2

HUMAN RESOURCE MANAGEMENT THROUGH A STRATEGIC PERSPECTIVE

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Chapter Overview

Defining the concept of strategy is both challenging and complicated at the same time. The strategy definition depends on the fundamental decisions about the future direction of an organization: its purpose, its resources and how it interacts with the environment in which it operates. Every aspect of the organization plays a role in this strategy: people, finance, production method, environment, customers, and so on. Moreover, changes in markets, regulations, technology, customers, competition and other factors mean that strategy formulation and implementation is an ongoing process that can be judged only from a historical perspective in the context of the organization's past events, resources and experience. In this chapter, we would like to analyse a new trend of modern strategies. Starting from the meaning of strategy and its definition, the authors will introduce the general formulation and implementation of strategies within the organization and the new framework that the organization has to consider to manage national and global strategies. The chapter will focus on the role of strategic human resource management (SHRM). As outlined in Chapter 1, SHRM involves a future-oriented process of implementing HR programs that address business problems and directly contribute to major long-term business objectives (Delery and Roumpi, 2017). SHRM covers the overall HR strategies adopted by business units and companies and tries to measure their impacts on performance (Lengnick-Hall et al., 2009). Several authors (Vrontis et al., 2017; Papa et al., 2018; Caputo et al., 2019) have asserted that strategy should fit with three generic conceptual variables: HRM practices, employee skills and employee behaviours. Soft skills used to be frequently described as a set of skills that most management scholars consider important in any work environment (Robles, 2012). Soft skills are connected with communication and interpersonal skills. Scientific articles analysed the managerial role of soft skills from several perspectives (Andrews and Higson, 2008; Laker and Powell, 2011; Del Giudice et al., 2017a).

In order to address these challenges, this chapter will investigate the role of soft skills in different strategic scenarios, with the aim of analysing the fundamental role of SHRM for the firm.

Learning Objectives

- **Explore the concepts of strategy and its core areas.**
- **Examine the different types of corporate strategy.**
- **Examine the different types of business strategy.**
- **Define the role of HR in strategic management.**

CASE STUDY 2.1

The management of human resources in Microsoft Corporation

William H. Gates III founded Microsoft Corporation in 1975. The declared mission of the company is to 'enable people and businesses throughout the world to realize their full potential' (Microsoft Corporation, 2015a). Microsoft Corporation operates in the information technology and software field. In 2019 the IT market's growth rate doubled compared to 2018, in spite of a general stagnation scenario. This trend is expected to consolidate in the following years with an overall growth in IT investments for the period 2018–2022 (Kappelman et al., 2019).

Microsoft Corporation was ranked 72nd on the Fortune 100 list and it was also ranked 86th on Fortune's Best Companies to Work For in 2014 (Fortune, 2015) that lists the companies with the best work environment. The rank in the 'Fortune's Best Companies to Work For' shows Microsoft has strong elements that give the company a competitive advantage, including the internal environment.

SHRM is one of the factors that gives Microsoft the ability to conduct better business analysis (Ferreira et al., 2018). Moreover, the company has integrated a HR approach into the strategic business plan in order to analyse and formulate a competitive strategy.

Microsoft provides a good case study to explore the relationship between IT and human resource management and they have invested in this area to enhance the strategic management of human resources. In particular, this example shows that employee engagement and retention are critical aspects of SHRM and are becoming more and more critical to effectively manage businesses (Lengnick-Hall et al., 2009; Boon et al., 2018).

In 2015, Microsoft stated that its 'current success is based on the drive of their 100,000 employees and to continue their success they believe they have a responsibility to create a respectful and rewarding work environment for them' (Microsoft Corporation, 2015b). In this way, Microsoft revealed that one of the most important strong points distinguishing the company from its competitors is internal resources management: employees who are able to help the firm to achieve its goals by exploiting transversal skills and creating a collaborative work environment. Employee engagement (Macey and Schneider, 2008) allows for profitable growth of human capital (Caputo et al., 2019) and it is an essential factor for the firm. As a matter of fact, due to

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the difficulty in conceptualization and operationalization of human capital, it is often used as a proxy variable. Several authors have also analysed the strategic role of employee engagement in fostering organizational change and performances (e.g. Delery and Roumpi, 2017). Organizations with a strategic approach to human resource management and assessment such as Microsoft have experienced not only impressive retention rates but also business success. Human capital must be constantly fed through training and learning, otherwise it can become passive and lag behind environmental changes (Delery and Roumpi, 2017).

Continuous learning and development of employees is a strategic key for competitiveness (Naim and Lenka, 2018). Learning and development programmes have always played a vital role in helping businesses to survive and achieve success. Through its 40-year history, Microsoft has organized learning and development programs in order to transfer to the employees the knowledge and mandatory skills needed to be part of an ever-changing company. It has also organized an online e-learning educational programs platform through the Microsoft Virtual Academy (Microsoft, 2015a).

Starting from these observations, it can be deduced that there are at least three human resource imperatives to ensure that SHRM practices will continue to support Microsoft's primary mission which aims at the constant development of internal resources for competitive advantage: i) keep developing new systems of human resource practices that support its future growth and competitiveness; ii) provide assistance to functions undergoing organizational change, including the HR function, and iii) implement the central position of the HR function. Specialization is crucial in this process and the above goals should be carefully considered to ensure success in SHRM functions (Delery and Roumpi, 2017).

Source: Adapted from Jacobs, *Microsoft: A Look at Strategic Human Resources* (2015)

Questions

1. What is the most important characteristic of Microsoft's mission from a HR point of view?
2. How does Microsoft's strategy for learning and developing HR fit with the issue for organization?
3. Do you think HR is an important driver in structuring strategy?

Introduction: Strategy in the twenty-first century

The last 20 years have witnessed environmental developments that have had considerable effects on strategy. Free market competition has been one element in supporting and encouraging growth in many newly developing countries. The lower labour costs and greater wealth in countries such as China and India have put pressure on Western and Japanese companies to cut costs or move to those countries. In addition to economic growth, the world marketplace has become more complex in cultural and social terms: markets have become more international, thus making it necessary to balance global interests and local demand variations. Furthermore, the rapid development of technology and new forms of communication have revolutionized strategy. The big change in the business environment has coincided with the higher level of training and deeper skill levels of employees on one side and the higher capability and knowledge of customers on the other. The previous two forces (employees and customers) have increased the level of competition, leading to more innovation in the market (Rieple et al., 2004).

Tough revolutions in the external environment impact on an organization's strategy, which changes as the environment surrounding the organization changes; this in turn alters the way the organization's strategy is created and developed.

Corporate strategy and business-level strategy

Corporate strategy defines the scope of the firm in terms of the industries and markets in which it competes, in order to reach a competitive advantage in selecting and managing different business ventures in different industries with different products and markets. Corporate strategy is the responsibility of both the top management team and the corporate strategy staff:

> **Corporate strategy is the pattern of major objectives, purposes or goals and essential policies or plans for achieving those goals, stated in such a way as to define what business the company is in or is to be in and the kind of company it is or is to be. (Andrews, 1971: 28)**

Corporate strategy is not a cohesive subject; different visions of corporate strategy have been developed because of its breadth and complexity. Two main approaches can be summarized:

1. *The prescriptive approach*: some researchers and scholars have judged corporate strategy to be essentially a linear and rational process, starting with where we are now and then developing new strategies for the future (see Argenti, 1965; Jauch and Glueck, 1988). A prescriptive corporate strategy is one whose objective has been defined in advance and whose main elements have been developed before the strategy commences.
2. *The emergent approach*: other scholars and commentators take the view that corporate strategy emerges, adapting to human needs and continuing to develop over time. It is evolving, incremental and continuous and therefore cannot be usefully or easily summarized in a plan (Mintzberg, 1987). An emergent corporate strategy is one whose final object is unclear and whose elements are developed during the course of its life as the strategy proceeds.

A corporate strategy needs to support an organization in obtaining superior return compared to the average as it happens at the business level. Product diversification is one of the most important corporate strategies when it comes to defining the industry and market where the organization competes. A successful organization will decrease the profit variability (and consequently the risk), balancing the cost and benefit of a diversification.

At the business level, strategy is concerned with competing for customers, generating value from resources and the underlying principle of achieving a sustainable competitive advantage over rival companies using those resources.

When a strategy is selected, the organization decides between a list of priorities and alternatives in order to compete in a selected market.

The common elements in a successful strategy can be assumed as follows:

- Simple, consistent and long-term goals.
- Profound understanding of the competitive environment.
- Objective appraisal of resources.
- Effective implementation of the strategy.

(Grant, 2008)

As shown in Figure 2.1, the firm embodies three of the above elements: goals and values (simple, consistent, long-term goals), resources and capabilities (objective appraisal of the resources) and structure and systems (effective implementation). The industry environment (a profound understanding of the competitive environment) is defined as the firm's relationships with customers, competitors and suppliers. The task of the business strategy, which represents a link between the firm and its environment, is to determine how the firm will deploy its resources within its environment and how it will organize itself to reach its long-term objectives. To be successful, a strategy must be consistent with the firm's external and internal environment, which includes goals and values, resources and capabilities, and structure and systems.

Figure 2.1 Grant's strategic vision

Source: Adapted from Grant (2008)

Focusing on specific links between business strategy and HR policies, it has been argued that organizations experience severe problems in strategy implementation if the strategy is not effectively linked with an appropriate policy of SHRM (Maxwell and Farquharson, 2008; Lengnick-Hall et al., 2009; Del Giudice and Maggioni, 2014). HR policy choice is seen as largely dependent on business strategy. However, as argued in Chapter 1, this is an interactive relationship: for example, HR policy choice may be broadly determined by business strategy, but its results (e.g. improved quality) may lead to a change in business strategy. Thus, while HR policy choice is generally seen as a lower order decision, it may also be an ingredient in the formulation of business strategy (Haesli and Boxall, 2005; Delery and Roumpi, 2017; Santoro et al., 2019).

REFLECTIVE ACTIVITY 2.1

1 One of the main disputes in corporate strategy over the last 20 years concerns the difference between prescriptive and emergent forms of strategy process. What is your view? Which approach is better and why?
2 What do you think is important in developing a winning strategy?
3 What is the main link between business strategy and SHRM?

The core areas of corporate strategy

The three core areas of corporate strategy are strategic analysis, strategic formulation and strategic implementation (see Figure 2.2):

1. *Strategic analysis*: the organization, its mission and objectives have to be analysed in order to provide value for the people involved in the organization – its stakeholders.
2. *Strategic formulation*: strategy options have to be formulated and then selected. The formulation has to be done according to the particular skills of the organization and the special relationships that it has or can develop with those outside – supplier, customer, distributor and government.
3. *Strategic implementation*: the selected options now have to be implemented.

