Ambidextrous or Stuck in the Middle? How to compete with two business models in the same industry

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Abstract

The growing frequency with which new and disruptive business models have invaded established industries in the last twenty years has brought to the fore an old strategy question: "How could a company compete with two business models in the same industry at the same time?" We argue that the standard answer given in the literature—which is to put the second business model in a separate business unit—is not enough to ensure success. Based on our own research, we provide a roadmap on how companies ought to approach this issue.

Ambidextrous or Stuck in the Middle? How to compete with two business models in the same industry

How could a company adopt two different and conflicting business models in the same industry? This question has become particularly pressing for an increasing number of established companies that have seen their markets invaded by new and disruptive business models. The success of these invaders in capturing market share has encouraged established firms to respond by adopting the new business models alongside their established ones. Yet, despite the best of intentions and significant resources invested in trying to compete with two business models, the evidence is that most such efforts end up in failure.

According to Porter (1980 and 1996), the challenge with attempting to manage two different business models in the same industry at the same time is that the two models (and their underlying value chains) could conflict with one another. For example, by selling their tickets through the Internet just like their low-cost competitors, established airline companies risk alienating their existing distributors (the travel agents). Similarly, established newspaper companies that attempt to offer "free" newspapers to respond to new entrants doing so, risk cannibalizing their existing customer base. And fast-moving consumer goods (FMGC) companies that move into the private label space risk damaging their existing brands and diluting their organizations' strong cultures for innovation and differentiation.

The existence of such trade-offs and conflicts means that a company that tries to compete in both positions simultaneously risks paying a huge straddling cost and degrading the value of its existing activities (Porter, 1996). The task is obviously not impossible but it is certainly difficult. This is the logic that led Michael Porter (1980) to propose more than thirty years ago that a company could find itself "stuck in the middle" if it tried to compete with both low-cost and differentiation strategies.

The proposed Solution: Create Separate Units

The primary solution offered to solve this problem is to keep the two business models (and their underlying value chains) physically separate in two distinct organizations.

This is the "innovator's solution" that's primarily associated with Christensen's (1997) work on disruptive innovation but other academics have advocated it as well (e.g. Bower and Christensen, 1995; Burgelman and Sayles, 1986; Cooper and Smith, 1992; Gilbert and Bower, 2002; Utterback, 1994). Even Porter (1996) has come out in favour of this organizational solution. Despite arguing that most companies that attempt to compete with dual strategies will likely fail, he has also proposed that: "…companies seeking growth through broadening within their industry can best contain the risks to strategy by creating stand-alone units, each with its own brand name and tailored activities." (Porter, 1996, page 77).

The rationale for this solution is quite straightforward. The presence of conflicts means that the existing organization and its managers will often find that the new business model is growing at their expense. They will therefore have incentives to constrain it or even kill it. Therefore, by keeping the two business models separate, you prevent the company's existing processes and culture from suffocating the new business model. The new unit can develop its own strategy, culture and processes without interference from the parent company. It can also manage its business as it sees fit without being suffocated by the managers of the established company who see cannibalization threats and channel conflicts at every turn.

Sensible as this argument might be, the separation solution is not without problems and risks. Perhaps the biggest cost of keeping the two businesses separate is failure to exploit synergies between the two. For example, Day, Mang, Richter and Roberts (2001: p. 21) have argued that: "…the simple injunction to cordon off new businesses is too narrow. Although ventures do need space to develop, strict separation can prevent them from obtaining invaluable resources and rob their parents of the vitality they can generate." Similarly, Iansiti, McFarlan and Westerman (2003: p. 58) reported that: "…spinoffs often enable faster action early on but they later have difficulty achieving true staying power in the market. Even worse, by launching a spinoff, a company often creates conditions that make future integration very difficult."

In recognition of the need to exploit the synergies between the two business models, the argument in favour of separation has now been revised to one that proposes the creation of separate units *that are linked together by a number of integrating mechanisms*. For example, O'Reilly and Tushman (2004) proposed that a truly ambidextrous organization is one where separate units are integrated into the existing management hierarchy of the firm by having a common general manager to supervise them all. Similarly, Ghoshal and Gratton (2003) argued in favour of creating incentives that encourage cooperation among the separate units; Gilbert (2003) proposed the creation of an active and credible integrator to help units cooperate; and Govindarajan and Trimble (2005) proposed systems and cultures that allow the parent and the separate unit to work together while maintaining their independence. Numerous other studies have identified other kinds of integrating mechanisms that successful companies have put in place and the list is large. Exhibit 1 identifies some of the mechanisms proposed in the academic literature[1].

Put Exhibit 1 here

Separation is not Enough

Although the separation solution sounds theoretically appealing, the evidence is that simply creating separate units is not enough to ensure success. Not only do we have an increasing number of examples of companies that have tried this solution and failed (such as British Airways with its GO subsidiary and KLM with its Buzz subsidiary) but we also see an increasing number of companies—such as Nintendo and Mercedes—that achieved ambidexterity without creating separate units.

[1] A variant to the idea of creating separate units that are linked together by a variety of integrating mechanisms (i.e. *spatial* separation) is the idea of *temporal* separation proposed by authors such as Nickerson and Zenger (2002), Puranam, Singh and Zollo (2006) and Siggelkow and Levinthal (2003). The main idea behind this proposal is that *the same unit or company* can undertake two seemingly incompatible activities (such as exploitation and exploration) *but at different times*. For example, Siggelkow and Levinthal (2003) showed through simulations of adaptation on rugged landscape that there are advantages to organizational forms that are initially decentralized but eventually centralized. Similarly, Puranam, Singh and Zollo (2006) argued that a firm needs to synchronize the shift in organizational emphasis (from exploitation to exploration) with stages of technological development—for example, structural forms that emphasize autonomy tend to outperform structural forms that emphasize coordination during exploration-intensive stages of development.

