CONTENTS

Why Study Strategy? 1 Why Economics? 2

The Need for Principles 2 So What's the Problem? 3

A Framework for Strategy 5 Boundaries of the Firm 6 Market and Competitive Analysis 6 Positioning and Dynamics 6 Internal Organization 6 The Book 7 Endnotes 7 ECONOMICS PRIMER: BASIC PRINCIPLES 8 Costs 9 Cost Functions 9 Total Cost Functions 9 Fixed and Variable Costs 11 Average and Marginal Cost Functions 11 The Importance of the Time Period: Long-Run versus Short-Run Cost Functions 14 Sunk versus Avoidable Costs 16 Economic Costs and Profitability Economic versus Accounting Costs 17 Economic Profit versus Accounting Profit 18 Demand and Revenues 18 Demand Curve 18 The Price Elasticity of Demand 19 Brand-Level versus Industry-Level Elasticities 22 Total Revenue and Marginal Revenue Functions 22 Theory of the Firm: Pricing and Output Decisions 23 Perfect Competition 25

INTRODUCTION: STRATEGY AND ECONOMICS 1

Game	Theory	/ 29
Calle		

Games in Matrix Form and the Concept of Nash Equilibrium 30 Game Trees and Subgame Perfection 31

Chapter Summary 33

Questions 33

Endnotes 34

PART ONE FIRM BOUNDARIES 35

1 THE POWER OF PRINCIPLES: AN HISTORICAL PERSPECTIVE 37

Doing Business in 1840 37

Business Conditions in 1840: Life without a Modern

Infrastructure 39

Transportation 39

Example 1.1 The Emergence of Chicago⁵ 40

Communications 40

Finance 41

Production Technology 42

Government 42

Example 1.2 Building National Infrastructure: The Transcontinental Railroad⁸ 43

Doing Business in 1910 44

Business Conditions in 1910: A "Modern" Infrastructure 45

Production Technology 45

Transportation 45

Communications 46

Finance 46

Government 46

Example 1.3 Evolution of the Steel Industry 47

Doing Business Today 48

Modern Infrastructure 49

Transportation 49

Communications 49

Finance 50

Production Technology 50

Government 50

Infrastructure in Emerging Markets 51

Example 1.4 The Gaizhi Privatization Process in China 51

Three Different Worlds: Consistent Principles, Changing Conditions, and Adaptive Strategies 52

Chapter Summary 52

Questions 53

Endnotes 54

2 THE HORIZONTAL BOUNDARIES OF THE FIRM 55

Definitions 55

Definition of Economies of Scale 55

Definition of Economies of Scope 57

Scale Economies, Indivisibilities, and the

Spreading of Fixed Costs 57

Economies of Scale Due to Spreading of Product-Specific Fixed Costs 58

Economies of Scale Due to Trade-offs among Alternative
Technologies 58 Indivisibilities Are More Likely When Production Is Capital
Intensive 60
Example 2.1 Hub-and-Spoke Networks and Economies of Scope in the
Airline Industry 61
"The Division of Labor Is Limited by the Extent of the
Market" 62
Example 2.2 The Division of Labor in Medical Markets 63
Special Sources of Economies of Scale and Scope 64
Density 64
Purchasing 65
Advertising 65
Costs of Sending Messages per Potential Consumer 65
Advertising Reach and Umbrella Branding 66
Research and Development 66
Physical Properties of Production 67
Inventories 67
Complementarities and Strategic Fit 68
Sources of Diseconomies of Scale 68
Labor Costs and Firm Size 69
Spreading Specialized Resources Too Thin 69
Bureaucracy 69
Economies of Scale: A Summary 70
The Learning Curve 70
The Concept of the Learning Curve 70
Expanding Output to Obtain a Cost Advantage 71
Example 2.3 Learning by Doing in Medicine 72
Learning and Organization 73
The Learning Curve versus Economies of Scale 74
Example 2.4 The Pharmaceutical Merger Wave 75
Diversification 75
Why Do Firms Diversify? 76
Efficiency-Based Reasons for Diversification 76
Scope Economies 76
Internal Capital Markets 77
Problematic Justifications for Diversification 78
Diversifying Shareholders' Portfolios 78
Identifying Undervalued Firms 78
Reasons Not to Diversify 79
Managerial Reasons for Diversification 79
Benefits to Managers from Acquisitions 79
Problems of Corporate Governance 80
The Market for Corporate Control and Recent Changes in
Corporate Governance 81
Example 2.5 Activist Investors in Silicon Valley 82
Performance of Diversified Firms 83
Example 2.6 Haier: The World's Largest Consumer Appliance and
Electronics Firm 84
Chapter Summary 85
Questions 86
Endnotes 88
- i i i i i i i i i i i i i i i i i i i

