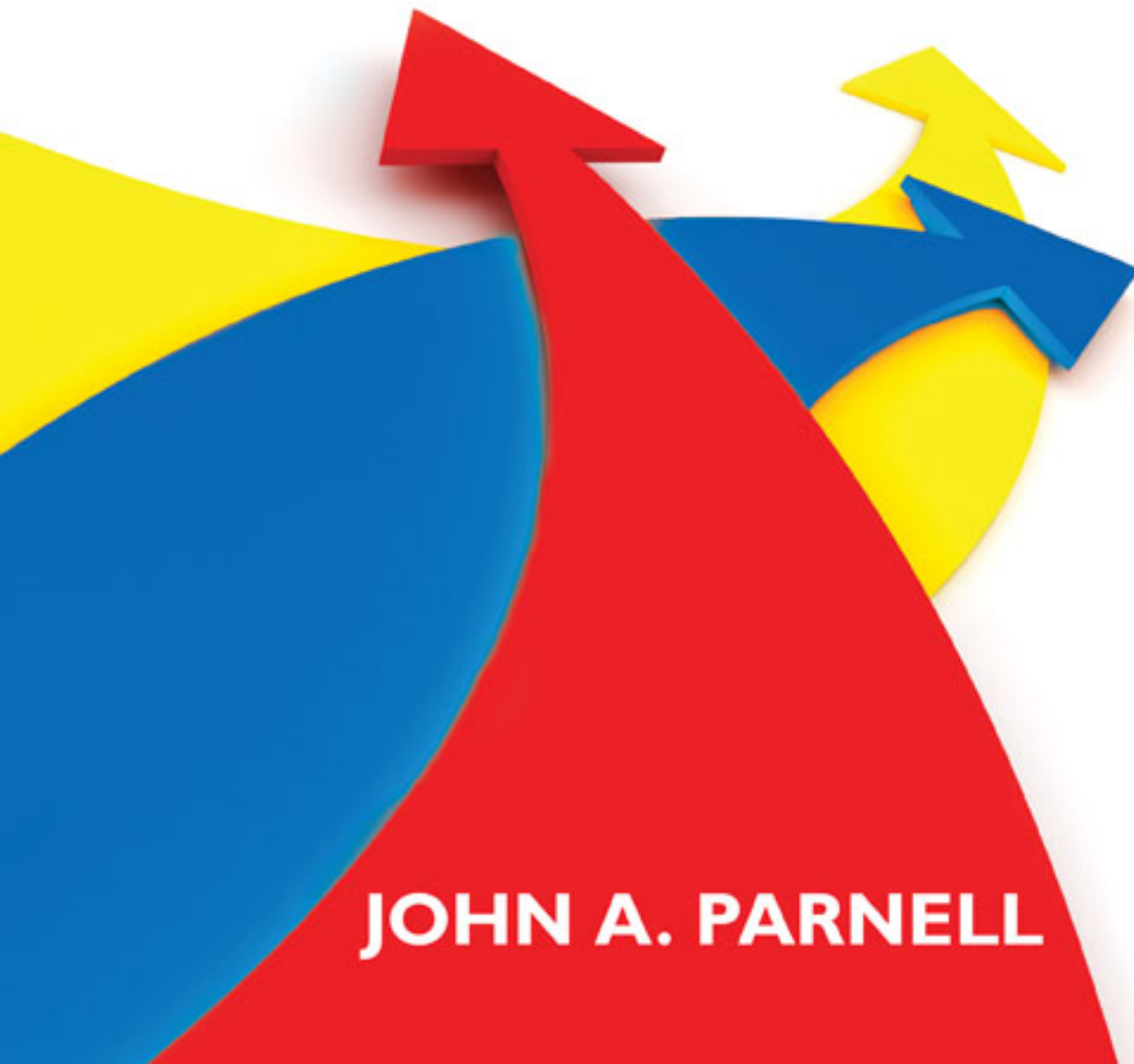


4^{EDITION}

STRATEGIC MANAGEMENT

Theory and Practice



JOHN A. PARNELL



4^{EDITION}

STRATEGIC
M A N A G E M E N T

4^{EDITION}

STRATEGIC MANAGEMENT

Theory and Practice

JOHN A. PARNELL

University of North Carolina, Pembroke

 SAGE

Los Angeles | London | New Delhi
Singapore | Washington DC



Los Angeles | London | New Delhi
Singapore | Washington DC

FOR INFORMATION:

SAGE Publications, Inc.

2455 Teller Road

Thousand Oaks, California 91320

E-mail: order@sagepub.com

SAGE Publications Ltd.

1 Oliver's Yard

55 City Road

London EC1Y 1SP

United Kingdom

SAGE Publications India Pvt. Ltd.

B 1/1 Mohan Cooperative Industrial Area

Mathura Road, New Delhi 110 044

India

SAGE Publications Asia-Pacific Pte. Ltd.

3 Church Street

#10-04 Samsung Hub

Singapore 049483

Acquisitions Editor: Patricia Quinlin

Associate Editor: Maggie Stanley

Assistant Editor: Megan Koraly

Editorial Assistant: Katie Guarino

Production Editor: Laureen Gleason

Copy Editor: Megan Markanich

Typesetter: C&M Digitals (P) Ltd.

Proofreader: Jen Grubba

Indexer: Wendy Allex

Cover Designer: Anupama Krishnan

Marketing Manager: Liz Thornton

Permissions Editor: Jennifer Barron

Copyright © 2014 by SAGE Publications, Inc.

All rights reserved. No part of this book may be reproduced or utilized in any form or by any means, electronic or mechanical, including photocopying, recording, or by any information storage and retrieval system, without permission in writing from the publisher.

Photo credits (listed by page number): xx: © Can Stock Photo Inc. / vally_home. 11: Comstock/Comstock/Thinkstock. 12: Protodisc/Photodisc/Thinkstock. 26: Jupiterimages/Comstock/Thinkstock. 31: BananaStock/BananaStock/Thinkstock. 39: Comstock/Comstock/Thinkstock. 41: Thomas Northcut/Digital Vision/Thinkstock. 52: Jupiterimages/Photos.com/Thinkstock. 55: Comstock/Comstock/Thinkstock. 57: Brand X Pictures/Brand X Pictures/Thinkstock. 62: Creatas Images/Creatas/Thinkstock. 68: Brand X Pictures/Brand X Pictures/Thinkstock. 78: Comstock Images/Comstock/Thinkstock. 83: Comstock/Comstock/Thinkstock. 86: Stockbyte/Stockbyte/Thinkstock. 90: Jeffrey Hamilton/Lifesize/Thinkstock. 92: Comstock/Comstock/Thinkstock. 116: George Doyle/Stockbyte/Thinkstock. 121: Hemera Technologies/Photos.com/Thinkstock. 123: Darrin Klimek/Digital Vision/Thinkstock. 132: Comstock/Comstock/Thinkstock. 133: Thinkstock/Comstock/Thinkstock. 150: ©iStockphoto.com/mediaphotos. 166: Goodshot/Goodshot/Thinkstock. 168: Brand X Pictures/Brand X Pictures/Thinkstock. 182: Siri Stafford/Lifesize/Thinkstock. 189: Brand X Pictures/Brand X Pictures/Thinkstock. 195: Ablestock.com/Ablestock.com/Thinkstock. 218: © Sam Robinson/Digital Vision/Thinkstock. 222 (top): RyanMcVay/Photodisc/Thinkstock. 222 (bottom): Thinkstock/Comstock/Thinkstock. 224: Jupiterimages/Comstock/Thinkstock. 228: Comstock/Comstock/Thinkstock. 232: Felipe Dupouy/Lifesize/Thinkstock. 246: Mike Powell/Digital Vision/Thinkstock. 247: Comstock/Comstock/Thinkstock. 255: Comstock/Comstock/Thinkstock. 270: iStockphoto/Thinkstock. 273: RyanMcVay/Photodisc/Thinkstock. 292: ©iStockphoto.com/Marcus Clackson. 296: DigitalVision/DigitalVision/Thinkstock. 300 (top): RyanMcVay/Lifesize/Thinkstock. 300 (bottom): Comstock/Comstock/Thinkstock. 326: © Can Stock Photo Inc./flickr. 335: Jupiterimages/Goodshot/Thinkstock. 336: Stockbyte/Stockbyte/Thinkstock.

