STRATEGIC HUMAN RESOURCE MANAGEMENT

An INTERNATIONAL PERSPECTIVE

Edited by
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Paul E. Smith

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STRATEGIC APPROACHES

Paola Pisano, Alison Rieple
and Marco Pironti

Chapter Overview

Defining the concept of strategy is both challenging and complicated at the same time. From the strategy definition depend 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 the 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. As the ultimate objective of every strategy is to increase the profit inside the organization, an analysis of the type of resources, objectives and activities the organization has to consider and exploit in order to achieve the best result is provided.

CASE STUDY 2.1

Subway world franchise

In 1965 17-year-old Fred DeLuca opened his first sandwich store in Bridgeport, Connecticut, on the suggestion of family friend Dr Peter Buck and a loan from him of US$ 1,000. It was called 'Pete's Super Submarines'. Fred himself ran the store and drove regularly to market to buy fresh vegetables and meat, obtaining the right quality at the right prices. A second store followed after one year and a third in 1967. This was in a more visible location and really a 'restaurant'.

For the next few years, the store/restaurant experimented with different approaches to the product range, marketing, purchase of fresh produce and in-store production. The company name was changed to 'Subway' and adopted a yellow logo. The founders developed a business formula for their restaurant:

- Low capital costs, around US$ 80–120,000
- Around 6–8 employees per store
- Clean and simple design with strong logo – name changed to 'Subway'
- Clear and simple in-store pricing and product presentation – hygiene factors and training are important to ensure that all food is fresh and clean.

This was the basis of the Subway franchise first offered in 1974. Over the next 30 years, Subway grew its operations mainly through franchising. It began to experiment with different locations: it found that its franchise could be operated in smaller and more specialist outlets – such as schools and factories – because of its smaller-scale business formula.

The strategic problem for Subway in North America was that sales growth was beginning to slow in the mid-1990s. To tackle this Fred DeLuca went back to his customers: he learned that an increasing number came to Subway because it offered a low-fat alternative to others' fast food. Using this, the company boosted its sales significantly. In 2000 the company decided to attract customers who wanted a full-calorie meal: by 2004, Subway had around 20,000 outlets in the USA and Canada.

The company opened its first franchise operation outside North America in 1984, and by 2004 it had opened 2,000 outlets in 75 countries.

Source: Adapted from Lynch (2006).

Introduction: Strategy in the twenty-first century

The last 20 years have witnessed further environmental developments that have had considerable effects on strategy (see Chapter 1). 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 (Chapters 11 and 12), 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 (see Chapter 10) on one side and the higher capability and knowledge of the customers on the other side. The previous two forces (employees and customers) have increased the level of competition, developing more innovation into the market.

Tough revolutions in the external environment impact on the 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. A list of corporate strategy decisions could include investment in diversification, vertical integration, acquisition, new ventures, allocation of resources, etc. 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, but a different vision of corporate strategy has 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 Jauch and Glueck 1988; Argenti 1965). 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. Figure 2.1 shows the two contrasting models.

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

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

1. Simple, consistent and long-term goals
2. Profound understanding of the competitive environment
3. Objective appraisal of resources
4. Effective implementation of the strategy (Grant 2008).

As shown in Figure 2.1, the firm embodies three of the previous 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 objective. 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).

PIT STOP: 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?

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.

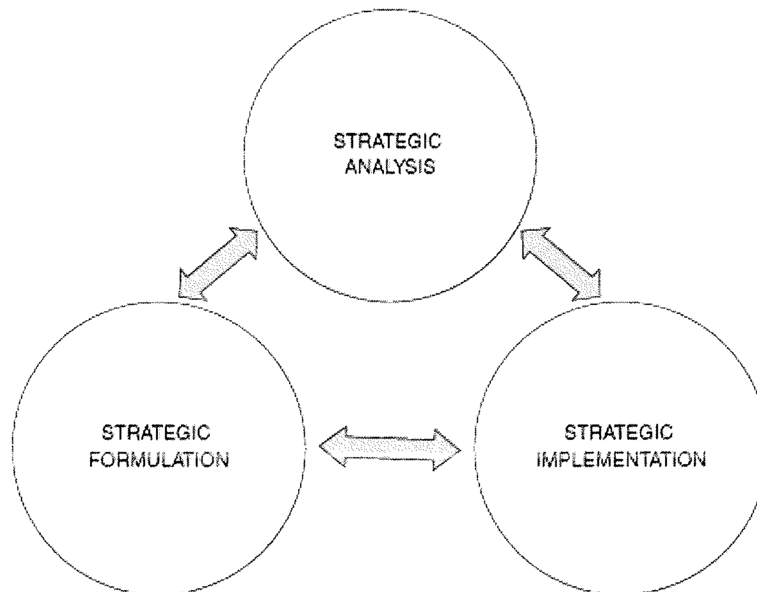

Figure 2.2 The core areas of corporate strategy
Source: author.

