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Wayne F. Cascio and John W. Boudreau
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1 What is strategy?

This book is about human resource (HR) strategy – *the decisions, processes, and choices that organizations make about managing people*. It is designed as a primer for students in master of business administration (MBA) or HR programs, as well as for HR and organization leaders and general managers. It aims to provide an overview of the elements of human resource plans at the strategic, operational, unit, and functional levels.

It is more than that, however. A unique aspect of this book is that we have incorporated a consistent perspective that human resource or human capital strategy is also about risk optimization and management. It is difficult to consider any arena of management without attention to risk, and this is especially true in the arena of human capital. Integrating risk into human resource strategy is a less traditional way to approach the topic, but an increasingly uncertain world demands such a perspective.

Not only is it important to incorporate risk more explicitly into the framework of human capital strategy, but also, we believe, doing so will enhance and extend the paradigms of human capital planning in new and useful directions, producing a unique perspective for leaders inside and outside the HR function. We will have much more to say about risk optimization and management in later chapters. The purpose of this opening chapter is to explore some of the fundamental ideas that underpin organizational strategy in general, because organizational strategy is the foundation of human resource strategy.

Strategy consists of the decisions, processes, and choices that organizations make to position themselves for sustainable success.[1] These decisions, processes, and choices define a firm's competitive position in the marketplace. This is the most common perspective, and one that we adopt frequently in our examples. This definition also

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includes organizations that are not companies, that operate in non-market environments, and that may define strategic success differently from financial or competitive outcomes. Nonetheless, the fundamental elements of strategy, including relative positioning, decisions, stakeholders, and dynamism, apply to all organizations.

Think of the automobile industry, for example. Think about the differences between the cheapest cars available (Chevy Aveo, Tata Nano), mid-priced offerings (Honda Accord, Toyota Camry), luxury cars (BMW, Mercedes, Lexus), and ultra-luxury cars (Rolls-Royce, Bentley, Aston Martin). Think about the differences between sedans, sports cars, and sport-utility vehicles, and between convertibles, hard tops, and hard-top convertibles. It is all about positioning a product or service in the marketplace (competitive positioning) so that it appeals to different customer segments.

Strategy answers the following questions. Why should customers buy from your company, as opposed to one of your competitors? What do you do better than anyone else? What do you offer that is valuable, rare, and difficult to imitate? Do you offer products or services that no other competitor can match, such as a patent-protected miracle drug? Do you offer the cheapest products or services? Are your products or services the highest-quality ones available? Do they fill a specialized niche? Do you deliver your products or services more rapidly than any competitor can? Does your company distinguish itself by providing the very best customer service? Competitive strategy is about the choices and trade-offs that firms make. It is about being different. It means deliberately choosing a different set of activities in order to deliver a unique mix of value to the customer.[2]

To appreciate how differences define competitive strategy, consider that a full-service airline is configured to get passengers from almost any point A to any point B. To reach a large number of destinations and serve passengers with connecting flights, full-service airlines employ a hub-and-spoke system centered on major airports. To attract passengers who desire more comfort, they offer first-class or business-class service. To accommodate passengers who must change planes, they coordinate schedules and check and transfer baggage. Because some passengers will be traveling for many hours, full-service airlines serve meals.[3]

In contrast, Southwest Airlines Company offers short-haul, low-cost, point-to-point service between midsize cities and secondary airports

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in large cities. It does not fly great distances, and, at least in its early years, it avoided large airports. Its customers include business travelers, families, and students. Southwest's frequent departures and low fares attract price-sensitive customers who otherwise would travel by bus or car, and convenience-oriented travelers who would choose a full-service airline on other routes.[4] As you can see from this brief introduction, strategy is the foundation for all organizational decisions.

Strategy provides an overall direction and focus for the organization as a whole, including for each functional area. In this book our primary focus is on one functional area: HR strategy. Overall business strategy, through its hierarchy of goals – vision, mission, and strategic objectives – provides helpful guidance about the type of talent that will be necessary to fulfill the organization's strategic objectives, and to move toward its mission and vision. HR strategy is much more specific with respect to the selection, deployment, and management of that talent.

