Organization Theory/Structure and Design
Prof. Zillur Rahman
Department of Management Studies
Indian Institute of Technology, Roorkee

Lecture - 13
Strategy - III

Welcome to Organization Theory/Structure and Design. Now, we will talk about module 13. So we are talking about the part 2 that is the determinants of organization structure and we had talked about in module 11 and 12 about the strategy and we will continue this discussion on strategy in this module that is module 13 also. Now, let us look at what are the things that we will talk about in this module. So we will start with explaining the structural implications from Porter's competitive strategies.

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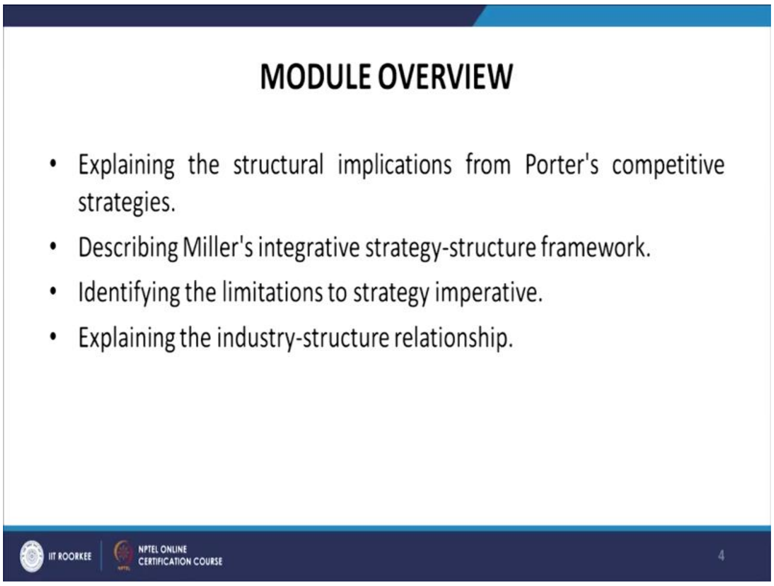

Then we will describe Miller's integrative strategy-structure framework thereafter we will identify the limitations of strategy imperative and then explain the industry-structure relationship. To introduce we ended the discussion in the last module with the Snow and Mill’s strategy structure theory. In this module we will start with the real life example of its applicability.

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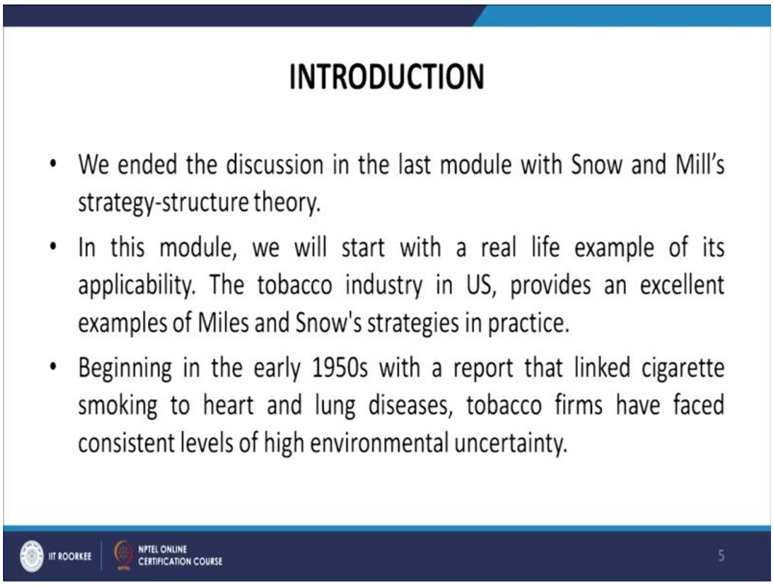

The tobacco industry in United States provides an excellent example of Miles and Snow's strategies in practice. Beginning in the early 1950's with the report that linked cigarette smoking to heart and lung diseases., tobacco firms have faced consistent levels of high environmental uncertainty.

Tobacco firms have been in the target of health and consumer action groups. A series of government regulations have restricted their ability to do business. Their access to the public broadcast media has been significantly limited.

And in response to this changing environment major tobacco firms choose very different strategies. Philip Morris that is one tobacco company chose the prospector route for example it was the first to design products specifically to bring women into the smoking market and has been a pioneer in product packaging.

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R.J. Reynolds that is another tobacco company which is part of RJR Nabisco was the analyzer. Its strategy has been to become an early adopter of successful innovations of others. As an analyzer, it operated in two product market spheres simultaneously; one relatively stable and the other changing.

In this stable sphere (established brand names) Reynolds has routine operations. In its more turbulent sphere 2 top managers watch competitors for new ideas and then rapidly adopt those that look most promising.

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American brands which is yet another tobacco company was the defender. In an environment of rapid change, American focused on a narrow product market segment and lost market share badly.

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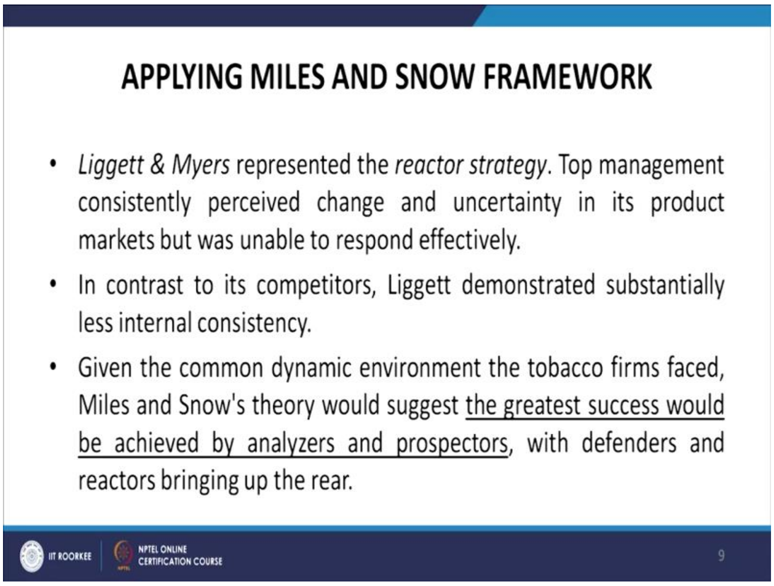

Liggett and Myer represented the reactor strategy. Top management consistently perceived changes and uncertainty in its product markets but was unable to respond effectively. In contrast to its competitors Liggett demonstrated substantially less internal consistency.

Given the common dynamic environment the tobacco firms faced, Miles and Snow's theory would suggest the greatest success would be achieved by analyzers and prospectors, with defenders and reactors bringing up the rear. And that is precisely what had happened. Between 1950 and 1975, Reynolds that was categorized as the analyzer.

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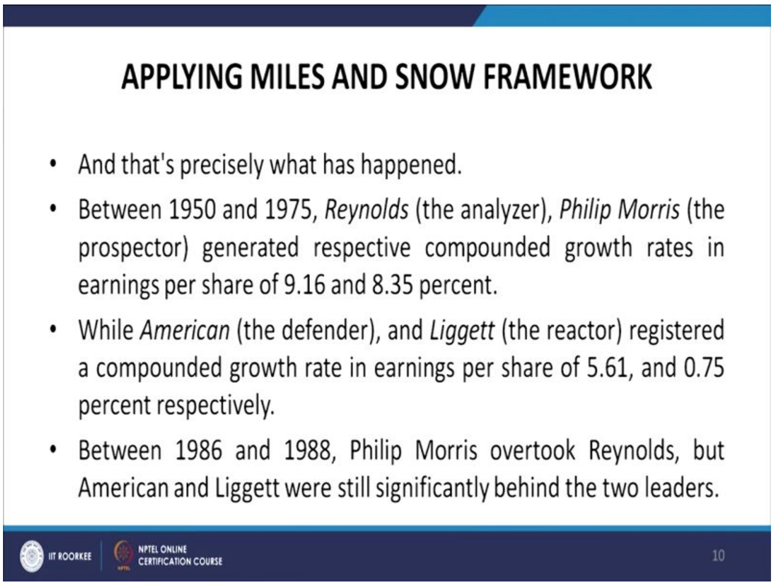

Philip Morris that was categorized as the prospector, generated respective compounded growth rates in earning per share of 9.16 and 8.35 percent, while American that is the defender and Liggett the reactor registered a compounded growth rate in earnings per share of 5.61 and 0.75 percent respectively. Between 1986 and 1988 Philip Morris overtook Reynolds but American and Liggett were still significantly behind the two leaders.

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Now let us look at the Porter's competitive strategies. The landmark work of Michael porter on competitive strategies has direct relevance to the strategy-structure relationship.

