15.903 Organization and Strategy

9 units, Spring 2001

MW 10:00-11:30, 1:00-2:30, 2:30-4:00, and 4:00-5:30

R. Gibbons (10:00, 1:00), J. Sorensen (2:30, 4:00)

Version 12/3/00

Overview

Organizational capability is increasingly believed to be a critical—perhaps the critical—source of competitive advantage. The new internet firms are held up as models for the "old" economy, and firms everywhere are advised to use aggressive incentives, to be fast, to be flexible, and to be networked. At the same time we are in the midst of the largest merger wave in history. The large firms are getting larger. Their CEOs talk of "building small-company spirit in large-company clothing" but the analysts talk of scale, routine, and regularity.

What is going on? When should organizations outsource and when should they produce internally? How can one maintain the creativity and enthusiasm characteristic of a small firm inside a large one? When should one even try? How do the answers to these questions change as one manages across boundaries, across industries, and over time?

This course attempts to provide the tools necessary to answer such questions. To do so, we utilize, deepen, and integrate three courses from the first-year fall core: microeconomics (15.010), organizational processes (15.311), and strategy (15.900). For example, from microeconomics we take the ideas of incentives and game theory, from organizational process power and culture, and from strategy industry structure and core competence.

Much of our discussion will explore the important two-way street between a firm's "external strategy" in its product market and its "internal strategy" regarding organizational issues. One direction on this street is widely appreciated: an optimal external-strategy decision frequently requires complementary internal-strategy implementation. We will frequently emphasize the opposite direction: some external-strategy decisions are driven by internal-strategy considerations. The course is therefore appropriate for those considering management consulting, as well as for general managers who seek to understand and influence the design and performance of their organizations.

Economic analyses of organizational issues are relatively new. In a typical course in microeconomics, for example, the firm is usually treated as a single, irreducible actor, analogous to the consumer. Such a firm buys labor and capital equipment in factor markets and sells output in product markets, but its internal organization and operations are a "black box." Over the last twenty-five years, however, new developments in game theory have made it possible to analyze incentives inside firms. We will find not only that these new models from economics are productive in their own right for those seeking to design and manage organizations, but also that the new economic models and the more established sociological analyses are important complements to each other.

Administration

The grading in this course is split between in-class activities and team papers. Half the grade is based on class attendance and participation. The second half of the course grade is based on four papers: 10% each for three papers written during the term and 20% for a final paper. The three term-time papers must each be no longer than 5 pages; the final paper must be no longer than 10. The teams for writing all four papers can have one, two, or three members. Teams can change during the term.

The three term-time papers are to be tied to the first five sections of the course: managing incentives, structuring the work, working with organizational culture and fields, thinking about boundaries, and hybrid organizational forms. In each paper, the team should pick one company and use the tools and lessons from that part of the course to analyze the company. The due dates for the term-time papers are as follows:

Incentives	Friday February 23
Structure	Friday March 9
Cultures & Fields	Friday April 6
Boundaries / Hybrids	Friday April 27

The final paper should pick one company and analyze the interplay between organization and strategy in that firm. In particular, the paper should use the material from the sixth section of the course, managing change, to assess the roles of incentives, structure, cultures and fields, and boundaries / hybrids. In this sense, the final paper should revisit and integrate the three term-time papers. (Rethinking and even rejecting the analyses from the term-time papers is definitely okay!) There may therefore be substantial economies from (a) choosing one company for all the papers and (b) fixing team membership for the entire term. The final paper is due on Wednesday May 16.

Recitations will be held on Thursday afternoons. Gibbons will hold recitations from 2:30 to 4:00 on half the weeks; Sorensen will hold recitations from 4:00 to 5:30 on the other weeks. Recitations will be unstructured sessions in which students may ask any questions they like. Appointments for office hours can of course also be arranged.

Schedule

Class 1 (2/7): *Introduction: Setting the Stage*

CASE: Cisco Systems and the Networking Equipment Industry (Tuck 98-353-1)

READING: “There’s Something about Cisco” *Fortune*, May 15,2000.

Introduce 2-way street between strategy and organization. Introduce course’s 6 sections and its connections to 010, 311, and 900.

I. Managing Incentives

Class 2 (2/12): *Basic agency theory*

CASE: The Lincoln Electric Company (HBS 376-028)

NOTE 1: Agency Theory, Part I—Pay for Performance [Notes available at http://web.mit.edu/rgibbons/www/index.html.]

