The External Environment and Organizational Culture

" *The essence of a business is outside itself.* "

— Peter Drucker

LEARNING OBJECTIVES

After studying Chapter 2, you will be able to:

LO 1 Describe how environmental forces influence organizations and how organizations can influence their environments. p. 48

LO 2 Distinguish between the macroenvironment and the competitive environment. p. 48

LO 3 Explain why managers and organizations should attend to economic and social developments. p. 50

LO 4 Identify elements of the competitive environment. p. 55

LO 5 Summarize how organizations respond to environmental uncertainty. p. 63

LO 6 Define elements of an organization's culture. p. 72

LO 7 Discuss how an organization's culture affects its response to its external environment. p. 72

CHAPTER OUTLINE

Management Close-Up

In 1981, Bob Stiller began serving his coffee to customers in a tiny Vermont café. He was focused simply on giving them the highest-quality freshly roasted coffee at a reasonable price. As his Green Mountain Coffee Roasters (GMCR) formula caught on, however, nearby restaurants asked him to supply them with coffee and roasting equipment so that they, too, could serve the coffee. Before long, Stiller discovered that he was not only a retailer but a wholesale supplier as well.

The coffee's popularity grew. Ski-season visitors fell in love with Green Mountain coffee and asked if they could ship it home. Thus, GMCR's mail-order business was born.

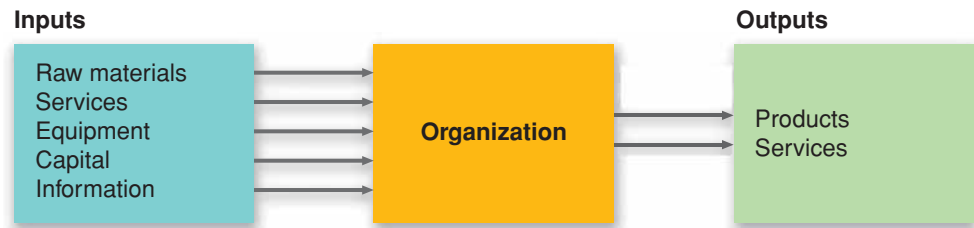Stiller wanted to keep growing his business, but he was limited by the times. In the 1980s, coffee was a commodity—something you drank when you ate your piece of pie or a donut. Not until the mid-1990s did coffee brewing became an art form, as the Starbucks-led coffee revolution began to sweep across America.

With the emergence of brands like Starbucks, Seattle's Best Coffee, Brothers, and Caribou Coffee, the industry became highly competitive and posed sizable barriers to those who wanted to enter it. To build and maintain retail coffee stores requires a significant monetary outlay, and in a field crowded with competitors, each retail outlet would need high-volume sales to be profitable. Entering the market that way wasn't a good option for Green Mountain Coffee Roasters. What could the company do to expand its growing brand and become a household name beyond New England?[1]

> Green Mountain Coffee Roasters started small but ultimately became a large enterprise selling its products through multiple channels. As you read this chapter, consider how this company grew by understanding not only its customers' needs but the needs of its external environment.

Inputs

Raw materials
Services
Equipment
Capital
Information

Organization

Outputs

Products
Services

FIGURE 2.1
Organization Inputs
and Outputs

open systems

Organizations that are affected by, and that affect, their environment.

LO 1

inputs

Goods and services organizations take in and use to create products or services.

outputs

The products and services organizations create.

external environment

All relevant forces outside a firm's boundaries, such as competitors, customers, the government, and the economy.

competitive environment

The immediate environment surrounding a firm; includes suppliers, customers, rivals, and the like.

macroenvironment

The general environment; includes governments, economic conditions, and other fundamental factors that generally affect all organizations.

As a coffee seller, Green Mountain Coffee Roasters does business all over the world. Its management must therefore keep a sharp watch on a broad spectrum of influences and events that can affect its operations. In this chapter, we discuss in detail how pressures from outside the organization help create the context in which managers and their companies must operate.

As we suggested in the first chapter, organizations are **open systems**—that is, they are affected by and in turn affect their external environments. For example, they take in **inputs** such as goods or services from their environment and use them to create products and services that are **outputs** to their environment, as shown in Figure 2.1. But when we use the term **external environment** here, we mean more than an organization's clients or customers; the external environment includes *all* relevant forces outside the organization's boundaries.

Many of these factors are uncontrollable. Companies large and small are buffeted or battered by recession, government interference, competitors' actions, and other factors. But their lack of control does not mean that managers can ignore such forces, use them as excuses for poor performance, and try to just get by. Managers must stay abreast of external developments and react effectively. Moreover, as we will discuss later in this chapter, sometimes managers can influence components of the external environment. We will examine ways in which organizations can do just that.

Figure 2.2 shows the external environment of a business organization. The organization exists in its **competitive environment,** which is composed of the firm and its rivals, suppliers, customers (buyers), new entrants, and substitute or complementary products. At the more general level is the **macroenvironment,** which includes legal, political, economic, technological, demographic, and social and natural factors that generally affect all organizations.

A Look Ahead

This chapter discusses the basic characteristics of an organization's environment and the importance of that environment for strategic management. We also examine the *internal environment*, or *culture*, of the organization and the way that culture may influence the organization's response to its environment. Later chapters elaborate on many of the basic environmental forces introduced here. For example, technology will be discussed again in Chapter 17. The global environment gets a thorough treatment in Chapter 6, which is devoted to international management. Other chapters focus on ethics, social responsibility, and the natural environment. Chapter 18 reiterates the theme that recurs throughout this text: organizations must change continually because environments change continually.

The Macroenvironment

LO 2

All organizations operate in a macroenvironment, which is defined by the most general elements in the external environment that potentially can influence strategic decisions. Although a top executive team may have unique internal strengths and ideas about its goals, it must consider external factors before taking action.
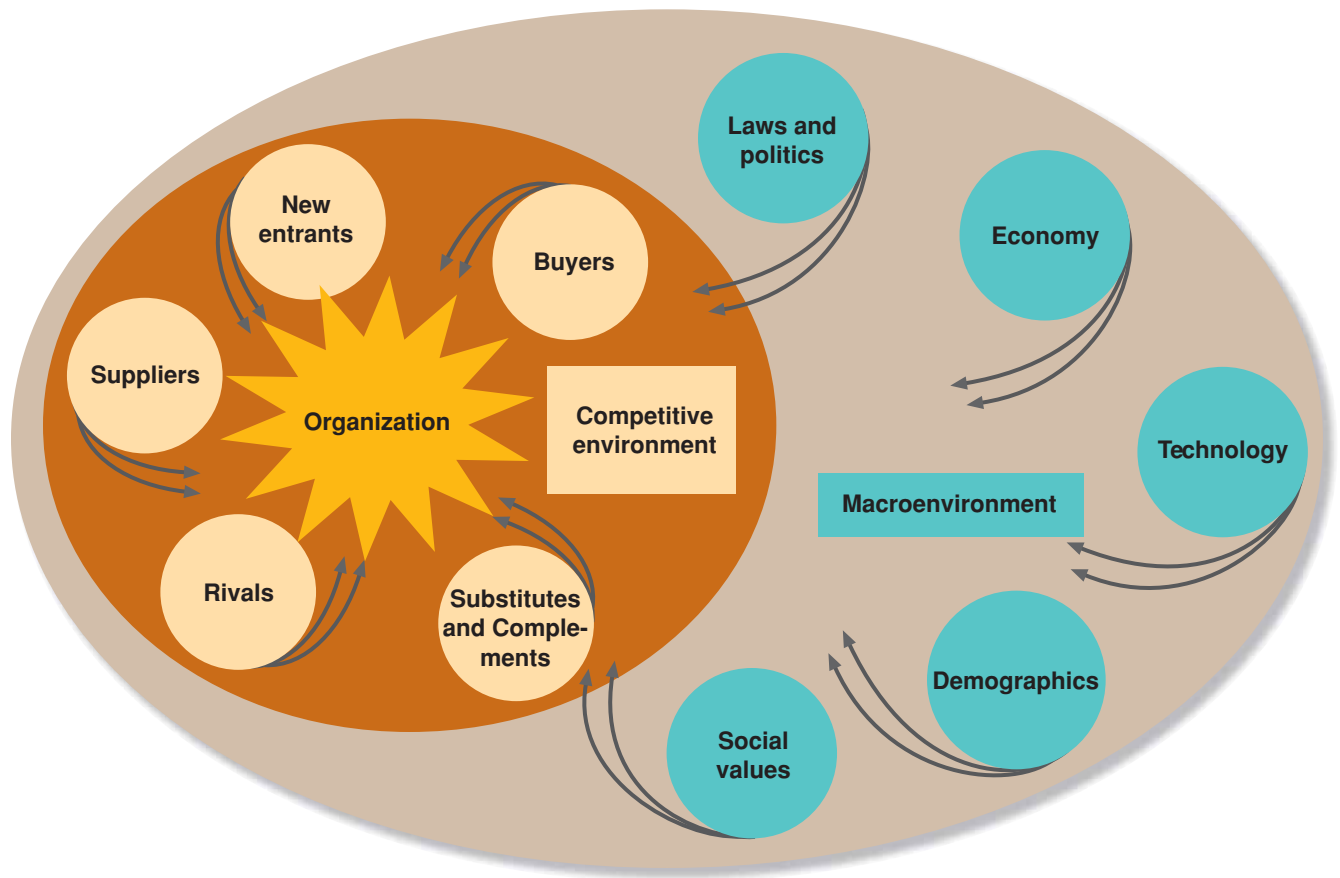
Laws and Regulations

U.S. government policies impose strategic constraints on organizations but may also provide opportunities. For example, the Library of Congress's Copyright Royalty Board recently alarmed Internet radio companies when it changed its regulations setting the royalty payments these companies owe recording companies and artists. Webcasters had been paying royalties computed as a percentage of their earnings, and because companies like AccuRadio are relatively young and have only begun turning a profit, that arrangement kept costs down. The new regulations would impose a flat fee each time a song is played. AccuRadio complained that this change would raise its annual royalty cost from less than $50,900 to about $600,000 a year—far more than its profits and nearly equal to its entire revenue. Even big Webcasters like RealNetworks and AOL Radio said if the ruling stands, the fees would force them to substantially cut back their offerings. Some companies would benefit from the change, however. Broadcast radio stations pay royalties only to the composers of the songs they play, so they would have an advantage relative to fast-growing but smaller online radio stations. And recording companies would receive more revenue from the new arrangement.[2]

The government can affect business opportunities through tax laws, economic policies, and international trade rulings. An example of restraint on business action is the U.S. government's standards regarding bribery. In some countries, bribes and kickbacks are common and expected ways of doing business, but for U.S. firms they are illegal practices. Some U.S. businesses have, in fact, been fined for using bribery when competing internationally. But laws can also assist organizations. Because U.S. federal and state governments protect property rights, including copyrights, trademarks, and patents, it is economically more attractive to start businesses in the United States than in countries where laws and law enforcement offer less protection.

Regulators are specific government organizations in a firm's more immediate task environment. Regulatory agencies such as the Occupational Safety and Health Administration (OSHA), the Interstate Commerce Commission (ICC), the Federal Aviation Administration (FAA), the Equal Employment Opportunity Commission (EEOC), the National Labor Relations Board (NLRB), the Office of Federal Contract Compliance Programs (OFCCP), and the Environmental Protection Agency (EPA) have the power to investigate company practices and take legal action to ensure compliance with laws.

The Securities and Exchange Commission (SEC) regulates U.S. financial markets. Its regulations are intended to protect investors. For instance, the SEC recently proposed regulations requiring companies to disclose more details about the total compensation paid to executives, including deferred compensation (pensions, severance pay) and perks (such as free housing and personal use of a corporate jet). The objective of the regulations would be to help investors in a company evaluate whether executives are being compensated at an appropriate level.[3]

Another example of a regulatory body is the Food and Drug Administration (FDA), which can prevent a company from selling an unsafe or ineffective product to the public. Following recent highly publicized incidents of illness from people who ate tainted peanuts, lettuce, spinach, and green onions, the FDA came under pressure to tighten its regulations for food safety.

Often the corporate community sees government as an adversary. However, many organizations realize that government can be a source of competitive advantages for an individual company or an entire industry. Public policy may prevent or limit new foreign or domestic competitors from entering an industry. Government may subsidize failing companies or provide tax breaks to some. Federal patents protect innovative products or production process technologies. Legislation may be passed to support industry prices, thereby guaranteeing profits or survival. The government may even intervene to ensure the survival of certain key industries or companies, as it has done to help auto companies, airlines, and agricultural businesses.

> The U.S. Department of Commerce's Trade Advocacy Center, at www.export.gov/advocacy/, was established to help U.S. businesses overcome hurdles that make it difficult for them to export goods or compete against foreign firms.

LO 3   The Economy

Although most Americans think in terms of the U.S. economy, the economic environment for organizations is much larger—created by complex interconnections among the economies of different countries. Wall Street investment analysts begin their workday thinking not just about what the New York Stock Exchange did yesterday but also about how the London and Tokyo exchanges did overnight. Growth and recessions occur worldwide as well as domestically.

The economic environment dramatically affects managers' ability to function effectively and influences their strategic choices. Interest and inflation rates affect the availability and cost of capital, growth opportunities, prices, costs, and consumer demand for products. Unemployment rates affect labor availability and the wages the firm must pay, as well as product demand. Steeply rising energy and health care costs have had a great effect on companies' ability to hire and their cost of doing business. Changes in the value of the dollar on world exchanges may make American products cheaper or more expensive than their foreign competitors.

An important economic influence is the stock market. When investors bid up stock prices, they are paying more to own shares in companies, which means the companies have more capital to fuel their strategies. Observers of the stock market watch trends in major indexes such as the Dow Jones Industrial Average, Standard and Poor's 500, and Nasdaq Composite, which combine many companies' performance into a single

$ **The bottom line**
COST

With increased competition from foreign and domestic companies, managers must pay particular attention to cost.

