CHARLES W.L. HILL | GARETH R. JONES | MELISSA A. SCHILLING

# STRATEGIC MANAGEMENT

## AN INTEGRATED APPROACH

11TH EDITION

| Industry Analysis | Functional Strategy | Business Level Strategy | Global Strategy | Corporate Strategy | Ethics/Social Responsibility |
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# Cases

11TH EDITION

# STRATEGIC MANAGEMENT

## AN INTEGRATED APPROACH

11TH EDITION

# STRATEGIC MANAGEMENT

## AN INTEGRATED APPROACH


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# Brief Contents

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# Preface

Consistent with our mission to provide students with the most current and up-to-date account of the changes taking place in the world of strategy and management, there have been some significant changes in the 11th edition of *Strategic Management: An Integrated Approach*.

First, we have a new co-author, Melissa Shilling. Melissa is a Professor of Management and Organization at the Leonard Stern School of Business at New York University, where she teaches courses on strategic management, corporate strategy, and technology and innovation management. She has published extensively in top-tier academic journals and is recognized as one of the leading experts on innovation and strategy in high-technology industries. We are very pleased to have Melissa on the book team. Melissa made substantial contributions to this edition, including revising several chapters and writing seven high-caliber case studies. We believe her input has significantly strengthened the book.

Second, several chapters have been extensively revised. Chapter 5: Business-Level Strategy has been rewritten from scratch. In addition to the standard material on Porter's generic strategies, this chapter now includes discussion of *value innovation* and *blue ocean strategy* following the work of W. C. Kim and R. Mauborgne. Chapter 6: Business-Level Strategy and the Industry Environment has also been extensively rewritten and updated to clarify concepts and bring it into the 21st century. Despite the addition of new materials, both chapters are shorter than in prior editions. Substantial changes have been made to many other chapters, and extraneous material has been cut. For example, in Chapter 13 the section on implementing strategy across countries has been entirely rewritten and updated. This chapter has also been substantially shortened.

Third, the examples and cases contained in each chapter have been revised. We have a new *Running Case* for this edition, Wal-Mart. Every chapter has a new *Opening Case* and a new *Closing Case*. There are also many new *Strategy in Action* features. In addition, there has been significant change in the examples used in the text to illustrate content. In making these changes, our goal has been to make the book relevant for students reading it in the second decade of the 21st century.

Fourth, we have a substantially revised selection of cases for this edition. All of the cases are either new to this edition or are updates of cases that adopters have indicated they like to see in the book. Out of 28 cases, 16 were written either by Charles Hill or Melissa Shilling. This represents a level of commitment to the case collection from the primary authors that you do not see in most strategy textbooks. Many of the cases are current as of 2013. We have made an effort to include cases that have high name recognition with students, and that they will enjoy reading and working on. These include cases on Toyota, Tesla, Apple, Ikea, Starbucks, Intel, Harley-Davidson and Skull Candy.

## Practicing Strategic Management: An Interactive Approach

We have received a lot of positive feedback about the usefulness of the end-of-chapter exercises and assignments in the Practicing Strategic Management sections of our book. They offer a wide range of hands-on and digital learning experiences for students. Following the Chapter Summary and Discussion Questions, each chapter contains the following exercises and assignments:

- **Ethical Dilemma**. This feature has been developed to highlight the importance of ethical decision making in today's business environment. With today's current examples of questionable decision making (as seen in companies like Countrywide Financial during the 2007–2009 global financial crisis), we hope to equip students with the tools they need to be strong ethical leaders.
- **Small-Group Exercise.** This short (20-minute) experiential exercise asks students to divide into groups and discuss a scenario concerning some aspect of strategic management. For example, the scenario in Chapter 11 asks students to identify the stakeholders of their educational institution and evaluate how stakeholders' claims are being and should be met.
- The **Strategy Sign-On** section presents an opportunity for students to explore the latest data through digital research activities.