Strategy + Business reading credits (listed by chapter): Chapter 1: "The China Challenge" by Edward Tse reprinted with permission from the Spring 2010 issue of *strategy+business* magazine, published by Booz & Company Inc., based on the book *The China Strategy*, published by Basic Books. Copyright © 2010. All rights reserved. www.strategy-business.com. Chapter 2: "Focus and Scale on the Internet" by Tim Laseter reprinted with permission from the Summer 2011 issue of *strategy+business*, published by Booz & Company Inc. Copyright © 2011. All rights reserved. www.strategy-business.com. Chapter 3: "Competing for the Global Middle Class" by Edward Tse, Bill Russo, and Ronald Haddock, reprinted with permission from the Autumn 2011 issue of *strategy+business* magazine, published by Booz & Company Inc. Copyright © 2011. All rights reserved. www.strategy-business.com. Chapter 4: "The Rise of Generation C" by Roman Friedrich, Michael Peterson and Alex Koster reprinted with permission from the Spring 2011 issue of *strategy+business* magazine, published by Booz & Company Inc. Copyright © 2011. All rights reserved. www.strategy-business.com. Chapter 5: "Values vs. Value" by Timothy Devinney, Pat Auger, and Giana M. Eckhardt reprinted with permission from the Spring 2011 issue of *strategy+business* magazine, published by Booz & Company Inc. Copyright © 2011. All rights reserved. www.strategy-business.com. Chapter 6: "The Unique Advantage," by Alexander Kandybin and Surbhee Grover reprinted with permission from the Autumn 2008 issue of *strategy+business*, published by Booz & Company Inc. Copyright © 2008. All rights reserved. www.strategy-business.com. Chapter 7: "Growth through Focus: A Blueprint for Driving Profitable Expansion" by Sanjay Khosla and Mohanbir Sawhney reprinted with permission from the Summer 2010 issue of *strategy+business* magazine, published by Booz & Company Inc. Copyright © 2010. All rights reserved. www.strategy-business.com. Chapter 8: "The Power of the Post-Recession Consumer" by John Gerzema and Michael D'Antonio reprinted with permission from the Spring 2011 issue of *strategy+business* magazine, published by Booz & Company Inc. Copyright © 2011. All rights reserved. www.strategy-business.com. Chapter 9: "10 Clues to Opportunity" by Donald Sull reprinted with permission from the Autumn 2011 issue of *strategy+business*, published by Booz & Company Inc. Copyright © 2011. All rights reserved. www.strategy-business.com. Chapter 10: "Design for Frugal Growth" by Jaya Pandrangi, Steffen Lauster, and Gary L. Neilson reprinted with permission from the Autumn 2008 issue of *strategy+business* magazine, published by Booz & Company Inc. Copyright © 2008. All rights reserved. www.strategy-business.com. Chapter 11: "CEO Succession 2010: The Four Types of CEOs" by Ken Favaro, Per-Ola Karlsson, and Gary L. Neilson reprinted with permission from the Summer 2011 issue of *strategy+business* magazine, published by Booz & Company Inc. Copyright © 2011. All rights reserved. www.strategy-business.com. Chapter 12: "How to Prevent Self-Inflicted Disasters" by Eric Kronenberg reprinted with permission from the *strategy+business* website, published by Booz & Company Inc. (<http://www.strategy-business.com/article/00086>) Copyright © 2011. All rights reserved. www.strategy-business.com.

Traditional case credits (listed by number): Case 1, Case 6, Case 7, Case 11: Reprinted with permission from the Society for Case Research. Case 2, Case 8, Case 9: Reprinted with permission from Rebecca Treadway. Case 3, Case 4: Reprinted with permission from Sue Cullers. Case 5: Reprinted with permission from Neilson Publishers. Case 10: Reprinted with permission from Marlene Reed.

Printed in the United States of America

Library of Congress Cataloging-in-Publication Data

Parnell, John A. (John Alan), 1964-

Strategic management : theory and practice / John A. Parnell. — 4th ed.

p. cm.

Includes bibliographical references and index.

ISBN 978-1-4522-3498-4 (pbk.)

1. Strategic planning. 2. Industrial management. 3. Organizational effectiveness. I. Title.

HD30.28.P316 2014

658.4'012—dc23 2012032644

This book is printed on acid-free paper.

Brief Contents

Preface	xv
About the Author	xix
1. Fundamentals of Strategic Management	1
2. Industry Competition	27
3. The External Environment: Political-Legal and Economic Forces	53
4. The External Environment: Social and Technological Forces	79
5. The Organization: Ethics and Corporate Social Responsibility	117
6. Corporate-Level Strategies	151
7. Business Unit Strategies	183
8. Functional Strategies	219
9. Strategy Formulation	247
10. Strategy Execution: Structure	271
11. Strategy Execution: Strategic Change, Culture, and Leadership	293
12. Strategic Control and Crisis Management	327
Appendix	353
Case Analysis	354
Real-Time Cases	361
Traditional Cases	395
Glossary	611
Index	621

Detailed Contents

Preface	xv
Description of Text	xv
Key Features	xvi
What's New in This Edition	xvi
Ancillaries	xvii
Acknowledgments	xviii

About the Author **xix**

1. Fundamentals of Strategic Management **1**

What Is Strategic Management?	1
<i>Intended and Realized Strategies</i>	4
<i>Scientific and Artistic Perspectives on Strategic Management</i>	5
Influence on Strategic Management	6
Corporate Governance and Boards of Directors	7
Strategic Decisions	10
The Global Imperative	12
Summary	13
Key Terms	13
Review Questions and Exercises	14
Practice Quiz	14
<i>True or False?</i>	14
<i>Multiple Choice</i>	15
Student Study Site	15
Notes	16
STRATEGY + BUSINESS READING: THE CHINA CHALLENGE	18

2. Industry Competition **27**

Industry Life Cycle Stages	30
Industry Structure	32
Intensity of Rivalry Among Incumbent Firms	32
<i>Concentration of Competitors</i>	34
<i>High Fixed or Storage Costs</i>	35
<i>Slow Industry Growth</i>	35
<i>Lack of Differentiation or Low Switching Costs</i>	35
<i>Capacity Augmented in Large Increments</i>	36
<i>Diversity of Competitors</i>	36

<i>High Strategic Stakes</i>	36
<i>High Exit Barriers</i>	36
Threat of Entry	37
<i>Economies of Scale</i>	38
<i>Brand Identity and Product Differentiation</i>	38
<i>Capital Requirements</i>	39
<i>Switching Costs</i>	39
<i>Access to Distribution Channels</i>	39
<i>Cost Advantages Independent of Size</i>	39
<i>Government Policy</i>	39
Pressure From Substitute Products	40
Bargaining Power of Buyers	40
Bargaining Power of Suppliers	41
Limitations of Porter's Five Forces Model	42
Summary	43
Key Terms	43
Review Questions and Exercises	44
Practice Quiz	44
<i>True or False?</i>	44
<i>Multiple Choice</i>	45
Student Study Site	45
Notes	46
STRATEGY + BUSINESS READING: FOCUS AND SCALE ON THE INTERNET	47

