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978-1-107-01105-2 - Innovating Organization and Management: New Sources of Competitive Advantage

Nicolai J. Foss, Torben Pedersen, Jacob Pyndt and Majken Schultz

Excerpt

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# I New sources of competitive advantage

## THE SEARCH FOR CORPORATE SUCCESS

Why are some firms successful – perhaps continually – while others are not? This is *the* fundamental question in the field of strategic management. In this regard, we argue that more attention needs to be dedicated to the role of organizational design and management processes in an attempt to understand corporate success. In this chapter, we provide an overview of our main arguments and explain a number of the key concepts and ideas used throughout this book.

The search for corporate success serves as the basis for organizational strategy. In the jargon of the strategic management field, the search for success is equivalent to the search for competitive advantage – the potential to earn above-average returns. The key question, then, is the following: What are the sources of those competitive advantages?

The answers provided by almost fifty years of academic research and practitioner interest have varied widely. Early research stressed that a strategist's aim should be to ensure that the various functions of the firm are tightly integrated and aligned with the firm's external environment. Later work, the most notable of which is the well-known five forces framework developed by Michael Porter, put almost all of the emphasis on how the strategist handles the environment in terms of positioning the firm relative to the threats posed by various competitive forces.<sup>1</sup> The internal workings of the firm have been the subject of less interest, although Porter himself later added an analysis

<sup>1</sup> The five forces framework is covered in virtually all strategy textbooks. The original source is Michael Porter's 1980 book, *Competitive Strategy* (New York: The Free Press).

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of value creation in firms through his notion of the value chain, which can be broken down into activities and value drivers.<sup>2</sup>

In recent decades, the business “environment” in its broadest sense has been radically reshaped. Globalization and its related process of deregulation mean that traditional bases of firm advantages, such as privileged or unique access to financial capital, labor, land, or markets, have declined in importance. In their place, a firm’s ability to build, hone, upgrade, leverage, and extend specialized productive knowledge – so-called “capabilities” or “competencies” – is increasingly viewed as important, particularly those “dynamic capabilities” that allow a firm to modify its existing routines, procedures, or capabilities (Chapter 2 provides a primer on these ideas).

Our message in this book, therefore, is that there are sources of competitive advantage and financial success that, while never entirely absent from strategic management, have not been given the attention they deserve. These sources of competitive advantage are rooted in organizational design and management processes.

For example, consider a group of firms that includes DuPont, General Motors, Sears Roebuck, 3M, Toyota, Lincoln Electric, and Oticon. Even if you do not know that Lincoln Electric is a world leader in the production of arc welders or that the Danish hearing-aid producer Oticon plays a similar role in the hearing aid industry, you would be able to deduce that there is a high degree of diversity in this group of firms. Their industries, sizes, and organizational forms differ considerably. However, there is one striking similarity: A substantial part of the success of these firms can be ascribed to the ways in which they have structured their organization and management processes.

In the 1920s, DuPont, GM, and other major American corporations implemented an organizational structure known as the “multi-divisional form” (the M-form). On the basis of this organizational

<sup>2</sup> The value chain is now recognized as a staple of strategic management. The original source is Michael Porter’s 1985 book, *Competitive Advantage* (New York: The Free Press).

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[More information](#)**BOX 1.1 The M-form**

“Multidivisional form” (M-form) describes a type of organizational structure that consists of a set of semi-autonomous units, typically product divisions, which are mainly controlled by the financial targets set by corporate headquarters. This organizational form substantially reduces the monitoring burden placed on the headquarters. The M-form combines complementary activities (R&D, production, sales, etc.) in organizational units. The relative autonomy available to units in an M-form organization creates room for local experimentation and flexibility.

The M-form of organization is typically depicted in contrast with the U-form (unitary), which was common prior to the introduction of the M-form. The U-form pools similar tasks in organizational units. Therefore, instead of defining divisions on product criteria, they are defined on the basis of task criteria. This organizational format is harder to manage but may offer scale advantages.

The classical work on these organizational forms is *Strategy and Structure: Chapters in the History of the American Industrial Enterprise* by Harvard University Business History Professor Alfred Chandler (Cambridge, MA: MIT Press). The book, published in 1962, revolutionized the field of business history.

concept, major industrial firms were organized in divisions defined by products rather than by function (see Box 1.1).

This organizational redesign offered several benefits. First, it reduced the coordination challenges faced by corporate headquarters and released managerial attention, which could be refocused on corporate strategy issues. Second, it made it easier to define performance targets for divisional managers and reward them accordingly.

In 1991, Oticon implemented a new version of the M-form in the form of a highly decentralized “spaghetti organization” – a radical attempt to build an internal market for projects and jobs inside the firm. Bottom-up initiatives were stimulated by delegating the rights to initiate and run major research and development (R&D) and

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**BOX 1.2 The Oticon spaghetti organization**

The turnaround in Oticon, a world leader in the hearing aid industry, is a common topic in organizational change literature. To restore innovativeness and entrepreneurial spirit in a firm that had become a low performer in the industry, CEO Lars Kolind decided to adopt an organizational form that was designed to mimic the market with respect to creativity and flexibility.