    - First, the Article File requires students to search business articles to identify a company that is facing a particular strategic management problem. For instance, students are asked to locate and research a company pursuing a low-cost or a differentiation strategy, and to describe this company's strategy, its advantages and disadvantages, and the core competencies required to pursue it. Students' presentations of their findings lead to lively class discussions.
    - Then, the **Strategic Management Project: Developing Your Portfolio** asks students to choose a company to study through the duration of the semester. At the end of every chapter, students analyze the company using the series of questions provided at the end of each chapter. For example, students might select Ford Motor Co. and, using the series of chapter questions, collect information on Ford's top managers, mission, ethical position, domestic and global strategy and structure, and so on. Students write a case study of their company and present it to the class at the end of the semester. In the past, we also had students present one or more of the cases in the book early in the semester, but now in our classes, we treat the students' own projects as the major class assignment and their case presentations as the climax of the semester's learning experience.

- **Closing Case.** A short closing case provides an opportunity for a short class discussion of a chapter-related theme.

In creating these exercises, it is not our intention to suggest that they should *all* be used for *every* chapter. For example, over a semester, an instructor might combine a group of Strategic Management Projects with 5 to 6 Article File assignments while incorporating 8 to 10 Small-Group Exercises in class.

We have found that our interactive approach to teaching strategic management appeals to students. It also greatly improves the quality of their learning experience. Our approach is more fully discussed in the *Instructor's Resource Manual*.

## Strategic Management Cases

The 28 cases that we have selected for this edition will appeal, we are certain, to students and professors alike, both because these cases are intrinsically interesting and because of the number of strategic management issues they illuminate. The organizations discussed in the cases range from large, well-known companies, for which students can do research to update the information, to small, entrepreneurial businesses that illustrate the uncertainty and challenge of the strategic management process. In addition, the selections include many international cases, and most of the other cases contain some element of global strategy. Refer to the Contents for a complete listing of the cases with brief descriptions.

To help students learn how to effectively analyze and write a case study, we continue to include a special section on this subject. It has a checklist and an explanation of areas to consider, suggested research tools, and tips on financial analysis.

We feel that our entire selection of cases is unrivaled in breadth and depth, and we are grateful to the other case authors who have contributed to this edition.

## Teaching and Learning Aids

Taken together, the teaching and learning features of *Strategic Management* provide a package that is unsurpassed in its coverage and that supports the integrated approach that we have taken throughout the book.

## For the Instructor

- The **Instructor's Resource Manual: Theory.** For each chapter, we provide a clearly focused synopsis, a list of teaching objectives, a comprehensive lecture outline, teaching notes for the Ethical Dilemma feature, suggested answers to discussion questions, and comments on the end-of-chapter activities. Each Opening Case, Strategy in Action boxed feature, and Closing Case has a synopsis and a corresponding teaching note to help guide class discussion.
- **Case Teaching Notes** include a complete list of case discussion questions as well as a comprehensive teaching notes for each case, which gives a complete analysis of case issues.
- **Cognero Test Bank:** A completely online test bank allows the instructor the ability to create comprehensive, true/false, multiple-choice and essay questions for each chapter in the book. The mix of questions has been adjusted to provide fewer fact-based or simple memorization items and to provide more items that rely on synthesis or application.
- **PowerPoint Presentation Slides:** Each chapter comes complete with a robust PowerPoint presentation to aid with class lectures. These slides can be downloaded from the text website.
- **CengageNow.** This robust online course management system gives you more control in less time and delivers better student outcomes—NOW. CengageNow™ includes teaching and learning resources organized around lecturing, creating assignments, casework, quizzing, and gradework to track student progress and performance. Multiple types of quizzes, including video quizzes are assignable and gradable. Flexible assignments, automatic grading, and a gradebook option provide more control while saving you valuable time. CengageNow empowers students to master concepts, prepare for exams, and become more involved in class.

- **Cengage Learning Write Experience 2.0.** This new technology is the first in higher education to offer students the opportunity to improve their writing and analytical skills without adding to your workload. Offered through an exclusive agreement with Vantage Learning, creator of the software used for GMAT essay grading, Write Experience evaluates students' answers to a select set of writing assignments for voice, style, format, and originality.

## For the Student

- **CengageNow** includes learning resources organized around assignments, casework, and quizzing, and allows you to track your progress and performance. A Personalized Study diagnostic tool empowers students to master concepts, prepare for exams, and become more involved in class.

