From a hierarchy to a heterarchy of strategies: Adapting to a changing context

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Abstract
Purpose of the paper: The purpose of this paper is to question the continued usefulness of the hierarchy of strategies framework and to propose a new approach.

Methodology/Approach: Reviewing extant literature and theorizing a new approach.

Findings: The hierarchy of strategies was a useful framework when it was first proposed, but since then a changed business context has made this framework obsolete. What is needed instead is a framework around a heterarchy of strategies. The locus of decision making is no longer hierarchical and corporate, business and functional strategies are far more interdependent and interlinked than they have been in the past.

Research Limitations/Implications: Research on a hierarchy of strategies has run its course. Future empirical and theoretical work should focus on a heterarchy of strategies.

Practical Implications: The paper provides a framework for managers whether from corporate, business divisions or functions to help with the continuous renewal of their firm.

Originality: Prior empirical and theoretical strategy research has taken the hierarchy of strategy framework for granted. The original contribution of this paper is to propose an alternative framework around a heterarchy of strategies.

Keywords: hierarchy of strategies, heterarchy of strategies, continuous renewal

Article Type: Conceptual paper
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Introduction

Strategic management has the ambition to be the field that informs the decisions and actions of general managers. In pursuit of this high goal the field has from time to time worshipped at various theoretical altars, both in economics and sociology. For example, it has looked to industrial-organization and transaction-cost economics, agency, network, contingency and, more recently, resource-based (or its cousin the dynamic-capabilities-based) theories of the firm, for inspiration. While some of these theories have helped guide general management decisions and actions, many have been hard to operationalize. The field still lacks an actionable theory.

While theoretical anchors are seen as giving the field academic respectability, strategic management has helped practitioners more by its frameworks and typologies. The traditional hierarchical view of strategies: corporate, business unit and functional, must be viewed in this light. While the hierarchical view of strategies has never had the pretensions of being a theory, it did capture the essence of what was seen as best practice in the 1960s and 1970s. It was a useful framework.

While the hierarchy of strategy is still often taught in business schools today, its theoretical relevance and empirical support have been severely questioned. It does not mirror the actual locus of decision making or the causality of strategy making in a global firm today. In a transnational firm, the corporate office continues to drive
corporate strategy for optimal portfolio balance. But this portfolio is defined not just along business lines but also along geography and resource dimensions, traditional prerogatives for business units and functions. Business units and functions are run globally and heads of these business units and functions are also corporate officers. Strategic initiatives at a business or functional level may indeed drive the development of corporate strategy, which, in the hierarchy of strategy, is viewed from the top down.

Corporate, business and functional strategies are not hierarchical anymore; they are contemporaneous and interactive. Instead of a hierarchy of strategies, we should think more in terms of a heterarchy of strategies (Hedlund, 1986). In a hierarchy every strategic decision making node is connected to at most one parent node. In a heterarchy, however, a node can be connected to any of its surrounding nodes without needing to go through or get permission from some other node.

We will review in this short article both the antecedents of the hierarchical view and why it was seen to be useful followed by its limitations and growing irrelevance to the strategic management challenges of today. We conclude the paper with a brief description of what corporate, business and functional strategies look like in a heterarchical world.
Hierarchy of strategies: A framework for its time

Two of the classics in the field of strategic management, the first by Ansoff (1965) and the other by Andrews (1971), both had Corporate Strategy in their titles. Strategy making, at the time, was considered the sole preserve of the firm’s corporate officers; hence the term corporate strategy. Only with the eventual democratization of strategy making did a hierarchy of strategies begin to emerge.

The origin of the hierarchical view of strategies dates back to the 1920s when some of the largest US firms started pursuing a strategy of diversification. At that time, these firms were typically organized functionally. But diversified growth using these organization structures soon led to severe coordination and resource allocation problems. Top management, in firms such as Dupont and General Motors, responded to this problem with the creation of the multidivisional organization structure, or the M-Form (Chandler, 1962).

