CORPORATE
AND
STRATEGIC MANAGEMENT

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CHAPTER i

UNIT OUTLINE

Welcome to this unit which I hope you will enjoy! The unit is run over the 15 week semester period. Note that you have to complete 2 pieces of assessed work for this unit. One is an essay and the other is a written report evaluating the management of change in your organisation. Both essays are to be no more than 2000 words each.

Unit Aims

In this unit you will

- explore theoretical debate concerning strategy and the organisation from a variety of perspectives in the social sciences;
- examine techniques used for analysing strategic issues;
- think critically about issues using activities centred around your own experiences and case studies;
- use the internet as a learning and communication tool.

Learning Outcomes

On completion of this unit you will have

- analysed the nature of organisational change in a variety of institutional contexts;
- assessed the processes of organisational transition;
- synthesised and evaluated a number of theoretical perspectives in strategic management;
- demonstrated improvements in Key Skills (notably numbers 1.1 – 1.7, 2.1 – 2.6; 3.1 – 3.3; 4.1 – 4.3; 5.3 shown in the Annex to this Chapter)

Topics Covered

I will address a number of topics in this unit and they cover three broad themes.

Traditional Views and Techniques in Strategic Management

Chapters 1 and 2 are dedicated to this area.

- First, we explore what we mean by strategy and examine some of the debates about how strategy develops within organisations. Strategy can be defined as a means to try and resolve the age-old economic problem of scarcity. It can also be used as a means to understanding competitive position. However, in this regard we will see that there is no such thing as a ‘best strategy’. In later chapters we argue that strategy is much more an art than a science when it comes to being a top performer. If an organisation had found the magic formula they would always be at the top of the league - but even the mighty fall!

- Second, we examine the formulation of strategy using a Planning perspective. Here you will be looking at documentation, notably Mission Statements. You will also be asked to explore strategy documentation on the web. When looking at formulation we will encounter a potentially linear approach but which emphasises feedback opportunities. It
leads naturally to the formal consideration of the concept of organisational learning in a later chapter.

**Environmental Issues and Strategic Management**

How strategic managers examine the world in which they operate is discussed in chapters 3 and 4.

- First, we examine the External Environment. We focus on some of the techniques used to consider what the organisation might face in both the short term and over a longer horizon. We look at familiar techniques such as PEST and the Five Forces typology but also consider Scenario Planning in some depth. The techniques examined provide a variety of functions but, in sum, they permit organisations to redirect resources and strategy to meet changing needs.

- Second, we take an introspective look at the organisation. By doing this we see where the strategic capability of the organisation lies. Thus, we examine the nature and sources of core competences within the organisation. These are those aspects of the organisation that make it unique and are difficult for others to imitate. Moreover, we need to know how these might be sustained and so consider some elements of performance management.

**Organisational Dynamics and Strategic Management**

The rest of this booklet is concerned with issues that embrace issues in the management of change. This, of course, reflects my personal preferences but these are current issues in the strategic management literature and I know of no one source that considers them all. Here we examine

- Organisational culture (Chapter 5). Specifically we define organisational culture and ask whether it is possible to shape it. The activities that you undertake are pragmatic and aim to help you understand what type of culture exists in your organisation and compare that with what you would like to see.

- Introducing Game Theory for Strategic Managers: Understanding Behaviour, Cooperation and Partnerships (Chapter 6). This topic confronts the issue of interdependence between individuals at the personal, organisational and societal level. A study of game theory is crucial to strategic thinking. One important aspect of this is ‘how do we achieve co-operative behaviour if there is a general tendency to compete against each other?’ To this end we examine the role of punishments and incentives. This is particularly relevant to our understanding of alliances and public partnerships in a strategic context.

- Organisational Change and Learning (Chapter 7). This chapter embraces Chaos and Complexity theory and Organisational Learning. These approaches are new to strategic management but they also provide a strong summation for the previous chapters. In the early chapters we consider planning and indicate the importance of feedback. In this chapter we see the type of feedback loops that are relevant to the strategic management process. In chapter 3 we noted that the external environment was complex and here we see why this is so and how strategic managers might embrace such complexity. The issues of core competence, organisational culture and game theory are also intimately associated with complexity and learning.

The booklet is self-contained but it is not exhaustive. For this reason you need to actively pursue other learning resources.
Learning Resources

A Textbook

After much deliberation, I am recommending the following book:


This is a classic strategic management text. It embraces private, public and non-profit organisation (though Johnson and Scholes have another book aimed at understanding strategy in the public sector - Johnson G and Scholes K editors (2001) Exploring Public Sector Strategy, Pearson Education, Harlow –which may be of interest to some of you).

Teaching and learning resources associated with the main text book can be found on the publisher's web site

http://cw.prenhall.com/bookbind/pubbooks/johnsonscholes_ema/

Throughout the notes that are provided you will be asked to read associated chapters from the main textbook. However, the book does not cover all the areas that I want to examine. In particular it does not cover learning organisations or complexity theory in great detail and it does not consider game theory at all. This is a weakness with which we can live.

You will be supplied with a study schedule that will provide an opportunity to seek out journal articles available on-line. There are a number of other books covering different aspects of the course that are worth dipping into. Here they are in alphabetical order.


Bryson J M (1995) Strategic Planning for Public and Nonprofit organisations. A guide to strengthening and sustaining organisational achievement. Jossey Bass, San Francisco. (This is a superb book for those interested in the Public and non-profit sectors. The cases are very well written but US focused. Still worth a read if not a purchase.)


McMillan J (1992) Games, Strategies, and Managers, Oxford University Press, Oxford. (Really well written business reader that uses countless examples to explain how game theory can be applied to management issues.)


Morgan G (1997) Images of the Organisation, Sage, London. (A great read and covers numerous perspectives on the organisation. Embraces the metaphor approach to organisations, e.g. the organisation as a ‘machine’, as a ‘brain’, as a ‘chaotic system’, etc. You should have a look at the associated website - http://www.imaginiz.com )

I will be recommending other books and articles as the course unfolds.

**The Electronic Library**

You will be allowed internet access to the on-line collection of articles in the library (known as the Athens Project) using a password which you collect from the library. You can get this by contacting the following url:

http://www.unn.ac.uk/central/isd/subj/distl.htm

This is the service for part-time and Distance Learning students.

There are a number of journals in the field of strategic management that you can download onto your desktop.

In particular you will be able to access:

- Business Strategy Review
- European Business Journal
- Harvard Business Review
- International Journal of Public Sector Management
- Public Money and Management

And countless others.

Once you have your password go to:

http://www.bids.ac.uk
and click on the link to INGENTA

We also have access to books at http://www.emerald-library.com though off campus users need a password which can be obtained from the library.

These articles only go back a few years and so the library is arranging a postal service for past articles and books (including inter-library loans).

**Electronic Resources and email**

The University has bought a dedicated learning platform, Blackboard, to facilitate off campus learning. This is available to all students following the course and can be obtained by accessing the following website:

http://elearning.unn.ac.uk

You will need to login using your University username and password.

Here you will find electronic course materials (notes, slides and links), on-line discussion and email facilities. In addition you will have a University of Northumbria email address available at

http://student.unn.ac.uk/
As you quickly discover your Blackboard and University email accounts are integrated.

**Assessments**

You will be required to complete 2 assignments.

**Assignment 1 (value = 50%)**

You are to write a 2000 word essay on either of the following

Critically examine the contention that planning makes for successful strategy.

or

Evaluate the importance of scenario planning for the modern organisation.

This is to be handed in at the **end of week 7** of the semester.

**Suggested Reading**

See the reading suggested at the end of chapters 1, 2 and 3 in the study booklet.

**Assignment 2 (value = 50%)**

You are to write a 2000 word essay (excluding bibliography and statistical tables but including footnotes and appendices) based on the following

‘The external environment is so complex and chaotic, the behaviour of individuals and groups so unpredictable, that managers can have little claim over the outcome from a change brought about by a crisis or even, more generally, by a purposeful strategic re-organisation’. Discuss this contention using examples where appropriate.

This is to be handed in at the **end of the semester**.

**Suggested Reading**

See the reading suggested at the end of chapters 4, 5, 6 and 7 in the Study Booklet.

**Assessment Styles**

The essay and report are to be word-processed and use the Harvard referencing system. Please note I am keen to see evidence of wide reading so please cite books and articles in the text and reference them in the bibliography. Note too that I like to see quotations properly referenced.

You can get hold of a little book called ‘Cite them Right’ from the library. It is also available on the internet. To obtain it you should first go to my web page [http://www.kevinhinde.com](http://www.kevinhinde.com) and then click on Web Links.
## Appendix: Key Skills Matrix

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CHAPTER ii

STUDY SCHEDULE

The study schedule below is designed to help you plan your study throughout the semester. You need to efficiently manage your time if you are to enjoy the learning process and participate in the on-line activities successfully. Moreover, by following the schedule and contributing to the learning process through on-line discussion with your peers you should be able to cope with the assessments.

The workload refers to Chapters 1 to 7 and will vary from chapter to chapter. Chapters 1, 2 and 5, for example, each require one week's work. However, other chapters involve more substantive research and reading and so require at least two weeks study.

You will note that the suggested time only accounts for 12 weeks whilst the semester is a little longer. This is usual practice. The extra space at the end of the semester gives you time to reflect on issues in the unit and finish assessments.

Remember that learning is meant to be an enjoyable process. Please email me if you are facing difficulties.

Chapter 1: What is Strategy and How does it Develop within Organisations

Suggested Study Time - 1 week

Things to do:
1. Look at the slide show for chapter 1. All slide shows are on the main web site.

2. Read and take notes on
   - Chapter 1 of the booklet ('The Meaning of Strategy')
   - Chapters 1 and 2 of the designated text (Johnson and Scholes)

3. Carry out Activity 1.1

4. Additional Reading available on-line:

   You can access these materials through http://www.unn.ac.uk/central/isd/gateway.htm


5. Consult other electronic resources on the Web Site http://elearning.unn.ac.uk. Type in your user name and password and click on the link to Corporate and Strategic Management.
Chapter 2: Using Planning to Formulate Strategy

Suggested Study Time - 1 week

**Things to do:**
1. Look at the slide show for Topic 2.

2. Read and take notes on
   - Chapter 2 of the booklet ('Using Planning to Formulate Strategy')
   - Chapters 1 and 2 of the designated text (Johnson and Scholes) if you haven’t already done so!

3. Carry out Activities 2.1 and 2.2

4. Additional Reading available on-line:
   
   You can access these materials through [http://www.unn.ac.uk/central/isd/gateway.htm](http://www.unn.ac.uk/central/isd/gateway.htm)


5. Consult other electronic resources on the Web Site [http://elearning.unn.ac.uk](http://elearning.unn.ac.uk). Type in your user name and password and click on the link to Corporate and Strategic Management.

Chapter 3: Assessing the External Environment

Suggested Study Time – 2 weeks

**Things to do:**
1. Look at the slide show for Topic 3.

2. Read and take notes on
   - Chapter 3 of the booklet (‘Analysing the External Environment’)
   - Chapter 3 of the designated text (Johnson and Scholes)

3. Carry out Activities 3.1, 3.2 and 3.3

4. Additional Reading available on-line:
   
   You can access these materials through [http://www.unn.ac.uk/central/isd/gateway.htm](http://www.unn.ac.uk/central/isd/gateway.htm)


5. Consult other electronic resources on the Web Site [http://elearning.unn.ac.uk](http://elearning.unn.ac.uk). Type in your user name and password and click on the link to Corporate and Strategic Management.
Chapter 4: Analysing Strategic Capability through Core Competences

Suggested Study Time – 3 weeks

**Things to do:**
1. Look at the slide show for Topic 4.
2. Read and take notes on
   - Chapter 4 of the booklet (‘Analysing Strategic Capability through Core Competences’)
   - Chapters 4, 8 and 10 of the designated text (Johnson and Scholes)
3. Carry out Activities 4.1, 4.2 and 4.3
4. Additional Reading available on-line:

You can access the above materials through [http://www.unn.ac.uk/central/isd/gateway.htm](http://www.unn.ac.uk/central/isd/gateway.htm)

5. Consult other electronic resources on the Web Site [http://elearning.unn.ac.uk](http://elearning.unn.ac.uk). Type in your user name and password and click on the link to Corporate and Strategic Management.

Chapter 5: Organisational Culture

Suggested Study Time – 1 week

**Things to do:**
1. Look at the slide show for Topic 5.
2. Read and take notes on
   - Chapter 5 of the booklet (‘Analysing the External Environment’)
   - Chapters 5, and 11 of the designated text (Johnson and Scholes). You should also recall the notes you took from Chapter 2 of the set text.
3. Carry out Activities 5.1, and 5.2
4. Additional Reading available on-line:

You can access the above materials through [http://www.unn.ac.uk/central/isd/gateway.htm](http://www.unn.ac.uk/central/isd/gateway.htm)

5. Consult other electronic resources on the Web Site [http://elearning.unn.ac.uk](http://elearning.unn.ac.uk). Type in your user name and password and click on the link to Corporate and Strategic Management.

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**Chapter 6: Introducing Game Theory for Strategic Managers: Understanding Behaviour, Co-operation and Partnerships**

**Suggested Study Time – 2 weeks**

**Things to do:**

1. Look at the slide show for Topic 6. You should also note that I have prepared a slide show with streaming audio so that you can listen and watch a presentation on the Prisoner’s Dilemma game.

2. Read and take notes on
   - Chapter 6 of the booklet ('Introducing Game Theory for Strategic Managers: Understanding Behaviour, Co-operation and Partnerships')
   - Chapter 7 of the designated text, Johnson and Scholes (1999), particularly pages 337 to 344.

3. Carry out Activities 6.1 and 6.2.

4. Additional Reading available on-line:

You can access the above materials through [http://www.unn.ac.uk/central/isd/gateway.htm](http://www.unn.ac.uk/central/isd/gateway.htm)

5. Consult other electronic resources on the Web Site [http://elearning.unn.ac.uk](http://elearning.unn.ac.uk). Type in your user name and password and click on the link to Corporate and Strategic Management.

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**Chapter 7: Organisational Change and Learning**

**Suggested Study Time – 2 weeks**

**Things to do:**

1. Look at the slide show for Topic 7.

2. Read and take notes on
3. Carry out Activities 7.1, and 7.2

4. Additional Reading available on-line:


You can access the above materials through [http://www.unn.ac.uk/central/isd/gateway.htm](http://www.unn.ac.uk/central/isd/gateway.htm)

You should also consult the following article available online at [http://www.mckinsey.com](http://www.mckinsey.com) (for which you have to supply your email address)


5. Consult other electronic resources on the Web Site [http://elearning.unn.ac.uk](http://elearning.unn.ac.uk). Type in your user name and password and click on the link to Corporate and Strategic Management.
CHAPTER 1

THE MEANING OF STRATEGY

1.1. Introduction: Aims and Learning Outcomes

The aims of this chapter are to

- Introduce the economic problem of scarcity and relate this to the concept of strategy.
- Explore the meaning of organisational strategy and competitive strategy.
- Investigate the processes by which strategy is formulated within the organisation.

By the end of the chapter you will be able to

- Summarise the economic problem and relate this to the issue of strategy through a self-assessment activity.
- Critically examine the concept of strategy and its relationship to the competitive process.
- Analyse how strategy develops within your organisation through on-line readings and an activity.

1.2. The economic problem of Scarcity

Parents are often heard to shout at their children, “Want! Want! Want! That’s all that you ever seem to do.”

Well, children are just acting rationally! Economists have long recognised that we all have needs and insatiable wants. Whether we act as consumers, employees, employers, public servants or citizens, are list of wants are never ending. Sadly, we cannot achieve all of our wants. Why? Well, there are resource problems in producing goods and services. The inputs (also called resources or factors of production by economists) we need to produce output are in scarce supply. In the short run the economic problem is one of scarcity of resources such as land, capital and labour, including skills and entrepreneurship. That is, the quantity and quality of inputs that are available to produce goods and services is fixed at this very minute in time. Of course, input quantity and quality will change over time (hopefully in a positive direction), as should the efficiency of resource usage, and this should lead to a corresponding change in output (hopefully economic growth). However, these processes develop (sometimes slowly) so that scarcity does exist at every moment in time.

Further, as scarcity of inputs exists choices have to be made about the output that is most wanted within society. In making choices there is an opportunity cost – the cost of foregoing the next best alternative activity. Take me as an example. To write these notes (which is an output) I needed time (an input). Time is a scarce resource and by writing these notes I have foregone some alternative activity, say I have missed out on writing an academic paper. So the opportunity cost of writing these notes is one academic paper foregone. Moreover there is an uncertainty issue involved for in writing these notes I am not sure that the course for which they are written will run because student numbers can fluctuate (if you are reading them then you’ll know I had little to be concerned about). The same arguments can be applied to organisations whether in the private, public or voluntary sectors. For example, with limited personnel, transport and donations an emergency aid charity has to decide how it will allocate resources. There is an opportunity cost in that another emergency relief programme has lower levels of support (or even none). There is uncertainty because the environment is likely to be highly unstable. Similarly, governments might choose to allocate resources to defence rather than farmers (the ‘guns for butter’ argument) with...
uncertain political consequences. Likewise a big multinational might consider switching resources from one product to another but forecasting demand in such markets is precarious.

1.3. Marvellous Markets?

Millions (Billions? Trillions?) of wants are satisfied every day. To make the process of resource allocation run as smoothly as possible, so that these wants are satisfied, markets have developed. Markets are complex social institutions where exchange takes place. For example, organisations offer individuals a wage package because they want workers. People who want to can buy beer by paying a price to get it. Local authorities and governments want roads built and so pay contractors. And so on. Of course, there is a different contractual arrangement involved when buying beer than when building a road. The latter involves a longer time period, large commitments of finance and resources, and, once the contract is signed, requires an element of trust between the parties such that one does not exploit the other. The possibility of opportunistic behaviour arises because parties to the exchange have different sets of information. The road builder could say that the price of materials has gone up; the local authority might say that it has not been given the required finance from central government. Both have access to different information about their own sectors and could ask to re-negotiate on the price of the road building contract.

There are a number of solutions to this information asymmetry difficulty. For example, each side might agree to bind themselves into a contract by (say) placing a financial guarantee not to change the price for a specified period or they might agree to monitor each other’s behaviour (perhaps by allowing a representative to sit on the Board of Directors). Another solution in this case would be for the local authority to set up its own road building organisation (it can’t work the other way for legal reasons!). So one resolution to the possibility of opportunistic behaviour in the presence of information asymmetry may be due to vertical or lateral integration. This occurs where a transaction that constitutes a necessary component part of the good or service is internalised within an organisation. Vertical integration involves an upstream or downstream component. Lateral integration involves related components. For example, if I specialise in the manufacture of shoes I may be unable to distribute my product successfully or keep accounts. I could look for other organisations that might carry out these functions for me (I just have to look in the phone book to find marketing organisations and bookkeepers). Alternatively, if I suspect opportunistic behaviour by these parties, then I could vertically integrate with the marketing organisation or laterally integrate with the accounting firm (and the presence of these functions within organisations suggests that opportunism is everywhere).

The optimal solution would be the presence of Trust between the parties but this takes time to evolve. However, many market participants involved in the exchange of complex goods and services find ways of successfully conducting transactions that do not require redress to sophisticated contracts or integration. Nissan, for example, has ‘letters of intent’ with some its major suppliers. We will discuss this issue (known as relational contracting) in Chapter 4.

It is interesting to note that in the UK Public Sector ‘Service Level Agreements’ between organisations, or even within organisations, provide an important pathway for the delivery of complex services. These documents could be quite simple. Simplicity suggests the existence of trust. However, complex Service Level Agreements are the norm in the UK public sector. These are justified on the grounds that they provide quality assurance but in doing so they also reflect accountability, identifying who is responsible if something goes wrong. They are essentially contracts though it would be misleading to suggest that arrangements between organisations reflect an absence of trust, particularly as this is a time of ‘joined up government’ and public - private partnerships. The complexity of such agreements reflects past concerns about delivery.

What is suggested thus far is that markets are complex social arrangements that can fail because human actors do not trust each other. Indeed, the organisation can develop because of this.
Markets can fail for other reasons. The existence of market dominance, but more particularly the abuse of market dominance, can also upset the efficient allocation of resources. Consumers and organisations are then seen to pay excessively high prices.

There are also externalities that arise in the provision of goods and services. These are social costs and benefits which arise from market transactions but which are not accounted for in the market price. Good examples are pollution (a social cost) and health and safety at work (a social benefit).

1.4. Marvellous Government?

Governments do not always intervene when markets fail. Where the possibility of opportunistic behaviour exists to the detriment of one or more participants to exchange then organisations can embark on self-regulation. The Federation of Master Builders, for example, exists to screen against ‘cowboy’ building firms and signal high quality to customers. Government is also seen as too costly. Thus, the costs of intervening to prevent monopoly power could be too high if we recognise that there are incentives for other market participants to act on the behalf of consumers. In the case of cartels there are powerful incentives for one of the participants to cut prices and increase their own profit. Further, the dynamic nature of markets may allow new entrants to undercut the higher prices of incumbents. It has also been suggested that government has been too hasty in intervening to correct negative externalities such as pollution. For example, where a polluter could negotiate an appropriate compensation for the victim then the presence of government bureaucracy would represent over-regulation. There is another alternative to government intervention for individuals and collections of individuals can venture to the Courts who will then make judgements about issues arising from market failure.

Clearly there are enormous difficulties in resolving market failure through anything other than government intervention because some individuals are not powerful or wealthy enough to use the Courts or the information available to particular parties may be incomplete. Thus, the democratic process (and other forces) has given us publicly financed organisations charged with looking after consumers, ensuring fair competition, and negating the excesses of pollution and so on.

Self Assessment Task

How many publicly financed organisations charged with resolving consumer interests can you name?

Sometimes the market cannot provide the product or service exclusively to those who pay for it. In such circumstances the incentives for individuals to ‘free ride’ and avoid payment is great and only Government, collecting through the tax system can provide these so-called ‘Public Goods’. Classic examples are street lighting, the armed forces, police and fire brigade. However, it could be argued that the government might put out to tender the subsidy associated with these services and award the contract to the lowest private sector bidder.

There are clearly political reasons why ‘public goods’ are not put out to tender; governments would be voted out of office! This raises the wider point about what should or should not be provided by government because it is largely a matter a decision determined by the democratic process. More generally, society may judge some services as merit goods and call upon Government to provide them. Examples include a National Health Service or State run education. The market could provide these goods but the price would be prohibitively expensive for many. By providing such services, Governments are re-distributing wealth and attempting to capture the enormous social benefits that would be good for all citizens.

Governments are crucial to the resource allocation process and the satisfaction of wants but, like markets, they are subject to imperfections. In spite of the stringent systems of
accountability they make mistakes. They are subject to human actors who may have objectives that satisfy their own agenda rather than the public interest. This process is sometimes known as **Public or Government Failure**. Governments also have limited resources to satisfy wants not provided by the market and this is where not-for-profit organisations enter the resource allocation process.

### 1.5. A Definition of Strategy?

So where does strategy fit in? Well, **strategy is the process by which individuals and organisations make choices about scarce resources so as to satisfy wants over time.** In making their choices individuals and organisations are constantly assessing market and non-market forces as vehicles to enhance economic welfare but they do so in an environment of complexity and uncertainty.

This is a global definition but it is important because it helps to put other definitions in perspective. For example, a definition of organisational strategy (I will now drop the reference to individuals, though it is not difficult to apply it) is as follows:

> "A strategy is defined as a pattern, of purposes, policies, programmes, actions, decisions, or resource allocations that define what an organisation is, what it does, and why it does it. Strategies can vary by level function, and by time frame."

(Bryson, 1995, p.32)

Bryson is applying this definition to public and non-profit organisations but it is a definition also used by those who have analysed private sector firms (see, for example, Andrews (1971)). It is a useful definition and is more practical but it can be easily compared to our global definition above. Thus, decision makers in organisations recognise they have scarce resources that must be allocated efficiently and effectively to produce core activities and meet the changing demands of their customers/clients. In doing so they formulate short, medium or long term strategies that underpin the rationale for the organisation’s continued existence. The phrase in ‘an environment of complexity and uncertainty’ is not present in this definition (nor, indeed, in those that follow). There is a hint that strategic managers have, at least, some measure of control over the process of change and this is an issue examined in the final chapter of the booklet.

### 1.6. Competitive Strategy

The definition of strategy used by Bryson provides a general framework from which to analyse strategy. However, it does not address the issue of competitive strategy, at least directly. Grant (1999, p.1) states boldly, “strategy is about winning”, by which (I think) he means strategy is about being successful. Clearly, some are more successful than others are and success can be short-lived. Manchester United is the most successful English soccer team of the 1990s but they were not always at the top of the league. Similarly, Marks and Spencers were noted as the best ‘high quality retailer’ in the UK for a number of years but in the late 1990s they experienced a downward change in fortunes from which they are trying to emerge.