Our own research has alerted us to the fact that to be successful in competing with two different and conflicting business models, a company needs to do much more than creating a separate unit. In an earlier study (Charitou and Markides, 2003), we reported the experiences of 68 companies that faced the challenge of competing with dual business models. Only 17 of these firms ended up being successful in their endeavors and of these, ten had created a separate unit while 7 achieved success without creating a separate unit. This implied that separation is not a necessary condition for success. In addition, of the 68 sample firms, forty-two followed the standard academic advice and created a separate unit for the new business model. Yet, only ten of them ended up being successful, implying that 32 firms had created a separate unit and still failed to play two games successfully. This suggested that separation on its own is not enough to ensure success.

If separation is not enough, what else should companies do? Over the last two years, we studied 65 companies that attempted to compete with dual business models in their markets (see Appendix A). By comparing the experiences of those firms that did so successfully with those that failed, we have identified five key questions that companies need to consider if they are to improve the odds of success in competing with dual business models in the same industry.

Question #1: Should I enter the market space created by the new business model?

Despite perceptions to the contrary, the markets that get created by the new business models are *not* necessarily more attractive than the established markets. Nor are the customers that make up the newly created markets necessarily attractive customers that established firms should be chasing after. For example, consider the huge market that Internet brokerage created in the USA. It is certainly a big market and it's growing. But is it a market that all established brokers ought to go after? Undoubtedly, some established brokers will find this an attractive market to chase but this may not be the case for everybody. Consider for example Edward Jones, one of the leading companies in the U.S. retail-brokerage industry. As ex-managing partner John Bachmann commented: "You will not buy securities over the Internet at Edward Jones. That's going to be true as far as I can see into the future…If you aren't interested in a relationship and you just want a transaction, then you could go to

E*Trade if you want a good price. We just aren't in that business[2]." The "unattractiveness" of this new market was reiterated by Edward Jones' next managing partner, Doug Hill who said to us: "We think online trading is for speculators who like entertainment. We don't want such customers…We are not in the entertainment business; we are in the "peace of mind" business."

What this implies is that the decision to enter the market space that the new business model has created is not (and should not be) an automatic one. Before jumping in, the established firm ought to carefully assess the "attractiveness" of the new market and determine whether this is a market it should be competing in.

Whether the new market is attractive or not will depend not only on its size and growth rate but also *on the firm's competences* and whether these would allow the firm to succeed in the new market. Yes, the new market may be huge, growing and appealing; and yes, it may look like a low-hanging fruit that can easily be exploited. But appearances can be deceiving. The established firm should approach the decision in exactly the same manner that it would approach a decision *to diversify into another market*. It must, therefore, assess not only if the new market is attractive in general but whether—given its own bundle of core competences—it is attractive *to this firm*. That would be determined by what competences the firm has and whether these competences can be applied in the new market in a *unique* way (Markides, 1997). The corporate graveyard is littered with companies that diversified into what appeared to be attractive markets, only to discover that these markets were themselves littered with mines.

This might seem like an obvious point but it is amazing how many established firms plunge into the new markets without giving careful consideration to whether the new market *is right for them*. The mistake they make is to assume that the new markets are just extensions of the established market. After all, what is the difference between the low-end of the airline market and the established airline market? Aren't they simply two segments of the same market? And if I can play the game so well in the established market, can I not do the same in the new market? This is a trap! The new

[2] E. Kelly: "Edward Jones and Me," Fortune, Monday June 12, 2000, p.145

markets are different—they are made up of different customers who want different value attributes. They also imply different key success factors and may require different skills from the firm. Moving into these newly created markets represents a fundamental **new market entry** for the established firms (or a **diversification move**). They should be evaluated as such before deciding to either enter them or not.

This does not mean that the firm should not "respond" to an invading business model. It should, but response does not necessarily imply that it has to adopt it. An established firm can "respond" to the innovation *not* by adopting it but by investing in its existing business to make the traditional way of competing even more competitive relative to the new way of competing. Alternatively, it could counter-attack the business-model innovators by introducing a new business model of its own—a "disrupt the disruptor" strategy. There are several options available to a firm that wants to respond to an invading business model (Charitou and Markides, 2003) and adopting the new model is only one of them.

Question #2: If I am to enter the new market space, can I do it with my existing business model or do I need a new business model?

If, after careful analysis, an established firm decides to exploit the newly-created market that the new business model has created, the question that must be answered is: *can I serve the customers in the newly-created market with my existing business model or do I need a new business model*? As we show below, the answer to this question is very subjective and firms from the same industry may look at the same market and answer this question in totally different ways. However, the importance of asking (and answering) this question cannot be emphasized enough! It can save the established firm enormous amounts of money and time in unnecessary investments.

Consider Internet banking and the new markets it has created in brokerage and retail banking. Should an established bank serve this market using its existing business model (i.e. by simply adding online distribution as an extra way to reach its customers)? Or does Internet banking require a dedicated business model, one that is different from the established business model? Most established banks have treated Internet banking as just another distribution method to add to their existing business model. But not the Dutch bank ING. By creating a separate unit called ING Direct and allowing it to develop its own business model and culture, ING has decided that Internet banking is much more than just another distribution channel and it's something that requires its own dedicated business model.

Consider, also, the rise of price-sensitive customers in the car industry (or any industry for that matter). Should established carmakers develop a separate business model to serve the low-end of the market or should they simply develop a cheap brand and sell it to the low-end using their existing business model? Most car companies decided to do the latter; Tata Motors decided to do the former. Or how about airline companies? Do they need to develop a separate business model (like Southwest and easyJet) to serve the price-conscious consumers or can they still serve this consumer using their existing business model by offering cheap seats and no frills on their existing planes? Many airline companies (e.g. Continental, BA, KLM and United) started out with the former. Most are now moving to the latter.