Following Chandler’s (1962) pioneering work showing how a strategy of diversification led to the use of a multidivisional structure, other researchers sought theoretical reasons for the emergence and adoption of the M-form organization structure. Using transaction cost economics reasoning, Williamson (1975) argued that the M-form was adopted because it did a better job than capital markets in allocating scarce capital between competing investment proposals. He suggested that both the monitoring and policing costs were also lower in the multidivisional structure when compared to capital markets.
However, the multidivisional structure was itself becoming unwieldy. Leading firms like General Electric (GE) invited McKinsey & Company, one of the founders of the now flourishing management consulting industry, to examine its corporate structure. GE had at that time nearly 200 profit centers and 145 departments. The McKinsey consultants advised GE’s top management to organize their firm’s businesses along strategic lines, influenced more by external industry conditions than internal organizational considerations (Ghemawat, 1997). GE’s profit centers and departments were consolidated into a smaller number of Strategic Business Units (SBU).

Each SBU became a stand alone entity deserving of its own strategy and dedicated functional support. While corporate strategy was concerned with domain selection (the portfolio of businesses that the firm should have in order to deliver value to its shareholders); business unit strategy was concerned with domain navigation (competitive positioning of each of the firm’s business within its industry environment). Finally, functional strategies specified the contributions that were expected from each function and their relative salience to the success of the firm’s business strategy.

Corporations also turned to consultants for answers regarding resource allocation. Starting with BCG’s growth share matrix, numerous other consulting firms introduced portfolio planning matrix as an answer to the resource allocation problem. The two axes of the matrix were typically the industry’s attractiveness and the company’s position within the industry. Each of the corporation’s strategic business units could
be mapped onto this matrix. SBUs with strong market positions in growing industries, the “star” businesses, were lavished with additional resources; even as SBUs with weak positions in stagnating or declining industries, the so called “dog” businesses, were slated for divestment. By the mid 1970s, portfolio planning became very popular. Indeed, by the early 1980s over half of the Fortune 500 had introduced portfolio planning techniques (Hasperslag, 1982).

Further, in order to bridge the multiple levels of decision making within the firm top management needed a process. Formal planning and control systems began filling this void. A study by Stanford Research Institute showed that a majority of US companies used formal planning systems by 1963. Vancil and Lorange (1977) and Lorange (1980) describe three distinct phases in a typical strategic planning process: agenda setting, strategic programming and budgeting. Aspirations of top management when cycled through these three phases and three layers of management (corporate, divisional and functional) resulted in concrete budgets for business units and functions within the firm. When the three phases were followed in a rigid sequential fashion, the intent was frozen when strategic programs began to be developed. In turn, the programs were non-negotiable once budgets were decided.

By the early 1980s, with the diffusion of M-form structure, the creation of SBUs, the adoption of formal planning systems and portfolio planning techniques, the separation of business unit and corporate strategies was complete in the US and Europe. Functional strategies had to be subservient to the business strategies that they
supported, and business strategies in turn had to be aligned with the firm’s corporate strategy.

Furthermore, this hierarchical view of strategy was also mapped on to levels of management within the firm. The locus of decision making for each strategy was thus clearly specified. The corporate office was the primary architect of strategy. Divisional managers helped in a more restricted fashion by detailing their business strategy within strict corporate guidelines. Functional managers supported their divisional heads with well aligned functional strategies.

It was assumed then that this unidirectional causality and hierarchically determined locus of decision making was the sine qua non for superior firm performance. No theoretical basis was provided for this assertion. Nor were there systematic empirical studies conducted to verify this claim. The assumption was that since the framework emerged from the practices of high performing companies like General Motors, Dupont, ITT and GE, it had to have universal appeal. It appeared to be a useful framework in practice and that seemed to have sufficed.

However, the hierarchical view of strategies has since unraveled because of both empirical and theoretical developments on corporate, business and functional strategies. It has also lost its relevance today mostly because strategic management has changed dramatically due to an increasingly turbulent business context (Chakravarthy, 1997). Strategy making in a transnational corporation cannot afford to
be hierarchical. It has to be more inclusive and heterarchical. We will examine next these challenges to the hierarchical view of strategies.