He argues that no firm can successfully perform at an above average level by trying to be all things to all people. He proposes that management must select a strategy that will give its organization a competitive advantage. The choice of strategy will depend on the organization's strengths and competitor’s weaknesses.

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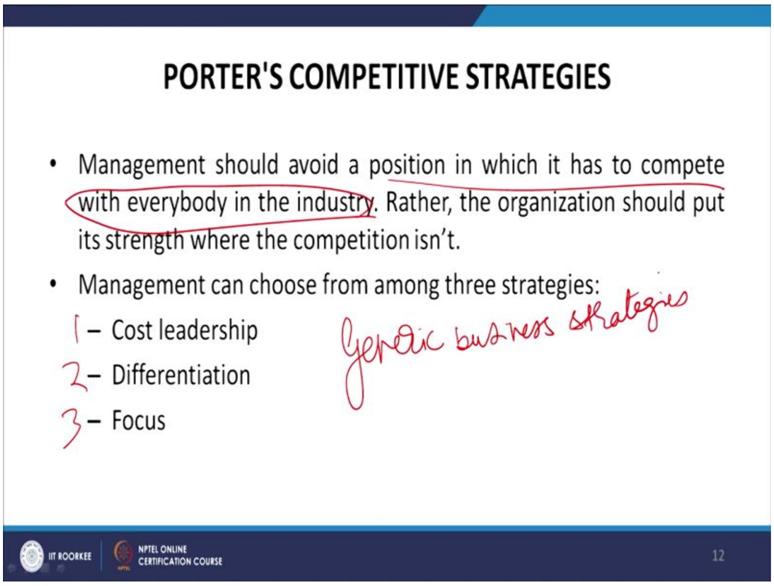

So we are talking about our strengths and competitor’s weaknesses. So management should avoid a position in which it has to compete with everybody in the industry. So we are not looking to compete with everyone in this industry rather the organization should put its strength where the competition is not putting various strength. So management can focus from among three different strategies. First is the cost leadership, the second is differentiation and the third is focus.

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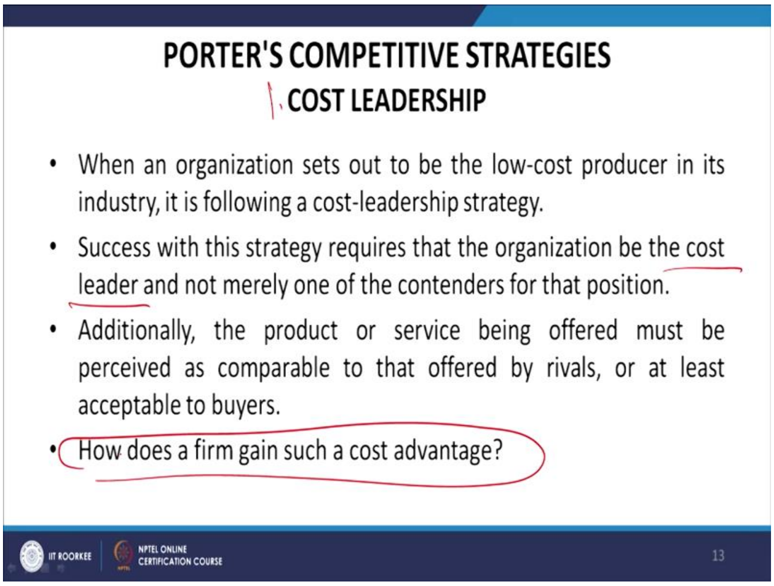

So, these are the three generic business strategies as proposed by Michael Porter. So let us look at each of this strategy one by one though for the first one is the cost leadership. When an organization sets out to be the low cost producer in its industry it is following a cost leadership strategy.

So, when an organization sets out to be the low cost producer in its industry, it is following a low cost leadership. Success with this strategy requires that the organization be the cost leader and not merely one of the contenders for that position. So, the organization has to be the cause reader not one amongst them. Additionally, the product or service being offered must be perceived as comparable to be offered by rivals or at least acceptable by the buyers. So cost leadership does not mean that the product is not acceptable by the buyers.

The product is acceptable by the buyers, it is similar to what rivals are offering, but then this company is giving that at a low cost. So how does the firm gain such a cost advantage? So that is a big question giving the same product at a lesser cost. So how should a company do that?

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Typical means through which a firms gains competitive advantage includes efficiency of operations, economies of scales, technological innovation, low cost labor and preferential access to raw material. Examples of firms that have used this study include Gallo Wines, largest exporter of California Wines and Hyundai automobiles.

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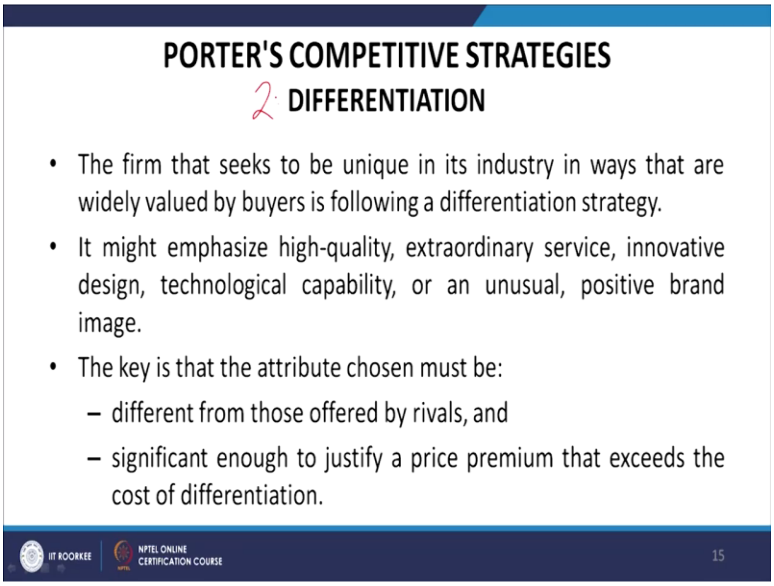

The second strategy as given by Michael Porter is differentiation. So the firm that seeks to be unique in its industry in ways that are widely valued by the buyer is following a differentiation strategy. It might emphasize high quality, extraordinary service, innovative design, technological capability or an unusual positive brand image.

The key is that the attribute chosen must be; one different from those offered by the rivals, two significant enough to justify a price premium that exceeds the cost of differentiation.

So the benefits should be more than the cost and therefore this company is can charge more. So there is no shortage of firms that have found at least one attribute that allows them to differentiate themselves from competitors. For example, Cray Research differentiates itself on the supercomputer technology.

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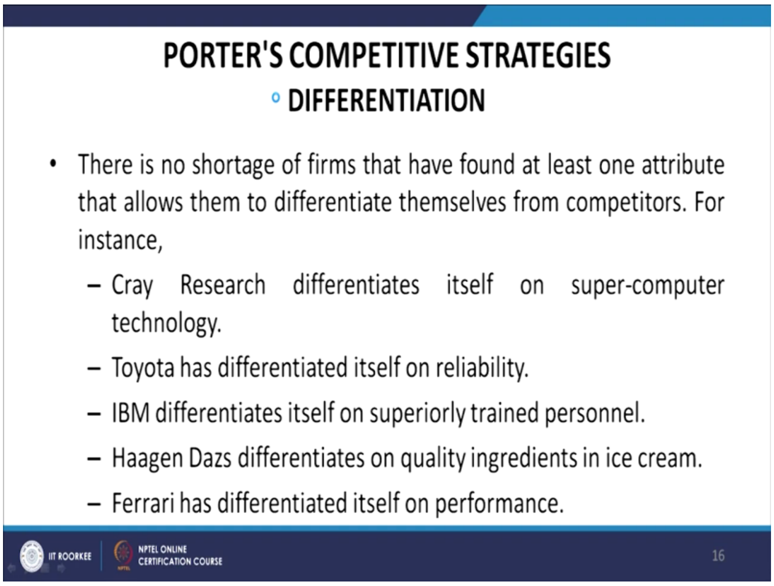

Toyota has differentiated itself on a reliability. IBM differentiates itself on superiorly trained personnel. Haagen Dazs differentiates on quality ingredients in ice creams and Ferrari has differentiated itself on performance.