Economic forces have caused the fortunes of corn-based ethanol producers to swing wildly. For a time, soaring gasoline prices intensified the demand for alternative fuel sources for automobiles. That fact, coupled with a belief that ethanol fuel would reduce emissions of greenhouse gases, inspired the U.S. government to mandate the use of ethanol. Farmers responded by planting more corn, and energy companies built ethanol refineries.

But soon other forces pummeled the ethanol producers. First, flooding in the Midwest led to forecasts of high corn prices, and many ethanol producers tried to protect themselves by signing contracts for a generous $7 and more per bushel. Then fields dried and prospects for a good harvest improved, so corn prices started falling, leaving producers with contracts for overpriced corn.

More recently, the economy swung downward. A "bubble" of inflated real estate prices burst, contributing to problems for mortgage lenders that quickly spread to the entire financial industry. As credit dried up, the overall pace of business slowed dramatically, and oil prices fell, erasing some of ethanol's competitive advantage in the marketplace for fuel. But prices for corn also fell, keeping production costs down. Ethanol producers are hopeful that in the long run, drivers will need to rely more and more on alternative fuels. Meanwhile, ethanol companies need steady and farsighted management to guide them through the ups and downs of commodity prices and demand.[4]

The recent economic woes in America have spurred the government to enact new laws to help lift the financial burden off of the shoulders of individuals and businesses that are struggling. Shown here is President Barack Obama signing the economic stimulus bill, as Vice President Joe Biden looks on. What affect do you think this bill will have on the economy?

measurement. Figure 2.3 shows how two of these indexes performed over a year's worth of trading. They are measured against their price level at the beginning of the period, set at an index value of 100. Both indexes had risen to great heights at the beginning of the period, and then they dropped rapidly during the autumn months. The falling prices reflected an economy in which demand for homes and cars had shriveled, credit was difficult to obtain, exports tumbled, and unemployment rates soared.[5] Lower stock values coupled with tight credit made it hard for most businesses to find capital for expansion and innovation. Governments launched a variety of stimulus efforts to help companies get financing and to encourage consumers to start spending again. Stock markets have always rebounded eventually, even after a steep decline such as this one, as investors see hope for renewed business growth.

The stock market may also have a profound effect on the behavior of individual managers. In publicly held companies, managers throughout the organization may feel required to meet Wall Street's earnings expectations. It is quite likely that you, too, at some point in your career, will be asked to improve a budget or estimate because your company does not want to disappoint "the Street." Such external pressures usually have a very positive effect—they help make many firms more efficient and profitable. But failure to meet those expectations can cause a company's stock price to drop,
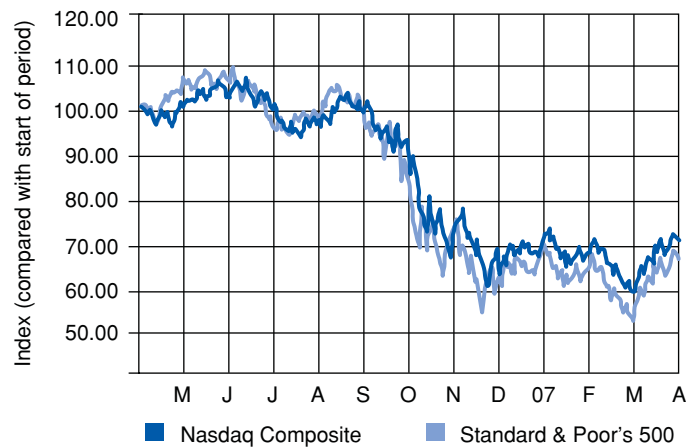
FIGURE 2.3
Twelve-Month Comparison
of Stock Markets

SOURCE: www.nasdaq.com.

making it more difficult for the firm to raise additional capital for investment. The compensation of managers may also be affected, particularly if they have been issued stock options. The net effect of these pressures may sometimes be that managers focus on short-term results at the expense of the long-term success of their organizations. Even worse, a few managers may be tempted to engage in unethical or unlawful behavior that misleads investors.[6] We will discuss managerial ethics in Chapter 5 and stock options in Chapter 10.

Economic conditions change over time and are difficult to predict. Bull and bear markets come and go. Periods of dramatic growth may be followed by a recession. Every trend undoubtedly will end—but when? Even when times seem good, budget deficits or other considerations create concern about the future.

Technology

Today a company cannot succeed without incorporating into its strategy the astonishing technologies that exist and continue to evolve. Technological advances create new products, advanced production techniques, and better ways of managing and communicating. In addition, as technology evolves, new industries, markets, and competitive niches develop. For example, early entrants in biotechnology are trying to establish dominant positions, while later entrants work on technological advances that will give them a competitive niche. Advances in technology also permit companies to enter markets that would otherwise be unavailable to them, such as when cable TV companies adapted their technology to enter the market for Internet services.

> **The bottom line**
> **SPEED**
> Managers with ready access to information gain a significant competitive edge.

New technologies also provide new production techniques. In manufacturing, sophisticated robots perform jobs without suffering fatigue, requiring vacations or weekends off, or demanding wage increases. New methods, such as injecting steam into oil fields at high pressure, are enabling Shell, ExxonMobil, and other oil companies to extract that valuable resource from locations that had once been considered depleted. In this case, technological and economic forces overlap: the rising price of oil has made it worthwhile for companies to develop and try the new technology.[7]

In addition, new technologies provide new ways to manage and communicate. Computerized management information systems (MISs) make information available when needed, and networking via the Internet makes it available where it is needed. Computers monitor productivity and note performance deficiencies. Telecommunications allow conferences to take place without requiring people to travel to the same location. Such technological advances create innovations in business. Strategies developed around the cutting edge of technological advances create a competitive advantage; strategies that ignore or lag behind competitors' technology lead to obsolescence and extinction. This issue is so important that we devote an entire chapter (Chapter 17) to the topic.

Demographics

Demographics are measures of various characteristics of the people who make up groups or other social units. Work groups, organizations, countries, markets, and societies can be described statistically by referring to demographic measures such as their members' age, gender, family size, income, education, occupation, and so forth.

Managers must consider workforce demographics in formulating their human resources strategies. Population growth influences the size and composition of the labor force. In the decade from 2004 to 2014, the U.S. civilian labor force is expected to grow at a rate of 10 percent, reaching 162.1 million.[8] This growth is slower than during the previous decade, partly because young workers—those between the ages of 16 and 24—are declining in numbers. The fastest-growing age group will be workers who are 55 and older, who are expected to represent more than one-fifth of the labor force in 2014. What does this mean for employers? They will need to find ways to retain and fully use the talents of their experienced workers while competing for relatively scarce entry-level workers. They may find that many of their older employees are willing to work past the traditional retirement age of 65; one reason is that research suggests that a lack of pensions and adequate savings will make retirement unaffordable for many of today's baby boomers.[9] Eventually, however, declining participation in work by older persons will require managers to find replacements for these highly experienced workers.

The education and skill levels of the workforce are another demographic factor managers must consider. The share of the U.S. labor force with at least some college education has been increasing steadily over the past several decades, from less than one-fourth of the workforce in 1970 to more than half today.[11] Even so, many companies find that they must invest heavily in training their entry-level workers, who may not have been adequately prepared for some of the more complex tasks the modern workplace requires. (We discuss training in greater detail in Chapter 10.) Also, as college has become a more popular option, employers are finding it difficult to recruit employees for jobs that require knowledge of a skilled trade, such as machinists and toolmakers, especially in areas where the cost of living is so high that most residents are professionals.[12] However, as education levels improve around the globe, more managers find they are able to send even technical tasks to lower-priced but highly trained workers overseas, which we discuss further in Chapter 6.

Another factor that significantly influences the U.S. population and labor force is immigration. Immigrants accounted for approximately 40 percent of the U.S. population growth recently, a trend that has an important impact on the labor force.[13] Immigrants are frequently of working age but have different educational and occupational backgrounds from the rest of the labor force. Immigration is one reason the labor force in the future will be more ethnically diverse than it is today. The biggest percentage employment increases will be by Asian Americans and Hispanic populations, followed by African Americans. The demographic importance of immigration intersects with legal issues governing who is permitted to work in the United States. For example, the federal government has recently cracked down not only on undocumented workers but also on the managers who hired them. Other companies have asked the government to admit more foreign workers with technical expertise that may be hard to find in the United States.

demographics

Measures of various characteristics of the people who make up groups or other social units.

Will the next generation of workers change the way we work? Researchers found that teens studying at their computers are also doing something else 65 percent of the time, and 26 percent of teens use several media at once. A study of multitasking and brain activity found that we use different parts of the brain when we multitask while learning. Multitaskers used the part of the brain involved in repetitive skills, while those engaged only in learning used the area associated with memory.[10] Will this influence future managers' ability to think deeply about problems?
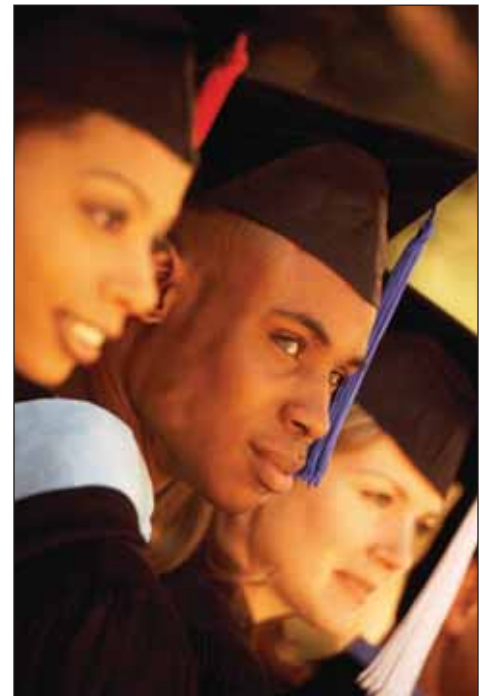
As the number of people in the workforce with a college education increases, managers must consider how this impacts their work.

Since the last quarter of the 20th century, women have joined the U.S. labor force in record numbers. Throughout the 1970s and 1980s, they became much more likely to take paying jobs. In the 1970s, only about one-third of women were in the labor force, but 60 percent had jobs in 1999. Since then, women's labor force participation rate has stayed near that level, declining only slightly. Women's participation contrasts with a participation rate of 73 percent for men, projected to decline to 70 percent by 2020, when a larger share of U.S. adults have retired.[14]

A more diverse workforce has many advantages, but managers have to make certain they provide equality for women and minorities with respect to employment, advancement opportunities, and compensation. They must make strategic plans to recruit, retain, train, motivate, and effectively utilize people of diverse demographic backgrounds who have the skills to achieve the company's mission. We discuss the issue of managing the diverse workforce in detail in Chapter 11.

Social Issues and the Natural Environment

Societal trends regarding how people think and behave have major implications for management of the labor force, corporate social actions, and strategic decisions about products and markets. For example, during the 1980s and 1990s women in the workforce often chose to delay having children as they focused on their careers, but today more women are having children and then returning to the workforce. As a result, companies have introduced more supportive policies, including family leave, flexible working hours, and child care assistance. Many firms also extend these benefits to all employees or allow them to design their own benefits packages, where they can choose from a menu of available benefits that suit their individual situations. Domestic partners, whether they are in a marital relationship or not, also are covered by many employee benefit programs. Firms provide these benefits as a way of increasing a source of competitive advantage: an experienced workforce.

A prominent issue today pertains to natural resources: drilling for oil in formerly protected areas in the United States. Firms in the oil industry face considerable public opinion both in favor of preserving the natural environment and against the country's dependence on other countries for fuel. The protection of the natural environment is so important in managerial decisions that we devote Appendix C following Chapter 5 to that subject.

How companies respond to these and other social issues may also affect their reputation in the marketplace, which in turn may help or hinder their competitiveness. The public health issue of childhood obesity has given videogames a bad name among those who advocate for children to get off the couch and get more exercise. But two games have generated favorable publicity: Konami's Dance Dance Revolution (DDR), where players compete with dance moves, and Nintendo's Wii Sports, where players swing a remote control containing motion sensors to move a virtual tennis racket, bowling ball, baseball bat, or boxing gloves. The games have also been praised as an alternative to the violent themes of many games. Dean Bender, the public relations agent for DDR, said of his client, "With all the bad PR about violence, we became the white knights."[15] And Wii Sports players have reported breaking into a sweat and even straining muscles.[16] However, one side effect of that vigorous play with the Wii system was a safety hazard. The company's first wrist straps for the remote controls occasionally broke. But within weeks, the company began replacing the straps with a stronger version at no charge, a rapid response that cemented customer satisfaction more than the defect harmed Nintendo's reputation.[17]

The Competitive Environment

All managers are affected by the components of the macroenvironment we just discussed. But each organization also functions in a closer, more immediate competitive environment. The competitive environment includes the organizations with which the organization directly interacts. As shown in Figure 2.4, the competitive environment includes rivalry among current competitors and the impact of new entrants, substitute and complementary products, suppliers, and customers. This model was originally developed by Michael Porter, a Harvard professor and a noted authority on strategic management. According to Porter, successful managers do more than simply react to the environment; they act in ways that actually shape or change the organization's environment. In strategic decision making, Porter's model is an excellent method to help managers analyze the competitive environment and adapt to or influence the nature of their competition.

Competitors

Among the various components of the competitive environment, competitors within the industry must first deal with one another. When organizations compete for the same customers and try to win market share at the others' expense, all must react to and anticipate their competitors' actions.