At the heart of this issue lies a (subjective) answer to another question that the established firm must ask, namely: "*Do I look at the new customers as simply another <u>segment</u> that can be served with my existing business model or as a completely different <u>market</u> that requires its dedicated value-chain activities?*" The way most banks approached Internet banking; or airline companies approached the no-frills, point-to-point way of flying; or carmakers and FMCGs companies approached the low-end of the market, suggests that they all looked at the new customers as just another *segment* that can be served with their existing business models. On the other hand, banks like ING (with ING Direct) and HSBC Midlands (with First Direct); airline companies like Singapore Airlines (with Silkair) and Qantas (with Jetstar); and other companies such as Dow Corning (with Xiameter), Intel (with Celeron), Tata Motors (with the Nano) and SMH (with Swatch) have all looked at the price-conscious customer as much more than another segment. They looked at it as a fundamentally different *market* that requires its own dedicated business model.

What is the "right" way to look at the new customer—as another segment or as a different market? There's obviously no "right" way and a lot depends on how *aggressive* the firm wants to be with the new market. To see this, consider the strategy of Nestle in the coffee market. In order to serve affluent coffee drinkers at the high-end of the market, Nestle created a separate unit called Nespresso and gave it the freedom to develop its own business model to serve its targeted customers. The business model that Nespresso has adopted is more akin to a luxury-goods manufacturer than a FMCGs company. A few years later, Nestle developed another coffee machine called Dolce Gusto. This was aimed for the discerning coffee drinkers at the low-end of the spectrum. But rather than set it up as a separate unit with its own business model, the Dolce Gusto was housed within an existing division (Nescafe) and offered to the customer using the existing Nescafe business model. Same company, similar products, different decisions on the same organizational issue!

The issue of whether the new customer is just another segment or a different market is so subjective that some companies treat it as both. In the UK, Waitrose supermarket—known as "the Queen's supermarket—has decided to treat the market created by home-distribution of groceries as both a segment and a market. On the one hand, it serves this market using its existing supermarket chain through Waitrose Direct, which is just an extension of its branch network. On the other hand, it has created a joint-venture separate unit called Occado to serve this market through its own dedicated business model.

What factors influence a firm's decision to treat the new customers as a totally different market rather than as just another segment of the existing market? Obviously the size and growth potential of the new market can play a big role—the bigger these two variables are, the more likely is the firm to go after the opportunity in an aggressive manner by treating it as a separate market. So would the assessment that the new market is strategically so different from the existing market that it cannot be adequately served with the existing business model; or that the conflicts created by trying to serve both the established and the new customers are so high that something different must be done (Markides and Charitou, 2004).

Perhaps the most important variable influencing this decision is top management's attitude towards the newly created market. As shown by Gilbert (2003), the new market is made up of two types of customers: customers of the established companies that desert the established market for the new value proposition; and new customers that get attracted into the market for the first time. The questions that all established companies need to answer are: How aggressively do I want to go after this newly created market? Is my goal *to limit* the cannibalization of my existing market or *to exploit* the new one? How many resources do I really want to put into it? If the decision is to aggressively exploit the opportunity (rather than defend against the threat), then chances are that the firm will choose to approach it as a new market that requires its dedicated business model if it's to be exploited properly[3].

Question #3: If I need a new business model to exploit the new market, should I simply adopt the invading business model that's disrupting my market?

Once the decision has been made to enter the new market by using a new business model, the firm has to decide exactly what business model to adopt and how different this model should be to the firm's existing business model. The big temptation is to simply adopt the same business model as the disruptors. After all, if this business model worked for *them*, surely it will work for us!

According to our research, this is a trap. Our evidence shows that by adopting the *same* business model as the invading one, established firms end up competing with their disruptors head-on. In other words, they simply play the same game as the disruptors but aim to beat them (at their own game!) by being *better* than them. What gives them the confidence that they will emerge victorious from such head-on competition is the fact that they are bigger and have more resources than the disruptors. Unfortunately for them, this strategy almost always ends up in failure.

The evidence shows that the established companies that succeed in entering the new markets do so by adopting a radically different business model—different from the one that the disruptors are using and different from the one the firm is using in its established market. What we found was that the best way for established firms to respond to their disruptors is by doing exactly what the disruptors did to them in the first place. In other words, the disruptors attacked the main market of the established

[3] Other factors that need to be considered in making this decision are discussed in: Mark W. Johnson, Clayton M. Christensen and Henning Kagermann: "Reinventing your business model," Harvard Business Review, December 2008, pp. 50-59.

firms by using a disruptive business model. What the established firm needs to do now is to attack the new market created by the disruptors by using their own disruptive business model. In a sense, they ought to adopt a business model that "disrupts-the-disruptor". Appendix B describes in more detail the example of Nintendo that adopted exactly this strategy to respond to Sony and Microsoft in the home games console market.

To really appreciate why established firms cannot simply try to become better than their disruptors but must counter-attack them with a radical new business model of their own, all we need to remember is that the new markets created by the invading disruptive business model are *different* from the established market— a fact that Christensen (1997) alerted us to when he described how disruptive innovations make inroads into established markets. This has a serious implication for established firms. Moving into them represents a fundamental **new market entry** for the established firms. And if that is the case, then success will only come to those firms that follow the cardinal rules of successful market entry.

What are these? The academic evidence of the past fifty years shows that most new entrants fail (e.g. Audretsch, 1995, Geroski, 1991, 1995). The evidence also shows that the probability of success in entering new markets (and in the process attacking established competitors) is enhanced significantly if the entrant adopts an innovative strategy, different from the one that the established players already use. This would be a strategy that disrupts the established players by breaking the rules of the game in their market. Adopting such a strategy does not guarantee success; it just improves the odds in the entrants' favor.

There are many examples that support this generalization. IKEA did it in the furniture retail business, Canon in copiers, Bright Horizons in the child care and early education market, MinuteClinic in the general health care industry, Starbucks in coffee, Amazon in bookselling, Southwest, easyJet and Ryanair in the airline industry, Enterprise in the car-rental market, Netflix and Lovefilm in the DVD rental market, Honda in motorcycles, Skype in telephony, Priceline in the travel agent market, Casella in the wine market, Metro International in newspapers and Home Depot in the home improvement market. The list could go on!