# Acknowledgments

This book is the product of far more than two authors. We are grateful to our Senior Product Managers, Michele Rhoades and Scott Person; our Senior Content Developer, Mike Guendelsberger; our Content Project Manager, Cliff Kallemeyn; and our Marketing Manager, Emily Horowitz, for their help in developing and promoting the book and for providing us with timely feedback and information from professors and reviewers, which allowed us to shape the book to meet the needs of its intended market. We are also grateful to the case authors for allowing us to use their materials. We also want to thank the departments of management at the University of Washington and New York University for providing the setting and atmosphere in which the book could be written, and the students of these universities who react to and provide input for many of our ideas. In addition, the following reviewers of this and earlier editions gave us valuable suggestions for improving the manuscript from its original version to its current form:

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Jun Zhao, *Governors State University*

**Charles W. L. Hill**
**Gareth R. Jones**
**Melissa A. Schilling**

# Dedication

To my children, Elizabeth, Charlotte, and Michelle

– Charles W. L. Hill

For Nicholas and Julia and Morgan and Nia

– Gareth R. Jones

For my children, Julia and Conor

– Melissa A. Schilling

# 1

# Strategic Leadership: Managing the Strategy-Making Process for Competitive Advantage

## OPENING CASE




### Wal-Mart's Competitive Advantage

Wal-Mart is one of the most extraordinary success stories in business history. Started in 1962 by Sam Walton, Wal-Mart has grown to become the world's largest corporation. In 2012, the discount retailer—whose mantra is "everyday low prices"—had sales of $440 billion, close to 10,000 stores in 27 countries, and 2.2 million employees. Some 8% of all retail sales in the United States are made at a Wal-Mart store. Wal-Mart is not only large; it is also very profitable. Between 2003 and 2012 the company's average return on invested capital was 12.96%, better than its well-managed rivals Costco and Target, which earned 10.74% and 9.6%, respectively (see Figure 1.1).

Wal-Mart's persistently superior profitability reflects a competitive advantage that is based upon a number of strategies. Back in 1962, Wal-Mart was one of the first companies to apply the self-service supermarket business model developed by grocery chains to general merchandise. Unlike its rivals such as K-Mart and Target that focused on urban and suburban locations, Sam Walton's Wal-Mart concentrated on small southern towns that were ignored by its rivals. Wal-Mart grew quickly by pricing its products lower than those of local retailers, often putting them out of business. By the time its rivals realized that small towns could support a large discount general merchandise store, Wal-Mart had already pre-empted them. These

## LEARNING OBJECTIVES

After reading this chapter you should be able to:

1-1 Explain what is meant by "competitive advantage"

1-2 Discuss the strategic role of managers at different levels within an organization

1-3 Identify the primary steps in a strategic planning process

1-4 Discuss the common pitfalls of planning, and how those pitfalls can be avoided

1-5 Outline the cognitive biases that might lead to poor strategic decisions, and explain how these biases can be overcome

1-6 Discuss the role strategic leaders play in the strategy-making process

# OPENING CASE



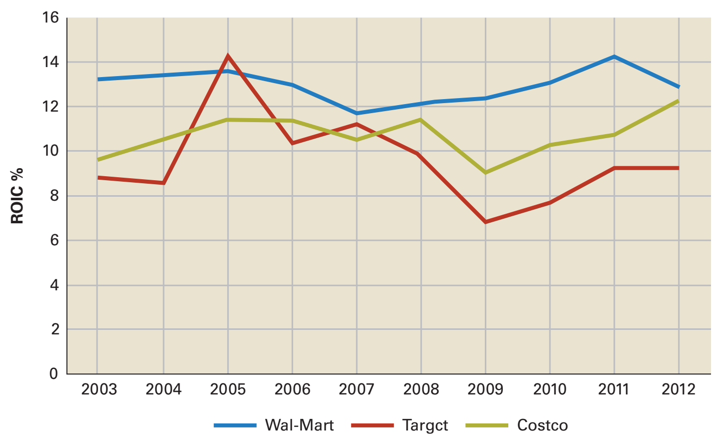
towns, which were large enough to support one discount retailer but not two, provided a secure profit base for Wal-Mart.

The company was also an innovator in information systems, logistics, and human resource practices. These strategies resulted in higher productivity and lower costs as compared to rivals, which enabled the company to earn a high profit while charging low prices. Wal-Mart led the way among U.S. retailers in developing and implementing sophisticated product tracking systems using bar-code technology and checkout scanners. This information technology enabled Wal-Mart to track what was selling and adjust its inventory accordingly so that the products found in each store matched local demand. By avoiding overstocking, Wal-Mart did not have to hold periodic sales to shift unsold inventory. Over time, Wal-Mart linked this information system to a nationwide network of distribution centers in which inventory was stored and then shipped to stores within a 400-mile radius on a daily basis. The combination of distribution centers and information centers enabled Wal-Mart to reduce the amount of inventory it held in stores, thereby devoting more of that valuable space to selling and reducing the amount of capital it had tied up in inventory.