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 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, 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 to 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.

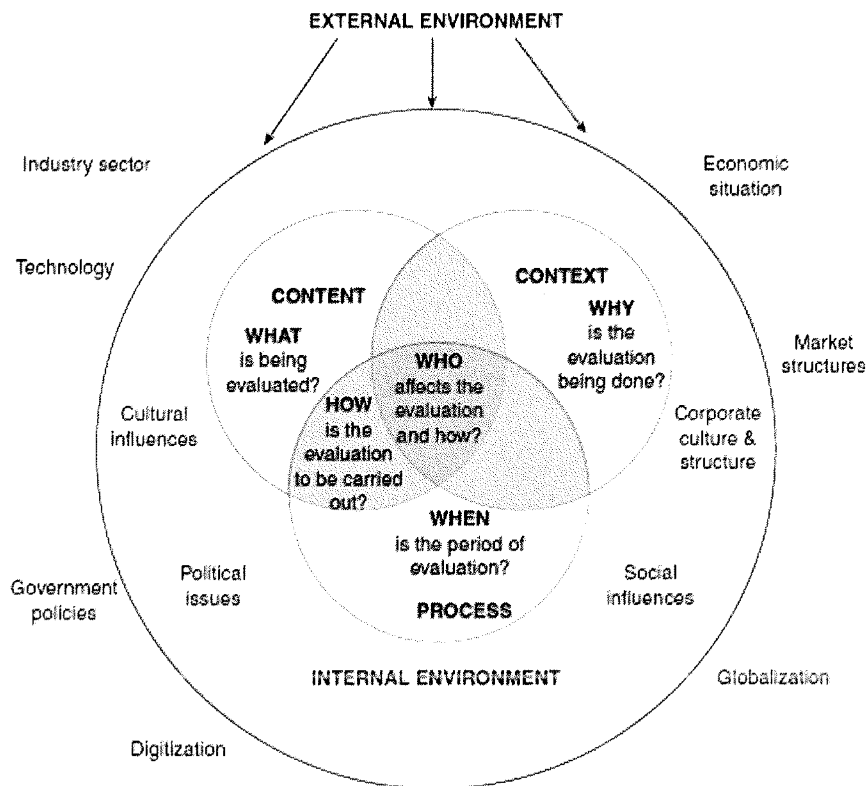

Figure 2.3 The content, context and process framework: internal and external environmental factors

Source: Adapted from Stockdale and Standing (2006: 1090–1102).

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.

Strategic analysis, in both the prescriptive and emergent approach, 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, 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.

The analysis of the internal and external environment helps the organization to apply a SWOT analysis – Strengths, Weaknesses, Opportunities and Threats – 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 the purpose statement over the following years.

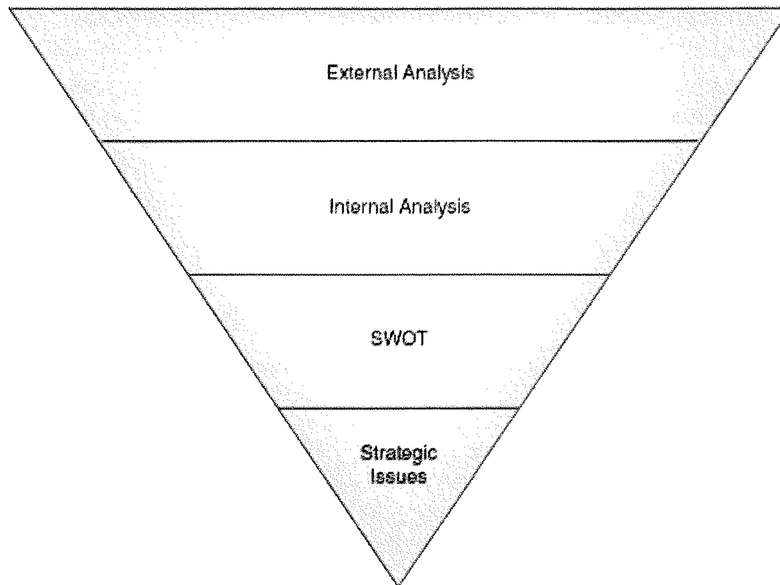

Figure 2.4 The process of strategic analysis
Source: author.

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 the 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 phase 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, or rather 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 has been 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 choices 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 did not need to touch or see before they bought 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 numbers of potential customers expanded as more people acquired Internet connections at work and at home.

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, are the very real risks that the 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 upon 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 per cent 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).