Lincoln: incentives fit with internal policies fit with strategy. LN 1: How to start thinking about what is going on at Lincoln?

Class 3 (2/14): *You get what you pay for*

READING: “ On the Folly of Rewarding A, While Hoping for B,” S. Kerr, *Academy of Management Journal*, December 1975.

NOTE 2: Agency Theory, Part II—You Get What You Pay For

CASE*:* Gain Sharing at Star Cablevision Group (HBS 9-692-012)

Kerr: class discussion of painful experiences. Further examples from Star Cable. Free-lunch challenge. LN 2: How to start thinking about these disasters?

2/19 National Holiday

Class 4 (2/20): *Relational Contracts as a Solution*

READINGS: “Taking the Dare,” *The New Yorker*, July 26, 1993.

“Lincoln Electric’s Harsh Lessons from International Expansion,” D. Hastings, *Harvard Business Review*, May-June 1999.

NOTE 3: Repeated Games, Part I—Introduction to Relational Contracts

What was “the deal” at CSFB? Importance (but difficulty) of clarity. CS strategy may have motivated reneging, especially after junk market collapses? Vice versa: changes in strategy at

Lincoln to avoid reneging. LN 3: How to start thinking about relational contracts (and their management)?

Class 5 (2/21): *Putting it into Practice*

NOTE 4: Repeated Games, Part II—Subjective Performance Evaluation

CASE: Brainard, Bennis, and Farrell (HBS 9-495-037)

BBF: when is a comp problem just a comp problem? Almost never: comp → orgzn → strategy.
LN4: Push subjective-bonus model towards team production and job design. Incentives wrap-up.

II. Structuring the Work

Background Reading: "Causes of Failure in Networked Organizations, " R. Miles and C. Snow, *California Management Review,* 1992.

Class 6 (2/26): *Structuring across Borders*

CASE: Citibank: European Strategy and Organization (HBS 9-395-099)

READING: "Choosing a Basic Structure — Strategic Groups," Ch. 5 in *Competing by Design* by D.Nadler and M. Tushman, Oxford University Press, 1997.

Introduce function vs. product vs. customer. Recall grouping, linking, and alignment.

Class 7 (2/28): *Structuring Teams:*

CASE: Business Teams at Rubbermaid Inc. (HBS 9-897-165)

READING: Ch. 8 from Clark-Wheelwright *Revolutionizing Product Development*

Difficulty in getting it right. Motives for oscillation and for intermediate forms.

Class 8 (3/5): *Matrices (Revisited):*

CASE: ABB's Relay Business: Building and Managing a Global Matrix (HBS 9-394-016)

READING: "Coordinating Work — Strategic Linking," Ch. 6 in

Competing by Design by D.Nadler and M. Tushman, Oxford University Press, 1997.

Formal and informal. Seeds of own destruction. Mandatory connection to environment and strategy.

III. Working with Organizational Cultures and Fields

Background Reading: “xxx, “ C. O’Reilly,
California Management Review, 199x.

Class 9 (3/7): *Structure Meets Culture*

CASE: Johnson & Johnson (A) (HBS ??)

READING: “On Structure and Structuring.” R. Eccles and N. Nohria, …

Transition from structure. Role of credo.

Class 10 (3/12): *Values, Environments, and Growth*

CASE: Guaranty Trust Bank PLC, Nigeria (HBS 9-897-118)

Culture as identity (and incentive and structure), but no reinvestment or updating. Transition to field(s).

Class 11 (3/14): *Internal Culture Meets External Field*

CASE: Saturn: A Different Kind of Car Company (HBS 9-795-010)

Brand new company, but external field constrains internal culture. Incentives + structure + culture + strategy, all while fighting against field?

Class 12 (3/19): *Complex Multi-Level Fields*

CASE: RU486: The Handling by Roussel-Uclaf of a Double Ethical Dilemma

READING: Teaching Note on “Organizational Environments” [on web]

Field as outside actors: what are their interests *and what are they invoking?*

3/21 Sloan Holiday

3/26-30 MIT Holiday

PAUSE FOR REFLECTION (AND RECOLLECTION)

Class 13 (4/2) *Incentives Meet Structure Meets Culture/Field*

Consider structure and culture/field at CSFB, incentives and culture/field at ABB, and incentives and structure at Saturn.