**The empirical challenge**

The portfolio planning models used in diversified firms were severely criticized on several grounds. First, industry growth as a proxy of industry attractiveness or relative market share as a proxy for company position, were seen as too simplistic. Second, these matrices were also open to multiple interpretations leading to the same business being variously described as a dog, cash cow or even star (Wind et al, 1983). Third, portfolio planning tools stated nothing about the potential synergies that obtained across the firm’s business units. Finally, they provided the corporation’s business units meaningless directives (such as “grow,” “harvest,” or “divest”) for dealing with their competitive realities (Gluck and Kauffman, 1979).

Academic researchers also began focusing on the links between diversification strategy and firm performance (see Ramanujam and Varadarajan, 1989 for a review.) The research tended to show that corporations with a portfolio of unrelated businesses (e.g. conglomerates) or set of vertically integrated businesses performed far worse than corporations with a portfolio of related businesses (Rumelt, 1982). Unless the firm’s corporate strategy explicitly worked for synergies across the firm’s businesses, its shareholders gained very little by trusting the firm’s top management to allocate resources on their behalf.
The linear and top-down view of strategy making was also challenged, notably by the work done by strategy process scholars. One of the pioneering studies on strategy process showed that strategy making was not top down as suggested by the hierarchical view of strategies but was essentially bottom up (Bower, 1970). In a detailed field study, Bower found that strategy originated from the “discrepancies” (something needed to change) experienced by functional managers, then given impetus by business divisional managers and finally approved by top management.

Another influential researcher, Mintzberg (1994), had similarly argued against the over reliance on planned strategies and the linear top down conceptualization of strategy making. He provided numerous empirical examples of strategies that had “emerged” with apparently little planning. Additional studies in strategy process kept chipping way at the hierarchical view of strategies (Chakravarthy and White, 2001).

Following Simon (1945), Bower (1970) suggested that the role of top management was not so much to make strategic decisions, but rather to set the premises for these decisions by shaping the strategic and organizational context of the firm. More recent research on strategic planning and control systems (Chakravarthy and Lorange, 1991; Lorange, 1980; Simons, 1994) has sought to describe how strategic planning systems can themselves set such a context. These newer studies suggest that the degree of interactions and iterations in a firm’s planning system have an important role in determining whether the strategies its managers pursue will explore new strategy frontiers and seek new competencies or exploit existing markets and competencies (March, 1991).
The theoretical challenge

The changing definition of corporate strategy

Agency theory began questioning the wisdom of trusting corporate managers to make the right resource allocation decisions on behalf of the firm’s shareholders. In the mid-eighties, shareholder activism and leveraged buyouts opened up a market for corporate control (see Jensen, 1989 for a review). Questions were raised as to who was the right corporate parent for the businesses in a firm’s portfolio.

At the same time, the development of the resource based view of the firm showed that synergy benefits did not come from the relatedness across product markets but from the underlying competencies across businesses. Indeed, Wernerfelt and Montgomery (1988) showed how a corporation was constrained in terms of its diversification distance not because of product-market relatedness but because of the specificity of the underlying resources and their transferability into different businesses. Corporations with more general resources seemed to diversify across a wider variety of industries.

Thus, the definition of corporate strategy expanded to not only include which businesses to be in but also how to manage those businesses: through coordination, control and organization such that the total value of the corporation was greater than the sum of each business unit value as a standalone entity (see Collis and Montgomery, 1995 or Goold and Campbell, 1987 for a review).
The ascendance of business strategy

By the early 1980s, heightened competition especially from Germany and Japan, shifted top management attention to competition, competitive strategy, and competitive advantage. Corporations, such as GE, became less fixated on synergy and more interested in making each of their businesses #1 or #2 in market position vis-à-vis their global competitors. Academic research picked up on these concerns rather quickly. Building on Industrial Organization research, Porter’s (1980) work on industry analysis and competitive strategy came as a big relief. Business strategy was elevated to the same if not greater level of importance than corporate strategy.