THE VERTICAL BOUNDARIES OF THE FIRM 90 3 Make versus Buy 90 Example 3.1 What Apple "Makes" and What It "Buys" for the iPhone 91 Upstream, Downstream 92 Example 3.2 Licensing Biotechnology Products 93 Defining Boundaries 94 Some Make-or-Buy Fallacies 94 Avoiding Peak Prices 95 Tying Up Channels: Vertical Foreclosure 96 Reasons to "Buy" 98 Exploiting Scale and Learning Economies 98 Example 3.3 Employee Skills: Make or Buy? 100 Bureaucracy Effects: Avoiding Agency and Influence Costs 101 Agency Costs 101 Influence Costs 102 Example 3.4 Disconnection at Sonv¹³ 103 Organizational Design 104 Reasons to "Make" 104 The Economic Foundations of Contracts 104 Complete versus Incomplete Contracting 105 Bounded Rationality 105 Difficulties Specifying or Measuring Performance 106 Asymmetric Information 106 The Role of Contract Law 106 Coordination of Production Flows through the Vertical Chain 107 Example 3.5 Nightmares at Boeing: The 787 Dreamliner 108 Leakage of Private Information 109 Transaction Costs 110 Relationship-Specific Assets 111 Forms of Asset Specificity 111 The Fundamental Transformation 112 Rents and Quasi-Rents 112 The Holdup Problem 113 Example 3.6 Power Barges 114 Holdup and Ex Post Cooperation 115 The Holdup Problem and Transaction Costs 115 Contract Negotiation and Renegotiation 115 Example 3.7 A Game of Chicken? Specificity and Underinvestment in the Broiler Industry 116 Investments to Improve Ex Post Bargaining Positions 116 Distrust 116 Reduced Investment 117 Recap: From Relationship-Specific Assets to Transaction Costs 117 Summarizing Make-or-Buy Decisions: The Make-or-Buy Decision Tree 118 Chapter Summary 119

4 INTEGRATION AND ITS ALTERNATIVES 124

What Does It Mean to Be "Integrated"? 124 The Property Rights Theory of the Firm 124