There is competition in the public and non-profit sectors too. In some instances there is direct competition. Most sections of central and local government have experienced privatisation in which private firms bid for services once solely supplied by public sector organisations. There is also competition for funding. Non-profit organisations compete against each other for donations. Public sector organisations usually have to meet detailed requirements in order to obtain funding, but in doing so they have to compete against others. For example, Best Value is the latest UK government initiative aimed at improving public services and this involves benchmarking, performance indicators and league tables.
In such an environment strategy is concerned with competition and some authors have readily acknowledged this in their definitions. For example, Johnson and Scholes (1999) note that

“Strategy is the direction and scope of an organisation over the long term: which achieves advantage for the organisation through its configuration of resources within a changing environment, to meet the needs of markets and to fulfil stakeholder expectations” (p.10).

The emphasis on direction is important for organisations. The need to know what the organisational objectives are and how they are to achieve them are fundamental to success. But success is based on some pre-determined measure in relation to others over time in a similar activity. That is why the key word in the above statement by Johnson and Scholes is ‘advantage’ which really implies ‘competitive advantage’ (Porter, 1985). The emphasis is on strategic positioning so that an organisation outperform others operating in the same activity.

This, of course, raises important questions as to the meaning of success. Are those who appear lower down any given league table not providing value to the customers or citizens? For example, the global market leader for providing a managed electronic learning environment is Blackboard. It has about 20 per cent market share (based on the number of users). Next is WebCT, another global player, and much lower down the market share league table are other private companies such as Learning Space or the university-funded project Centre of Student Environment. Yet many who use electronic platforms provided by these smaller organisations believe them to have strengths that the larger organisations do not possess - that is why they chose them.

The situation is somewhat different with public sector monopolies such as local authorities but the same point can be made. Citizens do not have the choice of authority from which they get their service in the main but similarly local authorities cannot choose their location or their citizens. For example, the cost of refuse collection is higher in rural areas than in towns and cities. It would be absurd to develop a league table showing the collection costs per capita for all locations. To get a more accurate comparison we can compare towns of similar population densities. However, it is not that straightforward. What if town A has winding, hilly roads and town B has flat straight roads with populations clustered differently to that of A? Can we put them in a league table based on refuse collection cost per capita for towns of similar population densities and say that one is better than the other? Well we can but we need to be aware in assessing them of the proviso about the unique geography of each town. They may both be providing an effective service for their citizens but town A is more expensive because of its geographical disadvantage. (We could make similar argument about differences in demography between authorities).

The point that needs to be made is that competitive advantage is important but we need to keep it in perspective: Strategy is not just about winning it is about the effective provision of products or services that customers or citizens, with their varying tastes and wants, truly desire.

1.7. Mintzberg’s 5 Ps

Henry Mintzberg (1998) suggests that authors on strategy characterise its meaning in one or more of the following 5 ways

1. A Ploy
2. A Position
3. A Perspective
4. A Plan
5. A Pattern
The first two are concerned quite openly with the issue of competitive strategy. Ploy refers to outwitting a rival. Position is about how an organisation places itself in the market. Both are concerned with obtaining a competitive advantage through the existence of core competence.

The view that strategy is a perspective identifies with those organisations where there is a powerful group of strategy makers. It is their whims, predilections and personality that influence organisational direction. This, of course, raises an issue about whether such views reflect an organisational consensus.

Most organisations have a strategic plan - a consciously intended course of action, general or specific. However, Mintzberg (1990), as you will note later, is very critical of what he calls the Design School of strategic management. He implies that this approach relies heavily on a group of decision-makers (strategy as a perspective) and that the formulation of strategy is detached from its implementation. He asks how such organisations can venture into new markets. What is required is ‘crafting’, which is in marked contrast to planning.

“Craft invokes traditional skill, dedication, perfection, mastery through detail. What springs to mind is not so much thinking and reason as involvement, a feeling of intimacy and harmony with the materials at hand, developed through long experience and commitment. Formulation and implementation merge into a fluid process of learning through which creative strategies emerge.” (Mintzberg (1987) p.66).

Interestingly, Mintzberg identifies strategy as a pattern because planners may justify what they have done even though it did not follow from the original plan. After having taken action, we reflect on what we have done and define it as a consistent pattern - whether or not it was intended. Because we "see" a pattern what we do is ascribe it as being intentional strategy - "the pattern stems from our plan!"

However, there has been no overseeing intention. Some plans may never be implemented or see the light of day. In the same way, a pattern of actions may arise without preconceived, integrative planning. Indeed, they can arise through the political, cultural and social forces that operate within and upon the organisation.

Mintzberg identifies with two sorts of strategy – deliberate and emergent.

- A deliberate strategy is an intended plan that is then realised (or otherwise).
- An emergent strategy arises from other sources, usually political and cultural or through imposition (possibly by an event over which the organisation has no control).

Figure 1.1 below illustrates the process.
1.8. How does Strategy develop within Organisations?

Strategy then is concerned with how resources are best allocated in order to achieve organisational ends and satisfy wants. Strategists need to consider the complexity of the external environment and prioritise resources in order to achieve competitive advantage or, more appropriately, achieve the effective delivery of products for a diversified consumer base.

There are a number of influences upon the formulation of strategy. In some organisations strategy develops largely from planners and the plan. However, this is only one influence and in other organisations strategy may develop primarily as issues emerge or plans fail to be realised in the way they were intended. Thus, there are other influences on the formulation of strategy, notably from organisational culture, organisational politics, very strong leaders and external forces (perhaps the Government, or a Parent company in another country, or a stock market crash). Johnson and Scholes (1997) have shown that some forces may dominate at one moment in time. Six forces are possible and Table 1.1 demonstrates the characteristics associated with each dimension. To show which forces are dominant a questionnaire is answered and a snowflake diagram drawn. Figures 1.2 and 1.3 show possible outcomes. A ‘Rational Command’, ‘Logical Incremental’ and ‘Externally Dependant’ are the key profiles shown. Clearly, this approach may allow managers to see where they are now and consider whether they can (or want to) influence the strategy process toward a more suitable direction in a few years time.

Kevin Hinde. EC490 Corporate and Strategic Management
Some very recent research demonstrates the crucial importance of formal planning systems alongside incremental approaches for successful organisations (Brews and Hunt, 1999).

Activity 1.1: Strategy Development in Your Organisation

- Table 3.1 (taken from Johnson and Scholes, 1997) provides details of ‘six dimensions of strategy development’ within organisations. There is also a questionnaire in the Appendix to this chapter that will allow you to carry out a strategy development audit in your own organisation.
- Answer the questionnaire yourself and follow the instructions to translate your answers into scores and a snowflake diagram.
- Repeat this activity with senior members of your own organisation.
- Show them the results and ask if they reflect what the organisation aspires to.
- Discuss your findings with other members of the class using the electronic notice board.
Table 1.1

**Six Dimensions in Strategy Development**

**The Planning Dimension**
- Strategies are the outcome of rational, sequential, planned and methodical procedures
- Definite and precise strategic objectives are set
- The organisation and environment are analysed
- Potential strategic options are generated and the optimum solution chosen
- Defined procedures for implementation and the achievement of the strategic objectives are developed
- The strategy is made explicit in the form of detailed plans

**The Incremental Dimension**
- Evolutionary but purposeful strategy development
- Strategy is developed as issues arise
- Strategy is continually adjusted to match changes in the operating environment
- Early commitment to a strategy is tentative and subject to review
- Strategic options are continually assessed for fit
- Successful options gain additional resources
- Strategic options are developed from existing strategies by experimentation and through gradual implementation

**The Cultural Dimension**
- A "way of doing things" in the organisation guides strategic direction
- Strategies evolve in terms of a core set of shared assumptions based on past experience, values and beliefs held by the organisation’s members
- The shared assumptions guide
  - the selection of goals and objectives
  - the identification of strategic issues
  - the selection of information
  - the selection of strategies

**The Political Dimension**
- Strategies are developed by negotiation and bargaining between interest groups
- The interest groups seek to realise their own desired objectives
- Their influence on strategy development increases with power
- Power comes from the ability to create or control the flow of scarce resources and the control and provision of information
- A strategy acceptable to powerful interest groups is achieved by a process of accommodation and mutual adjustment

**The Command Dimension**
- An individual is the driving force behind the organisation’s strategy.
- Strategy is primarily associated with the institutionalised power of an individual or small group.
- The strategy represents the aspirations for the organisation’s future of this individual.
- The strategic direction may be related to a "vision" based on rational understanding and intuition, or experience and intuition.
- The individual becomes the representation of the strategy for the organisation.

**The Enforced Choice Dimension**
- Strategic choice is prescribed or limited by external forces that the organisation is unable to control or influence.
- Organisations respond to environmental imperatives.
- Strategic change is instigated from outside the organisation.
- Barriers in the environment severely restrict strategic mobility.

Source: Johnson and Scholes (1997). Reproduced with permission of Pearson Education Ltd.
**Figure 1.2**

<table>
<thead>
<tr>
<th>Profile</th>
<th>Dominant dimensions</th>
<th>Characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Logical Incremental</td>
<td>Planning incrementalism</td>
<td>Standardised planning procedures Systematic data collection and analyses Constant environmental scanning On-going adjustment of strategy Tentative commitment to strategy Step-by-step, small-scale change</td>
</tr>
<tr>
<td>(b) Rational command</td>
<td>Planning Command</td>
<td>Senior figure determines and directs strategy Strong vision or mission Definite and precise objectives Analysis and evaluation of environments Clear plans</td>
</tr>
</tbody>
</table>

Source: Johnson and Scholes (1997)

**Figure 1.3**

<table>
<thead>
<tr>
<th>Profile</th>
</tr>
</thead>
<tbody>
<tr>
<td><img src="image" alt="Diagram" /></td>
</tr>
</tbody>
</table>

Source: Johnson and Scholes (1997)  
Reproduced with permission of Pearson Education Ltd
1.9. Summary

In this chapter we have introduced the concept of strategy using some introductory economics. We have examined the term organisational strategy and noted that it is important to consider the issue of competition irrespective of the sector. However, this has to be put into perspective as not every organisation can finish top of a league table. We have also considered intended and emergent strategies. There is a constant interaction within and between organisations that facilitates the formulation of strategy. There is evaluation, feedback and learning in the formulation and implementation stages of strategy. Planning matters but so do emergent (incremental / cultural / political) processes, particularly when plans are not being realised.

However, most organisations formulate strategic aims and objectives through a process they describe as strategic planning. This is the subject of the next chapter.
Reading (**= Key Reading)


Appendix 1.1: Strategy Development Questionnaire

This Questionnaire is taken from Bailey and Avery (1998). Answer the questions set by indicating your strength of feeling to each of the set questions.

<table>
<thead>
<tr>
<th>Strongly</th>
<th>Strongly</th>
<th>Disagree</th>
<th>Agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. We have definite and precise strategic objectives</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>2. To keep in line with our business environment we make continual small-scale changes to strategy</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>3. Our strategy is based on past experience</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>4. The influence a group or individual can exert over the strategy we follow is enhanced by their control of resource critical to the organisation’s activities</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>5. The strategy we follow is directed by a vision of the future associated with the chief executive (or another senior figure)</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>6. Our strategy is based on past experience</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>7. We evaluate potential strategic options against explicit strategic objectives</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>8. We keep early commitment to a strategy tentative</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>9. Our organisation’s history directs our search for solutions solutions to strategic issues</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>10. The information on which our strategy is developed often reflects the interests of certain groups</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>11. Our strategy is closely associated with a particular individual</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>12. Our freedom of strategic choice is severely restricted by our business environment</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>13 We have precise procedures for achieving strategic objectives</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>14. Our strategies emerge gradually as we respond to the need to change</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>15 There are beliefs and assumptions about the way to do things which are specific to this organisation</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>16 Our strategy develops through a process of bargaining and negotiation between groups or individuals</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>17. The chief executive determines our strategic direction</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>18. We are not able to influence our business environment; we can only buffer ourselves from it</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>19 We have well-defined procedures to search for solutions to strategic problems</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>20. We tend to develop strategy by experimenting and trying new approaches in the marketplace</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
</tbody>
</table>
21. The strategy we follow is dictated by our culture
<table>
<thead>
<tr>
<th>Suggested by</th>
<th>Strongly Disagree</th>
<th>Strongly Agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strongly Disagree</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly Agree</td>
<td></td>
<td></td>
</tr>
<tr>
<td>22. Our strategy is a compromise which accommodates the conflicting interests of powerful groups and individuals</td>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
<tr>
<td>23. Our strategic direction is determined by powerful individuals or groups</td>
<td>1 2 3 4 5 6</td>
<td></td>
</tr>
<tr>
<td>24. Barriers exist in our business environment which significantly restrict the strategies we can follow</td>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
<tr>
<td>25. Our strategy is made explicit in the form of precise plans</td>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
<tr>
<td>26. Our strategy develops through a process of ongoing adjustment</td>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
<tr>
<td>27. The strategies we follow develop from 'the way we do things around here'</td>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
<tr>
<td>28. The decision to adopt a strategy is influenced by the power of the group sponsoring it</td>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
<tr>
<td>29. Our chief executive tends to impose strategic decisions (rather than consulting the top management team)</td>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
<tr>
<td>30. Many of the strategic changes which have taken place have been forced on us by the those outside this organisation</td>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
<tr>
<td>31. We make strategic decisions based on systematic analysis of our business environment</td>
<td>1 2 3 4 5 6</td>
<td></td>
</tr>
<tr>
<td>32. Our strategy is continually adjusted as changes occur in the marketplace</td>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
<tr>
<td>33. There is resistance to any strategic change which does not sit well with our culture</td>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
<tr>
<td>34. Our strategies often have to be changed because certain groups block their implementation</td>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
<tr>
<td>35. A senior figure’s vision is our strategy</td>
<td>1 2 3 4 5 6</td>
<td></td>
</tr>
<tr>
<td>36. Forces outside this organisation determine our strategic direction</td>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
</tbody>
</table>
Strategy Development Questionnaire scoring sheet

Further Instructions

Please transfer the number circled for each statement of the Strategy Development Questionnaire to the corresponding box on the grid below. The number at the left of each box indicates the questionnaire statement to which it refers.

Having transferred the number for all statement to the grid, sum each column. Subtract 24 from each of the column totals to produce a score for each of the perspectives.

<table>
<thead>
<tr>
<th>Planning</th>
<th>Incrementalism</th>
<th>Cultural</th>
<th>Political</th>
<th>Command</th>
<th>Enforced Choice</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
<td>6</td>
</tr>
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<td>32</td>
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<tr>
<td><strong>Column Total</strong></td>
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<tr>
<td>-24</td>
<td>-24</td>
<td>-24</td>
<td>-24</td>
<td>-24</td>
<td>-24</td>
</tr>
</tbody>
</table>

Score = Column total - 24

Now transfer the scores onto the six axes within the concentric circles drawn below. You should end up with what is termed a ‘snowflake diagram’ (Figures 1.2 and 1.3 in the text will help you). Comment on your results.
CHAPTER 2

USING PLANNING TO FORMULATE STRATEGY

2.1. Introduction: Aims and Learning Outcomes

Aims

- To demonstrate the importance of planning techniques in the formulation of strategy.
- To encourage individuals to share experiences and expectations relating to strategy development.

Learning Outcomes

Having read this set of notes, undertaken the directed reading and worked through the activities you will be able to

- identify stages in the formulation of strategy using planning.
- evaluate the importance of various stakeholders in establishing organisational purpose.
- critically examine mission statements.
- Critically reflect upon the nature of strategy in your own organisation.

2.2. The Vocabulary of Strategy: Using Planning to Formulate Strategy

Most organisations use a planning process to articulate, implement and evaluate strategy. The process usually becomes on going. New strategy may emerge in the light of experience; some old strategy may be discarded, as it becomes unrealised, and some previously intended strategy remains. A large volume of documentation and a new and, often confusing, vocabulary accompanies the planning process. The purpose of this chapter is to examine some of the methods of the strategic planning process.

We will use Bryson (1995, p.23) quite extensively to illustrate the planning process. He suggests a Ten-Step approach using the public and non-profit sectors as his example but it can be readily adapted to a private sector context. The ten steps are as follows:

1. Initiate and agree upon the strategic planning process.
2. Identify Organisational Mandates
3. Clarify Organisational Mission and Values.
4. Assess the external and internal environments to identify SWOTs (Strengths, Weaknesses, Opportunities and Threats)
5. Identify the strategic issues facing the organisation
6. Formulate strategies to manage these issues
7. Review and adopt the strategic plan or plans.
8. Establish an effective organisational vision.
9. Develop an effective implementation process.
10. Reassess strategies and the strategic planning process

Note that these steps provide structure but are not ‘tablets of stone’- some organisations may feel that certain stages develop before others. These steps should lead to “action, results
and evaluation”. However, this is not a linear process: formulation is interdependent with implementation and evaluation.

Figure 2.1 depicts the ten steps in a simple way.
2.3. Stage 1: Initiate and agree upon the strategic planning process.

It is important that there is a dominant individual or coalition of individuals who sponsor (coerce?) the planning process. These are usually the key decision-makers.

This may be more difficult in cases where joint commissioning is present (Strategic Alliance). Where there is no history of joint working mechanisms must be put in place to facilitate developments (e.g. find individuals with common aims, negotiate on funding, start small scale....)

Agreement must be reached as to the
- purpose of the effort
- preferred steps in the process.
- form and timing of reports (the planning cycle)
- role, function and membership of groups established to oversee the effort.
- role, functions and membership of any strategic planning committee.
- commitment of resources for the process.

2.4. Stage 2: Identify Organisational Mandates

This is more prevalent in the public sector where statutory requirements can often hinder developments. But it applies to nearly all multi-product or multi-service organisations. Thus, there might be geographical and product development barriers imposed by corporate headquarters. The organisation or part thereof must understand the limits of its possibilities to develop products or services.

However, as Smith (1994) notes mandate analysis can clarify the boundaries between

- what must be done
- what could be done and
- what must not be done.

For example, the Driving Standards Agency found that it could introduce tests on Saturdays and that the public would pay the extra for it. Thus, whilst mandate analysis might seem a rather straightforward exercise it can aid the development of Mission for it informs individuals about what the key responsibilities are or could be.

**Stakeholders**

In considering mandates it is important to know who the stakeholders are. How important they are and how important they might become? As Bryson (1995) suggests identification of key stakeholders is the key means to success in public and non-profit organisations.

But who are the stakeholders? The following list adapted from Smith (1994) considers some of the stakeholders from public service organisations in the UK.

**Controllers of Resources**
- Her Majesties Treasury
- Supporting Government Department or Agency.
- Service recipients with an alternative source of supply
- Grant Awarding Bodies

**Involvement in Service Production**
- employees
- trade unions
- suppliers
- contractors
partners

Community
- consumers/customers/clients/users
- Regulators
- Neighbours
- local industry
- education and training establishments

Political Influence
- Parliament
- National Audit Office (who scrutinise the activities of public service organisations)
- Political parties
- Taxpayers
- pressure groups
- Media

For private sector organisations we might add Banks, creditors, debtors, strategic alliance partners, though for the profit driven organisation shareholders and customers are the key stakeholding groups.

To assess the power of each group we might use the Mendelow matrix (see Johnson and Scholes, 1999, ch. 5.) which provides an opportunity to score stakeholding groups by assessing their relative power and their interest. For example, some groups might have high levels of interest but little power or vice versa and sometimes those with the greatest interest and power may not be the ones who are best served by the strategy! There is great interest in the customer or user particularly if the organisation is attempting to ‘reinvent’ itself or ‘re-engineer’ its operations or employ Total Quality Management but this may be at the expense of other influential groups. And, of course, those with power and interest today might not be so influential or concerned in 5 years time.

Bryson (1995) suggests that in formulating strategy it is important to consider how stakeholding groups might react in the implementation stage. The following matrix shown in Figure 2.2 is modified slightly from Nutt and Backoff (1992) to interpret stakeholder positioning.

![Figure 2.2. Interpreting the Stakeholder](image)

Those responsible for the ‘drawing up’ of strategy must consider how to encourage coalitions of the most important and supportive stakeholding groups and develop mechanisms to encourage ‘low priority groups’ to be more involved. For those more difficult and hostile
groups, the priority is to defend the strategy, possibly by redefining it, and communicate the purpose of the strategy.

**Self Assessment Task**

Carry out an assessment of Stakeholders who affect your organisation. Think about their power and interest or the position on an issue. To what extent did the groups you identify have influence 10 years ago? Were other groups more powerful? Why? What do you think the stakeholding map will look like in 5 to 10 years time?

### 2.5. Stage 3: Clarify Organisational Mission and Values.

After deciding whom the strategy is for the **overriding purpose or intent of the organisation must be established. This is usually formalised in a Mission Statement.** Indeed, Campbell and Yeung (1990), citing a study undertaken by Peat Marwick McLintock, note that approximately 80% of top UK companies have a Mission Statement though some use a different name: Northumbria Police have a 'Statement of Common Purpose and Value' (Purpose Statement, Corporate Objectives, Business Definition, Company Philosophy, Corporate Principles, Core Values are also used (Campbell and Yeung, 1990)). Documents that represent mission may be short or long but it is important that the statement is easy to read.

To give you some idea of what a Mission Statement might entail the University of Northumbria’s Mission is set out in Table 2.1.

**Table 2.1. The University of Northumbria’s Mission Statement**

The Mission of the University of Northumbria at Newcastle is to be a leading, broad-based institution of higher education, serving national, regional and international needs and characterised by the outstanding quality of its teaching and research; by its concerns for the extension of access to flexible programmes which are responsive to the needs of students, employers and other clients; by its involvement with continuing education; by its dedication to the development of the full human potential of its students and to their better preparation for employment, through the development not only of their intellectual abilities but also enterprise, competencies and personal skills; by its determination to create equal opportunities and a harmonious and satisfactory learning and working environment for its students and staff; and by its cost-effective operation within an optimised resource framework.
Claims for mission

There have been a number of claims for mission. Peeke (1994) notes that mission

- encourages the development of a clear sense of purpose.
- facilitates decision making in the organisation.
- facilitates organisation-wide communication.
- aids evaluation activity.
- clarifies marketing strategy.
- is useful in the management of contraction (at least if the mission has been devised proactively).

Watson and Conway (1995) suggest it could be a way of establishing broad policy goals from which key objectives follow.

Does the notion of mission live up to these claims?

Goold and Campbell (1989) note, "the popular demand for mission and policy statement does not prove their worth". They can be bland statements that are not evidenced in the actions of management (Peeke, 1994). However, whilst there may be an element of truth in such observations, for many, Mission establishment is an important phase in the strategic management process. Indeed, the process of drafting them may be beneficial:

"...even if the mission statement ends up in everyone's wastebasket, there will still be beneficial effects resulting from the thinking and analysis involved in drafting it."
(Bowman, 1990)

Elements of a successful Mission Statement

Drucker (1973) noted

"That business purpose and business mission are rarely given adequate thought is perhaps the most single cause of business frustration and failure".

Peeke (1994) summarises the work of 3 authors - one from the UK, one from Australia and one from the USA - and suggests that there are certain CORE ELEMENTS of an effective Mission Statement. It should

- specify clearly the nature of the enterprise in terms of its products or services.
- reflect the concerns of organisation members.
- specify the enterprises' markets and customers.
- specify the beliefs and values prized by organisation members that it wishes to communicate.
- specify the technology in use.
- specify the growth policy of the organisation.
- be general enough to be flexible but specific enough to enable priorities to be established.

A study by David (1989) of 75 mission statements from the American Fortune 500 companies showed the most common components of Americas successful companies to be:

- concern for customers
- definition of the firm's major products or services
- concern for public image

The Ashridge Management Centre, which has many years experience in developing Mission Statement for organisations throughout the world, argues that there is a need to combine underlying beliefs and assumptions within the organisation, the purpose of the organisation and the actions it takes to achieve it purpose (see Figure 2.3).
"An organisation has a mission when its culture fits with its strategy". (Campbell and Yeung, 1990.)

Figure 2.3: The Ashridge Mission Model

The research by Campbell and associates at Ashridge led to the following guiding principles to implement mission:

- It takes years not month.
- True consensus is necessary within the top team.
- Action is a better communicator than words.
- Top team visibility is essential.
- Top team continuity helps.
- Strategy and Values should be formulated together.
- Management should focus on the link between behaviour and values.
- Make the mission inspirational but not unrealistic.

Campbell et al warn that developing a strong sense of mission in a period of change may be disastrous. So be wary.
Activity 2.1

Use the Ashridge Mission Model below to score your own organisation’s Mission Statement. Compare your Mission with a like organisation (you can easily find one on the internet). Additionally, you might like to score the University of Northumbria’s Mission Statement set out in Table 2.1

Would others in your organisation score it in a similar way? Explain your answer.

Email your findings to the discussion board or me.

