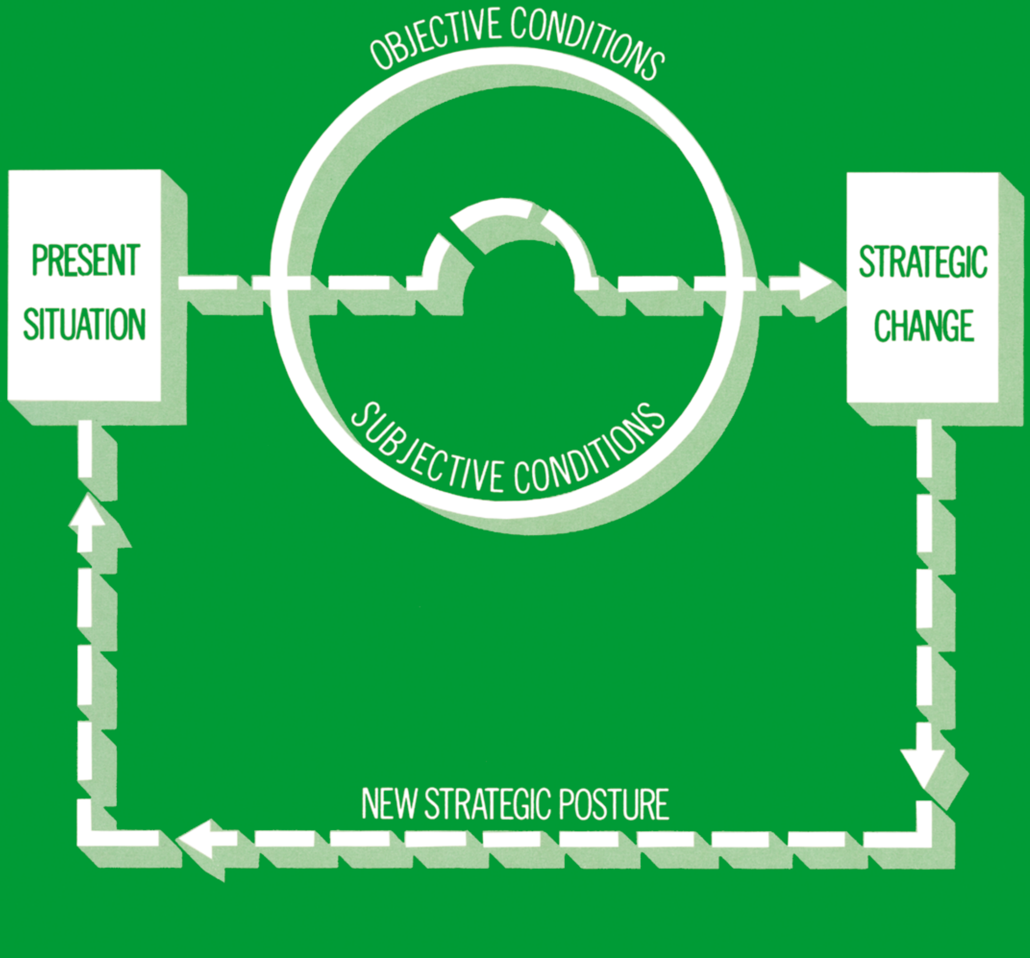
Strategic Management



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and David Asch

STRATEGIC MANAGEMENT

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Preface

Strategic management as a business and management subject has developed rapidly over the past few years. The study of corporate strategy has evolved a long way from the prescriptive 'corporate planning' model of the 1960s and early 1970s. The study of strategic management, that is, how a firm is managed in a strategic sense, embraces both the formulation and implementation of strategies. Prescriptions for better strategic decision-making need to be set against more developed insights into the realities of organisational life. This book is designed to reflect this broadening scope through the overall structure of the text, in particular, through the inclusion of important recent developments.

Corporate strategy is often used as a capstone unit in many advanced business and management courses, both as an important integrating mechanism because it incorporates and develops the more functional areas, and because of a recognition that a 'strategic perspective' is a desirable attribute for all levels of management. This book is primarily aimed at post-graduate (MBA, DMS) and final-year undergraduate Business Policy/Strategic Management courses, but we hope that it will be of use to anyone who is interested in strategic management, whether or not they encounter it as a part of a formal course of study.

In writing the book it has often been difficult to decide what to include and what to leave out, and in making these judgements we have assumed that the reader will already have some prior knowledge of the main functional areas in organisations.

Brief illustrations have been included to encourage the reader to relate the concepts developed in the text to practice examples. Although no case studies as such have been included, the text can be used to support a case-based study programme.

Finally, we would like to thank Joanna Witty for her valuable contributions to Chapter 10 on Managing Change, and Liz Knight and Denise Donovan for typing (and retyping!) the drafts of the chapters.

CLIFF BOWMAN
DAVID ASCH

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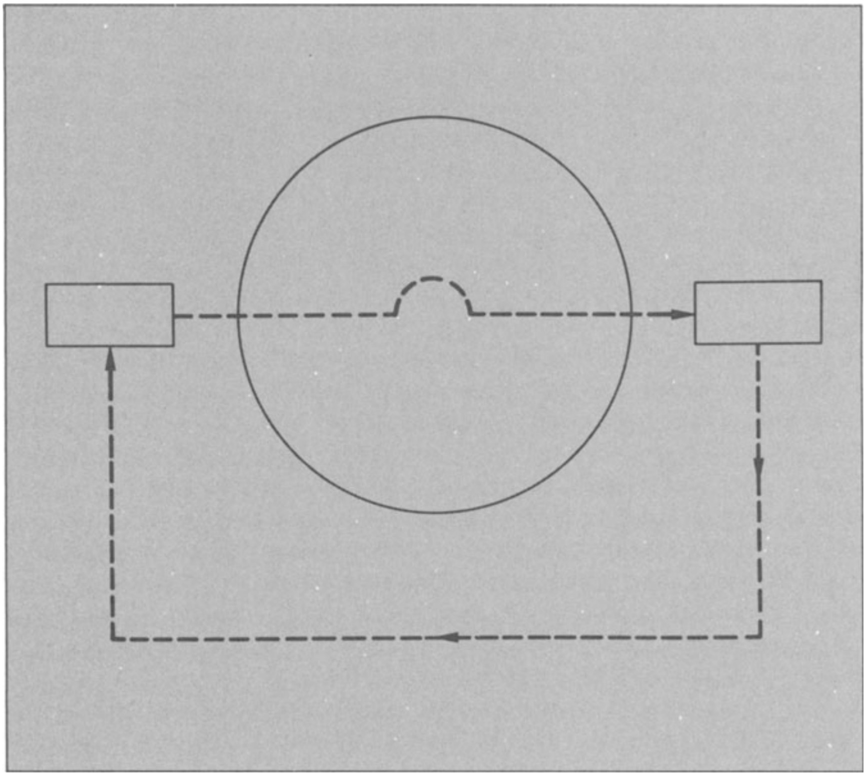
PART I

THE FORMULATION OF STRATEGY

CHAPTER 1

Introduction



On the outskirts of Crescent City, California is a small fast-food restaurant. On a sunny day around lunch-time, it seems to be doing little trade, and on investigation it appears that closure is a distinct possibility. Why has this little business not succeeded?