More research has shown that in most situations strategy is not simply a matter of taking a strategic decision and then implementing it; it takes a considerable amount of time to make the decision itself, and there is further delay before it comes into effect. There are two reasons for this: first, people are involved – managers, employees, suppliers and customers. Any of these may choose to apply their own business judgement to the chosen corporate strategy,

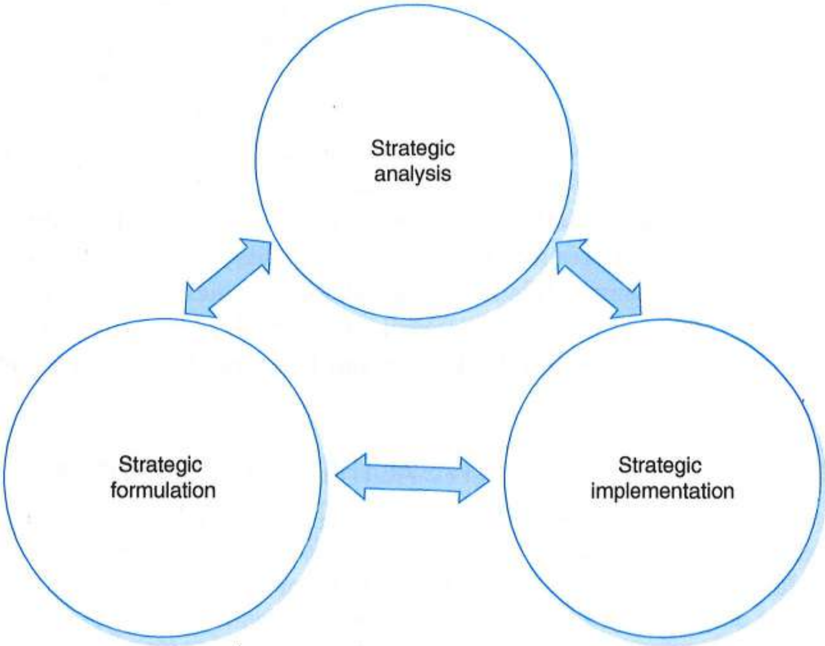

Figure 2.2 The core areas of corporate strategy

influencing both the initial decision and the subsequent actions that will be implemented. Second, the environment may change radically as the strategy is being implemented. This will invalidate the chosen strategy and mean that the process of strategy development needs to start again.

For these reasons, it's important to distinguish between context, content and process. While the context is the environment within which the strategy operates and is developed, the content consists of the main actions of the proposed strategy. Finally, the process is how to make actions link together or interact with each other.

As we can see in Figure 2.3, the intersection between context, content and process defines who affects the evaluation and who evaluates the strategy.

In most corporate strategy situations, context and content are reasonably clear: it is the way in which strategy is developed and enacted – the process – that usually causes the most problems.

The process of strategic analysis

The two different approaches to the core areas of corporate strategy underline important details.

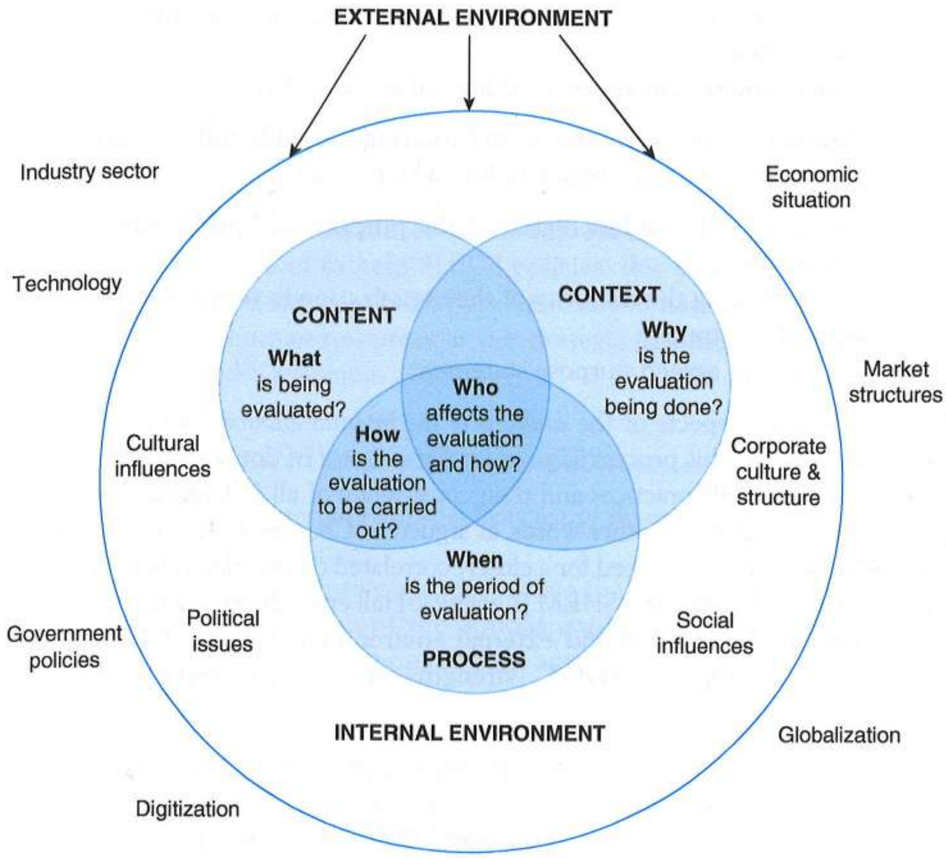

Figure 2.3 The content, context and process framework: Internal and external environmental factors

Source: Adapted from Stockdale and Standing (2006: 1090–102)

Strategic analysis, in both the prescriptive and emergent approaches, can be divided into:

- *Identification of vision, mission and objectives*: developing or reviewing the strategic directions and the more specific objectives, e.g. the maximization of profit or return on capital, or in some cases a social service. Some strategies place this third element before the other two, arguing that the organization should first set out the objectives and then analyse how to achieve them.
- *Analysis of the external environment*: examining what is happening or likely to happen outside the organization, or:
    - Understanding factors affecting the industry, the economy, communities and the environment.

- Surveying participants regarding the purpose and performance of the organization.
- Understanding the views of additional stakeholders.

- *Analysis of the internal environment*: exploring the skills and resources available besides those in the organization, which means:
  - Surveying stakeholders regarding the purpose and performance of the organization.
  - Understanding the maturity of the organization in terms of deriving and supporting strategy.
  - Deriving an agreed purpose statement.

One of the main aspects of the *analysis of the internal environment* is the setting up of HR policies. This process is based on the concept of double integration: consistency between HR practices and then consistency of all HR practices with the organization's strategy. In other words, as argued in Chapter 1, the key message of the HRM literature is the need for a closely correlated configuration between strategy or business planning and SHRM (Lengnick-Hall et al., 2009; Boon et al., 2018).

Looking at the internal and external environment (Figure 2.4) helps the organization to apply a SWOT (strengths, weaknesses, opportunities and

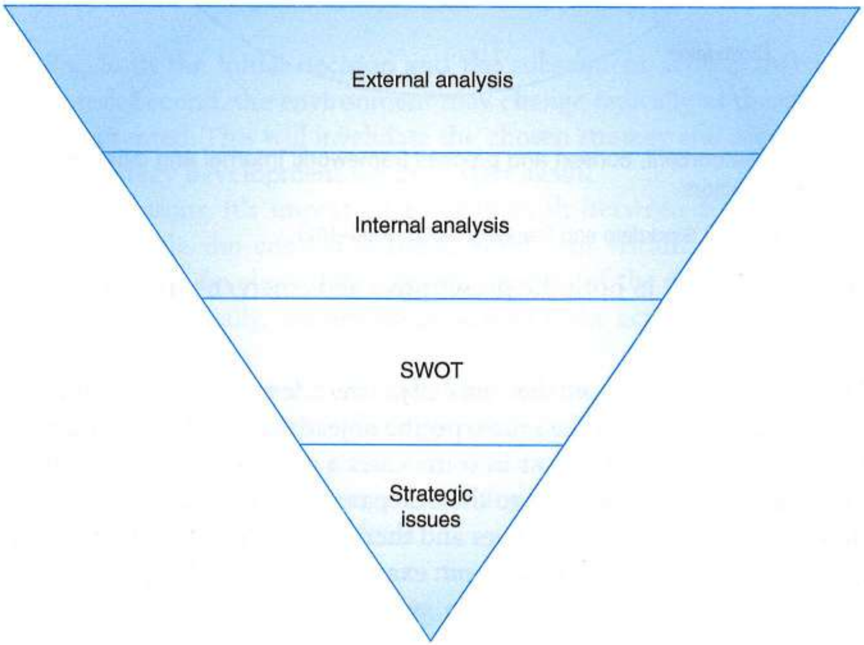

Figure 2.4 The process of strategic analysis

threats) analysis – an important tool used to define strengths and weaknesses internal to the organization and opportunities and threats external to the organization (see Chapter 1). Compiling the information from this analysis is useful for deriving the key strategic issues that the organization must address in order to satisfy its purpose statement over the following years.

SWOT analysis can be helpful to take an objective and critical insight of the whole organization (Jackson et al., 2003). Furthermore, SWOT analysis can also be used as a tool to help SHRM policies: this tool is appropriate for human resource development (HRD) professionals to handle human resource policy and exploit human resources in the strategic planning of the organization (Chermack and Kasshanna, 2007).

Strategy development and implementation

The prescriptive and emerging approaches clearly diverge in the development and implementation of strategy.

According to the prescriptive approach, once the objectives are set the next step is a formal consideration of the options available to achieve them. This is followed by selecting from those options according to identified criteria in order to arrive at the prescriptive strategy.

The emerging approach takes a much more experimental view of the strategy choice and its implementation. It seeks to learn by trial, experimentation and discussion as strategies are developed. There is no final agreed strategy, rather a series of experimental approaches that are considered by those involved and then developed further: strategy emerges during a process of crafting and testing. There is therefore no clear distinction in the emergent approach between the two stages of developing the strategy and its implementation: what is important is the strong link back to the earlier analytical phase, enabling the change in the environment and resources to be reflected quickly in the adaptive learning strategy.

When an organization needs to choose a strategy, the best approach would be to evaluate the strategy itself and then an alternative. The same approach used to value companies and business units can be applied to evaluating alternative strategies, or rather forecasting the cash flow under each strategy and then selecting the strategy that produced the highest NPV (net present value). The same DCF (discounted cash flow) methodology is used to value individual projects, individual business units and alternative business strategies.