The first question to consider is: Who is the competition? Sometimes the answer is obvious. The major competitors in the market for videogame consoles are Sony (whose brand is the PlayStation), Microsoft (Xbox 360), and Nintendo (maker of the Wii). However, if organizations focus exclusively on traditional rivalries, they miss the emerging ones. Coca-Cola and PepsiCo are obvious competitors, but consumer tastes have shifted away from soda to bottled water and other beverages. The two companies have had to compete in introducing new products, not just in winning consumers over to their brand of cola.

Thus, as a first step in understanding their competitive environment, organizations must identify their competitors. Competitors may include (1) small domestic firms, especially their entry into tiny, premium markets; (2) strong regional competitors; (3) big new domestic companies exploring new markets; (4) overseas firms, especially those that either try to solidify their position in small niches (a traditional Japanese tactic) or are able to draw on an inexpensive labor force on a large scale (as in China); and (5) newer entries, such as firms offering their products on the Web. The growth

The bottom line
Innovation

Companies often compete through innovation, quality, service, and cost. We will discuss the issue of competitors and strategy in further detail in Chapter 4.
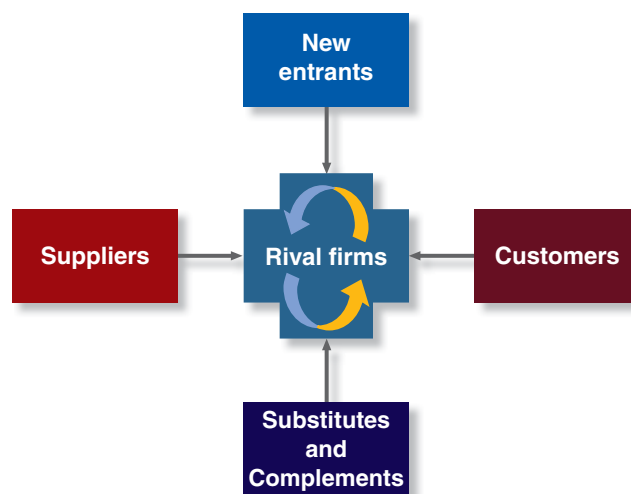
FIGURE 2.4
The Competitive Environment

in competition from other countries has been especially significant in recent years, with the worldwide reduction in international trade barriers. For example, the North American Free Trade Agreement (NAFTA) sharply reduced tariffs on trade between the United States, Canada, and Mexico. Managers today confront a particular challenge from low-cost producers abroad (see Chapter 6).

Once competitors have been identified, the next step is to analyze how they compete. Competitors use tactics such as price reductions, new-product introductions, and advertising campaigns to gain advantage over their rivals. In the market for videogame consoles, Sony had been a leader and was expected to maintain its dominance when it launched its powerful PS3 model, choosing a technology-based strategy. The PS3 is a technological marvel, which by one account combines "the [processing] speed of a low-end supercomputer with the [component] cooling techniques of a network server" (a high-end computer used to handle the needs of a network of personal computers).[18] Rather than using an existing processor, Sony tapped the expertise of suppliers to develop a new processor and interface. The system generates so much power that engineering teams had to bring in a special team of designers to simulate the air flow with various cooling designs and figure out how to arrange the microchips within the box to keep the whole system from melting down. In addition, Sony's engineers developed a high-definition display, with graphics so detailed that software engineers had to calculate the motions of the game's activities very precisely. If something in a game bounces or breaks, the software must show it moving as the laws of physics would in the real world. These advances generated a lot of excitement—and a high cost. By one estimate, making a top-of-the-line PS3 costs Sony about $840.

It's essential to understand what competitors are doing when you are honing your own strategy. When Sony launched its PS3, it couldn't charge a high enough price to cover its costs. It set the price at $599, which was still far above its competitors. The Xbox 360, which had been on the market for a year, was a less-advanced but comparable product selling for $399. But Nintendo became a surprise winner in the initial competition with PS3 by choosing an entirely different strategy for its Wii. Rather than competing on the basis of advanced graphics and powerful processing, the company chose to offer something new and easy to use—its remote-control motion sensors instead of buttons and knobs. A Wii console costs just $249. While the PS3 and

Nintendo's Wii video game console has been outselling its competitors due to its extremely competitive pricing strategy. Shown here is a young man playing the popular golf simulation game.

Wii both flew off store shelves in the early weeks of the products' launch, PS3 sales over the next few years continually fell below expectations, while Wii became the top-selling game console in the United States. In fact, PS3 fell to *fourth* place in game console units sold, behind the older-generation PS2, which became Sony's lower-priced—and therefore more popular—alternative.[19]

Competition is most intense when there are many direct competitors (including foreign contenders), when industry growth is slow, and when the product or service cannot be differentiated in some way. New, high-growth industries offer enormous opportunities for profits. When an industry matures and growth slows, profits drop. Then, intense competition causes an industry shakeout: Weaker companies are eliminated, and the strong companies survive.[20] We will discuss the issue of competitors and strategy in further detail in Chapter 4.

New Entrants

New entrants into an industry compete with established companies. Wireless telephone advances brought many new competitors into an industry where only a handful of landline companies had operated. Phone companies were further challenged when cable and satellite services began offering consumers attractive packages for broadband Internet services, instead of dial-up or DSL connections. More recently, the introduction of WiMax is poised to shake up cell phone and Internet carriers again. WiMax, which can deliver citywide wireless Internet access and fast download speeds, lets cell phone and computer users go online without hunting for a Wi-Fi hotspot, much less a cord.[21]

If many factors prevent new companies from entering an industry, the threat to established firms is less serious. If there are few such **barriers to entry,** the threat of new entrants is more serious. Some major barriers to entry are government policy, capital requirements, brand identification, cost disadvantages, and distribution channels. The government can limit or prevent entry, as occurs when the FDA forbids a new drug entrant. Some industries, such as liquor retailing, are regulated; more subtle government controls operate in fields such as mining and ski area development. Patents are also entry barriers. When a patent expires, other companies can then enter the market. For example, the patents have recently expired on several drugs made by Pfizer, including antidepressant Zoloft, allergy medicine Zyrtec, and blood pressure medicine Norvasc. At the same time, several research projects to introduce new, patented medicines have failed, so Pfizer was forced to lay off employees and close some facilities to cut costs.[22]

Other barriers are less formal but can have the same effect. Capital requirements may be so high that companies won't risk or try to raise such large amounts of money. Brand identification forces new entrants to spend heavily to overcome customer loyalty. Imagine, for example, the costs involved in trying to launch a new cola against Coke or Pepsi. Or as the *BusinessWeek* box describes, Google's entry into the market for business software surprised many people because Microsoft has dominated that segment for many years. The cost advantages established companies hold—due to large size, favorable locations, existing assets, and so forth—can also be formidable entry barriers.

Finally, existing competitors may have such tight distribution channels that new entrants have difficulty getting their goods or services to customers. For example, established food products already have supermarket shelf space. New entrants must displace existing products with promotions, price breaks, intensive selling, and other tactics.

Substitutes and Complements

Besides products that directly compete, other products can affect a company's performance by being substitutes for or complements of the company's offerings. A *substitute* is a potential threat; customers use it as an alternative, buying less of one kind of product but more of another. A *complement* is a potential opportunity because customers

barriers to entry

Conditions that prevent new companies from entering an industry.

Google Steps into Microsoft's Office

Greg Brandeau is itching to dump the decade-old homegrown e-mail system he manages at Pixar Animation Studies Inc. And the senior vice president for technology at the Walt Disney Company unit is sure about one thing: The replacement won't be Microsoft Corporation's Exchange and Outlook duo, whose e-mail, calendar, and other programs dominate corporate computing. Brandeau says it's difficult to manage the software because Pixar uses a variety of computers. His likely choice may surprise you: Google.

After months of dancing around with Web versions of e-mail, group calendars, and the like, Google is finally about to take a big leap onto Microsoft's turf. Since August 2006, the search leader has offered a test version of an online office productivity software suite, called Google Apps for Your Domain, that lets companies offload e-mail systems to Google while keeping their own e-mail addresses. Soon, it's expected to add word-processing and spreadsheet services to the suite, which includes an online calendar, chat service, and Web page builder. In coming weeks, Google Apps will turn into a real business as Google begins charging corporations a subscription fee amounting to a few dollars per person per month. "We're dying to use something like this," says Brandeau. He's "on the cusp" of signing a contract with Google.

For now, Microsoft has little to fear. Many large corporations are wary of having an e-mail system run outside their own walls, where they can't be sure it's secure from hackers and spies. And even Google concedes its services don't have all the bells and whistles of Microsoft's products, such as centralized e-mail backups that help them comply with regulatory rules. "We're not looking to make it us vs. them," swears Dave Girouard, vice president in charge of Google's enterprise group. "We're giving people choices." Still, his 300-person group's very existence—plus Microsoft's stated aim to extend its Office franchise to the Web—suggests that before long these two titans of tech will be battling over many of the same corporate customers.

Google's game is clearly different from Microsoft's. Its new thrust represents a dawning era in corporate computing: software delivered as a service over the Internet, so it's accessible anywhere there is a Web browser handy. This time consumers are leading the way as they flock to Web-based applications such as e-mail, chat, and phone services like eBay's Skype Technologies.

As traditional corporate software has grown complex and expensive to maintain, Web services are getting more capable and reliable every year. "For the first time, consumer-grade applications are good enough that they can be used by enterprises," says Douglas Merrill, a Google vice president for engineering.

It's a testament to Google's popularity that even though Google Apps is still in trial mode, hundreds of thousands of users at thousands of organizations are already using it. That includes a few big ones. Arizona State University reported plans to switch most of its 65,000 students to Gmail, Google Calendar, and a customized "start page."

But corporate users, accustomed to feature-rich applications from the likes of Microsoft and IBM, are more demanding than consumers. Google got a taste last October when it switched over most of its own employees from Outlook and Oracle's calendar program to Gmail and Google Calendar. Some features on the old systems that Googlers considered crucial—such as a way to schedule all those company-paid massages—weren't available on the new system. In all, employees shot back more than 1,000 requests for new features in the first two weeks after the changeover. More traditional companies, with a desire for more control, will be tougher to crack.

Also, competitors aren't standing still—least of all Microsoft. It recently debuted Office Live, which offers Web-based e-mail, calendar, and other services in packages ranging from free to $39.95 a month for a single business. Dozens of start-ups, some of which Google has already bought, also have piled into the nascent market for online office-productivity software.

SOURCE: Excerpted from Robert D. Hof, "Google Steps into Microsoft's Office," *BusinessWeek,* February 12, 2007, http://www.businessweek.com.

buy more of a given product if they also demand more of the complementary product. Table 2.1 lists a dozen products and their potential substitutes and complements.

Technological advances and economic efficiencies are among the ways that firms can develop substitutes for existing products. The introduction of videogame systems created a substitute for television viewing that has drawn a large share of young men away from TV audiences. More recently, the makers of videogames have said that Internet offerings such as YouTube and MySpace have attracted videogame players away from their TV sets to interact with one another online. This example shows that substitute products or services can limit another industry's revenue potential. Companies in those industries are likely to suffer growth and earnings problems unless they improve quality or launch aggressive marketing campaigns. Nintendo's success with the Wii game console partly results from its offering games such as Wii Sports that entice people who want to interact with the game, as well as by allowing them to create avatars to represent themselves in the various games, a feature that computer users enjoy in many online games and worlds. Sony's high-tech strategy for the PS3 aimed in part to make that console a substitute for buying a Blu-ray DVD player. However, prices of Blu-ray players have fallen dramatically, while the price of a PS3 remains high, so for many consumers, the combination of a Blu-ray player plus an Xbox 360 console has become a substitute for a PS3.[23]

$ The bottom line
COST
Cost is often a major barrier to entry.

In addition to current substitutes, companies need to think about potential substitutes that may be viable in the near future. For example, as alternatives to fossil fuels, experts suggest that nuclear fusion, solar power, and wind energy may prove useful one day. The advantages promised by each of these technologies are many: inexhaustible fuel supplies, electricity "too cheap to meter," zero emissions, universal public acceptance, and so on. Yet while they may look good on paper—and make us feel good about our choice—they often come up short in economic feasibility or technical viability.

Besides identifying and planning for substitutes, companies must consider complements for their products. When people are buying new homes, they are also buying appliances and landscaping products. When they buy a car, they buy insurance for it.

TABLE 2.1

Potential Substitutes for and Complements of Products

If the Problem Is . . .	The Solution Might Be . . .
Cotton	Polyester
Coffee	Energy drinks
Fossil fuels	Solar fusion
Music CD	MP3 player
House	Apartment, condo, mobile home
Local telephone	Cell phone
If the Product Is . . .	**The Complement Might Be . . .**
Computer printer	Ink cartridges
Tennis lessons	Tennis racquet
Circular saw	Lumber and nails
Apartment	Furniture
Gaming console	Videogames
New outfit	New shoes
Detergent	Mop
iPod	iTunes

And as we have noted, game consoles and videogames are complementary products. For this reason, console makers work closely with developers, giving them the information they need to create products to lure customers to their gaming systems. The complexity of the PS3 created another hurdle for Sony in this area. Because the system is so sophisticated, programming a game for PS3 costs roughly 30 percent more than creating a similar title for Microsoft's Xbox. That has made game developers cautious about launching PS3 titles, which in turn has made game players think twice about buying the new console. In the January following release of the PS3, only 2 of the top 20 games sold ("Resistance: Fall of Man" and "Madden NFL 07") were PS3 games.[24] To collaborate better with the game industry, Sony released programming tools for game developers.[25] The effort was especially important because developers such as Electronic Arts were quick to adjust their own product plans when sales of PS3 titles were lower than expected while sales of Wii titles were better than expected.[26]

As with substitutes, a company needs to watch for new complements that can change the competitive landscape. When the Wii became popular, some programmers saw an opportunity to offer a niche service: tweaking the software to offer customized avatars. Wii players can use Nintendo's software to select from a range of facial characteristics, height, and other features, but some users want a more customized look or perhaps a character modeled after a famous figure. An entrepreneur in Tokyo created Mii Station, which will use a customer-supplied photo to create a Mii look-alike for a $5 fee. A Web developer in Boston started Mii Plaza, a Web site where users can tap a database of more than 8,000 characters to collect and share Miis. Nintendo could have viewed these efforts as copyright infringement, but the company's initial response has been to treat Mii-related businesses as harmless.[27]

Suppliers

Recall from our earlier mention of open systems that organizations must acquire resources (inputs) from their environment and convert those resources into products or services (outputs) to sell. Suppliers provide the resources needed for production, and those resources may come in the form of people (supplied by trade schools and universities), raw materials (from producers, wholesalers, and distributors), information (supplied by researchers and consulting firms), and financial capital (from banks and other sources). But suppliers are important to an organization for reasons that go beyond the resources they provide. Suppliers can raise their prices or provide poor-quality goods and services. Labor unions can go on strike or demand higher wages. Workers may produce defective work. Powerful suppliers, then, can reduce an organization's profits, particularly if the organization cannot pass on price increases to its customers.