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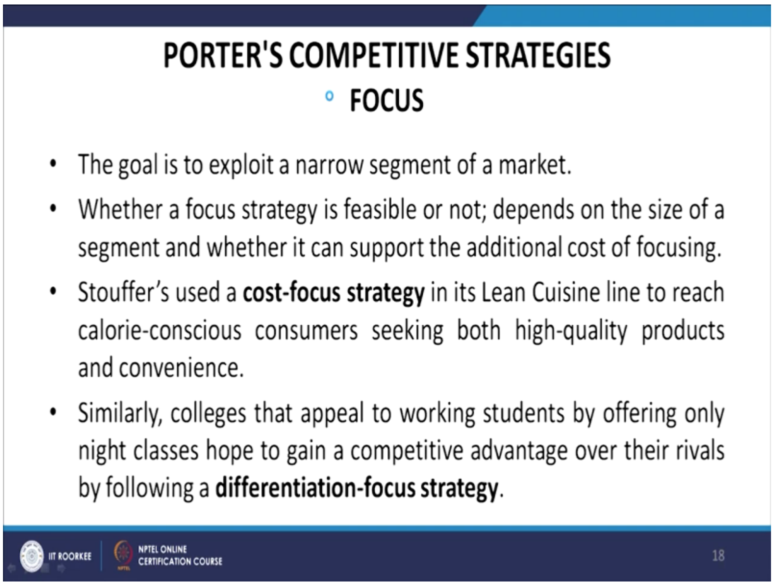

And the third type of his strategy proposed by Michael Porter is focus. The first two strategies sought a competitive advantage in a broad range of industry segments. The focus strategy aims at the cost advantage that is the cost focus or differentiation advantage that is the differentiation focus in a narrow segment.

So this third strategy that of focus is different from the earlier two on the basis of the narrow segment that it caters to. The earlier two were catering to broader market segments broader industry segments. The management will select a segment or a group of segments in an industry such as product variety, type of end buyers, distribution channels or geographical locations and tailor the strategy to serve them.

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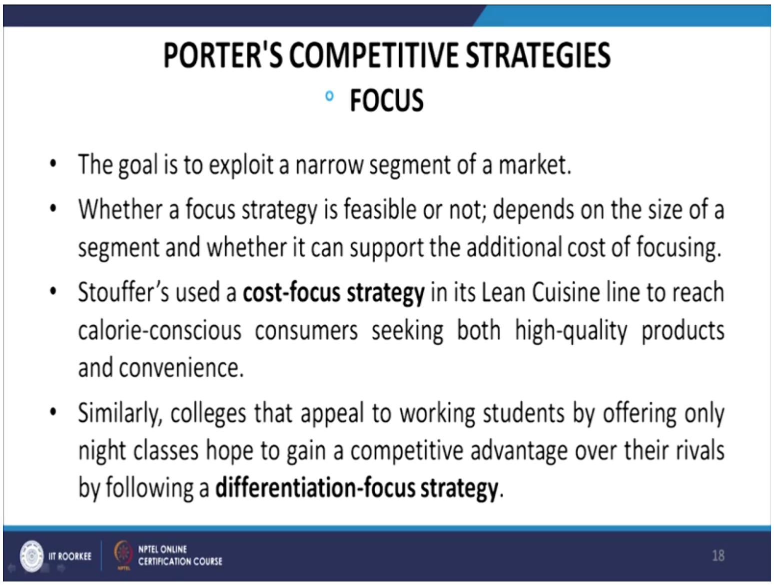

The goal is to exploit a narrow segment of a market. Whether a focus of strategy is feasible or not depends on the size of a segment and whether it can support the additional cost of focusing.

Stouffer's used a cost focus strategy in its Lean Cuisine line to reach calorie conscious consumers seeking both high quality products and convenience. Similarly, colleges that appeal to working students by offering only night classes hope to gain a competitive advantage over their rivals by following a differentiation focus strategy.

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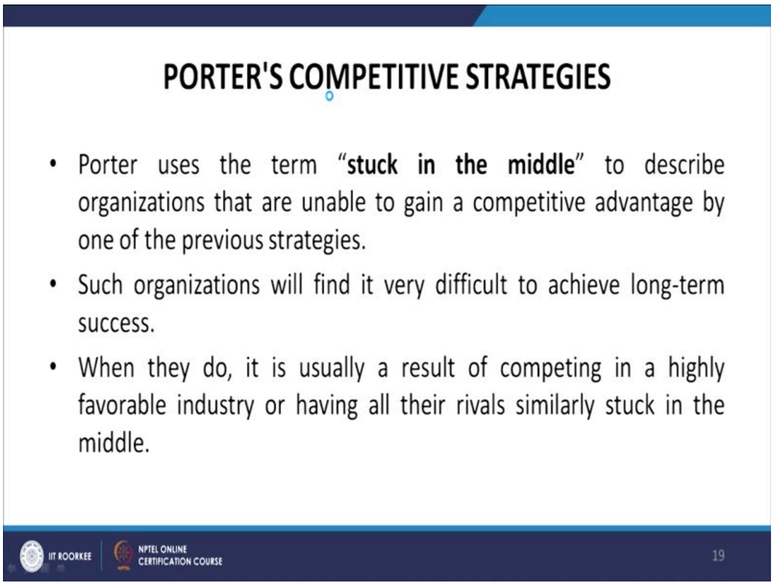

So Porter uses the term stuck in the middle to describe organizations that are unable to gain a competitive advantage by one of the previous strategies. Such organizations will find it very difficult to achieve long term success. When they do it is usually a result of competing in a highly favorable industry or having all these rivals similarly stuck in the middle.

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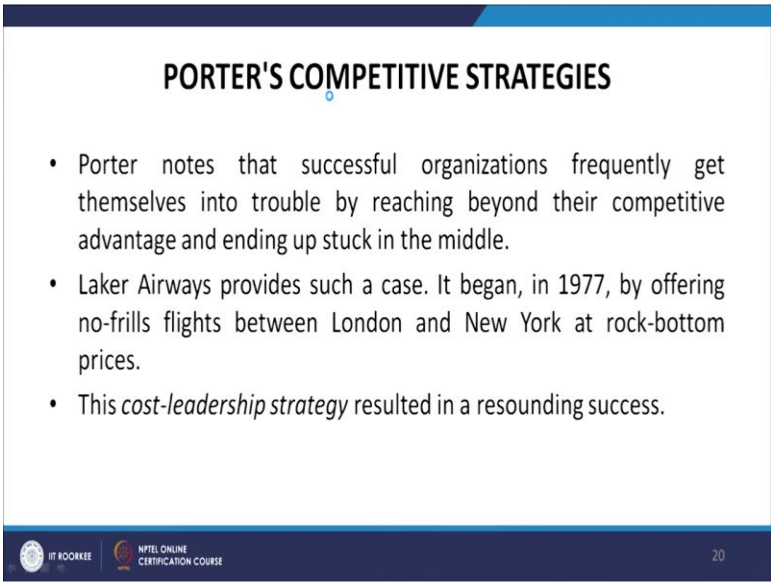

Porter notes that successful organizations frequently get themselves into trouble by reaching beyond their competitive advantage and ending up is stuck in the middle. Laker Airways provides such a case. It began in 1977 by offering no-frills flights between London and New York at rock bottom prices.

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This cost leadership strategy resulted in a resounding success. In 1979 however the firm began to add new routes and offer upscale services. The company stretched beyond its competitive advantage and ended up in stuck in the middle position.

The strategy of adding new routes and offering upscale services did the following things. First it blurred the public image of Laker, second it allowed the competition to make significant inroads and third it led to Laker's declaration of bankruptcy in 1982.

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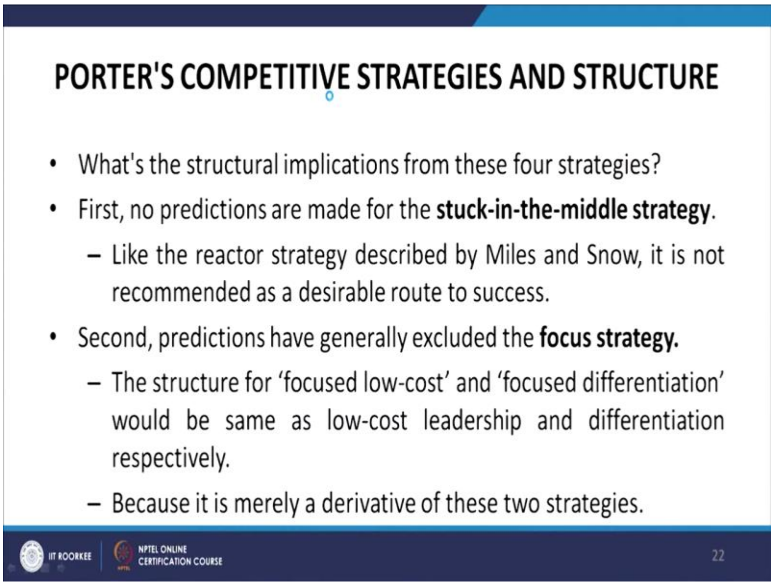

Now, let us look at Porter's competitive strategies and structure. What are the structural implications from these four strategies that we had talked about earlier? First no predictions are made for the stuck in the middle strategy. Like the reactor strategy described by Miles and Snow it is not recommended as a desirable route to success.