With regard to human resources, Sam Walton set the tone. He held a strong belief that employees should be respected and rewarded for helping to improve the profitability of the company. Underpinning this belief, Walton referred to employees as "associates." He established a profit-sharing scheme for all employees, and after the company went public in 1970, a program that allowed employees to purchase Wal-Mart stock at a discount to its market value. Wal-Mart was rewarded for this approach by high employee productivity, which translated into lower operating costs and higher profitability.

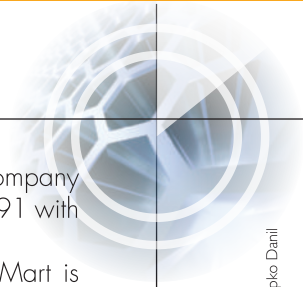
As Wal-Mart grew larger, the sheer size and purchasing power of the company enabled it to drive down the prices that it paid suppliers, passing on those saving to customers in the form of lower prices, which enabled Wal-Mart to gain more market share and hence lower prices even further. To take the

**Figure 1.1** Profitability of Wal-Mart and Competitors, 2003–2012




**Source:** Calculated by the author from Morningstar data.

## OPENING CASE



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sting out of the persistent demands for lower prices, Wal-Mart shared its sales information with suppliers on a daily basis, enabling them to gain efficiencies by configuring their own production schedules for sales at Wal-Mart.

By the time the 1990s came along, Wal-Mart was already the largest seller of general merchandise in the United States. To keep its growth going, Wal-Mart started to diversify into the grocery business, opening 200,000-square-foot supercenter stores that sold groceries and general merchandise under the same roof. Wal-Mart also diversified into the warehouse club business with the establishment of Sam's Club. The company began expanding internationally in 1991 with its entry into Mexico.

For all its success, however, Wal-Mart is now encountering very real limits to profitable growth. The U.S. market is saturated, and growth overseas has proved more difficult than the company hoped. The company was forced to exit Germany and South Korea after losing money there, and it has faced difficulties in several other developed nations. Moreover, rivals Target and Costco have continued to improve their performance, and Costco in particular is now snapping at Wal-Mart's heals.

**Sources:** "How Big Can It Grow?" *The Economist* (April 17, 2004): 74–78; "Trial by Checkout," *The Economist* (June 26, 2004): 74–76; Wal-Mart 10-K, 200, information at Wal-Mart's website, www.walmartstores.com; Robert Slater, *The Wal-Mart Triumph* (New York: Portfolio Trade Books, 2004); and "The Bulldozer from Bentonville Slows; Wal-Mart," *The Economist* (February 17, 2007): 70.

# OVERVIEW

Why do some companies succeed, whereas others fail? Why has Wal-Mart been able to persistently outperform its well-managed rivals? In the airline industry, how has Southwest Airlines managed to keep increasing its revenues and profits through both good times and bad, whereas rivals such as United Airlines have had to seek bankruptcy protection? What explains the persistent growth and profitability of Nucor Steel, now the largest steelmaker in the United States, during a period when many of its once-larger rivals disappeared into bankruptcy?

In this book, we argue that the strategies that a company's managers pursue have a major impact on the company's performance relative to that of its competitors. A **strategy** is a set of related actions that managers take to increase their company's performance. For most, if not all, companies, achieving superior performance relative to rivals is the ultimate challenge. If a company's strategies result in superior performance, it is said to have a competitive advantage. Wal-Mart's strategies produced superior performance from 2003 to 2012; as a result, Wal-Mart has enjoyed competitive advantage over its rivals. How did Wal-Mart achieve this competitive advantage? As explained in the opening case, it was due to the successful pursuit of a number of strategies by Wal-Mart's managers, including, most notably, the company's founder, Sam Walton. These strategies enabled the company to lower its cost structure, charge low prices, gain market share, and become more profitable than its rivals. (We will return to the example of Wal-Mart several times throughout this book in the *Running Case* feature that examines various aspects of Wal-Mart's strategy and performance.)