Do you have a Good Mission Statement?
Answer each question: 0=No, 1 = to some degree, 2 = Yes

<table>
<thead>
<tr>
<th>The Purpose</th>
<th>Score = 0, 1 or 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Does the statement describe an inspiring purpose that avoids playing to</td>
<td></td>
</tr>
<tr>
<td>the selfish interests of the stakeholders – shareholders, customers,</td>
<td></td>
</tr>
<tr>
<td>employees, suppliers?</td>
<td></td>
</tr>
<tr>
<td>b. Does the statement describe the organisation’s responsibility to its</td>
<td></td>
</tr>
<tr>
<td>stakeholders?</td>
<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Strategy</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Does the statement define a business domain explaining why it is</td>
<td></td>
</tr>
<tr>
<td>attractive?</td>
<td></td>
</tr>
<tr>
<td>b. Does the statement describe the strategic positioning that the</td>
<td></td>
</tr>
<tr>
<td>organisation prefers in a way that helps to identify the sort of</td>
<td></td>
</tr>
<tr>
<td>competitive advantage it will look for?</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Values</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Does the statement identify values that link with the organisation’s</td>
<td></td>
</tr>
<tr>
<td>purpose and act as beliefs that employees can feel proud of?</td>
<td></td>
</tr>
<tr>
<td>b. Do the values ‘resonate’ with and reinforce the organisation’s strategy?</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Behaviour Standards</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Does the statement describe important behaviour standards that serve</td>
<td></td>
</tr>
<tr>
<td>as beacons of the strategy and values?</td>
<td></td>
</tr>
<tr>
<td>b. Are the behaviour standards described in a way that enables individual</td>
<td></td>
</tr>
<tr>
<td>employees to judge whether they have behaved correctly or not?</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Character</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Does the statement give a portrait of the company capturing the culture</td>
<td></td>
</tr>
<tr>
<td>of the organisation?</td>
<td></td>
</tr>
<tr>
<td>b. Is the statement easy to read?</td>
<td></td>
</tr>
</tbody>
</table>

Maximum score 20, Good Score 15, Poor Score less than 10

Reproduced by permission of the Economist Intelligence Unit Limited.
2.6. Stage 4: Assess the external and internal environments to identify SWOTs (Strengths, Weaknesses, Opportunities and Threats)

It is important to understand both the dynamic of an uncertain external environment and those internal structures and processes that make up an organisation’s core competences. To this end it is essential that organisations consider the short, medium and possibly long term external events and internal strengths and weaknesses. This sort of analysis is crucial in providing a context for strategic planning. We examine it in more depth in Chapters 3 and 4.

2.7. Stage 5: Identify the strategic issues facing the organisation

At this stage specific strategic objectives could be considered although as the process is unravelling these may have already become clearer.

Objectives, according to Smith (1994), should be

- achievement (not activity) oriented (no ambiguous verbs such as maintain, understand...).
- specific.
- objective.
- ends not means.
- few in number (some would argue the need to identify Critical Success Factors).
- achievable.
- prioritised.

Here organisations might prioritise objectives, perhaps they have a set of **CORE OBJECTIVES**, which may overlap with others and these can be given greater emphasis because they yield more value from the resource outlay.

By understanding strategic objectives organisations can begin to assess their key strategic issues.

> “These are fundamental policy questions or critical challenges that affect an organisation’s mandates, mission and values; product or service level and mix; clients, users, or payers; or cost, financing, organisation or management” (Bryson, 1995, p.30).

Here the organisation should be setting out what these are. Developing workshops, board blasting sessions, writing succinct statements. In the case of Northumbria Police, a regional Police Force within the UK, their Strategic Issues are

- Managing Increasing Demand
- Managing People within the Organisation
- Managing Communication

With Quality of Service being pervasive in each.

A study by Watson and Conway (1995), which examined the possibilities of joint commissioning to facilitate ‘independent living’ among community care users, distinguished between ‘infrastructure’ and ‘mechanism’ issues. The former concentrated on four broad categories:

- The development of new and additional housing (including existing stock);
- The development of property-related services;
The conversion and upgrading of outdated accommodation facilities;
The reshaping of support services and the financing of support to individuals.

Mechanism factors related to specific issues:

- Access to housing and housing allocations;
- The development of inter-agency agreements at points of ‘critical transition’.

To make sure the organisation has identified the right strategic priorities key people should discuss the implications of not undertaking a particular task.

**Self Assessment Task**

Write down (a brief list will do) the key strategic issues facing your organisation and the strategies that are in place to deal with them.

### 2.8. Stage 6: Formulate strategies to manage these issues

The preferred definition of organisational strategy used in the last chapter was that of Bryson (1995).

> “A strategy is defined as a pattern, of purposes, policies, programmes, actions, decisions, or resource allocations that define what an organisation is, what it does, and why it does it. Strategies can vary by level function, and by time frame.”  
> (Bryson, p.32)

This sits nicely with the more global definition in the previous chapter. Organisations are part of the process by which scarce resources are allocated to satisfy wants. Not all wants can be satisfied but if the organisation can appropriately identify its purpose and its intent then planning systems may be useful vehicles for marrying resources and wants. Clearly, there will never be a perfect match. The environment is a complex and has large pockets of uncertainty. Moreover, decision makers have only bounded rationality, i.e. there are limits to their cognitive processing skills because information is incomplete. It is often the case that decision makers will believe they are in control of the environment; possibly, but they never have total control. This, of course, implies that there is no such thing as a perfect strategy. Indeed, if there were then strategy implementation and review would be largely wasteful processes. All organisations adopt and adapt their strategies and plans to meet the dynamic world.

### 2.9. Stage 7: Reviewing and Adopting the Strategies and Plan

This is important where official approval to proceed is required or where joint commissioning work is being undertaken.

This stage represents the formal seal of approval for the strategies to be adopted.

### 2.10. Stage 8: Establishing an Effective Organisational Vision
Vision Statements are seen as documents that set out the strategic intentions of the organisation (Hamel and Prahalad, 1994). They are about ‘animating the dream’. These statements offer aspirations about the future strategic direction of the organisation and are often incorporated in Mission Statements.

In this stage the organisation is developing a view of what it should look like once its strategies are achieved and developed to their full potential. It is the organisation’s ‘Vision of Success’. This vision may begin at the very earliest stage of the planning process - the initial agreement - but it can develop at this later stage. Indeed, many organisations may not need a vision of success, particularly if they only need to identify and resolve a few strategic issues.

2.11. Stage 9: Developing an Effective Implementation Process

Developing a document is not enough. For Strategies to be realised
- Individuals, teams etc. have to know their roles and responsibilities
- action plans have to be developed
- timescale has to be considered (that is, a Planning Cycle should develop).
- resources have to be committed, particularly to training
- communication processes have to be developed (and these have to be effective)
- Review and monitoring procedures have to be considered (This may involve, performance indicators, benchmarking)
- Accountability procedures must be put in place

2.12. Stage 10: Reassessing Strategies and the Strategic Planning Process

The process is on going. But remember, new strategies emerge and some old ones are discarded whilst others remain.

2.13. Conclusion

In this chapter we have presented Planning as a linear (‘Ten-Step’) process, though it clearly does not have to be. You might want to reflect upon the last chapter that considered emergent strategies and used Mintzberg’s phrase ‘strategy as crafting’. The activity set out below should let you think about these issues in more depth. You will also be asked to reflect upon your findings in Chapter 7 when we discuss organisational change and learning.

Activity 2.2

Consider the following questions.
- Is planning part of the strategy formulation process within your organisation? If not, how does it differ?
What are the advantages and disadvantages of planning?
Critically consider the strategy documents that you are familiar with in your own organisation. Do they reflect the Ashridge Mission Model? See your answer to the earlier activity.
Do you think planning necessary for successful strategy implementation? Explain your answer.

Write your answers down. Exchange ideas with other members of the group by email or email answers to me for comment.

Reading (** = Key Reading)


CHAPTER 3

ASSESSING THE EXTERNAL ENVIRONMENT

3.1. Introduction: Aims and Learning Outcomes

The approaches used in this and other chapters adopt a modernist or systems approach to organisations (see Hatch, 1997, chapter 2 and 3, for some excellent discussion of this and other approaches to organisational theory). Systems are holistic in that they depend on other inter-related parts (subsystems). Thus, we might be able to dissect a frog to provide us with an understanding as to the way it functions but we cannot put it back together again to make it live. Systems are also highly differentiated. Differentiation demonstrates variety and that, in turn, requires integration. Differentiation shows complexity in organisational forms. Thus, we can have ‘rational’ planning machines (sometimes called ‘mechanistic’ or ‘cybernetic’ organisations) that emphasise top-down management styles and control. There can be more organic forms of organisation, such as those emphasised by learning organisations, resource dependent theorists or population ecology models. Or we can have a mixture of the two, a contingency approach. The point is that all organisational types require environmental feedback for future development (see Morgan, 1997).

However, the aims of this chapter are more modest. We will be examining some of the techniques used by organisations to explore the complex and uncertain external environment over the short, medium and long term.

So, by the end of this chapter you will be able to

- identify a number of techniques for assessing the external environment facing an organisation.
- undertake a STEEPLE analysis of your organisation and compare it with those from other organisations.
- carry out a 5 forces analysis of another organisation
- work through a web based assignment on scenario planning
- demonstrate awareness of the complexities involved in assessing dynamic environments.

There are a number of excellent readings in this area. You should read Johnson and Scholes (1999, chapter 3), though you would also benefit from embracing the wider perspective of organisational theory offered by Morgan (1997) and Hatch (1997).

3.2. Viewing the environment

It is important to understand the nature of the external environment facing the organisation. The environment refers to those political, economic, social, technological, environmental and legal forces that come to bear on organisations through time. The current external environment will have been shaped by historical manifestations of these forces. They create complexity in our understanding of the current world in which the organisation finds itself. These forces also have a momentum that breeds uncertainty for decision takers. For example, who could have predicted the collapse of Communism in the late 1980s and early 1990s and the impact it would have on global institutions and organisations? And what of the future? What impacts will demographic changes have on consumer demand for public, private and charitable sector goods and services? How will the internet develop? What will be the response of governments and citizens to environmental damage?
These are what strategic managers might refer to as long term drivers of change but the long term is also made up of a series of short terms for which organisations have to plan. For example, what impact will a rising trend in interest rates have on resource allocation within the organisation and what are the implications of this for medium term strategy?

In recognising the dynamic complexity of the organisation’s position a better understanding of what the economist Robin Marris termed the ‘super-environment’ can be obtained. Adaptation to the environment is crucial for organisational survival and development. Adaptation will involve some painful changes and so must be carefully managed.

In this chapter we concentrate on some of the techniques for scanning and monitoring the environment. Such boundary spanning provides a means of buffering for the organisation that has to survive in environments of varying rates of change and degrees of complexity.

Ginter and Duncan (1990) suggest that such ‘macroenvironmental analysis’ involves:

- scanning
- monitoring
- forecasting as well as
- assessing current and future trends

A number of authors have stressed the importance of devoting time to scanning the external environment in the context of the public sector (for example, see Smith (1994) Bryson (1995)).

Bryson (1995) notes that external analysis helps:

- to provide information on emerging issues and trends.
- to develop networks and partnerships among the scanners and their organisations.
- to educate the participants about the scanning function and about specific issues and trends.
- to provide useful information for the strategy process.

However, some pragmatism is required. Thus, it is important that:

- a record of events is kept.
- the organisation focuses on key issues.
- organisations understand the issues cycle. That is, they know when the environment affects an organisation’s
  - mandate, mission and values;
  - product or service level mix;
  - relationship with customers, clients, users, payers or partners;
  - costs, financing, management or organisational design.

### 3.3. Techniques for the short to medium term

What techniques could be employed?

The answer seems to lie in blending traditional, quantitative, techniques with qualitative, judgmental, assessments. To look to the future as well as understand the present. It is in this respect that whole rafts of techniques appear, including experience and learning.

In this section we examine two well-known methods of assessing the external environment, PEST and the 5 forces approach.
**PEST**

Managers could use a PEST (sometimes called STEP, or STEEPLE to include educational, environmental and legal as well as Political, Economic, Social and Technological factors) analysis to assess the ‘super-environment’. Figure 3.3 illustrates the fairly obvious inter-relationships between the forces and the organisation.

Broadly speaking it involves a ‘first look’ at events. However, if done properly it can provide valuable information. External consultants can undertake PEST analysis but it can be a valuable internal communication tool. Managers might be put into workshops to discuss particular elements of the environment. By analysing the impact of the external environment managers can have a greater understanding of the constraints that face organisations in the implementation of strategy. Further, PEST analysis can be useful if Scenarios of the future are required or if SWOT analysis (see the next chapter) is to be carried out.

![Figure 3.1: PEST](image)

**Activity 3.1**

Make a list of the STEEPLE factors affecting your organisation. Elaborate on each item in your list. Now score each factor from 0 to 5 (where 5 is high) to demonstrate its impact on the organisation. What mechanisms are in place inside the organisation to deal with these events? If there are any, are they effective? If there are none, should there be?

Discuss this with your colleagues and peers on the course. Can your organisation learn any lessons?

**Porter’s Five Forces Model**

There are other typologies for analysing the super-environment. Porter’s work examines the determinants of potential and actual competitive forces within a sector and the scope for collaborative behaviour. It is often used to examine the private sector and there are numerous examples in the Johnson and Scholes (1999) to this end. However, there is no reason why certain public service functions could not be examined in a similar way.

Competitive pressures in public services may involve a scramble for resources. In the UK university sector, for example, Higher Education institutions have to compete for grants from
the Higher Education Funding Council. Money is likely to follow the student more closely in the future and the level of research activity. Interestingly, this may lead to more collaboration (strategic alliances, including merger) between institutions.

Entry into the sector is regulated but there is competition for overseas students such that the home institution may become important. There may also be some substitution of courses, particularly as the internet becomes more developed. Thus, distance learning may be a viable alternative to traditional courses.

Supplier and buyer power could well be related to students and the local economy. In the future students will have enormous purchasing power and this will have a bearing on the type and quality of provision.

**Self Assessment Task**

Carry out a brief analysis of your own sector using Porter’s Five Forces model.

![Figure 3.2: Porter’s 5 Forces](https://example.com/figure32.png)
3.4. Auditing the Future.

Most analysis focuses on analysing the environment over the next year or few years. However, many organisations are looking even further into the future. Here we analyse the Delphi Method and Scenario Planning. These approaches are attempts to assess where the organisation might be in 10 to 20 year’s time. This is clearly important because organisations need to consider future allocation of resources. The problem, of course, is that the future is uncertain and there are wide margins for error. However, it is possible, within limits, to look at the future and, more importantly, revisit previous findings. This will facilitate greater understanding of the dynamic forces that the organisation has to endure.

The Delphi method.

This long range forecasting technique relies upon a panel of experts answering questions about the future. It was developed by the Rand Corporation in Santa Monica in the 1950s to predict future opportunities in the defence industry. Figure 3.5 reflects the processes involved. An important aspect of the Delphi Technique is that it externalises the visionary process. In doing so this method may exclude key internal groups who have to be committed to any organisational changes that develop. It may be seen then as extenuating divisions within the organisation as to the ownership of the strategy process.

Figure 3.3: The Delphi Technique

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Kevin Hinde. EC490 Corporate and Strategic Management
Question
Do you know why it is called the Delphi Technique? (Clue: Do you know the story of the Oracle at Delphi?)

Scenario Planning.

The oil company, Shell, is probably the most famous user of this technique. However, it is now extensively used in both public and private sector organisations (see Ringland (1998) and Giesecke (1998)). The technique encompasses internal as well as external stakeholding groups as well as independent experts. The technique attempts to develop a small number of scenarios about an uncertain world based on a set of internally agreed facts and likely possibilities. It is part of an on-going process within organisations and should not be construed as ‘crystal ball gazing’.

There are a number of sequences in the development of Scenarios. The following based upon Hadfield (1991) and Bood and Postma (1997) is typical.

- **Stage 1: Identify problem.** Consider new turbulence and its impact on current strategy and vision.

- **Stage 2: Describe current events and identify relevant factors.** Align with previous general and specific scenarios.

- **Stage 3: Classify, assess and select scenario-elements.** Identify the major uncertainties and high impact factors in the environment. Determine their cause and effect and consider possible divergence points.

- **Stage 4: Construct scenarios based on plausible configurations of factors and analyse them.**

- **Stage 5: Support strategic decision-making with scenarios.**

**Some examples**

1. **Private Sector**

   Johnson and Scholes (1999, p.112) consider 3 possible future states for book publishing - no great change; electronic chaos (one where consumers are confused by IT developments) and an information society. Hadfield (1991) reports 2 scenarios being developed in Shell in the late 1980s. Given certain trends and perceptions in the global economies, a sustainable world might develop where a co-ordinated response to global warming would lead to a reconstruction of the world energy industry, lower energy consumption and a switch to cleaner fuels. Alternatively, the possibility of ‘global mercantilism’ might be realised as economic blocs develop. This would lead to a reconfiguration of energy markets, the demand for OPEC oil climbing, with the likelihood of higher prices and more service orientation in final markets.

2. **Public Sector**

   There are a number of examples cited in Ringland (1998) whilst Giesecke (1998) is dedicated to scenario planning in libraries. The following is based on work carried out by past students. I normally provide information from Bryson (1995, pp. 87- 89) which is set out in Table 3.1 below. Students present other information and discuss issues. They are then charged with designing possible scenarios for the UK public service sector.

   Clearly, we could add other issues. Developments in Europe or the trend of ‘globalisation’ might be powerful forces for public sector developments in the future.

   Students have suggested that Public Services face 2 scenarios - resource scarcity or decentralised regulator (see Figure 3.6 below). The former may reflect demographic trends,
particularly the need to fund future pension plans; developments in technology, which may provide a greater interface with the customer and further competitive pressures. The outcome would be a smaller public service function or, at least a customer focused function. The alternative scenario might reflect a growth in the powers of the European Commission and Parliament vis-à-vis the nation state as more countries join the European Union and the effects of a single currency take hold. Burgeoning European regulation will then have to be enacted by UK authorities. Moves towards greater regional assemblies within the UK might enhance this process because decentralisation may require greater administrative burdens. The function of UK public services would change to one of greater community action but with an emphasis on legislation and regulation.

Table 3.1: Future Issues for Public Services

- **Social and organisational complexity.** A number of forces are pertinent here. Technological change and the globalisation of information and economies. Indeed, “the consequent interconnectedness of almost everything (Bryson, 1995, p.88)”.

- **Privatisation and the consequent interaction among public, private and non-profit organisations.** Osborne and Gaebler (1992) pointed out the purpose of government today is to steer not row.

- **Continuation of technological change.** The future of work may change. Public service and non-profit organisations will have to adapt to new processes, structures and patterns of resource allocation. Work will change by revolutionary enforced practices such as Business Process Re-engineering. It might also change through natural developments elsewhere such as the growth of information technology.

- **Limited public sector resources and Growth.** The size of government in relation to GDP is unlikely to increase though the scope and cost of public problems almost certainly will. Bryson suggests the development of productivity enhancing designs and collaborative ventures across public, private and non-profit sectors. to overcome this.

- **Diversity of the Workforce, customer base, and citizenry.** Essentially the number of stakeholder groups will increase and become more specialised. Such differentiation will complicate governance, service design and delivery, and workforce recruitment, retention, training and management.

- **Individualism, personal responsibility, and community involvement.** The vision is that there will be greater decentralisation of responsibility. A move away from reliance on large governmental bureaucracies and toward personal action. The welfare to work programmes are beginning to bring this about in the sphere of the labour market. Future developments of pension provision will involve the private or non-profit making sectors rather than the welfare state. There will also be more community schemes.

- **Quality of life and environmentalism.** Concern for the quality of life is likely to increase. Issues that may be important include leisure, health and safety, health care, crime prevention, environmental issues.

- **Transitions with continuity, not revolution.** This one is open to some debate! The argument used (in an American context) is that muddling through in some disjointed manner is the way forward.

Source: Adapted from Bryson (1995 p.87-89)
PUBLIC SERVICES IN 2015?

TRENDS
- TECHNOLOGY
- DEMOGRAPHY
- NEW POLITICAL INSTITUTIONS
- EUROPE

PERCEPTIONS
- COMPETITION

SCENARIOS
- RESOURCE SCARCITY
- RE-ECONOMIC AWARENESS
- POLITICAL DYNAMIC
- REGULATORY EXPANSION

Re-emphasis on the nature of public service delivery: Targeting
Re-positioning of public service functions: local regulations and policing?

Figure 3.4: Scenarios for Public Services: Based on work by past students
Scenarios should not be viewed as ‘pie in the sky’. Indeed, Bood and Postma (1997) cite several functions of scenarios.

- They are concerned with the evaluation and selection of strategies. It is important to note there is no best scenario, rather managers must ‘bet’ on the most probable.
- They are about the integration of various kinds of future-oriented data. This can be qualitative or quantitative.
- Managers need to explore the future to identify how an organisation might react. This facilitates the development of contingency plans (note the public sector contingency plans for major emergencies)
- They make managers aware of environmental uncertainties.
- They stretch manager’s mental models, i.e. Make them confront their own personal biases. This facilitates consensus in the management team and acts to communicate information.
- They trigger and accelerate organisational learning. Scenarios are ‘transitional objects’ in which managers can play and learn.

Further, they must be viewed as part of an on-going process. Events in the external environment may have a dramatic impact on likely outcomes so by constantly re-visiting scenarios organisations can engage in a more inclusive approach to strategy development.

Activity 3.2

You are to read the article by Bood and Postma (1997) which is available on-line and summarise it in no more than 300 words. Having done so you are to share your views with others in the group via email or the on-line discussion board.

You should note this is your first venture into the concept of Organisational Learning and so you might want to search out other articles on the subject. There is a link on my web page to help you with this.

3.5. Summary

In this chapter we have reviewed various methods for assessing the external environment over the short and the long term. We have noted that analysis involves an understanding of dynamic forces that we need to constantly re-visit. In a later chapter we will look at the concept of Chaos and Complexity theory as applied to the management of change and it will show that strategic managers have to be aware of subtle changes in the environment along with internal issues if they are to achieve success.
Reading (**= Key Reading)


CHAPTER 4

ANALYSING STRATEGIC CAPABILITY THROUGH CORE COMPETENCES

4.1. Introduction: Aims and Learning Outcomes

In the last chapter we examined the external environment. In this one we analyse the internal aspects of the organisation. Johnson and Scholes (1999, chapters 4 and 10) offer a very informative view in this regard and should be read alongside this chapter. To distinguish this chapter from Johnson and Scholes we will offer additional insights as to the history of the term ‘core competence’ and explore the concept of ‘core competence’ using economic analysis. In particular we will cite the work of John Kay (1993) and Oliver Williamson (1985) and discuss the concept of tacit knowledge. We will also present information on performance measurement as a means of obtaining balance in core competences and we will examine the European Foundation for Quality Management approach. Crucially, we note that public service and non-profit organisations can benefit from an analysis of core competences.

The chapter begins with an examination of the origins of the term ‘core competence’ and we distinguish between it and competitive advantage. The following section involves an introspective investigation of the organisation using value chain analysis. This approach allows us to examine the value of particular constituent parts of the organisation and its linkages in terms of economy, efficiency and effectiveness. We then move on to examine the distinction between core business and peripheral activities using a case study taken from the public sector. The issue of core competence is more familiar to those in the private sector but the phrase has equal applicability to public services and so the following section briefly examines why this is so. Having justified the need to explore core competences we then examine where they can be found within the organisation in more depth. We distinguish between competences as core and those that are ‘threshold competences’. We observe that competences can lie in ‘strategic assets’. However, it is the ‘architecture’ of the organisation embodying a multitude of economic, social and political elements (including trust, reputation, networks, friendship, teamwork, innovation, culture and tacit knowledge) which make up the less tangible, but possibly more effective, core competences.

Having considered where competences lie within organisations we explore how these can be sustained by addressing the issues of performance and quality management. Finally, we examine that very familiar technique, SWOT (Strengths, Weaknesses, Opportunities and Threats), to consider an organisations strategic capability. By this stage we should have a fuller understanding of the internal workings of the organisation (its Strengths and Weaknesses) and we can analyse whether they sit well with the external environment it faces (the Opportunities and Threats).

Having read this chapter and the directed readings you will be able to

- Note the origins of core competence and consider the distinction with competitive advantage.
- Undertake a value chain analysis of your organisation and critically reflect upon its implications.
- Comment critically on the origins and nature of core competences using the economics and management literature.
Critically assess the nature and sustainability of core competences within your own organisation.

Carry out a SWOT analysis of your own organisation and, having done so, critically consider whether it has the appropriate capability to carry through its strategies.

4.2. Origins and definition of the term ‘Core Competence’

In chapter 1 we argued that strategy was the vehicle by which organisations dealt with the economic problem of scarcity given insatiable wants from society. In satisfying wants organisations are scanning the external environment trying to discover what people want (or tempting them with products or services that they think fit with their wants!) and comparing themselves with rivals to ensure that they can compete. This environmental school approach is exemplified in Porter’s (1985) ‘Five Forces’ framework. Critics would argue that this sort of approach leads to strategy being formulated with little thought given to implementation for it emphasises knowledge of the market place above internal characteristics (Hayes, 1985). The resource based school emphasises developing capabilities before plans. In this regard the focus is on the accretion of specialised organisational resources that can be used to gain competitive advantage. As in the earlier discussion about planning and strategic management the differences between the two approaches are slender. Indeed, Porter’s work on the value chain that we see below is testimony to his position that internal analysis is crucial for organisational success.