Second predictions have generally excluded the focus strategy. The structure for focused low cost and focused differentiation would be same as low cost leadership and differentiation respectively; because, it is merely a derivative from these two strategies but for a smaller market segments.

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So, the goal of cost leadership is to achieve efficiencies through tight controls, minimization of overheads and economies of scale. The best structure for achieving this end would be one that is high in complexity, high in formalization and centralized. In contrast a differentiation strategy relies essentially on the development of unique products. This demands a high degree of flexibility which can best be achieved through low complexity, low formalization and decentralized decision making.

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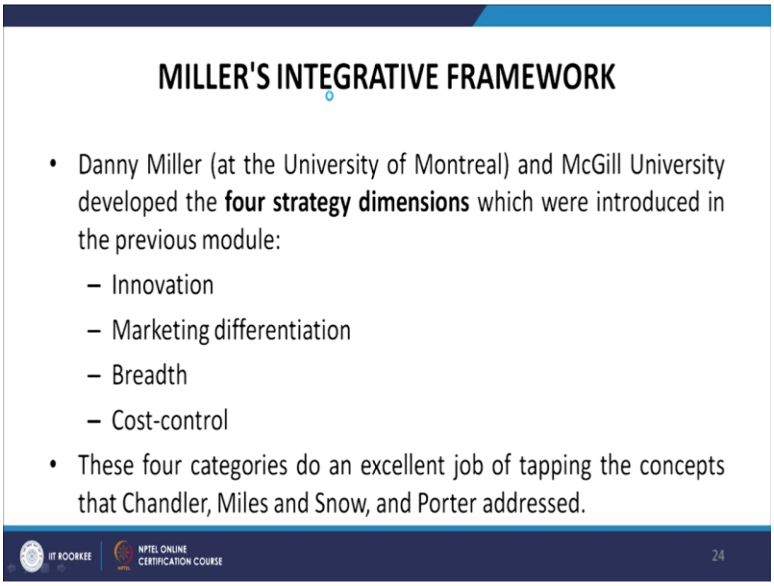

Another thing that we will talk about today is Miller's integrative framework; Danny Miller at the University of Montreal and McGill University developed the four strategy dimensions which were introduced in the previous module. The first is innovation, followed by marketing differentiation, breadth and cost control.

These four strategies do an excellent job of tapping the concepts that Chandler, Miles and Snow and porter addressed. For example, breadth encompasses Chandler’s concept of product diversification.

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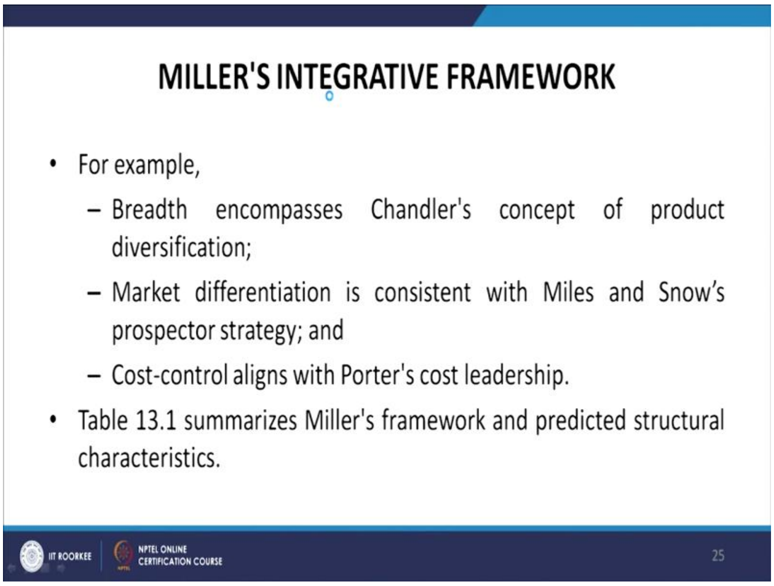

Market differentiation is consistent with Miles and Snow’s prospective strategy and cost control aligns with porter’s cost leadership. So the table 13.1 summarizes Miller's framework and predicted structural characteristics.

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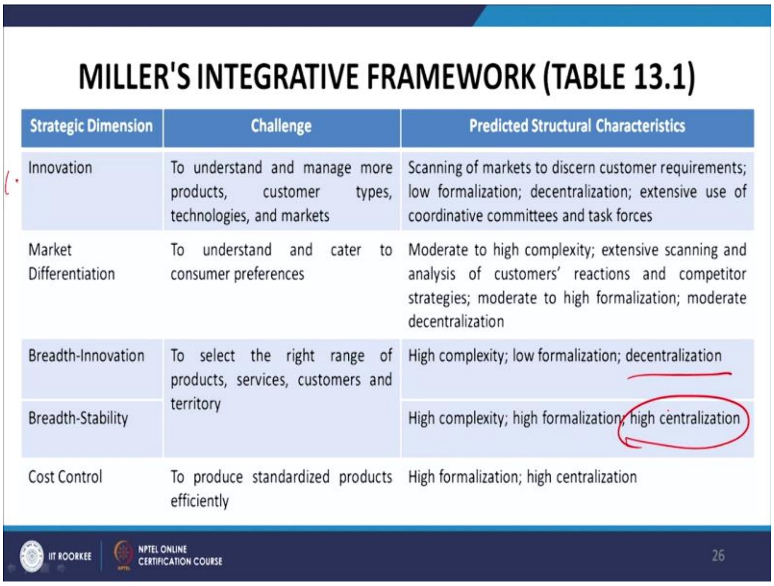

MILLER'S INTEGRATIVE FRAMEWORK (TABLE 13.1)

Strategic Dimension	Challenge	Predicted Structural Characteristics
Innovation	To understand and manage more products, customer types, technologies, and markets	Scanning of markets to discern customer requirements; low formalization; decentralization; extensive use of coordinative committees and task forces
Market Differentiation	To understand and cater to consumer preferences	Moderate to high complexity; extensive scanning and analysis of customers' reactions and competitor strategies; moderate to high formalization; moderate decentralization
Breadth-Innovation	To select the right range of products, services, customers and territory	High complexity; low formalization; decentralization
Breadth-Stability		High complexity; high formalization; high centralization
Cost Control	To produce standardized products efficiently	High formalization; high centralization

This is the Miller's integrative framework. To start with, on the left column we have a strategic direction, in the middle we have challenges and in the extreme right we have predicted structural characteristics. So let us start with the first one that is innovation. So the challenge in this strategic dimension that is innovation is to understand and manage more products, customer types, technologies and markets.

Now, the predicted structural characteristics in this category are scanning of markets to discern customer requirements, low formalization, decentralization, extensive use of coordinated committees and task force.

In market differentiation, the challenge is to understand and cater to consumer preferences. The predicted structural characteristics include moderate to high complexity, extensive scanning and analysis of consumer’s reaction and competitor’s strategies, moderate to high formalization and moderate decentralization.

In breadth innovation the challenge is to select the right range of products, services, customers and territory while the predicted structural characteristics include high complexity, low formalization and decentralization. In breadth stability, the challenge is the same but the structural characteristics include high complexity, high formalization and high centralization. Here it was decentralization while here it is high centralization.

And in cost control the challenge is to produce standardized products efficiently. And this requires structural characteristics like high formalization and high centralization. So, this categorization scheme dissects Porter's differentiation into two dimensions.

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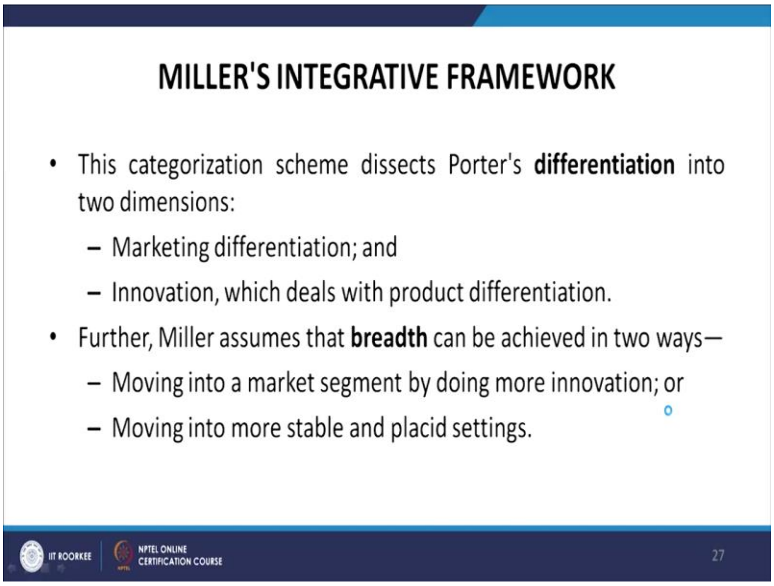

The first is marketing differentiation and innovation which deals with product differentiation. Further Miller assumes that breadth can be achieved in two ways moving into a market segment by doing more innovation or moving into more stable and placid settings.