Another method for evaluating the strategy is that of real options. The idea behind this method is simple: there is value in having the option to do something. In a world of uncertainty, where investments once made are irreversible, flexibility is valuable. Instead of committing to an entire project, it is more favourable to break the project into a number of phases, where the decision of whether and how to embark on the next phase can be made in the light of prevailing circumstances and what has been learned from the previous stage of the project. Most large companies have a 'phase and gate' approach to product development in which the development process is split into distinct phases, at the end of which the project is reassessed before being allowed through the 'gate'. Such a phased approach creates an option value that arises from the potential to revise the project during the development process, or even abandon it. Companies in every type of industry have to allocate resources to competing opportunities; whether in existing businesses or new ventures, they have to decide whether to invest at that moment, take preliminary steps reserving the right to invest in the future, or do nothing. Each of these choices creates a set of pay-offs linked to future choices.

This method is also used by venture capitalists to assess new business proposals when looking for the business's scalability – the potential to scale up or replicate the business if it proves successful. Scalability is a source of option values. The adoption of real option valuations to evaluate investment projects and strategies is limited by the complexity of the techniques for modelling uncertainty and the consideration of multiple scenarios in relation to the use of probability and/or the use of resources.

The core areas of business-level strategy

One of the classic questions that managers are supposed to ask themselves about their organization's strategy is 'Which business are we in?' The answer to this question – and to the related questions, '*How many* businesses are we in, and how do they connect to one another?' – is what we term the organization's competitive stance. Companies cannot do everything: their value chains, cultures, architectures and resources are not infinitely versatile, and will be more suited to one type of operation or market than another. This makes an organization's choice of competitive stance – which customers to serve and which products or services to offer them – the most fundamental of its strategic decisions (the term 'competitive stance' is our own, but forceful arguments for the importance of product and market selection in strategy can be found in Ohmae (1982) and Kim and Mauborgne (1999, 2004, 2005)).

In some cases, the starting point is an idea of how the value chain will be distinctive; the organization then works out which kinds of product and market will fit it. For example, Amazon, the world's leading internet retailer, began in 1995 when its founder Jeff Bezos realized that the World Wide Web, then in its early days, presented commercial opportunities. He concluded that books, which people do not need to touch or see before they buy them, would be the ideal product to sell via the internet, and would appeal to the affluent, educated people who were the early users of the Web. Later, Amazon was able to expand its product range to include CDs, electronic goods and a large range of other items, while the number of potential customers expanded as more people acquired internet connections at work and at home.

Finally, the business can also be defined through the analysis of the internal resources of the firm. This specific analysis also includes one of the most important resources for the company: human capital (Delery and Roumpi, 2017; Boon et al., 2018). The strength of a corporate strategy is sometimes based on the role that human capital plays within the firm. By defining the strategic aspect of human resources, the emphasis is placed on the strategic integration between business and human capital: staff structures, systems and organization must be designed to support the organization's strategy. Furthermore, the SHRM employs all human resources in the organization in order to pursue the strategic aim of the firm (Del Giudice and Maggioni, 2014).

Products and customer analysis

The concept of competitive stance also embraces decisions as to *how many* segments to serve and *how many* products to put on the market, and at a corporate level, how many businesses to be in. Should an organization concentrate on one product in one market, or spread itself more broadly across a number of different products, markets or even industries? There are clear attractions to being bigger and more diverse. By offering a broader range of choices to its customers, an organization can make itself attractive to them. If it can make the different parts of the company work well together, then it may become a more formidable competitor in other ways as well: more efficient and with a broader range of skills to call upon. Less obvious, however, is the very real risk that sales from the new products or markets will not be profitable, or that any profits will not justify the extra investment involved.

There are potent forces that drive organizations, particularly successful ones, to consider broadening the scope of their activities. One force is the fear of being dependent on one small set of customers or technologies. Probably more important is the fact that good entrepreneurs will, once they have found customers and developed the value chain to serve them, spot other ways that they can use their resources to generate profits.

Sometimes this expansion goes too far. Unilever, the Anglo-Dutch consumer goods conglomerate, found itself in 1999 with 1,600 brands (products, or variants of products), of which just 400 'power brands' accounted for 90% of sales. It decided that by disposing of some of the 1,600 and focusing its marketing, research and personnel, it could raise its profit margins closer to those of its leading competitors (Smith 1999; Willman 1999a, 1999b).

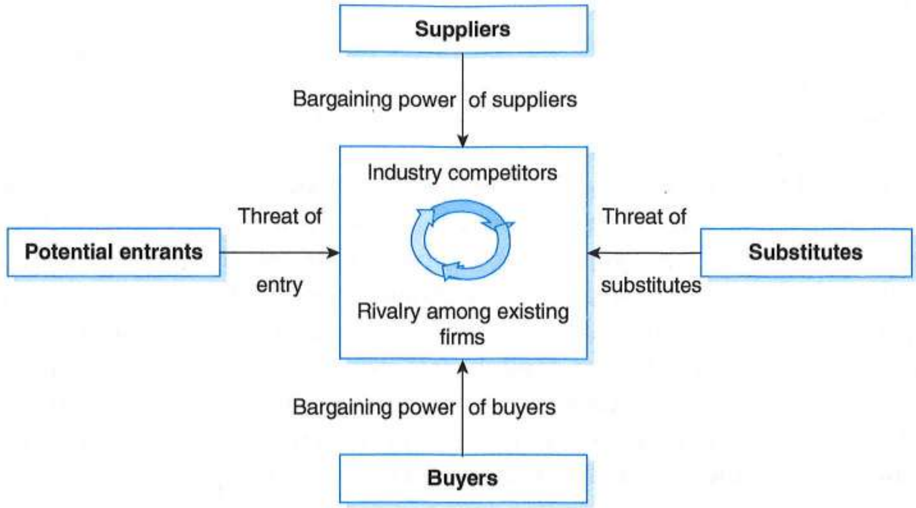

Figure 2.5 Porter's five forces of competition framework

Source: Adapted from Porter (1980)

Competitor analysis

The organization has to understand the competition in order to achieve 'competitor advantage' to outperform its rivals and capture a greater share of an existing market space.

To understand the competitor, it is useful to apply Porter's (1980) framework to classify and analyse those features of an industry that quantify the intensity of competition and the level of profitability (see Chapter 3). Porter defined the five forces of competition (see Figure 2.5) as follows:

- Competition from substitutes, from entrants and from established rivals as sources of 'horizontal' competition.
- The bargaining power of suppliers and buyers as sources of 'vertical' competition.

Horizontal competition

- Substitutes are products or services of a firm's rivals that meet approximately the same customer needs in the same ways, but do so in different ways, like the products or services provided by the firm itself.
- New entrants are firms that have recently begun operations in an industry or that threaten to begin operations in an industry soon. They are motivated

by the above-average economic profits that some incumbent firms in an industry may be earning.

Vertical competition

- Bargaining power of buyers: companies always appear on two markets. The first is the market in which they acquire the inputs for production (raw materials, components, financial and labour services) from the suppliers of these factors of production. The second is the market where they sell their output of production (goods, services) to customers (distributors, consumers, other manufacturers). In both cases, the relative profitability of buyers and suppliers in a transaction depends on their economic power.
- Bargaining power of suppliers: the analysis of suppliers' threat is similar to that of buyers. The determining factors for the effectiveness of the bargaining power of the supplier against the buying power in an industry are the same as those that decide the power of the industry against the power of its customers.

As Porter (1980) highlights, an industry structure that is stable and externally determined does not give a complete picture of industry competition. Competition is a dynamic process in which the industry structure changes through evolution and transformation. In the end, competition is not some constrained process that determines prices and profits and leaves the industry structure unchanged. Competition is a dynamic process in which a balance is never reached and, in the course of which, industry structures are continually reformed.

The dynamic interaction between competition and industry was first recognized and analysed by Joseph A. Schumpeter (1987[1942]). He was of the opinion that the fight for market shares compels companies to enforce both new production technologies and new products. These innovations are made by dynamic firms or trailblazer companies in the first place. They would be motivated by the chance to earn temporary monopoly profits. Such temporary profits draw imitators, which leads to the diffusion and establishment of innovations. In this way, a dynamic competition gets going, which is identified with an incessant search of innovations connected with a process of 'creative destruction'.

The question is whether current structures can be used as a solid base for forecasting competition and industry performance in this economic period. This depends on the speed of structural change in the industry. In the event that transformation is rapid, and innovations transubstantiate the industry structure fast by changing the process technology, creating new substitutes, and so on, then industry structure is not a useful basis for analysing competition and profit. Information technology is revolutionizing products. Once composed solely of mechanical and electrical parts, products have become complex systems that combine hardware, sensors, data storage, microprocessors, software and connectivity in myriad ways. These 'smart, connected products' – made possible by vast improvements in processing power and device miniaturization, and by the network benefits of ubiquitous wireless connectivity – have started a new era of competition. The Internet of Things offers exponentially expanding opportunities for new functionality, new product utilization and capabilities that cut across and transcend traditional product boundaries. The changing nature of products is also disrupting value chains and industry boundaries, forcing companies to rethink their strategy. These new types of products alter industry structure and the nature of competition, exposing companies to new competitive opportunities and threats. They are reshaping industry boundaries and creating entirely new industries. In many companies, smart, connected products will force the fundamental question, 'What business am I in?'

How to diversify different businesses

Substantial change to the range of offerings or to the markets served, or both, is known as *diversification*. This term was originally reserved for moves involving both new offerings and new markets (Ansoff 1965). However, it has come to denote any extension of an organization's activities into new areas.

It is now generally agreed that spreading risk is, in and of itself, an inadequate reason for a corporation to diversify into new markets, new customers and new offerings, as Figure 2.6 illustrates. Investors can achieve their desired spread of investment risks by diversifying their own shareholdings, at less cost than a corporation incurs in entering and leaving businesses and markets. There are

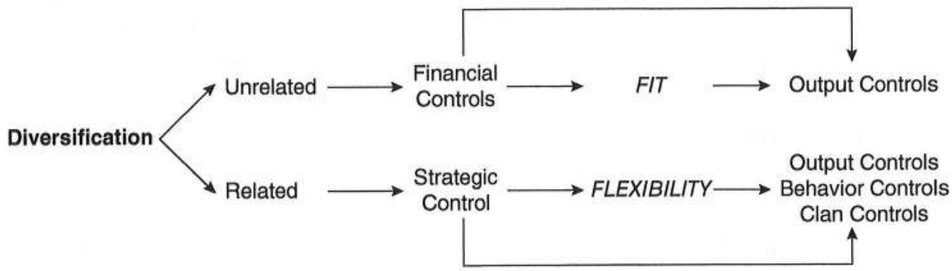

Figure 2.6 An expanded model illustrating the link between diversification, fit and flexibility, and HRM control systems

Source: From Rowe and Wright (1998)

exceptions to this where corporations are involved in businesses or geographical locations (the former Soviet Union, or China, for example) that have less well-developed capital or stock markets, and where the opportunities for buying a spread of shares are limited or risky because of a lack of information.