3. The External Environment: Political-Legal and Economic Forces

53

Analysis of the External Environment	53
Political-Legal Forces	54
<i>Global Considerations</i>	60
Economic Forces	63
<i>Gross Domestic Product</i>	64
<i>Inflation Rates</i>	66
<i>Interest Rates</i>	66
<i>Exchange Rates</i>	66
<i>Ecological Influences</i>	67
Summary	69
Key Terms	69
Review Questions and Exercises	69
Practice Quiz	69
<i>True or False?</i>	69
<i>Multiple Choice</i>	70
Student Study Site	70
Notes	71
STRATEGY + BUSINESS READING: COMPETING FOR THE GLOBAL MIDDLE CLASS	73

4. The External Environment: Social and Technological Forces

79

Social Forces	79
<i>Case #1: Eating Habits</i>	83

<i>Case #2: Automobiles</i>	86
<i>Global Concerns</i>	88
Technological Forces	90
The Internet	92
Strategic Dimensions of the Internet	96
<i>Movement Toward Information Symmetry</i>	96
<i>Internet as Distribution Channel</i>	97
<i>Speed</i>	97
<i>Interactivity</i>	97
<i>Potential for Cost Reductions and Cost Shifting</i>	97
Forms of Electronic Commerce	98
<i>Business-to-Business</i>	98
<i>Business-to-Consumer</i>	98
<i>Business-to-Government</i>	99
<i>Consumer-to-Consumer</i>	99
<i>Consumer-to-Business</i>	99
Commoditization and Mass Customization	99
Environmental Scanning	100
Summary	102
Key Terms	102
Review Questions and Exercises	103
Practice Quiz	103
<i>True or False?</i>	103
<i>Multiple Choice</i>	103
Student Study Site	104
Notes	104
STRATEGY + BUSINESS READING: THE RISE OF GENERATION C	108

5. The Organization: Ethics and Corporate Social Responsibility

117

Organizational Direction: Mission, Goals, and Objectives	118
<i>Goals and Stakeholders</i>	118
The Agency Problem	120
<i>Management Serves Its Own Interests</i>	120
<i>Management and Stockholders Share the Same Interests</i>	122
Managerial Ethics	123
<i>Perspectives on Ethics</i>	126
Social Responsibility	129
<i>Corporate Social Responsibility in Practical Terms</i>	132
<i>Sustainable Strategic Management</i>	135
Takeovers	135
Outsourcing and Offshoring	136
Linking Managerial Ethics and Corporate Social Responsibility	139
Summary	140
Key Terms	140
Review Questions and Exercises	141
Practice Quiz	141

<i>True or False?</i>	141
<i>Multiple Choice</i>	142
Student Study Site	143
Notes	143
STRATEGY + BUSINESS READING: VALUES VS. VALUE	146

6. Corporate-Level Strategies 151

The Corporate Profile	151
Strategic Alternatives at the Corporate Level	153
Growth Strategies	153
<i>Horizontal (Related) Integration</i>	156
<i>Horizontal (Related) Diversification</i>	156
<i>Conglomerate (Unrelated) Diversification</i>	157
<i>Vertical Integration</i>	157
<i>Strategic Alliances (Partnerships)</i>	157
Stability Strategy	159
Retrenchment Strategies	161
<i>Turnaround</i>	161
<i>Divestment</i>	163
<i>Liquidation</i>	163
Boston Consulting Group Growth-Share Matrix	163
Global Corporate Strategy	166
<i>Wal-Mart Abroad</i>	168
<i>Global Orientation Assessment</i>	169
Summary	170
Key Terms	170
Review Questions and Exercises	172
Practice Quiz	172
<i>True or False?</i>	172
<i>Multiple Choice</i>	172
Student Study Site	173
Notes	173
STRATEGY + BUSINESS READING: THE UNIQUE ADVANTAGE	176

7. Business Unit Strategies 183

Porter's Generic Strategies	184
<i>Low-Cost (Cost Leadership) Strategy (Without Focus)</i>	185
<i>Focus-Low-Cost Strategy</i>	187
<i>Differentiation Strategy (Without Focus)</i>	188
<i>Focus-Differentiation Strategy</i>	190
<i>Low-Cost-Differentiation Strategy</i>	191
<i>Focus-Low-Cost-Differentiation Strategy</i>	195
<i>Multiple Strategies</i>	195
The Miles and Snow Strategy Framework	196
Business Size, Strategy, and Performance	197
Assessing Strategies	198
Global Concerns	199
Summary	202

Key Terms	203
Review Questions and Exercises	204
Practice Quiz	204
<i>True or False?</i>	204
<i>Multiple Choice</i>	204
Student Study Site	205
Notes	205
STRATEGY + BUSINESS READING: GROWTH THROUGH FOCUS: A BLUEPRINT FOR DRIVING PROFITABLE EXPANSION	208

8. Functional Strategies 219

Marketing	221
<i>Pricing Strategies</i>	221
<i>Promotion Strategies</i>	222
<i>Product/Service Strategies</i>	222
<i>Place (Distribution) Strategies</i>	224
Finance	225
Production	227
<i>Quality Considerations</i>	228
<i>Research and Development</i>	229
Purchasing	230
Human Resources	231
<i>Human Capital and Knowledge Management</i>	233
<i>Knowledge and Competitive Advantage</i>	234
Information Systems Management	234
Functional Strategies and Industry Life Cycle	235
Summary	236
Key Terms	236
Review Questions and Exercises	237
Practice Quiz	237
<i>True or False?</i>	237
<i>Multiple Choice</i>	238
Student Study Site	238
Notes	239
STRATEGY + BUSINESS READING: THE POWER OF THE POST-RECESSION CONSUMER	241

9. Strategy Formulation 247

Strengths and Weaknesses	247
Human Resources	248
<i>Board of Directors</i>	249
<i>Top Management</i>	249
<i>Middle Management, Supervisors, and Employees</i>	250
Organizational Resources	250
Physical Resources	251
Opportunities and Threats	254
SW/OT Matrix	255

Issues in Strategy Formulation	260
<i>Evaluating Strategic Change</i>	260
<i>Strategy, Corporate Social Responsibility, and Managerial Ethics</i>	262
<i>Effects on Organizational Resources</i>	262
<i>Anticipated Responses From Competitors and Customers</i>	262
Summary	263
Key Terms	263
Review Questions and Exercises	264
Practice Quiz	264
<i>True or False?</i>	264
<i>Multiple Choice</i>	265
Student Study Site	266
Notes	266
STRATEGY + BUSINESS READING: 10 CLUES TO OPPORTUNITY	267

10. Strategy Execution: Structure

271

Organizational Structure	271
<i>Vertical Growth</i>	273
<i>Horizontal Growth</i>	274
Structural Forms	275
<i>Functional Structure</i>	275
<i>Product Divisional Structure</i>	276
<i>Geographic Divisional Structure</i>	277
<i>Matrix Structure</i>	278
<i>Assessing Organizational Structure</i>	279
Corporate Involvement in Business Unit Operations	281
Corporate Restructuring	282
Summary	282
Key Terms	283
Review Questions and Exercises	283
Practice Quiz	284
<i>True or False?</i>	284
<i>Multiple Choice</i>	284
Student Study Site	285
Notes	285
STRATEGY + BUSINESS READING:	
DESIGN FOR FRUGAL GROWTH	286