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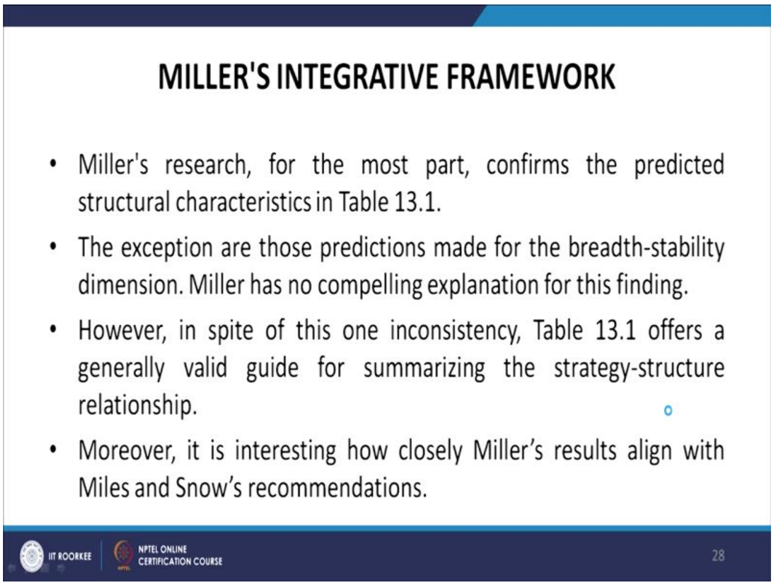

So, Miller's research for the most part confirms the predicted structural characteristics that are given in table 13.1. The exceptions are those predictions made for the breadth stability dimension. Miller has no compelling explanation for this finding. However, in spite of this one inconsistency table 13.1 offers a generally valid guide for summarizing the strategy-structure relationship.

Moreover, it is interesting how closely Miller's results are aligned with Miles and Snow's recommendations. What is this innovation and breadth innovation? It generally requires the same flexible structures as described by Miles and Snow for their prospector.

Cost control requires stability and structural characteristics consistent with Miles and Snow's defenders. Finally marketing differentiation, blends the need for flexible marketing and stable production which suggests its structural characteristics that Miles and Snow's attributed to their analyzers.

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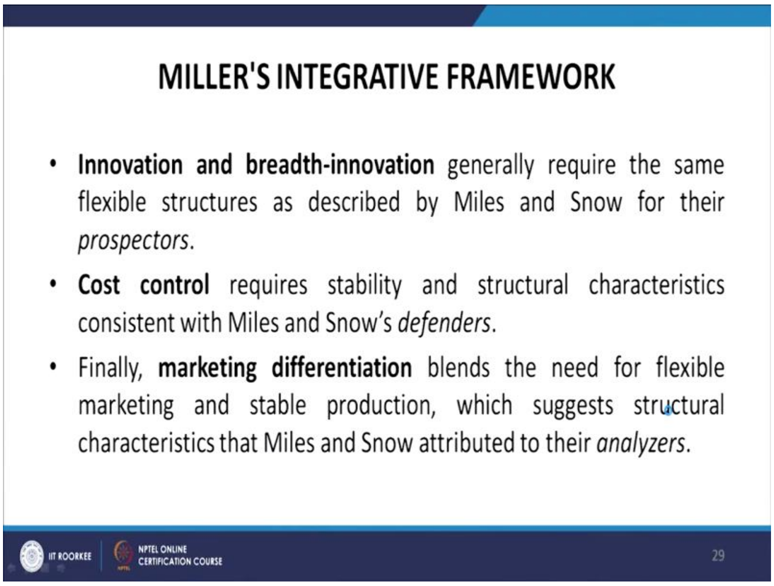

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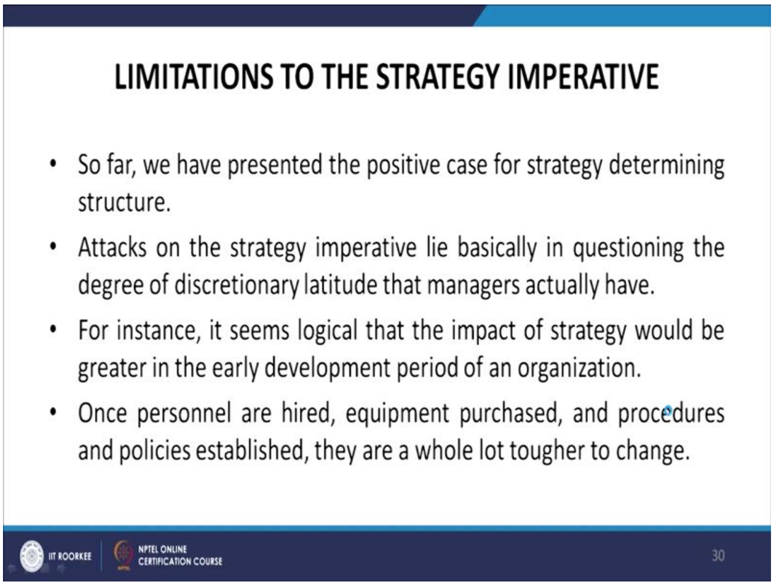

Now, let us look at the limitations to the strategy imperative. So far we have presented the positive case for strategy determining structure. Attacks on the strategy imperative lie basically in questioning the degree of discretionary latitude that managers actually have.

For instance, it seems logical that the impact of strategy would be greater in the early development period of an organization. Once personnel are hired, equipments purchased and procedures and policies established, they are a whole lot tougher to change.

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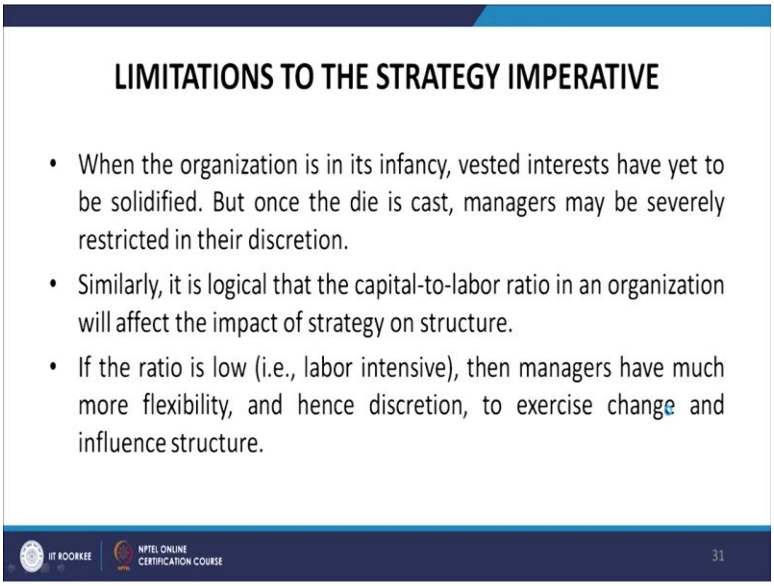

When the organization is in its infancy, vested interest have yet to be solidified, but once the die is cast managers may be severely restricted in their discretion. Similarly, it is logical that the capital to labor ratio in an organization will affect the impact of a strategy on structure. If the ratio is low that is labor intensive, then managers have much more flexibility and hence discretion to exercise changes and influence structure.

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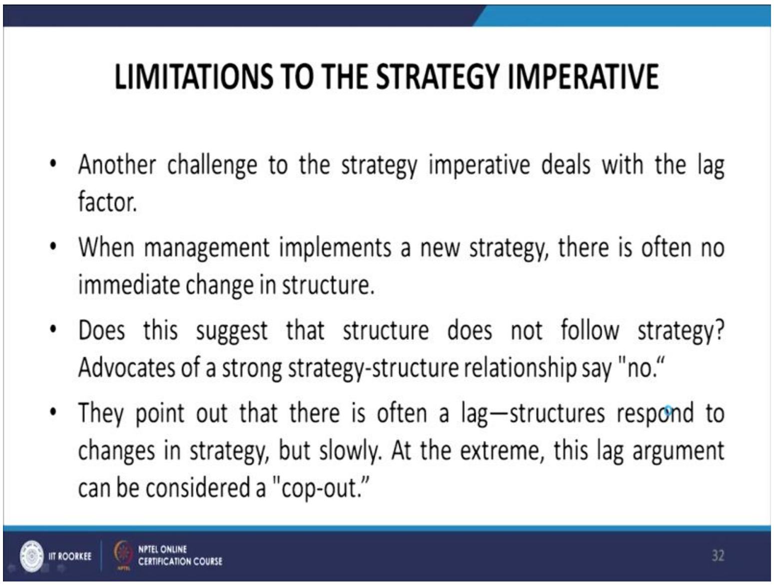

Another challenge to the strategy imperative deals with the lag factor. When management implements a new strategy there is often no immediate change in structure.

