Positions, Activities and Organization:
An economist view of strategy from conception to implementation
Environment
Learning Curves

Japanese clocks & watches, 1962-72

UK refrigerators, 1957-71

Accumulated unit production
(millions)

Accumulated units
(millions)

1960 Yen

50K

100K 200K 500K 1,000K

15K

20K

30K

75%

70% slope

50 100 200 300

5 10

50

Source: Robert Grant
(too) Simple industry and firm analysis: BCG
## Long-term Profitability of US Industries: EVA 1986-97

<table>
<thead>
<tr>
<th>Industry</th>
<th>EVA</th>
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</thead>
<tbody>
<tr>
<td>Tobacco</td>
<td>9.4</td>
</tr>
<tr>
<td>Computer software &amp; services</td>
<td>5.9</td>
</tr>
<tr>
<td>Personal care products</td>
<td>2.8</td>
</tr>
<tr>
<td>Medical products</td>
<td>2.7</td>
</tr>
<tr>
<td>Printing &amp; advertising</td>
<td>(2.0)</td>
</tr>
<tr>
<td>Food processing</td>
<td>2.5</td>
</tr>
<tr>
<td>Drugs &amp; research</td>
<td>0.7</td>
</tr>
<tr>
<td>Beverages</td>
<td>0.2</td>
</tr>
<tr>
<td>Textiles</td>
<td>(0.1)</td>
</tr>
<tr>
<td>Fashion retailing</td>
<td>(0.4)</td>
</tr>
<tr>
<td>Building materials</td>
<td>(0.6)</td>
</tr>
<tr>
<td>Metals</td>
<td>(1.0)</td>
</tr>
<tr>
<td>Telecom services</td>
<td>(1.2)</td>
</tr>
<tr>
<td>Discount retailing</td>
<td>(1.2)</td>
</tr>
<tr>
<td>Semiconductors &amp; components</td>
<td>(1.3)</td>
</tr>
<tr>
<td>Paper and products</td>
<td>(1.5)</td>
</tr>
<tr>
<td>Broadcasting and publishing</td>
<td>(1.5)</td>
</tr>
<tr>
<td>Cars &amp; trucks</td>
<td>(1.5)</td>
</tr>
<tr>
<td>Healthcare services</td>
<td>(1.7)</td>
</tr>
<tr>
<td>Machine tools, hand tools</td>
<td>(1.7)</td>
</tr>
<tr>
<td>Appliances and home furnishings</td>
<td>(1.9)</td>
</tr>
<tr>
<td>Telephone equipment &amp; services</td>
<td>(2.1)</td>
</tr>
<tr>
<td>Plastics &amp; products</td>
<td>(2.6)</td>
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<tr>
<td>Computers &amp; peripherals</td>
<td>(3.1)</td>
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<tr>
<td>Electrical products</td>
<td>(3.3)</td>
</tr>
<tr>
<td>Aerospace &amp; defense</td>
<td>(3.3)</td>
</tr>
<tr>
<td>Railroads</td>
<td>(3.4)</td>
</tr>
<tr>
<td>Airlines</td>
<td>(4.1)</td>
</tr>
<tr>
<td>Steel</td>
<td>(6.4)</td>
</tr>
<tr>
<td>Cable television</td>
<td>(7.2)</td>
</tr>
<tr>
<td>Electronics</td>
<td>(9.2)</td>
</tr>
<tr>
<td>Average</td>
<td>(1.1)</td>
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</table>

Structure Conduct Performance

Market Structure → Firm Conduct → Firm Performance
Porter’s “Five Forces”

- Threat of New Entrants
- Bargaining Power of Suppliers
- Rivalry Among Competitors
- Bargaining Power of Buyers
- Substitutes
The Modern version (Brandenburger and Nalebuff)

- Regulatory / Policy
- Actual and Potential Rivals
- Suppliers
- Firm
- Buyers
- Complementors
The Modern version (Brandenburger and Nalebuff)

- Regulatory / Policy
- Actual and Potential Rivals
  - Strength of Rivalry
  - Proximity of Substitutes
  - Barriers to Entry
- Suppliers
- Firm
- Complementors
- Buyers
Environment, Positions
Environment (industry, Regulation)

Key success factors

Strategy

- Scope (where?)
- Competitive Advantage (how?)
Example 2: Rental car industry

How attractive is the environment where rental car companies operate?