Questions 119 Endnotes 122

Alternative Forms of Organizing Transactions 125

	Example 4.1 Vertical Integration in a Mountain Paradise 126
	Governance 127
	Delegation 128
	Recapping PRT 128
	Path Dependence 129
	Making the Integration Decision 129 Technical Efficiency versus Agency Efficiency 130 The Technical Efficiency/Agency Efficiency Trade-off 130
	Example 4.2 Accountable Care Organizations 133
	Real-World Evidence 134 Double Marginalization: A Final Integration Consideration 136
	Example 4.3 Vertical Integration of the Sales Force in the Insurance Industry 137
	Alternatives to Vertical Integration 138 Tapered Integration: Make and Buy 138 Franchising 138
	Example 4.4 Franchise Heat in China 139 Strategic Alliances and Joint Ventures 140
	Example 4.5 Joint Ventures in Sub-Saharan Africa 141
	Implicit Contracts and Long-Term Relationships 143
	Example 4.6 Interfirm Business Networks in the United States: The Women's
	Dress Industry in New York City ¹⁹ 144
	Business Groups 145
	Keiretsu 145
	Chaebol 147 Business Groups in Emerging Markets 148
	Chapter Summary 149
	Questions 150
	Endnotes 151
	Enditotes 131
PA	RT TWO MARKET AND COMPETITIVE ANALYSIS 153
5	COMPETITORS AND COMPETITION 155
	Competitor Identification and Market Definition 156 The Basics of Market Definition and Competitor Identification 156
	The Basics of Market Definition and Competitor Identification 156
	The Basics of Market Definition and Competitor Identification 156 Putting Competitor Identification into Practice 157
	The Basics of Market Definition and Competitor Identification 156 Putting Competitor Identification into Practice 157 Example 5.1 The SSNIP in Action: Defining Hospital Markets 157
	The Basics of Market Definition and Competitor Identification 156 Putting Competitor Identification into Practice 157 Example 5.1 The SSNIP in Action: Defining Hospital Markets 157 Empirical Approaches to Competitor Identification 158
	The Basics of Market Definition and Competitor Identification 156 Putting Competitor Identification into Practice 157 Example 5.1 The SSNIP in Action: Defining Hospital Markets 157 Empirical Approaches to Competitor Identification 158 Geographic Competitor Identification 160
	The Basics of Market Definition and Competitor Identification 156 Putting Competitor Identification into Practice 157 Example 5.1 The SSNIP in Action: Defining Hospital Markets 157 Empirical Approaches to Competitor Identification 158 Geographic Competitor Identification 160 Example 5.2 Whole Foods Attempts to Acquire Wild Oats 161
	The Basics of Market Definition and Competitor Identification 156 Putting Competitor Identification into Practice 157 Example 5.1 The SSNIP in Action: Defining Hospital Markets 157 Empirical Approaches to Competitor Identification 158 Geographic Competitor Identification 160 Example 5.2 Whole Foods Attempts to Acquire Wild Oats 161 Measuring Market Structure 162
	The Basics of Market Definition and Competitor Identification 156 Putting Competitor Identification into Practice 157 Example 5.1 The SSNIP in Action: Defining Hospital Markets 157 Empirical Approaches to Competitor Identification 158 Geographic Competitor Identification 160 Example 5.2 Whole Foods Attempts to Acquire Wild Oats 161 Measuring Market Structure 162 Market Structure and Competition 163
	The Basics of Market Definition and Competitor Identification 156 Putting Competitor Identification into Practice 157 Example 5.1 The SSNIP in Action: Defining Hospital Markets 157 Empirical Approaches to Competitor Identification 158 Geographic Competitor Identification 160 Example 5.2 Whole Foods Attempts to Acquire Wild Oats 161 Measuring Market Structure 162
	The Basics of Market Definition and Competitor Identification 156 Putting Competitor Identification into Practice 157 Example 5.1 The SSNIP in Action: Defining Hospital Markets 157 Empirical Approaches to Competitor Identification 158 Geographic Competitor Identification 160 Example 5.2 Whole Foods Attempts to Acquire Wild Oats 161 Measuring Market Structure 162 Market Structure and Competition 163 Perfect Competition 163 Many Sellers 164 Homogeneous Products 164
	The Basics of Market Definition and Competitor Identification 156 Putting Competitor Identification into Practice 157 Example 5.1 The SSNIP in Action: Defining Hospital Markets 157 Empirical Approaches to Competitor Identification 158 Geographic Competitor Identification 160 Example 5.2 Whole Foods Attempts to Acquire Wild Oats 161 Measuring Market Structure 162 Market Structure and Competition 163 Perfect Competition 163 Many Sellers 164 Homogeneous Products 164 Excess Capacity 165
	The Basics of Market Definition and Competitor Identification 156 Putting Competitor Identification into Practice 157 Example 5.1 The SSNIP in Action: Defining Hospital Markets 157 Empirical Approaches to Competitor Identification 158 Geographic Competitor Identification 160 Example 5.2 Whole Foods Attempts to Acquire Wild Oats 161 Measuring Market Structure 162 Market Structure and Competition 163 Perfect Competition 163 Many Sellers 164 Homogeneous Products 164 Excess Capacity 165 Example 5.3 The Bottom Drops Out on Cubs Tickets 166
	The Basics of Market Definition and Competitor Identification 156 Putting Competitor Identification into Practice 157 Example 5.1 The SSNIP in Action: Defining Hospital Markets 157 Empirical Approaches to Competitor Identification 158 Geographic Competitor Identification 160 Example 5.2 Whole Foods Attempts to Acquire Wild Oats 161 Measuring Market Structure 162 Market Structure and Competition 163 Perfect Competition 163 Many Sellers 164 Homogeneous Products 164 Excess Capacity 165 Example 5.3 The Bottom Drops Out on Cubs Tickets 166 Monopoly 166
	The Basics of Market Definition and Competitor Identification 156 Putting Competitor Identification into Practice 157 Example 5.1 The SSNIP in Action: Defining Hospital Markets 157 Empirical Approaches to Competitor Identification 158 Geographic Competitor Identification 160 Example 5.2 Whole Foods Attempts to Acquire Wild Oats 161 Measuring Market Structure 162 Market Structure and Competition 163 Perfect Competition 163 Many Sellers 164 Homogeneous Products 164 Excess Capacity 165 Example 5.3 The Bottom Drops Out on Cubs Tickets 166 Monopoly 166 Monopolistic Competition 168
	The Basics of Market Definition and Competitor Identification 156 Putting Competitor Identification into Practice 157 Example 5.1 The SSNIP in Action: Defining Hospital Markets 157 Empirical Approaches to Competitor Identification 158 Geographic Competitor Identification 160 Example 5.2 Whole Foods Attempts to Acquire Wild Oats 161 Measuring Market Structure 162 Market Structure and Competition 163 Perfect Competition 163 Many Sellers 164 Homogeneous Products 164 Excess Capacity 165 Example 5.3 The Bottom Drops Out on Cubs Tickets 166 Monopoly 166 Monopolistic Competition 168 Demand for Differentiated Goods 168
	The Basics of Market Definition and Competitor Identification 156 Putting Competitor Identification into Practice 157 Example 5.1 The SSNIP in Action: Defining Hospital Markets 157 Empirical Approaches to Competitor Identification 158 Geographic Competitor Identification 160 Example 5.2 Whole Foods Attempts to Acquire Wild Oats 161 Measuring Market Structure 162 Market Structure and Competition 163 Perfect Competition 163 Many Sellers 164 Homogeneous Products 164 Excess Capacity 165 Example 5.3 The Bottom Drops Out on Cubs Tickets 166 Monopoly 166 Monopolistic Competition 168