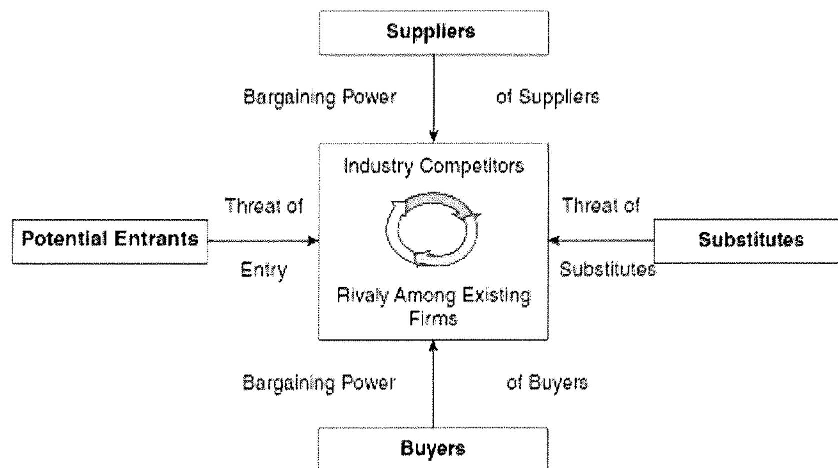

Figure 2.5 Porter's five forces of competition framework
Source: Adapted from Porter (1980).

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). He 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-normal 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 their customers.

As Porter 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. 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 the future. This depends on the speed of structural change in the industry. In the event that transformation is rapid, and innovations transubstantiate 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.

There are appropriate industries (computers, telecommunication, Internet access) where the relationship between competition and industry structure is unstable. These changes in the structure of industry are rapid and difficult to forecast. In such an industry it is not advisable to use current trends in industry structure to predict profitability several years ahead. However, most empirical

studies have shown that Schumpeter's process of 'creative destruction' does not have excessive significance for most industries. In the modern economy such competition is classified as 'hyper-competition'.

Hyper-competition is an industrial environment identified with intense and rapid competitive moves. Competitors must move quickly to build advantages and erode those of their rivals. This quickens the dynamic strategic interactions between competitors. Hyper-competitive behaviour is defined as a process of continuously generating new competitive advantages and destroying, obsolescing, or neutralizing the competitive advantage of adversaries, thereby creating disequilibrium, destroying perfect competition, and disrupting the status quo of the marketplace. This is possible for dynamic firms moving up their escalation ladders faster than competitors, restarting the cycles, or switching to new markets. The quest for profit by establishing competitive advantages is the driving force of competition. Such attained competitive advantages are transitory, and only by continually recreating and renewing competitive advantages can firms sustain market dominance and superior performance over the long run.

How to diversify different businesses

Substantial changes to the range of offerings or to the markets served, or both, are 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, of itself, an inadequate reason for a corporation to diversify in new markets, new costumers, 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 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.

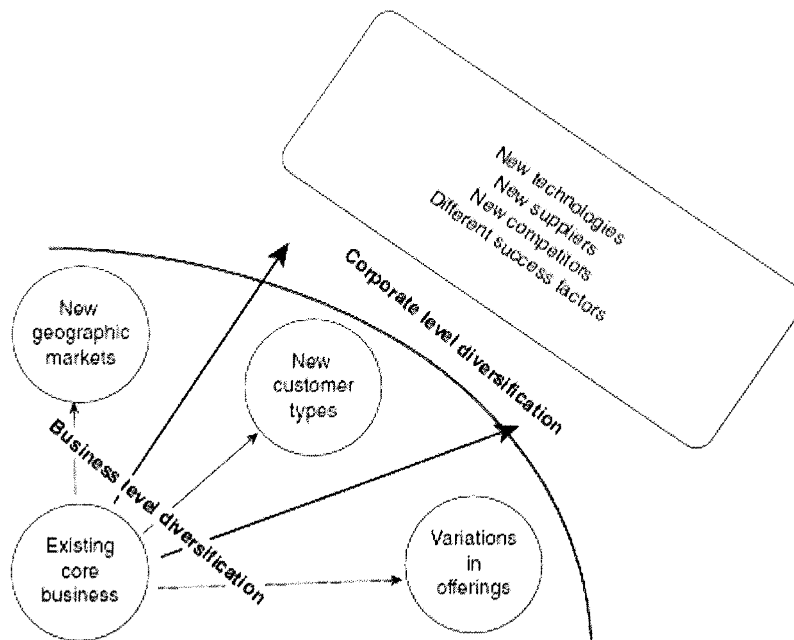

Figure 2.6 Diversification
Source: author.

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, to obtain lower prices, better quality or 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, so as to avoid a wasteful duplication of effort and improve 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 have 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 (Armstrong and Brodie 1994; Capon et al. 1987; Slater and Zwirlein 1992).