Selznick (1957) was one of the first writers to argue that factors internal to the organisation, such as personnel and history are crucial to the success of a chosen policy. Others such as Ansoff (1965) compile a comprehensive checklist of skills and resources that constitute a ‘grid of competencies’. By cross-matching competencies with other organisations a permanent reference guide can be used for future strategy direction. Learned, Christensen, Andrews and Guth (1965) suggesting that a firm’s competitive strength derives from its ‘distinctive competence’. Their work was the foundation for the famous SWOT framework.

Prahalad and Hamel (1990) introduced the term ‘core competence’, defining it as an integrated bundle of skills and technology. It represented a ‘messy accumulation of learning’ that contributes to organisational success. Many authors prefer the term ‘capabilities’ to express a dynamic and integrated learning process. As we will see below they are made up of a multitude of inter-related elements: strategic assets, reputation, innovation and, very importantly, organisational architecture. But it is the blending and application of these that gives an organisation a unique advantage. That is, we must examine trust, friendship, teamwork, networks and bureaucracies as well as the tacit knowledge embodied in the systems and structures within organisations.

Identifying and using core competences effectively will enable organisations to improve organisational performance. Though as we know from the history of soccer, remaining at the top or even within the division is a difficult task. Core competences can vary over time and with the strategy deployed by the organisation. Organisations build ‘core competences’ and, because the sum of the parts makes up the entity called ‘core competence’, the transfer of an asset elsewhere can have disastrous consequences. Indeed, Selznick observed that a distinctive competence in one activity such as ‘craftsmanship’ could be a ‘distinctive incompetence’ in mass production. We examine where they can be found within organisations in more depth below.

Before we formally end this section it is important to distinguish between ‘core competences’ and ‘competitive advantage’. The distinction is a little blurred. Indeed, some use the term interchangeably. However, the use of the terms is at the heart of the environmental-resource school debate. The direction of causality provides the main point of departure. Core competences clearly give competitive advantage but not vice versa. Core competences refer to how an organisation sees and develops it’s valuable, rare and
inimitable resources, whilst competitive advantage is how external agents, for example customers and funding bodies, view how the organisation uses these resources relative to its competitors. If an organisation understands its competitive advantage then it may be able to develop those core competences and so retain its position vis-à-vis its rivals.

### 4.3. The Value Chain

To truly understand where core competences can be found it is necessary to examine every aspect of the organisation’s activities and to ask what value is being provided at every stage in the delivery of a product or service. This is at the heart of value chain analysis.

Figures 4.1 and 4.2 provide insights as to the underlying logic of the value chain. Table 4.1 provides Porter’s definitions of what constitute primary and secondary activity within the organisation. This method was devised to explain generic activities within manufacturing, though it is readily applied to specific organisational types within manufacturing and to service providers irrespective of the sector they belong.

**Figure 4.1: Porter’s Value Chain**

Source: Porter (1985)

**Figure 4.2: Links between Organisational Value Chains**

Source: Porter M (1985)
Table 4.1
Activities in the Value Chain

Primary Activities
- Inbound Logistics: activities concerned with receiving, storing and distributing the inputs to the product or service e.g. materials handling, stock control, transport.
- Operations: transform these various inputs into the final product or service, e.g. machining, packaging, assembly, testing.
- Outbound Logistics: collect, store and distribute the product to customers, e.g. warehousing, materials handling, transport. In the case of services customers may be brought to the service, e.g. sports event.
- Marketing and Sales: customer/user awareness functions, e.g. sales admin., advertising, selling. In public services all communication functions are important.
- Services: all activities which enhance or maintain the value of the product/service, e.g. installation, repair, training, spares.

Support Activities
- Procurement: refers to the process of acquiring the various resource inputs to the primary activities (not of the organisation.
- Technology Development: includes R&D product design, process developments, and raw material improvements.
- Human Resource Management: includes all activities involved in training, developing and rewarding people within the organisation.
- Infrastructure: Systems of planning, finance, quality control. Infrastructure also consists of the structure and routines that sustain its culture.

Source: Porter (1985)

Porter notes that activities within value chains should be disaggregated if they have 'different economics', can be readily differentiated and represent a 'significant or growing proportion of cost'. Further, in using the value chain, finer disaggregation should be used "to expose differences important to competitive advantage". There may be differences as to the categorisation particularly in service industry but "everything a[n organisation] does should be captured in a primary or support activity".

Finally, Porter notes the interdependence between value chains. Understanding linkages between value chains enhances competitive advantage because it facilitates co-ordination and optimisation.

It is quite proper to use Value Chain Analysis in public services. They can be used to identify cost drivers, quality issues and overall effectiveness (See the chapter on Social Services in Wilcocks and Harrow, 1991). Note as well that public service organisations are often engaged in multi-agency approaches to issues. For example, the police service is concerned about reducing crime but this is only one aspect of the criminal justice system. Thus, looking at value in the linkages, or more properly looking at ways to improve the weak links, is the way to enhance core competences for the system as a whole. The diagram below is due to one of Kevan Schole’s students.
UK CRIMINAL JUSTICE SYSTEM......VALUE CHAIN

- Customers, suppliers of work
- Applying due process of law for society
- Funding, policy & direction
- Pre-sentence information, accommodation, care & rehabilitation

- Victims
- Criminals
- Police service
- Solicitors (Law Society)
- Barristers (The Bar)
- Lord Chancellors Dept

- Magistrates Court
- Crown Courts
- Court of Appeal

- Decision making & justice
- Investigation, detection, diversion & protection
- Defending rights of individuals, legal expenses

- Social Services
- Probation Services
- Prison Service
- Health Service

- LORD CHANCELLORS DEPT

- Funding courts, legal aid, policy & direction
Activity 4.1

Undertake a value chain analysis of your organisation. Remember you have to analyse upstream and downstream activities as well as primary and support functions. What are the main cost drivers? Can these costs be reduced without affecting the quality of service? What implications do your findings have for the core competences of your organisation and future strategy?

Share your information with others using the discussion board or email.

4.4. Core and Peripheral Business

By using value chain analysis organisations can critically examine the costs and quality associated with each link in the chain from input to output. It can facilitate a strategic assessment of the effectiveness of the contributions by other organisations to primary activities. It can also allow some reflection of the value of secondary activities, that is, to what extent would it be viable to outsource ‘peripheral’ parts of the business? Incidentally, this debate about what constitutes core business (for which read ‘primary activities’) and peripheral business has been raging in private sector for decades. However, in the last 20 years this debate has taken on some vehemence in the public sector as Case Study 4.1 below shows.

Case Study 4.1

**Shaping Core Business: The case of Compulsory Competitive Tendering (CCT) in English Local Government Finance**

The regulations governing CCT in local government ‘white collar’ services (finance, housing management, information technology, personnel and legal services) were passed through parliament in late 1995, some four years after the government had introduced the idea in it’s White Paper, ‘Competing for Quality’. During the interim intense lobbying had taken place and a number of concessions had been achieved. However, large proportions of services were to be put out to tender over the next few years. In local authority finance this eventually meant that over 50% of expenditure had to be subjected to competition, though there was a de minimus level of spending and some ‘credits’ were given for services that had already undergone some market testing. A project that the author was involved in considered the impact of CCT on the shape of the financial services function in local government by holding in-depth interviews with chief financial officers (CFOs) and senior officers in over half the local authorities of the North East of England during 1995 (See Hinde et al, 1996; Shaw et al, 1996). Financial services in local government is a multi-activity function, as Table 4.2 below shows, and CCT made CFOs consider the distinction between core business functions, which had to remain in-house, and services which were key candidates for the tendering process.

Though all authorities interviewed stated that CCT was to be resisted by all means possible within the law, the research clearly showed that professionals wanted to shape the core business to suit their own interests. CFOs had held discussions about the functions most likely to be selected to meet the competition requirement within all finance departments; ‘many a stormy departmental meeting’ had been held, said one CFO, echoing the views of others. Even though they recognised the potential damage created by compulsory competition, CFOs talked openly about exposing services that were not integral to the corporate finance role, notably council tax and payroll. In defending such ‘core functions’ as accountancy and audit, finance officers mentioned the traditional importance of statutory responsibilities, the need to maintain a ‘close relationship between treasurer and members’ and the uncertainty over the supply of corporate financial management if key areas were lost. Indeed, one identified core accountants as the ‘Praetorian Guard’ whilst another detected a
‘professional disinterest in revenues’ at regional Association of District Council meetings. Payroll and Council Tax Collection were among the services deemed ‘ancillary’, reflecting lower levels of skill but higher levels of cost.

There was an intra-regional variation among the local authorities affected. Larger urban authorities found they could avoid the process by exploiting the credits system. Smaller, semi-rural, authorities, on the other hand, were much more likely to put services out to tender; those with least resources were being forced down the contractual route. Ironically, the rewards for the private sector would have been greatest if the larger authorities had been exposed to competition.

<table>
<thead>
<tr>
<th>Table 4.2</th>
<th>Local Government Financial Services</th>
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<td>Budget Preparations</td>
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<td>Controlling cash flow</td>
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<td>Statutory Section 151 responsibilities in the areas of internal audit and Accountancy</td>
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<td><strong>Support</strong></td>
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<td><strong>Direct Services</strong></td>
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<td><strong>Services</strong></td>
<td>National non-domestic rates known as ‘revenues’</td>
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<td></td>
<td>Benefits administration</td>
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4.7. Competition and Public Services in England and Wales: in search of Core Competences

Whilst the private sector is largely synonymous with competitive forces much the same can be said of the UK public sector in recent times. Over the period 1979 to May 1997 successive Conservative governments placed emphasis on market mechanisms for the delivery of public services. Kieron Walsh (1995) wrote of the public sector

"Traditional hierarchy is giving way to markets, and the basis of co-ordination is changing from planning and control to price and exchange"

An overriding central government objective prior to 1997 was that public services (products) were to be delivered at a ‘price’ which would deter entry by private sector firms or, where this is difficult, ensure that the costs of the service provided are transparent to the user and the wider public. The taxpayer was the major stakeholder.

The change of government in May 1997 has lead to a move away from the forms of competition adopted by the Conservative government and the emphasis is shifting more to the user. In June 1997, for example, the Labour Government introduced the duty of ‘Best Value’ on the delivery of local government services. A pilot Best Value scheme is underway and around 30 local authorities are currently involved. The Local Government Act 1999 has now introduced Best Value for all public services.
Competition, however, remains a major stimulant to the delivery of public services. There is no presumption that a service will be privatised but the possibility remains. Government still gives emphasis to the ‘E’s’, economy, efficiency and effectiveness which are defined by the Audit Commission in its ‘Code of Audit Practice’ as:

**Economy:** acquiring human and material resources of the appropriate quality and quantity at the lowest cost

**Efficiency:** producing the maximum output for any given set of resource inputs or using the minimum inputs for the required quantity and quality of service provided

**Effectiveness:** having the organisation meet the citizens’ requirements and having a programme or activity achieve its established goals or intended aims.

Quality too remains an important issue. But Quality is also related to the competitive process. A recent definition of quality was given as

"Meeting agreed customer requirements, at the lowest cost, by releasing the potential of all employees" Cabinet Office (1995) p.5.

Government is emphasising what are being called the 4 C’s. The ‘4 Cs’ require authorities to:

- **challenge** why and how a service is being provided;
- **invite comparison** with others’ performance (including organisations in the private and voluntary sectors) across a range of relevant indicators;
- **consult** with local taxpayers, service users and the wider business community in the setting of new performance targets; and
- **embrace fair competition** as a means of securing efficient and effective services.

Competition and performance are the important dimensions of government policy toward public services. Best Value, for example, requires a ‘family’ of performance measures, including Local Performance Indicators, Audit Commission Indicators, Indicators established by Government departments and Best Value Corporate Health and Service Delivery Performance Indicators.

Public sector organisations have been reorganised and re-shaped because of the ideology of competition. Among the Agencies we see mergers such as that between the Inland Revenue and Contributions Agency. In local government the direct provision role has been substituted for an enabling functionality. Private firms now provide many services. Partnerships or alliances, between public sector providers and with the private sector are seen to be of paramount importance as part of New Labours ‘joined up solutions to joined up problems’ motto.

Resource constraints (such as an ageing population), technological developments and changing demand have shaped the environment facing public services but these have always been there. It is the response from Governments over the past twenty years that has re-focused public service management thinking. An important question is being asked, namely

**What is it about present public providers that give them the right to continue in that activity?**

This question could never be asked of private sector organisations that face product and capital market competition – customers and shareholders just go elsewhere. Public service providers are monopolies. Some have statutory obligations (such as the Police) but even they are being forced into the competing with others for resources through performance and accountability mechanisms. Those without statutory requirements will face greater
competitive pressures from the private sector as well as performance and accountability mechanisms.

In short, public service organisations are being asked to analyse their core competences. They must justify why they continue to provide the services they do.

4.8. Where are Core Competences found?

We looked earlier at the origins of the term core competence. The emphasis in this section is on the theoretical foundations of ‘core competence’. To begin, however, we continue with a definition. Note it is important to emphasise ‘core and ‘competence’. Organisations may have a unique resource, such as a large database, but that is not enough to make it a core competence. To be in any activity an organisation must have invested in some necessary resources (capital and human assets). Organisations in similar activities (and thus belonging to the same industry because their products are substitutable in the eyes of consumers and producers) will have some threshold competences. These are competences that allow an organisation to supply the product or service. They are common to all organisations in the industry. However, core competences are more special than that.

Kay (1993) defined these as ‘distinctive capabilities’ which yield a ‘competitive advantage’. They are features of an organisation that cannot readily be reproduced by competitors.

They provide organisations with that special advantage of reducing costs, through economies of scale, scope and learning, or of enhancing the value of products or services through innovation, marketing and quality.

Core competences can vary over time and with the strategy deployed by the organisation. They depend on the resources purchased and the way the resources are used. Identifying and using core competences will enable organisations to improve organisational performance. Though as we know from the history of soccer, remaining at the top or even within the division is a difficult task.

Core competences can be found in individual business units or in large hierarchical, multi-product/service organisations.

They can be associated with leaders. Perhaps Richard Branson is a core competence or Sir Alex Ferguson. However, there is a danger in relying on leadership as a core competence. If they retire or move elsewhere the organisation may fail.

In the following subsections we use John Kay’s framework for analysing where core competences are found within organisations. However, we elaborate upon it to discuss clans and organisational routines. In doing so we are also examining the work of Oliver Williamson (1985) on transaction costs, William Ouchi’s (1980) analysis of clans, Henry Mintzberg’s (1989) work on organisational forms, the exposition of Polanyi (1965) and Nonaka and Takeuchi (1995) on tacit knowledge and Nelson and Winter (1982) on organisational routines.

Finding Core Competences in Strategic assets

These are derived from external features such as the existence of natural monopoly, sunk costs or exclusivity (possibly from state legislation) though these are inter-related. A natural monopoly arises where it is cheaper for one organisation, rather than for two or more, to provide a product or group of products (or services). The classic examples are those provided by public utility networks like railway tracks, gas pipes or the electricity grid. However, other examples might be possible. The Wall Street Journal and The Financial Times are probably natural monopolies in their own countries. Standards can also create a natural monopoly if the market requires a compatibility standard and the standard is proprietary. The owner of the standard may then look to create a monopolistic advantage in that technology.
Self Assessment Activity

Can you think of any examples of standards that have provided such advantage? And remember standards can also attract the attention of competition authorities. Can you think of any cases?

Natural monopolies are important because they attract large customer bases. However they are not sacrosanct. BT was the sole supplier of telecommunication services in the UK but changes in technology, notably from cable and cellular phones, plus changes in demand have led to the erosion of natural monopoly status and this has been facilitated by the privatisation of the company since 1984. And, of course technology standards, virtually by definition, change. Thus, we can get technology races to establish new standards. For example, we are unsure of whether mp3 players will be the next major standard in the personal music player business.

Sunk costs are investments in assets that have little or no alternative use. Thus, if the organisation exits the sector they will only get a scrap value for the asset. This could apply to a pizza oven, a printing press, a nuclear power station or some other highly specific asset, tangible or intangible. So, it can equally apply to highly specific human capital. People and organisations build up occupational and industry specific knowledge and hope that this will give them and their organisation distinctiveness. Sunk costs are necessary investments to provide goods and services in that sector. However, they are expensive investments that can only be recouped after years of participation in a sector. Their advantage can be eroded by changes in demand, technology or the entry of new organisations whether from home or abroad.

Exclusivity refers to advantage provided by Statute. Organisations that have been granted such status are subject to accountability through regulation and other political forces, including pressure from the media. A good example of an organisation awarded exclusive rights is Camelot, which was given the right by legislation to provide the UK National Lottery until 2001, but it equally applies to other organisations, particularly those in the public sector. As with natural monopoly and sunk cost advantage this opportunity may not be long term.

Finding Core Competences in Innovation and Reputation

Innovation refers to new products or services, or styles of relationship not just technological innovations. Organisations usually protect their intellectual property via patents, trademarks and copyrights. However, there is something underpinning the innovation. For example, Sony recognises that miniaturisation is a key feature of its product range but it is Sony’s innovative culture that is the core competence.

Reputation is a situation where the organisation has a name for high quality in characteristics that cannot be easily monitored. This enables contracts to be made on more favourable terms than otherwise possible. Reputation is built upon investment in and development of assets, systems and structures, and knowledge of customer needs. However, reputation can be easily eroded as the famous UK retailer, Marks and Spencers has found out recently.
Finding Core Competences in Organisational Architecture

For economists and other social scientists, ‘Architecture’ is a key element in understanding core competence.

“Architecture does not create extraordinary organisations by collecting extraordinary people. It does so by enabling very ordinary people to perform in extraordinary ways.” (Kay, 1993, p. 69)

As we will see Organisational Architecture is dependent on a range of forces: legal, economic, sociological, cultural and political. Kay embodies the first three in his definition of architecture (though many would suggest that culture and power relations are equally crucial). He notes that

“Organisational Architecture consists of a distinctive collection of what legal theorists call relational contracts, economists call implicit contracts and sociologists refer to as trust relationships.”

These arise where

“an exchange relationship between 2 parties is not fully articulated. The rules of behaviour are implicit and the enforcement mechanism is the value of continuing the relationship” (Kay (1993 p. 375).

To understand how relational contracts develop we must first examine market exchange using spot contracts. We then look at longer-term exchange and the problems with spot contracts and formal written contracts. We see that where formal contractual relationships breakdown because of (potential) opportunistic behaviour organisations can extend their hierarchies through vertical and lateral integration or they can use quasi-market forms to carry out transactions; that is, they use relational contracts.

Relational contracts are crucial in creating a framework for the existence of core competences. However, other forces are at work. A passing reference to the importance of culture and politics has already been made in relational contracts. These are more to the fore in assessing networks and clans, though relational contracts are also important. Other economic explanations are relevant to our understanding of organisational routines. We begin though with a discussion of contracts.

Spot contracts

Relational contracts are different to spot contracts or formal written contracts. Spot contracts are contracts that take place on the spot. They involve very simple exchange transactions involving price and quality. For example, if I buy a loaf of bread in a shop a contract occurs – there is an offer to sell by the shopkeeper and an offer to buy by me. It is a verbal contract and law protects it. Of course, if I get a poor quality loaf and the shop keeper refuses to replace it I am unlikely to go to the expense of civil proceedings but it is in the economic interests of the shopkeeper to recompense me. If he does not then I will go elsewhere and as information passes from consumer to consumer a shopkeeper who sells shoddy goods would soon go out of business. There are other examples of spot contracts: posting a letter, asking someone to charge your account for goods purchased, getting in a taxi, the purchase of capital equipment and so on. These transactions could be carried out once or frequently (such that spot contracts are recurrent) and they have the following characteristics:

- They require low levels of asset specificity (i.e. sunk costs embodied in the transaction are minimal).
- The product or service on sale is relatively simple and there are few differences between sellers in the product or service on offer.
- The market is very competitive – there are many alternative sellers.
- There is complete or near complete information for all parties in the exchange.
Long term transactions

Where exchange is required over a longer period then the parties involved are looking to secure co-ordinated, co-operative behaviour but there is an inherent problem. Williamson’s (1985) work on transaction costs provides insights in this regard. His work showed that moral hazard may arise where participants in the exchange process

- are ‘locked-in’ (they have both agreed to continue with the exchange relationship);
- have invested heavily in resources (that is, there is a high level of asset specificity);
- have asymmetric information (that is, they each have knowledge about their part of the transaction); and
- face bounded rationality (this is a weak form of rationality that arises because there are limits to human capacity and uncertainty and complexity in the external environment).

Moral hazard (sometimes called the ‘hold-up’ problem) is a post-contractual problem that may result because participants to the exchange process are often assumed to operate in an ‘opportunistic’ manner. The assumption about people is that they act to maximise their gains from exchange because they believe the other participant(s) is (are) doing the same.

**One method of overcoming moral hazard, is that of buying out the other party.** In this case the transaction is internalised and the organisational hierarchy is extended by vertical or lateral integration (see chapter 1). Thus, hierarchy is seen as a substitute for the market in the allocation of resources to satisfy wants.

**Another method to overcome moral hazard is to have a written contract.** Contracts can provide useful information for both parties concerning their respective obligations to the exchange process. They may be very useful in initiating long term relationships. However, if the future environment is uncertain contracts will be difficult to write, negotiate and enforce. Further, they may be inappropriate over the longer term for the establishment of trust between the parties.

For example, Nissan is a major supplier of motor vehicles in Europe. It purchases its exhaust systems from Tihon, a German company. Both have invested heavily in highly specific assets. They have established a long-term relationship by which Tihon supplies a quantity of exhausts, at a particular time for a certain price. They are locked in to the exchange process. Tihon knows more about the price of steel than Nissan and Nissan knows more about the European car market than Tihon – so there is information asymmetry. Either party could act opportunistically. To overcome this both parties could have a written contract but the car market is volatile. Written contracts would offer little flexibility to either party so that the exchange relationship would break down. Both realise that maintaining the relationship is better than the costs of looking for new partners and negotiating contracts. Thus, Nissan and Tihon have developed **relational contracts** based on ‘letters of intent’ between the two parties.

Trust has evolved over the long term – in what game theorists would call a repeated game (see chapter 6). Indeed, the relationship between Japanese companies and their suppliers is generally different to that of its Western counterparts. Western companies tend to opt for written contractual statements with their sub-contractors and suppliers. Japanese firms tend to use less formal approaches (McMillan, 1992). However, dominant Japanese firms also use other methods to ensure that suppliers and sub-contractors do not act opportunistically. Notable in this regard are the availability of transparent accounts between the two parties and ensuring that at least one person from the dominant firm sits on the board of directors of the sub-contractor.

There may be some risk-sharing reason for the smaller firm accepting such arrangements. A small firm, being risk-averse, would be willing accept a reduction in the price it receives in exchange for some of the risk being taken away from it (in effect, it is willing to pay an insurance premium). The larger firm, being risk-neutral and thus indifferent to any risk, may be willing to accept the amortisation charges associated with specific investments made by
the supplier in, say, jigs and dies. If product demand is less than predicted the larger company passes on these charges in the price paid (McMillan 1992, chapter 13).

Relational contracts bridge a gap between the use of markets or hierarchies to govern transactions. Williamson is thus providing a framework by which we can understand how quasi-contractual relationships develop between participants in exchange. These relationships can be based on respect for the other participant(s) in that the exchange process can be shaped to meet the strategic ends of both participants. What is required is that participants have to bind themselves to the exchange or allow the other party to monitor their behaviour.

Relational contracts form a key determinant of organisational architecture as a core competence of organisations. The benefits of architecture typically rest in the creation and development of organisational knowledge, the establishment of a co-operative ethic and the implementation of organisational routines. Relational contracts facilitate flexibility in response and information exchange between and within organisations given an uncertain external environment.

Networks and strategic alliances

We noted in the last section how relational contracts between organisations formed the basis of transactions between suppliers. It is not difficult to extend this analysis to the wider economic arrangement between organisations. Networks are arrangements whereby organisations from within the sector and without come together for mutual advantage through a complex myriad of relational contracts that are based upon trust (which is usually achieved through repetition of, and reciprocation in, transactions). This embeds the notion of networks in economic forces. Such networks may be geographically specific such that they provide advantage for a location or a nation (Porter, 1990). These relationships can also be between organisations that compete in the same sector but who need to co-operate because of the high fixed costs associated with product development or perhaps the desire to integrate sophisticated products and services to suit changing consumer needs. In this form they are known as strategic alliances.

Networks are also the result of the cultural and political processes that society represents. We are all shaped by multiple institutions such as family, educational systems, the workplace, church, trade unions and professional bodies, community, nation, state and these influence our attitudes, behaviour and identity (Hatch, 1997). These forces tend to propel some socio-economic groups together such that networks can develop between and within organisations. These same forces, however, can keep others out of networks and so act as a barrier to core competence development.

Networks and alliances can also be developed via political forces that manifest themselves in legislation. In the UK there has been great emphasis on alliances and partnerships in and across the private, public and non-profit sectors to solve public service solution in such areas as community care and urban development.