11. Strategy Execution: Strategic Change, Culture, and Leadership

293

Organizational Culture and Strategy	295
<i>Cultural Strength and Diversity</i>	297
<i>Shaping the Culture</i>	298
<i>Global Concerns</i>	298
Strategic Leadership	299
<i>Leadership Style</i>	300
Executing Strategic Change	303

<i>Recognize the Need for Change</i>	304
<i>Create a Shared Vision</i>	304
<i>Institutionalize the Change</i>	304
Summary	306
Key Terms	306
Review Questions and Exercises	307
Practice Quiz	307
<i>True or False?</i>	307
<i>Multiple Choice</i>	307
Student Study Site	308
Notes	308

**STRATEGY + BUSINESS READING: CEO SUCCESSION 2010:
THE FOUR TYPES OF CEOs 311**

12. Strategic Control and Crisis Management

327

Step 1: The Focus of Strategic Control	328
Step 2: Strategic Control Standards (Benchmarks)	329
<i>Published Information for Strategic Control</i>	330
<i>Product/Service Quality</i>	330
<i>Innovation</i>	331
<i>Market Share and Relative Market Share</i>	331
Steps 3 Through 5: Exerting Strategic Control	332
<i>Control Through the Formal and Informal Organizations</i>	333
Crisis Management	334
<i>Prominent Crises in Recent History</i>	336
<i>Crisis Planning</i>	339
Trends in Strategic Management	341
Summary	342
Key Terms	342
Review Questions and Exercises	342
Practice Quiz	343
<i>True or False?</i>	343
<i>Multiple Choice</i>	343
Student Study Site	344
Notes	344

STRATEGY + BUSINESS READING: HOW TO PREVENT SELF-INFLICTED DISASTERS 347

Appendix 353

Case Analysis 354

Real-Time Cases 361

Case 1: Allstate	361
Case 2: Amazon.com	362
Case 3: American Express	363
Case 4: Anheuser-Busch InBev	364
Case 5: AutoZone	366
Case 6: Avon	366
Case 7: Bank of America	368

Case 8: Bed Bath & Beyond	369
Case 9: Stanley Black & Decker	370
Case 10: Cici's Pizza	371
Case 11: Costco	372
Case 12: Dell	373
Case 13: Delta Air Lines	374
Case 14: Dollar Tree	375
Case 15: FedEx	376
Case 16: Ford	377
Case 17: Home Depot	378
Case 18: International Paper	379
Case 19: Jack in the Box	380
Case 20: Kroger	382
Case 21: Lands' End	382
Case 22: Mattel	384
Case 23: Nike	385
Case 24: Papa John's	386
Case 25: Pfizer	387
Case 26: Southwest Airlines	388
Case 27: Starbucks	389
Case 28: Walgreens	391
Case 29: Wal-Mart	392
Case 30: Yum! Brands	393

Traditional Cases **395**

Case 1: Bob's Supermarket: Competing With the Big Boys	395
Case 2: Costco: Maximum Employee Benefits or Maximum Shareholder Return?	407
Case 3: Dollar General—Today's Neighborhood Store	422
Case 4: Family Dollar Stores	448
Case 5: General Electric: Ecomagination as a CSR Initiative	476
Case 6: Kapa, New Zealand: Eat Your Greens!	484
Case 7: Kodak's Challenge: Surviving the Disruptive "Winds of Change"	499
Case 8: Macy's, Inc. 2010: Could Macy's Bring Back the Magic?	518
Case 9: Netflix: Entering, Engaging, and Embracing Innovation in the Movie Rental Industry	539
Case 10: Skoda Auto—2011	552
Case 11: Staples—Pantaloen Retail Limited Tie-Up: Going for Growth in India's Modern Retail Market	563
Case 12: Hitting the Brakes: Toyota in Crisis	593

Glossary **611**

Index **621**

Preface

Description of Text

The challenge to lead an organization has never been more demanding. The impact of the global financial crisis of 2008 has lingered well into the 2010s. Ethical crises have plagued a number of well-known companies during this time as well. As a result, the stature of business organizations—particularly large, corporate entities—has declined with consumers demanding greater trust and responsiveness. Firms are expected to both generate satisfactory profits and pursue elusive social objectives in an environment marked by increasing government regulation. Managing organizations is complex, challenging, and fraught with uncertainty.

Executives and managers at all levels must think strategically and leverage firms resources so effectively. This text draws from all functional areas of business and presents a cohesive strategic management model from a top-level strategic perspective. It is most useful for students with backgrounds in related fields such as management, marketing, finance, accounting, and economics.

Unlike many other books on strategic management, the text is organized sequentially around the strategic management process. Readers begin with an assessment of the external environment, including industry, political-legal, economic, social, and technological influences on the organization. Within this context, they shift to internal considerations and evaluate the appropriateness of such factors as the mission, ethics, and social responsibility. Armed with a solid understanding of external and internal factors, they consider the content of various strategies at the corporate, business, and functional levels and proceed to formulate the strategy for the organization. Formal and informal influences on strategy execution are evaluated. The text closes with strategic control and a discussion on crisis management, a topic of keen interest in today's fast-paced business world. The chapters are outlined as follows:

- Foundation (Chapter 1)
- External Environment (Chapters 2–4)
- Internal Environment (Chapter 5)
- Fundamentals of Strategy (Chapters 6–8)
- Strategy Formulation (Chapter 9)
- Strategy Execution (Chapter 10–11)
- Strategic Control and Crisis Management (Chapter 12)
- Case Studies

Global issues are addressed in the various chapters, not as a separate concern. These include the nature of global competition and strategic issues like outsourcing and offshoring. The influence of emerging markets such as the BRIC (Brazil, Russia, India, and China) nations is addressed throughout the book. Global icons in the margins alert the reader to these discussions.

Numerous examples—many from the *Wall Street Journal*—are integrated in the chapters as well. This process orientation is augmented with a strong chapter on ethics and social responsibility *before* strategy content is addressed.

Key Features

This book is also distinguished from its peers in that the strategic analysis of a firm (i.e., a case analysis) is viewed as inseparable from the concepts presented in the chapters. As such, the 25 key questions that should be answered as part of a strategic analysis are presented in Case Analysis boxes throughout the text alongside the relevant theory.

Strategy at Work boxes provide examples of concepts introduced in the text. They focus on one or several firms and provide sufficient details to promote class discussion as well.

Strategy + Business Readings are included at the end of each chapter. These provide advanced and detailed discussions of select topics in the chapters.

End of chapter features such as Key Terms, Review Questions and Exercises, Practice Quiz, and Student Study Site provide students with the opportunity to apply concepts they have read about in the chapter. These sections are especially helpful as students prepare for lectures and exams.

Real-Time Cases are brief narratives of well-known firms. They can be used as a starting point for team case projects—as updated information is readily available on the Internet. Alternatively, they can be used as the basis for class discussion, particularly as it relates to analyzing cases.

Traditional Cases are full-length cases that feature small, private, and international enterprises. Although additional research is optional, these cases are self-contained. They can be used for term projects or daily discussions, giving instructors a broader range of assignment options.

The text is also very readable. It provides a comprehensive presentation of current strategic management thinking in a clear and succinct format. This approach enables the professor to cover the entire book in a typical capstone business course while retaining valuable course time for case projects, simulations, discussion of real-time strategic issues, and other activities.

What's New in This Edition

The fourth edition uses the same strategic management model presented in the previous edition though minor enhancements have been made. The integration of new concepts and the enhancement of existing ones can be seen throughout the chapters, including a large number of global strategy references and a chapter devoted entirely to ethics and social responsibility.