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 also are 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 (Amit and Schoemaker 1993; Nelson and Winter 1982; 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 learnt to do, in understanding 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 this 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 promotions (Chapter 10).

CASE STUDY 2.2

Egg 2.0

Egg 2.0 is a communication and research laboratory developed from an idea of Guido Avigdor, Giorgio Risi and Pietro Dotti in 2009. These are a group of young talents who express their expertise in every area of communication including editorial art direction, video-making and various digital activities, the pursuit of new trends, the organization of events, innovations in the app market, and social marketing.

Every year since 2009 a contest is launched – in Italian universities, on the Web and in social networks – with the aim of selecting the best talent. Participants are given a theme which they have to develop using the kind of media they believe will be the most suitable to express their talent. The members and employees of Egg 2.0 and the Eggers in their last year will preselect the works taking part in the contest, which will then be judged by a quality jury made up of different members every year. The jury can consist of people who have start-ups, newspaper editors, movie directors, musicians, advertisers, university professors, etc.

Egg 2.0 is a limited company that subsists thanks to its own work in the market: it has never received any government funds.

Their main activity is to study cross-media and non-conventional communication campaigns including Web 2.0, the organization of events, the development of apps on smartphones and tablets, and the study of image positioning and commercials.

The main milestones of Egg 2.0 are summarized in the following list:

- Mission: to train new creative talents and launch them in the working world and, at the same time, give the working world the young talents' innovative answers.
- Team selection: this is carried out by an external jury that selects the future members of the factory.

(Continued)

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- The working area: a loft that everyone shares without having fixed working spaces.
- Work management: a horizontal model which is transparent and inclusive.
- Sharing company challenges: sharing challenges and results.
- Factory life: paying attention to activities outside of work.
- Absence of hierarchy.
- Alternating work and appointments with personalities from the arts and communication world.

Every Egger takes part in the creative, executive and control phases. This is because one of the hinges of the experience at Egg 2.0 is understanding one's own role in connection with others, whether these are the group, the customer or the outside world.

Teamwork is focused on understanding the problem so that it can be handled in the best way, not just in terms of creativity but also in terms of strategy. One of the most acknowledged qualities of the projects carried out by clients is the attention given to finding good cross-media solutions in the short and long term.

This approach is inevitably more demanding both in terms of time dedication and mental application, but much more stimulating for everybody.

In a field of application such as creativity, linked with communication, it is hard to determine what the new trends and developments will be, and thus decide which expertise to invest in.

However, Egg 2.0 aims at steady growth through a continuous consolidation of the company, determined not only by its members' technical skills but also and especially by their aptitude.

The most important resource is the ability to become interested in the future, being aware that our role within the factory is not just functional but also motivational and that the co-responsibility for choices is the winning card that makes the individual or group evolve. With this approach we are training professional people who are completely different from those found in the market, or educated by universities: cross-media, multitasking, cool-hunting are the keywords that give everyone's profile extra points.

Egg 2.0 has decided to bet on young people alone and their ability to imagine the future by reinventing the present.

Doing this periodically, renewing the investment every year by using a considerable part of our turnover, and spending great energy on the creation and training of a new team are the strategic choices of Egg 2.0.

In only three years Egg 2.0 has seen the generation of as many as 64 young talents. Fortunately, this constant work has resulted in finding a job right away for more than 80 per cent of our young people: some by consolidating their role within the factory, some by co-operating in specific activities, and others by joining organizations closely linked with Egg 2.0 (customers, suppliers, partners).

This is a remarkable result for everyone: for the factory who can show with figures that their mission is valuable; for the young who, besides having training of a high quality, can really find a job; for the customers who can measure up to a world which is dynamic, fresh, full of ideas, and without structural barriers.

Nevertheless, in order to keep this approach reliable there are very few rules to follow and many choices to make, in most cases determined by common sense and the ability to

understand everyone's talent and personality and take them along a path where the single individual can learn how to be part of a bigger group which is very close and competitive, and able to meet the challenges of the world around them with a more clear and confident attitude.

Human resources have a centralized role in the company, they contribute to its development and enable it to adapt to the changes of the knowledge society.

While computer development brings a dematerialization of work and some trends lead to thinking that teamwork and direct and continuous co-operation are no longer an essential qualification, Egg 2.0 bets on sharing spaces, projects and emotions so that young people can start a professional growth which helps them measure up to their own talents as well as to those of others.

Source: author. With thanks to Dr Guido Avigdor – Creative Director and Partner at Egg 2.0.

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, a profit formula, key resources and processes. The most important to get right, by far, is the first.

- *Customer value proposition (CVP).* 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: How to Thrive in the Innovation Landscape* (2006b), 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 depends on some factors that Chesbrough (2006) 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 technology and the increase of competition and uncertainty inside industry moved the organization from a closed model to an inevitable open model.