**strategy**
A set of related actions that managers take to increase their company's performance.

This book identifies and describes the strategies that managers can pursue to achieve superior performance and provide their companies with a competitive advantage. One of its central aims is to give you a thorough understanding of the analytical techniques and skills necessary to identify and implement strategies successfully. The first step toward achieving this objective is to describe in more detail what superior performance and competitive advantage mean and to explain the pivotal role that managers play in leading the strategy-making process.

**strategic leadership**
Creating competitive advantage through effective management of the strategy-making process.

**strategy formulation**
Selecting strategies based on analysis of an organization's external and internal environment.

**strategy implementation**
Putting strategies into action.

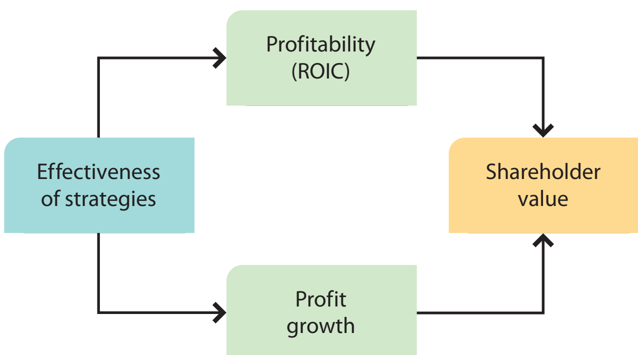
**Strategic leadership** is about how to most effectively manage a company's strategy-making process to create competitive advantage. The strategy-making process is the process by which managers select and then implement a set of strategies that aim to achieve a competitive advantage. **Strategy formulation** is the task of selecting strategies, whereas **strategy implementation** is the task of putting strategies into action, which includes designing, delivering, and supporting products; improving the efficiency and effectiveness of operations; and designing a company's organizational structure, control systems, and culture.

By the end of this chapter, you will understand how strategic leaders can manage the strategy-making process by formulating and implementing strategies that enable a company to achieve a competitive advantage and superior performance. Moreover, you will learn how the strategy-making process can go wrong, and what managers can do to make this process more effective.

## STRATEGIC LEADERSHIP, COMPETITIVE ADVANTAGE, AND SUPERIOR PERFORMANCE

Strategic leadership is concerned with managing the strategy-making process to increase the performance of a company, thereby increasing the value of the enterprise to its owners, its shareholders. As shown in Figure 1.2, to increase shareholder value, managers must pursue strategies that increase the profitability of the company and ensure that profits grow (for more details, see the Appendix to this chapter). To do this, a company must be able to outperform its rivals; it must have a competitive advantage.

Figure 1.2 Determinants of Shareholder Value



## Superior Performance

Maximizing shareholder value is the ultimate goal of profit-making companies, for two reasons. First, shareholders provide a company with the risk capital that enables managers to buy the resources needed to produce and sell goods and services. **Risk capital** is capital that cannot be recovered if a company fails and goes bankrupt. In the case of Wal-Mart, for example, shareholders provided Sam Walton's company with the capital it used to build stores and distribution centers, invest in information systems, purchase inventory to sell to customers, and so on. Had Wal-Mart failed, its shareholders would have lost their money—their shares would have been worthless Thus, shareholders will not provide risk capital unless they believe that managers are committed to pursuing strategies that provide a good return on their capital investment. Second, shareholders are the legal owners of a corporation, and their shares therefore represent a claim on the profits generated by a company. Thus, managers have an obligation to invest those profits in ways that maximize shareholder value. Of course, as explained later in this book, managers must behave in a legal, ethical, and socially responsible manner while working to maximize shareholder value.

**risk capital**
Equity capital for which there is no guarantee that stockholders will ever recoup their investment or earn a decent return.

By **shareholder value**, we mean the returns that shareholders earn from purchasing shares in a company. These returns come from two sources: (a) capital appreciation in the value of a company's shares and (b) dividend payments.

**shareholder value**
Returns that shareholders earn from purchasing shares in a company.

For example, between January 2 and December 31, 2012, the value of one share in Wal-Mart increased from $60.33 to $68.90, which represents a capital appreciation of $8.57. In addition, Wal-Mart paid out a dividend of $1.59 per share during 2012. Thus, if an investor had bought one share of Wal-Mart on January 2 and held on to it for the entire year, the return would have been $10.16 ($8.57 + $1.59), a solid 16.8% return on the investment. One reason Wal-Mart's shareholders did well during 2012 was that investors believed that managers were pursuing strategies that would both increase the long-term profitability of the company and significantly grow its profits in the future.