One particularly noteworthy set of suppliers to some industries is the international labor unions. Although unionization in the United States has dropped below 10 percent of the private labor force, labor unions are still powerful in industries such as steel, autos, and transportation. Even the Screen Actors Guild, the union representing workers in the entertainment industry, exerts considerable power on behalf of its members. Labor unions represent and protect the interests of their members on matters of hiring, wages, working conditions, job security, and due process appeals. Historically, the relationship between management and labor unions has been adversarial; however, both sides increasingly realize that to improve productivity and competitiveness, management and labor must work together in collaborative relationships. Troubled labor relations can create higher costs and productivity declines and eventually lead to layoffs.[28]

Organizations are at a disadvantage if they become overly dependent on any powerful supplier. A supplier is powerful if the buyer has few other sources of supply or if the supplier has many other buyers. One of the problems plaguing the launch of the PS3 was a shortage of parts, and during the weeks leading up to the console's first Christmas, it was often out of stock in U.S. stores. Sony depended on Panasonic to

provide disk drives and on IBM and ATI Technologies to deliver core processors and graphics chips.[29] For such a sophisticated product, the company couldn't go elsewhere for these components.

Switching costs are fixed costs buyers face if they change suppliers. For example, once a buyer learns how to operate a supplier's equipment, such as computer software, the buyer faces both economic and psychological costs in changing to a new supplier.

In recent years, supply chain management has become an increasingly important contributor to a company's competitiveness and profitability. By **supply chain management,** we mean the managing of the entire network of facilities and people that obtain raw materials from outside the organization, transform them into products, and distribute them to customers.[30] In the past, managers did not have to pay as much attention to supply chain management as they do today. Products tended to be standardized, overseas competition was still years in the future, and the pace of change was slower. But increased competition has required managers to pay very close attention to their costs. For example, they can no longer afford to hold large and costly inventories, waiting for orders to come in. Also, once orders do come in, some products still sitting in inventory might well be out of date.

With the emergence of the Internet, customers look for products built to their specific needs and preferences—and they want them delivered quickly, at the lowest available price. This requires the supply chain to be not only efficient but also *flexible*, so that the organization's output can quickly respond to changes in demand.

Today, the goal of effective supply chain management is to have *the right product in the right quantity available at the right place at the right cost.* Boeing, the aircraft and defense systems company, provides a good example of effective supply chain management. Boeing forges partnerships with its suppliers to share knowledge that will help them learn how to operate more efficiently. For example, at Boeing Integrated Defense Systems (IDS), Rick Behrens is senior manager of supplier development, charged with building close supplier relationships and helping them understand Boeing's commitment to "lean" operations, aimed at eliminating waste. Behrens tailors the supplier relationships to each supplier's familiarity with lean processes. He educates some suppliers in the basics of how to run lean operations; for others, he sends a supplier development team to the organization to help them streamline certain activities. He also identifies Boeing specialists who can help suppliers with particularly challenging problems. Along the way, Behrens helps suppliers develop their abilities so that they can move from simply selling parts to providing complete subassemblies. In Behrens's words, "We need suppliers that can grow with us."[31]

In sum, choosing the right supplier is an important strategic decision. Suppliers can affect manufacturing time, product quality, and inventory levels. The relationship between suppliers and the organization is changing in many companies. The close supplier relationship has become a new model for many organizations that are using a just-in-time manufacturing approach (discussed further in Chapters 16 and 17). And in some companies, innovative managers are forming strategic partnerships with their key suppliers in developing new products or new production techniques. We describe this kind of strategic partnership in more detail in Chapter 9. In the "Management Close-Up: Taking Action" feature, consider how Green Mountain Coffee Roasters played an active role with suppliers, collaborating with them by cultivating fair trade relationships and investing in a coffee maker system.

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switching costs

Fixed costs buyers face when they change suppliers.

supply chain management

The managing of the network of facilities and people that obtain materials from outside the organization, transform them into products, and distribute them to customers.

✓ **The bottom line**
SPEED

The ability to manufacture even customized products quickly has become a competitive requirement.

A Keurig single-serving coffee maker is shown at the Green Mountain Coffee Roasters outlet store in Waterbury, Vermont. Green Mountain Coffee Roasters was granted approval by the Federal Trade Commission to buy single-cup brewing systems maker Keurig Incorporated. Green Mountain already owned 35 percent of Keurig and announced that it would acquire the company outright. Do you think this collaboration will benefit the company or the customers?

Management Close-Up   TAKING ACTION

To expand Green Mountain Coffee Roasters, founder Bob Stiller began selling through several channels: in retail stores, in wholesale outlets, through direct-mail catalogs, and on the Web at www.GreenMountainCoffee.com. He also expanded its product line to include more than 100 gourmet coffee varieties under the Green Mountain name. In addition, the more the company learned about the growers who supplied its coffee beans, the more interested it became in the notion of fair trade—ensuring that farmers receive a fair price for their crops. GMCR is now one of the world's leading sellers of fair trade coffee. Recognizing consumers' growing interest in organic foods, GMCR added the Fair Trade Certified organic brand and Newman's Own Organics brand to GMCR's offerings.

During the mid-1990s, managers at Green Mountain discovered Keurig, a manufacturer of a single-serve coffee system. Using the Keurig machine, coffee drinkers could brew a single cup of their favorite blend. The system uses coffee packaged in tiny single-serve "K-cups."

GMCR leadership saw great potential in Keurig. They knew consumers were looking for easy ways to brew a perfect cup of coffee. Only a few competitors operated in the single-cup market. The single-cup brew has the advantage of a premium cup of coffee at a fraction of the price. Once Green Mountain became a Keurig investor, it began working with the company to fine-tune processes and to package and distribute K-cups.[32]

- How did GMCR's awareness of changing consumer preferences help shape the company's business plan?
- GMCR pioneered the concept of fair trade coffee. How did its interest in its suppliers change the face of Green Mountain Coffee Roasters?

Customers

final consumer

Those who purchase products in their finished form.

intermediate consumer

A customer who purchases raw materials or wholesale products before selling them to final customers.

Customers purchase the goods or services an organization offers. Without customers, a company won't survive. You are a **final consumer** when you buy a McDonald's hamburger or a pair of jeans from Aéropostale. **Intermediate consumers** buy raw materials or wholesale products and then sell to final consumers, as when Sony buys components from IBM and ATI Technologies and uses them to make PS3 consoles. Intermediate customers actually make more purchases than individual final consumers do. Types of intermediate customers include retailers, who buy clothes from wholesalers and manufacturers' representatives before selling them to their customers, and industrial buyers, who buy raw materials (such as chemicals) before converting them into final products.

Like suppliers, customers are important to organizations for reasons other than the money they provide for goods and services. Customers can demand lower prices, higher quality, unique product specifications, or better service. They also can play competitors against one another, as occurs when a car buyer (or a purchasing agent) collects different offers and negotiates for the best price. Many companies are finding that today's customers want to be actively involved with their products, as when Wii users create a Mii avatar so that the person playing the game looks like a cartoon version of themselves. Dell Inc. has taken customer input a step further by asking customers what they want the company to develop next. At Dell's IdeaStorm Web site (www.dellideastorm.com), visitors can post ideas for the next generation of computers and vote on the ideas they like best.[33]

The Internet has further empowered customers. It provides an easy source of information—both about product features and about pricing. In addition, today's

Internet users informally create and share messages about a product, which provides flattering free "advertising" at best or embarrassing and even erroneous bad publicity at worst. For example, enthusiastic gamers who favor one device or another have posted their homemade "commercials" pairing scenes from games with musical backgrounds on YouTube, as well as blunt point-by-point product comparisons about competing brands. Fans of the Wii have mocked Sony's claims that its PS3 is popular by visiting stores and filming inventory sitting on shelves. One group of videos on YouTube even portrays an unofficial "brand," Wii60, to drive home the idea that consumers could purchase both a Wii and an Xbox 360 for the price of a PS3.[34] Today's companies may find it difficult to identify, much less respond to, these unofficial messages.

As we discussed in Chapter 1, customer service means giving customers what they want or need, the way they want it, the first time. This usually depends on the speed and dependability with which an organization can deliver its products. Actions and attitudes that provide excellent customer service include the following:

Speed of filling and delivering normal orders.
Willingness to meet emergency needs.
Merchandise delivered in good condition.
Readiness to take back defective goods and resupply quickly.
Availability of installation and repair services and parts.
Service charges (that is, whether services are "free" or priced separately).[35]

An organization is at a disadvantage if it depends too heavily on powerful customers. Customers are powerful if they make large purchases or if they can easily find alternative places to buy. If you are the largest customer of a firm and you can buy from others, you have power over that firm, and

"Your most unhappy customers are your greatest source of learning." Bill Gates

you most likely can negotiate with it successfully. Your firm's biggest customers— especially if they can buy from other sources—will have the greatest negotiating power over you. Customer relationship management is discussed more fully in Chapter 9.

Environmental Analysis

LO 5

If managers do not understand how the environment affects their organizations or cannot identify opportunities and threats that are likely to be important, their ability to make decisions and execute plans will be severely limited. For example, if little is known about customer likes and dislikes, organizations will have a difficult time designing new products, scheduling production, or developing marketing plans. In short, timely and accurate environmental information is critical for running a business.

But information about the environment is not always readily available. For example, even economists have difficulty predicting whether an upturn or a downturn in the economy is likely. Moreover, managers find it difficult to forecast how well their own products will sell, let alone how a competitor might respond. In other words, managers often operate under conditions of uncertainty. **Environmental uncertainty** means that managers do not have enough information about the environment to understand or predict the future. Uncertainty arises from two related factors: (1) complexity and (2) dynamism. Environmental *complexity* refers to the number of issues to which a manager must attend as well as their interconnectedness. For example, industries that have many different firms that compete in vastly different ways tend to be more complex— and uncertain—than industries with only a few key competitors. Similarly, environmental *dynamism* refers to the degree of discontinuous change that occurs within the industry. High-growth industries with products and technologies that change rapidly tend to be more uncertain than stable industries where change is less dramatic and more predictable.[36]

environmental uncertainty

Lack of information needed to understand or predict the future.

As environmental uncertainty increases, managers must develop techniques and methods for collecting, sorting through, and interpreting information about the environment. We discuss some of these approaches in this section of the chapter. (In the next chapter, we will also discuss how managers make decisions under conditions of uncertainty.) By analyzing environmental forces—in both the macroenvironment and the competitive environment—managers can identify opportunities and threats that might affect the organization.

Environmental Scanning

Perhaps the first step in coping with uncertainty in the environment is pinning down what might be important. Frequently, organizations and individuals act out of ignorance, only to regret those actions in the future. IBM, for example, had the opportunity to purchase the technology behind xerography but turned it down. Xerox saw the potential, and the rest is history. However, Xerox researchers later developed the technology for the original computer mouse, but not seeing the potential, the company missed an important market opportunity.

environmental scanning

Searching for and sorting through information about the environment.

To understand and predict changes, opportunities, and threats, organizations such as Monsanto, Weyerhaeuser, and Union Carbide spend a good deal of time and money monitoring events in the environment. **Environmental scanning** means both searching out information that is unavailable to most people and sorting through that information to interpret what is important and what is not. Managers can ask questions such as these:

Who are our current competitors?
Are there few or many entry barriers to our industry?
What substitutes exist for our product or service?
Is the company too dependent on powerful suppliers?
Is the company too dependent on powerful customers?[37]

competitive intelligence

Information that helps managers determine how to compete better.

Answers to these questions help managers develop **competitive intelligence,** the information necessary to decide how best to manage in the competitive environment they have identified. Porter's competitive analysis, discussed earlier, can guide environmental scanning and help managers evaluate the competitive potential of different environments. Table 2.2 describes two extreme environments: an attractive environment, which gives a firm a competitive advantage, and an unattractive environment, which puts a firm at a competitive disadvantage.[38]

scenario

A narrative that describes a particular set of future conditions.

Scenario Development

As managers attempt to determine the effect of environmental forces on their organizations, they frequently develop **scenarios** of the future. Scenarios create alternative

TABLE 2.2
Attractive and Unattractive Environments

Environmental Factor	Unattractive	Attractive
Competitors	Many; low industry growth; equal size; commodity	Few; high industry growth; unequal size differentiated
Threat of entry	High threat; few entry barriers	Low threat; many barriers
Substitutes	Many	Few
Suppliers	Few; high bargaining power	Many; low bargaining power
Customers	Few; high bargaining power	Many; low bargaining power

combinations of different factors into a total picture of the environment and the firm. For example, when Congress and the president must forecast the size of the federal budget deficit, they develop several different scenarios about what the economy is likely to do over the next decade or so. Frequently, organizations develop a *best-case scenario* (the occurrence of events that are favorable to the firm), a *worst-case scenario* (the occurrence of unfavorable events), and some middle-ground alternatives. The value of scenario development is that it helps managers develop contingency plans for what they might do given different outcomes.[39] For example, as a manager, you will quite likely be involved in budgeting for your area. You will almost certainly be asked to list initiatives that you would eliminate in case of an economic downturn and new investments you would make if your firm does better than expected.