Consider, for example, Enterprise Rent-a-Car, the biggest car rental company in North America. It entered the car-rental market in 1957, at a time when established companies such as Hertz and Avis dominated the market. Yet, despite being a new entrant attacking established players with considerable first-mover advantages, Enterprise thrived. How did they do it? Rather than target travellers as its customers (like Hertz and Avis did), Enterprise focused on the replacement market (i.e. customers who had an accident). Rather than operate out of airports, it located its offices in downtown areas. Rather than use travel agents to push its services to the end consumers, it uses insurance companies and body shop mechanics. Rather than wait for the customer to pick up the rental, it brings the customer to the car. In short, Enterprise built a business model that was fundamentally different from the ones utilised by its biggest competitors. This allowed it to start out in 1957 as a new start-up firm in the industry and become the biggest player in less than 50 years.

All this suggests that if an established player: (a) has decided to enter the market space that the invading disruptive business model has created on the periphery of the main market; and (b) has decided to do so by adopting a business model that is different from the one it's using in the established market; **then** it has to develop and adopt a business model that is fundamentally *different from the one the disruptors are using*. This will not guarantee success but it will increase the probability that the established firm will compete with its disruptors successfully.

Question #4: If I develop a new business model, what degree of organizational separation should it have from the existing business model?

Having decided to enter the newly created market space by using its own disruptive business model, the established firm must next decide the degree of organizational separation between the new and the established business models. We found that the *wrong* way to tackle this issue is by asking the question: "should we separate the new business model or should we keep the two together?" The *correct* question to be asking is: "which activities do I separate and which do I keep the same with those of the established business model?"

The logic for this is straightforward. Proponents of the separation solution have justified their position by pointing out the benefits of keeping the two conflicting business models apart. The biggest of these benefits is that the new unit can develop its own strategy, culture and processes without interference from the parent company. It can also manage its business as it sees fit without being suffocated by the managers of the established company who tend to see cannibalization threats and channel conflicts at every turn. While nobody disputes the existence of these benefits, few seem to appreciate that separation is not cost-free. Perhaps the biggest cost to keeping the two businesses separate is failure to exploit synergies between the two. This implies that the firm has to achieve a delicate balance—on the one hand, it has to create enough distance between the two business models so that they don't suffocate each other; on the other hand, it has to keep them close enough to each other so that they can exploit synergies between the two. Such a balance will *never* be achieved if the new business model is kept totally separate from the established one. It can only be achieved if the firm thinks creatively on what activities to separate and what not to[4].

This decision on the appropriate degree of separation must be made for at least five areas:

(a) Location: Should the separate unit be located close to the parent firm or far away from it?

(b) Name: Should the separate unit adopt a name similar to the parent name (e.g. United and Ted; Nestle and Nespresso) or should its name be totally different? (e.g. BA and GO; HSBC Midlands and First Direct).

(c) Equity: Should the unit be a wholly owned subsidiary of the parent or should the parent own only a certain percentage of the equity?

(d) Value chain activities: Which value-chain activities should the unit develop on its own and which should it share with the parent? The usual answer is to allow the unit to develop its own dedicated customer-facing activities and share its back-office activities with the parent. This, however, may not be the

[4] The same point is made by Gulati and Garino (2000) who argue (p. 108): "Instead of focusing on an either-or choice—Should we develop our Internet channel in-house or launch a spin-off?—executives should be asking, "What degree of integration makes sense for our company?" Smith and Cooper (1994, pp. 319-321) raise the same point in their discussion of established and emerging new technologies and products.

appropriate solution for every firm so this issue has to be considered on a case-by-case basis.

(e) Organizational Environment: Should the unit be allowed to develop its own culture, values, processes, incentives and people, or should any of these be shared with the parent? Again, the usual answer is to allow the unit to develop its own culture but unite the parent and the unit through the adoption of common shared values. This, however, may not be appropriate for every firm, so this is again something that needs to be considered on a case-by-case basis.

Obviously there are no "right" answers to these questions. Contrary to what many academics have proposed, the separate unit does not need to have its own name, nor does it have to develop its own dedicated value chain activities. We have numerous examples of companies that did not do this and still succeeded in playing two different and conflicting games at the same time. The trick is to find the firm-specific answers to these questions that allow the firm to achieve the delicate balance between providing the unit independence and still helping it with the skills, knowledge and competences of the parent company.

Question #5: Over and above deciding on organizational separation, what else should I do to achieve ambidexterity?

Besides deciding what activities to separate and what to keep the same, the firm must also decide how to manage the separate unit next to the parent so as exploit potential synergies between the two markets and in the process achieve true ambidexterity. Several academics (e.g. Gilbert and Bower, 2002; Ghoshal and Gratton, 2003; Gibson and Birkinshaw, 2004; Govindarajan and Trimble, 2005, Tushman and O'Reilly, 1996) have already explored this issue and as a result, we now have a long list of ideas and suggestions on what companies ought to be doing. In fact, the items listed in Exhibit 1 are all tactics proposed by earlier research on exactly this issue.

In an earlier research project (Markides and Charitou, 2004), we also explored this issue. Specifically, we examined 42 firms that had created a separate unit to compete in the new market. Of these, ten were successful in their attempts while 32 failed. Exhibit 2 compares the two groups along the following dimensions: (1) how much strategic, financial and operational autonomy was given to the unit (measured on a scale of 1 to 5, with high scores implying that decision-making autonomy was granted to the unit); (2) how different the culture, budgetary and investment policies, evaluation systems and rewards of the unit were relative to the parent (measured on a scale of 1 to 6 with high scores implying that these policies were very different); (3) whether the new unit was assigned a new CEO to manage it; and (4) whether the new CEO was hired from outside the firm or transferred internally.