This small firm is the outcome of a series of decisions made by its owners, and it would seem, with the benefit of hindsight, that either their decisions were wrong, or they have been very unlucky, or maybe the lack of success is a result of a combination of the two. The owners must have decided, first, to go into business, then to single out the fast-food trade as a likely winner; then they must have looked around for premises, negotiated and purchased them; designed the menu, the décor, the seating arrangements, the kitchen, the staffing, the opening hours, etc., etc.

Which of these decisions were crucially wrong? Was it the *location* of the restaurant (it is, in fact, directly opposite a brand new Burger Chef)? Was it the quality of the food (should they have hired the owner's brother as the chef after all)? Well, the problem could have something to do with the name they chose: 'The Tired Chicken' (what images does this name conjure up in the hungry traveller's mind?)

This book is about strategic management and the reasons for starting with this seemingly trivial example are twofold. First, we want to make the point very forcibly at the outset, that strategic decisions take many forms. In the case of this firm, no one would argue that the location decision was of strategic importance. But maybe it was the name, or the décor, which caused the restaurant to fail. So, these decisions must also be of strategic importance. This leads us to our second reason for using this example, and that is that, unfortunately, it is only *in hindsight* that many decisions appear to have been critical; at the time they were made, they were not accorded the same care as more obviously crucial decisions.

Strategic decisions and strategic management

For our purposes *strategic decisions are big decisions; decisions which significantly affect the organisation's ability to achieve its objectives.* So this includes decisions which were seen as important at the time they were made and also decisions which only in restrospect appear to have been strategic. It could include decisions about what products to sell in which markets, where to build the new factory, as well as decisions about pay systems, production processes, organisation structure, management style, and management promotions.

One strategic management problem is that most prescriptive techniques and systems for making 'better', more 'rational' decisions (for example, corporate planning) will inevitably only capture the *a priori* strategic decisions – those that are acknowledged as critical and important *before* they are made. This brings us to another problem, and that is that strategic decisions could be made at many levels in the organisation. A decision of a purchasing manager to switch to a cheaper supplier could lead to a reduction in the quality of a vital component, then to a poorer product, a dissatisfied important customer, and a loss of business. A hasty decision to discipline a fitter by a production supervisor could lead to a damaging strike.

One way in which firms try to counter this problem is to draw as many decisions as possible up to the top of the organisation where a 'strategic perspective' can be brought to bear on each decision. This is often impractical as the relevant detailed information is not available at the top; it can lead to an overload of decision-making at the apex of the firm, and a demotivated lower and middle management lacking in initiative. Another reaction is to proceduralise and routinise as many of these desicions as possible, so that with double-checking and overseeing, errors in strategic decision-making are less likely. A third response would be to spread the strategic perspective further down the organisation structure, so that this broader view can inform many more decisions.

This book is concerned with problems of, and prescriptions for, strategic management. *Strategic management is the process of making and implementing strategic decisions, or put another way, strategic management is about the process of strategic change.* A decision which has no discernible impact on the organisation, which leads to no change in the organisation, is of little interest.

We are concerned as much with the *processes* of making strategic decisions, as with the *content* of these decisions, because the process of decision-making can have considerable impact on the subsequent implementation of those decisions.

Before we introduce the model which underpins the structure of the book, we should make one further point about the nature of *strategy*. 'Strategy' usually describes a thought-out plan of action, a consciously-formulated, broadly-defined policy for achieving an objective. The term 'strategy' has been borrowed from its military use and has been applied to decisions made at the 'corporate' level of the firm. Our use of the term is much looser than this. For our purposes the strategy of a firm refers to its perceived posture with regard to its customers, competitors, employees, production processes, structure etc. This posture may only have been consciously constructed in the mind of an outside observer –

in other words, a firm can have a strategy even if no one within the organisation perceives these different postures as an integrated policy. So *all* firms have a strategy; it is just in some firms someone has consciously tried to construct the strategy, in others it has emerged as a result of a series of separate decisions which collectively have resulted in a viable organisation.

We shall now introduce our model of the processes of strategic management which will help in explaining the structure of the book.

The process of strategic management

Figure 1.1 depicts the basic model. Strategic changes come about through the interaction of the objective and subjective conditions. Let us assume that a major competitor has launched a technically superior product (a change in the objective conditions facing the firm). The senior management, who have been surprised by the launch, conclude that a swift response is required to minimise the firm's loss of market share. They perceive that their firm cannot match the technology of the compe-

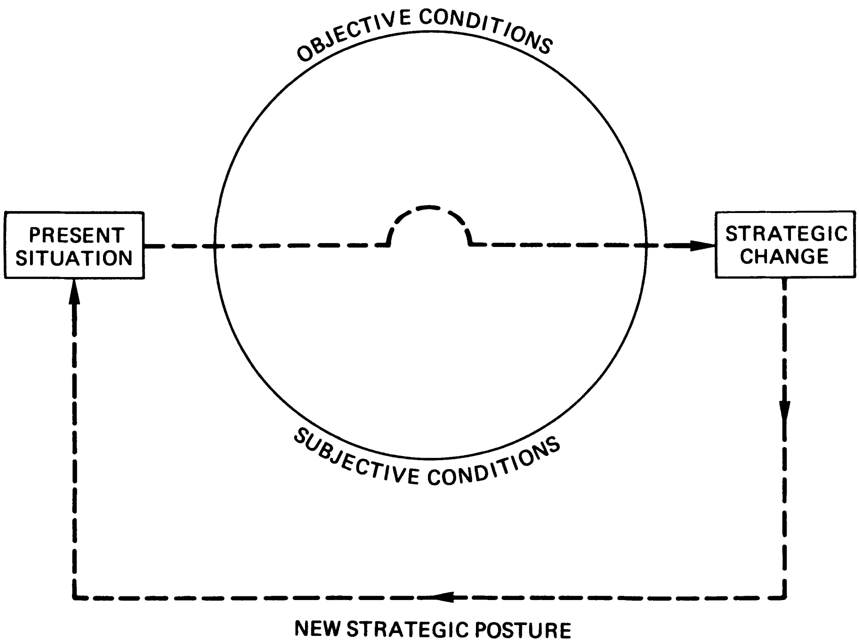


FIGURE 1.1 The process of strategic management

Notes:

