

strategic
management
SEVENTH EDITION

Dess
Lumpkin
Eisner
McNamara

creating competitive advantages

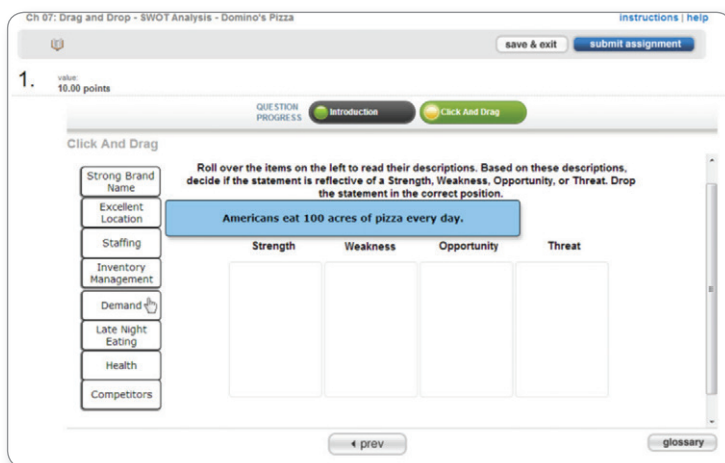




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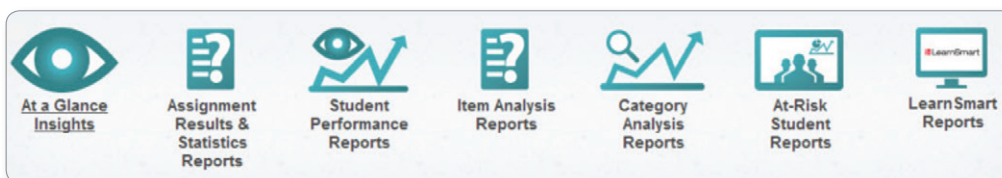
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SEVENTH EDITION



strategic management

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creating competitive advantages

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Education



STRATEGIC MANAGEMENT: CREATING COMPETITIVE ADVANTAGES, SEVENTH EDITION
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dedication

To my family, Margie and Taylor; my parents,
Bill and Mary Dess; and Walter Descovich

–Greg

To my lovely wife, Vicki, and my students
and colleagues

–Tom

To my family, Helaine, Rachel, and Jacob

–Alan

To my wonderful wife, Gaelen; my children,
Megan and AJ; and my parents, Gene and Jane

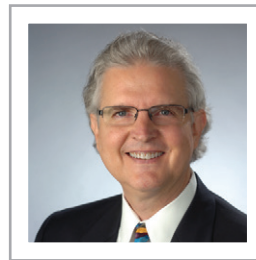
–Gerry

about the
authors



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is the Andrew R. Cecil Endowed Chair in Management at the University of Texas at Dallas. His primary research interests are in strategic management, organization–environment relationships, and knowledge management. He has published numerous articles on these subjects in both academic and practitioner-oriented journals. He also serves on the editorial boards of a wide range of practitioner-oriented and academic journals. In August 2000, he was inducted into the *Academy of Management Journal*'s Hall of Fame as one of its charter members. Professor Dess has conducted executive programs in the United States, Europe, Africa, Hong Kong, and Australia. During 1994 he was a Fulbright Scholar in Oporto, Portugal. In 2009, he received an honorary doctorate from the University of Bern (Switzerland). He received his PhD in Business Administration from the University of Washington (Seattle) and a BIE degree from Georgia Tech.



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preface

Welcome to the Seventh Edition of *Strategic Management: Creating Competitive Advantages!*

We are all very pleased with the positive market response to our previous edition. Below is some of the encouraging feedback we have received from our reviewers:

The text is thorough and all-inclusive. I don't need to refer to another book as a back-up. It addresses all aspects of strategic management from the initial inspiration of a vision to the nuts and bolts of putting the plan to work. It is well structured; it is clear how each chapter not only builds on the previous ones, but also how analysis, formulation, and implementation are interrelated.

Lois Shelton, California State University, Northridge

I use *Strategic Management* in a capstone course required of all business majors, and students appreciate the book because it synergizes all their business education into a meaningful and understandable whole. My students enjoy the book's readability and tight organization, as well as the contemporary examples, case studies, discussion questions and exercises.

William Sannwald, San Diego State University

It is very easy for students to read because it presents strategy concepts in a simple but comprehensive manner. It covers important developments in the strategic management field that are usually ignored by other textbooks (e.g., concepts like social networks and social capital, the balanced scorecard, and new forms of organizational structure).

Moses Acquah, University of North Carolina at Greensboro

Content is current and easy for students to grasp; good graphs and charts to illustrate important points in the chapter. Book is well organized around the AFI framework.

Lise Anne D. Slatten, University of Louisiana at Lafayette

It is the best written textbook for the undergraduate course that I have come across. Application materials tie concepts to real-world practice.

Justin L. Davis, University of West Florida

The Dess text takes a practical/easy approach to explain very difficult subject matter. It integrates a number of real-life scenarios to aid the student in their comprehension of key concepts. The standout of the text is the Reflecting on Career Implications. These end-of-chapter questions aid the student in applying their learning to their workplace in a manner that promotes career success.

Amy Patrick, Wilmington University

The Dess book overcomes many of the limitations of the last book I used in many ways: (a) presents content in a very interesting and engrossing manner without compromising the depth and comprehensiveness, (b) inclusion of timely and interesting illustrative examples, and (c) EOC exercises do an excellent job of complementing the chapter content.

Sucheta Nadkarni, Drexel University

We are always striving to improve our work, and we are most appreciative of the extensive and constructive feedback that many strategy professionals have graciously given us. As always,

we have worked hard to incorporate their ideas into the Seventh Edition—and we acknowledge them by name later in the Preface.

We believe we have made valuable improvements throughout our many revised editions of *Strategic Management*. At the same time, we strive to be consistent and “true” to our original overriding objective: a book that satisfies three R’s: relevant, rigorous, and readable. That is, our tagline (paraphrasing the well-known Secret deodorant commercial) is: “Strong enough for the professor; made for the student.” And we are pleased that we have received feedback (such as the comments on the previous page) that is consistent with what we are trying to accomplish.

To continue to earn the support of strategy instructors (and students!) we try to use an engaging writing style that minimizes unnecessary jargon and covers all of the traditional bases. We also integrate some central themes throughout the book—such as globalization, technology, ethics, environmental sustainability, and entrepreneurship—that are vital in understanding strategic management in today’s global economy. We draw on short examples from business practice to bring concepts to life by providing 85 Strategy Spotlights (more detailed examples in sidebars).

Unlike other strategy texts, we provide three separate chapters that address timely topics about which business students should have a solid understanding. These are the role of intellectual assets in value creation (Chapter 4), entrepreneurial strategy and competitive dynamics (Chapter 8), and fostering entrepreneurship in established organizations (Chapter 12). We also provide an excellent and thorough chapter on how to analyze strategic management cases.

In developing *Strategic Management: Creating Competitive Advantage*, we certainly didn’t forget the instructors. As we all know, you have a most challenging (but rewarding) job. We did our best to help you. We provide a variety of supplementary materials that should help you in class preparation and delivery. For example, our chapter notes do not simply summarize the material in the text. Rather (and consistent with the concept of strategy!), we ask ourselves: “How can we add value?” Thus, for each chapter, we provide numerous questions to pose to help guide class discussion, at least 12 boxed examples to supplement chapter material, and three detailed “teaching tips” to further engage students. Also, the author team completed the chapter notes—along with the entire test bank—ourselves. That is, unlike many of our rivals, we didn’t simply farm the work out to others. Instead, we felt that such efforts help to enhance quality and consistency—as well as demonstrate our personal commitment to provide a top-quality total package to strategy instructors. With the seventh edition, we also benefited from valued input by our strategy colleagues to further improve our work.