Put Exhibit 2 here

It is obvious from this comparison that successful firms gave much more operational and financial autonomy to the separate units than unsuccessful firms. They also allowed the units to develop their own cultures and budgetary systems and to have their own CEO. These are all policies consistent with the notion that the new units need freedom to operate as they see fit in their own environment. Note, however, that this autonomy did not come at the expense of synergies: the parent still kept close watch over the strategy of the unit (as shown by the low score on strategic autonomy); cooperation between the unit and the parent was encouraged through common incentive and reward systems; and the CEO of the units was transferred from inside the organization so as to facilitate closer cooperation and active exploitation of synergies.

All in all, our results as well as the results of other researchers (presented in exhibit 2) suggest that there are quite a few tactics that firms could use to manage the two business models effectively. But rather than provide laundry lists of things that companies could do to achieve ambidexterity, it may be better to develop a way of thinking about it. Every company could then apply this way of thinking to its specific circumstances. How, then, should managers think about the challenge of *achieving ambidextrous behaviors* in their organizations?

Over the past few years, executives throughout the world have been exposed to a fascinating "game" developed by Professors Jay Forrester and John Sterman at MIT.

Originally known as the “production-distribution game,” it is now more popularly known as “the Beer Game.” The game is played on a board that represents the production and distribution of beer. The main objective of the game is to make participants appreciate that *the underlying structure of the beer game creates the behaviors we observe in the game*; and that behaviors will change only when we change the underlying structure in the game.

This result has immediate applicability in real-life company situations: the behaviors that we observe in companies are created by the underlying structure or underlying “*organizational environment*” that exists in that company; and behaviors will only change if we first change this environment. Therefore, if for whatever reason we do not consider the behavior we observe in our company as optimal, the first thing we need to do is *not* to complain about it or blame people—rather, we should focus on changing the underlying environment of our organization. Behaviors such as innovation, trust, customer-orientation and the like do not occur simply because we ask for them; we need to create the appropriate *organizational environment* for the desired behavior to emerge.

What exactly is an “*Organizational Environment*?” Different academics have come up with different definitions. For the purposes of this paper, we define “*Organizational Environment*” as being made up of four interrelated components: the **culture** of the company, which includes its norms, values and unquestioned assumptions; the **structure** of the company, comprising not only its formal hierarchy but also its physical set-up as well as its systems (information, recruitment, market research and the like); the **incentives** in the company, both monetary and non-monetary ones; and finally, its **people**, including their skills and attributes (see Exhibit 3). It is the combination of these four elements that create the *organizational environment* that in turn supports and promotes the behaviors that we want in a company.

Put Exhibit 3 here

This suggests that to develop an organization that's capable of competing with dual business models (i.e. an ambidextrous organization), we must first ask and answer the question: "What kind of culture, structures, incentives and people do we need to put in place in our organization to promote and encourage ambidextrous behaviors on the part of our employees?"

There are many possible answers to this question and Exhibit 2 highlights only a few of them. But every company aspiring to manage two business models at the same time must ask this question and find the answers that are appropriate for its own specific context and circumstances. Appendix C describes in more detail how one company—the French supermarket chain E. Leclerc—has developed its own unique *Organizational Environment* that allows it to achieve ambidexterity.

Conclusion

A prevalent view in the strategic positioning literature is that a firm should not try to compete in two different and conflicting strategic positions in the same industry simultaneously. The main reason proposed to support this argument is the existence of conflicts between the two alternative ways of competing. Because of these positioning trade-offs, firms that try to compete in both positions simultaneously will eventually pay a huge straddling cost and degrade the value of their existing activities.

The primary solution offered to solve this problem is *spatial* separation—the firm ought to put the second business model in a separate unit and attempt to exploit synergies between the two by putting in place a number of integrating mechanisms. Valid as this solution might be, we have argued in this paper that more thinking is needed on the part of the firm if it is to achieve ambidexterity.

Our research suggests that an important element of the new thinking required is a fundamental reframing of the issue from: "How can the firm achieve ambidexterity" to: "How can we encourage ambidextrous behaviors by everyone in the firm." This might appear trivial and word play but we know from research in psychology that how we frame something determines how we approach the issue. If such reframing takes place, we will quickly realize that ambidextrous behaviors are not 'designed' by managers in a top-down approach. Rather, they *emerge* from within the organization. Just like life itself (with all its complexity) evolved over time without a master plan in place, so do ambidextrous behaviors emerge and evolve within the "appropriate" *organizational environment*. But the process of emergence is not (and should not be) a random process—successful business leaders shape and influence this emerging process; they shape and manage their organizations with an eye on the future, in such a way that ambidextrous behaviors emerge and profitable growth takes place. To do this, they put in place an *organizational environment* that encourages ambidextrous behaviors on the part of everybody. Only then can a firm expect to succeed in competing with dual business models in the same industry.

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Appendix A: The sample firms

Established Firm	Disruptor
Blockbuster	Netflix
Ladbrokes	Betfair
Sony	Apple
Matsui Securities	Daiwa Securities
Hindustan Lever Ltd	Private Label
Continental Airlines	Southwest
Tesco	Online distribution
British Airways	Ryanair
IBM	Apple
Gilette	Bic
Thompson Directories	Go2Net
Novartis	Generic drugs
France Telecom	Iliad
BBC	Youtube
Harley Davidson	Honda
SAP	Salesforce.com
NatWest Bank	HSBC First Direct
Societe Generale	Hedge funds
Kodak	Sony Mavica
SMH	Seiko
Qantas	Virgin Blue
Hennes & Mauritz (H&M)	Zara
Mercury Interactive	Online ASP
KLM	easyJet
Puma	Fashion sneakers (Vans)
Boston Globe	Monster.com
HP	Dell
Vodafone	Skype
Singapore Airlines	Low-cost airlines
Creative Technologies Ltd	Apple
L'Oreal	Body Shop
Rhapsody	Apple iTunes
Recruit	Online advertising
Bajaj Auto (BAL)	Hero Honda Motors Ltd
Albertson's	Webvan
Sprint	MVNOs
Omniture	Visual Sciences
MGM Mirage	Harrah
Kokuyo	Plus
Warner Music Group	Napster
P&G	Private label
BT	Skype
HMV	Amazon
Estee Lauder	Body Shop
Barnes and Noble	Amazon