The “spaghetti organization” – named for its ability to be simultaneously both flexible and structured, like cooked spaghetti – was implemented on August 8, 1991 at 8:00 a.m. It consisted of a very flat structure with considerable autonomy allotted to employees to start and participate in development and marketing projects. The adoption of this organizational style restored entrepreneurial spirit in the company and produced a series of breakthrough innovations that led to impressive financial performance.

The story of Oticon is told in Nicolai J. Foss’s “Selective intervention and internal hybrids: Interpreting and learning from the rise and decline of the Oticon spaghetti organization,” *Organization Science*, 14 (2003), 331–49.

development projects to employees. This was complemented with an emphasis on high-powered performance incentives.

Oticon was not the only company to adopt radically new concepts in organization. In the 1980s, 3M was one of the first firms to refine the role of the firm as an incubator and financier of spin-offs. Toyota’s experience with quality circle organization goes back to the 1950s and lean production has similar origins. Many contemporary management principles, such as discounted cash flow and activity-based costing, were developed, at least partly, as management practices in functioning companies.

**MANAGEMENT INNOVATION**

A significant amount of evidence suggests that the new organizational arrangements were vital to the performance successes of the firms that

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[More information](#)**BOX I.3 Management innovation**

Julian Birkinshaw, Gary Hamel, and Michael Mol have recently drawn attention to “management innovations.” In an award-winning article entitled “Management innovation” (*Academy of Management Review*, 33 (2008), 825–45) and in various other books and articles, they argue that academics and practitioners alike have emphasized innovations in products and processes but have paid much less attention to management innovations. They explicitly cite the examples mentioned above (the M-form and the spaghetti organization) as examples of management innovations.

Birkinshaw and Mol’s *Giant Steps in Management: Innovations that Change the Way You Work* (London: Prentice Hall, 2007) identifies what the authors argue are the fifty most important management innovations of the last 150 years.

implemented them. However, these arrangements greatly contributed not only to the performance successes of the relevant firms but also to the *novelty* of these situations. At the time of their implementation, the M-form, the spaghetti organization, the 3M incubator model, and the Toyota quality circles were highly *innovative* organizational practices. They may therefore be regarded as distinct “management innovations,” on a par with innovations in products and production processes.

Little is known about the conditions that prompt management innovations and the effects that arise from such innovations. Managers who seek to innovate processes and organizations therefore have little decision support in management research.

One reason why we know relatively little about management innovations is that – in their pure form – they are quite rare. It is sometimes argued that an innovation is something that is entirely new, such as the invention or adoption of a new production process. Such innovations occur more frequently in products or production processes than in management practices and organizational design.

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However, from a realist perspective, newness comes in degrees. A change in organizational design or management processes can be new to the world, to an industry, to a firm, or to a manager. While such a novelty may not be entirely new in a global sense, it may still be a source of advantage. A firm in an industry may benefit from imitating organizational forms, management practices, or business models used in other industries. In fact, new organizational designs and management processes tend to spread following their introduction to an industry by a pioneer firm (often inspired by developments in other industries). Industry incumbents later imitate the pioneer. This was true for the spread of the M-form, although it took that particular organizational form several decades to cross the Atlantic from the USA to Europe.

If we wish to understand how new organizational designs and management processes may give rise to successful performance, we cannot limit ourselves to those management innovations that are innovations in the strict, new-to-the-world sense. The perhaps more mundane management innovations – those innovations that are new to an industry or even “only” new to a firm – are certainly also interesting and relevant. This is the perspective we take in this book.

ORGANIZATIONAL DESIGN AND MANAGEMENT  
PROCESSES: SOURCES OF COMPETITIVE ADVANTAGE

The dominant thinking in strategic management stresses the importance of assets, such as reputation, intellectual property rights, and relations with suppliers and customers. Less attention has been dedicated to organizational design and new management processes. However, the above discussion highlights the fact that such designs and processes can serve as *strategic resources* for firms.<sup>3</sup> In other words, if they are properly organized and deployed, such resources

<sup>3</sup> In some cases, this was only realized *ex post*. For example, in General Motors, the M-form appears to have been implemented as a last-ditch effort to save a firm that was close to bankruptcy. The amount of rational planning and foresight behind the implementation seems to have been miniscule. However, the new organizational form contributed to the success of the firm.

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can contribute decisively to corporate success. Thus, they contribute to the value the company can create and the value it can appropriate. They also help to make sure that the focal firm's level of appropriated value is higher than that of the competition.

As mentioned above, management academics have only recently begun to put their academic talents to use in the analysis of management innovation. Therefore, the ways in which management innovations and improvements in organization and management processes can contribute to competitive advantage are far from fully understood. Despite cases such as those discussed here, the role of organizational design and management processes as drivers of value creation, value appropriation, and the competitive advantages of firms is still neglected by practitioners and management academics alike. It is not unfair to say that there is still a strong tendency to think of these designs and processes as necessary facilitators of successful performance rather than as drivers of such performance in their own right, although this may be a somewhat crude generalization.