Let’s now address some of the key substantive changes in the Seventh Edition. Then we will cover some of the major features that we have had in previous editions.

What’s New? Highlights of the Seventh Edition

We have endeavored to add new material to the chapters that reflects both the feedback that we have received from our reviewers as well as the challenges that face today’s managers. Thus, we all invested an extensive amount of time carefully reviewing a wide variety of books, academic and practitioner journals, and the business press.

We also worked hard to develop more concise and tightly written chapters. Based on feedback from some of the reviewers, we have tightened our writing style, tried to eliminate redundant examples, and focused more directly on what we feel is the most important content in each chapter for our audience. The overall result is that we were able to update our material, add valuable new content, and—at the same time—shorten the length of the chapters.

Here are some of the major changes and improvements in the Seventh Edition:

- **All of the 12 opening “Learning from Mistakes” vignettes that lead off each chapter at totally new.** Unique to this text, they are all examples of what can go wrong, and they serve as an excellent vehicle for clarifying and reinforcing strategy concepts. After all, what can be learned if one simply admires perfection!
- **Well over half of our “Strategy Spotlights” (sidebar examples) are brand new, and many of the others have been thoroughly updated.** Although we have reduced the number of Spotlights from the previous edition to conserve space, we still have a total of 85—by far the most in the strategy market. We focus on bringing the most important strategy concepts to life in a concise and highly readable manner. And we work hard to eliminate unnecessary detail that detracts from the main point we are trying to make. Also, consistent with our previous edition, many of the Spotlights focus on three “hot” issues that are critical in leading today’s organizations: ethics, environmental sustainability, and crowdsourcing.
- **We have added a new feature—Issue for Debate—at the end of each chapter.** We have pretested these situations and find that students become very engaged (and often animated!) in discussing an issue that has viable alternative points of view. It is an exciting way to drive home key strategy concepts. For example, in Chapter 1, Seventh Generation is faced with a situation that confronts their values, and they must decide whether or not to provide their products to some of their largest customers. In Chapter 3, some interesting tradeoffs arose when The World Triathlon Corporation expanded their exclusive branding of Ironman to products that didn’t reflect the “spirit” of the brand. And, in Chapter 6, Delta Airlines’ diversification into the oil business via their acquisition of an oil refinery poses an issue for some interesting alternative points of view.
- **Throughout the chapters, we provide many excerpts from interviews with top executives from Adam Bryant’s *The Corner Office*.** Such viewpoints provide valuable perspectives from leading executives and help to drive home the value and purpose of key strategy concepts. For example, we include the perspectives of Tim Brown (CEO of IDEO) on employee empowerment, John Stumpf (CEO of Wells Fargo) on strategy implementation, and Gordon Bethune (former CEO of Continental Airlines) on the importance of incentive systems.
- **We have completely rewritten the “Reflecting on Career Implications . . .” feature that we introduced in the Sixth Edition of *Strategic Management*.** Based on reviewer feedback, we directed our attention to providing insights that are closely aligned with and directed to three distinct issues faced by our readers: prepare them for a job interview (e.g., industry analysis), help them with current employers or their career in general, or help them find potential employers and decide where to work. We feel this feature is significantly improved and should be of more value to students’ professional development.

Key content changes for the chapters include:

- **Chapter 1 makes a strong business case for environmental sustainability and draws on Porter’s concept of “shared value” that was initially introduced in the Sixth Edition.** Such issues advance the notion that firms should go far beyond a narrow focus on shareholder returns. Further, shared value promotes practices that enhance the competitiveness of the company while simultaneously advancing the social and economic conditions in which it operates.

- **Chapter 2 makes the distinction between “hard trends” and “soft trends” that was articulated by Dan Burrus in his recent book *Flash Foresight*.** This distinction is important in determining the importance of current trends and their evolution over time. Soft trends are something that might happen and a probability with which it might happen can be assigned. In contrast, hard trends are based on measurable facts, events, or objects—they are something that will happen. We provide the example of how the identification of hard trends (in technology) led the renowned Mayo Clinic to develop a CD to help customers to access useful medical information. This initiative provided the Mayo Clinic with significant financial and nonfinancial benefits!
- **Chapter 4 addresses two issues that are important to not only developing human capital in organizations but also for students entering—or enhancing their success in—an organization: mentorship versus sponsorship and the “trap” of ineffective networks.** Knowing the distinction between mentors and sponsors has valuable implications for one’s career. Mentors may provide coaching and advice, and prepare one for the next position. Sponsors, on the other hand, are typically somebody in a senior position who can advocate and facilitate career moves. We also draw on research that suggests three types of “network traps” that professionals should work hard to avoid: the wrong structure, the wrong relationship, and the wrong behavior.
- **Chapter 6 discusses when actions taken to change the scope of businesses in which a corporation competes lead to positive outcomes for the firm.** We highlight the characteristics of both acquisitions and divestitures that lead to positive outcomes. With acquisitions, we focus on how the characteristics of the acquiring firm as well as the acquisition itself lead to positive reactions by the stock market to the announcement of the deal. With divestitures, we draw on the work by the Boston Consulting Group to highlight seven principles for effective divestitures.
- **Chapter 7 looks into the hidden costs of offshoring.** In recent years, many firms have moved parts of their operations to lower wage countries. In many cases, they have found that the expected cost savings were illusory. We discuss seven reasons why firms would not achieve the anticipated savings through offshoring and provide examples of firms that have benefited by bringing their operations back home.
- **Chapter 8 includes an examination of crowdfunding, a rapidly growing means to finance entrepreneurial ventures.** Crowdfunding involves drawing relatively small amounts of funding from a wide net of investors to provide potentially large pools of capital for entrepreneurial ventures. We discuss both the tremendous potential as well as the pitfalls of crowdfunding for entrepreneurs. Knowing that some of our students may want to be investors in these ventures, we also discuss issues that crowdfunding investors should consider when looking into these investment opportunities.
- **Chapter 9 addresses how firms can build effective boards of directors.** We identify how firms need to go beyond standard categories, such as insider versus outsider board members, to develop favorable board dynamics. We also discuss how the structure of boards has changed over the past 25 years.
- **Chapter 10 examines the costs and benefits of nurturing strong relationships to ensure cooperation and achieve high levels of performance.** Over the past 30 years, many scholars have argued that relational systems, where decisions regarding how to

facilitate control and coordination are driven by relationships rather than bureaucratic systems and contracts, are superior to more traditional control systems. We examine this issue and discuss how relational systems have both advantages and disadvantages. We conclude with a brief discussion of when managers may want to rely more on relationship systems and when they may want to rely more on formal structure and reward systems.

- **Chapter 11 introduces the concept of “competency conipanions,” an important idea for managers to consider in developing their leadership ability.** The idea is that leaders can benefit most by identifying and developing complementary strengths instead of continually working on already great qualities that they may possess. For example, a leader who has a strong competence in developing innovative ideas can extend that competency by developing strong communication skills.
- **Chapter 13 updates our Appendix: Sources of Company and Industry Information.** Here, we owe a big debt to Ruthie Brock and Carol Byrne, library professionals at the University of Texas at Arlington. These ladies have graciously provided us with comprehensive and updated information that is organized in a range of issues. These include competitive intelligence, annual report collections, company rankings, business websites, and strategic and competitive analysis. Such information is invaluable in analyzing companies and industries.

What Remains the Same: Key Features of Earlier Editions

Let’s now briefly address some of the exciting features that remain from the earlier editions.