Hierarchies and Clans

Williamson (1985) has argued that the development of hierarchies is due to the transaction costs associated with searching for the right partner, negotiating an appropriate contract and contract price, and enforcing the contract. Thus, hierarchies are a way of avoiding moral hazard. This argument flows quite readily from what was written above. It is interesting to note that many firms have their own accounting, administrative and distribution systems but that there are a plethora of private firms offering similar functions, e.g. there are private bookkeepers and accountants and transport firms.

Hierarchical forms develop because of internal efficiency in transactions, according to Williamson. Indeed, large multidivisional structures (he called them M-Forms) were prime examples of efficiency in transactions. Employment contracts within hierarchies provide some scope for bargaining and negotiation between employer and employee (or their
representative). However, this is constrained by the job definition and the ease of performance measurement. The employment contract is more likely to follow the classical approach of spot contracts where there is tightly defined routine work that can be easily metered. Relational contracts are more important where individuals have to respond to events, involve themselves in gathering and synthesising information and engage in people management. Efficiency in hierarchies is thus dependent on a mix of contracts, all relational with some erring toward the spot contract end of the spectrum.

The price of labour (the wage) is therefore not the sole determinant of efficiency. Other factors matter. Trust is clearly implicit in a labour contract but other factors determine organisational co-ordination. Ouchi (1980) argued that in modern organisations rules and norms replaced the personal authority of the classical entrepreneur. Weber (1925) had referred to the growth of bureaucracies. Ouchi though suggested that organisational co-ordination occurred through the socialisation of individuals, which ensured that they had common beliefs and norms and that "this 'clan' form can be very efficient in mediating transactions between interdependent individuals". Incidentally, this offers support to the view that organisational culture can be shaped (see Chapter 5).

Other forces may also be at work. Mintzberg’s (1989) marries his typology of organisational forms with their principal co-ordination mechanisms to offer additional insights as to the sources of efficiency within organisational structures (see Johnson and Scholes, 1999, pp.431 – 438, for a brief overview). These are set out below in Table 4.3

<table>
<thead>
<tr>
<th>Organisational Forms</th>
<th>Principal Co-ordinating mechanisms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Entrepreneurial</td>
<td>Direct Supervision</td>
</tr>
<tr>
<td>Machine</td>
<td>Standardisation of Work Processes</td>
</tr>
<tr>
<td>Professional</td>
<td>Standardisation of Skills</td>
</tr>
<tr>
<td>Diversified</td>
<td>Standardisation of Outputs</td>
</tr>
<tr>
<td>Innovative</td>
<td>Mutual Adjustment</td>
</tr>
<tr>
<td>Missionary</td>
<td>Standardisation of Norms</td>
</tr>
</tbody>
</table>

Source: Mintzberg (1989)

These are the most common configurations i.e. where organisational characteristics of structure, strategy and context are in natural co-alignment.

However, there are few circumstances where these configurations constitute effective organisations. Thus, managers must build their own unique solutions (hybrids?). This is the contingency approach - adapting the strategy process and content to the organisational context.

In analysing the organisational context, Mintzberg is showing the importance of internal social, psychological and cultural factors which drive the organisation as well as the possible management styles and processes that might be adopted to shape change.

Thus, it is within and between organisational hierarchies and their sub-structures that the establishment of appropriate relational contracts, clans and 'co-ordinating mechanisms' lead to core competences.

Organisational Routines

Organisational routines are reflections are the regular and predictable behaviour patterns of firms. There are production routines, advertising routines, hiring and firing routines as well as strategic routines. For Nelson and Winter (1982) routines rather than deliberate choice largely determine how an organisation functions. Further, this evolutionary theory suggests that successful routines are selected by the environment.
Routines are part automatic and programmable. As in riding a bike a routine must be first practised in a ‘learning by doing’ manner. However, it soon becomes automatic. Routines also embody tacit knowledge (see below). So although we might be able to ride a bike it is impossible to fully articulate how to ride a bike. In the same way some routines are difficult to articulate; for example, the selection of teams.

Routines do change through an iterative process. In an evolutionary approach such as this new routines are ‘mutations’ formed by chance or deliberate action. The environment will select those with the best chance of survival and there will be a cumulative retention of the successful routines. Successful core competence development will depend upon successful variation of routines by organisations. However, in contrast to some approaches suggesting that it is possible to determine success this approach lends itself to an acknowledgement of changes in the pecking order among competing organisations.

Building Core Competences through Tacit Knowledge

Clearly knowledge is integral to the categories noted by Kay. It is a strategic asset in that it is a sunk cost. It is embodied in innovation and reputation. It is also essential to the development of internal and external architecture - supplier, network and alliance relationships, hierarchies, clans, and routines. Knowledge is important for organisations but it can only be a core competence when it is not easily replicated.

Following Polanyi (1962 and 1967) knowledge is of two forms: explicit and tacit. Explicit knowledge is codified, ‘objective’ knowledge that is transmitted in formal systematic language. Tacit knowledge is personal, context-specific and therefore hard to formalise and communicate.

In their book, the Knowledge Creating Company, Nonaka and Takeuchi (1995) provide some important case examples of how an organisation can create new knowledge, i.e. build core competences. One interesting case is that of the creation of the Bread Making Appliance at Matsushita Electrical Industrial Co., Ltd. The Cooking Appliance Division at Matsushita arose out of the amalgamation of ‘three problem divisions’ in the home appliance business in the 1980s – rice cookers, food processors and toaster ovens and hot plates, all competing in mature markets with low growth. The combination of the three divisions facilitated economies of scale and innovation. After some ‘enabling conditions’ had been established by the centre (improved communication, cultural change and organisational intention) product innovation could take place. Essentially there are 4 modes of knowledge creation – socialisation, externalisation, combination and internalisation – which are especially suited to the mobilisation of tacit knowledge in the pursuit of creative innovation (see Table 4.4 below). The process of knowledge creation is not a linear process. Mistakes are made (in the bread making case a first prototype baked the crust but not the inside) so knowledge creation is an iterative process.
Table 4.4

Modes of Knowledge Creation:
Some examples from Matsushita Bread Making Machine

Socialisation is a process of sharing experiences between individuals and thereby allowing them to acquire tacit knowledge from others without a formal system or the use of language. The skills of making (particularly kneading) the bread were learnt by the company as a team member apprenticed herself to the Head Chef at the Osaka International Hotel. She learned the skill through discussion, observation, imitation and practice rather than reading documents.

Externalisation is the process of articulating tacit knowledge into explicit concepts perhaps by model building, metaphors or analogies. The team member was able to relate this information to the team building a bread making machine by devising the concept of the ‘stretching twist’. Further, this knowledge became externalised by translating the concept into a propeller within the machine.

Combination is the process of creating a knowledge system perhaps via formal meeting and documentation or computer networks. It is a means by which explicit knowledge is transferred within and across organisations. In the case of bread making, the twisting stretch and propeller concepts were brought together to develop a prototype that was justified against organisational intention to make a product that was “delicious and nutritious”… and “would respond to the needs of working women and gourmet aficionados.”

Internalisation is the process of turning explicit knowledge into tacit knowledge. It is closely related to ‘learning by doing’. In this instance, the bread making concept was transferred to other divisions in Matsushita.

Source: Based on Nonaka and Takeuchi (1995)
Activity 4.2

A useful way of narrowing down the search for core competences is provided by Johnson and Scholes (1997). They suggest that a distinction should be made between resources, unique resources, threshold competences and core competences. To do this first list the items that might constitute core competences. Go through them carefully. Divide them into resources/competences that reduce costs or add value as perceived by customers. Finally, consider whether they make the organisation sustainable and are difficult to imitate. To discover whether they are a genuinely unique resource or a core competence the following criteria might be used. Do purchasers value them? Are they rare? Are they complex to reproduce? Are they embedded in the tacit knowledge of the organisation?

Usually, such an analysis reveals very few core competences and for many it is the ability to manage linkages across separate activities as well as tacit knowledge that provides the competitive advantage.

Fill out the following table based on the activity you are familiar with. Try and pin down your Core competences. Share your experience with others in the group.

<table>
<thead>
<tr>
<th>Resources and Competences underpinning strategy</th>
<th>Which of these Resources/Competence are likely to create:</th>
<th>Which will be sustainable/difficult to imitate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost Reduction</td>
<td>Added Value in terms of need perceived by customers</td>
<td>Value d Rare Complex Tacit</td>
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</table>
4.9. Performance Management: Sustaining Core Competences

The area of performance management is vast. In this section we will make some general comments and examine one popular approach to systematising performance management. There are, of course, parallels between performance management and value chain analysis. In this section we use the former to consider how core competences might be sustained whilst value chain analysis was earlier used to signify where core competences might be found. It is quite possible to use value chain analysis as a means of sustaining performance and thus competences but here we choose to look at the Business Excellence Model.

An important opening consideration is that every performance management system is concerned with control. **Performance management has been described as a cybernetic system** where information is communicated about desired outcomes or goals but with an automatic control mechanism to regulate activity (see Morgan 1997; Hatch, 1997). A thermostat offers a useful comparison. A thermostat regulates room temperature to a desired state. Deviations from that state are regulated by internal automatic mechanisms that move the temperature up or down.

Performance management requires performance measurement, monitoring and adjustment devices just like a thermostat only, of course, we are dealing with humans not machines which suggests that most intervention is not automatic. Control systems are an important element of performance management because they signal where the organisation is doing well or badly but intervention is by people. Performance systems can offer insights as to how well core competences are being exploited and what can be done to rectify imbalances between desired and actual outcomes. It can facilitate the sustainability of core competences and the search for new ways of doing things. But it is important to remain wary of the pitfalls of performance management.

One problem is that of goal displacement. This occurs where higher order goals become displaced over time by lower order goals that meet the then appropriate performance measurement criteria. For example, public service organisations may displace the goal of access to all with an economy goal that acts as a rationing device. Both are equally valid goals but the latter may have surpassed the other in importance because political pressures have changed the performance criteria.

Another danger with performance control is that of impression management or even cheating, i.e. it encourages individuals to give the impression that performance is meeting desired targets. This arises because deviations from desired outcomes require **individuals** to be accountable, and individuals at all levels may fear loss of face or loss of employment.

To ensure that core competences are sustained analysis of performance must take place at every level of organisational activity. That is, within divisions or departments, across departments within the organisation, across linking organisations. However, this can give rise to ‘paralysis analysis’ (Jackson, 1995). Thus bureaucratic processes emphasise the discovery of new measurements and their pursuit rather than noting what makes the organisation successful. A further danger is that of the cost of performance management. A proliferation of measures to ensure compliance means someone has to pay whether it is a customer or a taxpayer. Care has to be taken to ensure that the appropriate number and right balance of measures are in place – a difficult task, indeed.

Thus, successful performance management requires a range of indicators and incentive systems that do not provide for a ‘blame culture’ environment or are excessively costly. It requires that the appropriate goals are achievable and desirable – it is not merely about cutting costs. Thus, what is required is a multifaceted performance management approach.
Self Assessment Activity

Write down the advantages and disadvantages of performance measures in your organisation. Are there areas where your organisation could improve upon the performance measures used?

The Business Excellence Model

A very popular approach to performance management in this respect is the Business Excellence Model that is used by both public and private sector organisations.

The following diagram provides the essence of the ‘model’

![Figure 4.4: The Business Excellence Model](http://www.efqm.org)

The Business Excellence Model asks ‘Enablers’ what do those in their organisation do in their organisation and what are their effects. The overall principle is that:

“Customer satisfaction, people satisfaction and impact on society are achieved through leadership driving policy and strategy, people management, resources and processes leading ultimately to excellence in business results.”

TQM International (1995), P.6

The model was developed in 1988 by 14 leading European Companies who formed the European Foundation for Quality Management (EFQM). The British Quality Foundation was set up in 1992 to promote the use of the model in the UK. Public sector organisations are as active in the use of this approach as the private sector. In response to the 1994 White Paper, “The Civil Service – Continuity and Change”, the Cabinet Office (Office of Public Service) sponsored 12 projects to examine the measurement of quality using a number of methods, including the EQFM model. The early participants in this project included the Contributions Agency and HM Customs and Excise –London Central Collection. Since then a number of other public sector organisations have used the model to examine the internal workings of their organisation through self assessment techniques. It has strengths.

- It is a useful communication device. It reinforces the concept of quality across the organisation and links well with other initiatives such as Investors in People and Charter Mark.
As it uses scoring techniques, it provides evidence about shortcomings that afford opportunities to prioritise issues and engage in action planning.

It is seen as a methodology for public sector benchmarking in general, and in recent times for the statutory 'Best Value' criteria offered by public service delivers (see Table 4. 5 below which provides some information on Newcastle City Council’s external comparators for Best Value). The Cabinet Office launched the Public Sector Benchmarking Project in 1996 and data derived from corporate assessments has been fed into the Civil Service College Benchmarking database. Thus, Benchmarking partnerships can be developed, at least among public sector organisations. Private sector partners are more problematic. And given that benchmarking is meant to reflect measurement against the 'best in class', public sector organisations will have to use appropriate calibration set by the EQFM.

As the diagram above indicates it is considered useful in the promotion of learning within the organisation. Old practices need to be unlearned and new ones put in their place if innovation is to occur.

Follow up Activity

Those who want to pursue the Business Excellence Model in more detail can look at the following websites

Http://www.quality-foundation.co.uk

If you want to see the outcome from Newcastle City council’s self-assessment exercise then visit the following site.

Newcastle City Council Best Value Bid: External Comparators

Newcastle City Council successfully applied for funding for the Best Value pilot scheme in relation to integrated environmental services and Council tax, both of which were underperformers in relation to national indicators. This project has been underway since 1st April 1998.

Newcastle City Council departments are participating/have recently participated in a number of benchmarking exercises with other authorities. These include:

- Development Control (three projects, with a range of local authorities)
- Street Cleansing (with Leeds City Council)
- Management information/indicators (with local authorities, through SOCPO)
- Housing Repairs and Maintenance (with Liverpool City Council, with Newcastle as the example to follow, recommended by Liverpool’s District Auditor)
- Leisure Newcastle (Sport and Leisure Management DSO) is a member of the University of Northumbria’s Best Practice Club and benchmarks for good practice with other public and private sector members.
- Community and Leisure Services are exploring the possibilities of benchmarking a range of services including libraries, arts, museums and tourism with other urban authorities in an initiative by Bristol City Council

At a corporate level, the Council is participating in the Core Cities benchmarking exercise.

The Core Cities of Birmingham, Leeds, Liverpool, Manchester, Sheffield and Newcastle have made a joint commitment to achieving continuous improvements in quality and cost through benchmarking, by establishing a benchmarking group which has been active for over a year. The group has developed and shared experience of benchmarking through a variety of specific projects. Current areas being benchmarked include street cleansing and refuse collection services, special educational needs and leisure facilities. The group has so far produced some very positive results that will lead to service improvements and closer working and sharing of initiatives between cities.

The Core Cities benchmarking group provides a well-developed mechanism for similar type authorities to disseminate information about Best Value pilot projects, to compare and contrast their experiences of different elements of the framework and compare performance.

**Source:** This was taken from the Newcastle City council Best Value Bid at [www.newcastle.gov.uk](http://www.newcastle.gov.uk) but is no longer available on their website. There are other sites on best value and performance management in local government in the UK. In particular you might want to look at Manchester City Council’s Best Value bid which is at [http://www.manchester.gov.uk](http://www.manchester.gov.uk). This local authority also won ‘Beacon Status’ for its Housing Maintenance and Repairs and has some excellent links to other ‘Beacon Status’ authorities in England and Wales.
4.10. Analysing Strategic Capability through SWOT

SWOT stands for Strengths, Weaknesses, Opportunities and Threats. This is a useful technique, if carried out appropriately, for it brings together an analysis of the internal strengths and weaknesses with the key environmental opportunities and threats. Details of this can be found in Johnson and Scholes (1999, chapter 4) and Bryson (1995). SWOT analysis allows strategic managers to examine whether core competences are sustainable because it facilitates an analysis of how the organisation can cope with particular strategies.

The results below are from a SWOT analysis undertaken by a hypothetical regional police force within the UK. The key issues in the environment are presented along the top. There is no set number but a lengthy list does not help. Then a list of the internal strengths and weaknesses is made. Again the list should not be lengthy and specific statements should be made. For example, poor management is not a helpful statement if what is really meant is that historically managers have been unable to manage change.

From the table we can see that the major problems from the environment come from ‘politics and legislation’ and ‘new technology’. These seem to have a particular impact because of under capacity in terms of manpower and the reactive approach adopted. However, being reactive is not a total disadvantage (look at the pluses against public expectation and ‘the major increase in crime’). There are some positives too: a new top team and a committed workforce, for example. But the key ‘core competence’ here might be ‘good community links’ (though, clearly, we would need to know precisely what that meant and how it came about to identify it as a core competence).

Further, we could use this sort of approach to compare alternative strategies. This hypothetical police force may be useful in comparing future strategies (see Jacobs et al, 1998). Assuming that there are no likely increases in resources to relieve the under capacity problem, this police force might consider 2 strategies for dealing with a key strategic issue: the fear of crime. One strategy might be to increase the physical presence of police officers on the street through an increase in volunteer police constables (called ‘Specials’ in the UK) and by re-deploying police officers from administrative to ‘front-line’ duties. Another might be to re-focus on core and statutory activities, possibly through re-structuring, and to target key areas. Both strategies could then be considered against strengths, weaknesses, opportunities and threats and a scoring system put in place to see which would be the better strategy.

Activity 4.3

Undertake a SWOT analysis of your organisation. Use the notes here and those set out in Johnson and Scholes (1999) to help you. Do you believe that the internal strengths can more than match the constraints posed by the external environment? What implications do your findings have for the strategic direction of your organisation?

Discuss your findings with others in the group via the electronic discussion board or email.
**Figure 4.5: A SWOT analysis of a hypothetical UK Police Force**

<table>
<thead>
<tr>
<th>Key issues in environment</th>
<th>Politics/legislation</th>
<th>New technologies</th>
<th>Changing roles in justice system/Europe</th>
<th>Public expectations</th>
<th>Increase in major crime</th>
<th>Social trends (demography)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Main strengths</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Committed employees</td>
<td>0</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>0</td>
<td>3</td>
</tr>
<tr>
<td>Good community links</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>++</td>
<td>+</td>
<td>7</td>
</tr>
<tr>
<td>New ‘top team’</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>0</td>
<td>5</td>
</tr>
<tr>
<td>New equipment (transport)</td>
<td>0</td>
<td>+</td>
<td>0</td>
<td>+</td>
<td>0</td>
<td>3</td>
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<tr>
<td>Operational planning</td>
<td>+</td>
<td>+</td>
<td>-</td>
<td>-</td>
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<tr>
<td><strong>Main weaknesses</strong></td>
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<td>Undercapacity</td>
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<td>Reactive approach</td>
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<td>IT systems</td>
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<td>Financial planning systems</td>
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<td>2</td>
<td>4</td>
<td>3</td>
</tr>
</tbody>
</table>

Source: Based on Johnson and Scholes (1997)
4.11. A Summary

This chapter has covered a vast amount of material. We have examined the origins of core competences and used value chain analysis to understand those parts of the organisation where they might be found. We have also looked at the theoretical foundations of ‘core competence’. We noted that the roots of core competence lie in economics, legal theory, organisational theory, sociology and politics. In particular, we discussed spot and relational contracts within a transaction cost approach; considered networks, clans and bureaucracies using Williamson, Ouchi and Mintzberg; analysed tacit knowledge and organisational routines using the work of Polanyi, Nonaka and Takeuchi as well as Nelson and Winter.

To sustain core competence we saw that performance management was necessary though a sensitive interpretation was required if the organisation was not to fall in to the ‘paralysis analysis’ trap. Finally by using SWOT analysis as a decision tool for competing strategies we noted that core competences could enhance strategic capability within the organisation.

Throughout we used examples, notably from the public sector, to demonstrate the importance of core competences within organisations. In the past public sector organisations have eschewed the concept but as competition for scarce resources has increased its importance is now paramount.
Reading (** = Key Reading)


CHAPTER 5
ORGANISATIONAL CULTURE

5.1. Introduction: Aims and Learning Outcomes

There is a great deal written about organisational culture. You should certainly read Johnson and Scholes (1999, chapters 5 and 11) but make an effort to read Hatch (1997, chapter 7) as well as the other readings cited at the end of this chapter. The aim of this chapter is to explore the concept of organisational culture and offer some practical insights as to how it can be analysed. So having followed this chapter and undertaken the recommended reading you will be able to

- Critically analyse the concept of organisational culture.
- Critically evaluate whether culture can be shaped to facilitate organisational change.
- Undertake a cultural web analysis of your organisation.
- Carry out a cultural audit of your organisation.

5.2. Why is an understanding of organisational culture important?

Peters and Waterman (1982) explained the consistently outstanding financial performance of over 40 American organisations in terms of the strength, dominance and coherence of their organisational culture.

Subsequent research has demonstrated a link between the culture an organisation has, or is, and

- its resultant managerial style (Sathe V, Organisational Dynamics, Winter 1983)
- its corporate and market strategy (Tichy N, Organisational Dynamics, Autumn, 1982)
- the quality of service it offers its customers (Harrison R, Organisational Culture and the Quality of Service, 1989)
- the successful management of strategic changes (see Johnson and Scholes, 1999, chapter 11)

5.3. A Definition of Organisational Culture

It is notoriously difficult to define organisational culture, and this is one reason why some suggest that it is impossible to alter it.

It has been widely suggested that it is “the way we do things around here”. However, more formal definitions have emerged.

Schein EH (1985) defined it as
"A deeper level of basic assumptions and beliefs that are shared by members of an organisation, that operate unconsciously and define in a basic 'taken for granted' fashion an organisation's view of itself and its environment".

For Johnson and Scholes (1999) the core of an organisation's culture is embodied in

- **Values**

  These may come from 'macro-environmental' forces (i.e. society or the sector) or from within the organisation itself. These may be easy to identify and are often written down in statements such as mission, objectives, and strategies. However, these tend to be vague e.g. 'service to the community'.

- **Beliefs**

  These are more specific, but they are issues that again surface and thus can be talked about, e.g. trade with repugnant regimes.

- **Assumptions**

  These are the real core of the organisation's culture as they are taken for granted.

Johnson and Scholes (1999) argue that an individual's experience is likely to be based on 'taken for granted' frames of reference. Within organisations, individuals, or distinct groups of individuals e.g. accountants, clerical grades, may have many interdependent 'frames of reference' - functional, professional, national, industrial and organisational- but it is the organisational frame of reference, called the paradigm, which is relevant to strategic direction. The Paradigm is the set of assumptions about the organisation that is held in common and taken for granted in the organisation. Values, assumptions and beliefs that help form the paradigm rationalise the environmental forces at work and the organisation's capabilities in dealing with them.

Specifically, it is BELIEFS AND ASSUMPTIONS that have to be considered if an organisation is to change its culture. We return to Johnson and Scholes work in more detail below.

Success or failure of an organisation's strategy are therefore tied up with the paradigm.

Clearly things can go wrong. Janis (1972) identifies a problem with the culture of particular groups. To maintain group cohesion individuals suspend critical thinking about the strategic nature of the organisation - this phenomenon is called 'Groupthink'. Groupthink is an illusion that may occur among groups that feel insulated and invulnerable. Unless treated this problem can become a barrier to strategic change.

This, of course, reveals an important issue.

### 5.4. Can an Organisation change its culture?

There is a view that organisational culture reflects history and the prevailing ideology. It is 'something an organisation is' not 'something an organisation has'. Sociologists such as V. Lynn Meek (1994) are concerned that some have selectively used the concept of culture. Thus, there has been an over-emphasis on the premise that norms, values and beliefs create consensus and unity among its members. Moreover, this view suggests that managers can somehow predict and so alter the behaviour of various groups to create a collective consciousness using reward systems, training programmes, mission statements and so on. However, for V. Lynn Meeks, organisational culture can breed 'counter cultures'. There are internal disputes and external forces that challenge the 'organisational consensus'. Indeed, for Lynn Meeks...
‘it is imperative that we understand the beliefs, symbols, myths, ideologies and folklores - the ‘culture’ - of the modern organisation as a form of social control. It is not a form of social control created and manipulated by management, but a process in which management, workers and the community at large participate alike” (p.272).

Thus, it is necessary to understand total organisational culture of which management is a part. Nevertheless,

“while...culture as a whole cannot be consciously manipulated by management or any other group, culture is not necessarily static: cultures do change within organisations, and management does have more direct control than other organisational members over certain aspects of the corporate cultures, such as control over logos and officially stated missions and ethos.” (p.272 - 273)

Bearing this critique in mind we shall espouse a view adapted by Peters and Waterman (1982):

“corporate culture is describable, measurable if necessary and, within limits, alterable.”

For a debate on the issues see Wilson and Rosenfeld (1990).

In the following sections we examine three approaches to organisational culture. The first, that provided by Pettigrew (1979) offers insights into the complex nature of organisational culture and concludes that culture can be only marginally changed. Johnson and Scholes (1999) accept the complexity of culture but suggest that with appropriate management skills the ‘cultural web’ of an organisation can be changed to suit strategic ends. We conclude with Charles Handy descriptive approach to culture. Handy (1995) offers some practical insights by identifying particular types of organisational culture and considering whether a ‘cultural gap’ exists between an individual’s expectations of what an organisation has to offer and what they believe it should provide.