Whatever the reasons for expansion into new areas, the benefits may come at a price. Organizations that do not focus adequately on the needs of particular customers or segments risk losing business to firms that do. Senior managers in firms which diversify too much appear to lose the ability to oversee the different products or businesses in their portfolio. Their management attention and expertise are diluted, allowing competitors who are specialists (and therefore more likely to have deep knowledge which is unique and inimitable) to gain advantage – a process which happens individually in each product or market in which the diversified firm competes.

While the link between diversification and corporate controls is well-established (Chang, 1996; Lins and Servaes, 2002; Hoechle et al., 2012), little attention has been paid to the effect of diversification and corporate controls on HRM practices at divisional level and the consequent micro controls.

In order to analyse how SHRM acts in relation to diversification strategies, it is necessary to introduce the concepts of *fit* and *flexibility* in HRM practices (Wright and Snell, 1998). From the perspective of SHRM, *fit* is conceptualized as internal consistency among a set of underlying and theoretically related variables (Schuler and Jackson, 1987; Wright and Snell, 1998). Boon et al. (2011) argue that *fit*, as it relates to HRM, concerns the relationships among HRM practices and it means that various HR practices, such as selection, training, performance appraisal and compensation, complement and support each other. In contrast, *flexibility* regards the ability of an entity to quickly and easily change and adapt its policies, practices or procedures to meet the diverse or changing demands of the environment (Wright and Snell, 1998). Milliman et al. (1991) define HRM *flexibility* as the capability to facilitate a firm's ability to adapt effectively, and in a timely manner, to diverse and changing demands from within the firm itself and/or from its environment.

Several authors (Baysinger and Hoskisson, 1989; Wright and Snell, 1998; Boon et al., 2011) have empirically shown that the implementation of strategic controls leads to *flexibility* in HRM strategy, while the imposition of financial controls leads to *fit* in HRM strategy.

The risk of dilution of management attention can be reduced, and the chances of success in diversification increased, if the elements in a portfolio are *strategically related*: that is, if the industry success factors are similar. This is particularly important in the case of corporate-level diversification.

How to balance different businesses

As a firm's degree of product and market diversity increases, it loses some economies of scale, but may be compensated by what are known at the business level as *economies of scope*, and at corporate level as *synergies*. These take six main forms (Goold and Campbell, 1998):

- *Sharing tangible resources*,such as manufacturing, research or head office or IT facilities. Having such facilities fully utilized across a range of products makes more economic sense than having them specialized but half-used.
- *Pooling negotiating power*, primarily vis-à-vis suppliers, not only occurs to obtain lower prices, better quality or a more responsive service, but also to obtain better treatment from retailers (more prominent displays of the firm's products), customers, regulators or even investors.
- *Co-ordinating strategic business unit (SBU) strategies*, such as market entries, new product launches or pricing moves, avoids a wasteful duplication of effort and improves the effectiveness of the company's response to competitors' moves. Large conglomerates involved in multiple marketplaces, where some of their products may even be substitutes for each other, can benefit from a co-ordinated approach to product pricing across the divisions (Besanko et al., 1996).Margins across all their divisions are likely to increase – something known as the *efficiency effect*. Divisions can also cross-sell one another's products.
- *Vertically co-ordinating* the provision of goods and services across SBUs can help to minimize inventories, improve asset utilization and speed up product development.
- *Creating combined businesses*. Corporations can link the expertise from different SBUs to produce new products or businesses or can pull particular activities out of individual SBUs and combine them into a new business.
- *Sharing intangible resources.* Hamel and Prahalad (1994) showed how a number of, mostly Japanese, corporations discovered that knowledge about particular technologies or markets could profitably be applied to businesses or products that, to an outsider, often appeared completely unrelated to the firm's original sphere of operations. Nonetheless, the genuine similarities in terms of market needs, technological characteristics or manufacturing processes justified a move into them.Businesses may also exchange information on customers – their details and preferences for the cross-selling of products, for example. When intangible resources are shared in this way, they are sometimes said to be *leveraged* across businesses – their power is multiplied by being shared, in the same way that a lever multiplies the force applied by a person or machine. Virgin, a London-based conglomerate, has a brand

name and corporate identity that is distinctive and recognizable to a specific group of its potential target customers, mainly younger people. It attaches that brand to around 50 businesses, including airlines, mobile phone services, financial services, cosmetics, saucy underwear and space travel, whose products might be attractive to those target customers. Virgin's understanding of those customers' needs is an intangible resource that it leverages across all those businesses. The brand is similarly leveraged. Every time the group's charismatic founder, Richard Branson, generates favourable press coverage – as he has a gift for doing – he boosts the brand image of every single one of those businesses, at no greater cost than if Virgin were a small firm with just a single product.

Many strategy writers, particularly in the 1970s, felt that it was important for a portfolio to be 'balanced' – displaying a mixture of different characteristics. Balance might be achieved across a number of dimensions:

- Size – a mix of small and large businesses.
- The age or the life-cycle stage of the industry – a mix of young, fast-growing businesses and more mature ones (see Chapter 3).
- The extent to which the businesses are net producers or consumers of cash.

One theoretical benefit of a balanced portfolio is a reduction of risk, since it would minimize the likelihood of all the businesses facing severe problems at the same time. A second potential benefit is that resources can be redistributed from the businesses that have them to those that need them – for example, a mature business can become a source of cash and of marketing and production expertise for a younger one. However, there is absolutely no evidence that firms that have balanced portfolios perform any better (or worse) than those that do not.

The main tools used to assess balance in a portfolio are the well-known matrices developed by the Boston Consulting Group (the BCG Growth-Share Matrix) and General Electric (the Business Attractiveness Screen).

However, empirical studies have not found any systematic differences in the way in which businesses appearing in different parts of these matrices need to be managed. This implies that it may not be valid to make investment decisions on the basis of such a simple piece of two-dimensional analysis, without, for example, taking account of an SBU's or product's relationship with the others in the portfolio. Moreover, certain of the assumptions behind the frameworks are false, notably the assumption that 'dogs' – low-growth, low-share products or businesses – are likely to consume rather than generate cash. In fact, the limited amount of testing that has been conducted on these frameworks suggests that managers who employ them make *worse* investment decisions than those who do not (Capon et al., 1987; Slater and Zwirlein, 1992; Armstrong and Brodie, 1994).

The importance of HRM in strategy

Organizations cannot achieve sustainable competitive advantage just by selecting the right combination of products and services, and positioning them to appeal to attractive target market segments. Although these decisions are a vital part of strategy, and may lead to desirable economies of scale and scope, they are not sufficient in themselves because they are too easy for competitors to notice and copy. The munificence, dynamism and complexity of an industry environment are also not enough to explain the very real differences in profitability between firms in the same industry. After all, if the industry was the only factor, then all the firms in an industry would have similar levels of profits – and they do not. The 'resource-based view of the firm' (RBV) which emerged towards the end of the twentieth century focuses on organizational features – resources – that are the basis of competitive strength, if exploited properly (see Chapter 3). Edith Penrose (1959) showed how, over time, firms built up human and physical resources and the capability to use them to provide different kinds of services, some of which could be used in different products and markets from the ones for which they were developed. Subsequent developments of this theory (Nelson and Winter, 1982; Amit and Schoemaker, 1993; Peteraf, 1993) focused on the importance of the unique, often hidden, aspects of an organization, such as tacit knowledge, or the things that it has learned to do, in understanding the differences between firms.

These differences arise because two firms can start from a common base, yet end up over time with very different sets of routines, capabilities and knowledge, something now known as path dependence. Time also means that competitors find it difficult to copy a firm's resources, because they may not be able to understand precisely how and when they were developed – in other words, there is causal ambiguity. These resources may also be part of a complex interaction with a number of other, *complementary*, resources within the firm that make them more effective than they would be if used on their own.

The human resource is a complex and important resource inside the organization that has to be managed in a close relationship with the strategy to create competitive advantage.

Recruitment, selection (Chapter 5), training and development (Chapter 10) are all aimed at bringing in or building certain skills, enabling employees to effectively perform their jobs. In addition, their experience with these practices, along with rewards, performance management (Chapter 7) and communication (Chapter 8), shape workers' perceptions of the company's fairness and desirability. And those perceptions then influence their commitment, motivation and engagement.

Researchers have found a significant relationship between HR strategies and profitability (see Chapters 3 and 13). However, this research has seldom identified how the relationship works.

Investing in employee management not only delivers administrative cost savings but is also, in fact, one of the best performance-enhancing investments a company can make. Research overwhelmingly indicates that effective employee management can and does lead to a competitive advantage in the form of a more motivated workforce and improved operational and business performance. By sharpening our focus on the relationship between employee management and business performance in the management of the strategy, it is important to identify practices that will maximize the return on the investment in employee management practices and achieve the positive business results experienced by other companies. It is also important to align people management practice with the business objective.

The purpose of employee management is to solidify and enhance the advantage of human resources to motivate, develop and retain employees more effectively than your competitors.

The practices that apply to managing employees can be summarized as follows:

- *Hiring practices*: ensure that employees hired for different positions have the necessary skills and background to be successful in their individual jobs (Chapter 5).
- *Evaluation practices*: ensure that employees are being provided with useful feedback about their performance (Chapter 7).
- *Compensation practices*: provide employees with what they consider to be fair pay for their work (Chapter 7).
- *Training and development practices*:provide employees with opportunities to grow through job training, job rotation and promotion (Chapter 10).

Focus on strategic human resource management

Strategic human resource management represents one of the most important aspects of HR management in the firm. In the current context, firms that intend to increase the possibility of growth must engage in strategic HR management, as a fundamental and strategic driver for competitive advantage and value creation (Gupta et al., 2016).

Several scholars (Del Giudice et al., 2017b; Ferreira et al., 2018; Papa et al., 2018) have noted general improvements in the organizations in which this culture is applied: increasing competitiveness, reducing staff turnover, improving staff climate, and reducing indirect HR costs (Vrontis et al., 2017).