Corporate identity: fundamental enabler of strategy

A distinctive, coherent corporate identity is the fundamental enabler of strategy and the source of competitive advantage.[5] It is the quality that attracts customers, allies, stakeholders, investors, employees, and suppliers. It is grounded in the things that an organization can do with distinction (its internal capabilities) and in market realities (based on its assessment of the external environment and the industry or industries in which it chooses to compete). To develop its own capabilities-driven strategy, each organization must be able to answer questions such as the following. How do you capture value, now and in the future, for your chosen customers? What are your most important capabilities, and how do they fit together? How do you align them with your portfolio of products and services? The more clearly and strongly a company makes these choices, the better its chances of creating a corporate identity that allows it to win in the long run.[6]

Strategy formulation

Strategy formulation answers the basic question "How will we compete?"[7] Answering this question is a vital role of senior leaders within an organization, and to do so they typically consider trends and forces in the competitive environment, customer wants and

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needs, competitive positioning, and their firms' internal strengths and weaknesses. In this section we consider frameworks for analyzing the external environment, and in the following section we do the same with respect to internal strengths and weaknesses.

A popular framework for analyzing environmental opportunities and threats in an industry is the "five-forces model" that Michael Porter and his associates have developed. It considers the threat of new entrants, the power of suppliers, the power of buyers, the threat of substitutes, and rivalry among competitors.[8]

Typical steps in the analysis include: (1) definition of the industry (products, geographic scope); (2) identification of participants (buyers, suppliers, competitors, substitutes, potential entrants); (3) identification of the overall industry structure (forces that control profitability, understanding why the level of profitability is what it is); (4) analysis of recent and likely future changes in each force; and (5) identification of aspects of industry structure that might be influenced by competitors, new entrants, or your company. The overall objective is to understand the underpinnings of competition and the root causes of profitability. This is the job of the strategist: to understand and cope with competition.[9]

Strategy can also usefully be viewed as building defenses against competitive forces or finding a position in the industry at which the forces are weakest. Here is an example presented by Porter.[10] Paccar Inc. manufactures premium commercial vehicles sold around the world under the Kenworth, Peterbilt, and DAF nameplates. The heavy-truck industry is structurally challenging. Many buyers operate large fleets or are large leasing companies, with both the leverage and the motivation to drive down the price of one of their biggest purchases. Most trucks are built to regulated standards and offer similar features, so price competition is rampant. Capital intensity causes rivalry to be fierce, especially during recurring cyclical downturns. Unions exercise considerable supplier power. Although there are few direct substitutes for an eighteen-wheeler, truck buyers face important substitutes for their services, such as cargo delivery by rail.

In this setting, Paccar, a company based in Bellevue, Washington, with about 20 percent of the North American heavy-truck market, has chosen to focus on one group of customers: owner-operators – drivers who own their trucks and contract directly with shippers or serve as

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subcontractors to larger trucking companies. Such small operators have limited clout as truck buyers. They are also less price-sensitive, because of their strong emotional ties to and economic dependence on the product. They take great pride in their trucks, in which they spend most of their time.

Paccar has invested heavily in order to develop an array of features with owner-operators in mind: luxurious sleeper cabins, plush leather seats, noise-insulated cabins, sleek exterior styling, and so on. At the company's extensive network of dealers, prospective buyers use software to select among thousands of options to put their personal signature on their trucks. These customized trucks are built to order, not to stock, and delivered in six to eight weeks. Paccar's trucks also have aerodynamic designs that reduce fuel consumption, and they maintain their resale value better than other trucks. Paccar's roadside-assistance program and its system for distributing spare parts, which is supported by information technology (IT), reduce the time a truck is out of service. All these are crucial considerations for an owner-operator. Customers pay Paccar a 10 percent premium, and its Kenworth and Peterbilt brands are considered status symbols at truck stops.

Paccar illustrates the principles of positioning a company within a given industry structure. The firm has found a portion of its industry in which the competitive forces are weaker – in which it can avoid buyer power and price-based rivalry – and it has tailored every single part of the value chain to cope well with the forces in its segment. As a result, Paccar has been profitable for sixty-eight years consecutively and has earned a long-run return on equity of more than 20 percent.

Strategy formulation may be quite formal and last for long periods, or it may be highly dynamic and adaptive, as was the case during the Great Recession of 2007–9. In response to sharp swings in consumer demand during the recession, many firms discovered that increased flexibility and accelerated decision making were preferable to static five-year strategic plans. What was new was a heavy dose of opportunism based on rough "adaptive strategies" that considered multiple scenarios. For example, before the recession and the housing crisis, appliance maker Whirlpool Corporation considered scenarios based on a 5 percent increase or decrease in consumer demand. During the recession, however, the firm discovered that the rate of

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change and the width of volatility were considerably greater than it had assumed previously. The company now considers alternative scenarios in response to swings as wide as 15 percent.[11] In the process of strategy formulation, analysis of the competitive environment is necessary, but not sufficient. A complete understanding of the sources of competitive advantage also requires analyses of a firm's strengths and weaknesses.