- **Traditional organizing framework with three other chapters on timely topics.** Crisply written chapters cover all of the strategy bases and address contemporary topics. First, the chapters are divided logically into the traditional sequence: strategy analysis, strategy formulation, and strategy implementation. Second, we include three chapters on such timely topics as intellectual capital/knowledge management, entrepreneurial strategy and competitive dynamics, and fostering corporate entrepreneurship and new ventures.
- **“Learning from Mistakes” chapter-opening cases.** To enhance student interest, we begin each chapter with a case that depicts an organization that has suffered a dramatic performance drop, or outright failure, by failing to adhere to sound strategic management concepts and principles. We believe that this feature serves to underpin the value of the concepts in the course and that it is a preferred teaching approach to merely providing examples of outstanding companies that always seem to get it right! After all, isn’t it better (and more challenging) to diagnose problems than admire perfection? As Dartmouth’s Sydney Finkelstein, author of *Why Smart Executives Fail*, notes: “We live in a world where success is revered, and failure is quickly pushed to the side. However, some of the greatest opportunities to learn—both for individuals and organizations—come from studying what goes wrong.”* We’ll see how, for example, Borders went from enjoying enormous success as an innovative firm—with revenues of nearly \$4 billion in 2005—to bankruptcy six years later. We will also explore why Daimler’s “ultra-urban” Smart car—despite its initial acclaim—has cost the firm \$5.3 billion in cumulative losses over the years. And we’ll explore why

*Personal communication, June 20, 2005.

Cisco's eagerness to enter the digital video market via its acquisition of Pure Digital Technologies didn't pan out.

- **Consistent chapter format and features to reinforce learning.** We have included several features in each chapter to add value and create an enhanced learning experience. First, each chapter begins with an overview and a set of bullets pointing to key learning objectives. Second, as previously noted, the opening case describes a situation in which a company's performance eroded because of a lack of proper application of strategy concepts. Third, at the end of each chapter there are four different types of questions/exercises that should help students assess their understanding and application of material:

1. Summary review questions.
2. Experiential exercises.
3. Application questions and exercises.
4. Ethics questions

Given the centrality of online systems to business today, each chapter contains at least one exercise that allows students to explore the use of the Web in implementing a firm's strategy.

- **“Reflecting on Career Implications” for each chapter.** This feature—at the end of each chapter—will help instructors drive home the immediate relevance/value of strategy concepts. It focuses on how an understanding of key concepts helps business students early in their careers.
- **Key Terms.** Approximately a dozen key terms for each chapter are identified in the margins of the pages. This addition was made in response to reviewer feedback and improves students' understanding of core strategy concepts.
- **Clear articulation and illustration of key concepts.** Key strategy concepts are introduced in a clear and concise manner and are followed by timely and interesting examples from business practice. Such concepts include value-chain analysis, the resource-based view of the firm, Porter's five-forces model, competitive advantage, boundaryless organizational designs, digital strategies, corporate governance, ethics, and entrepreneurship.
- **Extensive use of sidebars.** We include 85 sidebars (or about seven per chapter) called “Strategy Spotlights.” The Strategy Spotlights not only illustrate key points but also increase the readability and excitement of new strategy concepts.
- **Integrative themes.** The text provides a solid grounding in ethics, globalization, environmental sustainability, and technology. These topics are central themes throughout the book and form the basis for many of the Strategy Spotlights.
- **Implications of concepts for small businesses.** Many of the key concepts are applied to start-up firms and smaller businesses, which is particularly important since many students have professional plans to work in such firms.
- **Not just a textbook but an entire package.** *Strategic Management* features the best chapter teaching notes available today. Rather than merely summarizing the key points in each chapter, we focus on value-added material to enhance the teaching (and learning) experience. Each chapter includes dozens of questions to spur discussion, teaching tips, in-class group exercises, and about a dozen detailed examples from business practice to provide further illustrations of key concepts.

Student Support Materials

Online Learning Center (OLC)

The following resources are available to students via the publisher's OLC at www.mhhe.com/dess7e:

- Chapter quizzes students can take to gauge their understanding of material covered in each chapter.
- A selection of PowerPoint slides for each chapter.
- Links to strategy simulations the Business Strategy Game & GLO-BUS. Both provide a powerful and constructive way of connecting students to the subject matter of the course with a competition among classmates on campus and around the world.

Instructor Support Materials

Instructor's Manual (IM)

Prepared by the textbook authors, along with valued input from our strategy colleagues, the accompanying IM contains summary/objectives, lecture/discussion outlines, discussion questions, extra examples not included in the text, teaching tips, reflecting on career implications, experiential exercises, and more.

Test Bank

Revised by Christine Pence of the University of California–Riverside, the test bank contains more than 1,000 true/false, multiple-choice, and essay questions. It has now been tagged with learning objectives as well as Bloom's Taxonomy and AACSB criteria.

- **Assurance of Learning Ready.** Assurance of Learning is an important element of many accreditation standards. Dess 7e is designed specifically to support your Assurance of Learning initiatives. Each chapter in the book begins with a list of numbered learning objectives that appear throughout the chapter, as well as in the end-of-chapter questions and exercises. Every test bank question is also linked to one of these objectives, in addition to level of difficulty, topic area, Bloom's Taxonomy level, and AACSB skill area. *EZ Test*, McGraw-Hill's easy-to-use test bank software, can search the test bank by these and other categories, providing an engine for targeted Assurance of Learning analysis and assessment.
- **AACSB Statement.** The McGraw-Hill Companies is a proud corporate member of AACSB International. Understanding the importance and value of AACSB accreditation, Dess 7e has sought to recognize the curricula guidelines detailed in the AACSB standards for business accreditation by connecting selected questions in Dess 7e and the test bank to the general knowledge and skill guidelines found in the AACSB standards. The statements contained in Dess 7e are provided only as a guide for the users of this text. The AACSB leaves content coverage and assessment within the purview of individual schools, the mission of the school, and the faculty. While Dess 7e and the teaching package make no claim of any specific AACSB qualification or evaluation, we have labeled selected questions within Dess 7e according to the six general knowledge and skills areas.
- **Computerized Test Bank Online.** A comprehensive bank of test questions is provided within a computerized test bank powered by McGraw-Hill's flexible electronic testing program, *EZ Test Online* (www.eztestonline.com). *EZ Test Online*

allows you to create paper and online tests or quizzes in this easy-to-use program! Imagine being able to create and access your test or quiz anywhere, at any time without installing the testing software. Now, with *EZ Test Online*, instructors can select questions from multiple McGraw-Hill test banks or author their own, and then either print the test for paper distribution or give it online.

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 - Set availability dates and time limits for your quiz or test.
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 - Create practice tests online to enable student mastery.
 - Your roster can be uploaded to enable student self-registration.
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 - Manual rescoring and feedback is also available.
 - *EZ Test*’s grade book is designed to easily export to your grade book.
 - View basic statistical reports.
- **Support and Help.**
 - User’s guide and built-in page-specific help.
 - Flash tutorials for getting started on the support site.
 - Support website: www.mhhe.com/ezttest.
 - Product specialist available at 1-800-331-5094.
 - Online Training: <http://auth.mhhe.com/mpss/workshops/>.

PowerPoint Presentation

Prepared by Pauline Assenza of Western Connecticut State University, it consists of more than 400 slides incorporating an outline for the chapters tied to learning objectives. Also included are instructor notes, multiple-choice questions that can be used as Classroom Performance System (CPS) questions, and additional examples outside of the text to promote class discussion.

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Less Managing. More Teaching. Greater Learning. McGraw-Hill *Connect Management* is an online assignment and assessment solution that connects students with the tools and resources they’ll need to achieve success.