Considering human resources as an investment rather than a cost, business management develops the idea that the strategic exploitation of human resources is a factor that must be always present in the firms (Carayannis et al., 2017; Del Giudice et al., 2017c). In this vein, firms are more likely to be successful when all teams are working towards the same objectives. One of the main needs of the firms' HR management is the identification of the skills and knowledge (soft skills) necessary to carry out current and future tasks (Dezi et al., 2019).

To ensure SHRM is effective, firms will need to create a strategic HR planning and management process using the following steps:

- Analysis of mission and objectives of the organization/firm.
- Analysis of opportunities and threats externally and analysis of strengths and weaknesses internally.
- Definition of the strategic choices of the organization/firm.
- Definition of human resources requirements, consisting of the dimensions: i) skills and ii) behaviours.
- Activation of HR processes of HRM such as:
    - Search and selection of HR corresponding to needs: companies must equip the HR function with workers with suitable skills for strategic objectives.
    - HR training to cover internal needs: SHRM must update human resources in every context.
    - Management of cohesion in HR relations: the internal environment must always be collaborative.
    - Benefit and reward systems management: SHRM must reward HR if certain tasks are achieved.
    - HR assessment: human resources must be constantly evaluated in order to verify the short- and long-term objectives.
    - Job analysis.
- Design and management of HR assessment models, in terms of performance, skills, and objectives.

This bullet list determines the main steps in defining a good human resources strategy. Therefore, a firm's management must be able to determine the value of human resources and reward them according to the tasks achieved.

Emergent corporate strategy

In the following paragraphs, we will examine different kinds of corporate strategy and analyse:

- The open business model strategy.
- The network strategy.

Open business model strategy

Johnson et al. (2008) defined a business model as the union of four blocks that, taken together, create and deliver value: customer value proposition, profit formula, key resources and processes. The most important to get right, by far, is the first.

- *Customer value proposition*. A successful company is one that has found a way to create value for customers – that is, a way to help customers get an important job done. By 'job', the authors mean a fundamental problem in a given situation that needs a solution.
- *Profit formula*. The profit formula is the blueprint that defines how the company creates value for itself while providing value to the customer. It consists of the following:
    - Revenue model: price × volume.
    - Cost structure: direct costs, indirect costs, economies of scale; cost structure will be predominantly driven by the cost of the key resources required by the business model.
    - Margin model: given the expected volume and cost structure, the contribution needed from each transaction to achieve desired profits.
    - Resource velocity: how fast we need to turn over inventory, fixed assets and other assets – and, overall, how well we need to utilize resources – to support our expected volume and achieve our anticipated profits.
- *Key resources*. The key resources are assets such as the people, technology, products, facilities, equipment, channels and brand required to deliver the value proposition to the targeted customer. The focus here is on the key elements that create value for the customer and the company, and the way those elements interact. (Every company also has generic resources that do not create competitive differentiation.)
- *Key processes*. Successful companies have operational and managerial processes that allow them to deliver value in such a way that they can successfully repeat and increase in scale. These may include such recurrent tasks as

training, development, manufacturing, budgeting, planning, sales and service. Key processes also include a company's rules, metrics and norms.

These four elements form the building blocks of any business. The customer value proposition and the profit formula define value for the customer and the company, respectively; key resources and key processes describe how that value will be delivered to both the customer and the company. As simple as this framework may seem, its power lies in the complex interdependencies of its parts.

An open system model is a model in which the firm creates and captures value by taking advantage of both the internal and external resources (see Chapter 1). Chesbrough, in his book *Open Business Models* (2006a), analysed the characteristics that a firm should have to create an open organization.

In the old model of *closed organization*, companies must generate their own ideas which they will then develop, manufacture, market, distribute and service themselves. For years, this was the 'right way' to bring new ideas to the market, and successful companies were those who invested more heavily in internal research and development (R&D) than their competitors and attracted the brightest employees. Thanks to such investments, they were able to discover the best and greatest number of ideas which allowed them to get to the market first. This, in turn, enabled them to gather most of the profits, which they protected by aggressively controlling their intellectual property (IP) to prevent competitors from exploiting it. Closed organizations then reinvested the profits in conducting more R&D, which then led to additional breakthrough discoveries, creating a virtuous inner cycle of innovation. For most of the twentieth century, the model worked – and it worked well.

The passage from closed organizations to open organizations depended on some factors that Chesbrough (2006a) has summarized. The most critical of these was the dramatic rise in the number and mobility of knowledge workers, making it increasingly difficult for companies to control their proprietary ideas and expertise. In other words, nowadays knowledge and ideas are spread out in different knots of social and productive networks. Another important factor was the growing availability of private venture capital, which helped to finance new firms and their efforts to commercialize ideas that spilled outside the silos of corporate research labs. Moreover, globalization, the increasing cost and complexity of R&D, the shortening of the technology life cycle, the improvement of ICT and the increase of competition and uncertainty inside industry moved the organization from a closed model to an inevitably open model.

The open organization model goes through some organizational characteristics. Chesbrough underlined the importance of having a new management capable of innovation, which includes the process of acquiring and integrating new ideas into the organization and commercializing them: 'Valuable ideas can come from inside or outside the company and can go to market from inside or outside the company as well' (Chesbrough, 2006b: 43). In the open organization model, firms commercialize external and internal ideas by deploying both outside and in-house pathways to the market. Specifically, companies can commercialize internal ideas through channels outside their current businesses, as well as external ideas through channels inside their current businesses, in order to generate value for the organization.

Some vehicles for accomplishing this include startup companies (which might be financed by and staffed with some of the company's own personnel) and licensing agreements (Ferraris et al., 2018).

Within this mechanism, the number of ideas that can be potentially produced increases massively, so companies have to be able to screen their ideas and separate bad proposals from good ones so that they can discard the former while pursuing and commercializing the latter (Lowik et al., 2017). While both closed and open models are adept at weeding out 'false positives' (that is, bad ideas that initially look promising), open innovation also incorporates the ability to rescue 'false negatives' (projects that initially seem to lack promise but turn out to be surprisingly valuable). A company that is too focused on the inside misses all the opportunities placed outside the organization's current businesses or those external technologies that, combined with internal ideas, could create a successful innovation. From this point of view, the profit for a company does not only come from using the patents they have developed, but also from selling these patents to other companies.

The firm's value is contingent upon its ability to create and lay claim to the knowledge derived from participating in various kinds of collaborations with other actors (Dezi et al., 2018; Ferraris et al., 2018; Cillo et al., 2019).

It has been shown that connectivity with external actors is important in order for firms to remain innovative (Freeman 1991), and in the network literature it is commonly argued that firms benefit from the social landscapes in which they are embedded. Scholars writing along these lines have developed important findings in terms of how certain network structures (see Chapter 1) influence a firm's behaviour and performance (Ahuja, 2000; Baum et al., 2000a; Gulati et al., 2000). Relationships with other actors help firms to absorb different knowledge technology (Ahuja, 2000), improve survival rates (Baum and Oliver, 1991), increase innovativeness (Baum et al., 2000b; Stuart, 2000), improve performance (Hagedoorn and Schakenraad, 1994; Shan et al., 1994) and in general grow faster (Powell et al., 1996; Stuart, 2000).

Beyond the relationship with the network's partners, there are two important capabilities needing to be set up and developed by the organization. The first is the capability to absorb the external knowledge and skill to create and develop internal core competence beneficial to those firms that master it (Lorenzoni and Lipparini, 1999; Brunswicker and Vanhaverbeke, 2015; Dezi et al., 2019), and the second is the capability to choose and manage the relationships within the network.

Some of the literature underlines the fact that firms need to increase processes that ensure the assimilation of developments in the external environment through the progress of absorptive capacity (Cohen and Levinthal, 1990; Lane and Lubatkin, 1998; Zahra and George, 2002). Research has shown that firms need to have competencies in areas related to their partners in order to assimilate external sources (Brusoni et al., 2001; Granstrand et al., 1997; Mowery et al., 1996). Internal capabilities and external relations must therefore be seen not as substitutes but as complements. The ability to absorb external inputs depends on what the firm knows. Another important point is related to the similarity of knowledge bases and how they facilitate the integration of ideas from distant realms (Kogut and Zander, 1992), because shared languages, common norms and cognitive configurations enable communication (Cohen and Levinthal, 1990). In absorbing new knowledge, the firm also increases its possibilities for making novel recombinations. Incorporating knowledge bases too close to what the firm already knows will hamper the positive effect of assimilating external inputs. For instance, Ahuja and Katila (2001) suggested that knowledge relatedness between the acquiring and acquired firms is curvilinearly related to innovative performance. Too-distant inputs are harder to align with existing practices, and if knowledge bases are too similar it is difficult to come up with novel combinations (Sapienza et al., 2004). In other words, the effectiveness of openness is also contingent upon the resource endowments of the partnering organization.

For the second point – the set-up and management of the relationship – Chesbrough's (2006a) work has underlined that the larger the number of external sources of innovation, the more open the firm's search strategy will be, because innovation is often about leveraging on the discoveries of others. Firms that manage to create a synergy between what the firm does and the external environment are able to benefit from the creative ideas of outsiders: available resources become greater than what a single firm could handle, but enable innovative ways to market, or the creation of standards in emerging markets. Moreover, extant research (Ardito et al., 2018) has neglected an in-depth examination of the relationship between external knowledge sourcing and the ability of firms to balance radical and incremental innovation activities (i.e., innovation ambidexterity). These results expand the literature discussing the relationship between inbound open innovation and ambidexterity performance (West and Bogers, 2014; Scuotto et al., 2017).

Lakhani et al. (2007) examined a new form of increasing the value of external sources of innovation through knowledge-brokering, by exploring how the firm InnoCentive adopted openness to broadcast problems to a large pool of diverse individuals. They argued that openness and transparency are necessary to increase the value of the entire accumulation of scientific knowledge available and present evidence that problem-solving success is associated with the ability to attract specialized solvers with a range of diverse scientific interests. This 'broadcast search' can attract solutions from external actors who have experience with the problem from a different domain of expertise.

Through the lens of the OI model and knowledge-based view (KBV), several authors (Scuotto et al., 2017) also investigated the factors (i.e. the cognitive dimensions, the knowledge-driven approach and the absorptive capacity) that are likely to determine the preference for an informal inbound open innovation (OI) mode. The innovation literature has differentiated these collaborations into informal inbound OI entry modes and formal inbound OI modes, giving an advocative and conceptual view (Martinez-Conesa et al., 2017). The field of open innovation is still at an early stage; however, it offers a wide field in which academics, practitioners and policy-makers can be active (Gassmann et al., 2010).