Growing importance of functional strategies

Competitive advantage, according to Porter (1985) stemmed from the “fit” of the discrete activities that a firm performed in designing, producing, marketing, delivering with its business unit strategy. The disaggregation of businesses into their component activities in Porter’s value chain heightened the importance of functions to competitive success. This led to the emergence of specialized functional consulting firms in marketing strategy, supply chain strategy, manufacturing strategy, and the like.

resource strategy, Johnson, 1984, Miller, 1995 for R&D strategy). Functional strategies were not merely subservient to business and corporate strategies but in their own right were important to the competitive success of the firm. Indeed functions were the homes of many of the firm’s distinctive competencies.

Towards a heterarchy

The hierarchy of strategy has become irrelevant. Empirical studies have shown that the traditional role of corporate strategy – portfolio planning – does not lead to higher performance and the causality of strategy formulation is not always top down. Furthermore, advances in agency, industrial organization, resource based theories (including others) have shaped our thinking on what the new roles, causality and locus of decision making in corporate, business unit and functional strategies could be. Faced with the turbulent environment that confronts a typical firm today, we should thus view corporate, business and functional strategies not as a top down hierarchy with very separate roles and responsibilities but as an interdependent network or heterarchy with the fundamental challenge, for all levels of strategy, being continuous renewal (Chakravarthy, 1996).

Continuous renewal

The continuous renewal challenge can be best understood through a simple framework (See Figure 1) (Chakravarthy and Lorange, 2007). The matrix is defined by the two traditional dimensions of markets that a firm currently participates in or wishes to; and the distinctive competencies that it has or seeks to access in order to
defend its presence in these chosen markets. These correspond to the traditional product-market axis and the more recent resource and capabilities axis.

Markets refer to the customer sectors and geographies that a firm participates in. Each market has a defined set of customers and competitors. Firms also operate globally and can define their markets by the countries in which they operate. Whichever markets the firm competes in there are always new markets that are open to it. Some of these may have to be discovered de novo by the firm (Hamel and Prahalad, 1994), but others may already exist and are merely new to the firm. Distinctive competencies are the second dimension. These may be in the form of firm’s tangible assets like raw material reserves, financial resources, plant, equipment, distribution channels, logistical assets, patents etc. as well as in its intangible assets like brand name and customer relations. They could also be in the firm’s know-how and skills, which are embedded in its people and processes. Any element of the firm’s value chain is a potential source of distinction; whether it is procurement, R&D, operations, logistics, selling or even support-activities like Information Technology. Since competencies eventually lose their distinction, new distinctive competencies are needed both to protect the core business of the firm and to provide a platform to enter new markets.

Renewal is not only a matter of positioning the firm in a more attractive opportunity space but is equally about accumulating new distinctive competencies that will allow
a defense of these new found positions. In fact there is a growing body (Barney, 1986; Barney 1991, Collis and Montgomery, 1995; Peteraf, 1993; Prahalad and Hamel, 1990; Teece, et. al., 1997) of research in strategic management that extols the virtues of the competence dimension (sometimes to the exclusion of the equally important product-market dimension). We believe that market positioning and distinctive competencies are complementary dimensions in defining a renewal initiative. Continuous renewal must involve market positioning and distinctive competencies simultaneously. It is about exploiting existing market positions and distinctive competencies, as well as exploring new markets and competencies – not one or the other but one and the other.

The lower left hand cell in Figure 1 describes the present core of the firm, the markets that it participates in and the distinctive competencies that it currently has. Protecting and extending the core is the obvious first renewal initiative. The other initiative is competing for the future by proactively migrating to new markets and acquiring new competencies (migrating to the upper right hand cell in Figure 1). This migration is transforming the core. Chakravarthy and Lorange (2007) propose two other renewal initiatives that link these two: leverage and build. The upper left hand cell in Figure 1 describes new markets that the firm can enter by leveraging the existing competencies that it already has. But this is just the initial step. Complementary new competencies will have to be added in order for the firm to compete successfully in these new markets. Similarly, the lower right hand cell describes the new distinctive competencies that the firm must build in order to protect its existing market franchise. But this too cannot be a dead end initiative. The new competencies that are built must allow for future leverage into new markets. Both leverage and build should logically
lead to the other (hence the bent arrows for leverage and build in Figure 1). If the two are linked systematically, it can help the firm migrate to new markets and new competence platforms progressively over time.