- Suppliers
  - Airport!
    - (space, counter)
- Actual and Potential Rivals
  - Rivalry fierce (no differentiation)
  - Easy entry
- Firm
- Buyers
- Complementors

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Enterprise

• **Scope**
  – Replacement market/2\textsuperscript{nd} car
  – Local: garages/bodyshops/city corners

• **Competitive advantage**
  – Convenient
  – Friendly
  – Service/partner of garages
An update: Game Theory

Environment
(industry, Regulation)

Strategy
• Scope (where?)
• Competitive Advantage (how?)
### Pricing like a prisoner’s dilemma (players a and b)

<table>
<thead>
<tr>
<th></th>
<th>(b) confess</th>
<th>(b) deny</th>
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<tbody>
<tr>
<td>(a) confess</td>
<td>-10</td>
<td>-25</td>
</tr>
<tr>
<td>-10</td>
<td>-1</td>
<td>-3</td>
</tr>
<tr>
<td>(a) deny</td>
<td>-3</td>
<td>-3</td>
</tr>
</tbody>
</table>
Some insights

On market structure

depends on the extent to which endogenous sunk costs matter (Sutton)

e.g. Coke vs. Pepsi

On price competition

changing the game?
Environment, Positions, Organization
Recall

Assignment:

- design a firm that can implement the previous rental strategy
- service oriented, flexible
- convenient
- replacement (local segment)
- referral flow from garages
Environment (industry, Regulation) → Strategy
  - Scope (where?)
  - Competitive Advantage (how?) → Org. Design
Organizational Structure

People

Architecture

Ø Division of labor
Ø Hierarchy
1. Managerial decision rights and incentives
2. Unit Structure: Grouping units into subunits
3. Integrating Mechanisms

Culture
2. Hierarchy + Strategy

- Frequency
- Cost of training

Key principles:
- Solving versus asking
- Utilization of knowledge

What lower level can do
What he asks
Problems

LSE, October 2007
2. Hierarchy + Strategy

- Skills
- Type of technology
- Complexity
- Example: consultants

Frequency

Cost of training

What lower level can do

Problems
3. Decision Rights and Incentives

Complementarities between DR and incentives

Substitutions among efforts in tasks
  the danger of high powered incentives
  “you get what you pay for”
  measurability

example: FBI counterterrorism

Initiative Versus Coordination
3. Coordination vs Motivation

- Centralized DR: Low-powered, firm-wide incentives
- Decentralized DR: High-powered, divisional incentives

Motivation (or initiative/innovation)
4. Unit Structure and Strategy  

(with Dessein, Gertner)  

General principle:  

• Client units: adaptation  

• Operational units – shared resources: Synergies/cost savings  

Hybrid structures: communication out of unit critical– which limits incentives strength
5. Integrating Mechanisms

Rarely only one principle (e.g. functional vs. product) used

I. Hybrids: Functional principle at some level, business at another

II. Using specialized coordinators:
   One principle has priority, with coordinating devices: Teams, centers of excellence, and other intermediate coordination devices

III. Matrix: Both at the same time
Culture

(with Cremer, Prat)

• Knowledge–based
  – Codes/language… Shared Specific Human Capital
  Application: tradeoff between merger/stand alone
Culture and Incentives

• Incentives –based
  – Unforeseen contingencies: what constitutes acceptable behavior? What is undesired cheating that must be punished?

• High powered incentives
  – Use culture (relational contracts) to help control Multitasking (YGWYPF)

• Low Powered Incentives
  – Use culture (relational contracts) to substitute for direct, explicit incentives
Complementarities among tools

• Lots of peaks/partial optima
  – Non-convexities – gets worse before it gets better

• System-changes
  – Partial adjustment is useless or worse
  – Need to move multiple tasks

(leader needed! Vision, conviction…)
Back to Enterprise

• How would you implement it?
Application: Some thoughts on BP
Application: Some thoughts on BP

From strategy to organization

E&P- few interdependencies, measurable...
  high powered incentives

Process safety

  like counterterrorism, hard to measure, hard to measure
  consequences of mistakes (take years) easy to save on today…
Wholesale change?

True, complementarities exist

But can do better on existing structure

- Seggregate hard to measure tasks into separate job and hierarchy
- Use lower power incentives for those
- Rely on direct control/monitoring