Effective managers regard the scenarios they develop as living documents, not merely prepared once and put aside. Instead, they constantly update the scenarios to take into account relevant new factors that emerge, such as significant changes in the economy or actions by competitors.

Forecasting

Whereas environmental scanning is used to identify important factors and scenario development is used to develop alternative pictures of the future, **forecasting** is used to predict exactly how some variable or variables will change in the future. For example, in making capital investments, firms may try to forecast how interest rates will change. In deciding to expand or downsize a business, firms may try to forecast the demand for goods and services or forecast the supply and demand of labor they probably would use. Publications such as *BusinessWeek's Business Outlook* provide forecasts to businesses both large and small.

Although forecasts are designed to help executives make predictions about the future, their accuracy varies from application to application. Because they extrapolate from the past to project the future, forecasts tend to be most accurate when the future ends up looking a lot like the past. Of course, we don't need sophisticated forecasts in those instances. Forecasts are most useful when the future will look radically different from the past. Unfortunately, that is when forecasts tend to be less accurate. The more things change, the less confidence we tend to have in our forecasts. The best advice for using forecasts might include the following ideas:

Use multiple forecasts, and perhaps average their predictions.
Remember that accuracy decreases the further into the future you are trying to predict.
Forecasts are no better than the data used to construct them.
Use simple forecasts (rather than complicated ones) where possible.
Keep in mind that important events often are surprises and represent a departure from predictions.[40]

Benchmarking

In addition to trying to predict changes in the environment, firms can undertake intensive study of the best practices of various firms to understand their sources of competitive advantage. **Benchmarking** means identifying the best-in-class performance by a company in a given area, say, product development or customer service, and then comparing your processes to theirs. To accomplish this, a benchmarking team would collect information on its own company's operations and those of the other firm to determine gaps. These gaps serve as a point of entry to learn the underlying causes of performance differences. Ultimately, the team would map out a set of best practices that lead to world-class performance. We will discuss benchmarking further in Chapter 4.

forecasting

Method for predicting how variables will change the future.

benchmarking

The process of comparing an organization's practices and technologies with those of other companies.

Responding to the Environment

For managers and organizations, responding effectively to their environments is almost always essential. Clothing retailers who pay no attention to changes in the public's style preferences, or manufacturers who don't make sure they have steady sources of supply, are soon out of business. To respond to their environment, managers and companies have a number of options, which can be grouped into three categories: (1) adapting to the environment, (2) influencing the environment, and (3) selecting a new environment.

Adapting to the Environment: Changing Yourself

To cope with environmental uncertainty, organizations frequently make adjustments in their structures and work processes. When uncertainty arises from environmental complexity, organizations tend to adapt by *decentralizing* decision making. For example, if a company faces a growing number of competitors in various markets, if different customers want different things, if the characteristics of different products keep increasing, and if production facilities are being built in different regions of the world, it may be impossible for the chief executive (or a small group of top executives) to keep abreast of all activities and understand all the operational details of a business. In these cases, the top management team is likely to give authority to lower-level managers to make decisions that benefit the firm. The term **empowerment** is used frequently today to talk about this type of decentralized authority. We will address empowerment and decision making in more detail in Chapters 3 and 9.

empowerment

The process of sharing power with employees, thereby enhancing their confidence in their ability to perform their jobs and their belief that they are influential contributors to the organization.

Organizations can compete more effectively in volatile environments if they have knowledgeable and skilled workers. One way to obtain these workers is to sponsor training programs. Alliances among employers, community colleges, universities, and nonprofit training programs are producing workers with much-needed skills in many industries, and those workers now can earn higher wages. One program in New York, Per Scholas, trains computer repair technicians in one of the country's poorest areas—the Bronx. Funded by grants from private foundations and the New York City Council, the program gained momentum through its collaboration with companies such as Time Warner Cable that were looking for skilled employees.

Per Scholas boasts a job placement rate of 80 percent of its graduates, who earn about $12 per hour in the first year and $15 per hour in two years—often double what they would have earned without the training. One such graduate, Cristina Rodriguez, now works at Time Warner Cable as a broadband specialist for a similar wage plus health insurance coverage. Her new skills have empowered her to become a high-performing employee. "What feels great is when I resolve someone's issue," she says. Rodriguez, fluent in both English and Spanish, is able to solve customers' problems in both languages.

Training programs such as Per Scholas have grown more sophisticated in the last few years because of their close association with the companies that hire their graduates. These relationships foster "the deep understanding these programs develop of the workings of industries where they place people," explains MIT Professor Paul Osterman. Connie Ciliberti, vice president of human resources for Time Warner Cable, confirms the importance of this collaboration. "Per Scholas has spent time learning our business, understanding our measures of success," she says.[41]

In response to uncertainty caused by change (dynamism) in the environment, organizations tend to establish more flexible structures. In today's business world, the term *bureaucracy* generally has a bad connotation. Most of us recognize that bureaucratic organizations tend to be formal and very stable; frequently they are unable to adjust to

change or exceptional circumstances that "don't fit the rules." And while bureaucratic organizations may be efficient and controlled if the environment is stable, they tend to be slow-moving and plodding when products, technologies, customers, or competitors are changing over time. In these cases, more *organic* structures give organizations the flexibility to adjust to change. We will discuss organic structures in more detail in Chapter 9, but we can simply say here that they are less formal than bureaucratic organizations—making decisions through interaction and mutual adjustment among individuals rather than from a set of predefined rules. Table 2.3 shows four different approaches that organizations can take in adapting to environmental uncertainty.

Adapting at the Boundaries   Because they are open systems, organizations are exposed to uncertainties from both their inputs and outputs. To help them compete, they can create buffers on both the input and output boundaries with the environment. **Buffering** creates supplies of excess resources to meet unpredictable needs. On the input side, organizations establish relationships with employment agencies to hire part-time and temporary help during rush periods when labor demand is difficult to predict. In the U.S. labor force, these workers, known as *contingent workers*, include 2.5 million on-call workers, 1.2 million temporary-help agency workers, and more than 800,000 workers provided by contract firms, suggesting widespread use of this approach to buffering labor input uncertainties.[42] On the output side of the system, most organizations use some type of ending inventories that allow them to keep merchandise on hand in case a rush of customers decide to buy their products. Auto dealers are a common example of this use of buffers, but we can see similar use of buffer inventories in fast-food restaurants, bookstores, clothing stores, and even real estate agencies.[43]

In addition to buffering, organizations may try **smoothing,** or leveling normal fluctuations at the boundaries of the environment. For example, during winter months in the north, when automobile sales drop off, it is not uncommon for dealers to cut the price of their in-stock vehicles to increase demand. At the end of each clothing season, retailers discount their merchandise to clear it out to make room for incoming inventories. These are examples of smoothing environmental cycles to level off fluctuations in demand.

Adapting at the Core   While buffering and smoothing manage uncertainties at the boundaries of the organization, firms also can establish **flexible processes** that allow for adaptation in their technical core. For example, firms increasingly try to customize their goods and services to meet the varied and changing demands of customers. Even in manufacturing, where it is difficult to change basic core processes, firms are adopting techniques of mass customization that help them create flexible factories. Instead of mass-producing large quantities of a "one-size-fits-all" product, organizations can use mass customization to produce individually customized products at an equally low cost. Whereas Henry Ford used to claim that "you could have a Model T in any color you wanted, as long as it was black," auto companies now offer a wide array of colors and trim lines, with different options and accessories. The process of mass customization involves the use of a network of independent operating units in

buffering

Creating supplies of excess resources in case of unpredictable needs.

smoothing

Leveling normal fluctuations at the boundaries of the environment.

flexible processes

Methods for adapting the technical core to changes in the environment.

✔ The bottom line

Quality

The Internet lets customers quickly find products with the cost and quality features they want.

	Stable	Dynamic
Complex	Decentralized	Decentralized
	Bureaucratic (standardized skills)	Organic (mutual adjustment)
Simple	Centralized	Centralized
	Bureaucratic (standardized work processes)	Organic (direct supervision)

TABLE 2.3
Four Approaches for Managing Uncertainty

which each performs a specific process or task such as making a dashboard assembly on an automobile. When an order comes in, different modules join forces to deliver the product or service as specified by the customer.[44] We will discuss mass customization and flexible factories in more depth in Chapter 9.

Influencing Your Environment

In addition to adapting or reacting to the environment, managers and organizations can develop proactive responses aimed at changing the environment. Two general types of proactive responses are independent action and cooperative action.

independent strategies

Strategies that an organization acting on its own uses to change some aspect of its current environment.

Independent Action   A company uses **independent strategies** when it acts on its own to change some aspect of its current environment.[45] Table 2.4 shows the definitions and uses of these strategies. For example, Southwest Airlines demonstrates competitive aggression by cutting fares when it enters a new market, and Sony used competitive aggression when it aimed to position itself as the gaming industry's technological leader with the launch of the PS3. In contrast, when Kellogg Company promotes the cereal industry as a whole, it demonstrates competitive pacification. Weyerhaeuser Company advertises its reforestation efforts (public relations). The Gap, Motorola, Nike, American Express, Converse, and other companies have signed on to Product Red, a program in which they market special Red-themed products and donate a percentage of the profits to the Global Fund, a project to help end AIDS in Africa (voluntary action). Viacom sued Google for allowing users to post copyrighted video clips on the Google-owned YouTube Web site (legal action). In a recent year, pharmaceutical companies spent $1.1 billion to lobby members of Congress (political action); insurers, the second biggest spenders on lobbying, paid out almost $900 million.[46] Each of these examples shows how organizations—on their own—can have an impact on the environment.

cooperative strategies

Strategies used by two or more organizations working together to manage the external environment.

Cooperative Action   In some situations, two or more organizations work together using **cooperative strategies** to influence the environment.[47] Table 2.5 shows several

TABLE 2.4   Independent Action

Strategy	Definition	Examples
Competitive aggression	Exploiting a distinctive competence or improving internal efficiency for competitive advantage	Aggressive pricing, comparative advertising (e.g., Wal-Mart)
Competitive pacification	Independent action to improve relations with competitors	Helping competitors find raw materials
Public relations	Establishing and maintaining favorable images in the minds of those making up the environment	Sponsoring sporting events
Voluntary action	Voluntary commitment to various interest groups, causes, and social problems	Johnson & Johnson donating supplies to tsunami victims
Legal action	Engaging company in private legal battle	Warner Music lawsuits against illegal music copying
Political action	Efforts to influence elected representatives to create a more favorable business environment or limit competition	Issue advertising; lobbying at state and national levels

SOURCE: Adapted from *Journal of Marketing,* published by the American Marketing Association. C. Zeithaml and V. Zeithaml, "Environmental Management: Revising the Marketing Perspective," Spring 1984.

Strategy	Definition	Examples
Contraction	Negotiation of an agreement between the organization and another group to exchange goods, services, information, patents, and so on	Contractual marketing systems
Cooptation	Absorbing new elements into the organization's leadership structure to avert threats to its stability or existence	Consumer and labor representatives and bankers on boards of directors
Coalition	Two or more groups that coalesce and act jointly with respect to some set of issues for some period of time	Industry associations; political initiatives of the Business Roundtable and the U.S. Chamber of Commerce

TABLE 2.5
Cooperative Action

SOURCE: Reprinted from *Journal of Marketing,* published by the American Marketing Association. C. Zeithaml and V. Zeithaml, "Environmental Management: Revising the Marketing Perspective," Spring 1984.

examples of cooperative strategies. An example of contracting occurs when suppliers and customers, or managers and labor unions, sign formal agreements about the terms and conditions of their future relationships. These contracts are explicit attempts to make their future relationship predictable. An example of cooptation might occur when universities invite wealthy alumni to join their boards of directors.

Finally, an example of coalition formation might be when local businesses band together to curb the rise of employee health care costs and when organizations in the same industry form industry associations and special-interest groups. You may have seen cooperative advertising strategies, such as when dairy producers, beef producers, orange growers, and the like, jointly pay for television commercials. Life Is Good, a New England–based T-shirt company, used the latest economic downturn as an opportunity to strengthen cooperative action with the retailers that stock its products. According to cofounder Bert Jacobs, employees at Life Is Good began calling retailers to ask how they could help them through the slow times. Based on the feedback, Jacobs identified a need to establish online networks that retailers—his company's customers—could use for sharing ideas.[48]

At the organizational level, firms establish strategic alliances, partnerships, joint ventures, and mergers with competitors to deal with environmental uncertainties. Cooperative strategies such as these make most sense when (1) taking joint action will reduce the organizations' costs and risks and (2) cooperation will increase their power, that is, their ability to successfully accomplish the changes they desire.
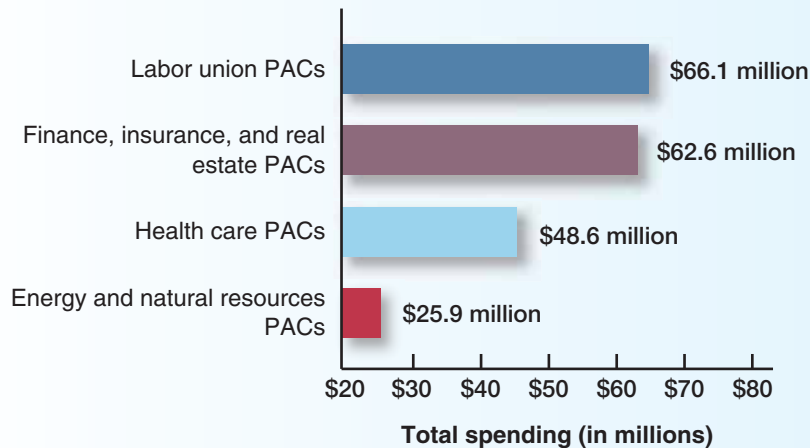

Celebrities Bono and Oprah have supported organizations participating in the Product Red Program to help end AIDS in Africa through the Global Fund. What other opportunities do companies have to participate in voluntary actions to change their environment?