The open organization model goes through some organizational characteristics. Chesbrough (2006) underlined the importance of having a new management capable of innovation which includes the process of acquiring and integrating such 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 2006). 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 start-up companies (which might be financed and staffed with some of the company's own personnel) and licensing agreements.

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. 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.

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 relation 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), 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 re-combinations. 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 (2006) work 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.

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.

CASE STUDY 2.3

InnoCentive

InnoCentive is the global leader in crowdsourcing innovation problems to the world's smartest people who compete to provide ideas and solutions to important business, social, policy, scientific, and technical challenges.

Its global network of millions of problem-solvers, proven challenge methodology, and cloud-based technology combine to help the clients transform their economics of innovation through rapid solution delivery and the development of sustainable open innovation programs.

Since 2001, InnoCentive has been making a profound impact on the world:

- Total registered solvers: more than 270,000 from nearly 200 countries
- Total solver reach: 12+ million through our strategic partners (e.g., Nature Publishing Group, *Popular Science*, *The Economist*)
- Total challenges posted: 1,500+ external challenges and hundreds of internal challenges (employee-facing)
- Project rooms opened to date: 450,000+
- Total solution submissions: 34,000+
- Total awards given: 1,300+
- Total award dollars posted: $37+ million
- Range of awards: $500 to $1+ million based on the complexity of the problem and nature of the challenge
- Average award rate: 57 per cent.

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InnoCentive adopts the electronic marketplace business model. Through its open innovation marketplace, InnoCentive seeks to match a global network of solvers with R&D challenges faced by a number of seeker organizations.

Seekers post challenges, along with the associated financial award, by paying InnoCentive a fee of $35,000 and are allowed to post challenges anonymously to avoid competition-related issues. Solvers can view the challenges and submit solutions to any challenge without being charged anything. If the seeker is satisfied with the workability of the solution to a challenge provided by a solver, then the seeker provides this solver with the pre-specified award in exchange for the acquisition to the intellectual property (IP) rights to the winning solution. The seeker also pays InnoCentive a commission on the amount awarded. InnoCentive ensures IP protection for both seekers and solvers and facilitates the transfer of IP rights from the solver to the seeker.

The value proposition that the business model offers is twofold:

- First, InnoCentive allows seeker organizations to reduce their R&D budget by tapping into the wisdom and innovative capacity of a network of more than 200,000 solvers in order to find solutions to their difficult problems (challenges).
- Second, InnoCentive gives solvers the opportunity to focus on a range of challenging problems that are of interest with the hope of receiving a financial reward.

Source: author.

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 (Freeman and Soete 1997; Rosenberg 1982; Schumpeter 1942/87; Tidd et al. 2000; von Hippel 1988). As many authors underlined (Chesbrough 2006), 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.

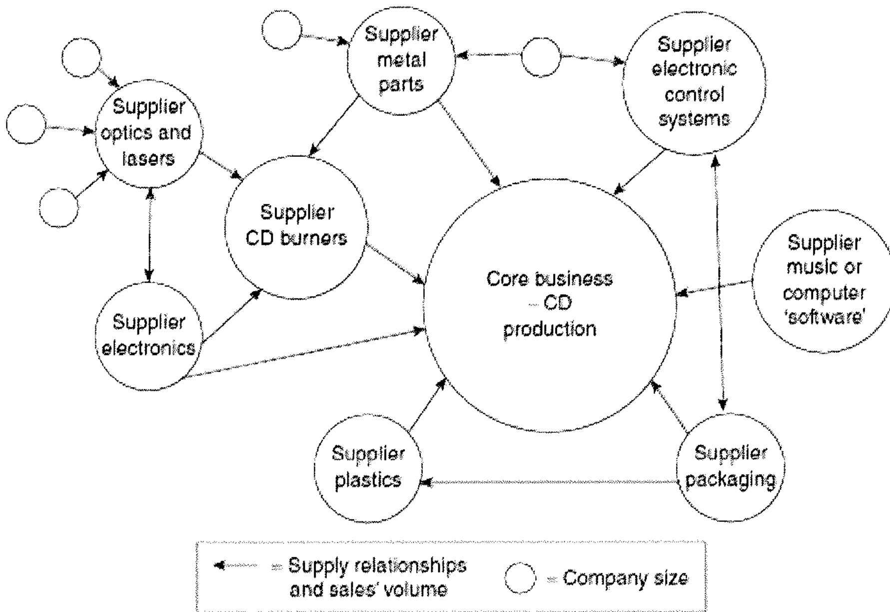

Figure 2.7 A networked value system
Source: author.

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 whom 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 development, marketing), have a particular expertise (website maintenance, computer network installation) or specialize in 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 orchestrators: they specialize in finding and managing suppliers for whatever product their client may choose to offer, but have no product brands of their own.