- **McGraw-Hill *Connect Management* Features.** *Connect Management* offers a number of powerful tools and features to make managing assignments easier, so faculty can spend more time teaching. With *Connect Management*, students can engage with their coursework anytime and anywhere, making the learning process more accessible and efficient. *Connect Management* offers you the features described below.
 - There are chapter quizzes for the 12 chapters, consisting of 15–25 multiple-choice questions, testing students’ overall comprehension of concepts presented in the chapter.
 - There are 2 specially crafted interactives for each of the 12 chapters that drill students in the use and application of the concepts and tools of strategic analysis.
 - The majority of the *Connect* exercises are automatically graded, thereby simplifying the task of evaluating each class member’s performance and monitoring the learning outcomes.
- **Student Progress Tracking.** *Connect Management* keeps instructors informed about how each student, section, and class is performing, allowing for more productive use of lecture and office hours. The progress-tracking function enables you to
 - View scored work immediately and track individual or group performance with assignment and grade reports.
 - Access an instant view of student or class performance relative to learning objectives.
 - Collect data and generate reports required by many accreditation organizations, such as AACSB.
- **Smart Grading.** When it comes to studying, time is precious. *Connect Management* helps students learn more efficiently by providing feedback and practice material when they need it, where they need it. When it comes to teaching, your time also is precious. The grading function enables you to
 - Have assignments scored automatically, giving students immediate feedback on their work and side-by-side comparisons with correct answers.
 - Access and review each response, manually change grades, or leave comments for students to review.
 - Reinforce classroom concepts with practice tests and instant quizzes.
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Videos

A set of videos related to chapters can be found on the Online Learning Center (OLC) or Connect to support your classroom or student lab, or for home viewing. These thought-provoking video clips are available upon adoption of this text.

Online Learning Center (OLC)

The instructor section of www.mhhe.com/dess7e also includes the Instructor's Manual, PowerPoint Presentations, as well as additional resources.

The Business Strategy Game and GLO-BUS Online Simulations

Both allow teams of students to manage companies in a head-to-head contest for global market leadership. These simulations give students the immediate opportunity to experiment with various strategy options and to gain proficiency in applying the concepts and tools they have been reading about in the chapters. To find out more or to register, please visit www.mhhe.com/thompsonsims.

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Learning Objectives

Learning Objectives numbered LO5.1, LO5.2, LO5.3, etc. with corresponding icons in the margins to indicate where learning objectives are covered in the text.

Business-Level Strategy:

Creating and Sustaining Competitive Advantages

After reading this chapter, you should have a good understanding of the following learning objectives:

- LO5.1** The central role of competitive advantage in the study of strategic management, and the three generic strategies: overall cost leadership, differentiation, and focus.
- LO5.2** How the successful attainment of generic strategies can improve a firm's relative power vis-à-vis the five forces that determine an industry's average profitability.
- LO5.3** The pitfalls managers must avoid in striving to attain generic strategies.
- LO5.4** How firms can effectively combine the generic strategies of overall cost leadership and differentiation.
- LO5.5** What factors determine the sustainability of a firm's competitive advantage.
- LO5.6** How Internet-enabled business models are being used to improve strategic positioning.
- LO5.7** The importance of considering the industry life cycle to determine a firm's business-level strategy and its relative emphasis on functional area strategies and value-creating activities.
- LO5.8** The need for turnaround strategies that enable a firm to reposition its competitive position in an industry.

Learning from Mistakes

Some of the most widely known brands and snack foods arena have been owned Corporation.¹ Since the 1930s, Hostess Brands founded as Interstate Bakeries) produced popular baked goods, including Wonder Bread, Ring Dings, Yodels, Zingers, and many more. Even with its iconic brands and sales in 2012, Hostess Brands found itself in a perilous position and went into bankruptcy in 2012. Unable to find a solution to remain viable, in November 2012, Hostess Brands closed down all of its bakeries and was forced to sell off its brands to other bakeries. Was this a surprise to many seeing the firm's long history?

The viability of a firm's business-level strategy is determined by both the internal operations of a firm and the preferences of the market. Firms that do not take the appropriate resources and cost structure into account when designing their products and services are more likely to fail. Hostess had long been successful in the baked goods business, but its reliance on a single product (snack goods) in a highly competitive market was a liability. The environment was unfriendly to a company that was not diversified.

Learning from Mistakes

In 1997, Daimler AG introduced an "ultra-urban" car at the Frankfurt Motor Show amid much fanfare.¹ Envisioned by Nicholas Hayek (inventor of Swatch Watch) and Mercedes-Benz, it received acclaim for its innovation, advanced engineering, and functionality as well as being simply fun to drive. Over one million were sold worldwide before it entered the U.S. market a decade later. What was this car that was transforming the urban transportation market? It was the Smart fortwo—a pocket-sized two-seater, high-efficiency vehicle made with cutting-edge materials that were as light as they were strong and had an impressively engineered Mercedes-Benz engine that made it fun to drive.

On January 16, 2008, the first Smart fortwo streaked through the streets of Manhattan, New York. The Smart fortwo was an immediate sensation in the United States, with sales of 24,600 units in its first year. With rising gas prices, a buoyant economy, and increasingly ecologically-aware consumers, Daimler had not only found a market, but also it was blazing a trail all across the United States. However, sales quickly dropped—just 20,000 cars were sold over the following three years. So where did Smart take a wrong turn?

Learning from Mistakes

Learning from Mistakes are examples of where things went wrong. Failures are not only interesting but also sometimes easier to learn from. And students realize strategy is not just about "right or wrong" answers, but requires critical thinking.

Strategy Spotlight

These boxes weave themes of ethics, globalization, and technology into every chapter of the text, providing students with a thorough grounding necessary for understanding strategic management. Select boxes incorporate crowdsourcing, environmental sustainability, and ethical themes.

STRATEGY SPOTLIGHT 1.3 ETHICS

NGOs AS MONITORS OF MNCs
Although the number of NGOs worldwide is hard to determine, according to a recent study there are at least 40,000 multinational NGOs. There are also hundreds of thousands based in individual countries, with India leading the pack with one NGO for 400 of its citizens. NGOs have become an important part of the global business landscape, often acting as a check and balance to multinational corporations. They have gained media attention because they procure finished goods from Chinese textile companies with questionable environmental practices. These cases highlight that MNCs face substantial challenges in what is commonly assumed to be an arm's length market transaction.

STRATEGY SPOTLIGHT 1.4 ENVIRONMENTAL SUSTAINABILITY

THE BUSINESS CASE FOR SUSTAINABILITY
The corporate sustainability, or "green," movement describes a business philosophy that goes beyond legal compliance with environmental regulations. Historically, companies engaged in social issues by donating out checks to charities or victims of natural disasters. However, the business case for sustainability is becoming increasingly clear. Companies that invest in sustainability can reduce costs, improve efficiency, and enhance their reputation. For example, Walmart more than \$195,000 a year. International Paper (IP), a global paper and packaging company, has reduced its carbon footprint by 25 percent since 2007. The company's environmental improvement reduced packaging weight by 25 percent and lowered freight and warehouse costs by 13 percent, saving \$1.2 million per year.

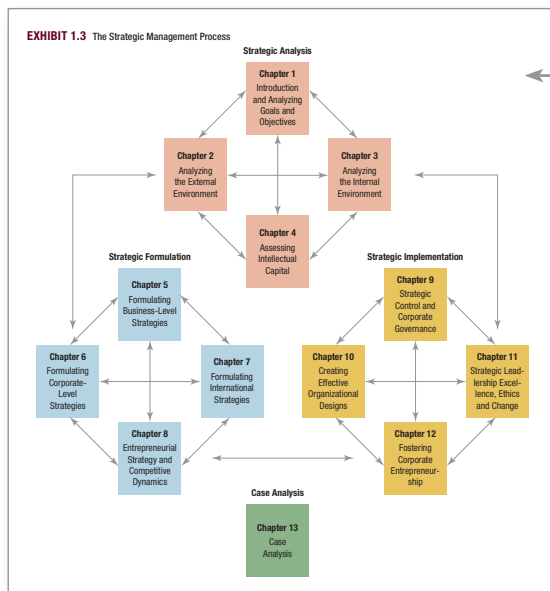
STRATEGY SPOTLIGHT 2.5 CROWDSOURCING

HOW GOLDCORP USED CROWDSOURCING TO STRIKE GOLD!
About 15 years ago, Toronto-based gold mining company Goldcorp was in big trouble. Besieged by strikes, lingering debts, and an exceedingly high cost of production, the firm had terminated mining operations. Conditions in the marketplace were quite poor, and the gold market was contracting. Most analysts assumed that the company's 50-year-old mine in Red Lake, Ontario, was nearly dead. Without solid evidence of substantial new gold deposits, Goldcorp was likely to fail.
Clearly, CEO Robert McEwen needed a miracle. He was frustrated with his in-house geologists' reliability in estimating the value and location of gold on his property. He did something that was unprecedented in the industry: He published his geological data on the Web for all to see and challenged the world to do the prospecting. The "Goldcorp Challenge" posted a total of \$575,000 in prize money to be awarded to the participants who submitted the best methods and estimates.
His reasoning: If he could attract the attention of world-class talent to the problem of finding more gold in Red Lake, just as Linux managed to attract world-class programmers to the cause of better software, he could tap into thousands of minds that he wouldn't otherwise have access to. He could also speed up exploration. In 2012, Goldcorp had annual revenues of over \$5 billion and a market value of \$36 billion! Not bad for a once failing firm...