6

Example 5.4 Capacity Competition in the U.S. Beef Processing Industry ¹³ Cournot Quantity Competition 171 The Revenue Destruction Effect 174 Cournot's Model in Practice 175 Bertrand Price Competition 175 Example 5.5 Cournot Equilibrium in the Corn Wet Milling Industry 176 Why Are Cournot and Bertrand Different? 177 Example 5.6 Electric Markets, Bertrand Competition, and Capacity Constraints 178 Bertrand Price Competition When Products Are Horizontally Differentiated 179 Evidence on Market Structure and Performance 181 Price and Concentration 181 Chapter Summary 182 Questions 182 Endnotes 184
ENTRY AND EXIT 186
Some Facts about Entry and Exit 187 Entry and Exit Decisions: Basic Concepts 188 Barriers to Entry 188 Bain's Typology of Entry Conditions 189 Analyzing Entry Conditions: The Asymmetry Requirement 189 Example 6.1 How the Japanese Broke into the U.S. Car Market 190 Structural Entry Barriers 191 Control of Essential Resources 191 Economies of Scale and Scope 192 Example 6.2 Emirates Air ⁸ 193 Marketing Advantages of Incumbency 194 Barriers to Exit 195
Entry-Deterring Strategies 196 Limit Pricing 196
Example 6.3 Limit Pricing by Brazilian Cement Manufacturers 197 Is Strategic Limit Pricing Rational? 198 Example 6.4 Entry Barriers and Profitability in the Japanese Brewing Industry 199
Predatory Pricing 200 The Chain-Store Paradox 200
Example 6.5 Predatory Pricing in the Laboratory 201 Rescuing Limit Pricing and Predation: The Importance of Uncertainty and Reputation 202 Wars of Attrition 203 Example 6.6 Walmart Enters Germany and Exits 204
Predation and Capacity Expansion 204 Strategic Bundling 205
"Judo Economics" 206
Evidence on Entry-Deterring Behavior 207 Contestable Markets 208
An Entry Deterrence Checklist 208
Entering a New Market 208
Preemptive Entry and Rent-Seeking Behavior 210
Chapter Summary 211
Questions 212
Endnotes 213