The present situation: This is the state of the firm today, its current strategic posture.
Strategic change: Any adjustment to the existing strategy is a strategic change. Changes may be organisation-wide or very localised; they may be the outcome of an elaborate corporate planning process, or the change may have resulted from an ill-thought-out decision made in haste by an executive under pressure.
The 'new strategic posture' loop: The model is dynamic, implying that the process of strategic change is continuous. Today's strategic change forms tomorrow's present situation.
Objective conditions: These include the present and future states of the firm's environment, and the deployment of the firm's resources. The environment of the firm includes the competitive situation, the economic and technological environments, and the political and social context in which the firm is operating. The objective conditions, both external and internal are more amenable to systematic analysis than the subjective conditions.
Subjective conditions: These refer to the complex of social, psychological and political variables that pervade the organisation. Included here would be a wide range of conditions which have evolved and emerged from past management decisions, the external environment, leadership influence (both formal and informal), and the structure of the organisation. Some examples might be: the firm's culture; power relationships; inertia; management values, beliefs and aspirations; trust; hostility. The subjective conditions affect the way in which the members of the firm perceive the objective conditions. For example, the way the firm is organised, how the firm splits up tasks between specialisms, will lead to the development of functional perspectives: marketing people are likely to see the firm's problems in a different way from production people.

titor, and so they decide to boost their marketing efforts in order to keep their existing customers. One executive suggests the firm look for a better advertising agency: the others round on him saying that their present agency has done well for them in the past and it would be precipitous, if not just plain unfair, to ditch them at this time. In the end they agree to double their advertising budget, and place it with their present agency.

So the change in the objective conditions impacts upon the subjective conditions to produce an implemented decision, a strategic change. The decision emerges from a complex process, the starting-point being in this case the change in the competitive environment. The resulting strategic decision stimulated by the change in the objective conditions reflects the perceptions, aspirations, fears and loyalties of those involved in the decision process. Therefore, it is neither the objective conditions alone, nor the subjective conditions alone which determine the shape of strategic change. Rather, it is the *interactions* of both the subjective and objective conditions together which produce the change.

In this example, the stimulus for change originated in the objective conditions facing the firm. Strategic changes can also be instigated by shifts in the subjective conditions. Consider, for instance, the promotion to Works Manager of a more aggressive person, with new ideas and a desire to make an immediate impact. The new manager may introduce a whole series of changes in work practices at such a rate that production supervisors and operatives become confused and demoralised. This could feed through to the objective conditions through reduced efficiency, overrunning delivery dates and a loss of customer confidence.

The model provides us with a loose and adaptable framework for analysing the processes of strategic management. We believe that a broadly-drawn model is appropriate if we are to successfully explore the complexities of the subject. In particular, the differences between prescriptive and descriptive approaches to strategic management can be usefully drawn out with the aid of the model.

Prescriptive and descriptive approaches

Prescriptions for 'better' management can be traced back as far as Henri Fayol (Mullins 1985) and his suggestions for improving the administration of business organisations. The scientific-management approach of Taylor, Gantt and Gilbreth, whilst chiefly concerned with improving operating-level efficiency, has inspired a range of management disciplines concerned with telling managers how to do their job more efficiently and effectively. At the 'hard-edged', quantitative end of the spectrum are the management scientists and operations researchers, with an expanding tool kit of techniques for solving particular problems, and at the 'softer' end are the descendants of the human-relations movement proffering prescriptions about management style, job design and organisation structure.

In the 1960s the scientific-management tradition moved into the upper reaches of the firm with the emergence of systematic corporate planning. Here was a 'logical' approach to the making of the most important decisions facing the firm's management. The corporate-planning technique has been augmented by other analytical techniques (for example, the BCG matrix, structural analysis of industries) which can be used either as part of a corporate planning exercise, or as 'stand-alone' pieces of analysis. These logical methods are primarily focused on the *objective conditions* facing the firm.

There is gathering evidence that the corporate planning approach has not been successfully applied in practice by some organisations, and, more importantly, many firms do not appear to use systematic approaches of any kind in making strategic decisions. And firms that *have* used corporate planning often find problems when they come to implement the selected strategy.

The descriptive tradition in organisation research is much stronger in the sociological and socio-psychological disciplines. Perhaps because the researchers were less pressured by the need to provide solutions than those with a more obvious management orientation, they have been able to bring a more rounded, 'warts-and-all' perspective on the firm. These disciplines help us to explore the *subjective conditions* within the firm.

Hopefully, a useful synthesis is now emerging in strategic management where prescriptions for 'better' management have been thoroughly informed by a sophisticated understanding of the internal structures and processes of the organisation. And, in the same way that management theory has developed contingency approaches to management style and organisation structure (so there is no longer 'one best way' to organise, it all depends on the situation) so too may we see the emergence of contingency approaches to strategic management (see Luthans). This prospect is considered further in Chapter 14 on Models of Strategic Decision-making.

The structure of the book

Figure 1.2 locates the major chapters on our model of strategic management. Chapter 2 on Objectives spans both the objective and subjective hemispheres: here we are exploring the *raison d'être* of the organisation, what it is established to do, and the extent to which the objectives reflect the external influences on the firm, or the values and aspirations of the managers who control the organisation. Chapters 3, 4, 5, 6 and 7 are largely concerned with exploring the objective conditions facing the firm. In these chapters techniques of strategic analysis are presented which can help managers systematically to explore the external and internal environments of the firm, for the purpose of generating successful strategic options. Chapter 8 on Strategic Selection focuses on the evaluation and choice processes prior to implementation. Chapter 9 considers the more 'objective' aspects of implementation: action planning and budgeting, whereas Chapter 10 reviews the human aspects of managing change: resistance and strategies for coping with change, and