Changing the Environment You Are In

As we noted previously, organizations can cope with environmental uncertainty by changing themselves (environmental adaptation), changing the environment, or changing the environment they are in. We refer to this last category as **strategic maneuvering.** By making a conscious effort to change the boundaries of its competitive environment, a firm can maneuver around potential threats and capitalize on

Companies or organizations within an industry sometimes form political action committees (PACs) to raise money to help elect lawmakers with favorable points of view. During the most recent presidential-election year, the biggest spenders were labor unions; the most PAC spending by businesses came from companies in finance, insurance, and real estate.[49]

Top four industry/labor sectors for PAC spending

Sector	Spending
Labor union PACs	$66.1 million
Finance, insurance, and real estate PACs	$62.6 million
Health care PACs	$48.6 million
Energy and natural resources PACs	$25.9 million

Total spending (in millions)

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arising opportunities.[50] Managers can use several strategic maneuvers, including domain selection, diversification, merger and acquisition, and divestiture.[51]

Domain selection is the entrance by a company into another suitable market or industry. For example, the market may have limited competition or regulation, ample suppliers and customers, or high growth. An example is Nintendo's decision to create products such as the Wii that appeal to customer segments that have not been enthusiastic to purchase videogames—for instance, people intimidated by complicated game controllers and parents concerned about the violent content and sedentary play involved in videogames. By avoiding head-on competition to be the product with the best graphics or most advanced play, Nintendo was able to enjoy immediate profits from its new console. This approach builds on the company's earlier success with its DS, which lured not only young game players but also women and older-than-average players with its touch screens and games like Brain Age and Nintendogs.[52] Thus, Nintendo has used an existing expertise to broaden the goods and services it offers.

Diversification occurs when a firm invests in different types of businesses or products or when it expands geographically to reduce its dependence on a single market or technology. Apple's launch of the iPod is a good example of effective diversification. While Apple struggled in the highly competitive computer industry, where its Macintosh had only a 3 percent market share, its iPod has gobbled up three-quarters of the market for portable digital music players *and* for online music sales. More recently, its launch of the iPhone has generated considerable buzz. The company's name change from "Apple Computer" to simply "Apple" makes sense in light of these diversification moves.[53]

A **merger** or **acquisition** takes place when two or more firms combine, or one firm buys another, to form a single company. Mergers and acquisitions can offer greater efficiency from combined operations or can give companies relatively quick access to new markets or industries. After Bayer acquired Schering, it announced plans to cut more than 6,000 jobs to "create an internationally successful pharmaceutical company with competitive cost structures," in the words of Werner Wenning, Bayer Schering Pharma's board chairman.[54] Electronic Arts, publisher of videogames, acquired Headgate Studios, a smaller game publisher whose titles include "Tiger Woods PGA Tour" and "Madden NFL." The acquisition helped Electronic Arts add quickly to its list of games for the Wii when sales of the console and its games exceeded expectations.[55]

Divestiture occurs when a company sells one or more businesses. At Ford Motor Company, recent operating losses and the costs of restructuring its workforce have brought about a cash shortage. To raise cash, Ford sold its Aston Martin sports-car brand and its Hertz rental-car unit.[56]

Organizations engage in strategic maneuvering when they move into different environments. Some companies, called **prospectors,** are more likely than others to engage in strategic maneuvering.[57] Aggressive companies continuously change the boundaries of their competitive environments by seeking new products and markets, diversifying, and merging or acquiring new enterprises. In these and other ways, corporations put

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strategic maneuvering

An organization's conscious efforts to change the boundaries of its task environment.

domain selection

Entering a new market or industry with an existing expertise.

diversification

A firm's investment in a different product, business, or geographic area.

merger

One or more companies combining with another.

acquisition

One firm buying another.

divestiture

A firm selling one or more businesses.

prospectors

Companies that continually change the boundaries for their task environments by seeking new products and markets, diversifying and merging, or acquiring new enterprises.

their competitors on the defensive and force them to react. **Defenders,** in contrast, stay within a more limited, stable product domain.

Choosing a Response Approach

Three general considerations help guide management's response to the environment. First, organizations should attempt to *change appropriate elements of the environment.* Environmental responses are most useful when aimed at elements of the environment that (1) cause the company problems, (2) provide it with opportunities, and (3) allow the company to change successfully. Thus, Nintendo recognized that its game console would have difficulty competing on superior graphics, so it addressed underserved segments of the market, where customers and favorable publicity made the Wii a successful entrant.

Second, organizations should *choose responses that focus on pertinent elements of the environment.* If a company wants to better manage its competitive environment,

> No business likes bad press, but if it occurs, managers must choose a response. They can ignore the negative publicity or address it in such a way that the incident is viewed as neutral, or even positive. When Washington, D.C., restaurateur Mark Sakuta discovered criticisms of his restaurant on the Web site for the *Washington Post,* he was at first puzzled. About 10 negative reviews appeared simultaneously, accusing the restaurant of using cookbook recipes instead of its own original concoctions, claiming that the floor was unstable, and other negative statements. A month later, another harsh review criticized the gratuity policy for large groups.
>
> Sakuta knew that the first group of accusations was simply untrue. He suspected they were written by disgruntled former employees. So he called customer service at the Web site and asked to have them removed. The site manager agreed. But Sakuta did not ask to have the comment about the tipping policy removed because it was accurate. Instead, he decided to adjust the policy. He reasoned that if customers were uncomfortable with it, they might choose to dine elsewhere. Now Sakuta keeps closer tabs on food-related Web sites and blogs, looking for any comments about his business.[58]

competitive aggression and pacification are viable options. Political action influences the legal environment, and contracting helps manage customers and suppliers.

Third, companies should *choose responses that offer the most benefit at the lowest cost.* Return-on-investment calculations should incorporate short-term financial considerations as well as long-term impact. Strategic managers who consider these factors carefully will guide their organizations to competitive advantage more effectively.

> In the case of online critics, most responses cost little or nothing. Often, a person just wants to be heard. If it's a customer, "Maybe something they bought isn't working, and customer service says they can't do anything, so now they want to drag that business through the mud," says Joseph Fiore, vice present of CoreX Technology and Solutions. "They're hoping someone will come along and say that happened to me too." Fiore's firm investigates such blogs. Most such situations can be solved with an e-mail or a phone call. But a firm's managers must take action to correct any false information that has been posted so that it doesn't spread and ruin the company's reputation.
>
> Taking a proactive stance can be helpful as well. A company can set up its own site, providing a forum for customers to share feedback. "Some people just need to vent, and if you don't provide a place where you can monitor and do something about those complaints, then they often go elsewhere," warns Alysa Zeltzer, an associate attorney with a law firm in Washington, D.C. Either way, a firm should keep an eye on its Internet reputation—failing to do so can ultimately be costly in both sales and image.[59]
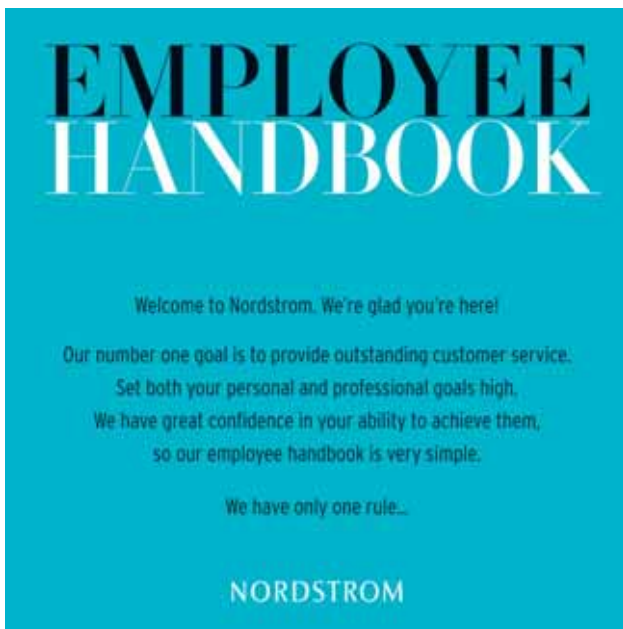
Culture and the Internal Environment of Organizations

organization culture

The set of important assumptions about the organization and its goals and practices that members of the company share.

One of the most important factors that influence an organization's response to its external environment is its culture. **Organization culture** is the set of important assumptions about the organization and its goals and practices that members of the company share. It is a system of shared values about what is important and beliefs about how the world works. In this way, a company's culture provides a framework that organizes and directs people's behavior on the job.[60] The culture of an organization may be difficult for an observer to define easily, yet like an individual's personality, it can often be sensed almost immediately. For example, the way people dress and behave, the way they interact with each other and with customers, and the qualities that are likely to be valued by their managers are usually quite different at a bank than they are at a rock-music company, and different again at a law firm or an advertising agency.

EMPLOYEE HANDBOOK

Welcome to Nordstrom. We're glad you're here!

Our number one goal is to provide outstanding customer service.
Set both your personal and professional goals high.
We have great confidence in your ability to achieve them,
so our employee handbook is very simple.

We have only one rule...

NORDSTROM

OUR ONE RULE

USE GOOD JUDGMENT IN ALL SITUATIONS.

Please feel free to ask your department manager, store manager or Human Resource office any question at any time.

At Nordstrom, the fashion retailer, employees are simply given a five-by-eight-inch card with one rule on it.
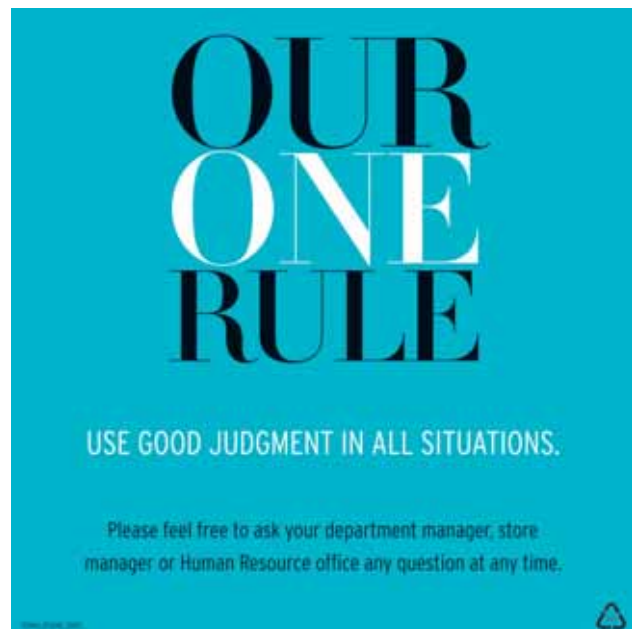
Cultures can be strong or weak; strong cultures can have great influence on how people think and behave. A strong culture is one in which everyone understands and believes in the firm's goals, priorities, and practices. A strong culture can be a real advantage to the organization if the behaviors it encourages and facilitates are appropriate ones. For example, the Walt Disney Company's culture encourages extraordinary devotion to customer service; the culture at Apple Inc. encourages innovation. Employees in these companies don't need rule books to dictate how they act, because these behaviors are conveyed as "the way we do things around here"; they are rooted in their companies' cultures.

In contrast, a strong culture that encourages inappropriate behaviors can severely hinder an organization's ability to deal effectively with its external environment—particularly if the environment is undergoing change, as is almost always the case today. A culture that was suitable and even advantageous in a prior era may become counterproductive in a new environment. For instance, a small start-up may have an informal culture that becomes less suitable when the company grows, faces more competition, and requires decision making by a wide range of specialized employees spread out over many locations.

In its relatively short life as a company, Google quickly became a role model for its brainy culture of innovation. Software writers and engineers were attracted to Google not just for its famous perks such as free meals and laundry facilities but also for a climate in which they were encouraged to let their imaginations roam free, dreaming up ideas that could be crazy but just might be the next big thing on the Internet.

During a long-running business boom, that culture served Google well. The best engineers were thrilled to work for a company that let them spend one-fifth of their time on new projects of their own choosing. But when the economy slowed and the stock market nosedived, Google's managers had to cope with a new reality in which money was tight. Google could no longer afford its free-spending culture. Managers had to figure out how to maintain the best of the culture while innovating at a more prudent pace.