Specifically, key changes to the fourth edition include the following:

- Coverage of ethics and social responsibility has been expanded and integrated with other topics related to organizational direction in Chapter 5.
- Coverage of the external environment has been expanded into two chapters. Chapter 3 explores political, legal, and economic forces while Chapter 4 discusses social and technological forces.

- A large number of recent examples have been added. Many of these address the effects of social, technological, and other external forces on firm performance. Others highlight the success and failure of specific firms.
- A new section on emerging trends in Chapter 12 integrates key topics in the text along the themes of global competitiveness, the Internet, sustainability, strategic complexity, and crisis management.
- This edition features 11 new Traditional Cases. Real-Time Cases have been updated as well.
- References have been completely updated, and a large number of new global references have been added to this edition.

Ancillaries

The password-protected Instructor Teaching Site at www.sagepub.com/parnell4e gives instructors access to a full complement of resources to support and enhance their course. The following assets are available on the site:

- *Test bank*: This Word test bank offers a diverse set of test questions and answers for each chapter of the book. Multiple-choice, true or false, short-answer, and essay questions for every chapter help instructors assess students' progress and understanding.
- *PowerPoint slides*: Chapter-specific slide presentations offer assistance with lecture and review preparation by highlighting essential content, features, and artwork from the book.
- *Sample syllabi*: Two sample syllabi—for a semester and a quarter-length class—are provided to help professors structure their courses.
- *Discussion questions*: Chapter-specific questions help launch discussion by prompting students to engage with the material and by reinforcing important content.
- *SAGE journal articles*: Links to full-text SAGE journal articles provide opportunity for further study in key subject areas.
- *Web resources*: These links to relevant websites direct both instructors and students to additional resources for further research on important chapter topics.

The open-access Student Study Site—available at www.sagepub.com/parnell4e—is designed to maximize student comprehension of the material and to promote critical thinking and application. The following resources and study tools are available on the student portion of the book's website:

- *Answers to end-of-chapter quizzes*: Full answers to each chapter quiz are provided on the Student Study Site.
- *SAGE journal articles*: Links to full-text SAGE journal articles provide opportunity for further study in key subject areas.
- *Web resources*: These links to relevant websites direct both instructors and students to additional resources for further research on important chapter topics.
- *E-flashcards*: These study tools reinforce students' understanding of key terms and concepts that have been outlined in the chapters.
- *Web quizzes*: Flexible self-quizzes allow students to independently assess their progress in learning course material.

Acknowledgments

SAGE and the author gratefully acknowledge the contributions of the following reviewers: Kristin Backhaus, State University of New York at New Paltz; Thomas M. Box, Pittsburg State University; Jacalyn M. Flom, The University of Toledo; John M. Guarino, Averett University; Keith Harman, Oklahoma Baptist University; Maureen S. Heaphy, Ferris State University; Mazhar Islam, Drexel University; Sonya B. Merrill, Towson University; David Olson, California State University Bakersfield; Vasu Ramanujam, Case Western Reserve University; E. Kevin Renshler, Florida Southern College; Peter Schneider, College of Saint Elizabeth; Jeffrey Slattery, Regent University; David L. Sturges, The University of Texas-Pan American; James L. Whitney, Champlain College; and Gregory F. Zerovnik, Touro University Worldwide.

About the Author

Dr. John A. Parnell currently serves as the William Henry Belk Distinguished Professor of Management at the University of North Carolina at Pembroke. He completed the BSBA, MBA, and MA Ed degree from East Carolina University, the EdD degree from Campbell University, and the PhD degree from the University of Memphis. His academic career includes a number of institutions, including service as professor and head of the Department of Marketing & Management at Texas A&M University-Commerce. He received the H. M. Lafferty Distinguished Faculty Award at Texas A&M-Commerce in 2002, the Adolph Dial Award for Scholarly & Creative Activity at UNC-Pembroke in 2005, and the Pope Center Spirit of Inquiry Award in 2011.

Dr. Parnell is a recognized authority in the field, having published more than 200 articles, cases, proceedings, books, and book chapters in strategic management and related fields. Recent work appears in leading journals such as *Academy of Management Learning and Education*, *Management Decision*, and the *British Journal of Management*. He serves on a number of academic journal editorial boards and consults with select firms in the area of strategic planning. He has also appeared frequently as a guest discussing issues related to business and competitiveness on Sirius XM's The Wilkow Majority.

Dr. Parnell has lectured at a number of institutions abroad, including Instituto Tecnológico Y De Estudios Superiores De Monterrey-Campus Estado de Mexico (ITESM-CEM), Chung Yuan Christian University in Taiwan, and China University of Geosciences in Beijing. He also served as a Fulbright Scholar in Cairo, Egypt, in 1995.

strategy
a strategic
strategy
ure, °schem
scenario:

Chapter Outline

What Is Strategic Management?

Intended and Realized Strategies

Scientific and Artistic Perspectives on Strategic Management

Influence on Strategic Management

Corporate Governance and Boards of Directors

Strategic Decisions

The Global Imperative

Summary

Key Terms

Review Questions and Exercises

Practice Quiz

Student Study Site

Notes

chapter 1

Fundamentals of Strategic Management

What do Circuit City, Washington Mutual, Saab, Blockbuster, and Borders have in common? All of these recognized companies filed for bankruptcy during the past several years. While the situation surrounding each firm is different, all of them failed to meet various strategic challenges. Put another way, organizations typically do not succeed or fail randomly. Some plan, prepare, and execute more effectively than others.

Today's business world is global, Internet-driven, and obsessed with speed. The challenges it creates for strategic managers are often complex, ambiguous, and unstructured. Add to this the incessant allegations of top management wrongdoings, economic stagnation, and increasing executive compensation, and it is easy to see why firm leaders are under great pressure to respond to strategic problems quickly, decisively, and responsibly. Indeed, the need for effective **strategic management** has never been more pronounced. This text presents a framework for addressing today's strategic challenges.

This chapter introduces the notion of strategic management, highlights its importance, and presents a five-step process for strategically analyzing an organization. The remaining chapters expand on the various steps in the process with special emphasis on their application to ongoing enterprises.

What Is Strategic Management? _____

Organizations exist for a purpose. The **mission** is articulated in a broadly defined but enduring statement of purpose that identifies the scope of an organization's operations and its offerings to affected groups and entities. Most organizations of a significant size or stature have developed a formal mission statement, a concept discussed further in Chapter 5.

Strategy refers to top management's plans to develop and sustain **competitive advantage**—a state whereby a firm's successful strategies cannot be easily duplicated by its

competitors¹—so that the organization’s mission is fulfilled.² Following this definition, it is assumed that an organization has a plan, its competitive advantage is understood, and its members understand the reason for its existence. These assumptions may appear self-evident, but many strategic problems can be traced to fundamental misunderstandings associated with defining the strategy. Debates over the nature of the organization’s competitive advantage, its mission, and whether or not a strategic plan is really needed can be widespread.³ As such, comments such as “We’re too busy to focus on developing a strategy” or “I’m not exactly sure what my company is really trying to accomplish” can be overheard in many organizations.

Strategic management is a broader term than *strategy* and is a process that includes top management’s analysis of the environment in which the organization operates prior to formulating a strategy, as well as the plan for implementation and control of the strategy. The difference between a strategy and the strategic management process is that the latter includes considering what must be done before a strategy is formulated through assessing whether or not the success of an implemented strategy was successful. The strategic management process can be summarized in five steps, each of which is discussed in greater detail in subsequent chapters of the book (see Figure 1.1):⁴

1. *External Analysis:* Analyze the opportunities and threats, or constraints, that exist in the organization’s external environment, including industry and forces in the external environment.
2. *Internal Analysis:* Analyze the organization’s strengths and weaknesses in its internal environment. Consider the context of managerial ethics and corporate social responsibility.
3. *Strategy Formulation:* Formulate strategies that build and sustain competitive advantage by matching the organization’s strengths and weaknesses with the environment’s opportunities and threats.
4. *Strategy Execution:* Implement the strategies that have been developed.
5. *Strategic Control:* Measure success and make corrections when the strategies are not producing the desired outcomes.