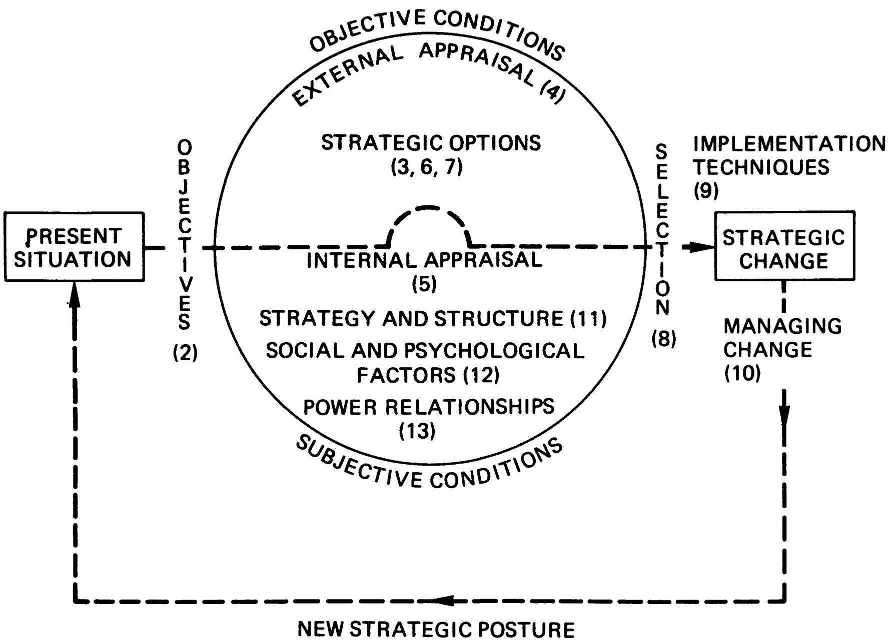


FIGURE 1.2 The structure of the book

Note: Figures in brackets are chapter numbers.

shifts the emphasis towards the subjective conditions extant in the firm. The relationships between strategy and structure, (Chapter 11), social and psychological factors influencing decision processes (Chapter12), and power relationships and power strategies (Chapter 13) complete the exploration of subjective conditions. Chapter 14 evaluates various prescriptive and descriptive models of strategic decision-making. The final chapter on Not-For-Profit Organisations considers their particular strategic management issues which, in our view, merit separate treatment.

There is one feature of the version of the model depicted in Fig 1.2 which has so far not been explained: that is the penetration of the subjective conditions into the objective conditions, represented by the bulge in the dotted line linking the present situation to the strategic change. The space represented by the bulge defines internal factors that are more open to objective analysis, for example, particular skills or capabilities the firm possesses, locations, machinery, cash resources, credit ratings, etc. This space is explored specifically in Chapter 5 on internal appraisal, and Chapter 11 which examines the interrelationship between objective conditions facing the firm and the resultant structural configurations that seem to fit these circumstances.

Although the reader can dip into sections of the book in a piecemeal way, we recommend that to gain a fuller picture of strategic management all the chapters should be covered. The only way of getting this more rounded view is to develop a familiarity with the techniques of strategic management, *coupled with* sophisticated insights into the complexity of the subjective conditions extant in the organisation. This should help the manager to realise the limitations of the analytical approaches. More importantly, it should help the manager to make *better* strategic decisions, so that both the *content* of the decisions and the *processes* of making and implementing strategic decisions are all made more effective.

Illustrations

Illustrations have been included to illuminate the issues being raised in the text. Many have been extracted from newspapers and widely available periodicals. The reason for using these sources is to encourage the reader to make connections between theory and practice, so that by reading the business press real-life examples can be constantly accessed in such a way as to strengthen the reader's insights into strategic management. The illustrations are arranged in separate boxes, so that the flow of the argument in the main body of the text is not interrupted. However, we hope that this will not discourage the reader from getting some benefit from a consideration of the examples in the illustrations.

References

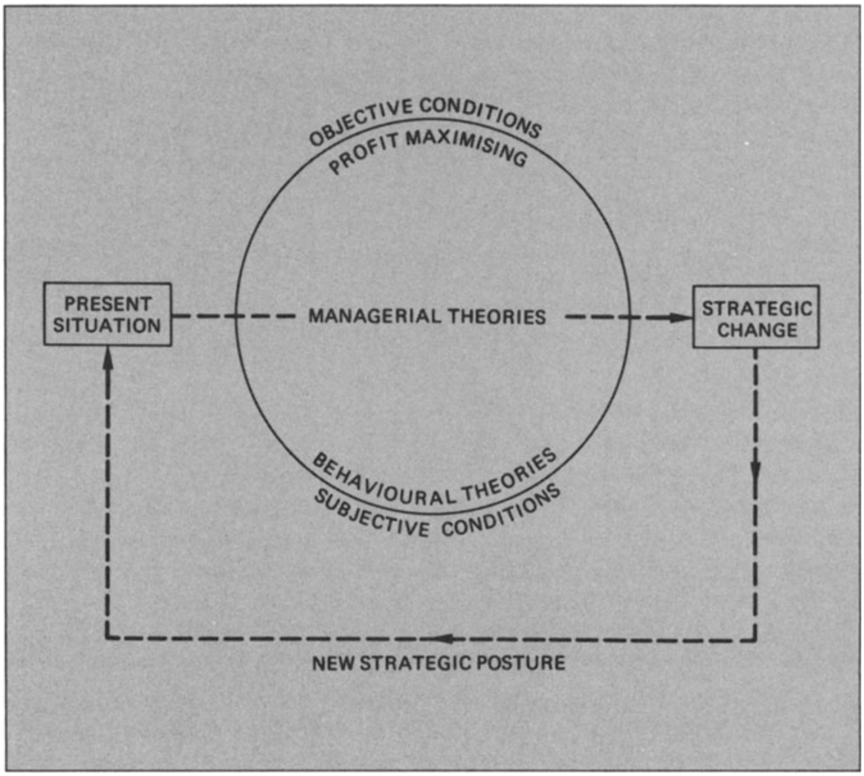
Luthans, Fred (1977) *Organisational Behaviour* (New York: McGraw-Hill) pp. 441–5 for a discussion of contingency theory of leadership style.

Mintzberg, Henry (1983) *Structure in Fives* (Englewood Cliffs, New Jersey: Prentice-Hall) for a well-developed theory of organisation structure.

Mullins, Laurie J. (1985) *Management and Organizational Behaviour* (London: Pitman) ch. 3, for a review of the classical and scientific management approaches.