5.5. The Pettigrew (1979) Model: A Pessimistic view

The starting point for an analysis of strategic change is the notion that formulating the content of any new strategy inevitably entails managing its context and process. The ‘what’ of change is encapsulated under the label content and may be organisational culture itself. Much of the ‘why’ of change is derived from an analysis of inner and outer context, and the ‘how’ of change can be understood from an analysis of process.
Pettigrew states that action to change the strategy and cultures of an organisation is dependent on the ability of the organisation to understand the outer (the social, economic, political and competitive environment), and inner contexts by astute considerations about the process of management. However, the complex nature of context makes the management of organisational culture difficult.

Seven factors have been advanced by Pettigrew to illustrate this.

- **The Levels issue.**
  Relates to the fact that culture exists at a variety of different levels in the organisation. He argues that it is rather more difficult to change or shape the core beliefs and assumptions within the organisation than it is to change some of the manifestations of culture in, for example, the organisation’s structure and systems.

- **The Pervasiveness Issue.**
  As a corollary of the above, culture is not only deep, it is also broad. It refers not just to people, their relationships and beliefs, it also refers to their views about an organisation’s services, structures, systems, corporate purpose and modes of recruitment, socialisation and reward.

- **The Implicitness Issue.**
  This relates to the fact that much of an organisation’s culture is taken for granted. It is difficult to change things that are implicitly part of peoples’ thinking and behaviour, and are rarely brought out explicitly for consideration.

- **The Imprinting Issue.**
  This draws attention to the deep historical roots of much of an organisation’s culture. History has an important influence on the present and future management of most organisations.

- **The Political Issue.**
  This refers to the connections between culture and the power distributed in the organisation. Certain power groups in the organisation have a vested interest in the beliefs and assumptions that may have primacy at any point in time in the organisation’s development. These power groups are unlikely to be willing to discard these beliefs and assumptions without persistent challenge.

- **The Plurality Issue.**
  Most organisations do not have a single culture but at any time may have a variety of different sets of beliefs and assumptions.

- **The Interdependence Issue.**
  Here the focus is on the fact that culture is interconnected not only with the politics of the organisation, but also with the structure, systems, people and priorities of the organisation.

Between them, the above seven issues make organisational culture very difficult to manage, and certainly to shape or change.

### 5.6. Johnson and Scholes: The Cultural Web

The paradigm is made up of a number of overlapping values, beliefs and assumptions that make up a 'Cultural Web'. The diagram below provides insights as to the components of the Web as described for the a UK National Health Service hospital.
There are clearly common components to the web for all organisations.

**Stories**

Members of the organisation tell these to insiders and outsiders. The history of the organisation is embedded in the present through important past events and personalities, including mavericks that deviate from the norm.

**Routines and Rituals**

Routines are part of the culture (‘the way things are done around here’) and as such may demonstrate a beneficial competency. Rituals signal what is especially valued. They include events such as training programmes, promotion and assessment.

**Symbols**

These are demonstrated by the language and terminology used in the organisation. They include logos, offices, cars and titles.

**Control Systems**

These are measurement and reward systems that monitor activities designated as important.
**Power Structures**

These are most likely to be considered as integral to the nature of the paradigm. Key groups are likely to be associated with an organisation’s core assumptions and beliefs.

**Organisational Structure**

These are more informal ways in which the organisation works. Structures are likely to reflect power.

**The Paradigm**

These are the taken for granted assumptions about the organisation. They partly appear in Mission Statements and other documents but it would be a misrepresentation to say that these were the paradigm.

The ‘real’ culture is evidenced by the way the organisation actually operates. It concerns ‘what really matters’ and it may be an element of organisational architecture that provides core competence. For example a Police Force may look to catching criminals as its primary task but it also looks to crime prevention, support against ‘the fear of crime’, victim support and community relations.

The concept of the Cultural Web is a useful device for mapping out change but its real worth is in the fact that we can identify which elements of culture need to change. Johnson (1998) has shown that this is a useful management tool. It can allow managers to compare today’s organisational culture with one more appropriate for the near future. As such managers have to find ways of getting to such a desiderata.

---

**Activity 5.1**

Carry out a Cultural Web analysis of your organisation. Use Table 5.1 below to construct a Cultural Web. Consider the following:

Would the cultural web have looked the same ten years ago?

Explain what might have been different. Alternatively, if you have an ‘inappropriate’ culture construct a more appropriate cultural web for your organisation?

Share your answers with the rest of the group.

---

**Table 5.1**
**Question that might be asked to draw up a Cultural Web?**

<table>
<thead>
<tr>
<th>Stories</th>
<th>Control Systems</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. What core beliefs do stories reflect?</td>
<td>1. What is most closely monitored or controlled?</td>
</tr>
<tr>
<td>3. How pervasive are these beliefs (through levels)?</td>
<td>2. Is emphasis on reward or punishment?</td>
</tr>
<tr>
<td>3. Do stories relate to strengths or weaknesses? successes or failures? conformity or mavericks?</td>
<td>3. Are controls related to history or current strategies?</td>
</tr>
<tr>
<td>4. Who are the heroes and villains?</td>
<td>4. Are there many/few controls?</td>
</tr>
<tr>
<td>6. What norms do mavericks deviate from?</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Routines and Rituals</th>
<th>Power Structures</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Which routines are emphasised?</td>
<td>1. What are the core beliefs of the leadership?</td>
</tr>
<tr>
<td>2. Which would look odd if changed?</td>
<td>2. How strongly held are these beliefs (idealists or pragmatists)?</td>
</tr>
<tr>
<td>3. What behaviour do routines encourage?</td>
<td>3. How is power distributed in the organisation?</td>
</tr>
<tr>
<td>4. What are the key rituals?</td>
<td>4. Where are the main blockages to change?</td>
</tr>
<tr>
<td>5. What core beliefs do they reflect?</td>
<td></td>
</tr>
<tr>
<td>6. What do training programmes emphasise?</td>
<td></td>
</tr>
<tr>
<td>7. How easy are rituals/routines to change?</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Symbols</th>
<th>Organisational Structures</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. What language and jargon are used?</td>
<td>1. How mechanistic/organic are the structures?</td>
</tr>
<tr>
<td>2. How internal or accessible is it?</td>
<td>2. How flat/hierarchical are the structures?</td>
</tr>
<tr>
<td>3. What aspects are highlighted in publicity?</td>
<td>3. How formal/informal are the structures?</td>
</tr>
<tr>
<td>4. What status symbols are there?</td>
<td>4. Do structures encourage collaboration or competition?</td>
</tr>
<tr>
<td>5. Are there particular symbols that denote the organisation?</td>
<td>4. What sort of power structures do they support?</td>
</tr>
</tbody>
</table>


### 5.6. Handy: The Cultural Gap

Charles Handy (1993) identifies culture with organisational forms. Four types are identified. Though many large organisations may find that they possess elements of each type.

**Power Culture**

Patron god is Zeus. Culture depends upon Power that is centralised. The structure is best described as a web ('A web without a spider has no strength'). Size is a problem for these sorts of organisations.

**Role Culture**

Often stereotyped as a bureaucracy but this has pejorative connotations so role is used. Its structure can be thought of as a Greek Temple. The patron god is Apollo, the god of reason; for this culture works by logic and rationality.
The pillars of the temple (the functions) are strong in their own right but they also need each other to hold up the pediment (the narrow band of senior managers). This is done by:

- procedures for roles, e.g. job descriptions, authority definitions.
- procedures for communications
- rules for settlement of disputes.

Temples provide security for individuals but are unstable when the ground shakes.

**Task Culture**

This culture is job or project oriented. Its patron god is Athena, the warrior goddess and champion of the commando leader Odysseus for the whole emphasis is on getting the job done. The appropriate structure is that of a net with some strands thicker than others. Power lies at the knots or interstices. The ‘matrix organisation’ is one structural form of the task culture.

The task culture is about teams and is extremely flexible. Most middle and junior managers prefer this culture because it gives them a sense of responsibility. However, this culture may find that it creates fewer experts and so loses appropriate scale economies. In addition, senior managers find that attaching costs to particular activities is difficult in such an environment.

**Person Culture**

This culture exists in barristers’ chambers, architects' partnerships, hippy communes, social groups, families, small consultancy firms. The structure that best describes it is a cluster or perhaps a galaxy of individual stars. The patron god is Dionysus, the deity of the self-oriented individual.

Here the problem is that of the competing ego.

Clearly these are characterisations of organisational culture but they do have their uses.

Handy, borrowing from the work of Roger Harrison, has built a self-assessment questionnaire to demonstrate whether an individual belongs to a power, role, task or person culture and to compare this with the sort of organisational culture they actually want to belong to. The questionnaire is available in appendix 1 at the end.

This sort of method is called a cultural audit and is becoming commonplace in organisations. The Contributions Agency was actively involved in one such exercise in the mid-1990s. The Agency was promoting its AHEAD programme (Acting on ideas, Having clear goals, Ensuring people are valued, Achieving value for money, Delivering a quality service) and called in Touche Ross to carry out an assessment. A questionnaire was used to gain views on issues such as teamwork, respect and dignity, bureaucracy, and learning and development. Essentially individuals are comparing statements about what they believe their organisation to be doing with what they expect it to do. The forms were handed out to a large sample of individuals across the organisation. In sum 32 issues were considered and as you can see from the results set out in Figure 5.3 there were several areas that had to be developed.

---

Kevin Hinde. EC490 Corporate and Strategic Management
Activity 5.2

Carry out the Handy 'Cultural Gap' analysis within your own organisation using the questions set out in Appendix 5.1. Experiment with the results that you get by carrying out the exercise with different tiers of the organisation. Do you get different results? Explain why or why not.

Present your findings to the rest of the group

5.7. Strategic Change and the cultural context

Strategic change has to be managed correctly. This requires a change in the 'paradigm', although for Johnson and Scholes the change should be incremental. Change may come about because of some 'unfreezing' mechanism; a change in market share, a change in government. In the unfreezing phase previous ideas and practices are being analysed constructively and people are being prepared for change.

Once in place there are further stages of change which have to be anticipated including organisational flux and experimentation or even 'refreezing' which confirms the organisational validity of the change.

Strategic change can be managed in a number of ways. The style used may depend upon the situation the organisation is in. There are problems whatever method is used. However, it is important to recognise that when managing change there will be disruptions in organisational routines. Political and symbolic mechanisms must be developed to encourage change. Managers have to change the culture as best they can.
Reading (**= Key Reading)


Janis I L (1972) *Victims of Groupthink*, Houghton Mifflin, Boston


Appendix 5.1. What kind of organisation do you belong to?

To be done by individuals (40 minutes) and the scores collated in groups.

1. What kind of organisation do you belong to? What set of values, styles of behaviour, characterise it?
2. What kind of organisation would you like to belong to?

Please complete this questionnaire:

(a) For yourself, your own values and beliefs;
(b) For your own organisation.

Rank each statement in order of salience. Put ‘1’ against the statement which best represents the dominant view in your organisation, ‘2’ for the next closest. Then go back and do the same for your own beliefs.

At the end, please add up the scores for the first statement under each heading, the scores for the second statement, and so on (e.g. a score of 15 for the first statement would mean that it had ranked top in all categories).

The group should then analyse its combined results.

(a) Ask each individual to note which set of statements had the lowest score for himself; for his organisation.
(b) Complete the following matrix for the group

<table>
<thead>
<tr>
<th>Numbers of individuals with lowest score for statements</th>
</tr>
</thead>
<tbody>
<tr>
<td>self</td>
</tr>
<tr>
<td>organisation</td>
</tr>
</tbody>
</table>

(c) The four sets of statements describe the four cultures described in the text. If statement number 1 has the lowest total score for any individual that would suggest that culture number 1 is his preferred culture. The numbering of the statements corresponds to the order in which the cultures are listed in the text.

(d) How dominant a cultural preference is in the life of an individual or an organisation will be represented by the difference between the total scores for the four sets of cultures. A score of 15 would imply that the corresponding culture was totally dominant.

A perfect match between an individual’s preferences and his organisation’s cultures would suggest a perfectly fitting psychological contract. Most people will not have a perfect match. The group may like to explore the reasons for the differences after they have read the text.

<table>
<thead>
<tr>
<th>Own ranking</th>
<th>Organisations ranking</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. A good boss</td>
<td>is strong, decisive and firm but fair. He or she is protective, generous and indulgent to loyal subordinates.</td>
</tr>
<tr>
<td>is impersonal and correct, avoiding the exercise of personal authority for personal own advantage. A good boss demands from subordinates only that which is required by the formal system</td>
<td></td>
</tr>
</tbody>
</table>
is egalitarian and influenceable in matters concerning the task. He or she uses their authority to obtain the resources needed to get on with the job.

Is concerned and responsive to the personal needs and values of others. He or she uses their position to provide satisfying and growth stimulating work opportunities for subordinates.

2. A good subordinate

Is compliant, hard-working and loyal to the interests of the superior.

Is responsible and reliable, meeting the duties and responsibilities of the job and avoiding actions which might surprise or embarrass a superior.

Is self-motivated to contribute his or her best to the task and is open with ideas and suggestions, but is nevertheless willing to give the lead to others when they show greater expertise or ability.

Is vitally interested in the development of personal potentialities and is open to learning and receiving help. He or she also respects the needs and values of others and is willing to give help and contribute to their development.

3. A good member of the organisation gives first priority to

The personal demands of the boss

The duties, responsibilities and requirements of their own role, and the customary standards of personal behaviour.

The requirements of the task for skill, ability energy and material resources

The personal needs of the individual involved

4. People who do well in the organisation

Are shrewd and competitive with a strong drive for power.

Are conscientious and responsible with a strong sense of loyalty to the organisation.

Are technically competent and effective, with a strong commitment to getting the job done.

Are effective and competent in personal relationships, with a strong commitment to the growth and development of people.

5. The organisation treats the individual

As though his or her time and energy were at the disposal of the persons higher in the hierarchy.
As though his or her time and energy were available through a contract having rights and responsibilities on both sides.

As a co-worker who has committed his or her skills and abilities to the common cause.

As an interesting and worthwhile person in their own right.

6. People are controlled and influenced by

The personal exercise of economic and political power (rewards and punishments).

Impersonal exercise of economic and political power to enforce procedures and standards of performance.

Communication and discussion of task requirements leading to appropriate action motivated by personal commitment to goal achievement.

Intrinsic interest and enjoyment in the activities to be done; and/or concern and caring for needs of other persons involved.

7. It is legitimate for one person to control another’s activities

If that person has more authority and power in the organisation.

If the role prescribes that they are responsible for directing the other.

If he or she has more knowledge relevant to the task at hand.

If the other accepts that the first person’s help or instruction can contribute to the other’s learning and growth.

8. The basis of task assignment is

The personal needs and judgement of those in authority.

The formal divisions of functions and responsibility in the system.

The resource and expertise requirements of the job to be done.

The personal wishes and needs for learning and growth of the individual organisation members.

9. Work is performed out of

Hope of reward, fear of punishment or personal loyalty towards a powerful individual.

A respect for contractual obligations backed up by sanctions and personal loyalty towards the organisation or system.
Satisfaction in excellence of work and achievement and/or personal commitment to the task or goal.

Enjoyment of the activity for its own sake and concern and respect for the needs and values of the other persons involved.

10. People work together

When they are required to by higher authority or believe they can use each other for personal advantage.

When co-ordination and exchange are specified by the formal system.

When their joint contribution is needed to progress the task.

When the collaboration is personally satisfying, stimulating or challenging.

11. Competition

Is for personal power and advantages.

Is for high-status position in the formal system.

Is for excellence of contribution to the task.

Is for attention to one’s own personal needs.

12. Conflict

Is controlled by the intervention of higher authority and often fostered by them to maintain their own power.

Is suppressed by reference to rules, procedures and definitions of responsibility.

Is resolved through full discussion of the merits of the work issues involved.

Is resolved by open and deep discussion of personal needs and values involved.

13. Decisions

are made by the person with the higher power and authority.

Are made by the person whose job description carries the responsibility.

Are made by the persons with most knowledge and expertise about the problem.

Are made by the persons most personally involved and affected by the outcome.

14. The appropriate control and communication structure
Command flows from the top down in a simple pyramid so that anyone who is higher in the pyramid has authority over anyone who is lower. Information flows up through the chain of command.

Directives flow from the top down and information flows upwards within functional pyramids which meet at the top. The authority and responsibility of a role is limited to the roles beneath its own pyramid. Cross-functional exchange is constricted.

Information about task requirements and problems flows from the centre of task activity upwards and outwards, with those closest to the task determining resources and support needed from the rest of the organisation. A co-ordinating function may set priorities and overall resource levels based on information from all task centres. The structure should shift with the nature and location of the tasks.

Information and influence flow from person to person, based on relationships that are voluntarily entered into for purposes of work, learning, mutual support and enjoyment, shared values. A co-ordinating function may establish overall levels of contribution needed for maintenance of the organisation. These tasks are assigned by mutual agreement.

15. The environment is responded to as though it were

a competitive jungle in which all are against all and those who do not exploit others are themselves exploited.

An orderly and rational system in which competition is limited by law and conflicts yield to negotiation and compromise.

A complex of imperfect forms and systems which are to be re-shaped and improved by the achievements of the organisation.

A complex of potential threats and support. It is to be manipulated by the organisation to extract nourishment from it, pull its teeth and use it as a play and work space for the enjoyment and growth of members.

Adapted from a questionnaire compiled by Dr Roger Harrison.


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CHAPTER 6
INTRODUCING GAME THEORY FOR STRATEGIC MANAGERS: UNDERSTANDING BEHAVIOUR, CO-OPERATION AND PARTNERSHIPS

6.1. Introduction: Aims and Learning Outcomes

I can only really ‘scratch the surface’ in this fascinating area of strategic management. I wanted to include this chapter because it represents the application of an important and recent addition to the stock of knowledge in a number of fields: notably biology, political science, and economics. Its origins are with the work of John von Neumann in the 1930s but it has really gained prominence in the field of Strategic Management since the late 1980s. I suggest that you read Poundstone (1993) for some biography on von Neumann and an introduction to the games here. You might also read the work of Richard Dawkins (1989) who applies it to Darwinian biology. If you want to see how it is applied to business situations then read Dixit and Nalebuff (1991) though it is pervasive in books by economists about strategy (see Kay, 1993; Macmillan, 1992; Dixit and Skeath, 1999).

Game theory has enormous applicability to our everyday understanding of human behaviour and particularly our understanding of rationality, co-operation, reciprocity, trust, punishments and learning. Thus, it has an important bearing on the understanding of how core competences develop. It is also relevant to our understanding of behaviour within dynamic frameworks and so has a bearing on the next chapter. Thus, the aim of this chapter is to explore behaviour between individuals using game theory as our guide.

In order to examine the implications of game theory for issues in strategic management we need to explore some concepts. This requires a logical approach and an element of mathematical understanding. However, the maths involved will be kept to an absolute minimum. We will see that strategy in game theory involves a choice between alternative policies and that the one adopted depends upon how the player reasons. In some cases there will be ‘dominant strategies’ such that it does not matter what other players do because this policy choice offers greater net benefits than any alternative. However, where the gains are not clear-cut individuals or organisations have to anticipate what they believe their opponents might do. Throughout the early part of this chapter I will try and use examples taken from the public and private sectors where possible to avoid being esoteric. At the end of this chapter I will briefly relate theory to explain the development of partnerships / strategic alliances in the public and private sectors.

After following this chapter and carrying out the associated activities you will be able to

- Identify a dominant strategy and a Nash equilibrium.
- Identify with co-ordination problems like that associated with the battle of the sexes game.
- Critically examine behaviour within the Prisoner’s Dilemma game and make reference to the implications of such behaviour within your own organisation.
- Evaluate the importance of eliciting co-operation through ‘Tit for Tat’ strategies.
- Critically examine the assumptions of game theory, notably that of rationality.
Synthesise the knowledge gained from the theory and apply it more widely to strategic situations in the workplace.

6.2. Basic Concepts in Game Theory

The essence of Game theory is that there is interdependence when making strategic decisions, i.e. what one player does affect and may have been affected by other players. To understand the essence of games we have to look for solutions but such solutions can be rather difficult to deduce. We will begin with the easiest, a dominant strategy equilibrium and then examine the Nash strategy equilibrium.

1. Dominant strategy

This can be defined as the strategy which yields the optimal pay off irrespective of what its rival(s) is (are) doing.

One of Dixit and Nalebuff’s rules for game theory is

“If you have a dominant strategy use it” (1991, p.66).

To see how it works consider Figures 6.1 and 6.2. Figure 6.1 shows how a local authority and a potential inward investor might arrive at a mutually advantageous situation. There are two choices (strategies) for the Local Authority: adopt an active or a passive (non-active) inward investment policy towards private firms. The payoffs for the local authority are expressed in Gross Domestic Output in millions of £s (though we could use wider social objectives or even votes). The payoffs for the private firm are measured as millions of £s profit. (Note that in all the figures the left hand side figure in the parentheses represents the pay off for the player noted at the side of the matrix whilst the right hand side figure is the pay off for the player denoted on the top. These are also known as the row and column players respectively).

The resulting equilibrium occurs when the local authority engages in an active inward investment policy and the private firm invests in local authority A. Why? Well, the firm sees that it has a better pay off from investing in Local authority A irrespective of what the authority does (Its profits of 10 or 8 are greater than 5). Likewise Local authority A sees that by adopting an active industrial policy the returns to the local economy in terms of Gross Domestic Output are either 20 or -5 which is better than similar outcomes for not acting positively in attracting firms to the area (5 and –8). So both players have a ‘win-win’ outcome. Note that in game theory jargon ‘non-active’ and ‘invest in B’ are Dominated strategies for each player.

Figure 6.2 involves a slight variation on a dominant strategy equilibrium. Here there are two Housing Associations (these are providers of social housing provision in the UK, though you can substitute two chemical firms if you wish). The payoffs in the matrix are profits measured in millions of £s. We see that Housing Association 2 (HA2) has a dominant strategy, that of seeking an alliance (profits of 4 and 3 are greater than 2 irrespective of what strategy Housing Association 1 adopts). HA1 does not have an outright dominant strategy but (and here we are making an assumption that information is perfect) it can see that HA2 has a dominant strategy of seeking an alliance. In this case it would be folly (given the rationality implied by the payoffs) for HA1 not to seek an alliance.
Figure 6.1. Foreign Investment in a local economy.

<table>
<thead>
<tr>
<th></th>
<th>Invest in A</th>
<th>Invest in B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Active</td>
<td>(20, 10)</td>
<td>(-5, 5)</td>
</tr>
<tr>
<td>Local Authority A</td>
<td>(5, 8)</td>
<td>(-8, 5)</td>
</tr>
</tbody>
</table>

Figure 6.2. A Housing Association (H.A.) Merger

<table>
<thead>
<tr>
<th></th>
<th>H.A 2</th>
<th>No Alliance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alliance</td>
<td>(3, 4)</td>
<td>(2, 2)</td>
</tr>
<tr>
<td>H.A 1</td>
<td>(1, 3)</td>
<td>(4, 2)</td>
</tr>
</tbody>
</table>

Note that it is possible to distinguish between strong and weak dominance. Figures 6.1 and 6.2 are examples of strong dominance for one or both players. Consider 6.3. In this example, player 1 will never play down whilst player 2 will never play right. This is sub-optimal. They will play left, up though they would be better playing down, left. The reason for this inefficient outcome is the possibility of defection by one of the players.

Figure 6.3. Weak Dominance.

<table>
<thead>
<tr>
<th></th>
<th>FIRM 2</th>
<th>Right</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up</td>
<td>(7, 2)</td>
<td>(5, 2)</td>
</tr>
<tr>
<td>FIRM 1</td>
<td>(7, 4)</td>
<td>(2, 0)</td>
</tr>
<tr>
<td>Down</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Activity 6.1

Try your brain on the following

The Rational Pigs.

Two pigs, one dominant and the other subordinate, are put in a box. There is a lever at one end of the box which, when pressed, dispenses food at the other end. Thus, the pig that presses the lever must run to the other end; by the time it gets there, the other pig has eaten most, but not all, of the food. The dominant pig is able to prevent the subordinate pig from getting any of the food when both are at the food. Assume that pig survival depends upon getting the most food it possibly can, which pig will press the lever?

Incidentally, you might interpret this as a large and small firm and the payoffs could be profits. You can think about the strategies.

Email your responses to the discussion board. Don’t panic if your lost I will help you out. However, if you want to see the answer consult the reference below.


2. Nash strategy

This can be defined as a set of strategies where each player does their best given what they assume the other(s) is (are) doing. Thus, no player can improve upon his or her payoff by adopting an alternative strategy.

Named after the mathematician, John Nash, who discovered the concept in the late 1940s, this is a stable, self-enforcing and generalised equilibrium concept in Game theory. It arises because not all games have dominant strategies. So again using a Dixit and Nalebuff rule

"Having exhausted the simple avenues of looking for dominant strategies or ruling out dominated ones, the next thing to do is to look for an equilibrium of the game" (1991, p.77).