Established Firm	Disruptor
AOL Time Warner	ebooks
HSBC	ING Direct
Nokia	RIMM
Bandai	Nintendo
Aegon Asset Mgmt	Hedge funds
EDS	Indian low cost IT providers
Encyclopaedia Brittanica	Encarta
USA Today	online news
Canon	digital cameras
Netscape	Explorer
Sotheby	Ebay
Columbia University	Univ of Phoenix
Hertz	Zipcar
Timex and Seiko	Swatch
Citibank	Hedge funds
Sony	Second Life
AXA Insurance	Wells Fargo (index funds)
Sony	Microsoft (Xbox)
Guardian	online news and free newspapers
Nintendo	Sony and Microsoft

Appendix B: Nintendo responds to Sony and Microsoft

In early 2001, Nintendo, the Kyoto-based games manufacturer and one of the pioneers of the home console market had fallen so far behind Sony and Microsoft that industry analysts were predicting that the company will withdraw from the home console market altogether. Its fall from grace was indeed spectacular.

The home console market had evolved from the arcade games of the 1970s and was originally dominated by companies such as Mattel, Magnavox and Atari. In fact, Atari's "Pac Man" was synonymous with home gaming in the early 1980s. Nintendo entered the market in 1983 when it launched its own home console, the 'Family Computer.' After initial problems, this became Japan's best-selling console by the end of 1984. It was followed in 1985 by the launch of the Nintendo Entertainment System (NES) which took North America by storm. Combined with Nintendo's wider variety of games, this console won over Sega's graphically superior "Sega Master System."

Throughout the early years, games consoles were viewed as toys, primarily targeted at young teenage boys with non-violent titles such as Super Mario, Donkey Kong, Zelda (all Nintendo) and Sega's Sonic the Hedgehog. The game consoles market continued to expand during the early 1990's, with the two companies introducing more advanced 'third generation' 8-bit cartridge models and fighting it out between them. Nintendo continued to dominate when the 16 and then 32-bit cartridges were launched in the early 1990's with both companies seeing off PC games. In 1991, Nintendo launched its highly popular Super NES console.

Games were still on cartridge format but both Sony and Philips were developing new CD-rom/XA technology that Nintendo believed could be suitable for gaming. Nintendo wanted to incorporate this technology into its next generation hardware. It approached Sony to develop a CD-rom add on to its console and unwittingly gave Sony a launch pad into the marketplace. Conflicts and disagreements between the two companies arose particularly on ownership and licensing. Nintendo cancelled the partnership and instead started to work with Philips.

Faced with a choice of abandoning its investment in the new technology or producing the new console themselves, and with the financial clout of its entertainment empire behind it, Sony began planning its domination of the games industry. Unlike Nintendo and Sega who made their money from in-house software development and controlling all aspects of the supply chain, Sony chose to work with external suppliers (although it bought one games developer prior to launch) and to engage with independent retailers by involving them in development. Crucially, Sony decided to launch with a full suite of games titles available, giving customers a wide purchasing choice.

Sony's Playstation launched in Japan in December 1994 and in North America and Europe in September 1995. It was an immediate success. With superior graphics, CD-quality sound playing techno tracks, and a full range of games titles, it was unlike anything seen before. For the target market of 18-24 year olds (mainly males) who had grown up on early game consoles but were no longer catered for, Playstation broke out of the toy niche[5]. Sony's audience was on average aged 22, with a third over the age of 30. Games were targeted at adults, who had larger disposable incomes to purchase new titles. The games themselves were darker, more sophisticated and more violent. Nintendo was caught out with nothing to offer but its SNES cartridge-based console.

Nintendo was on the back foot. Its traditional market of easy to play, non-violent games that appealed to all age groups across different cultures was no longer what the primary gaming audience wanted. Nintendo tried various pricing and marketing strategies as well as launching upgraded consoles (the N64 in 1996 based on 64-bit technology and the 128-bit GameCube in 2001) but Sony surged ahead becoming the dominant player. Things got worse for Nintendo with the arrival of Microsoft's Xbox in May 2001, which effectively pushed Nintendo into third position. At this point, Sega decided to exit the console market altogether and returned to its roots producing gaming software for the console manufacturers.

The three-way battle focused the manufacturers on a continual and seemingly unending battle for technological advancement and superiority of hardware. Consoles had to have faster processing speeds and higher definition graphics. The games became more and more complex, requiring gamers to invest time learning how to play. An entire allied industry sprang up with websites and magazines that offered gamers tips on strategies to win as well as how to actually use the games controllers with their combinations of buttons and joysticks. Gamers themselves were seduced into immersing themselves ever deeper into these increasingly sophisticated fantasy worlds.

The response

Tipped by industry analysts to withdraw altogether from the console marketplace, Nintendo had other ideas. In 2002, it appointed Satoru Iwata as fourth President and CEO of Nintendo. Iwata was charged with bringing a new vision and approach to the flagging company. Having spent his entire career in the games industry, including two years in corporate planning at Nintendo, Iwata had a deep insight, experience and understanding of the evolution of gaming. He saw the relentless pursuit of technology by Sony and Microsoft as counterproductive—customers were driven away and the market was shrinking because of the complexity of the games and the time required to learn and also to play them. This 'barrier to entry' was a big disincentive for novice gamers and an effective deterrent for non-gamers to start playing. Even occasional gamers had stopped playing due to other priorities in their busy lives.