Does this suggest that structure does not follow strategy? Advocates of a strong strategic and structural relationships say no.

They point out that there is often a lag, structure responds to changes in the strategy but slowly. At the extreme this lag argument can be considered a cop out. If researchers fail to find a strategy-structure relationship in the study of an organization, they can always claim that there is a lag and the structure just has not caught up yet.

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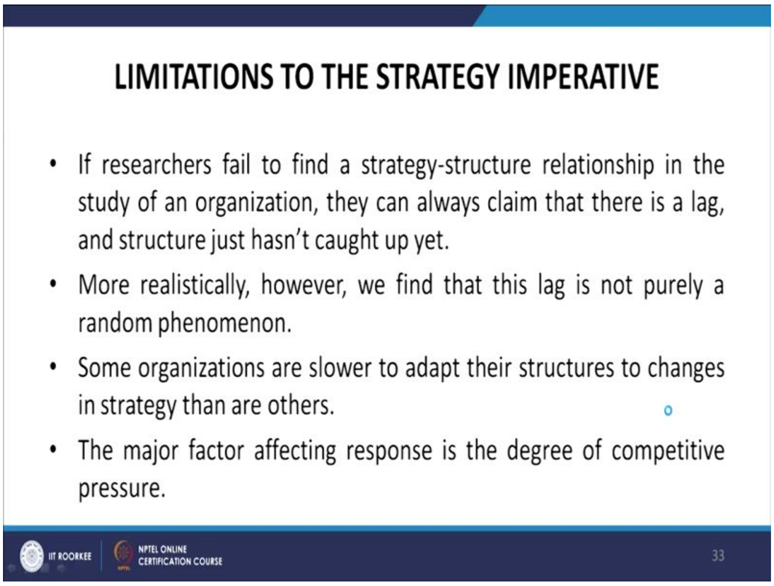

More realistically however we find that this lag is not purely a random phenomenon. Some organizations are slower to adapt their structure to changes in their strategy than the others. The major factor affecting response is the degree of competitive pressure.

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The less competition and organization face the less rapid its structural response. Without competitors the concern for efficiency is reduced. We would conclude that where an organization face minimal competition there is likely to be a significant lag between changes in a strategy and modification in structure.

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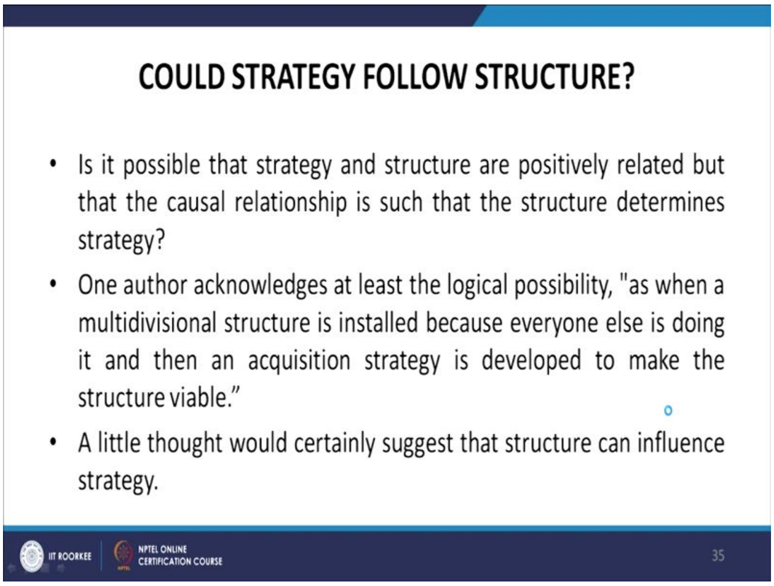

Now, could strategy follow a structure? That is the other way around. Is it possible that a strategy and structure are positively related, but that the causal relationship is such that the structure determines strategy? One author acknowledged at least the logical possibility as when a multidivisional structure is installed because everyone else is doing it and then an acquisition strategy is developed to make the structure viable. A little thought would certainly suggest that a structure can influence the strategy.

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Structure can motivate or impede strategic activity as well as simply constrain strategic choices. For instance, strategic decisions made in a centralized structure are typically going to have less diversity of ideas and are more likely to be consistent over time. In comparison, in a decentralized organization input is likely to be diverse and the people providing that input will change depending on the situation.

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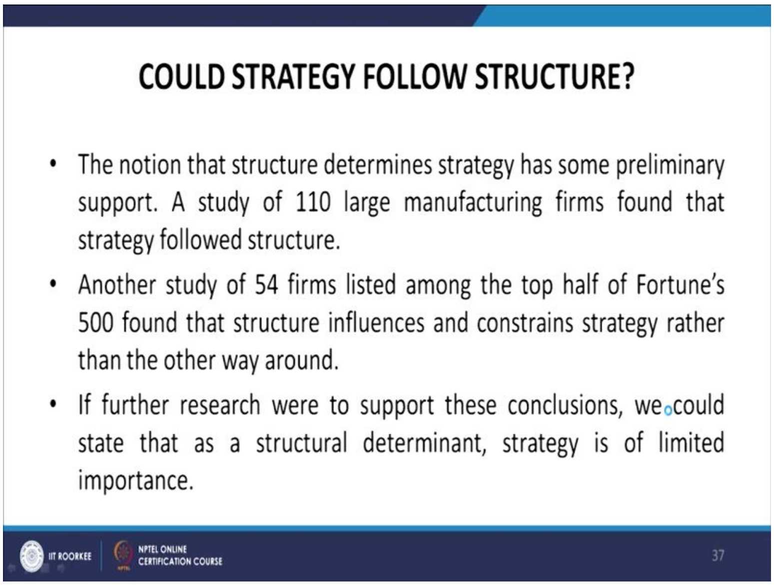

The notion that strategy determines structure has some preliminary support. A study of 110 large manufacturing firms found that strategy followed structure. Another study of 54 firms listed among the top half of the Fortune's 500 found that a structure influences and constraints strategy rather than the other way around. If further research were to support these conclusions, we would state that as a structural determinant, strategy is of limited importance.

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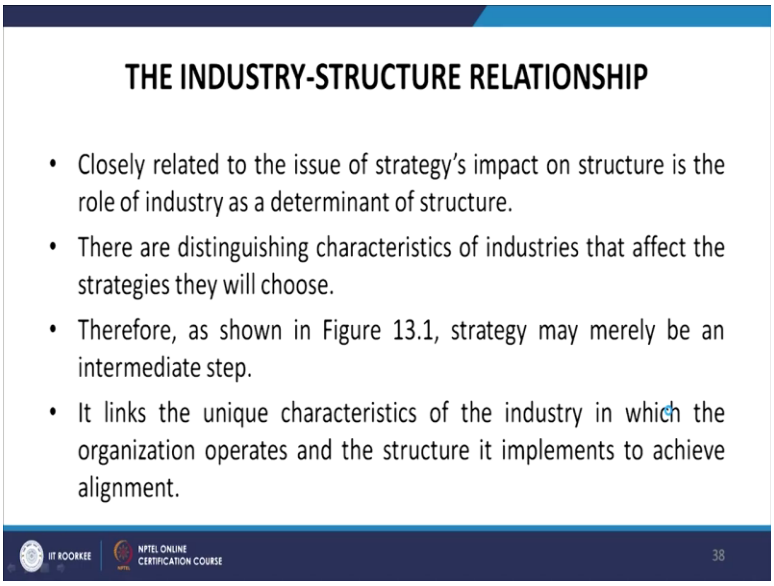

Now, we are looking at the industry-structure relationship. Closely related to the issue of strategy's impact on its structure is the role of industry as a determinant of structure. There are distinguishing characteristics of industries that affect the strategy they will choose. So, therefore as shown in figure 13.1, strategy may merely be an intermediate step.

It links the unique characteristics of the industry in which the organization operates and the structure it implements to achieve alignment. So this is the strategy structure relationship, industry determines strategy and it determines the structure. So this is figure 13.1.