Google's modified culture now values setting priorities. New ideas are still welcome if they are focused on core businesses of search, advertising, and Web-based software applications. Managers are reassigning employees away from teams working on unrelated projects and using them to staff teams working on profitable ideas in the core areas. Employees who have an idea that can improve the computer user's experience are asked to consider also what impact that idea might have on Google's bottom line. Similarly, hiring has slowed, because managers must not only justify the talent of a candidate but also target hiring to particular business needs. The challenge will be to keep employees as excited about targeted innovation as they have been about freewheeling innovation.[61]

Similarly, when a merger or acquisition brings together organizations with strong cultures, cultural differences can encourage behaviors that are harmful to the combined organization. After Sprint acquired Nextel, conflicts arose because the two wireless carriers had different cultures. Sprint moved cautiously, whereas Nextel's culture was more entrepreneurial. Such differences in style can be unsettling to employees on both sides and may help to explain why research has found much higher turnover rates among managers at companies that have been acquired.[62]

In contrast to strong cultures, weak cultures have the following characteristics: Different people hold different values, there is confusion about corporate goals, and it is not clear from one day to the next what principles should guide decisions. Some managers may pay lip service to some aspects of the culture ("we would never cheat a customer") but behave very differently ("don't tell him about the flaw"). As you can guess, such a culture fosters confusion, conflict, and poor performance. Most managers would agree that they want to create a strong culture that encourages and supports goals and useful behaviors that will make the company more effective. In other words, they want to create a culture that is appropriately aligned with the organization's competitive environment.[63]

Diagnosing Culture

Let's say you want to understand a company's culture. Perhaps you are thinking about working there and you want a good "fit," or perhaps you are working there right now and want to deepen your understanding of the organization and determine whether its culture matches the challenges it faces. How would you go about making the diagnosis? A variety of things will give you useful clues about culture:

Corporate mission statements and official goals are a starting point, because they will tell you the firm's desired public image. Most companies have a mission statement—even the CIA, as shown in Figure 2.5. Your school has one, and you can probably find it online. But are these statements a true expression of culture? A study of hospital employees and their managers found that managers rated their mission statement more positively than nonmanagers (even though employees had participated in developing it), and 3 out of 10 employees were not

Vision	We will provide knowledge and take action to ensure the national security of the United States and the preservation of American life and ideals.
Mission	We are the eyes and ears of the nation and at times its hidden hand. We accomplish this mission by:
	• Collecting intelligence that matters.
	• Providing relevant, timely, and objective all-source analysis.
	• Conducting covert action at the direction of the president to preempt threats or achieve United States policy objectives.
Values	In pursuit of our country's interests, we put Nation before Agency, Agency before unit, and all before self. What we do matters.
	• Our success depends on our ability to act with total discretion and an ability to protect sources and methods.
	• We provide objective, unbiased information and analysis.
	• Our mission requires complete personal integrity and personal courage, physical and intellectual.
	• We accomplish things others cannot, often at great risk. When the stakes are highest and the dangers greatest, we are there and there first.
	• We stand by one another and behind one another. Service, sacrifice, flexibility, teamwork, and quiet patriotism are our hallmarks.

FIGURE 2.5

CIA Vision, Mission, and Values

SOURCE: CIA Web site accessed March 10, 2005, at www.cia.gov/information/mission.html.

even aware that the hospital had a mission statement (even though the hospital had processes for communicating about it).[64] So, even after reading statements of mission and goals, you still need to figure out whether the statements truly reflect how the firm conducts business.

Business practices can be observed. How a company responds to problems, makes strategic decisions, and treats employees and customers tells a lot about what top management really values. The Tribune Company's repeated efforts to cut costs at the *Los Angeles Times* and consolidate its Washington bureau with that of the chain's other newspapers told the acquired company's employees about the parent company's priorities.

Symbols, rites, and ceremonies give further clues about culture. For instance, status symbols can give you a feel for how rigid the hierarchy is and for the nature of relationships between lower and higher levels. Who is hired and fired—and why—and the activities that are rewarded indicate the firm's real values.

The stories people tell carry a lot of information about the company's culture. Every company has its myths, legends, and true stories about important past decisions and actions that convey the company's main values. The stories often feature the company's heroes: people once or still active who possessed the qualities and characteristics that the culture especially values and who act as models for others about how to behave.

A strong culture combines these measures in a consistent way. The Ritz-Carlton hotel chain gives each employee a laminated card listing its 12 service values. Each day it carries out a type of ceremony: a 15-minute meeting during which employees from every department resolve problems and discuss areas of potential improvement. At these meetings, the focus is on the day's "wow story," which details an extraordinary way that a Ritz-Carlton employee lived up to one of the service values. For example, a family arrived at the Bali Ritz-Carlton with special eggs and milk because of their son's allergies, but the food had spoiled. The manager and dining staff couldn't find

replacements in town, so the executive chef called his mother-in-law in Singapore and asked her to buy the necessary products and fly with them to Bali.[65]
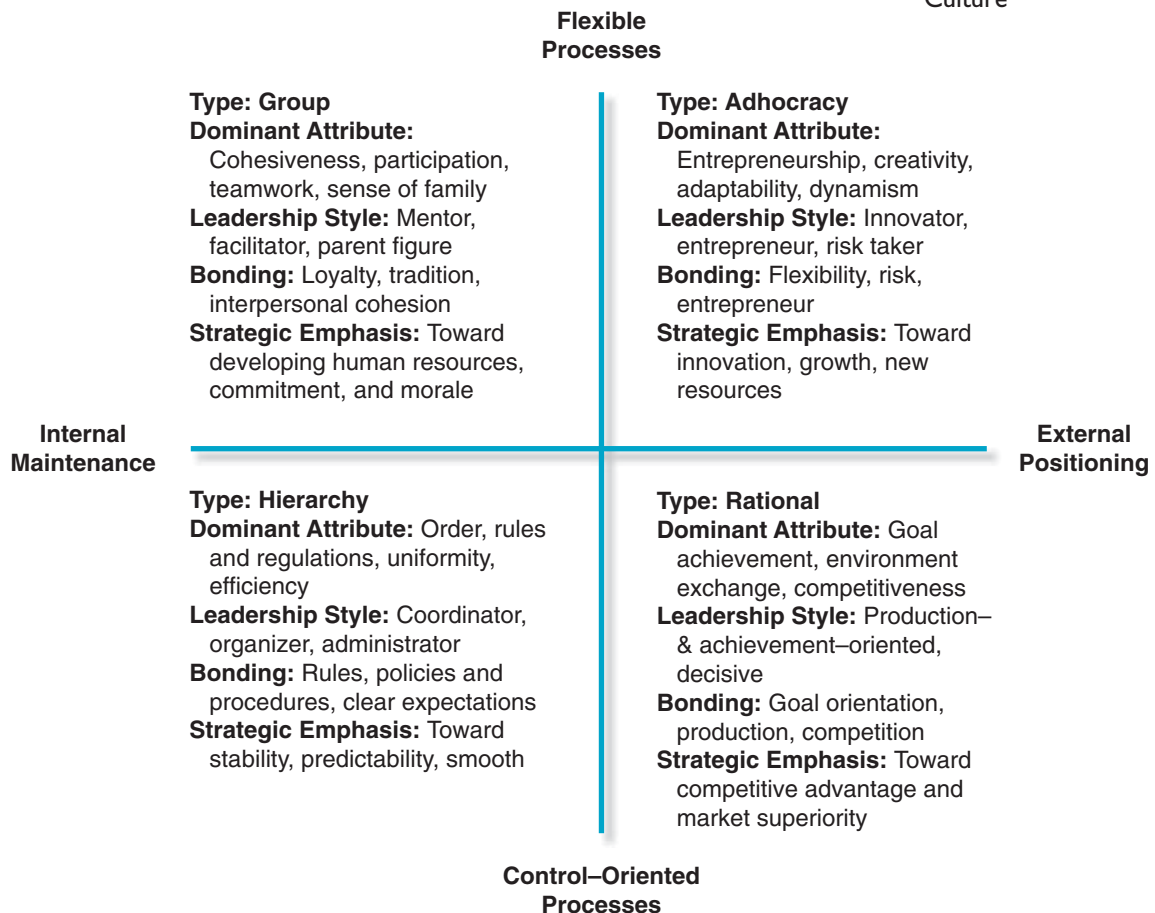
In general, cultures can be categorized according to whether they emphasize flexibility versus control and whether their focus is internal or external to the organization. By juxtaposing these two dimensions, we can describe four types of organizational cultures, depicted in Figure 2.6:

Group culture. A group culture is internally oriented and flexible. It tends to be based on the values and norms associated with affiliation. An organizational member's compliance with organizational directives flows from trust, tradition, and long-term commitment. It tends to emphasize member development and values participation in decision making. The strategic orientation associated with this cultural type is one of implementation through consensus building. Leaders tend to act as mentors and facilitators.

Hierarchical culture. The hierarchical culture is internally oriented by more focus on control and stability. It has the values and norms associated with a bureaucracy. It values stability and assumes that individuals will comply with organizational mandates when roles are stated formally and enforced through rules and procedures.

Rational culture. The rational culture is externally oriented and focused on control. Its primary objectives are productivity, planning, and efficiency. Organizational members are motivated by the belief that performance that leads to the desired organizational objectives will be rewarded.

FIGURE 2.6
Competing-Values Model of Culture

Flexible Processes

Type: Group
Dominant Attribute:
Cohesiveness, participation, teamwork, sense of family
Leadership Style: Mentor, facilitator, parent figure
Bonding: Loyalty, tradition, interpersonal cohesion
Strategic Emphasis: Toward developing human resources, commitment, and morale

Type: Adhocracy
Dominant Attribute:
Entrepreneurship, creativity, adaptability, dynamism
Leadership Style: Innovator, entrepreneur, risk taker
Bonding: Flexibility, risk, entrepreneur
Strategic Emphasis: Toward innovation, growth, new resources

Internal Maintenance ———————————————— **External Positioning**

Type: Hierarchy
Dominant Attribute: Order, rules and regulations, uniformity, efficiency
Leadership Style: Coordinator, organizer, administrator
Bonding: Rules, policies and procedures, clear expectations
Strategic Emphasis: Toward stability, predictability, smooth

Type: Rational
Dominant Attribute: Goal achievement, environment exchange, competitiveness
Leadership Style: Production– & achievement–oriented, decisive
Bonding: Goal orientation, production, competition
Strategic Emphasis: Toward competitive advantage and market superiority

Control–Oriented Processes

SOURCE: Kim S. Cameron and Robert E. Quinn, *Diagnosing and Changing Organizational Culture* (Englewood Cliffs, NJ; Addison-Wesley, 1988). Used by permission of the authors.

Adhocracy. The adhocracy is externally oriented and flexible. This culture type emphasizes change in which growth, resource acquisition, and innovation are stressed. Organizational members are motivated by the importance or ideological appeal of the task. Leaders tend to be entrepreneurial and risk takers. Other members tend to have these characteristics as well.[66]

This type of diagnosis is important when two companies are considering combining operations, as in a merger, acquisition, or joint venture, because as we noted, cultural differences can sink these arrangements. In some cases, organizations investigating this type of change can benefit from setting up a "clean team" of third-party experts who investigate the details of each company's culture. For example, they might conduct employee focus groups to learn about leadership styles, the way policies are established, and the kinds of behavior that are rewarded. They can look for systems that indicate employees are empowered to make independent decisions or that directions are handed down from above. They can note how management talks about the company's founder, customers, and employees. In this way, the clean team can identify for the organizations' leaders the types of issues they will have to resolve and the values they must choose among as they try to establish a combined culture.[67]

Managing Culture

We mentioned earlier in this chapter that one important way organizations have of responding to the environment is to *adapt* to it by changing the organization itself. One of the most important tools managers have for implementing such a change lies in their management of their organization's culture. A culture that is inwardly instead of customer focused, for example, when the new competitive environment requires excellence in customer service, can delay or even defeat a manager's efforts to effect change. Simple directives alone are often ineffective; the underlying values of the organization also have to be shifted in the desired direction. Most companies today know that adopting a customer orientation, improving quality, and making other moves necessary to remain competitive are so essential that they require deep-rooted cultural changes. When that kind of change occurs, organization members may then begin to internalize the new values and display the appropriate behaviors on their own.

A culture aligned with its environment helps the organization succeed.

Top managers can take several approaches to managing culture. First, they should espouse lofty ideals and visions for the company that will inspire organization members. (We will discuss vision more fully in Chapter 4, on strategy, and in Chapter 12, on leadership.) That vision—whether it concerns quality, integrity, innovation, or whatever—should be articulated over and over until it becomes a tangible presence throughout the organization.

Second, executives must give constant attention to the mundane details of daily affairs such as communicating regularly, being visible and active throughout the company, and setting examples. Not only should the CEO talk about the vision, but he or she should also embody it day in and day out. This makes the CEO's pronouncements credible, creates a personal example others can emulate, and builds trust that the organization's progress toward the vision will continue over the long run.

Important here are the moments of truth when hard choices must be made. Imagine top management trumpeting a culture that emphasizes quality and then discovering that a part used in a batch of assembled products is defective. Whether to replace the part at great expense in the interest of quality or to ship the defective part just to save time and money is a decision that will go a long way toward reinforcing or destroying a quality-oriented culture.

To reinforce the organization's culture, the CEO and other executives should routinely celebrate and reward those who exemplify the new values. Another key to managing culture involves hiring, socializing newcomers, and promoting employees on the basis of the new corporate values. In this way, the new culture will begin to permeate

the organization. While this may seem a time-consuming approach to building a new culture, effective managers recognize that replacing a long-term culture of traditional values with one that embodies the competitive values needed in the future can take years. But the rewards of that effort will be an organization much more effective and responsive to its environmental challenges and opportunities.

Relationships with customers and suppliers have enabled Green Mountain Coffee Roasters to establish itself as a strong competitor that adapts to and influences its environment. As you read the "Management Close-Up: Assessing Outcomes and Seizing Opportunities" feature, consider what qualities could help the company succeed in its expansion plans.

Management Close-Up

ASSESSING OUTCOMES AND SEIZING OPPORTUNITIES

After initially investing in Keurig's single-cup brewing system, Green Mountain Coffee Roasters' founder Bob Stiller saw a bigger opportunity. Because Keurig brewing systems sell at or near cost, the real money comes from the royalties other brands pay to have their coffee, tea, or cocoa products distributed in K-cups. So GMCR acquired Keurig in 2006. With that acquisition, GMCR's fortunes soared, growing at double-digit rates. The company forecasted a 40 to 45 percent increase in sales for a recent year.