Emergent business strategy

In the following paragraphs we will examine different kinds of business-level strategies.

In the business strategy 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

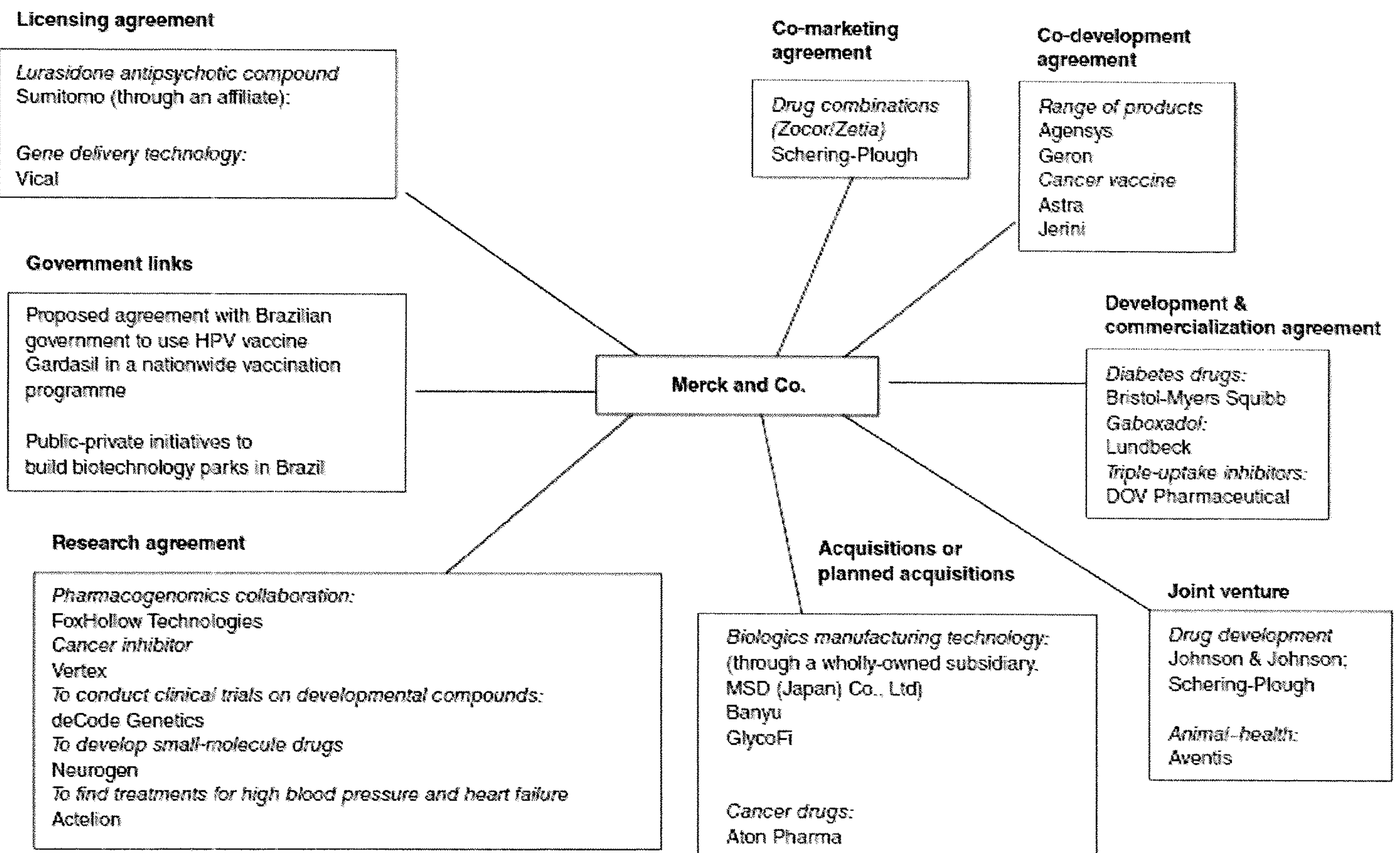

Figure 2.8 Merck's network of strategic alliances in 2006
Source: Numerous industry reports.

understanding the desires of the 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 impetus for innovations demanded by significant current customers, 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 that use metrics tailored to the organization's mainstream markets. Managers' unwillingness to displease 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; Frosh 1996). Measures of customer satisfaction can overwhelm other strategic performance indicators, discouraging risk-taking explorative efforts outside the scope of currently served markets (Reichheld 1996). Decisions relating to business development become biased against new products and technologies (Leonard-Burton and Doyle 1996; Tauber 1974). 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 repackaged '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.