The sequential order of the steps is logical. A thorough understanding of the organization and its environment is essential if the appropriate strategy is to be developed, put into action, and controlled. One could transpose the first two steps and analyze the internal environment before the external environment—the logic being that comprehending the organization informs the strategic assessment of factors outside of the firm. The external environment is analyzed before the internal environment in Figure 1.1, however, because internal goals, resources, and competencies are viewed in a relative fashion to some extent and are understood within the context of the industry and the factors that drive it. This dilemma resembles the *chicken and egg* argument; in a practical sense, external and internal analysis often occurs simultaneously.

A distinction between outside and inside perspectives on strategy is also relevant. *Outsiders* analyzing a firm should apply a systematic approach that progresses through these steps in order. Doing so develops a holistic understanding of the firm, its industry, and its strategic challenges.

Inside organizations, strategies are being formulated, implemented, and controlled simultaneously while external and internal factors are continually reassessed. In addition, changes in one stage of the strategic management process will inevitably affect other stages as well. After a planned strategy is implemented, it often requires modification as conditions change. Hence, because these steps are so tightly intertwined, *insiders* tend to treat all of the steps as a single integrated, ongoing process.⁵

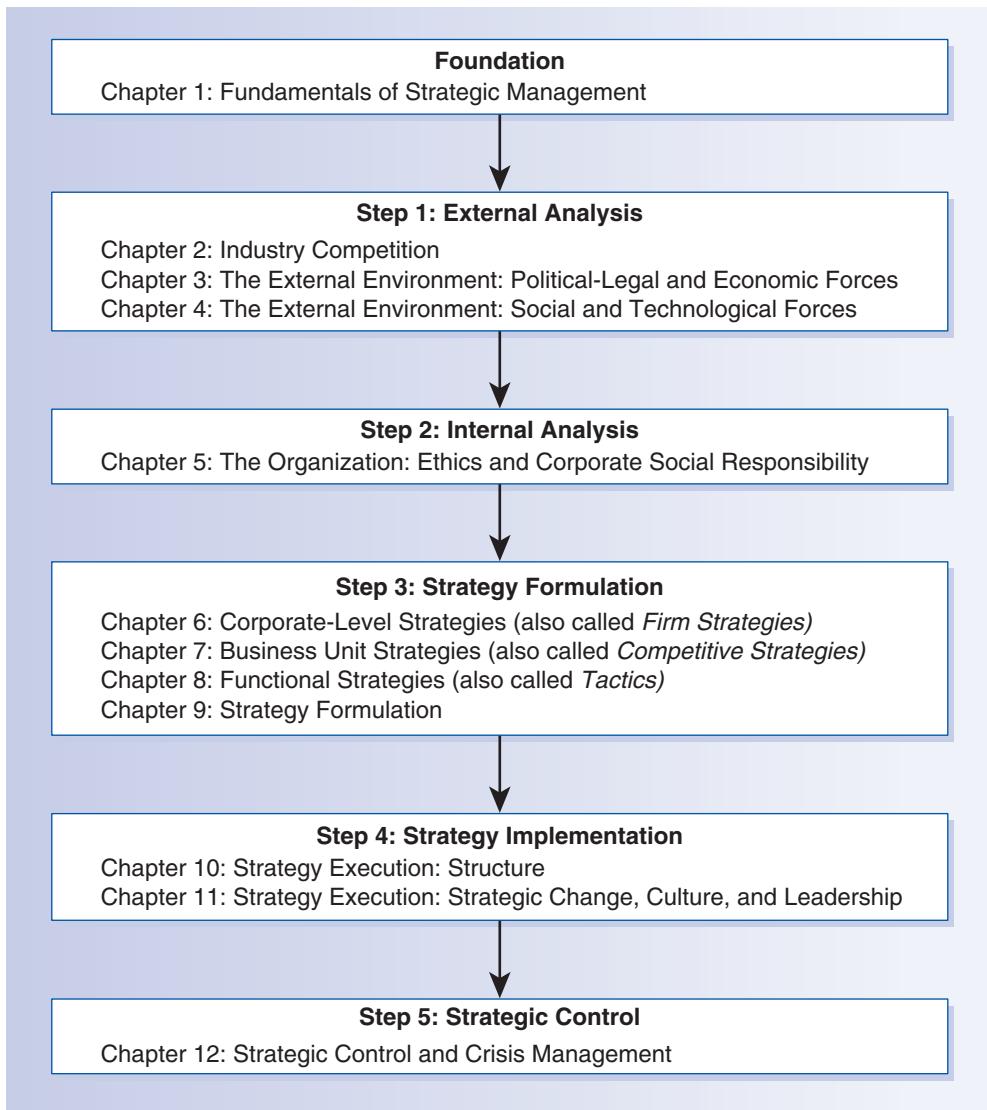


Figure 1.1 Organization of the Book.

Consider the strategic management process at a fast-food restaurant chain. At any given time, top managers are likely assessing changes in consumer taste preferences and food preparation, analyzing the activities of competitors, working to overcome firm weaknesses, controlling remnants of a strategy implemented several years ago, implementing a strategy crafted months earlier, and formulating strategic plans for the future. Although each of these activities can be linked to a distinct stage in the strategic management process, they occur simultaneously.

An effective strategy is built on the foundation of the organization's **business model**, the mechanism whereby the organization seeks to earn a profit by selling its goods or services. While all firms seek to produce a product or service and sell it at a price higher than its production and overhead costs, a business model is stated in greater detail. For example, a magazine publisher might adopt a *subscription model*, an *advertising model*, or perhaps some combination of the two. Profits would be generated primarily from readers under the subscription model but from advertisers under the advertising model. As we can see, identifying a firm's business model can become more complex when intricate details are considered. Progressive firms often devise innovative business models that extract revenue—and ultimately profits—from sources not identified by competitors.

Consider the *razor and blades* business model invented by Gillette. A company gives away or deeply discounts a product—the razor—while planning to profit from future sales of required replacement or complementary products—the blades. Cell phones are often given to customers willing to sign a 2-year service contract. Computer printers are typically sold below production cost, but customers must periodically replace the ink cartridges, which are high-margin items. This model is not foolproof, however. In a competitive marketplace, customers may be able to purchase the required complementary products at lower prices from rivals not under pressure to recoup initial losses.

Successful business models can change over time. Since the early 2000s, a number of authors have strayed from the traditional business model whereby book publishers offer contracts and pay royalties of 10% to 15%. Leveraging advances in publishing software, social media, and a strong online retail book market, they have opted for a self-publishing model. Enterprising authors who publish their own work also shoulder the initial risk but can net as much as a 70% return on e-book sales from companies such as Amazon.com. The total print book and e-book output of self-publishers in the United States rose from about 50,000 titles in 2006 to over 125,000 in 2010.⁶

While a successful strategy is built on the firm's business model, crafting one can be a challenge. Realistically, a number of factors are typically associated with successful strategies. Some of these factors including the following:

1. The organization's competitive environment is well understood, in detail.
2. Strengths and weaknesses are assessed in a thorough and realistic manner.
3. The strategy is consistent with the mission and goals of the organization.
4. Plans for putting the strategy into action are designed with specificity before it is implemented.
5. Possible future changes in the proposed strategy—a process called strategic control—are evaluated before the strategy is adopted.