CHAPTER 2

Objectives



2.1 Introduction

In the introductory chapter we concluded that to adopt either a wholly prescriptive or a wholly descriptive perspective on strategic management was inappropriate and that the differences between these approaches would be considered in the context of particular topics. So, in a discussion of objectives we must distinguish between views about what the firm is *believed* to be doing, and opinions as to what firms *should* be doing. However, when consideration is given to various models of the firm's objectives, which purport to be essentially descriptive in nature, a normative element can be detected. In as much as any attempt to model the objectives of the firm is motivated by a desire to demonstrate or prove a particular point of view, we should not expect to discover an 'objective theory of objectives'! It should be no surprise that theories about objectives are inextricably linked with more widely drawn theories about the firm's behaviour. These broader models will also be considered briefly in his chapter. First, though, we should explore whether or not an organisation *can* have a goal!

2.2 Can an organisation have a goal?

What does it mean to say that an organisation has a goal? Can only people have goals? Can the goal of the organisation be regarded as something separate from the goals of various individuals who inhabit or control the organisation?

One view, a 'rational' perspective, would contend that an organisation is set up to achieve something; it is an instrument for achieving a particular end. But this picture is complicated by the existence of actions and behaviours in actual organisations which do not appear to be helping the organisation to reach the stated goal.

Reification, treating the organisation as something more than a system of interacting individuals, has been thoroughly criticised by many organisation theorists. But if people inside and outside an organisation *perceive* that the organisation has a goal and 'does things to them', then as far as their behaviour is concerned, the organisation *is* a separate and distinct entity, over and above the individuals in it.

If we can observe some consistent pattern in the decisions and actions of an organisation, then we might infer that there is some intention (or goal) driving these actions. So in what circumstances is this consistency likely to emerge? Mintzberg (pp. 246–7) identifies two sets of circumstances where 'intended consistency' is likely to emerge:

1. *An organisation with a strong ideology*: Here all the members of the organisation share a set of beliefs, for example, a religious sect, a revolutionary political group. People who wish to join have to accept the organisation's goals as their own. Clearly, we would expect a high degree of consistency in decisions emerging from this type of organisation.
2. *An organisation with a dominant influencer*: In this organisation the influencer is able to *impose* his or her goals on the organisation through the exercise of formal power. Other members of the organisation may not necessarily share these goals, they comply with them to further *their* own interests (salary, status, security).

We shall return to the 'dominant-influencer' concept at the end of the chapter, after we have considered a variety of theories about objectives. Before we focus on the firm's objectives,we shall distinguish firms from other types of organisation which can be collectively labelled as 'not-for-profit' organisations.

2.3 For-profit and not-for-profit organisations

For most of this book we will be concentrating on the *firm* in our exploration of strategic management. This is because most of the theoretical and empirical work in strategic management relates to firms rather than to other types of organisation. We believe, however, that there are particular strategic issues facing not-for-profit organisations (like charities, local authorities, universities, nationalised industries) that stem largely from their objectives, which require them to be treated as a distinct category of organisation. Whereas firms are required to make some level of profits (otherwise they cease to exist), this 'bottom-line' objective is missing for most not-for-profit organisations (NFPs).

Let us consider as an example of an NFP the UK Civil Aviation Authority. Illustration 2.1 contains extracts from the Civil Aviation Act 1982 which lays down what parliament's objectives for the CAA are. Paragraph 4 offers guidance about how the CAA amongst its other duties, should go about licensing air routes and approving fare increases. The words in italics have been highlighted to illustrate some of the problems in carrying out these objectives. Phrases like 'reasonable interests', 'economic return' and 'efficient operators' leave a lot of scope for argument and interpretation. So, in so far as objectives drive the organisation and inform its decision-making there is a good deal of ambiguity even, as in this case, where the objectives are spelt out in

ILLUSTRATION 2.1 Objectives of the Civil Aviation Authority (Excerpts from the Civil Aviation Act 1982)

4. (1) It shall be the duty of the CAA to perform its functions in the manner which it considers is best calculated -

   (a) to secure that British airlines provide air transport services which satisfy *all substantial* categories of public demand (so far as British airlines may *reasonably* be expected to provide such services) at the *lowest charges consistent with a high standard of safety* in operating the services and an *economic return* to *efficient* operators on the sums invested in providing the services and with securing the *sound development* of the civil air transport industry of the United Kingdom; and

   (b) to further the *reasonable interests* of users of air transport services.

5. (1) It shall be the duty of the CAA in exercising any aerodrome licensing function to have regard to the need to *minimise so far as reasonably practicable* -

   (a) any adverse effects on the environment, and

   (b) any disturbance to the public

   from noise, vibration, atmosphere pollution or any other cause attributable to the use of aircraft for the purpose of civil aviation.

legislation. Moreover, the problem of measuring the organisation's performance (in terms of its efficiency and effectiveness) is largely a matter of subjective judgement.

A firm's performance, in contrast, can be quantitatively measured (for instance, return on capital employed) and using this criterion a firm making baby clothes can be compared with one manufacturing nuclear-powered submarines.

We explore the specific strategic management issues of NFPs in Chapter 15. However, there are organisational and managerial aspects of many NFPs that make them appear very similar to firms (for example, many firms and NFPs have bureaucratic structures) so the reader will be able to relate a lot of the earlier material to the strategic management of NFPs.

We shall now turn to our exploration of theories of the firm's objectives, beginning with an economics perspective.

2.4 Profit maximisation

Economists, since the rise of microeconomics in the late nineteeth Century, have considered the firm to be their special area of interest. The reader may well be familiar with the elegant and elaborate structures of cost and revenue functions to be found in the introductory economics texts.

The neoclassical theory of the firm is centred on the assumption that the entrepreneur brings together the 'factors of production ' (land, labour and capital) with a view to making and selling something which the sovereign consumer wants to buy; and, as a reward for his efforts, after the other factors have received their returns, the entrepreneur might make a profit. The firm will be managed so as to 'maximise' these profits – that is, decisions about what to make, in what proportions men and machines should be combined, what price to charge, are made with this objective in mind.

This view of the firm has served economists well for many years, but it has not been without criticism:

(a) How can the entrepreneur 'maximise profits' when he cannot predict the outcome of his decisions? Moreover, no one person or group of people is smart enough to consider all the alternatives available, before selecting the maximising strategy.
(b) Will he seek to maximise profits regardless of risk?
(c) The owner-controlled firm describes only a very small portion of economic activity (and one which is probably shrinking).

In addition to these difficulties, there have been other criticisms of the wider theory based on the assumption of profit maximisation because the theory really only applies to single-product firms, and, second, firms do not have information about cost-curves and, more critically, revenue (demand) schedules upon which to base decisions.