To understand how the Nash equilibrium works consider the following game in Figure 6.4. This is a game of best replies. Further we must remember that in this and other games described in this chapter

"there is complete but imperfect information. It is complete because both know the strategies and payoffs available to each other, yet imperfect because decisions have to be made before the other’s choice has been revealed." (Lyons, ibid. p.98)

Individuals are making their choices independently of one another though they recognise that what they do will be affected by the other’s independent choice. Look at Figure 6.4. If X plays Top then Ys best response is to play Right and get 5. If X plays Bottom then Y should play Left. The better of these two payoffs obtained by Y is 6 so they will play Left. Similar reasoning yields that Player X is better off playing Bottom. If Y plays Left then X’s best response is Top, where they gain 4. If Y plays Right then X should play then Y should play Bottom where they would gain 6. The Nash Equilibrium is thus Left, Bottom.

(If you found the use of X and Y and Left, Right and Top, Bottom rather esoteric why not substitute the players and strategies from Figure 6.2.)
The Nash equilibrium is a more powerful solution concept than dominant strategy equilibrium (indeed, the latter are a subset of the former). But clearly a Nash equilibrium is a non-trivial solution. It requires that individuals are game theoretic thinkers with a powerful logic to their reasoning.

In this game the Nash Equilibrium yields the optimal payoff for both players (although there are unequal distributions of the gains). There are, however, problems for Nash equilibrium. In the next section we examine two.

![Game Matrix]

**Self Assessment Exercise**

Look again at Figures 6.1, 6.2 and 6.3 and consider the Nash equilibrium.

### 6.3. Problems for Nash Equilibrium

1. **Multiple equilibria in one-shot games**

Figure 6.5 shows the Battle of the Sexes game so called because it recognises potential difficulties between individuals in relationships. The matrix shows the strategies and payoffs for two individuals sitting at work wondering what to do in the evening. Both want to be together, though they have slightly different preferences as to what they want to do. Being apart is the worst outcome and this is given a payoff of zero points of satisfaction. As to the co-ordinated activity that may take place, ‘getting your own way’ yields more than ‘giving in’ and is rewarded with 2 rather than one point.
Figure 6.5: The Battle of the Sexes Game

There are two Nash equilibrium – (knitting, knitting) and (sumo, sumo) – and we need two Nash Equilibrium ‘like we need two heads’ (Poundstone, 1993, p. 199). How might the problem be resolved?

- Well there could be a hierarchy between the players (one of them is dominant and the other acquiescent)
- It might be that one of the players makes what game theorists term a ‘credible commitment’. For example, she could ‘burn her bridges behind her’ (another game theory phrase) and buy tickets for the Sumo.
- Alternatively, there might be a convention between the players. One chooses one week and the other the next. Thus game theorists often talk about ‘focal points’ in games. These arise because of the historical, legal, cultural or social background between the players (Schelling, 1960).

(There is also a mixed equilibrium strategy that can be adopted here but it has little value to the resolution of the problem in the short term.)

The Battle of the Sexes Game has implications in any co-ordination issue. In the public services, mergers between Housing Associations might be seen as beneficial but there may be a dispute over the method of implementation. Similarly, multi-agency approaches to problems are commonplace in the public services. However, establishing an appropriate solution is rather more difficult. The game might also be characterised by wage bargaining or the allocation of scarce funds between parties.

Figure 6.6 illustrates an example from the private sector taken from John Kay (1993) showing the importance of co-ordination in a standards game. Again there may well be parallels with situations such as installing a particular IT system. It could also be that public service providers agree on the need for partnership activity but not on its form.

<table>
<thead>
<tr>
<th></th>
<th>Her</th>
<th>Sumo</th>
</tr>
</thead>
<tbody>
<tr>
<td>Knitting</td>
<td>(2, 1)</td>
<td>(0, 0)</td>
</tr>
<tr>
<td>Him</td>
<td>(0, 0)</td>
<td>(1, 2)</td>
</tr>
</tbody>
</table>

Figure 6.5: The Battle of the Sexes Game
In Figure 6.6 there are 2 possible outcomes each buy VHS or each buy Betamax. However, one consumer does not optimise their payoffs.

What is required is:
1. **Hierarchy** - governments often attempt to establish a particular standard.
2. **Commitment.** This means
   - The rapid achievement of an installed base, e.g. In the provision of satellite TV Sky won against the British Satellite Broadcasting Company in spite of the fact that it was sponsored by the European Commission.
   - Establishing reputation and credibility quickly, e.g. JVC offered an open licensing policy to win the VHS/Betamax game.

**Self Assessment Question**
Can you think of other examples where organisations have had to establish credibility in order to win battle of the sexes games?

### 2. A Classic Game: The Prisoner’s Dilemma (Due to A.W. Tucker)

In this game 2 prisoners have been brought in for questioning by the police about a serious crime. The police have some information and so can make some charges hold but they need to question the suspects if they are to get the whole picture. The police interview the suspects in separate rooms. The prisoners now find themselves in a dilemma. The game is shown in the matrix below. Both have two choices, to confess or not confess. The payoffs in Figure 6.7 for prisoner 1 are shown in the right of the bracket and those for prisoner 2 on the left. They are negative to reflect years in prison.

Both prisoners will get either 5 years or 6 months in prison for confessing and 10 years or 1 year if they keep quiet. Given the possibility of a 6 month sentence both players find themselves confessing. Why? Well put yourself in the place of one of the prisoners (say Prisoner 1) and consider the case of not confessing. You can see that by co-operating with each other you would only face 1 year each in prison. But you ask yourself, ‘will prisoner 2 behave like this?’ You can see from the payoffs that there is a huge incentive for Prisoner 2 to defect from this arrangement – they might only get 6 months in gaol. The logic of Game theory would imply that Prisoner 2 would employ similar reasoning in determining the likely strategy of Prisoner 1.
The implications of the Prisoner’s Dilemma Game are clear enough. If they follow the logic of game theory then both players will obtain a sub-optimal payoff – They each get 5 years in prison when they could cooperate with each other and get out in one year’s time.

Figure 6.7. The Prisoner’s Dilemma

<table>
<thead>
<tr>
<th>Prisoner 2</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>No Confession</td>
<td>Confession</td>
</tr>
<tr>
<td>(-1, -1)</td>
<td>(-10, -0.5)</td>
</tr>
<tr>
<td>(-0.5, -10)</td>
<td>(-5, -5)</td>
</tr>
</tbody>
</table>

So the Prisoner’s Dilemma game sits uneasily with a simple use of rational behaviour. But this and all the other games represented in Figures 6.1 to 6.7 are what game theorists call ‘one-shot’ games. We need to examine the repeated game to understand how the players obtain the optimal payoffs. Perhaps you’ve already figured out that the Prisoners have learnt how to play the game (They say there is ‘honour among thieves’).

Questions

Do we want the Prisoner’s to win the game? What mechanisms have been developed by the authorities to prevent Prisoners winning the repeated game?

Can you think of any other situations where you would not want the players to co-operate?

However, before entertaining the repeated game which will enable us to understand how co-operation develops between players, Figure 6.8 below provides a general format to understand the Prisoner’s Dilemma game.

Player 2

<table>
<thead>
<tr>
<th>Cooperate</th>
<th>Defect/Compete</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cooperate</td>
<td>(Good, Good)</td>
</tr>
<tr>
<td></td>
<td>(Best, Worst)</td>
</tr>
</tbody>
</table>

Figure 6.8. A more General Version of the Prisoner’s Dilemma
This figure shows the stark contrasts available to the players. They can compete or cooperate. If player 1 was XYZ Incorporated and player 2 was ABC inc. and they had two strategies charge high prices or sell at low prices then they would be better off co-operating with each other and charging higher prices. This, of course, would be good for the players but bad for society. It would also be illegal because the firms would be deemed as acting as a cartel. Further the powerful forces indicated by game theory would suggest that both firms would compete against each other and their profits would be acceptable (or, as I’ve expressed it in Figure 6.8, Okay). This is, of course, what consumers want and so the ‘Prisoner’s Dilemma’ game works to society’s advantage. But this is not always the case. Indeed, there are situations where one party might defect rather than cooperate. For example,

- **Consider the collection of taxes to pay for emergency services or services such as street lighting.** People want the benefits from taxation but do not want to pay. There is a “free-rider” problem, which suggests that defect (competitive) strategies develop. To see this, think about it from the point of view of the individual. Society would be better off if everyone participated in providing public goods and services. However, an individual may reason that if I do not pay then my net pay off is higher than if I do pay. I get the benefits of health care (or whatever) but not the costs. Clearly, if everyone behaves like this then society loses out.

- **Consider why some team members shirk in the work place.** If we work in teams then the rewards an individual gets from an extra unit of effort are diluted among our colleagues. If there are 10 people in a team and one person puts in the extra unit of effort the payoffs (and these can be non–pecuniary payoffs like satisfaction from seeing the team succeed, as well as monetary rewards) are shared by the other 9. Again we have the ‘free rider’ problem as some team members take advantage of the hard work of others. Of course, if everyone does this then the organisation will collapse. Appropriate punishment and reward systems have to be put in place to overcome the problem but this can create other difficulties.

Some relationships do not even get started or start off badly.

- **Why do employers and unions play tough guy strategies in industrial relations strategies (tantamount to our defect/compete choice in Figure 6.8)?** Would a more professional, co-operative approach give higher returns?

- **Why do strategic alliances or, more generally, partnerships fail to get off the ground?** Most players play the game cautiously to begin with. They might recognise the benefits of an alliance but they are unwilling to commit themselves or resources initially because that would mean upsetting the status quo or perhaps they believe potential partners could perceive it as a sign of weakness.

We will examine the latter in a little more detail later. For the moment let us acknowledge that the Prisoner’s Dilemma game is pervasive in social and organisational settings. How does game theory set about resolving the problem?

### 6.4. Eliciting Co-operation through ‘Tit for Tat’

**Punishments: A repeated Prisoner’s Dilemma Game**

If the participants in a Prisoner’s Dilemma game believe that they will face each other on more than one occasion then there exists a repeated game in which players may signal that they are willing to act co-operatively. However, there are powerful forces acting to push players back towards the Nash Equilibrium. Why? Because the payoffs are greater to an individual if they defect whilst the other continues to act co-operatively (the so-called ‘sucker’s payoff’). To develop co-operative behaviour and to ensure that such mutual co-operation

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Kevin Hinde. EC490 Corporate and Strategic Management
persists over the long term game theorists have suggested that a system of punishments is adopted. The most well known punishment strategy is ‘Tit-for tat’ (TFT). This, of course, requires that the game is played repeatedly over an undetermined length of time (preferably infinitely), otherwise the incentives to defect increase. It also requires that the players recognise co-operation when it occurs and that once mutual co-operation is established that the ‘agreement’ is effectively monitored and appropriate punishment metered out.

Why has TFT emerged as such an important punishment strategy? The reason is fairly simple. A political scientist, Robert Axelrod held a tournament in which he invited game theorists to submit a computer program that would resolve the Prisoner’s Dilemma. The winner was TFT submitted by Anatole Rappaport. The program was very simple, TFT

- Acted co-operatively in the first round.
- In subsequent rounds, it adopted its opponent strategy from the previous round.

In the tournament each program
- Competed head-to-head against another
- Competed against itself
- Competed against another that was randomly selected by a computer.

Clearly, TFT would always lose out if it met up with a permanent defector but when it met a co-operative player or a similar TFT player they would achieve the optimal payoffs. When defectors met defectors then they would achieve the sub-optimal payoff. Players who were permanent co-operators would lose out in a big way to defectors as they always wanted to co-operate whilst the defector continued to compete. See Table 6.1 for an illustration of the process using two players – a TFT and a permanent defector.

As Axelrod noted TFT won the tournament because it is

- Nice (a player starts out co-operatively and is not the first to defect)
- Provocable (a TFT player will punish defection quickly)
- Forgiving (a TFT player will act co-operatively again if their opponent signalled co-operation in period t – 1)
Table 6.1: Tit for Tat versus Permanent Defection

Assume that there are two players, a TFT player and a permanent defector. The payoffs are measured in £s and shown in Figure 6.9. The defector will always play defect. The TFT will play as outlined in the text.

![Payoff Matrix](image)

To see why TFT was so successful we shall play the game over 10 rounds (though the players won’t know this) using the Axelrod tournament rules. We will be Player 1 in Tables 6.1a and 6.1b below and play TFT. First, we play against a player (Player 2) who always defects (D) – this is the dominant strategy in a one shot game.

Table 6.1a

<table>
<thead>
<tr>
<th></th>
<th>Player 1 Tit for Tat</th>
<th>Player 2 Defect Strategy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Round 1</td>
<td>C           100</td>
<td>D                        400</td>
</tr>
<tr>
<td>Round 2</td>
<td>D           200</td>
<td>D                        200</td>
</tr>
<tr>
<td>Round 9</td>
<td>D           200</td>
<td>D                        200</td>
</tr>
<tr>
<td>Round 10</td>
<td>D          200</td>
<td>D                        200</td>
</tr>
<tr>
<td>Total Profits</td>
<td>1900</td>
<td>2200</td>
</tr>
</tbody>
</table>

In the next game we will play another TFT player (itself).

Table 6.1b

<table>
<thead>
<tr>
<th></th>
<th>Player 1 Tit for Tat</th>
<th>Player 3 Tit for Tat</th>
</tr>
</thead>
<tbody>
<tr>
<td>Round 1</td>
<td>C           300</td>
<td>C                    300</td>
</tr>
<tr>
<td>Round 2</td>
<td>C           300</td>
<td>C                    300</td>
</tr>
<tr>
<td>Round 9</td>
<td>C           300</td>
<td>C                    300</td>
</tr>
<tr>
<td>Round 10</td>
<td>C          300</td>
<td>C                    300</td>
</tr>
<tr>
<td>Total Profits</td>
<td>3000</td>
<td>3000</td>
</tr>
</tbody>
</table>

Now the firm playing a defector has to play against itself (a similar player).
Table 6.1 continued

Table 6.1c

<table>
<thead>
<tr>
<th></th>
<th>Player 2 Defect Strategy</th>
<th>Player 4 Defect Strategy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Round 1</td>
<td>D 200</td>
<td>D 200</td>
</tr>
<tr>
<td>Round 2</td>
<td>D 200</td>
<td>D 200</td>
</tr>
<tr>
<td>Round 9</td>
<td>D 200</td>
<td>D 200</td>
</tr>
<tr>
<td>Round 10</td>
<td>D 200</td>
<td>D 200</td>
</tr>
<tr>
<td>Total Profits</td>
<td>2000</td>
<td>2000</td>
</tr>
</tbody>
</table>

We can see that TFT wins in terms of the cumulative payoffs. The TFT player has cumulative payoffs of 4900 whilst the Defector player has payoffs of 4200.

The implication of the Prisoner’s Dilemma is that whilst players will compete against each other in one shot games, in repeated (multiple shot) games, where there is no knowledge of the length of the game, co-operation may lead to the development of a form of trust. This, of course, was an important determinant of organisational architecture in Chapter 4. However, Axelrod (1984) puts a different emphasis on the development of co-operation. He suggests that we need to

- Teach people to care about each other
- Improve recognition abilities and
- Teach reciprocity

But Axelrod is not an altruist. For Axelrod the foundation of co-operation is not really trust but the durability of a relationship in which we can elicit co-operation through the use of punishment for defection. We saw that TFT was a particularly successful strategy but it did suffer from fairly obvious problems, notably in one off games against defectors. However, studies have shown that TFT is a very high ranking strategy. Where there are a sufficient number of TFT players interacting with each other and with others playing different strategies Dawkins (1989) has convincingly argued that ‘Nice guys finish first’! However, there are situations where the population is made up largely of defectors and where TFT players hardly interact with each other. In such cases sub-optimal outcomes for the players can be expected. In these circumstances regulations may be put in place to elicit co-operation.

6.5. Partnerships and Alliances

We now have some quite substantive building blocks to apply game theory to the real world. There is more that can be stated but space and time constraints prevent an in-depth analysis. However, we can use and develop this framework to analyse how game theory might be used to explain a topical issue in strategic management, namely strategic alliances. We can only scratch the surface in analysing the types and rationale for alliances, which include mergers, equity and non-equity joint ventures, and public sector partnerships (see Johnson and Scholes, 1999, for some further analysis).

However, it is clear that these are classic ‘Prisoner Dilemma’ games. An alliance to supply a new and expensive product or service (or an existing service more effectively) would yield benefits to both parties but there are powerful forces to defect rather than cooperate. Clearly, we could rely on TFT strategies to establish co-operation but that could take a very long time. Some sectors such as the multimedia, entertainment and computing sectors are developing very rapidly. Moreover, the public and not-for-profit sectors are under political and public pressure to deliver services that cut across traditional organisational boundaries. Thus, whilst
punishment strategies such as TFT may be relevant other mechanisms can be employed to create and sustain alliances.

Many organisations from the public and private sector want to realise the enormous potential benefits from creating and sustaining strategic alliances but are aware that the risks could create ruin. International strategic alliances in new technologies might lead to sharing of the huge research and development costs, create new market opportunities, shape the future competitive environment and even reduce trade restriction costs if the alliance engages players in those parts of the world where neo-protectionist arguments circulate. It could also lead to a cross-fertilisation of technical knowledge but this may lead to knowledge loss and the very existence of an alliance could lead to the opportunistic behaviour by one or other of the parties to the exchange process as we noted in chapter 4. To overcome these problems many of the high-technology firms in fast moving sectors have developed a number of solutions including

- The establishment of Property Rights through the use of majority equity arrangements. For example a 51:49 share ownership overcomes some of the opportunism issues because on key strategic issues the majority owner has more votes.

- The use of contracts. As we noted in chapter 4 contracts can bind parties in to the exchange process because the aggrieved have redress to the courts. They also provide a framework in which respect and co-operation can develop. Again as we noted in chapter 4 the parties can make self-enforcing agreements to bind themselves to the exchange process. They can show commitment by allowing independent scrutiny of activities, perhaps through transparent accounting of the project.

The implication is that where the external environment is complex and dynamic the nature of information and knowledge about the transaction becomes more ambiguous. As a result the analysis of payoffs becomes problematic and the game theoretic solutions we sought in the earlier sections require greater mathematical sophistication. So game theory is not dead it is very alive but requires sophisticated analysis beyond the scope of this course.

We can conclude this analysis by examining one other resolution to the Prisoner’s Dilemma game of partnerships, the creation of incentives. The UK government has created a framework of laws that are to encourage the development of multi-agency-(public, private and voluntary sector) partnerships by only allowing funding for joint working on particularly difficult and inter-related socio-economic problems such as inner city housing, health and education, rising crime rates, poverty and unemployment. There is now an attempt toward a holistic approach, and talk is of ‘joined-up thinking’ and ‘joined-up policy’. For example, urban economic development initiatives such as City Challenge and the Single Regeneration Budget usually involve local authorities, the police force, Health Trusts and charitable organisations. The overall payoffs are in terms of targeted outcomes such as lower crime rates, lower levels of social exclusion, and the greater empowerment of local people who will be more involved in community-based regeneration initiatives and the management of the process. Sustainable social and economic regeneration is the key long-term goal.

The successful bids for urban regeneration funding have usually come from those areas where there has been a well established, relatively harmonious, set of working relationships among key agents within formal organisational structures (community-based bids have fared less well). However, some have noted how the initial provision of funding–led initiatives in urban regeneration is creating it’s own inter-organisational dynamic. Thus, the creation of formal partnerships through financial incentives from government may lead to the development of more ‘informal’ network structures in which social and economic relationships will flourish (Lowdnes et al, 1997). Transactions will then embody trust, co-operation and mutual advantage through the use of incentives rather than punishments.
6.6. Summary

In this chapter we have used game theory to explore the issue of interdependence in decision-making. We argued that it allowed us study the logic of the situation in a scientific manner. Further, we used game theory to explore some important and complex strategic issues. For the main part we examined the ‘Prisoner’s Dilemma’ game as a one-shot and as a repeated game. In particular we noted the importance of punishment strategies in resolving the Prisoner’s Dilemma game and to development of a form of trust. However, to facilitate a more in depth understanding of the strategic possibilities embodied in game theory to elicit co-operation we examined the strategic issue of partnerships in the private and public sector. Here we saw that information and knowledge asymmetries between the parties involved in the creation of alliances may resort to contractual devices to avoid opportunistic behaviour. Additionally, incentive systems can help to create trust in exchange.

Activity 6.2


Summarise the article in no more than 300 words and consider the following question:

To what extent are alliances, partnerships and networks important to your organisation and how effective are they? Try and use the language of transaction costs and game theory to guide your answer.

Post your findings on the discussion board.
Selected Reading (** = Key Reading)


CHAPTER 7
ORGANISATIONAL CHANGE AND LEARNING

7.1. Introduction: Aims and Learning Outcomes

In this chapter we will examine some important and recent developments in strategic management. In particular we will examine the work of Ralph Stacey (1996) and others who uses chaos and complexity theory to explore whether managers have control over the organisation. You’ll be glad to know that they do but that these new theories help us to think differently about the nature of control. We have to understand that organisations are complex adaptive systems and that emergent strategies (and the management of emergent strategies) become of paramount importance to establish new futures. In such a dynamic world where uncertainty prevails there is, we will argue, still a place for formal strategic planning but it needs to very sensitive to minute changes in external phenomena. Indeed, small changes have big impacts – the so-called ‘Butterfly Effect’.

The Butterfly Effect

To underpin the idea that little changes have big effects it has been suggested that when a butterfly flaps its wings in one part of the world it cause a hurricane to develop somewhere else. When watching a television programme about the weather with my family the subject of Chaos Theory began to be discussed. My eleven-year-old son asked what was Chaos Theory and I dutifully gave him the simplest example I knew, namely the ‘Butterfly Effect’. However, when I finished he exclaimed with some horror: ‘DOES THAT MEAN WE HAVE TO KILL ALL THE BUTTERFLIES?’ If he had used a sinister tone to announce this then perhaps he should be teaching this strategic management unit and not me!

In this chapter we are exploring how change processes may develop and how organisations might anticipate and react to such changes. The process is non-linear and the feedback loops plentiful. This naturally leads to a discussion of how organisations learn and to some consideration of the methods of managing organisational changes. The latter is dealt with in Johnson and Scholes (1999, chapter 11) and so is only briefly alluded to in this chapter. This will provide space for an introductory discussion of ‘chaos’ and ‘complexity’ in organisations and the concepts of ‘organisational learning’ and the ‘learning organisation’.

By following this chapter and the associated readings you will be able to

- Identify the concepts associated with Chaos and Complexity and Organisational Learning.
- Demonstrate critical awareness of dynamic environments and the impact that they have on the strategy development process.
- Critically examine the function of planning in a world of complexity and change.
- Critically consider the role of organisational learning in making organisations more proactive to their environments.
7.2 Organisations as Chaotic and Complex Systems

Most people learn about Chaos Theory from James Gleick’s popular book Chaos: Making a New Science (1987). Chaos Theory involves mathematical modelling of systems. It focuses on non-linear situations, that is situations where a change in one causal variable may lead to no response in the intended outcome, a dramatic response or a response only at various levels of the causal variable. This is very different to a linear response, i.e. where a change in a causal variable (say, x) leads to some proportionate change in the outcome variable (say, y). Marion (1999) uses the example of two dogs that approach each other and they are assumed to only have two emotions: fear and anger. He explains the difference between linear and non-linear responses thus:

“As two dogs approach each other, they may express anger at the intrusion of the other and bark furiously. A simple model of causality would predict that the anger of each dog would increase in proportion to the proximity of the other until a fight results. Non-linear theories argue that a fight is not a foregone conclusion; rather when the situation reaches a certain level of intensity, the emotional state of one dog may precipitously flip to fear, leading it to tuck tail and run. Fight or run: the outcome is sensitively dependent upon the precise state of each dog’s emotions, upon subtle nuances of interaction between the dogs, and between each dog and – goodness knows what.” (p.6)

Chaos theory tends to focus on systems that are mechanistic for example, the atmosphere and resulting weather patterns, and chemical reactions such as that present in fluid turbulence. Chaos arises where there are few variables influencing an outcome in a non-linear way. Chaotic systems respond to and magnify minute differences in initial conditions. They are therefore unpredictable over the long term. Where Chaos theory has dealt with living things it has been used to explain either the ‘physics’ of systems – the rise and fall of insect populations, the spread of disease, the rhythm of the heartbeat – or with the dynamics of change in populations and the stock market.

Complexity theory is more likely to be applied to social systems that are adaptive and open. Social systems are made up of living entities that carry information about themselves and their environments. They also learn from past behaviour and their interaction with others. Complex systems can become chaotic. Indeed, complexity is stated to be at the ‘edge of chaos’ (see Beinhocker, 1997; Marion, 1999; Stacey, 2000). However, complex systems are more stable than chaotic systems. This is true even though a complex social world has more variables that interact upon each other. Social beings adapt to changes because they have memories and can evolve (and human beings have the extra advantage of intelligence). Further, complexity theory is associated with evolution (of species and organisational forms) and with social phenomena such as self-organisation (see below).