Keurig has captured the single-brew coffee market in offices, hotel rooms, and homes, yet enormous potential remains. The office coffee market has about 2.6 million brewers. About 12 percent have single-cup systems, and half of those are Keurig's. About 80 percent of America's 5 million hotel rooms have traditional coffeemakers. As single-brew popularity spreads, GMCR sees upscale hotels as a prime target. But the fastest-growing market is homes. Keurig is used in just 6 percent so far, but the single-brew system is now available in retail outlets like Costco,

Sears, BJ's, and Macy's. On deck is a smaller, portable Keurig brewer with its own travel bag.

Two years after the Keurig acquisition, GMCR founder Stiller stepped down as president and CEO but remains chairman. The experience of his successor, Larry Blanford, helps GMCR continue its unprecedented growth. Blanford has a background in large consumer goods companies such as Maytag and Procter & Gamble.

Under Blanford, GMCR is continuing its expansion by opening roasting and K-cup processing units in Tennessee and buying Seattle-based Tully's Coffee. The Tully's acquisition provides a foothold in office coffee services, food service distributors, and more than 5,000 grocery stores in the West. The link to supermarkets reinforces the sale of Keurig brewers in supermarkets.[68]

- Despite economic and environmental uncertainty, GMCR is growing rapidly while its industry as a whole is struggling. Why do you think this is so?
- What should be Larry Blanford's next move as CEO?

KEY TERMS

SUMMARY OF LEARNING OBJECTIVES

Now that you have studied Chapter 2, you should be able to:

LO 1   Describe how environmental forces influence organizations and how organizations can influence their environments.

Organizations are open systems that are affected by, and in turn affect, their external environments. Organizations receive financial, human, material, and information resources from the environment; transform those resources into finished goods and services; and then send those outputs back into the environment.

LO 2   Distinguish between the macroenvironment and the competitive environment.

The macroenvironment is composed of international, legal and political, economic, technological, and social forces that influence strategic decisions. The competitive environment is composed of forces closer to the organization, such as current competitors, new entrants, substitute and complementary products, suppliers, and customers. Perhaps the simplest distinction between the macroenvironment and the competitive environment is in the amount of control a firm can exert on external forces. Macroenvironmental forces such as the economy and social trends are much less controllable than are forces in the competitive environment such as suppliers and customers.

LO 3   Explain why managers and organizations should attend to economic and social developments.

Developments outside the organization can have a profound effect on the way managers and their companies operate. For example, higher energy costs or increased spending on security may make it harder for managers to keep their prices low. The growing diversity of the labor force gives managers access to a much broader range of talent but also requires them to make sure different types of employees are treated equally. The worldwide increase in free trade can open up overseas markets, but it may also encourage more foreign competition in the domestic market. Effective managers stay aware of trends like these and respond to them effectively.

LO 4   Identify elements of the competitive environment.

Elements in the environment can range from favorable to unfavorable. To determine how favorable a competitive environment is, managers should consider the nature of the competitors, potential new entrants, threat of substitutes, opportunities from complements, and relationships with suppliers and customers.

Analyzing how these forces influence the organization provides an indication of potential threats and opportunities. Effective management of the firm's supply chain is one way to achieve a competitive advantage. Attractive environments tend to be those with high industry growth, few competitors, products that can be differentiated, few potential entrants, many barriers to entry, few substitutes, many suppliers (none with much power), and many customers. After identifying and analyzing competitive forces, managers must formulate a strategy that minimizes the power external forces have over the organization.

LO 5   Summarize how organizations respond to environmental uncertainty.

Responding effectively to the environment often requires devising proactive strategies to change the environment. Strategic maneuvering involves changing the boundaries of the competitive environment through domain selection, diversification, mergers, and the like. Independent strategies do not require moving into a new environment but rather changing some aspect of the current environment through competitive aggression, public relations, legal action, and so on. Cooperative strategies, such as contracting, cooptation, and coalition building, involve the working together of two or more organizations.

LO 6   Define elements of an organization's culture.

An organization's culture is its set of shared values and practices related to what is important and how the world works. The culture provides a framework that organizes and directs people's behavior at work. Elements of the culture may be expressed in corporate mission statements and official goals, assuming these reflect how the organization actually operates. Business practices are a basic measure of culture. Symbols, rites, ceremonies, and the stories people tell express and reinforce their cultural values.

LO 7   Discuss how an organization's culture affects its response to its external environment.

A culture may be strong or weak and may be one of four types: group, hierarchical, rational, or adhocracy. These cultures shape whether they are flexible and whether the focus is on the external or internal environment. Managing and changing the culture to align it with the organization's environment will require strong, long-term commitment by the CEO and other managers. Managers should espouse high ideals, pay constant attention to conveying values by communicating and modeling them, making decisions that are consistent with cultural values, and rewarding those who demonstrate the organization's values.

DISCUSSION QUESTIONS

1. This chapter's opening quote by Peter Drucker said, "The essence of a business is outside itself." What do you think this means? Do you agree?

2. What are the most important forces in the macroenvironment facing companies today?

3. Review the example in the three parts of the "Management Close-Up." What other organizations or industries have faced or are facing similar circumstances in their external environments?

4. What are the main differences between the macroenvironment and the competitive environment?

5. What kinds of changes do companies make in response to environmental uncertainty?

6. We outlined several proactive responses that organizations can make to the environment. What examples have you seen recently of an organization's responding effectively to its environment? Did the effectiveness of the response depend on whether the organization was facing a threat or an opportunity?

7. Select two organizations that you are interested in. Research information about the firms or talk with an employee, if possible. What types of cultures do they have? Write a paragraph that describes each culture.

8. When you visited colleges to select one to attend, were there cultural differences in the campuses that made a difference in your choice? Did these differences help you decide which college to attend?

CONCLUDING CASE

Wild Water Gets Soaked

Jason and Marie Salerno, brother and sister, have been running their family business, a water park called Wild Water, since they both graduated from college. The Salernos operate the park, which is located near the New Jersey shore, with help from their parents. Marie's husband and Jason's wife are also involved in the business. Wild Water has now been in business for more than 40 years—it is a landmark to both locals and summer tourists. The water park features such attractions as a wave pool, several water slides, a flume ride, a kiddie pool, and a tube ride. A picnic park, shaded petting zoo, aquarium, snack bar, and restaurant called the Seafood Shack round out the park's offerings.

The park opens on Memorial Day and cuts back to weekends only after Labor Day, typically closing in the fall. With just a few months to accumulate revenue, the family and employees of the park work extremely hard. Marie oversees the financial aspects of the business, while Jason manages the staff. The staff—ride operators, ticket takers, lifeguards, and the like—are very loyal. Some have parents who once worked at the water park, and many have siblings who also work there. By its very nature, the organization culture of Wild Water is hierarchical—but most who work there, including Jason and Marie, would refer to their employees as part of the family. Jason holds weekly staff meetings, where employees are encouraged to voice their ideas about any aspect of the park's operations. Photos of workers and customers line the walls of Jason and Marie's tiny office, and stories about the park and its people abound, including sightings of celebrity visitors and near-disasters such as a close call with a hurricane.

While the organization culture has remained largely unchanged for the past four decades, the environment in which the park operates is changing. A new state safety law requires some expensive updating to meet the code. The Salernos recently learned that some of the smaller beach cottages in the area are going to be torn down to make way for a development of expensive condominiums. Vacationers who rent the condos are more likely to be looking for entertainment in the form of golf, deep-sea fishing trips, and exclusive restaurants. One of the major amusement park chains has been looking at a piece of real estate nearby. This chain is well known for its high-end rides, shows, and eating establishments. The Salernos point out that an entire family could enter Wild Water for the cost of one ticket at one of the chain's parks.

While the Salernos acknowledge that they have serious challenges ahead, they remain upbeat. Wild Water has been a favorite of families for more than two generations, and they expect it to continue to be a destination for local residents as well as vacationers. But they need to make some changes to keep those visitors—and the new condo owners—coming through the turnstile.

QUESTIONS

1. Imagine that you are a management consultant hired by the Salernos to help them navigate the choppy waters ahead. First, describe the elements of the macroenvironment and competitive environment that affect Wild Water now. Then describe elements that you anticipate will affect the water park in the next few years.

2. Next, describe the organization's culture. Discuss how the current culture affects the way it responds to the organization's external environment.

3. Now, create a plan for Wild Water. In your plan, describe what changes the organization needs to make in its culture to meet upcoming challenges in the external environment. Then describe steps that Wild Water can take to compete successfully against the new amusement park. How can the Salernos keep their loyal customers happy while attracting new ones?

EXPERIENTIAL EXERCISES

2.1   External Environment Analysis

OBJECTIVE

To give you the experience of performing an analysis of a company's external environment

INSTRUCTIONS

Select a company you like in the music industry. Using online and/or library resources, including Web sites on the music industry and your company's Web site and annual report, fill out the following External Environment Worksheet for that company:

External Environment Worksheet

Laws and regulations
What are some key laws and regulations under which this company and the music industry must operate?
_____

_____

The economy
How does the state of the economy influence the sales of this company's products?
_____

_____

Technology
What new technologies strongly affect the company you have selected?
_____

_____

Demographics
What changes in the population might affect the company's customer base?
_____

_____

Social issues
What changes in society affect the market for your company's music products?
_____

_____

Suppliers
How does your company's relationship with suppliers affect its profitability?
_____

_____

Competitors
What companies compete with the firm you have selected? Do they compete on price, on quality, or on other factors?
_____

_____

New entrants
Are new competitors to the company likely? possible?
_____

_____

Substitutes and Complements
Is there a threat of substitutes for the music industry's existing products? Are there complementary products that suggest an opportunity for collaboration?
_____

_____

Customers
What characteristics of the company's customer base influence the company's competitiveness?
_____

_____

DISCUSSION QUESTIONS

1. What has the company done to adapt to its environment?

2. How does the company attempt to influence its environment?

2.2 Corporate Culture Preference Scale

OBJECTIVE

This self-assessment is designed to help you to identify a corporate culture that fits most closely with your personal values and assumptions.

INSTRUCTIONS

Read each pair of the statements in the Corporate Culture Preference Scale and circle the statement that describes the organization you would prefer to work in. This exercise is completed alone so students assess themselves honestly without concerns of social comparison. However, class discussion will focus on the importance of matching job applicants to the organization's dominant values.

Corporate Culture Preference Scale

I would prefer to work in an organization:

1a.	Where employees work well together in teams.	**OR**	1b. That produces highly respected products or services.
2a.	Where top management maintains a sense of order in the workplace.	**OR**	2b. Where the organization listens to customers and responds quickly to their needs.
3a.	Where employees are treated fairly.	**OR**	3b. Where employees continuously search for ways to work more efficiently.
4a.	Where employees adapt quickly to new work requirements.	**OR**	4b. Where corporate leaders work hard to keep employees happy.
5a.	Where senior executives receive special benefits not available to other employees.	**OR**	5b. Where employees are proud when the organization achieves its performance goals.
6a.	Where employees who perform the best get paid the most.	**OR**	6b. Where senior executives are respected.
7a.	Where everyone gets his or her job done like clockwork.	**OR**	7b. That is on top of new innovations in the industry.
8a.	Where employees receive assistance to overcome any personal problems.	**OR**	8b. Where employees abide by company rules.
9a.	That is always experimenting with new. ideas in the marketplace.	**OR**	9b. That expects everyone to put in 110 percent for peak performance.
10a.	That quickly benefits from market opportunities.	**OR**	10b. Where employees are always kept informed of what's happening in the organization.
11a.	That can quickly respond to competitive threats.	**OR**	11b. Where most decisions are made by the top executives.
12a.	Where management keeps everything under control.	**OR**	12b. Where employees care for each other.

SOURCE: Steven L. McShane and Mary Ann Von Glinow, *Organizational Behavior,* 3rd ed. (New York: McGraw-Hill/Irwin, 2005), p. 499. © 2005 The McGraw-Hill Companies.

Scoring Key for the Corporate Culture Preference Scale

Scoring Instructions: In each space, write in a "1" if you circled the statement and "0" if you did not. Then add up the scores for each subscale.

Control Culture _____ + _____ + _____ + _____ + _____ + _____ = _____
(2a)   (5a)   (6b)   (8b)   (11b)   (12a)

Performance Culture _____ + _____ + _____ + _____ + _____ + _____ = _____
(1b)   (3b)   (5b)   (6a)   (7a)   (9b)

Relationship Culture   _____ + _____ + _____ + _____ + _____ + _____ = _____
                                    (1a)   (3a)   (4b)   (8a)   (10b)   (12b)

Responsive Culture   _____ + _____ + _____ + _____ + _____ + _____ = _____
                                    (2b)   (4a)   (7b)   (9a)   (10a)   (11a)

Interpreting Your Score: These corporate cultures may be found in many organizations, but they represent only four of many possible organizational cultures. Also, keep in mind none of these subscales is inherently good or bad. Each is effective in different situations. The four corporate cultures are defined here, along with the range of scores for high, medium, and low levels of each dimension based on a sample of MBA students:

Corporate Culture Dimension and Definition   **Score Interpretation**

Control Culture: This culture values the role of senior executives to lead the organization. Its goal is to keep everyone aligned and under control.

High: 3 to 6
Medium: 1 to 2
Low: 0

Performance Culture: This culture values individual and organizational performance and strives for effectiveness and efficiency.

High: 5 to 6
Medium: 3 to 4
Low: 0 to 2

Relationship Culture: This culture values nurturing and well-being. It considers open communication, fairness, teamwork, and sharing a vital part of organizational life.

High: 6
Medium: 4 to 5
Low: 0 to 3

Responsive Culture: This culture values its ability to keep in tune with the external environment, including being competitive and realizing new opportunities.

High: 6
Medium: 4 to 5
Low: 0 to 3