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 than 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. 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. 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 strategies: the *red ocean strategy* or the *blue ocean strategy* (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 of the competitor's, while in the blue ocean strategy the organization moves the competition on different variables that are difficult to imitate. In the following we describe the two different 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

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 strategy
Source: author.

of the other players. In Five Forces analysis 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 co-operate, 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. Simple game models like 'prisoner's dilemma' forecast co-operative versus competitive consequences, whereas more complex games, especially within the context of multi-period games, allow analysis of the effects of reputation, deterrence, information and commitment. With game theory, you have the ability to view business interactions as comprising both competition and co-operation. The Five Forces framework has the deficiency to view rivalry and bargaining as competitive in nature. Business relationships have a competitive (co-operative) duality. 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. Figure 2.10 shows the value net which recognizes the relationship of both competition and co-operation.

Microsoft and Netscape are a good example of duality and multiple roles. On the one hand they compete fiercely to dominate the market for Internet

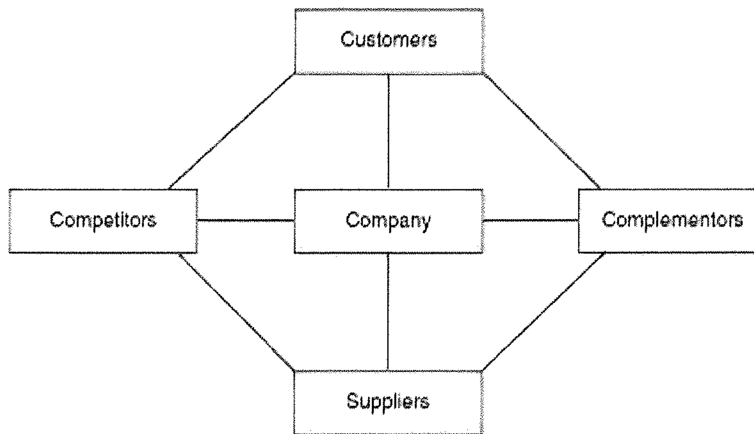

Figure 2.10 The value net
Source: Adapted from Brandenburger and Nalebuff (1996).

browsers. However, the two companies co-operate 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 nature of interactions among players and identifies the alternative actions available to different players and relates these to possible outcomes.

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 per cent premium. The company has been profitable for 68 consecutive years and has earned a long-run return on equity above 20 per cent.

Exploit the changes in the forces

Example:

With the advent of the Internet and 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.

Lavazza

The history of Lavazza started in 1895 when Luigi Lavazza took over a small grocery store in the old centre of Turin (Italy). He decided to produce a new coffee concept, 'the coffee blend', where different types of coffee were mixed together to achieve a more tasty and harmonious flavour. Today Lavazza is the leader in Italy in the mass market channel with a market share of 48 per cent; 40 per cent of the company's turnover is generated outside of Italy; and Lavazza is also ranked seventh as a green coffee importer worldwide. The current dimension of the company is defined by the following data:

- 17 billion cups consumed worldwide each year;
- the turnover is €1276 million;
- six industrial facilities;
- 3800 employees;
- geographical coverage is over 90 countries.

In 2010 the net revenue of the Lavazza Company amounted to €1147 million and earnings before interest, taxes, depreciation and amortization (EBITDA) were €145 million.

Lavazza makes coffee for home use, institutional customers, and restaurants: its objective is to expand the aroma, quality and culture of Italian espresso worldwide. The core values of Lavazza are based on two fundamental concepts:

- The internationalization of the business and consequentially of its human resources.
- The development capabilities to bring innovation inside the organization.

Lavazza has created a business model based on direct distribution through its own subsidiaries in 12 countries and indirect distribution through a wide network of distributors – specialized in different channels – in about 80 countries.

In general the concern for emerging markets shows an interesting potential in the growth of coffee consumption in Asia, South America and Eastern Europe.

Innovation is of fundamental importance if Lavazza is to continue to contend in a competitive international market.

Innovation activities are conducted by joining the exploration of new alternatives and the evolution of existing ones with a creative communication strategy. Since 2006 the company has enhanced several partnerships with universities by organizing MBA training programmes for their employees and setting up specific 'company projects' such as case studies for university students.

The link with the university makes it possible for the company to improve the capability of its employees and increase the potential resources of new ideas, strengthening relationships between 'potential employees and the company' and reinforcing the image of the company.

Collaboration with universities of international fame has been essential in guaranteeing an up to date research base and that personnel are able to take on market challenges.

Source: author. With thanks to Dr Anna Abbate – Human Resources Management and Development Manager, Lavazza Spa.

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 demands by offering their customers new values 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 used to be established players when they created blue oceans in the auto industry, and so were CTR and 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 or IBM, established corporations that 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.