7 DYNAMICS: COMPETING ACROSS TIME 214

Microdynamics 215

The Strategic Benefits of Commitment 215

Strategic Substitutes and Strategic Complements 216

The Strategic Effect of Commitments 217

Example 7.1 Committed to a Settlement 218

Tough and Soft Commitments 219

A Taxonomy of Commitment Strategies 219

The Informational Benefits of Flexibility 220

Example 7.2 Commitment at Nucor and USX: The Case of Thin-Slab

Casting⁹ 221

Real Options 222

A Framework for Analyzing Commitments 223

Competitive Discipline 224

Dynamic Pricing Rivalry and Tit-for-Tat Pricing 225

Example 7.3 What Happens When a Firm Retaliates Quickly to a Price Cut:

Philip Morris versus B.A.T. in Costa Rica²¹ 226

Why Is Tit-for-Tat So Compelling? 227

Coordinating on the Right Price 227

Impediments to Coordination 229

The Misread Problem 229

Example 7.4 Forgiveness and Provocability: Dow Chemicals and the Market for Reverse Osmosis Membranes 230

Lumpiness of Orders 230

Information about the Sales Transaction 231

Volatility of Demand Conditions 231

Asymmetries among Firms and the Sustainability of

Cooperative Prices 232

Price Sensitivity of Buyers and the Sustainability of Cooperative Pricing 233

Market Structure and the Sustainability of Cooperative Pricing: Summary 233

Facilitating Practices 234

Price Leadership 234

Advance Announcement of Price Changes 234

Most Favored Customer Clauses 234

Example 7.5 Are Most Favored Nation Agreements Anticompetitive? 235
Uniform Delivered Prices 236

Where Does Market Structure Come From? 237

Sutton's Endogenous Sunk Costs 238

Example 7.6 The Evolution of the Chinese Down Apparel Industry 239

Innovation and Market Evolution 240

Learning and Industry Dynamics 241

Chapter Summary 241

Questions 242

Endnotes 244

8 INDUSTRY ANALYSIS 247

Performing a Five-Forces Analysis 248

Internal Rivalry 249

Entry 250

Substitutes and Complements 251

Supplier Power and Buyer Power 251

Strategies for Coping with the Five Forces 252

Coopetition and the Value Net 253 Applying the Five Forces: Some Industry Analyses 255 Chicago Hospital Markets Then and Now 255 Market Definition 255 Internal Rivalry 255 Entry 256 Substitutes and Complements 257 Supplier Power 257 Buyer Power 258 Commercial Airframe Manufacturing 259 Market Definition 259 Internal Rivalry 259 Barriers to Entry 260 Substitutes and Complements 261 Supplier Power 261 Buyer Power 262 Professional Sports 262 Market Definition 262 Internal Rivalry 262 Entry 264 Substitutes and Complements 266 Supplier Power 267 Buyer Power 267 Conclusion 267 Professional Search Firms 268 Market Definition 268 Internal Rivalry 268 Entry 269 Substitutes and Complements 269 Supplier Power 270 Buyer Power 270 Conclusion 270 Chapter Summary 271 Questions 271 Endnotes 275 PART THREE STRATEGIC POSITION AND DYNAMICS 277