Network strategy

Even if the network model is not a recent strategic discovery, the increasing cost and complexity of R&D, the shortening of the technology life cycle, the improvement of ICT technology and the increase in competition and uncertainty inside the industry drive the organization toward a network model where partner selection and relationship management become important strategic variables. The early Schumpeterian model of the lone entrepreneur bringing innovations to markets has been superseded by a rich picture of different actors working together in iterative processes of trial and error to bring about the successful commercial exploitation of a new idea (Rosenberg, 1982; Schumpeter, 1987[1942]; von Hippel, 1988; Freeman and Soete, 1997; Tidd et al., 2000). As many authors have underlined (e.g. Chesbrough, 2006b), being inside a network is not enough if the organization is not able to perceive the business opportunities of the environment, exploiting the network potentiality and management generally (Coles et al., 2003; Ritter and Gemünden, 2003). The evidence on the management of networks (see Chapter 1) shows that managing informal and formal agreements while establishing trust means that the management of network relationships is inherently difficult (Biemans, 1991). Those responsible for managing network relationships need to learn core network competencies over time – for example, being able to identify when an agreement needs a contract or should be based on good faith, the role that friendship or reputation plays in the identification of partners and the kinds of milestones or interventions that are needed to ensure a project stays on course (Shaw, 1998). Knowledge of how to collaborate accumulates over time through experience, reflection and interpretation (Lorenzoni and Lipparini, 1999). The degree to which firms learn about new opportunities is of course a function of the extent of their existing participation in networks (Powell et al., 1996) as well as their actual level of knowledge, skill and competence. Gulati (1999; Gulati et al., 2000) argues that a firm's position in a network provides 'network resources' that are difficult to imitate and thus potentially provide an enduring competitive advantage.

Networks like the one in Figure 2.7 enable small firms to appear to clients as if they are large corporations, with access to a wide range of resources. If one firm in the network receives an enquiry for some business that it cannot handle itself, it calls in one of its partners, or passes the enquiry on to them. Sometimes a single firm acts as the 'server' at the centre of the network, taking in the work and allocating it to the other partners. In other types of network, firms are part of a confederation of more equal alliance partners – some of which will have alliances with only one firm in the network, others with several. Each partner may specialize in a certain part of the value chain (product

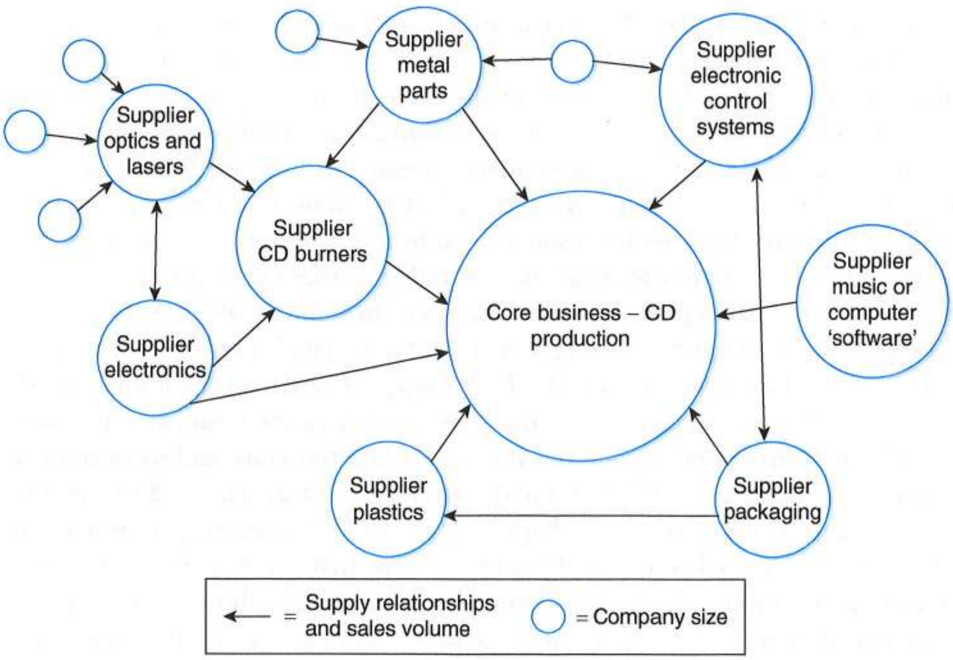

Figure 2.7 A networked value system

development, marketing), have a particular expertise (website maintenance, computer network installation) or concentrate on particular market segments (retailers or local governments). But it is not just small firms that feel the need to build such networks. For complex or technologically sophisticated products, it is very unlikely that one firm can contain all the necessary resources in-house.

Companies which, like Merck and H&M, sit at the centre of networks of suppliers, specifying the outputs and determining which supplier should do what, are called *orchestrators* or *servers* (Figure 2.8). There are even companies, like Hong Kong's Li and Fung, whose only role is as an orchestrator: they specialize in finding and managing suppliers for whatever product their client may choose to offer, but have no product brands of their own.

REFLECTIVE ACTIVITY 2.2

1. In which marketplace are networks developing more quickly and effectively: on the internet or in the real marketplace?
2. Do you think that the industry characteristics influence the network formation?
3. What kind of links and/or partners are more effective in strategy development?

Emergent business strategy

In the following paragraphs, we will examine different kinds of business-level strategies. We will analyse:

- The strategy based on customers.
- The strategy based on competitors.

Strategy based on customers

There is a general consensus in the literature about the positive role of customer orientation for short-term performance. Market-oriented businesses focus on understanding the desires of customers and on developing products and services that satisfy those desires (Slater and Narver, 1998). In this way, firms provide superior value to customers, which in turn may lead to an advantage over competitors and to superior performance. Nevertheless, studies focusing on the capabilities of firms to secure long-term performance have argued that listening too carefully to customers, while positive in the short term, may be negative in the long term. Thus, firms led by a strong market orientation easily find an impetus for innovations demanded by significant current customers,

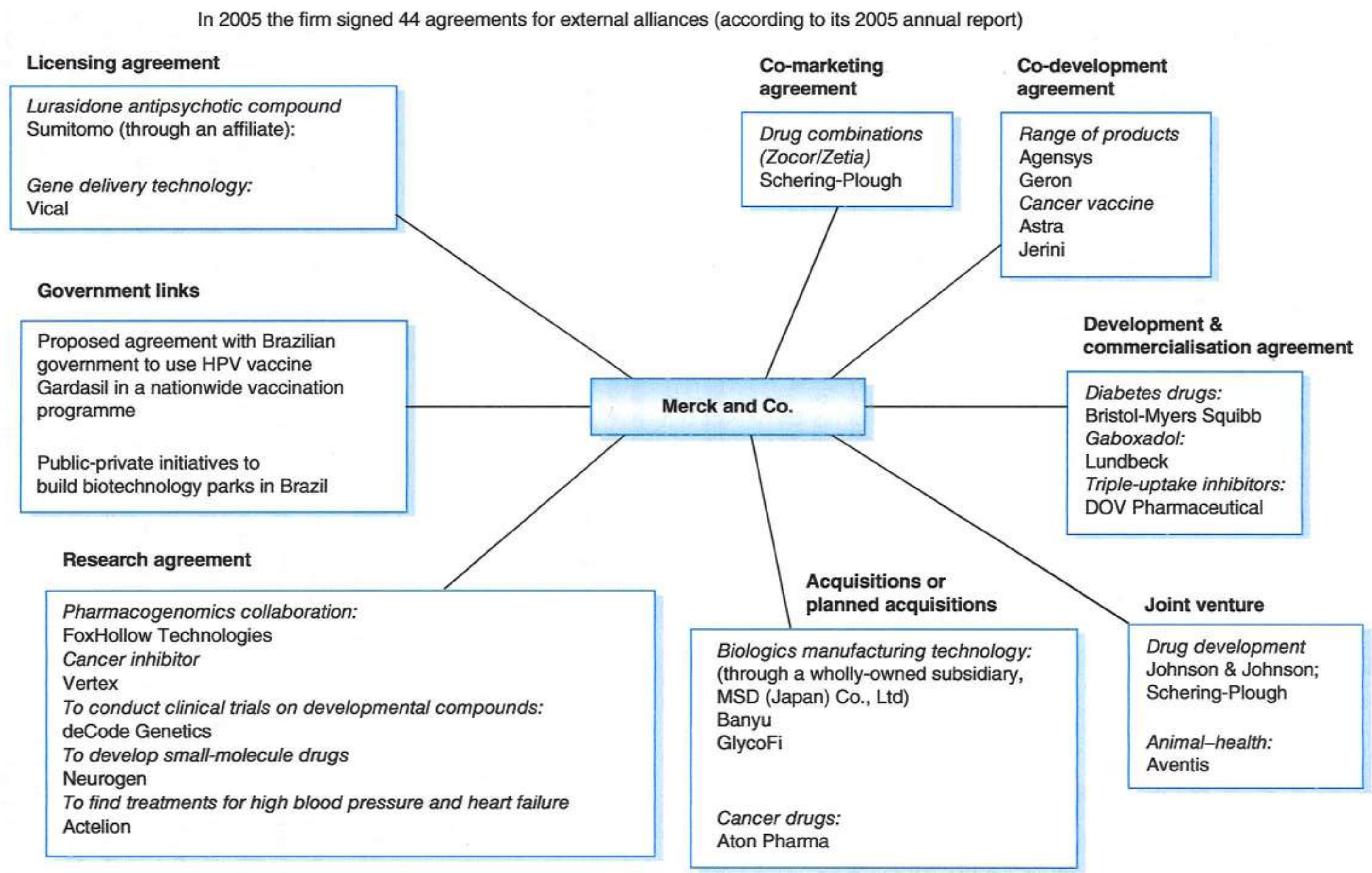

Figure 2.8 Merck's network of strategic alliances in 2006

Source: Numerous industry reports

while failing to exploit opportunities that stem from the needs of peripheral or potential clients. These opportunities are only seldom perceived and, in any case, when perceived, they are usually evaluated negatively by managers who use metrics tailored to the organization's mainstream markets. Managers' unwillingness to displease their main customers transforms core competences, built to satisfy the current markets progressively, into core rigidities.

As a consequence, in customer-oriented firms, adaptive learning processes tend to dominate generative processes (Senge, 1990). Product development efforts become trivial and incremental due to R&D programmes focused on a narrow range of opportunities for innovation (Bennett and Cooper, 1979; Frosch, 1996). Measures of customer satisfaction can overwhelm other strategic performance indicators, discouraging risk-taking and explorative efforts outside the scope of currently served markets (Reichheld, 1996). Decisions relating to business development become biased against new products and technologies (Tauber, 1974; Leonard-Burton and Doyle, 1996). This in turn hampers the ability of the firm to renovate its assets and to create conditions for future higher performance.