Key Terms

Key Terms defined in the margins have been added to improve students' understanding of core strategy concepts.

competitive advantage
A firm's resources and capabilities that enable it to overcome the competitive forces in its industry(ies).



Exhibits

Both new and improved exhibits in every chapter provide visual presentations of the most complex concepts covered to support student comprehension.

Reflecting on Career Implications

This new section before the summary of every chapter consists of examples on how understanding of key concepts helps business students early in their careers.

Reflecting on Career Implications . . .

- **Creating the Environmentally Aware Organization:** Advancing your career requires constant scanning, monitoring, and intelligence gathering to find out not only future job opportunities but also to understand how employers' expectations are changing. Consider using websites such as LinkedIn to find opportunities. Merely posting your resume on a site such as LinkedIn may not be enough. Instead, consider in what ways you can use such sites for scanning, monitoring, and intelligence gathering.
- **SWOT Analysis:** As an analytical method, SWOT analysis is applicable for individuals as it is for firms. It is important for you to periodically evaluate your strengths and weaknesses as well as potential opportunities and threats to your career. Such analysis should be followed by efforts to address your weaknesses by improving your skills and capabilities.
- **General Environment:** The general environment consists of several segments, such as the demographic, sociocultural, political/legal, technological, economic, and global environments. It would be useful to evaluate how each of these segments can affect your career opportunities. Identify two or three specific trends (e.g., rapid technological change, aging of the population, increase in minimum wages) and their impact on your choice of careers. These also provide possibilities for you to add value for your organization.
- **Five-Forces Analysis:** Before you go for a job interview, consider the five forces affecting the industry within which the firm competes. This will help you to appear knowledgeable about the industry and increase your odds of landing the job. It also can help you to decide if you want to work for that organization. If the "forces" are unfavorable, the long-term profit potential of the industry may be unattractive, leading to fewer resources available and—all other things being equal—fewer career opportunities.



Online Learning Center (OLC)

The website www.mhhe.com/dess7e follows the text chapter-by-chapter. OLC content is ancillary and supplementary germane to the textbook. As students read the book, they can go online to take self-grading quizzes, review material, or work through interactive exercises. It includes chapter quizzes, student PowerPoint slides, and links to strategy simulations The *Business Strategy Game* and GLO-BUS.

The instructor section also includes the Instructor's Manual, PowerPoint Presentations, Test Bank as well as all student resources.

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Strategic Management: Text and Cases, 7/e

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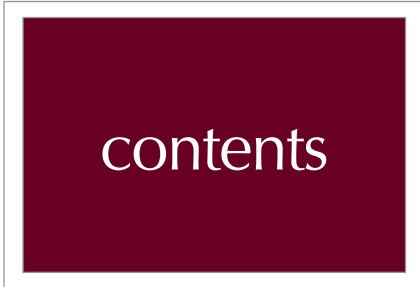
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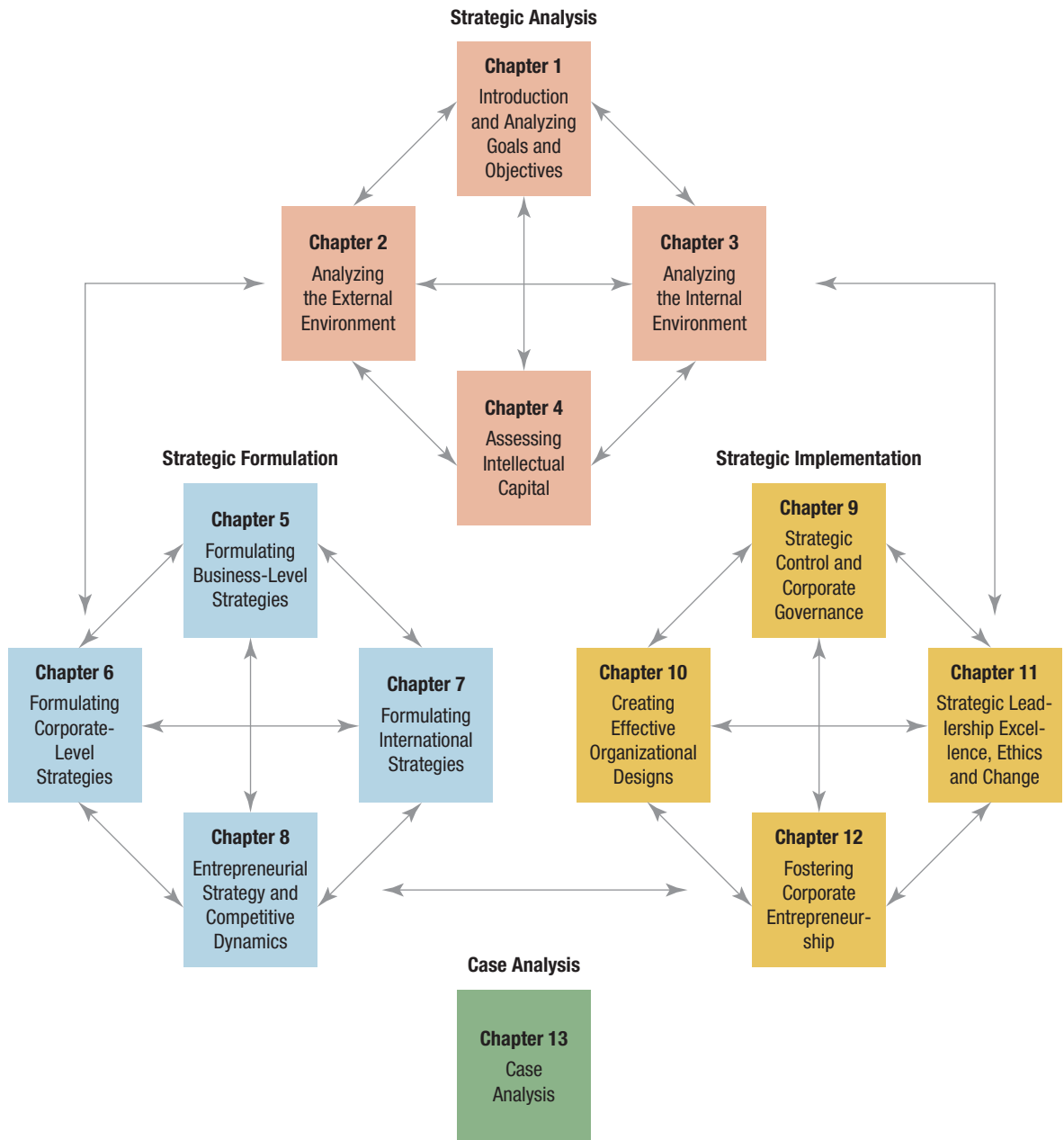
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The Strategic Management Process



chapter 1

Strategic Management

Creating Competitive Advantages

After reading this chapter, you should have a good understanding of the following learning objectives:

- LO1.1** The definition of strategic management and its four key attributes.
- LO1.2** The strategic management process and its three interrelated and principal activities.
- LO1.3** The vital role of corporate governance and stakeholder management, as well as how “symbiosis” can be achieved among an organization’s stakeholders.
- LO1.4** The importance of social responsibility, including environmental sustainability, and how it can enhance a corporation’s innovation strategy.
- LO1.5** The need for greater empowerment throughout the organization.
- LO1.6** How an awareness of a hierarchy of strategic goals can help an organization achieve coherence in its strategic direction.