More pragmatic economists would counter these criticisms by pointing out that the predictions based on the theory compare reasonably well with the way firms actually behave. They might also suggest that in the light of the role of the firm in society as a whole (that is, the free-enterprise, or capitalist economy) the pursuit of profit in competition with others ensures economic efficiency: so not only *do* firms effectively aim to maximise profits, they *should* do so for the benefit of society.

2.5 Managerial theories

Berle and Means' empirical investigation into the ownership and control of US business resulted in a need to reconsider the entrepreneurial view of the firm (see Wildsmith 1973 for a full treatment of this, and other managerial theories). They discovered that, for many corporations in the US, the people who owned the firm were different from those who managed it (the shares often being dispersed among a large number of passive stockholders, whilst the day-to-day decisions about the firm were being made by hired managers, usually non-stockholding).

This finding raised the question as to whether we could expect these hired managers to behave as if they owned the firm, or might they make decisions based on their own personal interests? However, we cannot rule out the fact that, either through coercion (threat of dismissal by the shareholders' representatives, the board) or through loyalty (and, possibly, the internalisation of the shareholders' interests into the way the manager sees his job) the manager may behave as if he owned the firm, thereby leaving most of the theory intact.

Nevertheless, this divorce of ownership from control creates a situation whereby the firm may be managed in a way which might not be wholly in the interests of the shareholders (see Illustration 2.2). Economists have responded to this problem by putting forward developments and refinements to the profit-maximising model. We will briefly consider four of these, revenue maximisation, managerial discretion, growth theory and managerial utility.

Revenue maximisation

The basic Baumol model is a fairly straightforward development of the profit-maximising model, and assumes that managers seek to maximise

ILLUSTRATION 2.2 On the Power of Shareholders: Dunlop

Almost half of Dunlop's equity is now in the hands of (mostly small) British shareholders. A revitalised Dunlop Shareholders Association gave Sir Michael Edwardes a lecture in director's accountability. The group urged the board to consult shareholders and employees, rather than present a non-negotiable rescue plan to the shareholders at the special meeting to be held to approve a capital restructuring of the company. Existing shareholders may salvage next to nothing from the wreckage.

The same cannot be said of some of Dunlop's former directors, who walked away with hundreds of thousands of pounds in goodbye cash. And Dunlop's new directors may have strong conflicts of interest. Put in by the banks but responsible to the shareholders, whose interests will they protect?

Directors in essence write their own contracts, fix their own salaries and at worst leave no poorer when a company fails. In theory, shareholders can butt in. But annual reports often appear barely a month before a company's annual general meeting; resolutions must be put in writing to the company at least 21 days in advance; and at least 10 per cent of thousands of shareholders must agree to it.

(Source: *The Economist*, 24 November 1984)

sales subject to a minimum-profit constraint. Profit-maximisation is seen as a poor explanation of the firm's behaviour, especially in oligopolistic industries. Scale of operations (that is, the size of sales revenue) increases the magnitude of profits which can be used to finance expansion (even though the return on capital may be unremarkable). Size also confers benefits on the management, such as bigger salaries, more prestige and status. Shareholders are rewarded with a level of dividend and reinvestment which they would consider 'satisfactory'.

Managerial discretion

O. E. Williamson's approach introduces a much stronger flavour of organisation theory than does the Baumol model. He postulates that management is interested in pursuing the following:

1. Salary
2. Security
3. Status
4. Power
5. Prestige
6. Professional excellence

Non-pecuniary goals

The concept of 'expense preference' is used to describe the process whereby the non-pecuniary goals are achieved. Hence, the classical economists' assumption of cost-minimisation is abandoned.

(a) *Staff expenditure* contributes to the attainment of power, status, prestige and, as size is often related to security, and staff expansion, these objectives are also met.
(b) *Emoluments* These are rewards in terms of salary, but more usually in the form of cars, expense accounts, interest-free loans, etc., which the management are able to grant themselves. The non-salary perquisites have the advantage of being less visible to other members of the firm, the shareholders and the tax authorities.
(c) *Discretionary profit* In contrast to Baumol, the managers may pursue profits in excess of the minimum level acceptable to shareholders. This is because higher profits mean that more staff and emoluments can be obtained; and there is a certain satisfaction and achievement to be gained through managing a firm that has a favourable profit performance.

One interesting development of this model concerns the *structuring of organizations*. The ownership and control problem is exacerbated in large, functionally-specialised firms. Here the risks of functional managers pursuing their own, functionally-related interests are maximised. However, the trend in very large firms towards multidivisional structures, with each division being operated as a profit centre (the 'holding company' structure) may mean that the management will be forced into pursuing more or less profit maximising behaviour (see Chapter 11). So, paradoxically, the concentration of *capital* (rather than concentration within a particular industry) may be leading, through developments in organizational structures, towards a return to behaviour akin to the firm in a perfectly competitive market.

This could lead to the development of the model depicted in Figure 2.1. There is some empirical support for the managerial models presented here. Pondy (1969) in a survey of forty-five manufacturing firms,

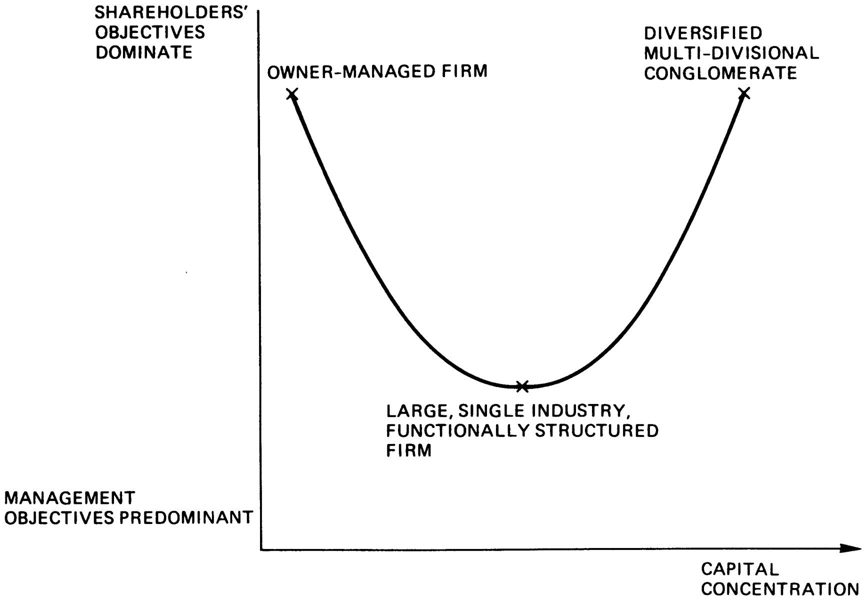


FIGURE 2.1 Objectives and capital concentration

discovered that the ratio of administrative to operating personnel increased as ownership was more divorced from management. And Wolf (quoted in Mintzberg (1983) p. 125) surveyed ten firms, with stated goals of improving profitability, that had changed their chief executives (CEOs). Five firms brought in outsiders, the other five promoted internally. All those organisations who recruited externally achieved increased profitability, which was correlated with decreased selling, general and administrative expenses. Only one of the firms that promoted internally showed profit improvement, which was not, however, linked with decreased administrative expenses.