IV. Thinking About Boundaries

Class 14 (4/4) *Incentives Between Firms*

READING: "How Chrysler Created an American Keiretsu," J. Dyer, *Harvard Business Review*, July-August 1996.

Recall: Crown Equipment (not Crown Cork & Seal!) from 15.900

There are incentives between firms as well as within. Incentive contracts between firms are both formal (which suffer from GWYPF) and relational (which are vulnerable to reneging). What are w, p and y?

Class 15 (4/9): *Incomplete Contracts Between Firms*

NOTE 5: Asset Ownership, Part I—Hold-Up *May* Be Your Friend

Hildebrand, Gorman, & Alexander: hold-up may be bad, but its alternative may be worse. Fisher Body: formal solution to one hold-up problem (whether contract or ownership) may create another. Coase-Heckman figure: firms exist in tough environments, so may be best of a bad lot. Foreshadow 2 merger cases: are we sure things would be so much better?

Class 16 (4/11): *Mergers, I: Corporate Strategy*

CASE: Kraft General Foods: The Merger (A) (HBS 9-391-139)

READING: "From competitive advantage to corporate strategy," M. Porter, *HBR*, May-June 1987.

PM-GF: Does this fit one of Porter's reasons (various efficiencies)? Or is it foreclosure or fad in financial market? Or empire building? Foreshadow GE.

Kraft-GF (basically ignoring PM): Why not contract? Why not new managers without merger? Downside of merger? Why so half-hearted? Foreshadow Novartis.

4/16 Massachusetts Holiday

Class 17 (4/18): *Mergers, II: Incentives, Structure, Cultures, and Field*

CASE: Novartis (A): Being a Global Leader (HBS 9-198-041)

Incentives, culture, and even field (20% of Swiss market cap and 10% of top 20 pharmas). Fast merger (like ABB) vs. Kraft-GF: tough to go fast b/c so much is reputational. Big conflict between empowerment and control (cf. ABB)? Unclear about strategy? More about fixing / blending Ciba and Sandoz – jump from second- to first-tier in pharma?

V. Hybrid Organizational Forms

Background Reading: "Hybrid Organizational Arrangements: New Form or Transitional Development?," W. Powell, *California Management Review*, Fall 1987.

Class 18 (4/23): *Hybrids: Networks, Alliances, and Virtual Organizations*

NOTE 6: Asset Ownership, Part II—Make, Buy, or Cooperate?

READING: "Case Study: The Toyota Group and the Aisin Fire," T. Nishiguchi and A. Beaudet, *SMR*, 1998.

Recall: "When is Virtual Virtuous? Organizing for Innovation." H. Chesbrough and D. Teece, *Harvard Business Review*, Jan.-Feb. 1996.

Relationships within and between firms (upstream division vs. supplier). Initiative vs. control frontier, ranging from spot market to alliance to new organization to formal firm. Incentives/initiative vs. Coordination/control figure, with new emphasis on alliance and new organization as relational improvements on spot market and formal hierarchy, respectively.

Class 19 (4/25): *Hybrid Forms between Organizations*

CASE: LoJack and the MicroLogic Alliance (Babson BAB011)

What are the important control rights (defined as those that others care about) and who “owns” them? What are the important relational contracts, what would constitute reneging, and what are the available punishments?

Class 20 (4/30): *Hybrid Forms within Organizations*

CASE: Xerox Technology Ventures: March 1995 (HBS 9-295-127)

VI. Managing Change

Class 21 (5/2): *Change: Structure, Incentives, and Culture*

CASE: Appex (HBS 9-491-082)

READING: “Evolution and revolution as organizations grow,” L. Greiner, *Harvard Business Review*, 1972

Class 22 (5/7): *Radical Change*

READING: “Internal Disaggregation in Oticon: Interpreting and Learning from the Rise and Decline of the Spaghetti Organization,” N. Foss, 2000 (pp. 1-20).

Class 23 (5/9): *Change Between Organizations*

CASE: BMW - British Aerospace: The Rover Deal (University of Navarra IES023)

READINGS: On the web.

Class 24 (5/14): *Change in Large Organizations*

CASE: Jack Welch: GE’s Revolutionary (HBS 9-394-065)

READING: “GE Capital: Jack Welch’s Secret Weapon,” *Fortune*, Nov. 10 1997, pp. 116-34.

Which of Porter's reasons apply? Compare PM – GF. Was it Jack? If so, can anyone else do it? Under what circumstances should GE be splintered?

Class 25 (5/16): *Conclusions*