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. According to this thesis, companies can either create greater value for customers at a higher cost or create reasonable value at a lower cost. 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. 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 in 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 2.5

Ferrero

Ferrero is a multinational corporation which originated in Italy and was founded in 1946 in Alba (Piedmont) by the family of the current owner, Mr Michele Ferrero. The total production of chocolate confectionery products is in excess of 800,000 tons. Ferrero has local companies in 38 countries and operates 19 factories around the world with 23,000 employees, 30 per cent of which are based in Italy. As an organization, Ferrero has enjoyed growth of 9 per cent during 2012 with a particular contribution from the extra-European countries such as Russia, the United States, Brazil and Asia, while in Europe growth was close to 5 per cent. Turnover is around €7.3 billion.

Since its origins the company has grown using exclusively self-generated financial resources and has never made acquisitions: 100 per cent of the shares are still owned by the Ferrero family. Ferrero is the major Italian-owned food group, the first chocolate confectionery company in Europe, and the fourth in the world. It is a brand-based company, marketing- and consumer-oriented, with outstanding innovation capabilities, and devotes considerable attention to human resources.

The company's strategy is strongly linked with its products, following the highest quality standards and with a strong tradition of innovation streamed in product ideas and underpinned technology, widely distributed and supported by major marketing investments.

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Ferrero develops and launches only products that will deliver unique benefits to the consumer. All the products allow, thanks to some of their features, a unique selling proposition (USP) which is able to generate new distinctive niches or change the rules of the markets by redesigning the segmentation. Nutella, Kinder Sorpresa, Rocher, Mon Cheri, Kinder Cioccolato and Kinder Bueno, etc., are only some of Ferrero's products that are recognized by consumers to be unique and not imitable by any competitor. Ferrero competes against competitors by delivering a high level of product quality not only inside the factories (through a high level of process quality) but also outside, concentrating on the freshness and protection of the products all the way through to the final customer. This means shorter shelf-lives, lower stocks, caring about sell-out more than sell-in, monitoring the freshness of products, ensuring refrigerated transport and appropriate stocking conditions even when the product is out of their control, stopping sales and withdrawal during summer. The management of a product and distribution process controlled in this way means the company achieve something close to hand-crafted products. Ferrero does not only compete on differentiation of products but also makes the price of its products affordable because they are able to produce at a cost lower than others thanks to a strong business relationship with their suppliers (Ferrero buys 23 per cent of the world's production of nuts).

Finally, one of Ferrero's most important milestones is their human resource strategy, based on a long-term vision and an employee branding strategy. Starting from the *employment experience*, Ferrero invests time and resources in understanding the employees' needs and creating a high-quality work environment. Their great attention towards human resources means a low turnover rate and a high rate of *employment experience* satisfaction inside the organization.

Source: author. With thanks to Dr Dioguardi – Global Employer Branding and Talent Acquisition Director at Ferrero International S.A.

Conclusion

According to Leavy (1999), Samli (2006), and Perrott (2008), industries where the 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, etc. Turbulent environments can create uncertainty for firms in terms of both the supply side and demand side. The increase of uncertainty increases the actors' heterogeneity, the array of activities, the linkages and interaction that define the firm's environment (Dess and Beard 1984).

Managers that guide the 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, the 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 claimed by Darwin on animal species. This is what we call 'co-operative 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 co-operate. Co-operation reveals a new competitive profile: from firm-to-firm competition to a network-to-network competition. Co-operative relationships are the result of a compromise between competition and co-operation at the same time. Thus co-operation 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 co-operation so that the ability inside the enterprise is a sort of trading currency which, on the one hand, can contribute

to co-operation and thus participate in having co-operative relationships with other enterprises, and on the other hand it can benefit from the co-operation itself (Park and Russo 1996).

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

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, to anticipate their needs or 'be there' at the right moment (time to market) that makes a company successful and, consequently, earns greater profits. It is because of these needs that more and more enterprises focus 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.

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DICHIARAZIONE SOSTITUTIVA DI CERTIFICAZIONE
(art. 46 T.U. – D.P.R. n. 445 del 28/12/2000)

Il sottoscritto Marco Pironti nato a Foggia il 5 novembre 1972 residente in Moncalieri, Via Ungaretti n. 15 consapevole che in caso di mendaci dichiarazioni il Dpr 445/2000 prevede sanzioni penali e decadenza dai benefici (artt. 76 e 75) e informato/a che i dati forniti saranno utilizzati ai sensi del D.lgs 196/2003

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è stata concepita unitariamente con gli altri Autori, il cui contributo è quindi da considerarsi equivalente ed equidistribuito.
In particolare l'apporto del sottoscritto ha riguardato l'analisi delle strategie sui seguenti focus:

- Emergent corporate strategy
- Network strategy
- Cases study
- Conclusion

Torino, 5 novembre 2016

Il dichiarante