Growth theory

Galbraith (1967) has suggested that, whereas the expansion of industry in the eighteenth and nineteenth centuries resulted in a power shift from land-owners to capitalists, the increasing rates of development in 'technology' (broadly defined) in the latter half of this century have resulted in a shift of power from owners of capital to the 'technostructure' (the management élite). Capital is no longer in scarce supply for the well-run, large organisation.

The technostructure has three objectives:

1. to make sufficient profit to secure the independent life of the organisation;
2. to achieve the maximum rate of growth;
3. to produce things which are challenging to technological ingenuity.

The technostructure designs new products, establishes levels of production and then influences the consumers to buy the products. It may also have scant regard for the wider interests of society, with regard to pollution, congestion etc. (See 2.7 'Social responsibility').

Galbraith's idea of 'countervailing power' suggests that organisations must grow large in order that they can stand up to other groups and organisations that are also increasing in size and power (Galbraith, 1967). So 'big business' begets 'big government' and big unions. Perrow (1970) observes that 'as the pond grows bigger, so does the size of the frog', so the individual manager benefits from the growth of his employing organisation. And Katz and Kahn (1966) see growth as a means of solving some awkward management problems. For example, one department may perceive itself to be disadvantaged relative to another in terms of status and promotions: it is much easier to solve this problem by *adding* resources to the disadvantaged group than by subtracting them from the privileged group.

Marx also sees the need to grow, to 'accumulate' capital, as being an inherent tendency in the capitalist system. Accumulation is a defensive strategy pursued by the capitalist so as to preserve the value of his initial investment in the face of competition and technological change. This concept is linked with the existence of economies of scale in many industries, where a downward-sloping long-run average-cost curve means that the firm that reaches the high capacity/low unit cost-point first can squeeze its rivals out of the market by undercutting their prices.

Managerial utility

Following on from the divorce of ownership from control, R. L. Marris (1964) raises the question as to the ability of the shareholder to exert influence over the management. If the chances of forcing the management to adopt different policies are slim, the best policy is to 'vote with the feet' and sell your shares to a 'raider' who is aiming to own a substantial proportion of the shares (sufficient to enable the raider to change management). So, we might expect the present management group, who should be aware of this possibility, to pursue policies which would discourage takeovers by raiders (see Illustration 2.3). Therefore the firm should be managed sufficiently well to suggest to outsiders that there are no obvious, simple and cheap ways to improve performance

ILLUSTRATION 2.3 On Vulnerability to Takeover

(1) THE DIXONS BID FOR CURRYS

Mr Kalms, Chairman of Dixons: 'Curry's business is not performing anywhere near adequately. We believe we can make dramatic improvement'.

Financial Times: 'The failure of Currys' business-computers operation lends substance to the change that tough markets have exposed strategic shortcomings; the parallel development of several retailing ideas at once within the group does not suggest a strong case of immediate direction'.

Mr Terry Curry, joint MD of Currys: 'Recent market research shows customers think we are more up-to-date than Dixons. Their offer is totally inadequate'.

(Source: *Financial Times*, 5 October 1984)

(2) REED INTERNATIONAL AND MIRROR GROUP NEWSPAPERS

The ruthless manner in which Reed plans to float MGN next year will leave MGN vulnerable to a wave of stock-market raids on its shares – and to the attentions of unwelcome predators. Once the shares are floated a predator could buy 29.9 per cent before having to make a full public takeover bid. MGN's only defence would be its recent profits performance and its board's plans for the future to keep the MGN share price too high to make it worth a bidder's while to enter the fray.

But there are benefits through not being tied to a large conglomerate: MGN chief executive Douglas Long: 'If we are on our own we are much more liable to be entrepreneurial than in a large corporation. We will not be restricted by the need for business plans and cash-flow projections, and we won't have to get through a huge layer cake full of accountants to get approval for new ideas, in a situation where you are competing for money with paint factories'.

(Source: *Sunday Times*, 16 October 1983)

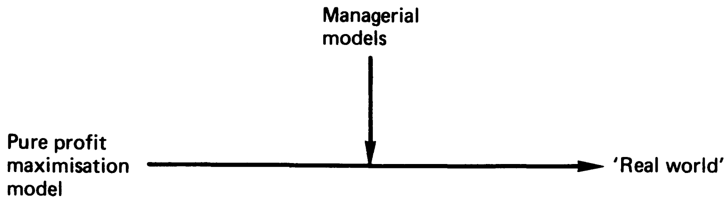


FIGURE 2.2 The objectives continuum

markedly. The stock-market valuation should reflect the real value of the firm, so as to discourage take-overs.

In addition to the concern for security from take-over, Marris includes power, prestige, salary and stock market approval as components in the managerial utility function.

2.6 Coalitions and Stakeholders

We can view the theories of the 'managerial economists' as attempts to move away from the pure profit maximising model towards an incorporation of empirical reality that begun with the Berle and Means study. (See Figure 2.2). However, the terminology, orientation and algebraic style adopted by these models is clearly descended from the neoclassical economists' tradition. So these models retain a strong economics perspective which, it could be argued, results in an exclusion of rich varieties of concepts that have been developed in other disciplines (such as sociology, social psychology, systems theory). We would argue that economists have been guilty of treating the firm and its internal workings as a 'black box', which is defensible up to a point given the 'scientific method' adopted by the discipline: that is, moving from fundamental principles towards adaptions and elaborations which cope with real-world complexities. The managerial models have succeeded in inching up the lid of the black box and as such they should be regarded as a step in the right direction.