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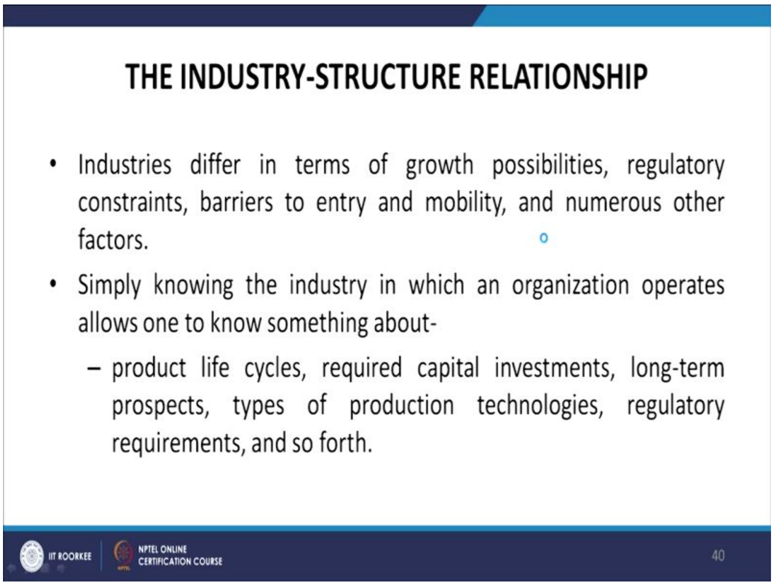

Industries differ in terms of growth possibilities, regulatory constraints, barrier to entry and mobility and numerous other factors. Simply knowing the industry in which an organization operates allows one to know something about product life cycle, required capital investments, long term prospects, types of production technologies, regulatory requirement and so forth.

Public utilities, for example, face little competition and can have more tightly controlled structure. In some industries strategic options are relatively few. The major home appliance industry is rapidly becoming the exclusive area of companies that compete only on a high volume low cost basis.

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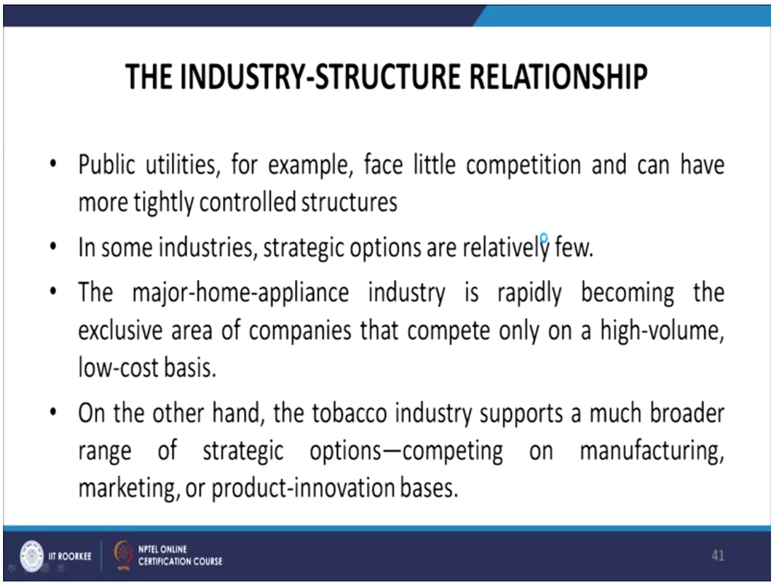

On the other hand, the tobacco industry supports a much broader range of strategic options competing on manufacturing, marketing or product innovation basis.

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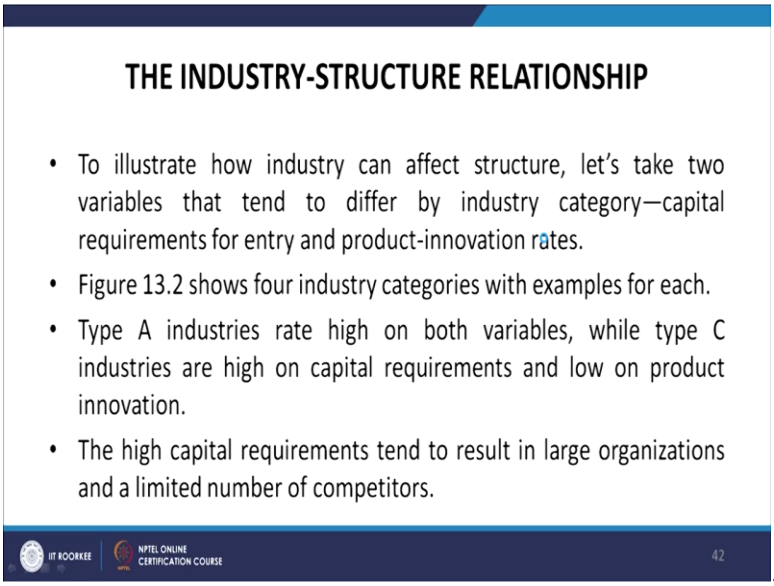

To illustrate how industry can affect a structure, let us take two variables that tend to differ by industry category-capital requirements for entry and product innovation rates. figure 13.2 shows four industry categories with examples for each. Type A industries rate high on both variables while type C industries are high on capital requirements and low on product innovation. The high capital requirements tend to result in large organization and a limited number of competitors.

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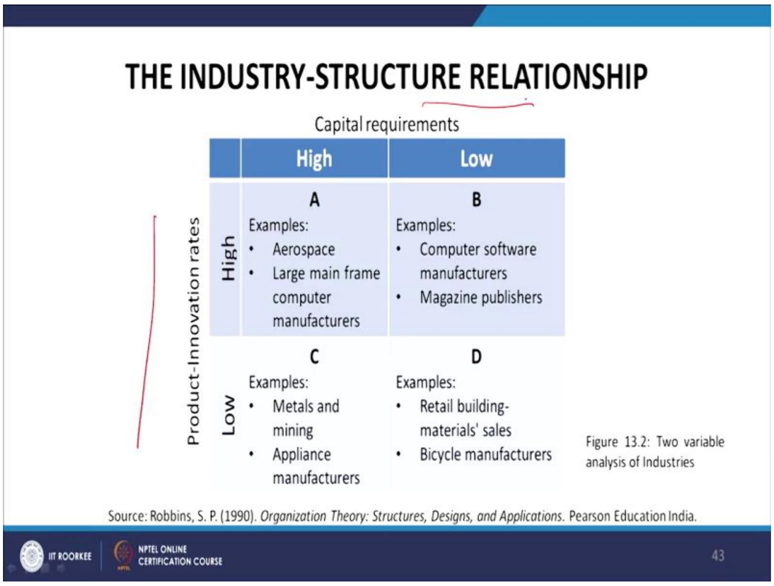

This is figure 13.2. So on the y axis we have product innovation rates and on the x axis we have capital requirement. So both of them have two categories high low and high low. So, now you see that in A when product innovation rate is high and the capital requirement is also high, examples include aerospace, large mainframe computer manufacturers.

While in B where the product innovation rates are high but capital requirements are low, so, this includes computer software manufacturers and magazine publishers. In C where the capital requirement is high but the product innovation rates are low, examples include metals and mining and appliances manufacturers. And in D where both these dimensions are low, it includes retail building material sales bicycle manufacturers.

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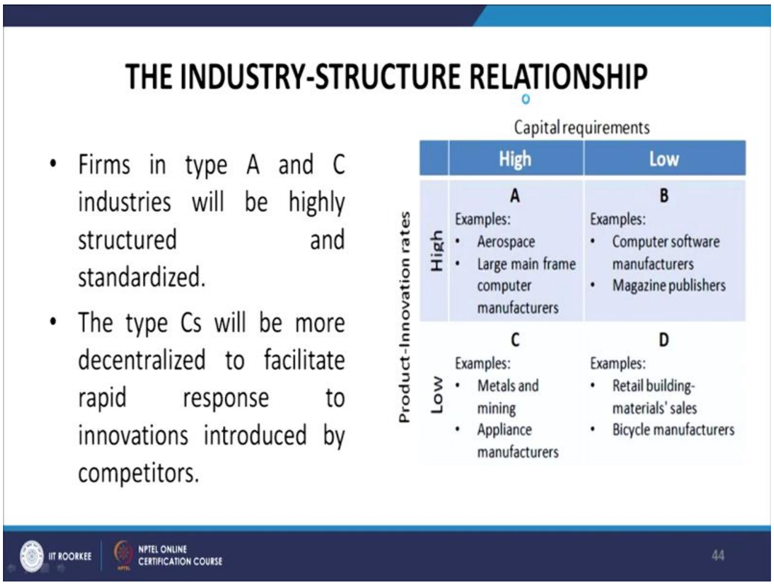

So the firms in type A and C industries will be highly structured and standardized. The type C will be more decentralized to facilitate rapid response to innovations introduced by competitors.