Analyzing internal strengths and weaknesses

Internal strengths and weaknesses arise from "resources" and "capabilities." In their quest to develop bases for competitive advantage, firms try to offer something that is valuable, rare, and difficult to imitate. This section considers each of these.

A firm's resources and capabilities add value by allowing it to exploit opportunities or to neutralize threats.[12] 3M, for example, used its skills and experience in substrates, coatings, and adhesives – along with an organizational culture that rewards risk taking and creativity – to exploit numerous market opportunities in six broad areas: consumer and office; display and graphics; electro and communications; healthcare; industrial and transportation; and safety, security, and protective services. Some of its notable products include Scotch-Brite™ cleaning products, Scotch® tapes, Nexcare™ skincare products, Scotchguard™ fabric protection, Microtouch™ touch screens, Fastbond™ adhesives, Filtrete™ air filters, O-Cel-O™ sponges, and Post-it® notes.[13]

Strategically, 3M's managers linked their analysis of the firm's internal resources and capabilities with their analysis of environmental opportunities and threats. Those resources are not valuable on their own, but they become valuable when they exploit opportunities or neutralize threats. For example, Post-it® notes exploited an untapped opportunity in the marketplace for adhesive-backed notepads that do not lift the print off of the paper on which they are stuck. The "five-forces model" that we discussed earlier can be used to isolate potential opportunities and threats that can be exploited or neutralized by the resources a firm controls.

As Jay Barney has noted, valuable but common resources and capabilities are sources of competitive parity.[14] To be a genuine source of competitive advantage, a firm's resources and capabilities must be rare among competing firms. Consider, for example, Apple Inc.'s

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meticulous attention to product design and functionality. These features have made products such as the iPod, iPhone, iPad, and Macintosh computers favorites among consumers. In fact, in 2012 Apple topped *Fortune* magazine's listing of "World's most admired companies" for the fifth year in a row. What makes Apple so admired? Well, for starters, this is the company that changed the way we do everything from buying music to engaging with the world around us (think about instant access to the internet from mobile devices, such as the iPhone and iPad). Its track record for innovation and fierce consumer loyalty translates into tremendous respect across the highest ranks of business; or, as BMW chief executive officer (CEO) Norbert Reithofer put it, "The whole world held its breath before the iPad was announced. That's brand management at its very best."[15]

Firms that possess valuable, rare resources and capabilities can gain at least a temporary competitive advantage – unless or until competitors are able to imitate them. If competing firms face a cost disadvantage in imitating these resources and capabilities, however, then firms with these special abilities can obtain a sustained competitive advantage over time.[16] Such is the case with operating systems for personal computers (PCs), which are exceedingly complex and difficult to imitate. This helps to explain why Microsoft's Windows™ and Apple's MAC OS X™ operating systems have a near-monopoly on the PC market worldwide.

Finally, to exploit its potential fully for competitive advantage, a firm needs "complementary resources," in the form of organizational structure and management systems. These include reporting relationships, management control systems, and compensation policies.[17] To appreciate the importance of these organizational resources, consider an example presented by Barney. Through the 1960s and early 1970s Xerox invested in a series of innovative technology-development research efforts through its stand-alone research laboratory, Xerox PARC, in Palo Alto, California. The innovative scientists and engineers who worked there developed an amazing array of technological innovations, including the personal computer, the mouse, windows-type software, the laser printer, and Ethernet, among others. These technologies were rare, and their market potential was enormous.

Unfortunately, Xerox did not have an organization in place to take advantage of these resources. No structure existed by which Xerox

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PARC's innovations could become known to managers at Xerox. When managers finally did become aware of these innovations, in the mid-1970s, very few of them survived Xerox's highly bureaucratic product-development process. Moreover, Xerox managers failed to exploit fully those that did, because their own compensation depended on maximizing current revenue, not developing markets for future sales and profitability. Xerox's formal reporting structure, its explicit management-control systems, and its compensation policies were all inconsistent with exploiting the valuable, rare, and costly-to-imitate resources developed at Xerox PARC.[18] Not surprisingly, then, Xerox failed to exploit any of these potential sources of sustained competitive advantage.[19]

Broad strategies for achieving competitive advantage

At a broad level, firms may achieve competitive advantage through strategies such as cost leadership, differentiation, or speed, or by focusing narrowly on a market segment. For instance, differentiation as a strategy seeks to exploit differences in a firm's products or services by creating something that is perceived industry-wide as unique and valued by customers; examples include:

- prestige (Ritz-Carlton hotels or BMW automobiles);
- technology (Bose sound systems, Apple's iPad);
- innovation (Apple, 3M, Medtronic medical equipment, Intel); and
- customer service (Lexus, Amazon.com).