A new blend of strategies

Strategy is about commitments (Ghemawat, 1991) and yet it is also about learning. The resources on which a firm commits to a strategy may not be as distinctive as first assumed, or it may lead to newer opportunities that are far more attractive. Commitments have to be flexible as well. This may sound like an oxymoron, but this is precisely what the challenge is in continuous renewal. The portfolio choice here is not just in terms of the market dimension but also the competence dimension. Actively monitoring the Protect and Extend, Build, Leverage and Transform initiatives in the firm’s portfolio is a key element of corporate strategy in a transnational firm. Instead of managing a portfolio of businesses or resources, the new corporate role is to manage a portfolio of renewal initiatives.

Top management also has to focus on deliberate and controlled experiments. It has to be the prime mover in Transform initiatives, either setting these up as corporate ventures or by creating the right platform through targeted acquisitions. It may also prompt Build and Leverage initiatives but should generally rely on the business and functional divisions to propose these. Build and Leverage are initiatives that call for a partnership between top management and business/functional heads.
The business division head in a transnational company is the corporate officer responsible for its major markets. This manager is typically the prime mover for the Protect and Extend initiative. In contrast with the role assigned to this manager under the hierarchical view of strategies, the business divisional head is also expected to explore for new markets and competencies and not just be responsible for strategy execution. In this capacity this manager does shape corporate strategy.

The functional manager in a transnational company is the corporate officer responsible for its competencies. Maintaining functional excellence, promoting its sharing and leveraging it across the entire firm are also some of the key responsibilities of this manager. His role is vital to the Build and Leverage initiatives of the firm. He must also partner with the business division head on Protect and Extend initiatives.

As Bartlett and Ghoshal (1989) so eloquently described, transnational strategy is in part global efficiency and learning, but in part also about local responsiveness. The strategy process has to be highly interactive and iterative. It is essentially heterarchical in nature.

Build, Leverage and Transform initiatives require a bottom up adaptive planning process, and in contrast a Protect & Extend initiative requires a top down integrative planning process. While the two systems can co-exist within a firm, they have to be administered differently by the corporate officers. Interactions in planning refer to the levels of managers who are involved in developing the firm’s strategic plan. The
greater this interaction, the richer are the strategic alternatives which are considered.

High interaction is crucial for exploration (Chakravarthy and Lorange, 1991).

Another consideration is the degree of iteration in the planning process. When each phase of planning (agenda setting, strategic programming and budgeting) is seen more as a guide to the next without rigidly constraining it, the planning process is more iterative. For exploration, the planning process must encourage the continuous questioning of the relevance of approved strategic programs and the appropriateness of accepted goals.

Table 1 provides a contrast between what we propose here and the traditional hierarchical view of strategies.

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Figure 1

A Framework for Continuous Renewal

Table 1
From Hierarchy to Heterarchy of Strategies

<table>
<thead>
<tr>
<th>STRATEGY</th>
<th>Hierarchical View</th>
<th>Heterarchical View</th>
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| Corporate | • Product-Market Portfolio Choice  
             • Optimal resource allocation  
             • Domain Scope: Defines boundaries for each business in the portfolio  
             • Sole prerogative of top management | • Continuous Renewal  
             • Portfolio of Renewal Strategies  
             • Prime mover for Transform initiatives and partners in Build/Leverage initiatives |
| Business | • Domain Navigation  
            • Exploiting Industry Opportunities  
            • Top down: Informed by corporate strategy  
            • Divisional managers propose, top management approves | • Continuous Renewal  
            • Exploiting & Diversifying Business Opportunities and Firm Competencies  
            • Top down & Bottom Up: Informed by and Shapes corporate strategy  
            • Prime mover for Protect & Extend initiatives. Partners in Build/Leverage initiatives. Contributes to Transform initiatives |
| Functional | • Functional support  
             • Value Chain aligned with business strategy  
             • Functional managers propose, divisional manager approves | • Continuous Renewal  
             • Functional excellence, but also tailored to business strategy  
             • Champion sharing & learning of best practice  
             • Partners in Protect & Extend, Leverage and Build initiatives. Contributes to Transform initiatives |
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