STRATEGIC POSITIONING FOR COMPETITIVE ADVANTAGE 279

Competitive Advantage and Value Creation: Conceptual Foundations 280

Competitive Advantage Defined 280

Maximum Willingness-to-Pay and Consumer Surplus 281

From Maximum Willingness-to-Pay

to Consumer Surplus 282

Value-Created 284

Example 9.1 The Division of Value Creation for Gilead

Sciences' Sovaldi on the Back of an Envelope 286

Value Creation and "Win-Win" Business Opportunities 287

Value Creation and Competitive Advantage 288

Analyzing Value Creation 288

Example 9.2 Kmart versus Walmart 290

Example 9.3 The Emergence of Uber . . . and the Demise of the Taxi? 291

Value Creation and the Value Chain 292

Value Creation, Resources, and Capabilities 292

Example 9.4 Creating Value at Enterprise Rent-a-Car¹⁷ 294

Example 9.5 Measuring Capabilities in the Pharmaceutical Industry 295

Strategic Positioning: Cost Advantage and Benefit Advantage 296

Generic Strategies 296

The Strategic Logic of Cost Leadership 296

The Strategic Logic of Benefit Leadership 298

Example 9.6 "Haute Pot" Cuisine in China 299

Extracting Profits from Cost and Benefit Advantage 301

Comparing Cost and Benefit Advantages 302

"Stuck in the Middle" 304

Example 9.7 Strategic Positioning in the Airline Industry: Four Decades of Change 304

Diagnosing Cost and Benefit Drivers 306

Cost Drivers 306

Cost Drivers Related to Firm Size, Scope, and Cumulative Experience 307

Cost Drivers Independent of Firm Size, Scope, or Cumulative Experience 307

Cost Drivers Related to Organization of the Transactions 308

Benefit Drivers 308

Methods for Estimating and Characterizing Costs and Perceived

Benefits 309

Estimating Costs 309

Estimating Benefits 310

Strategic Positioning: Broad Coverage versus Focus Strategies 310

Segmenting an Industry 310

Broad Coverage Strategies 311

Focus Strategies 312

Chapter Summary 314

Questions 315

Endnotes 318

10 INFORMATION AND VALUE CREATION 320

The "Shopping Problem" 321

Unraveling 322

Alternatives to Disclosure 323

Example 10.1 A Warranty for Surgery 324

Example 10.2 The Evolution of Branding in Appliance Retailing 326

Nonprofit Firms 327

Report Cards 327

Multitasking: Teaching to the Test 328

Example 10.3 Teachers Teaching to the Test 329

What to Measure 331

Example 10.4 Calorie Posting in New York City Restaurants 333

Risk Adjustment 335

Presenting Report Card Results 336

Gaming Report Cards 337

Example 10.5 Hospital Report Cards 338

The Certifier Market 339

Certification Bias 340

Matchmaking 342

When Sellers Search for Buyers 343

	Example 10.6 The Netflix Challenge 343 Chapter Summary 345 Questions 346 Endnotes 347
11	SUSTAINING COMPETITIVE ADVANTAGE 349
	Market Structure and Threats to Sustainability 349 Threats to Sustainability in Competitive and Monopolistically Competitive Markets 350 Threats to Sustainability under All Market Structures 351 Evidence: The Persistence of Profitability 351 The Resource-Based Theory of the Firm 353 Imperfect Mobility and Cospecialization 353 Example 11.1 Coffee, Tea, or Starbucks? 354 Isolating Mechanisms 355 Example 11.2 Sports Dynasties 357 Impediments to Imitation 358 Legal Restrictions 358 Superior Access to Inputs or Customers 359 Example 11.3 Cola Wars in Venezuela 360 The Winner's Curse 361 Market Size and Scale Economies 361 Intangible Barriers to Imitation 362
	Causal Ambiguity 363 Dependence on Historical Circumstances 363 Social Complexity 363
	Early-Mover Advantages 364 Learning Curve 364 Reputation and Buyer Uncertainty 364 Buyer Switching Costs 364 Network Effects 365 Networks and Standards 365 Example 11.4 Building Blocks of Sustainable Advantage 366 Competing "For the Market" versus "In the Market" 366 Knocking Off a Dominant Standard 367 Early-Mover Disadvantages 367
	Imperfect Imitability and Industry Equilibrium 368 Creating Advantage and Creative Destruction 370 Disruptive Technologies 370 The Productivity Effect 371 The Sunk Cost Effect 371 The Replacement Effect 372 The Efficiency Effect 372
	Disruption versus the Resource-Based Theory of the Firm 373 Innovation and the Market for Ideas 373 Example 11.5 Patent Racing and the Invention of the Integrated Circuit ²³ 374
	Evolutionary Economics and Dynamic Capabilities 375 The Environment 376 Factor Conditions 376 Demand Conditions 376 Related Supplier or Support Industries 376
	Example 11.6 The Rise of the Swiss Watch Industry ²⁷ 377