#### THE PURPOSE OF THIS BOOK

##### *Four key ideas*

The key purpose of this book is to improve management students' and academics' appreciation of the importance of organizational design and managerial processes to a firm's success. We emphasize both theoretical arguments (in this and the following chapter as well as in the concluding chapter) and case descriptions.

We develop four key points theoretically and illustrate them empirically. First, we argue that organizational design and management processes may be strategic resources *in their own right*. In other words, innovation in organization and management may create value, may assist in the appropriation of value, and may sustain these processes on levels above those attained by the competition.

Second, organizational design and management processes can be deployed to *create new strategic resources*. Notably, organizations

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**BOX 1.4 Key ideas**

Organizational design and management processes:

1. can serve as strategic resources;
2. may be deployed to assist in the creation of new strategic resources;
3. are increasingly considered by managers in a proactive way; and
4. may sometimes be described as “management innovations.”

can be designed to increase their receptivity to outside knowledge and ideas.

Third, managers have begun to think of organizational design and management processes in a *proactive* way rather than seeing them more passively as necessary facilitators of success. This is evident in a number of our cases. The interest in business models that began with the dot-com revolution, and its related focus on the stark contrast between the companies of the “old economy” and those of the “new economy,” most likely did much to stimulate this interest.

Fourth, this new way of looking at organization and management requires a search for *new* ways of structuring organizational design and managerial processes. In this regard, we establish a link with the management innovation theme (see Box 1.3).

*Our cases and their lessons*

To drive home these points, we examine a series of business cases encompassing the Danish firms LEGO Group, Vestas Wind Systems, Coloplast, Chr. Hansen, IC Companys, and NKT Flexibles. These companies differ significantly across a number of basic dimensions, such as industry, size, and age. However, these firms all explicitly treat their organization and management systems as key strategic resources. Moreover, they view their organization and management processes as more than just passive facilitators of strategies. The



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philosophy that underlies the experimentation with organization and management processes in these firms is that there is more to organizational design than just the implementation of efficient ways of organizing those resources that the firm already controls. In fact, these firms *explicitly* see organizational design and management processes as structures that can further the development of those resources that will allow them to compete in the future. In other words, they think of their organizational and management processes as what the strategic management literature defines as “dynamic capabilities.”

A fundamental difference between the case examples discussed in this book and the cases mentioned above (DuPont, Sears Roebuck, etc.) is the role of organizational design and management processes in the strategy of the firms in question. For the Danish firms investigated here, organization and processes do more than support the firm’s strategy – they are, in a very real sense, *part* of the strategy. This may sound similar to the idea of a business model – the way in which a company makes money in terms of articulating competencies to a specific environment through a defined mission. However, we have more in mind than this well-established concept.

Consider the toy producer LEGO Group, the eighth-largest firm in the global toy industry and one of the world’s most recognized brands. In recent years, LEGO® has engaged in a major turnaround program – a crucial component of which is a series of deep-seated changes in the firm’s organizational and management processes. Notably, the firm’s current organizational design goes beyond supporting the firm’s overall strategy: *The design itself and its complementary management processes are viewed as sources of new learning for the organization.* Such new learning, in turn, may give rise to new capabilities that can serve as the foundation for new strategies.

In particular, LEGO has adopted an organization form designed to improve its ability to tap into the creativity of LEGO fans and consumers. It has done so through such initiatives as the LEGO Community (which organizes hardcore fans and lead users, some of whom have become LEGO Certified Professionals) and by supporting

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**BOX 1.5 Open innovation**

The basic idea behind “open innovation” is that companies increasingly need to source the knowledge needed in their innovation process from external knowledge sources. In other words, they cannot rely solely on knowledge produced internally, such as knowledge produced through the R&D function, if they wish to remain competitive. They increasingly need to tap into knowledge held by suppliers, customers, academics, and firms that control complementary technologies.

An excellent introduction to open innovation can be found in Henry Chesbrough’s *Open Innovation: The New Imperative for Creating and Profiting from Technology* (Boston: Harvard Business School Press, 2003), which coined the concept of open innovation.

user communities created by fans, including user-organized conventions. This has led to a continual process of what the company refers to as “co-creation by fans.” In fact, LEGO is moving beyond the user-innovation model and is, in general, striving to make its corporate boundaries more permeable. This shift includes moves toward closer cooperation with suppliers, as declared by CEO Jørgen Vig Knudstorp:

We are in the process of breaking up the value chain and inviting people in everywhere in the value chain. This is a paradigmatic shift that has huge implications for management, for our mindset, for incentive structures, for creativity and for all other aspects of the firm.

In effect, LEGO has adopted an “open innovation” model – shifting much of the creation and sourcing of knowledge from internal sources to external sources – and has taken it to what seems to be an extreme.

This example illustrates that organization and management processes can serve as sources of competitive advantage and success not only because they are resources in their own right but also because they contribute to the creation of new strategic resources. This is not the way practitioners, gurus, and management academics have