One way of measuring the **profitability** of a company is by the return that it makes on the capital invested in the enterprise.[1] The return on invested capital (ROIC) that a company earns is defined as its net profit over the capital invested in the firm (profit/capital invested). By net profit, we mean net income after tax. By capital, we mean the sum of money invested in the company: that is, stockholders' equity plus debt owed to creditors. So defined, *profitability is the result of how efficiently and effectively managers use the capital at their disposal to produce goods and services that satisfy customer needs.* A company that uses its capital efficiently and effectively makes a positive return on invested capital.

**profitability**
The return a company makes on the capital invested in the enterprise.

The **profit growth** of a company can be measured by the increase in net profit over time. A company can grow its profits if it sells products in markets that are growing rapidly, gains market share from rivals, increases the amount it sells to existing customers, expands overseas, or diversifies profitably into new lines of business. For example, between 1994 and 2012, Wal-Mart increased its net profit from $2.68 billion to $15.7 billion. It was able to do this because the company (a) took market share from rivals, (b) established stores in 27 foreign nations that collectively generated $125 billion in sales by 2012, and (c) entered the grocery business. Due to the increase in net profit, Wal-Mart's earnings per share increased from $0.59 to $4.52, making each share more valuable, and leading in turn to appreciation in the value of Wal-Mart's shares.

**profit growth**
The increase in net profit over time.

Together, profitability and profit growth are the principal drivers of shareholder value (see the Appendix to this chapter for details). *To both boost profitability and grow profits over time, managers must formulate and implement strategies that give their company a competitive advantage over rivals.* Wal-Mart's strategies have enabled the company to maintain a high level of profitability, and to simultaneously grow its profits over time. As a result, investors who purchased Wal-Mart's stock in January 1994, when the shares were trading at $11, would have made a return of more than 620% if they had held onto them through until December 2012. By pursuing strategies that lead to high and sustained profitability, and profit growth, Wal-Mart's managers have thus rewarded shareholders for their decisions to invest in the company.

One of the key challenges managers face is how best to simultaneously generate high profitability and increase the profits of the company. Companies that have high profitability but profits that are not growing will not be as highly valued by shareholders as companies that have both high profitability and rapid profit growth (see the Appendix for details). This was the situation that Dell faced in the later part of the 2000s. At the same time, managers need to be aware that if they grow profits but profitability declines, that too will not be as highly valued by shareholders. What shareholders want to see, and what managers must try to deliver through strategic leadership, is *profitable growth*: that is, high profitability and sustainable profit growth. This is not easy, but some of the most successful enterprises of our era have achieved it—companies such as Apple, Google, and Wal-Mart.

## Competitive Advantage and a Company's Business Model

**competitive advantage**
The achieved advantage over rivals when a company's profitability is greater than the average profitability of firms in its industry.

**sustained competitive advantage**
A company's strategies enable it to maintain above-average profitability for a number of years.

**business model**
The conception of how strategies should work together as a whole to enable the company to achieve competitive advantage.

Managers do not make strategic decisions in a competitive vacuum. Their company is competing against other companies for customers. Competition is a rough-and-tumble process in which only the most efficient and effective companies win out. It is a race without end. To maximize shareholder value, managers must formulate and implement strategies that enable their company to outperform rivals—that give it a competitive advantage. A company is said to have a **competitive advantage** over its rivals when its profitability is greater than the average profitability and profit growth of other companies competing for the same set of customers. The higher its profitability relative to rivals, the greater its competitive advantage will be. A company has a **sustained competitive advantage** when its strategies enable it to maintain above-average profitability for a number of years. As discussed in the opening case, Wal-Mart had a significant and sustained competitive advantage over rivals such as Target, Costco, and K-Mart for most of the last two decades.