Careful consideration of these factors reinforces the interrelatedness of the steps in the strategic management process. Each factor is most closely associated with one of the five steps, yet they fit together like pieces of a puzzle. The details associated with the success factors—and others—will be discussed in greater detail in subsequent chapters.

While some of these success factors are associated with the competitive environment in profit-seeking firms, strategic management is not limited to for-profit organizations. Top managers of any organization, regardless of profit or nonprofit status, must understand the organization's environment and its capabilities and develop strategies to assist the enterprise in attaining its goals. Former Drexel University president Constantine Papadakis, for example, was widely considered to be a leading strategic thinker among university top executives. The innovative Greek immigrant promoted Drexel through aggressive marketing, while campaigning for an all-digital library without books. In many respects, he managed the university in the same way that other executives manage profit-seeking enterprises. His annual salary was close to \$1,000,000 in the years preceding his death in 2009, making him one of the highest paid university presidents in the country.⁷

Intended and Realized Strategies

One of the most critical challenges facing organizations is the reality that strategies are not always implemented as originally planned. Sometimes strategic decisions seem to evolve. In this respect, strategy formulation can be seen as an iterative process where decision

makers take actions, make sense of those actions afterward, and then decide how to proceed.

Henry Mintzberg introduced two terms to help clarify the shift that often occurs between the time a strategy is formulated and the time it is implemented. An **intended strategy** (i.e., what management originally planned) may be realized just as it was planned, in a modified form, or even in an entirely different form. Occasionally, the strategy that management intends is actually realized, but the intended strategy and the **realized strategy**—what management actually implements—usually differ.⁸ Hence, the original strategy may be realized with desirable or undesirable results, or it may be modified as changes in the firm or the environment become known.

The gap between the intended and realized strategies usually results from unforeseen environmental or organizational events, better information that was not available when the strategy was formulated, or an improvement in top management's ability to assess its environment. Although it is important for managers to formulate responsible strategies based on a realistic and thorough assessment of the firm and its environment, things invariably change along the way. Hence, it is common for such a gap to exist, creating the need for constant strategic action if a firm is to stay on course. Instead of resisting modest strategic changes when new information is discovered, managers should search for new information and be willing to make such changes when necessary. This activity is part of strategic control—the final step in the strategic management process.

Scientific and Artistic Perspectives on Strategic Management

There are two different perspectives on the approach that top executives should take to strategic management. Most strategy scholars have endorsed a *scientific perspective*, whereby strategic managers are encouraged to systematically assess the firm's external environment and evaluate the pros and cons of myriad alternatives before formulating strategy. The business environment is seen as largely objective, analyzable, and largely predictable. As such, strategic managers should follow a systematic process of environmental, competitive, and internal analysis and build the organization's strategy on this foundation.

According to this perspective, strategic managers should be trained, highly skilled analytical thinkers capable of digesting a myriad of objective data and translating it into a desired direction for the firm. *Strategy scientists* tend to minimize or reject altogether the role of imagination and creativity in the strategy process and are not generally receptive to alternatives that emerge from any process other than a comprehensive, analytical approach.

Others have a different view. According to the *artistic perspective* on strategy, the lack of environmental predictability and the fast pace of change render elaborate strategy planning as suspect at best. Instead, strategists should incorporate large doses of creativity and intuition in order to design a comprehensive strategy for the firm.⁹ Henry Mintzberg's notion of a craftsman—encompassing individual skill, dedication, and perfection through mastery of detail—embodies the artistic model. The strategy artist senses the state of the organization, interprets its subtleties, and seeks to mold its strategy like a potter molds clay. The artist visualizes the outcomes associated with various alternatives and ultimately charts a course based on holistic thinking, intuition, and imagination.¹⁰ Strategy artists may even view strategic planning exercises as time poorly spent and may not be as likely as those in the science school to make the effort necessary to maximize the value of a formal planning process.¹¹

This text acknowledges the artistic perspective but emphasizes the science view. Creativity and innovation are important and encouraged but are most likely to translate into organizational success when they occur as part of a comprehensive, systematic approach to strategic management. Nonetheless, the type of formal strategic planning proposed in this text is not without its

critics. Some charge that such models are too complex or that they apply only to businesses in highly certain environments.¹² Others emphasize that the stages in the process are so closely interrelated and that considering them as independent steps may be counterproductive. Still others, such as Mintzberg, argue that planning models stifle the creativity and imagination that is central to formulating an effective strategy.¹³ Although these views have merit, the comprehensive, systematic model proposed herein is presented as a proper foundation for understanding the strategic management process. It does not, however, preclude the application of other approaches.

Influence on Strategic Management

The roots of the strategic management field can be traced to the 1950s when the discipline was originally called “business policy.” Today, strategic management is an eclectic field, drawing upon a variety of theoretical frameworks. Three prominent perspectives are summarized in Table 1.1 and discussed next. There are a number of other influences as well, but these three illustrate how competing viewpoints have coalesced into an overarching discipline.

Theoretical Perspective	Primary Influence on Firm Performance	How Perspective is Applied to the Case Analysis
Industrial organization (IO) theory	Structure of the industry	Industry analysis portion of the external environment
Resource-based theory	Firm’s unique combination of strategic resources	Analysis of internal strengths and weaknesses
Contingency theory	Fit between the firm and its external environment	SWOT (strengths, weaknesses, opportunities, and threats) analysis and SW/OT matrix

Table 1.1 Theoretical Perspectives on Firm Performance

Industrial organization (IO), a branch of microeconomics, emphasizes the *influence of the industry environment* upon the firm. The central tenet of IO theory is the notion that a firm must adapt to influences in its industry to survive and prosper; thus, its financial performance is primarily determined by the success of the industry in which it competes. Industries with favorable structures offer the greatest opportunity for firm profitability.¹⁴ Following this perspective, it is more important for a firm to choose the correct industry within which to compete than to determine *how* to compete within a given industry. Recent research has supported the notion that industry factors tend to play a dominant role in the performance of most firms, except for those that are the notable industry leaders or losers.¹⁵

IO assumes that an organization’s performance and ultimate survival depend on its ability to *adapt* to industry forces over which it has little or no control. According to IO, strategic managers should seek to understand the nature of the industry and formulate strategies that feed off the industry’s characteristics.¹⁶ Because IO focuses on industry, forces, strategies, resources, and competencies are assumed to be fairly similar among competitors within a given industry. If one

firm deviates from the industry norm and implements a new, successful strategy, other firms will rapidly mimic the higher-performing firm by purchasing the resources, competencies, or management talent that have made the leading firm so profitable. Hence, although the IO perspective emphasizes the industry's influence on individual firms, it is also possible for firms to influence the strategy of rivals and in some cases even modify the structure of the industry.¹⁷

Perhaps the opposite of the IO perspective, **resource-based theory** views performance primarily as a function of a firm's ability to utilize its resources.¹⁸ Although environmental opportunities and threats are important, a firm's unique resources comprise the key variables that allow it to develop a **distinctive competence**, enabling the firm to distinguish itself from its rivals and create competitive advantage. Resources include all of a firm's tangible and intangible assets, such as capital, equipment, employees, knowledge, and information.¹⁹ An organization's resources are directly linked to its capabilities, which can create value and ultimately lead to profitability for the firm.²⁰ Resource-based theory focuses primarily on individual firms rather than on the competitive environment.

If resources are to be used for **sustained competitive advantage**—a firm's ability to enjoy strategic benefits over an extended period of time—those resources must be valuable, rare, not subject to perfect imitation, and without strategically relevant substitutes.²¹ Valuable resources are those that contribute significantly to the firm's effectiveness and efficiency. Rare resources are possessed by only a few competitors, and imperfectly imitable resources cannot be fully duplicated by rivals. Resources that have no strategically relevant substitutes enable the firm to operate in a manner that cannot be effectively imitated by others and thereby sustain high performance.