Learning from Mistakes

What makes the study of strategic management so interesting? For one, struggling firms can become stars, while high flyers can become earthbound very rapidly. As colorfully noted by Arthur Martinez, Sears’ former chairman: “Today’s peacock is tomorrow’s feather duster.” Consider, for example, the change in membership on the prestigious *Fortune 500* list of the largest U.S. firms:¹

- Of the 500 companies that appeared on the first list in 1955, only 62, ranked by revenue, have appeared on the list every year since.
- Some of the most powerful companies on today’s list—businesses like Intel, Apple, and Google—grew from nothing to great on the strength of new technologies, bumping venerable old companies off the list.
- Nearly 2,000 companies have appeared on the list since its inception, and most are long gone from it. Just making the list guarantees nothing about your ability to endure.
- Between 2009 and 2013, admittedly more volatile years than most, over one hundred companies—including Bear Stearns, Chrysler, Circuit City, Merrill Lynch, RadioShack, and Tribune—dropped off the 500.



Maintaining competitive success or even surviving over long periods of time is indeed very difficult for companies of any size. As John Donahue, CEO of eBay, notes, “Almost every company has hot moments. But only great companies achieve strong, sustainable performance over time. While it’s fun to be hot; it’s far more gratifying to create an enduring, sustainable business.”² Next, we will look at Borders, a firm which after years of success went into a rapid decline that eventually led to its death.

In 1971, Louis and Tom Borders opened their first store in Ann Arbor, Michigan.³ The brothers, while students at the University of Michigan, created a then-revolutionary system to track sales and inventory—and for years executives called it the company’s “secret sauce.” With their “Book Inventory System,” Borders could oversee the flow of a huge number of titles broken into thousands of different subject categories across multiple stores. As it grew, Borders provided the knowledge and feel of the independents with its distinctive architecture, comfortable chairs, and reading nooks. In addition, the stores carefully screened and trained employees, paying them relatively well along with a generous set of benefits. It seemed like a winning strategy—and it worked for quite a while. By the 1990s it, along with Barnes and Noble, controlled 40 percent of the retail book market. Borders’ financials were impressive: between 2003 and 2005, sales increased 11 percent to nearly \$4 billion and net income jumped 23 percent to \$132 million. Unfortunately, 2005 was its last profitable year. By 2009 and 2010, Borders was well into the red, losing a combined \$293 million. In February 2011 it filed for bankruptcy protection. Attempts at reorganization failed, it soon began its final liquidation of assets, and its last remaining stores closed their doors on September 18, 2011. What went wrong?

Sticking to what you know best can be dangerous. We’ve all heard the old adage: Focus on your “core competency” and don’t get distracted by trends or flashy ideas. Borders became a multibillion dollar business because of its physical retail presence. However, this approach also led to its demise.

Borders focused on its retail strategy in the 2000s, expanding aggressively in the United States and internationally—and taking on debt. It strove to improve the in-store experience for shoppers, added cafes, and experimented with new concepts. Such a strategy may have worked a few decades earlier, but while Borders was investing in physical real estate, shoppers were flocking to the Internet. Borders was left with a conflicted strategy: Declining sales forced it to close hundreds of stores (including its entire Waldenbooks chain), while it doubled down on other retail outlets.

Unfortunately, it treated the Internet like a passing trend instead of as a transformational phenomenon. The company outsourced its Web operation to Amazon—which obviously became a fierce rival. It waited until 2008 to develop its own Web strategy. Meanwhile, Amazon became the dominant player in online bookselling and e-books, introducing the Kindle e-reader. Its big brick-and-mortar rival, Barnes & Noble, a laggard itself, later introduced the popular Nook e-reader and invested heavily in its own website. Borders was clearly late to the party—by then it had taken on quite a bit of debt and had little to invest. In essence, it was forced to rely on third-party readers from Sony and Kobo, which made it impossible to distinguish its Web offerings.

During its last eleven years, Borders was led by six different CEOs. None were around long enough to make a lasting change or provide the vision that could maneuver the debt-laden company through a shifting landscape. To the end, it kept a traditional mindset—focusing on rivals with which it was most familiar. As the book industry continued to consolidate, this meant Barnes & Noble. However, discounters like Walmart and Target sell a ton of books—at big discounts—and their prices are usually matched by Amazon. Borders was faced with a dilemma: It could take the losses and match the discounters, or it could justify its higher prices by convincing customers that they'd enjoy a premium experience. Neither worked. As noted by Michael Souers, an analyst at Standard & Poor's: "They over-expanded and built up some debt on their balance sheet. Instead of leading and being innovative, they were certainly a follower."

A concluding note: Amazon continues to outdistance its rivals. Its sales have grown from \$25 billion to \$57 billion over the last three years. During the same period, Amazon's stock has soared over 100 percent, and its market capitalization stands at an impressive \$121 billion as of mid-2013. Jeff Bezos, Amazon's founder and CEO, can boast a net worth of over \$23.6 billion. In contrast, Borders is extinct.

Discussion Questions

1. What lessons can we learn from Borders' failure?
2. What was their most critical error? Why?
3. What could Best Buy, a firm now facing a powerful challenge from Amazon, learn from Borders?

The recent demise of Borders illustrates how even well-established firms can fail in the marketplace if they do not anticipate and respond proactively to changes in the environment. Today's leaders face a large number of complex challenges in the global marketplace. In considering how much credit (or blame) they deserve, two perspectives of leadership come immediately to mind: the "romantic" and "external control" perspectives.⁴ First, let's look at the **romantic view of leadership**. Here, the implicit assumption is that the leader is the key force in determining an organization's success—or lack thereof.⁵ This view dominates the popular press in business magazines such as *Fortune*, *BusinessWeek*, and *Forbes*, wherein the CEO is either lauded for his or her firm's success or chided for the organization's demise.⁶

romantic view of leadership

situations in which the leader is the key force determining the organization's success—or lack thereof.

Consider, for example, the credit that has been bestowed on leaders such as Jack Welch, Andrew Grove, and Herb Kelleher for the tremendous accomplishments when they led their firms, General Electric, Intel, and Southwest Airlines, respectively.

Similarly, Apple's success in the last decade has been attributed almost entirely to the late Steve Jobs, its former CEO, who died on October 5, 2011.⁷ Apple's string of hit products, such as iMac computers, iPods, iPhones, and iPads, are testament to his genius for developing innovative, user-friendly, and aesthetically pleasing products. In addition to being a perfectionist in product design, Jobs also was a master showman with a cult following. During his time as CEO between 1997 and 2011, Apple's market value soared by over \$300 billion!

On the other hand, when things don't go well, much of the failure of an organization can also, rightfully, be attributed to the leader.⁸ Borders's leadership clearly failed to respond effectively to changes taking place in the book retailing industry. In contrast, Apple fully capitalized on emerging technology trends with a variety of products, including sophisticated smartphones.

The contrasting fortunes of Hewlett-Packard under two different CEOs also demonstrate the influence leadership has on firm performance.⁹ When Carly Fiorina was fired as CEO of the firm, HP enjoyed an immediate increase in its stock price of 7 percent—hardly a strong endorsement of her leadership! Her successor, Mark Hurd, led the firm to five years of outstanding financial results. Interestingly, when he abruptly resigned on August 6, 2010, the firm's stock dropped 12 percent almost instantly! (To provide some perspective, this represents a decrease in HP's market value of about \$12 billion.) And, since Hurd's departure, HP's market capitalization has dropped about 80 percent—as of early 2013!