So, although the terms Chaos and Complexity suggest that there is disorder or even anarchy, nothing could be further from the truth. Indeed, “despite all the unpredictability, coherent order always emerges out of the randomness and surface chaos” (Morgan, 1997, p.262). What managers’ see is emerging complex patterns within a complex world, much like scientists have seen fractal patterns in science. Chaotic and Complex systems have mathematical properties that have applicability to the organisation and change management. We avoid the Maths but present some of the main features below.
Follow up activity

We have avoided the Maths to try to demonstrate intuitively what chaotic and complex systems are about. Those interested can ask me for an excel spreadsheet with a simple logistic function that shows chaotic behaviour and bifurcation. You should also see the slide show presented by J C Sprott at http://sprott.physics.wisc.edu/lectures/complex/. This has examples of chaotic patterns from nature and the laboratory. You would also benefit from reading Gleick’s book (1987).

Feedback

An important feature of chaotic and complex systems is feedback. We have discussed feedback in relation to strategy formulation and performance management. However, this is negative feedback and linear in form. Negative feedback is the error correction type of feedback discussed in relation to cybernetic systems. It is a dampening mechanism that brings the system back to equilibrium. Chaos and complexity approaches emphasise positive feedback as well as dampening effects. Positive feedback takes the system away from equilibrium, for example: vicious and virtuous circles, bandwagon effects and chain reactions. Thus, in addition to negative effects there are amplification effects so that the system as a whole is non-linear.

Weick (1979) discusses positive and negative feedback effects during a meeting. The chair of a meeting may become less willing to intervene as participants begin to ‘horse around’. As the level of ‘horse play increases’ the chairs understanding of the meeting diminishes. As the chairs understanding diminishes his embarrassment rises and he becomes less willing to intervene. The meeting is becoming unstable because of positive feedback. However, there could be an offsetting (negative feedback) effect. Thus, as the horsing around increases so does the Chairs boredom. As boredom increases then the chairs willingness to intervene and participate increases. The willingness to comment cuts down on the horseplay. So there is a self-regulating loop that brings us back to equilibrium. Note that the system moves of its own accord, because of its non-linear feedback structure, from an unstable to a stable one.

Clearly, the time lag can have some important implications here. Morgan (1997) discusses ‘mad cow’ disease in the UK. He demonstrates that the positive feedback effects outweigh the negative (dampening) effects throughout the early years of the crisis. For example, the discovery in 1989 that the use of animal remains in cattle feed leads to cows having BSE starts off the positive feedback aspects of this system. Other facts also come to light: for example, evidence that the disease can be transferred to humans in the form of Creutzfeld-Jacob Disease; that Ministers and Civil Servants were slow to respond to the initial impact and that adverse media publicity developed. There are some dampening effects but they take a long time to take effect – for example, the mass slaughter of cattle, the introduction of a scheme to depict the history of every cow, and the announcement where an enquiry into the crisis in 1998. However, even at the time of writing (2000), there are fears of the crisis having similar effects in France.

Attractors

An important concept in chaos and complexity theory is that of ‘attractors’. Some attractors pull a system into equilibrium or near equilibrium; for example, as a result of negative feedback loops which counteract destabilising fluctuations. Other attractors flip a system into completely new configurations. The system is then pushed far from its original equilibrium point. These departures are bifurcation points.

The concept of the attractor can be explained in the following way. Imagine that your organisation has been engaged in a number of relatively successful ventures over recent times. You have built up a network of friendships, business contacts and a trusting relationship with regulators and the media. Your stakeholders seem happy with the way the
organisation is working. However, quite recently the organisation has embarked on a new venture, one that was characterised as having a higher level of risk than other activities. This venture was perceived necessary for future growth. It as launched on a wave of publicity and most commentators were optimistic about its success. However, the venture has involved large sunk costs. It is a capital-intensive project and absorbs greater than expected numbers of personnel. The income streams that are associated with the project are not forthcoming. Other activities are cross subsidising the venture and stakeholders start to voice concerns.

Here there are two attractors, the traditional activities and the new venture. Managers are being shifted between the two. The system may be flipped towards one or other of these attractors or into another (perhaps there is a fundamental re-organisation or alliance). The outcome depends on the balance of negative and positive feedback loops within the system, which may be, in turn, determined by factors such as experience, creativity, leadership or a random event like a change in regulation.

Self-Assessment Activity
Can you rationalise the concept of ‘Attractors’ and Bifurcation points for the meeting of the two dogs in the above quotation from Marion (1999)?

Self-organisation and Emergence

The following definition is a useful starting point.

“Self-organisation is a process in which the components of a system in effect spontaneously communicate with each other and abruptly cooperate in co-ordinated and concerted common behaviour”
Stacey (1997, p.330)

In complex systems self-organisation is symptomatic of evolutionary behaviour. That is, patterns form and re-form over and over again because of interaction within the species. Morgan (1997) adapts metaphors with biology to illuminate the concept. In Case 7.1 Morgan observes that apparently random behaviour by termites has led to the creation of termite hills. Each hill has a similar pattern but they are remarkably individual. Further, they were all built without a plan. There are lessons for managers in behaving like termites. A key issue for managers is therefore to allow emergence rather than prescription. Cybernetic controls can still exist but the trick is to create an environment of self-regulating behaviour to occur. Morgan (1997, p. 94 –100) cites Ouchi’s comparison between Japanese and American managers. The American view is that objectives should be precise and clearly stated for all to see. The Japanese view is that objectives emerge from a fundamental process of exploring and understanding the values through which an organisation should be operating. Thus, Japan was noted as being successful because managers were allowed space to explore innovative ways of dealing with situations.

Beware, however, Japan and other South East Asian ‘Tigers’ have undergone fundamental transformations of their economic position. They may well have been victims of positive feedback as predicted by Chaos theories.

Note also that, interaction via communicative self-organising behaviour does not always lead to positive outcomes. Anyone who has read Richard Dawkins book ‘The Selfish Gene’ (1989) will have noted that the Prisoner’s Dilemma game is a powerful tool in explaining the survival of species. But as we saw in the previous chapter, it offers some important insights in business and social relationships. Playing ‘Tit-for-Tat’ (TFT) strategies was seen to be a higher order strategy to ensure success for a population of individuals than playing a ‘nasty’ defection strategy. It is not strictly what biologists call an ‘Evolutionary Stable strategy’ because a population of ‘TFT’ individuals can be invaded by a mutant strategy with disastrous consequences. It cannot be invaded by a ‘nasty’ defect strategy but when ‘always cooperate’ individuals enter the population the consequences can become awkward for the population as
a whole. There will be no advantage gained by a population of TFT and ‘always cooperate’. However, the existence of the latter means that invasion by ‘nasty’ defectors will keep down the numbers playing nice strategies. Defectors will always win against players who ‘always cooperate’ and will win first round tournaments against TFT players. What we have is error-correction learning by TFT players but the system (population) as a whole starts to display some chaotic behaviour because of the invasion by ‘nasty defectors’. What sort of behaviour depends upon the initial population. If the initial population held only a few TFT players and co-operators and the rest were “nasty defectors” then co-operators would soon become extinct (because they would rarely meet TFT players or other co-operators) and TFT players would soon embrace defection too. Thus, the population has sub-optimal payoffs as everyone defects; co-operative behaviour backed up by TFT punishment offers far superior outcomes. The key then is to note the crucial balancing points in populations—these are the ‘knife edge’ situations or bifurcation points that can flip populations into unpredictable and inappropriate outcomes.

How can this be translated into the language of strategic management? Within organisations there are populations of individuals that make up departments, teams, divisions, and so on. If the organisation is over-populated with defectors, strategies have to be devised to ensure co-operation. Sometimes this will involve using incentive systems but it may also involve stronger measures such as re-structuring and the establishment of rules to ensure compliance. The use of inappropriate ‘sticks’ rather than appropriate ‘carrots’ could, of course, create positive feedback that could send an organisation to the brink of extinction. Within sectors there are populations of organisations that interact. The interaction is often competitive because that is the natural order of the system. However, there are plenty of situations where co-operation is required. Suppliers and buyers build up trust as the relationship lengthens and contracts become a backcloth to a transaction rather than a de facto instrument for punishing miscreants. There are also joint ventures and strategic alliances among private sector companies who actively compete in other products and services. They cooperate on common issues for mutual benefit, such as sharing the high costs of research and development. And, as we noted in previous chapters, there is co-operative behaviour among public sector bodies. In the past strict delineation of activities led to a culture where individual public sector bodies in the UK were reluctant to share resources with others, although the problems may have required a ‘joined-up solution’. Successive UK governments in the 1980s and 1990s established legislation tying funding to partnership among public, private and non-profit organisations. The result has been greater co-operation than in the past.

There are some important implications for managers from self-organisation and emergence. Clearly self-organisation is a natural process: it is an evolutionary process. It might be argued that managers should leave the system to its own devices but this would lead to random activity not the patterns exemplified by the mathematics of Chaos and Complexity. These patterns need to be understood by managers and acted upon not ignored. Managers need to understand where they are in the dynamic of the system. They require mechanisms that facilitate superior outcomes. The Japanese system of management cited above was a success but only for a time. Thus, care has to be taken to acknowledge when bifurcation points are approaching. We need to know where the knife-edge is in population distributions. There are times when managers need to allow space that facilitate emergence and other times when managers will have to intervene directly. This is a difficult balancing act.
Case 7.1

Strategic Termites: The Power of Self-Organisation

"Termite! Small, blind creatures related to the cockroach.
Creepy, crawly things that eat wood and make houses crumble.
Whenever I mention the possibility of becoming a "strategic termite" most managers seize on negative interpretations.
"You want us to eat away at the bureaucracy?"
"You're inviting us to become subversive?"
The metaphor, at first sight, does have these negative associations. But they're not the ones that I want to emphasise here. Subversive behaviour in an organisation tends to attract the exterminator. The person who seeks to create change by directly undermining existing policies and structures often runs into trouble. Create a hole in bureaucratic functioning one week, and chances are that next week the basic structure will be twice as strong as before. So let's redirect attention to some of the more positive aspects of termite behaviour, especially those exemplified in the processes through which termites build their nests and engage in mutually supporting activities.

Imagine a termite colony somewhere in the tropics. There are thousands of termites milling around.
The ground on which they start to build their nest is quite flat. The termites begin their work by moving earth in a random fashion. Gradually, distinct piles of earth begin to emerge. These then become the focus of sustained building activity, resulting in columns located in more or less random positions. These are built to a certain height, then construction stops. When columns emerge that are sufficiently close together, building resumes until they are joined at the top to form a rounded arch. In this way the termite nest evolves as an increasingly complex structure, with the arch as the basic unit. The approach eventually results in a kind of free-form architecture, comprised of interlocking caverns and tunnels that are ventilated, humidity-controlled and beautifully formed. African termite nests may rise twelve feet high and measure a hundred feet across. They can house millions of termites. In terms of scale, they're equivalent to human beings creating a building over a mile high.

Needless to say, the accomplishment has attracted the attention of many scientists. How do these blind creatures manage to produce such architectural masterpieces?

No one knows for sure.
A queen termite occupies a royal cell in the centre of the mound. It's suspected that she plays a crucial role in processes of communication within the colony. But if there's a plan or blueprint, where does it come from?

How do the termites direct and control their activity?

How do they co-ordinate their work?

How do they acquire the ability to repair parts of nests when they are destroyed, returning them to states that are as good as new?

There are lots of unresolved issues here. Instinct, habit and various forms of communication, play an important role. For example, the termites' deposits of saliva are believed to form important parts of their communication system. But one thing is clear. Termites don't build their nests like humans build houses and office towers. They don't follow predetermined plans.
One exciting theory emerging from the study of termite behaviour is that work in the termite colony reflects a self-organising process where order emerges "out of chaos." While the nest always has a familiar pattern, it is infinitely variable in terms of detailed form. It is impossible to predict the detailed structure in advance, because it emerges as a result of the scattered pattern of droppings. This is what makes the construction process so different from that of human beings. The "masterpiece" evolves from random, chaotic activities guided by what seems to be an overall sense of purpose and direction, but in an open-ended manner.

We have in this view of termite behaviour a splendid image for rethinking many aspects of the leadership process in human organisations. For example, it suggests that effective leadership or change management may not have to be based on a detailed strategic plan. It may not be something that has to be imposed. It may be something that can emerge and take form in a self-organising, evolutionary way.

In my research on the management of change I encounter many successful "strategic termites." They are managers who operate out of a strong sense of vision, while letting the detailed course of implementation emerge from the evolving situations being faced. "Strategic termites" are incremental and opportunistic in their approach to change. They build on ideas, actions and events that they create, or spontaneously come their way. They are strategic in the sense that, while their activity is open to the influence of random opportunity, decisions and actions are always informed and guided by a strong sense of what they are ultimately trying to achieve. They have "plans;" but they don't implement plans and are not constrained by plans. They are people who know where they would like to go. But they do not always know the route by which they're going to get there!

In this positive, expansive and free-ranging interpretation of termite-like behaviour, I believe there's an important message for people who wish to undertake leadership roles in turbulent times...."


Managing in the midst of Chaos

If Chaos and complexity are the natural order then systems are in a constant state of flux and transformation. Managing in the midst of such chaos, as we suggested above, is a delicate balancing act. Stacey (1997) suggests that we need to distinguish between ‘Ordinary and Extraordinary Management’

Ordinary Management, according to Stacey (2000), can be practised where the external environment is stable. Further, the system as a whole is seen to closed or contained and traditional management methods such as rational planning can be practised with appropriate cybernetic controls. In addition, individuals share the same mental models or paradigm. The existing paradigm goes largely unchallenged as forces from outside that try to ‘unfreeze’ the paradigm are rationalised within the existing state of affairs (see Johnson and Scholes, 1999, pp. 499 – 501, for a discussion of this). Clearly, this can lead to what was termed ‘Groupthink’ in Chapter 5. It is possible to challenge the existing paradigm through trial-and-error incrementalism but virtually by definition this is non-revolutionary for it takes time. The implication is that something more radical is required if an organisation is to succeed hence Extraordinary Management.

“Extraordinary management involves questioning and shattering paradigms and then creating new ones.....Extraordinary Management .. is the use of intuitive, political, group learning modes of decision making and self-organising forms of control in open-ended change situations. It is the form of management that managers must use if they are to change strategic direction and innovate." (Stacey, 1997, p72)
Further, Stacey notes that it is important that successful management requires an understanding of the organisation’s **shadow system**, which are the networks we discussed in chapter 4. These networks evolve in a self-organising way and are based on individuals “who share similar experiences and expectations, and take an interest in similar matters, who resent and try to offset the alienating, anomic and deskilling consequences of bureaucracy, [and who] form social groupings” (Stacey, 1997, p381). Networks can develop within departments, across departments and across organisations and are bound together by social and work relationships.

In addition Extraordinary Management involves an understanding of all those factors that we discussed in Chapters 4 and 5: including, relational contracts, tacit knowledge and organisational culture. The problem for Stacey is that in adopting a scientific approach, that of Chaos and Complexity, he needs to identify with the ‘art’ of change management. Stacey notes that extraordinary management requires partial intervention in the ‘shadow system’ and that such intervention should be flexible to encourage self-organisation and thus creativity. However, flexibility must occur within structures that are neither too loose nor too tight. Power and control must be decentralised but not lost. “All we can do is control the boundaries within which behaviour favourable to the emergence of an innovative choice might occur (p.465)”. So change management is a delicate balancing act.

This is a problem for all writers on strategic management. The insight offered by Stacey and others, such as Morgan, is that Chaos and Complexity are invaluable tools for assessing where the organisation is currently at and where it might be headed. The tools required to develop the organisation are plentiful (See Chapter 11 of Johnson and Scholes, 1999) but making them work in the desired way is another matter. In the management of organisational change there are no 100% correct fixes.

**What of Strategic Planning?**

According to Stacey vision and long term plans are fantasy defences against anxiety. Managers must focus on constantly changing agendas of strategic issues, challenges and aspirations that are detached from the constraints of vision. New strategic direction is indicated but can never be totally controlled. All managers can do is create an environment to facilitate innovative and emergent strategies. If the system is chaotic then perhaps we should reject planning and encourage organisational learning? There is some credence in this statement but planning is still important.

Phelan (1995) argues quite convincingly that Stacey’s argument that business is a complex system in a state of chaos is not only difficult to prove empirically but it ignores the existence of different sorts of complexity. Using the literature on complex adaptive systems Phelan argues that consistent patterns may emerge from the interaction of many elements under different rule sets. What this means is that whilst Chaotic and unpredictable patterns may exist there are examples from nature that show structures that have an order while retaining a capacity to change. These are, as we noted above, complex systems at the edge of chaos. In such states “strategic planning is still effective because stable conditions may prevail for protracted periods of time (Phelan p.8)”. However, the existence of instability requires the use of adaptive behaviour too – individuals (and organisations) have to change their behaviour as a result of interaction with each other and the environment. In short, organisational learning has to take place.
Activity 7.1

I want you to consider the following question: What is the role of planning in a world of complexity and chaos?

To get you started go to the following site and read the article on planning. http://www.vha.com/edgeplace/think/main_apptoc2.html

You will probably note that this emanates from a major site on Complexity Theory and Organisational Change, namely http://www.plexusinstitute.com/edgeware/archive/index.html. Take a tour of this site to see what you can learn about the concepts. You will also gain some insights from a paper by Phelan (1995). Also consult the other reading materials cited at the end and in the study schedule.

You are then to discuss your findings with your peers on the discussion board or via email.

7.3. Organisational Learning

The discussion of what constitutes appropriate methods for managing in the midst of complexity raises an issue that has been ‘bubbling under the surface’ throughout these chapters, that of organisational learning. In the opening chapter about planning and incremental strategy development we argued that feedback was an essential element of the strategy process. In addition, the discussion of topics such as scenario planning, core competences, organisational culture and strategic behaviour implies that individuals have gathered information, knowledge and understanding over time, that is, learning has taken place. The concept of organisational learning has been much discussed in the strategic management and organisational theory literature. We can distinguish Organisational Learning from the notion of a ‘Learning Organisation’. A Learning Organisation is an ideal towards which an organisation aspires. Organisational Learning is the activity and process by which organisations reach their ideal.

Organisational learning is noted as producing a number of benefits. It is seen as a pre-requisite for organisational survival (Cyert and March, 1963), a decrease in organisational errors (Weick and Roberts, 1993), improved decision making (Cangelosi and Dill, 1965) and an improvement in future performance (Fiol and Lyles, 1985).

However, there is no agreement as to what constitutes organisational learning and this has caused some consternation (Prange, 1992). Some describe the process of organisational learning (OL) in general terms. For example, Cyert and March (1963) describe OL in terms of the adaptive behaviour of the whole organisation to changes in the external environment over time through internal search. For Levitt and March (1988) organisations learn from their history by adapting their rules, procedures to suit environmental needs and so head towards higher aspiration levels. Duncan and Weiss (1979) define OL as a process within the organisation by which knowledge about action-outcome relationships and the effect of the environment on these relationships is developed. The individual is the only entity who can learn. However, there is collective learning as knowledge is shared, evaluated and integrated into the organisation.

We shall adopt the definition of Argyris and Schon (1978) who similarly judge OL through the sum of individual learning. It was they who introduced the concept of single loop and double loop learning (See Figure 7.1 for a distinction between the two). Single loop learning is about error correction in relation to a set of operating norms. Many organisations use single loop learning through their ability to scrutinise their environments, set objectives and monitor their performance. This type of learning is compatible with incremental developments in the environment. It is also self-fulfilling because the norms of the organisation go unchallenged.
Double loop learning “takes a double look at the situation by questioning the relevance of the operating norms” (Morgan, 197, p.87). For Stacey (2000) double loop learning is “partly the negative feedback learning about the consequences of actions but also the partly amplifying, positive feedback loop of questioning the underlying assumptions” (p.176)

**Steps**
- **Step 1**: the process of sensing, scanning and monitoring the external environment.
- **Step 2**: the comparison of this information against conventional norms.
- **Step 2a**: the questioning existing norms
- **Step 3**: Initiating appropriate action

Close the loop by beginning again at Step 1

*Figure 7.1 Single and Double Loop Learning*

Double loop learning is enforced upon organisations by external and internal pressures and no sector is exempt. Briefly consider the public sector. Privatisation has brought with it new regulations and competitive pressures that have forced public service organisations to re-examine the way services have been delivered. Competition from multinationals in all aspects of public service provision is now common place and these same companies are creating greater political pressure for further liberalisation within the public sector. Public service organisations are therefore facing a dilemma: competing against substantive private sector firms whilst retaining public service objectives.

As well as this external pressure public sector organisations are facing political forces for reform. There has been an ideological questioning of the legitimacy of state provision in general, a policy that has led to considerable ballot box success. As a result there has been a fragmentation of service provision as politicians have put pressure on public service providers to improve quality of service. In addition, nation states have transferred some of their decision-making power to supranational authorities. Bodies such as the IMF (International Monetary Fund) and WTO (World Trade Organisation) are putting further pressure on governments for further deregulation and privatisation of the public sector. Public sector bodies are therefore under internal pressure for reform from politicians and citizens.

In looking for ‘new ways’ of doing things in a dynamic environment public service organisations are embracing the concept of organisational learning. In a case study of the
Swiss Post Office, which is facing global competition from multinationals such as FedEx and DHL, Finger and Brand (1999) identify four stages of creating (double-loop) organisational learning in public service organisations. First, there is unlearning. This is where critical questioning of the dominant administrative and bureaucratic culture takes place and the main cultural obstacles to a learning organisation are identified. Second, there is conversion learning, that is where the organisation must turn to the customer and the market and learn from them. The customer is seen as important in determining quality and that employees must be converted to understanding the process of quality by training. Following conversion an important next step is continuous improvement. At this stage the organisation and its members must learn to continually improve themselves by adapting to the dynamic of the market and error correction learning. The final stage is the development of a learning culture that embraces a public service identity. At this point learning becomes an organisational principle. The first three stages provide an environment of flexibility and efficiency but this latter stage will add cohesion and identity.

For Finger and Brand organisational learning cuts across all strategic objectives including the creation of a ‘learning organisation’. Moreover some initiatives such as Management by Objectives, Total Quality Management and Business Process Reengineering may facilitate both organisational learning and the goal of the Learning Organisation. However, some initiatives may be detrimental. They cite the case of ISO certification which tended to cement hierarchical structures, reinforce administrative procedures and strengthen bureaucracy.

Organisational learning has many benefits but there are also costs. As ‘double loop learning’ is pervasive throughout the organisation it can have some potentially destabilising effects on individuals. They have to question their own, other individuals and shared group mental models, which can mean fears begin to develop, such as the fear of failing, of being embarrassed and embarrassing others. In these circumstances, individuals automatically develop defensive routines to deflect problems such that covert politics becomes influential. Further, double loop learning is usually associated with increased workloads for in challenging existing norms and encouraging creative thinking systems of accountability increase. Individuals can feel the stress associated with such developments.

Moreover, increases in bureaucracy and quality control systems are a cost that may deflect an organisation from its original purpose. Indeed, the possibilities of these costs may deter smaller organisations from entertaining creative developments. There is a further danger that the existence of ‘bounded rationality’ (due to informational incompleteness among individuals) can inhibit the development of double loop learning. This is particularly the case in organisations with strong hierarchical and divisional structures, where individuals occupy a pre-defined space, thereby inhibiting the flow of information and knowledge throughout the organisation.

So double loop learning has costs that have to be managed and yet it is also an important requirement for managing in the midst of complexity. To enable an organisation to engage in double loop learning successfully there needs to be

- A shared vision (Senge, 1990). Thus, at the corporate level, there must be a strategic commitment to learning and which everyone must feel ownership. Further, visions should be bound by a common aspiration that facilitates creativity through risk taking but is achievable.

- Appropriate organisational structures and systems (Morgan, 1997). Bureaucratic organisations have strong hierarchies that may prohibit information flows and thinking. Organisations need to encourage the ‘emergent’ organisation, that is create organisational designs that facilitate learning. In doing so organisations will enable individuals to bring their individual skills and expertise to bear on problems in a unique manner, a way not dictated to by a bureaucratic structure. Flatter, decentralised, team-based structures have greater flexibility and should therefore facilitate double loop learning.
There needs to be a blame free culture (Denton, 1998). The culture of the organisation needs to nurture, support and encourage the learning ability of individuals. Organisations need to encourage and value openness and accept that errors are inevitable, particularly as the organisation is subject to random shocks from the environment. By achieving openness and accepting errors the organisation may eliminate some of the problems which inhibit organisational learning (Morgan 1997).

Activity 7.2

Read the following article


Summarise its findings in no more than 300 words.

Look at the other on-line readings and consider the following question:

To what extent is your organisation engaged in effective learning?

Please respond to this latter question via the discussion board.

Summary

In this chapter we have explored two relatively new and important developments in the field of strategic management, chaos and complexity and organisational learning. We have demonstrated the principal concepts in a non-quantitative manner and noted that in the interaction between individuals (and organisations) with the environment stable and ordered patterns can, within predictable limits, emerge. In such a world there is scope for strategic planning. However, amidst this order there is a dynamic that creates for uncertainty. In such a world, double loop learning can help individuals and organisations break out of existing mental models of behaviour and create innovative solutions to organisational problems.
Reading (** = Key Reading)