The key to understanding competitive advantage is appreciating how the different strategies managers pursue over time can create activities that fit together to make a company unique or different from its rivals and able to consistently outperform them. A **business model** is managers' conception of how the set of strategies their company pursues should work together as a congruent whole, enabling the company to gain a competitive advantage and achieve superior profitability and profit growth. In essence, a business model is a kind of mental model, or gestalt, of how the various strategies and capital investments a company makes should fit together to generate above-average profitability and profit growth. A business model encompasses the totality of how a company will:

- Select its customers.
- Define and differentiate its product offerings.
- Create value for its customers.
- Acquire and keep customers.
- Produce goods or services.
- Lower costs.
- Deliver goods and services to the market.
- Organize activities within the company.

- Configure its resources.
- Achieve and sustain a high level of profitability.
- Grow the business over time.

The business model at discount stores such as Wal-Mart, for example, is based on the idea that costs can be lowered by replacing a full-service retail format for with a self-service format and a wider selection of products sold in a large-footprint store that contains minimal fixtures and fittings. These savings are passed on to consumers in the form of lower prices, which in turn grow revenues and help the company to achieve further cost reductions from economies of scale. Over time, this business model has proved superior to the business models adopted by smaller full-service mom-and-pop stores, and by traditional high-service department stores such as Sears. The business model—known as the self-service supermarket business model—was first developed by grocery retailers in the 1950s and later refined and improved on by general merchandisers such as Wal-Mart. More recently, the same basic business model has been applied to toys (Toys “R” Us), office supplies (Staples, Office Depot), and home-improvement supplies (Home Depot and Lowes).

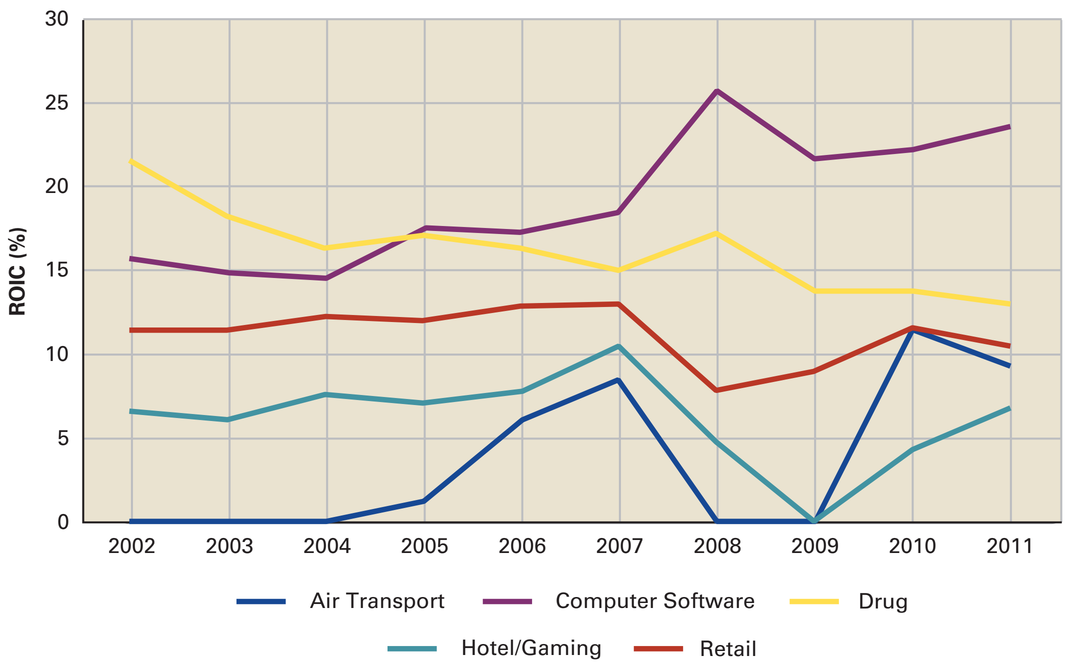
Wal-Mart outperformed close rivals that adopted the same basic business model, such as K-Mart, because of key differences in strategies, and because Wal-Mart implemented the business model more effectively. As a result, over time, Wal-Mart created unique activities that have become the foundation of its competitive advantage. For example, Wal-Mart was one of the first retailers to make strategic investments in distribution centers and information systems, which lowered the costs of managing inventory (see the opening case). This gave Wal-Mart a competitive advantage over rivals such as K-Mart, which suffered from poor inventory controls and thus higher costs. So although Wal-Mart and K-Mart pursued a similar business model, they were not identical. Key differences in the choice of strategies and the effectiveness of implementation created two unique organizations—one that attained a competitive advantage, and one that ended up with a competitive disadvantage.

