize that the company's main problems stemmed from its global strategy and structure.⁴⁹

Over time, the company had developed a multidomestic approach to planning its global value-chain activities and it had divided its activities up into world regions, where essentially each world region acted as the product group that made decisions inside its world region/group. The problem was that each of the heads of the regional groups had gained a near total control of their operations, so each world region was doing things such as manufacturing and marketing and sales in its own unique way. As a result, managers at corporate headquarters, and especially its top-management team, were not getting accurate information about the way each region, and especially the country operations within each region, were performing. And major drug quality problems had arisen because the corporate center didn't find out about the problems at the country level until a long time after they had occurred because of all the bureaucracy that had emerged at the level of the regional groups.

Schering only makes one major type of product—drugs—so Hassan decided it did not need separate worldwide product groups or separate regional groups. He

decided to slash the number of levels in the company's global corporate hierarchy, eliminating all the layers between the country managers and himself. The heads of

each international division now report directly to him or one of his top-management team members, so it is much easier to observe and evaluate their performance—and that of their divisions. It is also easier to standardize issues such as quality and sales practices around the world. He has also worked to expand the range of products each international division sells to achieve economies of scale. In 2007, for example, Hassan engaged in related diversification when he bought a major Dutch pharmaceutical company that is a leader in producing vaccines for animals and pets, as well as possessing a pipeline of potentially best-selling new drugs—it has five drugs in late trials, including an important new treatment for schizophrenia and bipolar disorder.

His new global organizational structure worked so well and sales and profits increased so much that by 2010 it was bought by and became part of Merck, one of its major competitors. Hassan is now the chairman of Bausch & Lomb, an optical products company, where he is applying the same kinds of organizational structure changes to help increase that company's global competitive position.⁵⁰

Discussion Questions

1. What kinds of problems was Schering-Plough experiencing with its global strategy and structure?
2. How did Schering Plough change its global structure to solve these problems?

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