Following their customers too closely, organizations may miss opportunities to increase performance in the long run. Unless the firm is able to adopt a market orientation that goes beyond a strict customer-led approach, it is likely that being customer-oriented will hamper its long-term performance (Slater and Narver, 1998). Too often, product managers simply launch line extensions or repackage 'new and improved' products that fail to advance the innovation and growth agenda over the long term. This is partly the fault of senior management, which often responds coolly to speculative, high-risk initiatives that have long payback periods but that could secure longer-term growth.

More recently, some authors (Liew, 2008; Shih et al., 2010; Santoro et al., 2019) have introduced the concept of strategic integration of knowledge management (KM) and customer relationship management (CRM). CRM offers functionality for marketing, sales and services, providing tools to help companies to find and retain customers, build relationships and implement customer-focused strategies in order to increase the loyalty of the customers (Bull, 2003; Chen and Popovich, 2003). Customer-based strategy assumes that customer relationship management is identified as a firm's core competency (Liew, 2008). The integration between KM and CRM leads to the achievement of a strategic result in the long term. This innovative perspective can also be applied to supply chain management, product development management and retail network management that offer different views into knowledge management adoption (Liew, 2008; Del Giudice and Maggioni, 2014; Della Peruta et al., 2014).

To keep customers, it is important to delight them, exceed their expectations and anticipate, discover and fulfil their latent needs. With the increasing sophistication of market research tools, it is becoming easy and inexpensive to track customers' needs, and most companies now do this effectively. The board needs to be attuned to this research. Once or twice a year, marketing should review for the board how the customer base is segmented, how the size and profitability of each segment are changing, and how the company's products and services address the needs of each segment. If the board can't get a succinct answer to the question, 'How are your customers' needs changing?', marketing aren't doing their job.

Strategy based on competitors

If we think about the industry in this historical period, we will quickly realize the plethora of new industries that only a few years ago didn't exist: cellular phones, biotechnology, nanotechnology, tablets and snowboards, to name a few. Just three decades ago, none of these industries existed, and if we think about the next ten years new industries will be created and existing ones will probably be recreated (Bettis and Hitt, 1995; Etzkowitz and Zhou, 2017; McRobbie, 2018). If we start to look inside the different industries, we can perceive a common phenomenon: a huge number of companies struggling to achieve more market share in a market where the population is declining. The result is that the number of organizations is overtaking the product demand. Thanks to the technological advances that have improved industrial productivity, suppliers can produce an unprecedented array of products and services free to move between nations and regions, wiping out niche markets (Del Giudice et al., 2017c; Santoro et al., 2019). As Kim and Mauborgne held in an article in the *Harvard Business Review*:

> This situation has inevitably hastened the commoditization of products and services, stoked price wars, and shrunk profit margins. According to recent studies, major American brands in a variety of product and service categories have become more and more alike. And as brands become more similar, people increasingly base purchase choices on price. People no longer insist, as in the past, that their laundry detergent be Tide. Nor do they necessarily stick to Colgate when there is a special promotion for Crest, and vice versa. In overcrowded industries, differentiating brands *becomes harder both in economic upturns and in downturns*. (2004: 78)

In this framework, organizations can choose to compete by following two macro types of strategy: the *red ocean strategy* or the *blue ocean strategy* (Kim and Mauborgne, 2005) (see Figure 2.9).

With the red ocean strategy, companies try to outperform rivals in order to grab bigger slices of existing demand using the same competitive leverage as the competitors, while in the blue ocean strategy the organization moves the competition on different variables that are difficult to imitate (Kim and Mauborgne, 2005). In the following, we describe the two different strategies.

Red ocean strategy	Blue ocean strategy
Compete in existing market space	Create uncontested market space
Beat the competition	Make the competition irrelevant
Exploit existing demand	Create and capture new demand
Make the value/cost trade-off	Break the value/cost trade-off
Align the whole system of a company's activities with its strategic choice of differentiation or low cost	Align the whole system of a company's activities in pursuit of differentiation and low cost

Figure 2.9 Red ocean and blue ocean strategies

The red ocean strategy

The red ocean strategy can't consider the competitive interactions between firms: the entity of strategic competition is the interaction between players. A decision made by one player is dependent on the actual and anticipated decisions of the other players (Kim and Mauborgne, 2015). In Five Forces analysis (Porter, 2008) competition is a mediating variable that links industry structure with profitability. Thus, it gives only a small insight into the firms' selection of whether to compete or to cooperate, the sequential competitive moves and the role of threats, promises and commitments.

Game theory makes it possible for us to prognosticate the balance results of competitive situations and the consequences of strategic moves by any one player because it makes it possible to recognize central issues of strategy (Pisano, 2017). Simple game models like the 'prisoner's dilemma' forecast cooperative versus competitive consequences, whereas more complex games, especially multi-period games, allow analysis of the effects of reputation, deterrence, information and commitment (Embrey et al., 2018; Romero and Rosokha, 2018). With game theory, you have the ability to view business interactions as comprising both competition and cooperation (Tomlinson and Fai, 2013). The Five Forces framework has the deficiency to view rivalry and bargaining as competitive in nature. Business relationships have a competitive (cooperative) duality (Mattsson and Tidström, 2015). For example, Coca-Cola's relationship with Pepsi-Cola is essentially competitive, but the relationship between Intel and Microsoft is primarily complementary. It follows that if customers value your product more when they have the other player's product than when they have your product alone, the other player is your complementor. And if customers value your product less when they have the other player's product than when they have your product alone, the other player is your competitor. However, it is very important to realize that a player may hold multiple roles.

Microsoft and Netscape are a good example of duality and multiple roles (Mattsson and Tidström, 2015). On the one hand, they compete fiercely to dominate the market for internet browsers. However, the two companies cooperate in establishing security protocols for protecting privacy and guarding against credit card fraud on the internet.

In summary, game theory offers the possibility of understanding the nature of situations involving interactions among multiple players. It explains the structure of relationships and the nature of interactions among players and identifies the alternative actions available to different players and relates these to possible outcomes (Romero and Rosokha, 2018).

Game theory could be a valuable decision support, because it provides excellent insights and understanding, though it has been less valuable in forecasting outcomes and designing strategies. In highly stylized situations involving few external variables and highly restrictive assumptions, game theory provides clear prognostications. However, in more complex and more realistic situations, it often results in either no balance or multiple balances. Even these results are highly sensitive to small changes in assumptions.

The red ocean strategy in practice

To set up the red ocean strategy in practice, the organization's management need to:

- Position the company where forces are weaker.

  Example:

  In the heavy-truck industry, many buyers operate large fleets and are highly motivated to drive down truck prices. Trucks are built to regulated standards and offer similar features, so the price competition is stiff, unions exercise considerable supplier power, and buyers can use substitutes such as cargo delivery by rail. To create and sustain long-term profitability within this industry, the heavy-truck maker Paccar chose to focus on one customer group where competitive forces are weakest: individual drivers who own their trucks and contract directly with suppliers. These operators have limited clout as buyers and are less price-sensitive because of their emotional ties to and economic dependence on their own trucks. For these customers, Paccar has developed such features as luxurious sleeper cabins, plush leather seats and sleek exterior styling. Buyers can select from thousands of options to put their personal signature on these built-to-order trucks. Customers pay Paccar a 10% premium. The company has been profitable for 68 consecutive years and has earned a long-run return on equity above 20%.

- Exploit changes in the forces.

  Example:

  With the advent of the internet and the digital distribution of music, unauthorized downloading created an illegal but potent substitute for record companies' services. The record companies tried to develop technical platforms for digital distribution themselves, but major labels didn't want to sell their music through a platform owned by a rival. Into this vacuum stepped Apple, with its iTunes music store supporting its iPod music player. The birth of this powerful new gatekeeper has whittled down the number of major labels from six in 1997 to four today.

- Reshape the forces in your favour – use tactics designed specifically to reduce the share of profits leaking to other players.

  Example:

  To neutralize supplier power, standardize specifications for parts so your company can switch more easily among vendors.

  To counter customer power, expand your services so it's harder for customers to leave you for a rival.

  To temper price wars initiated by established rivals, invest more heavily in products that differ significantly from competitors' offerings.

  To scare off new entrants, elevate the fixed costs of competing – for instance, by escalating your R&D expenditure.

  To limit the threat of substitutes, offer better value through wider product accessibility.

CASE STUDY 2.2

Nespresso

Nespresso is a powerful example of how a business model could change in a red ocean context. Nespresso is part of Nestlé, the largest food company in the world, which employs more than 13,500 people worldwide in 2019, compared to 331 in 2000.

In 1976 Nestlé dominated the large instant coffee market with its Nescafé brand but was weak in the roasted and powdered coffee segments. In the same year Eric Favre, a young researcher from Nestlé research laboratories, registered the first patent for the Nespresso

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system, designed to bridge the gap between espresso machines and capsule-based systems, with the aim of being able to produce a coffee with the high quality required by restaurants.

After an unsuccessful attempt to enter the restaurant market segment, in 1986 Nestlé created Nespresso SA, a subsidiary that was supposed to start promoting the system in offices, in support of another joint venture producing coffee machines, also owned by Nestlé, and already active in the office segment. However, because of the red ocean context, Nespresso sales were far below initial expectations and the company was kept alive only because huge stocks of expensive coffee machines remained.

In 1988 Nestlé appointed Jean Paul Gaillard as CEO of Nespresso, who completely overturned the company's business model with two drastic changes:

1. Nespresso shifted its attention from offices to high-income families and began to sell coffee capsules directly by postal service. Up to that time, such a strategy had been absolutely unthinkable for Nestlé, which traditionally addressed the mass market through retail distribution channels. Using this new business model, in the last ten years Nespresso has declared an annual growth rate of over 35%.
2. Nespresso then began selling online and creating high-level retail stores (the Nespresso 'boutiques') in prestigious locations, such as the Champs-Élysées in Paris, as well as creating points of sale inside high-end department stores.

The two business models require different logistic systems, strategies, and resources. The risk of direct cannibalization between the two brands (Nestlé and Nespresso) was avoided because of the clear differences in objectives and positioning, even if this meant no possibility of synergies between the two activities.

Nespresso has managed to change the business model in a very competitive environment, exploiting a strategic optimization of HR.