According to the third perspective, **contingency theory**, the most profitable firms develop *beneficial fits* with their environments. In other words, a strategy is most likely to be successful when it is consistent with the organization's mission, its competitive environment, and its resources. Contingency theory represents a *middle ground* perspective that views organizational performance as the joint outcome of environmental forces and the firm's strategic actions. Firms can become proactive by choosing to operate in environments where opportunities and threats match the firms' strengths and weaknesses.²² Should the industry environment change in a way that is unfavorable to the firm, its top managers should consider leaving that industry and reallocating its resources to other, more favorable industries.

Differences aside, each perspective has merit and has been incorporated into the strategic management process laid out in this text. The IO view is seen in the industry analysis phase, most directly in Michael Porter's *five forces* model. Resource-based theory is applied directly to the internal analysis phase and the effort to identify an organization's resources that could lead to sustained competitive advantage. Contingency theory is seen in the strategic alternative generation phase, where alternatives are developed to improve the organization's fit with its environment. Hence, multiple perspectives are critical to a holistic understanding of strategic management.²³

Corporate Governance and Boards of Directors _____

A small business is often governed by one or several individuals well known to everyone in the organization. Ownership is often *privately held* and may rest with a single person, a family, or a few business partners. Because more resources are needed, many midsize and large organizations are *publicly held*, with shares of stock available for purchase on exchanges such as the New York Stock Exchange. In public corporations, shareholders—the owners of the firm—are represented by an elected board of directors legally authorized to monitor firm activities as well as the selection, evaluation, and compensation of top managers. Strategic

decision making in these firms is more complex because the ownership is widely dispersed and often changes frequently.

Corporate governance refers to the board of directors, institutional investors (e.g., pension and retirement funds, mutual funds, banks, insurance companies, among other money managers), and large shareholders known as **blockholders** who monitor firm strategies to ensure effective management. Boards of directors and institutional investors—representatives of pension and retirement funds, mutual funds, and financial institutions—are generally the most influential in the governance systems. Because institutional investors own more than half of all shares of publicly traded firms, they tend to wield substantial influence. Blockholders tend to hold less than 20% of the shares, so their influence is proportionally less than that of institutional investors.²⁴

Boards of directors often include both inside (i.e., firm executives) and outside directors. Insiders bring company-specific knowledge to the board whereas outsiders bring independence and an external perspective. Over the past several decades, the composition of the typical board has shifted from one controlled by insiders to one controlled by outsiders. This increase in outside influence often allows board members to oversee managerial decisions more effectively.²⁵ Moreover, when additional outsiders are added to insider-dominated boards, dismissal of the chief executive officer (CEO) is more likely when corporate performance declines²⁶ and outsiders are more likely to pressure for corporate restructuring.²⁷

A number of companies became concerned about both potential conflicts of interest and the amount of time a board member who sits on multiple boards can spend with the affairs of each company. As a result, many companies have begun to limit the number of board memberships their own board members may hold. Approximately two-thirds of corporate board members at the largest 1,500 U.S. companies do not hold seats on other boards. The average director's direct compensation ranged from \$90,775 at firms with revenues between \$50 million and \$500 million to \$228,058 at the 200 largest firms in the Standard & Poor's 500 based on revenue.²⁸

The **Sarbanes-Oxley Act**, which was passed in 2002, requires firms to include more independent directors on their boards and make disclosures on internal controls, ethics codes, and the composition of their audit committees on annual reports. The act requires that both the CEO and the chief financial officer (CFO) certify every report that contains company financial statements. It restricts membership of the firm's audit committee—the formal group charged with reporting oversight—to outsiders (i.e., board members who are not managers). Sarbanes-Oxley also prohibits firms from extending personal loans to board members or executives.

Even with new disclosure regulations, however, it can be difficult to determine precisely what top executives earn at public companies. A number of analysts have noted positive changes among boards as a result of this legislation in terms of both independence and expertise, while others contend that government regulations like Sarbanes-Oxley have merely added more costly paperwork.²⁹ A record number of public firms went private in the mid-2000s primarily due to investor and management frustration with the legislation. Evidence also suggests that many CEOs have become more reluctant to sit on boards of publicly held companies. Increased liability on the part of board members and recent policy changes that often restrict the number of outside boards on which a CEO may serve have also contributed to this change.³⁰

Boards of directors are responsible for monitoring activities in the organization, evaluating top management's strategic proposals, and establishing the broad strategic direction for the firm. As such, boards select and terminate the CEO, establish his or her compensation package, advise top management on strategic issues, and monitor managerial and company performance as representatives of the shareholders. Critics charge that board members do not always fulfill their legal roles.³¹ One reason is that they are nominated by the CEO, who expects them to

support his or her strategic initiatives. The generous compensation they often receive is also a key issue.³²

When insiders control a board, a *rubber stamp* mentality can develop, whereby directors do not aggressively challenge executive decisions as they should. This is particularly true when the CEO also serves as chair of the board, a phenomenon known as **CEO duality**.³³ Insider board members may be less willing to exert control when the CEO is also the chair of the board because present rewards and future career prospects within the firm are largely determined by the CEO. In the absence of CEO duality, however, insiders may be more likely to contribute to board control, often in subtle and indirect ways so as not to document any opposition to the decisions of the CEO. For example, the insiders may ostensibly present both sides of various issues while carefully framing the alternatives in favor of one that may be in opposition to the wishes of the CEO.

Activist shareholders can significantly influence a firm's operations. Target, for example, suffered the effects of the recession and experienced sluggish sales in the late 2000s. Investor activist William Ackman challenged Target to address the recession more aggressively. Ackman's Pershing Square Capital Management **hedge fund**—an investment fund open to only a small number of investors but permitted by regulators to undertake riskier and more speculative investments—is Target's sixth largest shareholder and has actively supported dissident nominees for board slots. In response to Ackman, Target expanded its fresh foods and other "recession-proof" offerings in many of its stores.³⁴

Pressure on directors to acknowledge shareholder concerns has continued into the 2010s. The major source of pressure in recent years has come from institutional investors, owners of large chunks of most publicly traded companies via retirement or mutual funds. By virtue of the size of their investments, they wield considerable power and are more willing to use it than ever before (see Strategy at Work 1.1).

Strategy at Work 1.1. The Growing Responsiveness of Corporate Boards³⁵

There is an adage on Wall Street: "If you don't like the stock, sell it." Over the past decade, however, a number of dismayed investors have decided to challenge the board instead. Many corporate boards have historically functioned as rubber stamps for top executives. Nonetheless, the directors of many prominent corporations have become increasingly responsible to shareholder interests, thanks in part to the increased influence of institutional shareholders. These large investment firms control substantial numbers of shares in widely held firms and have the clout necessary to pressure board members for change when needed.

Consider the case of Nell Minow. A principal at activist money-management firm Lens Inc., Minow searches for companies with strong products and underlying values that appear to be underperforming. After identifying a target, Minow purchases a substantial number of shares in the company and then advises the CEO of her ownership position. She requests a meeting with the CEO and/or the board to discuss changes that could improve the performance of the firm. Activist owners like Minow have sent a message to both top executives and boards that poor performance is not unlikely to go unchallenged.

However, a number of analysts and executives believe that further change to the system is needed. According to David Leighton, former chairman of the board at Nabisco Brands, Ltd., companies should seek out more independent and qualified board members who will consider the strategic direction of the firm more aggressively.