Rather than follow Sony and Microsoft, Iwata took a different tack with Nintendo[6]. For too long gaming was becoming exclusive, with an image of young men and boys sequestered away for hours in a voluntary solitary environment, not interacting with anyone else. Iwata recognised that there was a huge potential market of people who wanted to play simple, fun games for a few minutes at a time and potentially with family members and friends. These same people might currently be playing games on their PC's in their odd moments of free time but wouldn't dream of buying a games

[5] Console Wars, The Economist (print edition), 20 June 2002
[6] Playing a different game, The Economist (print edition), 26 October 2006

console. Nintendo's strategy was essentially to expand the market by developing consoles that would support simple, real life games that could be learnt quickly and played by all members of the family including the very youngest and the very oldest.

The first test of the new market-expansion strategy was the launch of the hand-held DS console. The DS and its slogan 'touching is good' was a hit with 500,000 units sold in the US in its first week[7]. Nintendogs was also a resounding success, attracting a mainly female audience of children and adults alike, who were able to take their dogs for walks, teach them tricks and enter them in competitions. Voice recognition via the DS's built in microphone enabled players to teach their pets to respond to vocal commands while the touch screen technology allowed dogs to be 'petted'. Brain Training games further expanded the gaming audience, particularly amongst older people who bought the DS console specifically to play the puzzle games. The DS also re-launched popular titles such as Mario the Plumber and Pokemon both with a wealth of different adventures.

Focusing their attention back to creating a traditional console/TV screen market, Nintendo's engineers decided they would neither recreate a console based on the popular DS nor follow the joystick/button consoles of Sony and Microsoft. Initial meetings focused on basic concepts and goals, taking the perspective of what would convince mothers to buy the new console for their families[8]. The developers looked beyond technical specifications, creating instead a console that was quiet, used less electricity, and that enabled households to play every Nintendo game ever made, rather than having to keep old consoles. Pricing was key, capped at approximately $200. What resulted from the 'back to scratch' approach was the Nintendo Wii.

Launched in November 2006, the Wii was a quiet, small console, controlled by a controller that looks like a television remote control but with fewer buttons. Using motion sensor technology, it allows whole-body physical movements rather than only small, repetitive, finger/thumb movements of the traditional joystick/button controllers. By playing simulation games such as tennis, bowling, baseball and golf, gamers are encouraged to move around and exercise. Nintendo wanted to create an online community presence so the Wii could also be connected to the internet for online news and weather updates and to access Nintendo's back catalogue, encouraging players to download classic games from the web.

The Wii's launch was also different to Nintendo's rivals. While Sony launched the PS3 at a glitzy party with a list of Hollywood stars and A-list celebrities, Nintendo's guests included working women with families[9]. The same women who usually control family-spending whom, Nintendo hoped, could be persuaded of the Wii's family-friendly advantages: encouraging family members of all ages to play together, helping children (and adults) get physical through the body movements allowed by the motion sensors. The women who got to try out the Wii at a marketing event often left saying they wanted one for themselves, as much to play with their girlfriends as with their families[10]!

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[7] Hand to hand combat, The Economist (print edition), 16 December 2004
[8] The Big Ideas Behind Nintendo's Wii, Hall, Kenji, Business Week, 14 August 2009
[9] Survival Through Innovation, Strategic Direction, Vol 24, No. 1, 2008, pp21-24
[10] Console Makers Go For a Slam Dunk, Nuttal, Chris, The Financial Times, 17 November 2006

The strategy seems to have paid off. By 2007, the launch of the Wii led to household penetration of consoles rising for the first time in 25 years. The console outsold the PS3 three-to-one in the Japanese market and five-to-one in the US. It was also been crowned the fastest selling console in history in the UK after one million units were sold in just eight months[11].

In December 2007, Wii Fit was launched in Japan. It was rolled out in Europe in April 2008 and in the US in May 2008. This was essentially a platform with in-built motion sensors that encourages fitness through yoga, aerobic games, balance and strength exercises. Wii Fit sold over a quarter of a million copies in its first week in Japan[12]. Among games not packaged with a console, it became the fifth best selling videogame in history—barely a year after its release, it sold 18.22 million copies[13]. It further added to Nintendo's successful strategy of targeting non-gamers and its broadening appeal for video-game playing among non-gamers.

Nintendo, the dominant giant brought to its knees, has now re-emerged as a dominant player in the videogames industry. By August 2009 Nintendo had sold 52.29 million Wii units, capturing 49% of the market since its launch. Microsofts' Xbox360 (launched November 2005) had 29.3% of the market and sold 31.30 million units, while Sony with its PS3 had been relegated to third with 21.7% of the market, selling 23.16 million units[14].

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[11] Game on: Console makers in three-way shoot-out, Fildes, Nic, The Independent, 26 October 2007.
[12] Wii Fit misses out on Japan number 1, GamesIndustry.biz, 6 December 2007
[13] Financial Results Briefing for Fiscal Year Ended March 2009, Nintendo 30 March 2009, p6
[14] Data from Hardware Chart, VGChartz.com, accessed 16 August 2009

Appendix C: Ambidexterity at E. Leclerc

The French supermarket chain E. Leclerc was founded in the late 1950s by Eduard Leclerc. Mr Leclerc was training to become a Catholic priest but decided to give up the priesthood to start a supermarket dedicated to offering branded products at cheap prices. The organization has been very successful and has grown to a chain of more than 500 hypermarkets. It is now expanding into overseas markets.

When one looks at this organization, one cannot fail but notice how it is able to balance quite a few conflicting forces: it has achieved low cost and differentiation simultaneously; it is very decentralized and yet centralized at the same time; it is broken up into many small autonomous units but still enjoys the benefits of size; it is structured as a federation of independent stores yet behaves as an integrated network; it encourages continuous experimentation with new products and concepts yet survives the inevitable losses without pain; employees feel and behave as "owners" of the organization, yet own no stock; the whole organization behaves like one big family, yet it is a money-making machine. How could they possibly achieve all this ambidexterity and how do they manage such variety of organizational features?

The answer to this question has many angles. First of all, Leclerc is not a single company. Each store is owned and operated by different individuals who choose to trade under the Leclerc name. But they are not franchisees either: they do not have to pay for the right to trade under the Leclerc name (in fact, as described below, they receive numerous other benefits from their Leclerc association for which they do not have to pay anything). However, they have to agree to abide by certain norms and values—the primary one being that they will never be undersold by competitors. In addition, no individual—not even the Leclercs themselves—are allowed to own more than two stores.