Strategy, Structure, and Rivalry 378
Chapter Summary 378
Questions 379
Endnotes 381

PART FOUR INTERNAL ORGANIZATION 383

12 PERFORMANCE MEASUREMENT AND INCENTIVES 385

The Principal-Agent Relationship 386

Combating Agency Problems 386

Example 12.1 Differences in Objectives in Agency Relationships: Yahoo! and English Fruit 387

Performance-Based Incentives 388

Example 12.2 Hidden Action and Hidden Information in Garment Factory Fire Insurance 391

Problems with Performance-Based Incentives 393

Preferences over Risky Outcomes 393

Risk Sharing 394

Risk and Incentives 396

Example 12.3 "Target and Terror" in English Hospitals 398

Performance Measures That Fail to Reflect

All Desired Actions 399

Selecting Performance Measures: Managing Trade-offs between Costs 401

Example 12.4 Herding, RPE, and the 2007–2008 Credit Crisis 403

Do Pay-for-Performance Incentives Work? 404

Implicit Incentive Contracts 405

Subjective Performance Evaluation 405

Promotion Tournaments 406

Example 12.5 Quitters Never Win³² 408

Efficiency Wages and the Threat of Termination 409

Incentives in Teams 410

Example 12.6 Teams and Communication in Steel Mills⁴² 412

Chapter Summary 413

Questions 414

Endnotes 416

13 STRATEGY AND STRUCTURE 419

An Introduction to Structure 421

Individuals, Teams, and Hierarchies 421

Complex Hierarchy 424

Departmentalization 424

Coordination and Control 426

Approaches to Coordination 428

Example 13.1 ABB's Matrix Organization 430

Types of Organizational Structures 431

Functional Structure (U-form) 431

Example 13.2 Organizational Structure at AT&T 432

Multidivisional Structure (M-form) 433

Matrix Structure 434

Matrix or Division? A Model of Optimal Structure 435 Network Structure 436

Why Are There So Few Structural Types? 438

Strategy-Environment Coherence 439

Technology and Task Interdependence 440 Example 13.3 Steve Jobs and Structure at Apple 441

Information Processing 442

Structure Follows Strategy 443

Example 13.4 Strategy, Structure, and the Attempted Merger Between the University of Chicago Hospital and Michael Reese Hospital 445

Strategy, Structure, and the Multinational Firm 445

Example 13.5 Multinational Firms: Strategy and Infrastructure³⁹ 446

Example 13.6 Reorganization at Rhône-Poulenc S.A.⁴¹ 447

Hybrid Organizations 449

Chapter Summary 451

Questions 452

Endnotes 453

14 ENVIRONMENT, POWER, AND CULTURE 456

The Social Context of Firm Behavior 456 Internal Context 458

Power 459

The Sources of Power 460

Example 14.1 The Sources of Presidential Power 462

Structural Views of Power 463

Do Successful Organizations Need Powerful Managers? 464

Example 14.2 Power and Poor Performance: The Case of the 1957 Mercury¹⁶ 465

The Decision to Allocate Formal Power to Individuals 466

Example 14.3 Power in the Boardroom: Why Let CEOs Choose Directors? 466

Culture 468

Culture Complements Formal Controls 470

Example 14.4 Corporate Culture and Inertia at ICI³⁰ 470

Culture Facilitates Cooperation and Reduces

Bargaining Costs 471

Culture, Inertia, and Performance 472

A Word of Caution about Culture 473

Example 14.5 Corporate Culture at Aetna: Yoga and the CEO³⁷ 474

External Context, Institutions, and Strategies 474

Example 14.6 Corporate Culture at Ford³⁸ 475

Institutions and Regulation 477

Interfirm Resource Dependence Relationships 478

Example 14.7 Preserving Culture in the Face of Growth: The Google IPO 480 Industry Logics: Beliefs, Values, and Behavioral Norms 481

Chapter Summary 483

Questions 484

Endnotes 485

GLOSSARY 488

NAME INDEX •••

SUBJECT INDEX •••