Cyert and March's 'Behavioural Theory of the Firm' (1963) was, in a sense, freed from many of the constraints imposed by the economist's perspective. Here we have a well-developed, sophisticated model of the firm which tackles the 'human dimension' explicitly, in contrast to the rational consumer/entrepreneur/rentier, etc., of neoclassical economics. The crucial elements of the theory are:

1. The firm is a coalition of sub-groups whose individual goals are inherently contradictory.
2. In the 'classical' model the shareholders determine the objective (profits) and other groups, such as the employees, are paid a wage in return for an agreement to work for the firm; in the Cyert and March model these 'side payments' to sub-groups can take the form of *policy commitments*, not just wages. So, in the process of bargaining over side payments many of the firm's goals are determined.
3. Some of these objectives are stated in the form of aspiration-level constraints, rather than maximising constraints. (Satisficing).
4. Conflicting objectives can be dealt with by the organization dealing with each in turn (sequential attention to goals).
5. Problems lead to search behaviour aimed at finding the simple, least painful solutions first (and, if none exist, more complex solutions will be explored).
6. 'Organisational slack' is a reserve of 'fat' in the organisation that comes about through an imperfect matching (in an upward direction) between the *minimum* necessary level of resources required to maintain the coalition (deployed as inducements to sub-groups) and the *actual* level absorbed by sub-groups. Slack permits a degree of stability to obtain in the organisation during fluctuations in the environment.

The coalition concept certainly has its attractions. The picture of a rather messy process of bargaining, policy compromises and the need to tackle goals sequentially (rather than expecting some synthesis of conflicting goals to emerge) probably relates more to the reader's experience than the single-minded, all-knowing, efficient, maximising corporate person which may be conjured up in the pure economics model.

This behavioural model has been extended into an almost normative theory of the firm. We might now view the firm as consisting of different societal groupings who agree to work together to satisfy their separate interests. These stakeholders get their just rewards in a variety of forms:

Stakeholder	*Rewards*
Employees	Wages, job satisfaction, etc.
Society at large	No pollution, 'good works'
Government	Tax and rate income to enable them to do 'good works'
Managers	Salaries, status, responsibility, challenge, perks, etc.

Consumers	Useful, desirable products
Shareholders	Dividends, capital growth
Loan financiers	Interest

Therefore, as long as every stakeholder group is satisfied with the relationship between its contribution to the firm's effort and its rewards, the stakeholder coalition carries out its social and economic purpose.

This view of the firm has developed alongside the 'human relations' movement in management thinking. If we see the employee as having 'needs' which can to an extent be satisfied at work (typified by the writings of Maslow, Herzberg, Argyris, etc.) through the enlightened redesigning of jobs, organisation structures and management styles, the employee is satisfied and the firm's objectives are satisfied. The employee achieves self-actualisation through applying his effort and talent at work; the shareholders concurrently achieve their objective of profit. The other important strand in this 'consensus' perspective is the notion of *social responsibility*.

2.7 Social responsibility

The issue of some form of corporate social responsibility emerged strongly in the early 1960s and probably reached its peak in the early 1970s. In essence the concept is that the firm has a duty to conduct itself in the interests of society as a whole. This has been variously interpreted as: concern about employee safety, employment of ethnic minorities/disabled people, positive discrimination in favour of women, making and selling safe products, avoiding pollution, giving to charities, etc. (see Illustration 2.4).

Galbraith argues that the large corporation (which bears so little resemblance to the tiny firm, buffeted by the actions of cut-throat competitors and the fickle demands of the consumer idealised by some proponents of the market system) has enormous power which can be exercised in the interests of the ruling managerial oligarchy, the shareholders, consumers and the wider society. Indeed it is possible to argue that only the large oligopolistic or monopolistic corporations are in the comfortable position of being able to decide to behave in a manner other than the basic struggle for survival experienced by small firms in competitive industries.

However, there is evidence that the concern for socially responsible behaviour is no longer such an issue in the minds of corporate executives in the 1980s. Managers can look to champions of freedom like

ILLUSTRATION 2.4 On Stated Objectives

UNITED BISCUITS

Extracts from Chairman's Statement (1977):

1. **Return on Capital Employed**
   Objectives: To make a profit, before interest and tax, of not less than 20 per cent of capital employed, with a target of 25 per cent on an historical cost basis. Capital employed is defined as the total of shareholders' funds plus long- and short-term borrowings.
2. **Sales and Profits**
   Objectives: At least to maintain the increase in profits in line with the increase in sales, i.e., to maintain net profit margins.
3. **Capital Expenditure**
   Objective: To maintain the quality of existing assets by investing not less than 5p per £ sales annually and to make new investments at rates of return applicable to the risk involved to meet the Group's targeted return on capital employed.
4. **Dividends**
   Objective: That the return to shareholders should grow in line with the growth in net profit.

These objectives are designed to give security of employment and the highest possible standard of living to our employees, the best possible value for money to the consumer, and consistently reward the investor at a level which fully recognises the element of risk, while ensuring that the business remains internationally competitive.

INDIAN HEAD MILLS

Extract from the CEO's policy manual:

The company is *not* in business to grow bigger for the sake of size, nor to become more diversified, nor to make the most or best of anything, nor to provide jobs, have the most modern plants, the happiest customers, lead in new product development, or to achieve any other status which has no relationship to the economic use of capital.

Any or all of these may be, from time to time, a means to our objective, but means and ends must never be confused. Indian **Head Mills** is in business solely to improve the inherent value of the common stockholders' equity in the company.

(Quoted in Mintzberg's, 'Power In and Around Organizations', p. 280)

WANG LABORATORIES

Dr An Wang: 'I am there to impart the philosophy I value, to serve a useful purpose to society at large and to make sure that the people we serve – stockholders, employees and customers, get a fair return'.

(Source: *Sunday Times*, 17 October 1982).

Milton Friedman to provide arguments as to why the most socially responsible action the corporation can do is to work flat out in the interests of its shareholders. 'Socially responsible' actions can still play a part as a public relations device, to improve the corporate image, but it is possible to imagine a collective sigh of relief emanating from boardrooms across the nation freed from the need to develop arguments, evidence and excuses about the less obviously 'social' aspects of their 'legitimate' business pursuits.

We might suggest that the concern for 'social responsibility' varies directly with the stages of the business cycle, in so far as it is perceived as a luxury born out of the good times with which firms need not concern themselves in a recession. (The influence of pressure groups and societal norms is considered further in Chapter 13 on Power).

2.8 Single or multiple objectives?

One of the problems raised by the stakeholder theory is how the management cope with the multiple objectives of the different stakeholders groups. We have mentioned one way out; the sequential attention to goals suggested by Cyert and March. It would appear to be an enormously difficult management task to make decisions about the firm's activities even within this piecemeal approach unless an implicit goal hierarchy is being operated. For example, let us assume our employees are concerned to increase their wages; let us further assume that management decide to meet these aspirations. There is obviously some