However, this reflects only part of the picture. Consider another perspective, called the **external control view of leadership**. Here, rather than making the implicit assumption that the leader is the most important factor in determining organizational outcomes, the focus is on external factors that may positively (or negatively) affect a firm's success. We don't have to look far to support this perspective. Developments in the general environment, such as economic downturns, governmental legislation, or an outbreak of major internal conflict or war, can greatly restrict the choices that are available to a firm's executives. Borders, as well as several other book retailers, found the consumer shift away from brick and mortar bookstores to online book buying (e.g., Amazon) and digital books an overwhelming environmental force against which they had few defenses.

Major unanticipated developments can often have very negative consequences for businesses regardless of how well formulated their strategies are.

Let's look at a few recent examples:¹⁰

- Hurricane Katrina in 2007 had a disastrous effect on businesses located along the Gulf Coast.
- The financial meltdown of 2008 and the resultant deep recession during the following two years forced once proud corporations like General Motors and Citigroup to ask for government bailouts. Others, such as Merrill Lynch and Washington Mutual, had to be acquired by other firms.
- In the aftermath of BP's disastrous oil well explosion on April 20, 2010, the fishing and tourism industries in the region suffered significant downturns. BP itself was forced to pay a \$20 billion fine to the U.S. government.
- On March 11, 2011, a 9.0 earthquake and tsunami devastated Japan and resulted in the loss of more than 20,000 lives. During the next two trading days, the country's stock exchange (Nikkei) suffered its biggest loss in 40 years. The disaster hit nearly every industry hard—especially energy companies. For example, Tokyo Electric Power Co., which operates a nuclear power plant that was severely damaged, fell 24.7 percent, and Toshiba Corp., a maker of nuclear power plants, slid 19.5 percent.

external control view of leadership

situations in which external forces—where the leader has limited influence—determine the organization's success.



ECONOMIC CRISIS IN EUROPE: THE FALLOUT CONTINUES

The European economic crisis increasingly appears to be an unending drama in slow motion. While finance ministers and central bankers propose and reject or implement and fail with one solution after another, unemployment keeps rising, banks falter, and public anger boils over. Greece is on the verge of a political and economic meltdown, Portugal and Spain are in prolonged recession, and Italy's problems now seem worse than anticipated. Only a decade ago, the 27-nation European Union, and the 17-nation Eurozone within that, was considered an economic powerhouse. Today, the very future of the Union and the Euro seems mired in uncertainty.

What are some of the implications of the economic crisis so far? First, it has led to widespread political protests. As governments like Portugal and Spain have been forced to cut government spending as part of the austerity programs they are implementing, public resentment has boiled over into often violent street protests. A public long used to generous welfare payments by the government finds it difficult to adjust to an environment without the safety nets that they have taken for granted for at least two generations. Second, political resentment has, in turn, led to changes in governments. In 2012, Francois Hollande was elected as president of France on a platform that threatened 75 percent taxes on the wealthy (which caused many prominent French citizens to change their citizenship!). Italy brought in Mario Monti, a seasoned economist, to lead the country out of the quagmire in place of the colorful, but highly controversial Silvio Berlusconi.

A major cause as well as consequence of the financial crisis has been the weakening of European banks, especially in countries such as Spain. As the real estate boom in Spain ended in an inevitable bust, banks found themselves holding too much real estate as collateral that did not cover the value of the loans. The resulting crisis of confidence in banks has forced the European Central Bank to pump in vast resources to prop up the tottering banks.

The joint effects of less government spending, inability of banks to lend, and civil unrest in various countries has been devastating on the employment situation in Europe. Spain currently has an unemployment rate of 24 percent. At the beginning of 2012, the under-25 unemployment rate in Spain stood at a staggering 51.4 percent. This compares to an overall unemployment rate of 7.9 percent in the United States as of early 2013—a rate that most Americans consider unacceptable. This certainly helps us to place the situation in perspective! The high unemployment rate among the youth has led to a number of social problems, such as increased crime rates, drug use, and depression. Because many young people in Europe do not expect the situation to improve in the foreseeable future, there has been a sudden increase in outward migration. Thousands of Portuguese youngsters, for example, have been migrating to their country's former colonies, such as Angola and Mozambique in Africa and Brazil in South America. One in ten college graduates now leave the country. In 2010 alone, the number of Portuguese workers in Brazil jumped by 60,000. Skilled Portuguese workers are also increasingly immigrating to countries such as the United States, Canada, and Australia. There are 50,000 Germans in Silicon Valley and over 500 start-ups in the San Francisco Bay area with French founders.

One industry that is feeling immense pain from the economic crisis is tourism. France, Spain, and Italy—the three biggest tourist destinations in Europe—have experienced double-digit declines in tourist arrivals and hotel occupancy rates in recent years. The tourism industry in France employs 900,000 people and generates \$96 billion in revenues. In Spain, the industry employs 1.4 million people and generates about \$110 billion in revenues. The decline in tourist arrivals has had a devastating effect on employment in tourism-related businesses such as hotels, restaurants, and travel.

Sources: Ash, L. 2011. Portugal's jobless graduates flee to Africa and Brazil. *bbc.co.uk*, August 31: np; Les miserables. 2012. *economist.com*, July 28, np; Clouds over the Mediterranean. 2012. *economist.com*, July 28: np; and Govan, F. 2012. Spain's lost generation: Youth unemployment surges above 50 percent. *telegraph.co.uk*, January 27: np.

Firms as diverse as Toyota, Honda, and Sony were forced to halt production because extensive damage to roads and distribution systems made it nearly impossible to move products.

The continuing economic in Europe has been a source of considerable uncertainty for firms doing business in Europe and throughout the world. Strategy Spotlight 1.1 discusses some of the causes and consequences of the ongoing European crisis.

Before moving on, it is important to point out that successful executives are often able to navigate around the difficult circumstances that they face. At times it can be refreshing to see the optimistic position they take when they encounter seemingly insurmountable odds. Of course, that's not to say that one should be naïve or Pollyannaish. Consider, for example, how one CEO is handling trying times:¹¹

Name a general economic woe, and chances are that Charles Needham, CEO of Metorex, is dealing with it.

- Market turmoil has knocked 80 percent off the shares of South Africa’s Metorex, the mining company that he heads.
- The plunge in global commodities is slamming prices for the copper, cobalt, and other minerals Metorex unearths across Africa. The credit crisis makes it harder to raise money.
- And fighting has again broken out in the Democratic Republic of Congo, where Metorex has a mine and several projects in development.

Such problems might send many executives to the window ledge. Yet Needham appears unruffled as he sits down at a conference table in the company’s modest offices in a Johannesburg suburb. The combat in northeast Congo, he notes, is far from Metorex’s mine. Commodity prices are still high, in historical terms. And Needham is confident he can raise enough capital, drawing on relationships with South African banks. “These are the kinds of things you deal with, doing business in Africa,” he says.

What Is Strategic Management?

Given the many challenges and opportunities in the global marketplace, today’s managers must do more than set long-term strategies and hope for the best.¹² They must go beyond what some have called “incremental management,” whereby they view their job as making a series of small, minor changes to improve the efficiency of their firm’s operations.¹³ Rather than seeing their role as merely custodians of the status quo, today’s leaders must be proactive, anticipate change, and continually refine and, when necessary, make dramatic changes to their strategies. The strategic management of the organization must become both a process and a way of thinking throughout the organization.

strategic management

the analyses, decisions, and actions an organization undertakes in order to create and sustain competitive advantages.

Defining Strategic Management

Strategic management consists of the analyses, decisions, and actions an organization undertakes in order to create and sustain competitive advantages. This definition captures two main elements that go to the heart of the field of strategic management.