Each store is given total autonomy over its affairs. For example, given each store's unique geographical location and different consumers, each store is free to decide what products to sell, what prices to charge, what promotions to run, and so on. In addition, each store can find its own suppliers and negotiate its own prices. All this decentralization and autonomy encourages experimentation and achieves differentiation.

But this differentiation is not achieved at the expense of low cost: for example, each region has its own regional warehouse (which is owned by the member stores). The warehouse orders and stores those types of products that do not need to be sold fresh. This achieves purchasing economies. In addition, a central purchasing department in Paris identifies potential suppliers and negotiates prices with them. Individual stores do not have to agree to any supplier recommended by the center but this method certainly achieves purchasing economies. The use of the Leclerc name by all also achieves advertising and promotional benefits and cuts costs. Finally, new Leclerc stores are always started by current Leclerc employees who receive the financial backing and guarantees of current Leclerc store owners. The financial backing of a prominent local businessperson has inevitable benefits in dealing with the banks for start up capital.

In addition to all this, every store owner is active in the management of the whole organization. They all attend monthly regional meetings as well as frequent national meetings where decisions are taken and experiences exchanged. Stores belong to regions and each region is "run" by a member for 3 years (on a voluntary basis of course). Not only does the region's President run the affairs of the region but he or she travels extensively to individual stores to offer advice, monitor plans and transfer best practice. Furthermore, at the end of every year, each store owner has to distribute 25% of the store's profits to its employees. He or she also has the "duty" (not obligation) to act as a "godparent" to one of his/her employees. The selected employee is someone who has been identified as high potential and a possible future Leclerc store owner. This individual receives continuous support and advice and when the time comes, financial backing and moral support to start his/her own store. If the new store fails, the "godparent" is financially liable for any liabilities.

How is so much variety managed? Information systems are definitely used to monitor what is happening across the "federation." Frequent meetings also help exchange ideas and monitor progress. However, the two primary mechanisms of control are: (a) a common and deeply-felt vision that sets the parameters within which each member store operates; and (b) a strong family culture where everybody is treated with fairness and openness and where everybody is equal. It is interesting that each store has its own unique culture (created primarily by the personality of the store owner), yet a "common" Leclerc culture still permeates the whole organization. This common culture sets the parameters; the accepted norms; the shared values; and the constraints within which individuals behave. It is this shared culture that allows so much autonomy and freedom without the fear that somebody, somewhere will do something nasty.

So, how did Leclerc achieve such ambidexterity? Part of the answer lies in its strong vision and culture. Part of it is in its strong shared values. A lot has to do with the kind of individuals being recruited and promoted in such a system. And some of it has to do with the structures and processes that have been put in place. In short, ambidexterity is achieved because the total "*Organizational Environment*" of Leclerc has been designed to promote ambidextrous behaviors by everybody in the organization.

<u>Exhibit 1: Create a separate unit but put Integrating Mechanisms in place, such as:</u>

(1) Appoint a common general manager between the main and the new business
(2) Allow different cultures to emerge but a strong shared vision should unite the parent with the separate unit
(3) Put in place targeted (limited) integrating mechanisms
(4) Staff it with ambidextrous individuals
(5) Legitimize diverse perspectives and capabilities
(6) Nurture strong shared values that unite the people in the two businesses
(7) Do everything to avoid a silos mentality (e.g. transfer of people; common conferences; rituals)
(8) Frame it as both a threat and an opportunity
(9) Fund it in stages
(10) Cultivate outside perspectives by hiring new people for the separate unit
(11) Appoint an active and credible integrator
(12) Emphasize "soft" levers such as a strong sense of direction, strong values, a feeling of: "we are in this together"
(13) Develop incentives that encourage cooperation between the two
(14) Identify measurement and evaluation metrics that are specific to the unit
(15) Hire outsiders to run the separate unit with a mixture of insiders
(16) Be patient for revenues but impatient for profits
(17) Integrate the activities that cannot be done well if they become independent
(18) Allow the unit to borrow brand name, physical assets, expertise & useful processes
(19) Give the unit enough power to fight its own corner
(20) Ensure adequate flow of information through transfer of people and the Intranet
(21) Develop a culture of openness
(22) Insulate the unit but don't isolate it
(23) Develop strong shared values and a strong culture
(24) Let an independent executive from outside the business unit secure an internal champion to manage the unit and provide oversight
(25) Give it operational autonomy but exercise strong central strategic control
(26) Allow the unit to develop its own strategy, without even thinking about the existing business
(27) Think of phased integration
(28) Give the unit autonomy but don't lose control
(29) Allow the unit to differentiate itself by adopting a <u>few</u> of its own value-chain activities but at the same time exploit synergies by ensuring that some value chain activities are shared with the parent
(30) Evaluate the separate unit subjectively

Exhibit 2

Administrative mechanisms in the firms that created a separate unit

Administrative Mechanism	Successful Firms (10)	Unsuccessful Firms (32)
Strategic autonomy (1-5)	3.0	3.2
Financial autonomy (1-5)	4.1	2.9
Operational autonomy (1-5)	4.4	3.1
Different culture (1-6)	4.6	4.0
Different budgetary policies (1-6)	4.5	3.9
Different incentive systems (1-6)	3.2	3.6
Different Rewards (1-6)	3.2	3.2
Appointed CEO (0-1)	0.8	0.6
CEO from inside (0-1)	0.8	0.6

(Autonomy is measured on a scale of 1-to-5, with 1 being "no autonomy to the separate unit" and 5 being "the unit makes all decisions." Other variables are measured on a 1-to-6 scale, with 1 meaning that the policies between the main business and the unit are very similar and 6 being very different).

<u>Exhibit 3: The Underlying *Organisational Environment* that determines behaviors in a firm</u>