## Industry Differences in Performance

It is important to recognize that in addition to its business model and associated strategies, a company’s performance is also determined by the characteristics of the industry in which it competes. Different industries are characterized by different competitive conditions. In some industries, demand is growing rapidly, and in others it is contracting. Some industries might be beset by excess capacity and persistent price wars, others by strong demand and rising prices. In some, technological change might be revolutionizing competition; others may be characterized by stable technology. In some industries, high profitability among incumbent companies might induce new companies to enter the industry, and these new entrants might subsequently depress prices and profits in the industry. In other industries, new entry might be difficult, and periods of high profitability might persist for a considerable time. Thus, the different competitive conditions prevailing in different industries may lead to differences in profitability and profit growth. For example, average profitability might be higher in some industries and lower in other industries because competitive conditions vary from industry to industry.

Figure 1.3 shows the average profitability, measured by ROIC, among companies in several different industries between 2002 and 2011. The computer software industry had a favorable competitive environment: demand for software was high and competition was generally not based on price. Just the opposite was the case in the air transport industry, which was extremely price competitive. Exactly how industries differ is discussed in detail

Figure 1.3 Return on Invested Capital (ROIC) in Selected Industries, 2002–2011




**Source:** Value Line Investment Survey.

in Chapter 2. For now, it is important to remember that the profitability and profit growth of a company are determined by two main factors: its relative success in its industry and the overall performance of its industry relative to other industries.[2]

## Performance in Nonprofit Enterprises

A final point concerns the concept of superior performance in the nonprofit sector. By definition, nonprofit enterprises such as government agencies, universities, and charities are not in "business" to make profits. Nevertheless, they are expected to use their resources efficiently and operate effectively, and their managers set goals to measure their performance. The performance goal for a business school might be to get its programs ranked among the best in the nation. The performance goal for a charity might be to prevent childhood illnesses in poor countries. The performance goal for a government agency might be to improve its services while not exceeding its budget. The managers of nonprofits need to map out strategies to attain these goals. They also need to understand that nonprofits compete with each other for scarce resources, just as businesses do. For example, charities compete for scarce donations, and their managers must plan and develop strategies that lead to high performance and demonstrate a track record of meeting performance goals. A successful strategy gives potential donors a compelling message about why they should contribute additional donations. Thus, planning and thinking strategically are as important for managers in the nonprofit sector as they are for managers in profit-seeking firms.

# STRATEGIC MANAGERS

Managers are the linchpin in the strategy-making process. It is individual managers who must take responsibility for formulating strategies to attain a competitive advantage and for putting those strategies into effect. They must lead the strategy-making process. The strategies that made Wal-Mart so successful were not chosen by some abstract entity known as "the company"; they were chosen by the company's founder, Sam Walton, and the managers he hired. Wal-Mart's success was largely based on how well the company's managers performed their strategic roles. In this section, we look at the strategic roles of different managers. Later in the chapter, we discuss strategic leadership, which is how managers can effectively lead the strategy-making process.

In most companies, there are two primary types of managers: **general managers**, who bear responsibility for the overall performance of the company or for one of its major self-contained subunits or divisions, and **functional managers**, who are responsible for supervising a particular function, that is, a task, activity, or operation, such as accounting, marketing, research and development (R&D), information technology, or logistics. Put differently, general managers have profit-and-loss responsibility for a product, a business, or the company as a whole.

A company is a collection of functions or departments that work together to bring a particular good or service to the market. If a company provides several different kinds of goods or services, it often duplicates these functions and creates a series of self-contained divisions (each of which contains its own set of functions) to manage each different good or service. The general managers of these divisions then become responsible for their particular product line. The overriding concern of general managers is the success of the whole company or the divisions under their direction; they are responsible for deciding how to create a competitive advantage and achieve high profitability with the resources and capital they have at their disposal. Figure 1.4 shows the organization of a **multidivisional company**,

**general managers**
Managers who bear responsibility for the overall performance of the company or for one of its major self-contained subunits or divisions.

**functional managers**
Managers responsible for supervising a particular function, that is, a task, activity, or operation, such as accounting, marketing, research and development (R&D), information technology, or logistics.

**multidivisional company**
A company that competes in several different businesses and has created a separate self-contained division to manage each.

Figure 1.4 Levels of Strategic Management