First, the strategic management of an organization entails three ongoing processes: *analyses*, *decisions*, and *actions*. Strategic management is concerned with the *analysis* of strategic goals (vision, mission, and strategic objectives) along with the analysis of the internal and external environment of the organization. Next, leaders must make strategic decisions. These *decisions*, broadly speaking, address two basic questions: What industries should we compete in? How should we compete in those industries? These questions also often involve an organization’s domestic and international operations. And last are the *actions* that must be taken. Decisions are of little use, of course, unless they are acted on. Firms must take the necessary actions to implement their **strategies**. This requires leaders to allocate the necessary resources and to design the organization to bring the intended strategies to reality.

Second, the essence of strategic management is the study of why some firms outperform others.¹⁴ Thus, managers need to determine how a firm is to compete so that it can obtain advantages that are sustainable over a lengthy period of time. That means focusing on two fundamental questions:

- *How should we compete in order to create **competitive advantages** in the marketplace?* Managers need to determine if the firm should position itself as the low-cost producer or develop products and services that are unique and will enable the firm to charge premium prices. Or should they do some combination of both?
- *How can we create **competitive advantages** in the marketplace that are unique, valuable, and difficult for rivals to copy or substitute?* That is, managers need to make such advantages sustainable, instead of temporary.

L01.1

The definition of strategic management and its four key attributes.

strategy

The ideas, decisions, and actions that enable a firm to succeed.

competitive advantage

A firm’s resources and capabilities that enable it to overcome the competitive forces in its industry(ies).

operational effectiveness

performing similar activities better than rivals.

Sustainable competitive advantage cannot be achieved through operational effectiveness alone.¹⁵ The popular management innovations of the last two decades—total quality, just-in-time, benchmarking, business process reengineering, outsourcing—are all about operational effectiveness. **Operational effectiveness** means performing similar activities better than rivals. Each of these is important, but none lead to sustainable competitive advantage because everyone is doing them. Strategy is all about being different. Sustainable competitive advantage is possible only by performing different activities from rivals or performing similar activities in different ways. Companies such as Walmart, Southwest Airlines, and IKEA have developed unique, internally consistent, and difficult-to-imitate activity systems that have provided them with sustained competitive advantages. A company with a good strategy must make clear choices about what it wants to accomplish. Trying to do everything that your rivals do eventually leads to mutually destructive price competition, not long-term advantage.

The Four Key Attributes of Strategic Management

Before discussing the strategic management process, let's briefly talk about four attributes of strategic management.¹⁶ It should become clear how this course differs from other courses that you have had in functional areas, such as accounting, marketing, operations, and finance. Exhibit 1.1 provides a definition and the four attributes of strategic management.

First, strategic management is *directed toward overall organizational goals and objectives*. That is, effort must be directed at what is best for the total organization, not just a single functional area. Some authors have referred to this perspective as “organizational versus individual rationality.”¹⁷ That is, what might look “rational” or ideal for one functional area, such as operations, may not be in the best interest of the overall firm. For example, operations may decide to schedule long production runs of similar products to lower unit costs. However, the standardized output may be counter to what the marketing department needs to appeal to a demanding target market. Similarly, research and development may “overengineer” the product to develop a far superior offering, but the design may make the product so expensive that market demand is minimal.

Second, strategic management *includes multiple stakeholders in decision making*.¹⁸ **Stakeholders** are those individuals, groups, and organizations who have a “stake” in the success of the organization, including owners (shareholders in a publicly held corporation), employees, customers, suppliers, the community at large, and so on. (We'll discuss this in more detail later in this chapter.) Managers will not be successful if they focus on a single stakeholder. For example, if the overwhelming emphasis is on generating profits for the owners, employees may become alienated, customer service may suffer, and the suppliers may resent demands for pricing concessions.

Third, strategic management *requires incorporating both short-term and long-term perspectives*.¹⁹ Peter Senge, a leading strategic management author, has referred to this need as a “creative tension.”²⁰ That is, managers must maintain both a vision for the future of the organization as well as a focus on its present operating needs. However, financial

stakeholders

individuals, groups, and organizations who have a stake in the success of the organization, including owners (shareholders in a publicly held corporation), employees, customers, suppliers, and the community at large.

EXHIBIT 1.1

Strategic Management Concepts

Definition: Strategic management consists of the analyses, decisions, and actions an organization undertakes in order to create and sustain competitive advantages.

Key Attributes of Strategic Management

- Directs the organization toward overall goals and objectives.
- Includes multiple stakeholders in decision making.
- Needs to incorporate short-term and long-term perspectives.
- Recognizes trade-offs between efficiency and effectiveness.

markets can exert significant pressures on executives to meet short-term performance targets. Studies have shown that corporate leaders often take a short-term approach to the detriment of creating long-term shareholder value. Consider the following:

According to recent studies, only 59 percent of financial executives say they would pursue a positive net present value project if it meant missing the quarter's consensus earnings per-share estimate. Worse, 78 percent say they would sacrifice value—often a great deal of value—to smooth earnings. Similarly, managers are more likely to cut R&D to reverse an earning slide if a significant amount of the company's equity is owned by institutions with high portfolio turnover. Many companies have the same philosophy about long-term investments such as infrastructure and employee training.²¹

Fourth, strategic management *involves the recognition of trade-offs between effectiveness and efficiency*. Some authors have referred to this as the difference between “doing the right thing” (**effectiveness**) and “doing things right” (**efficiency**).²² While managers must allocate and use resources wisely, they must still direct their efforts toward the attainment of overall organizational objectives. Managers who only focus on meeting short-term budgets and targets may fail to attain the broader goals. Consider the following amusing story told by Norman Augustine, former CEO of defense giant Martin Marietta (now Lockheed Martin):

I am reminded of an article I once read in a British newspaper which described a problem with the local bus service between the towns of Bagnall and Greenfields. It seemed that, to the great annoyance of customers, drivers had been passing long queues of would-be passengers with a smile and a wave of the hand. This practice was, however, clarified by a bus company official who explained, “It is impossible for the drivers to keep their timetables if they must stop for passengers.”²³

Clearly, the drivers who were trying to stay on schedule had ignored the overall mission. As Augustine noted, “Impeccable logic but something seems to be missing!”

Successful managers must make many trade-offs. It is central to the practice of strategic management. At times, managers must focus on the short term and efficiency; at other times the emphasis is on the long term and expanding a firm's product-market scope in order to anticipate opportunities in the competitive environment. For example, consider Kevin Sharer's perspective. He is CEO of Amgen, the giant \$17 billion biotechnology firm:

A CEO must always be switching between what I call different altitudes—tasks of different levels of abstraction and specificity. At the highest altitude you're asking the big questions: What are the company's mission and strategy? Do people understand and believe in these aims? Are decisions consistent with them? At the lowest altitude, you're looking at on-the-ground operations: Did we make that sale? What was the yield on that last lot in the factory? How many days of inventory do we have for a particular drug? And then there's everything in between: How many chemists do we need to hire this quarter? What should we pay for a small biotech company that has a promising new drug? Is our production capacity adequate to roll out a product in a new market?²⁴

Some authors have developed the concept of “**ambidexterity**” which refers to a manager's challenge to both align resources to take advantage of existing product markets as well as proactively explore new opportunities.²⁵ Strategy Spotlight 1.2 discusses ambidextrous behaviors that are required for success in today's challenging marketplace.

The Strategic Management Process

We've identified three ongoing processes—analyses, decisions, and actions—that are central to strategic management. In practice, these three processes—often referred to as strategy analysis, strategy formulation, and strategy implementation—are highly interdependent and do not take place one after the other in a sequential fashion in most companies.

effectiveness

tailoring actions to the needs of an organization rather than wasting effort, or “doing the right thing.”

efficiency

performing actions at a low cost relative to a benchmark, or “doing things right.”

ambidexterity

the challenge managers face of both aligning resources to take advantage of existing product markets as well as proactively exploring new opportunities.

strategic management process

strategy analysis, strategy formulation, and strategy implementation

L01.2

The strategic management process and its three interrelated and principal activities.