FedEx CEO and founder Fred Smith claims that the key to his firm's success is innovation. He contends that his management team did not understand its real goal when the firm started operating in 1971: "We thought that we were selling the transportation of goods; in fact, we were selling peace of mind."[20] To that end, by 2000 FedEx was providing each driver with a hand-held computer and a transmitting device, so as to make it possible for customers to track their packages right from their PCs (and, today, from their mobile devices).

While it is possible to provide examples of each of the broad strategies that enable firms to differentiate themselves from competitors, pure forms of them are rare. Consider Amazon, for example, the king of e-commerce, and one of *Fortune* magazine's top five "World's most admired companies" in 2011.[21] Amazon excels in innovation, in cost

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leadership, and in customer service. Founded in 1994 as an online bookstore, Amazon is now the internet's largest retailer, with some 33,700 employees and 2011 sales of $48.1 billion. In the area of innovation, consider Amazon's e-reader, the Kindle. In 2011 the company sold more than 12 million Kindles, making it Amazon's best-selling product. More importantly, the Kindle allowed Amazon to stake out an early lead in e-books. Since 2010 it has sold three times as many e-books as hardcovers, and it dominates the fast-growing new market. Indeed, creating the hardware helped create the market.

In terms of cost, in a Morgan Stanley survey of fifty products, Amazon sold items for 6 percent less, on average, than Wal-Mart and 9 percent less than Best Buy. Finally, Amazon's customer service (along with that of its subsidiary, Zappos) ranked higher than any other retailer's, according to a recent National Retail Federation survey. Amazon recognizes the need to continue to innovate, for that is the only way to outrun the competition. Recently it introduced Amazon Prime, which offers free shipping for a $79 annual fee. The program is a hit with customers and a way for Amazon to boost repeat sales across its categories – a difficult feat for online retailers to achieve.[22]

Strategy analysis

Strategy analysis is the process that defines the crucial (or pivotal) elements for the strategy's success. It answers the question "Where does superior execution most enhance our strategic success?" Analyzing the overall strategy to reveal the implications of these pivotal elements focuses attention on the execution of the broader business strategy.

As an example, consider Sysco Corporation of Houston, Texas. Sysco is the number one food service marketer and distributor in North America. In fiscal year 2010 its revenues exceeded $37 billion, it employed almost 50,000 people, and it served 500,000 customers with approximately 300,000 different products. What makes Sysco special is that it excels in innovation as well as in the execution of a well-developed strategy. That strategy is based on differentiation. To do that, the company serves not just as a vendor to its customers, but also as a partner, for its objective is to help its customers succeed. One way it does this is by providing third-party financing for its customers – restaurant owners who seek financing for a new kitchen, for example.

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In terms of strategy execution, consider just one business process: order fulfillment. Of the more than 4 million cases of food and related products that Sysco ships every day, it receives about 85 percent of its orders after 5:30 p.m. the day before they are supposed to be delivered. The company relies on an enterprise resource planning (ERP) system, an integrated computer-based application, to process orders and to set up routing. Warehouse employees wear wrist computers to ensure correspondence between customers' orders and the items that actually are loaded onto trucks for delivery. This process results in more than 99 percent accuracy.[23]

ERP systems facilitate the flow of information among all business functions inside the boundaries of the organization, and they manage the connections to outside stakeholders.[24] At Sysco, delivery trucks are loaded in the middle of the night from warehouses, and they are dispatched up to 150 miles away, beginning at 5:00 a.m. Such dedication to process has resulted in high levels of control as well as transparency. Beyond that, Sysco's compensation system for drivers – activity-based compensation – rewards them for delivering customers' orders on time and in good condition. This is strategy analysis that leads to strategy execution.

The process of accurate, timely order fulfillment is aligned with incentive compensation to ensure end-to-end excellence in the overall process of order realization. Such alignment leads to solid execution of a critically important aspect of Sysco's well-developed strategy. Execution represents the implementation of strategy and makes it real, so that an organization can sustain its competitive advantages. At a broader level, how firms compete with each other, and how they attain and sustain competitive advantage, constitute the essence of what is known as strategic management.[25]

Before we leave the subject of execution, which focuses on operational effectiveness (OE), it is important to emphasize that OE is not strategy.[26] OE means performing similar activities better than rivals. Execution-oriented ideas, such as reengineering, benchmarking, outsourcing, and change management, all have the same strategic limit; that is, they all lead to better operations, but ignore the question of which businesses to operate in the first place. This is why strategy formulation must precede strategy analysis. First choose industries or markets in which overall conditions are favorable – most companies

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