The development of tools to foster the collaboration between HRs, the integration of strategic aims and tools in HRM operations, and the ability of the management to look beyond the traditional context enabled Nespresso to develop innovative product lines as well as to achieve profitable objectives even in a highly competitive market.

SHRM and the relationship with the corporate strategy are the basis of Nespresso's success. The strength of Nespresso's corporate strategy is based on the role that human capital plays in business renewal.

Questions

1. Which features of red ocean strategy does Nespresso highlight?
2. What are the key strategic factors that have led to the firm's success?

Blue ocean strategy

The blue ocean strategy is based on moving competition from overcrowded industries to uncontested market spaces where competition is irrelevant. Organizations will invent and capture new demand by offering their customers new value while shrinking costs.

As Kim and Mauborgne held in their article in the *Harvard Business Review* in 2004, the blue ocean strategy is not about technology innovation. Blue oceans seldom result from technological innovation. Often, the underlying technology already exists – and blue ocean creators will then link it to what buyers value. Compaq, for example, used existing technologies to create its ProSignia server, which gave buyers twice the file and print capability of the minicomputer at one-third the price.

Another important feature of the blue ocean strategy is that the incumbents are not at a disadvantage: still better are those who *create* a blue ocean strategy, usually within their core businesses. GM, Japanese car makers and Chrysler were established players when they created blue oceans in the auto industry, and so were CTR, IBM and Compaq in the computer industry. This suggests that incumbents are not at a disadvantage in creating new market spaces. Moreover, the blue oceans made by incumbents are usually within their core businesses.

In the blue ocean strategy, the traditional units of strategic analysis – company and industry – have little explanatory power when it comes to analysing how and why blue oceans are created.

There is no consistently excellent company; the same company can be brilliant at one time and wrong-headed at another. The most appropriate unit of analysis for explaining the creation of blue oceans is the strategic move – the set of managerial actions and decisions involved in making a major market-creating business offering. Kim and Mauborgne showed in their article how the blue ocean strategy can create brand equity that lasts for decades, using examples of companies such as Ford and IBM – established corporations, which are traditionally seen as the victims of the new market space creation – as important players for this kind of strategy. What they reveal is that large R&D budgets are not the key to creating a new market space: the key is making the right strategic moves. What's more, companies that understand what drives a good strategic move will be well-placed to create multiple blue oceans over time, thereby continuing to deliver high growth and profits over a sustained period. The creation of blue oceans, in other words, is a product of strategy, and, as such, is also very much a product of managerial action (Agnihotri, 2016; Kampa et al., 2017; Au and Tucker, 2018).

The general characteristics of the blue ocean strategy

The most important feature of the blue ocean strategy is that it rejects the fundamental tenet of conventional strategy: that a trade-off exists between value and cost (Kim and Mauborgne, 2004). According to this thesis, companies can either create greater value for customers at a higher cost or create reasonable value at a lower cost (Au and Tucker, 2018). In other words, strategy is essentially a choice between differentiation and low cost, but when it comes to creating blue oceans the evidence shows that successful companies pursue differentiation and low cost simultaneously. A rejection of the trade-off between low cost and differentiation implies a fundamental change in the strategic mindset – we cannot emphasize enough how fundamental a shift it is (Aithal, 2016). The red ocean assumption that industry structural conditions are a given and firms are forced to compete within them is based on an intellectual worldview that academics call the *structuralist view*, or *environmental determinism*. According to this, companies and managers are largely at the mercy of economic forces greater than themselves. Blue ocean strategies, by contrast, are based on a worldview in which market boundaries and industries can be reconstructed by the actions and beliefs of industry players. Kim and Mauborgne call this the *reconstructionist view*.

Adopting a blue ocean strategy is difficult to imagine and create but attracts customers in large volumes, generating scale economies very rapidly, putting the imitator at a continuing cost disadvantage. Moreover, when a company offers a leap in value it rapidly earns a brand buzz and a loyal following in the marketplace.

CASE STUDY 2.3

Alibaba

Alibaba, a legendary company in the Chinese e-commerce world, started off with the concept of its founder Jack Ma, and was founded in 1999. In a short period of time, Alibaba has become the largest online marketplace in the world. The Alibaba group was founded in the early growth phase of Chinese e-commerce where the concept of the internet was known among just a few people.

Alibaba has more than three million member companies, and numbers keep growing rapidly with an increase of more than 6000 users per day. All these major improvements have occurred as a result of the profound leadership of Jack Ma and the enormous potential of Alibaba's SHRM.

Particularly, in Alibaba the role played by HR in mergers and acquisitions (M&As), as well as in the international context, should not be underestimated. The HR department and the SHRM have played a key role in guiding employees in the integration process (Liu, 2010). To be successful in the global market, Alibaba has needed a well-structured strategic plan (Sparrow et al., 2016). To be efficient, the judgment of the HR function has been considered one of the main points for Alibaba's international success (Wulf, 2010).

Alibaba has also managed to formulate an innovative strategy exploiting the SHRM. Alibaba created a blue ocean strategy as a new unexplored market. A blue ocean market is an environment where growth opportunities are enormous and competition is irrelevant (Kim and Mauborgne, 2005). In this context, the goal of Alibaba was to create an open, balanced, and healthy economic internal 'ecosystem'.

Nowadays, Alibaba uses a lot of resources to implement relationships combining HR and managerial strategies. A strong stimulus in the management of HR in a blue ocean context is the continuous encouragement and development of human capital. By continuing to renew the functions of SHRM, Alibaba has managed to strengthen the human capital within its own company (Wang, 2012). Alibaba's intuition has been to include young people who have new ideas in HR and are ready to handle different scenarios at work. To support this concept, Alibaba launched a recruitment campaign for young workers in 2016. They hired hundreds of young graduates with poor work experience and offered them a one-year study period before providing employment in their headquarters in Hangzhou, Southern China. This project led to the birth of the *Alibaba Global Leadership Academy*, a school for Alibaba's young employees with a programme dedicated to promoting future international leaders.

With the strategic exploitation of HR in a blue ocean market, Alibaba has managed to excel over competitors, defining competitive strategies based on SHRM. Based on a long-term vision and an employee strategy, Alibaba invests time and resources into understanding new employees' needs and creating a high-quality work environment (Tan et al., 2015).

REFLECTIVE ACTIVITY 2.3

1. Which would be the correct strategy to choose in case of a radical innovation market introduction?
2. Which, in your opinion, is the strategy most frequently followed by organizations and why?
3. Are you able to create a list of organizations that could apply the blue ocean strategy?

Conclusion

According to Leavy (1999), Samli (2006) and Perrott (2008), industries where organizations have to compete are turbulent and dynamic due to different factors such as economic crisis, technology, globalization, competition, speed, changing power structure and lifestyles, downsizing, shareholders, trade unions, government policy, relevant legislation, and so on. Turbulent environments can create uncertainty for firms in terms of both the supply side and demand side. Greater uncertainty increases the actors' heterogeneity, the array of activities, the linkages and interaction that define the firm's environment (Dess and Beard, 1984).

Managers who guide their organizations have to develop more than the well-known capability to think outside of the box. They must have the dynamic capability to manage the different sources and resources of creativity and innovation that surround the organization, skill and core competence in a better execution of the creativity strategy called 'creative problem-solving', and speed in understanding and solving internal and external potential or effective problems. There is no list of practical actions that help to achieve these objectives, only some clues to consider, for example identifying unsolved problems, mapping the wider system that influences the results and determining which weak links need strengthening and which gaps need filling. To continually identify gaps in the market, firms need real-time data and the ability to share these widely throughout the organization. These hard data must be supplemented with a direct observation from the field. But to do all this effectively, we must take into consideration a long-term vision on setting up and developing the right team inside the organization and the right partners outside.

Megginson (1963: 4), in remarks based on Charles Darwin's theory of natural selection, claimed: 'It is not the strongest of the species that survives, nor the most intelligent that survives. It is the one that is the most adaptable to change'. If we look at this concept today and at the new economic-productive scenario, we will find an evolution of enterprises based on a natural selection similar to that suggested by Darwin on animal species. This is what we call 'cooperative Darwinism' and it applies to a great many enterprises.

Many of these new enterprises will not be able to survive: they will either die or be absorbed by predators who are actually market giants with large financial resources. Others will consolidate their position of power. But all of them will have to face the environmental threats brought on by organizational and technological evolution. Recent studies have underlined that the traditional competitive view of relationships between enterprises is inadequate for a market structure which, on the contrary, shows the will of enterprises to cooperate. Cooperation reveals a new competitive profile: from a firm-to-firm competition to a network-to-network competition. Cooperative relationships are the result of a compromise between competition and cooperation at the same time. Thus, cooperation defines a new form of a more complex interdependence: co-opetition (Brandenburger and Nalebuff, 1996).

The performance of the network leans on a principle of complementarity between internal ability and external cooperation so that the ability inside the enterprise is a sort of trading currency which, on the one hand, can contribute to cooperation and thus participate in having cooperative relationships with other enterprises, and, on the other hand, can benefit from the cooperation itself (Park and Russo, 1996).

This new economy founded on knowledge and information diffusion is affected not only by changes in technology, but also by changes in the behaviour of people who live and work in a new way.

In this environment of change and technological innovation, the role of SHRM becomes essential in a firm (Lengnick-Hall et al., 2009; Santoro et al., 2019). In the last decade companies have faced a reality characterized by deep technological revolutions, consequently making changes in their HR. The importance of skills, knowledge, and continuous learning capacity has proved to be fundamental for companies that show interest in grabbing and retaining people with the greatest talent (Delery and Roumpi, 2017). The HR function thus began to occupy an increasingly central role, realizing that HR constitutes a real capital for the company (Vrontis et al., 2017; Papa et al., 2018; Caputo et al., 2019). Therefore, the belief that proper management of HR can determine the success of the company, or rather, can be a fundamental element for the formulation of the organization's strategy, is expanding (Caputo et al., 2019). Putting people into strategic variables has two implications. The first is that management must have a clear understanding of how to operate in HR in order to facilitate the implementation of strategic business objectives. The second is that indicators can be identified so as to measure HR-related variables (Lengnick-Hall et al., 2009; Delery and Roumpi, 2017).

The size of a company is no longer a key point, nor does it justify its success. As already stated above, it is rather the ability to innovate, to establish solid relationships with customers, and to anticipate their needs or 'be there' at the right moment (time to market) that makes a company successful and, consequently, earn greater profits. It is because of these needs that more and more enterprises are focusing on their core business, so they can enhance their distinguishing skills (value-added activities) and outsource all the other activities, creating particular and new organization models as a result.

Further reading

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