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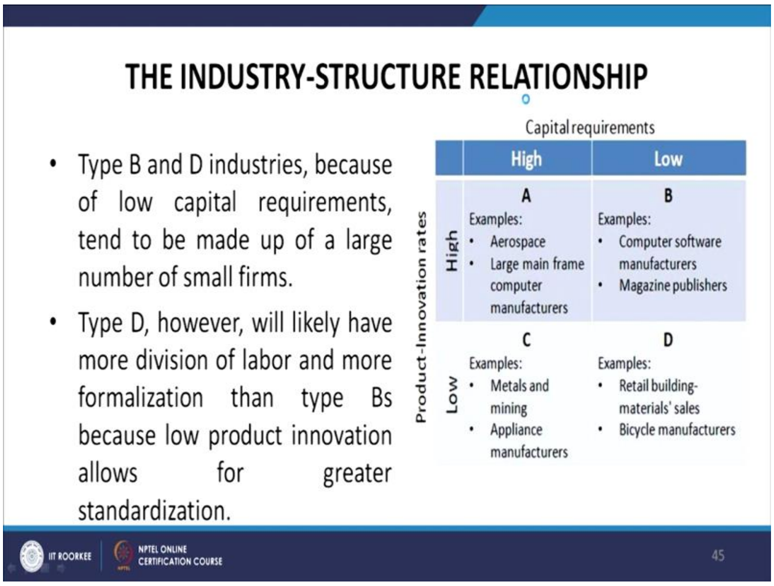

Type B and D industries because of low capital requirements tend to be made up of a large number of small firms and type D however will likely have more division of labor and more formalization than type Bs because low product innovation allows for greater standardization.

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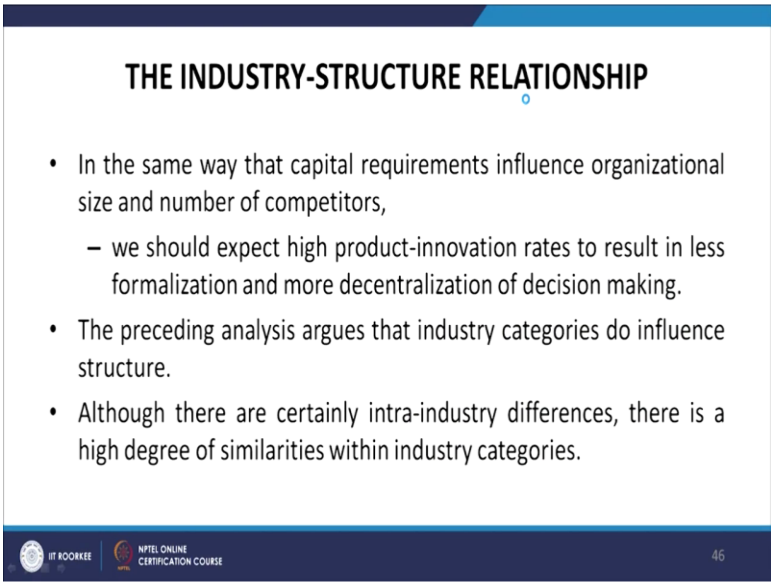

In the same way that capital requirements influence organizational size and number of competitors we would expect high product innovation rates to result in less formalization and more decentralization of decision making. The preceding analysis argues that industry categories do influence structure. Although there are certainly intra industry differences there is a high degree of similarities with in industry categories.

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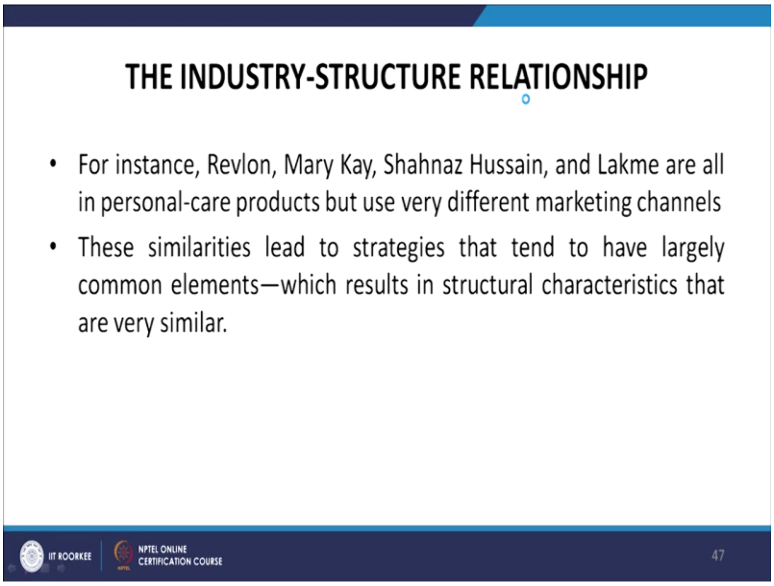

For instance Revlon, Mary Kay, Shahnaz Hussain and Lakme are all in personal care products but use very different marketing channels. These similarities lead to strategies that tend to have largely common elements which results in structural characteristics that are very similar.

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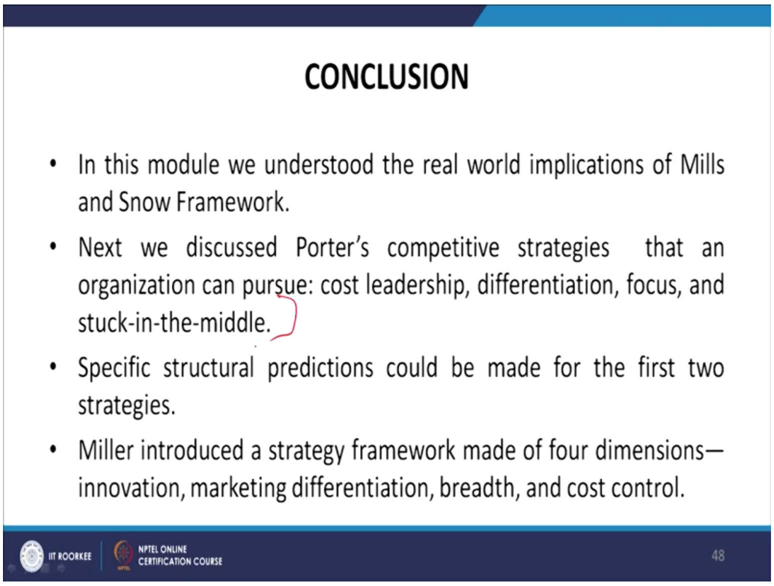

So, in order to conclude this module, in this module we understood the real world implications of Miles and Snow's Framework, then we have talked about and discussed Porter's competitive strategies that an organization can pursue and these are the three strategies, the cost leadership, differentiation focus and this is the fourth one that is when a company is nowhere so which is called as stuck in the middle.

Specific structural predictions could be made for the first two strategies. Miller introduced a framework made of four dimensions, innovation, marketing differentiation, breadth and cost control.

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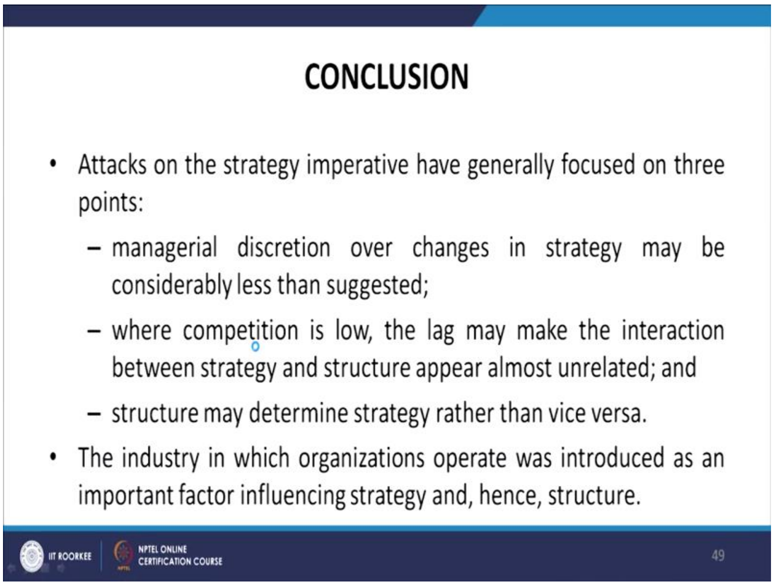

Attacks on the strategy imperative have generally focused on three points; managerial discretion over changes in a strategy may be considerably less than suggested. When competition is low, the lag may make the interaction between strategy and structure appear almost unrelated and the structure may determine strategy rather than vice versa. The industry in which organization operates was introduced as an important factor influencing strategy and hence, structure.

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And these are the four books from which the material for this module was taken.

Thank you.