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TENTH EDITION

Strategic Management

Creating Competitive Advantages

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McGraw Hill

STRATEGIC MANAGEMENT

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tenth edition

STRATEGIC MANAGEMENT

creating competitive advantages

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STRATEGIC MANAGEMENT: CREATING COMPETITIVE ADVANTAGES

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dedication

To my family, Margie, Taylor, Alex - our new son-in-law, and my parents, the late Bill and Mary Dess

To my first two academic mentors—Charles Burden and Les Rue (of Georgia State University)

—Greg

To my wonderful wife, Gaelen, and my children, Megan and AJ

—Gerry

To my family, Helaine, Rachel, and Jacob

—Alan

To my family, Hannah, Paul, and Stephen; and my parents, Kenny and Inkyung

—Sean

about the authors

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preface

Welcome to the Tenth Edition of *Strategic Management: Creating Competitive Advantages!* We always appreciate the constructive and helpful feedback that we have received on our work. And, later in the Preface, we are happy to acknowledge the reviewers for all of the 10 editions of *Strategic Management* by name. The following are some examples of the encouraging feedback we have received:

> Dess and colleagues have crafted a globally compelling, innovatively current, and poignantly challenging strategic tool for those of us passionate about teaching strategy. Educators will be inspired and impressed by the portfolio of relevant concepts linked to practical applications through Learning From Mistakes (my favorite), Strategy Spotlights, Insights from Executives, Reflecting on Career Implications, and Cases. Nicely done!
>
> **Marta Szabo White, Georgia State University**

> We like to change up our cases each term so this gives us a good variety to pick from and rotate through. I feel like each case offers a different learning experience so it is good to incorporate variety.
>
> **Nicole Lowes, Liberty University**

> The Dess book comprehensively covers the fundamentals of strategy and supports concepts with research and managerial insights.
>
> **Joshua J. Daspit, Mississippi State University**

> Very engaging. Students will want to read it and find it hard to put down.
>
> **Amy Gresock, University of Michigan, Flint**

> *Strategic Management* by Dess, McNamara, Eisner, and Lee is the most engaging and relevant strategy text on the market. The information is convincingly presented and with enough timely examples that students will be engaged. The text also provides thorough, accurate coverage of strategy concepts. These factors combined are a recipe for student learning.
>
> **Drake Mullens, Tarleton State University**

> 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**

> The content is current and my students would find the real-world examples to be extremely interesting. My colleagues would want to know about it and I would make extensive use of the following features: Learning from Mistakes, Strategy Spotlights, Issues for Debate, and I especially like the Reflecting on Career Implications feature. Bottom line: the authors do a great job of explaining complex material and at the same time their use of up-to-date examples promotes learning.
>
> **Jeffrey Richard Nystrom, University of Colorado at Denver**

> The examples in each chapter are extremely useful to the students and the choice of cases are excellent for case study analysis.
>
> **Michael L. Sloan, San Diego State University**

We always endeavor to improve our work and we are most appreciative of the extensive and thoughtful feedback that many strategy professionals have graciously given us. The author team has worked hard to incorporate many of their ideas into the Tenth Edition.

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 Rs—rigor, relevance, and readable. 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.

What are some of the features in *Strategic Management* that reinforce the three Rs? First, we build in rigor by drawing on the latest research by management scholars and insights from management consultants to offer a current and comprehensive view of strategic issues. We reinforce this rigor with our Issues for Debate and Reflecting on Career Implications that require students to develop insights on how to address complex issues and understand how strategy concepts can enhance their career success. Second, to enhance relevance, we provide numerous examples from management practice in the text and Strategy Spotlights (sidebars). We also increase relevance by relating course topic and examples to current business and societal themes, including environmental sustainability, ethics, globalization, entrepreneurship, and data analytics. Third, we stress readability through an engaging writing style with minimal jargon to ensure an effective learning experience. This is most clearly evident in the conversational presentations of chapter opening Learning from Mistakes and chapter ending Issues for Debate.

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 Advantages*, 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. For example, we provide several useful insights on strategic leadership from one of Greg's colleagues, Charles Hazzard (formerly Executive Vice President, Occidental Chemical). Also, we completed the chapter notes 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 Tenth 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 Tenth Edition. Then we will cover some of the major features that we have had in previous editions.

WHAT'S NEW? HIGHLIGHTS OF THE TENTH EDITION

We have endeavored to add new material to the chapters that reflects the feedback we have received from our reviewers as well as the challenges today's managers face. 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.

PREFACE

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

- **Digital Economy.** We discuss and illustrate how the rise in digital technologies is changing the competitive environment and how firms are enhancing their strategic position by leveraging elements of the digital economy. A few examples include:
    - How Alibaba has created a sprawling e-commerce giant in Chapter 1
    - How Zara is restructuring its operations to serve online customers in Chapter 3
    - How Unilever uses artificial intelligence to hire the best talent in Chapter 4
    - How firms use data analytics to enhance organizational control in Chapter 9
- **Sustainability.** With sustainability being an increasing concern of our students, customers, and investors, sustainability has become a key driver of organizational success. We illustrate how firms have incorporated sustainability as a core element of their strategy. A few examples include:
    - How firms proactively incorporate environmental concerns in their business practices by eliminating plastic waste in Chapter 2
    - How firms are focusing on sustainability across a range of elements of the value chain and how these efforts support the attainment of long-term financial performance in Chapter 3
    - How sustainable business strategies can attract and retain talent in Chapter 4
    - How entrepreneurial firms are working to produce more environmentally sustainable batteries in Chapter 12
- **The importance of human and social capital for career and firm success.** We enhance our discussion of how building and leveraging human and social capital is a core strategic activity. A few examples include:
    - How to network more effectively in Chapter 4
    - How firms can build and leverage independent work teams in Chapter 9
    - How firms can inspire passion in their employees in Chapter 9
    - How superbosses can help employees working for them accomplish more than they ever thought possible in Chapter 11
- **Executive Insights: The Strategic Management Process.** Here, we introduce an in-depth interview with Mr. Usman Ghani, an internationally recognized consultant who is Chairman of ConfluCore LLP. Usman provides several practical insights into the strategic management process based on his extensive consulting experience and academic background at the Massachusetts Institute of Technology, where he earned three graduate degrees.
- **Over half of the 12 opening Learning from Mistakes vignettes that lead off each chapter are 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?
- **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 60—among 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 two "hot" issues that are critical in leading today's organizations—ethics and environmental sustainability—as well as the digital economy in this edition.

Key content changes for the chapters include:

- **Chapter 1 addresses why executives must communicate their long-term thinking to help ensure the support of investors and other stakeholders.** Such an initiative has many benefits. Among these are to provide investors with two critical elements: a long-term value creation *story* (the past) and a long term-value creation *plan* (the future). Further, when a company espouses an authentic, sustainable purpose, it is more likely to attract, motivate, and retain talent—a core objective in the knowledge economy. We also address how research by Andrew Winston, founder of Winston Eco-Strategies, has demonstrated the dramatic increase in the percentage of S&P companies that have produced detailed and rigorous reports on how they manage environmental and social issues as well as how they have incorporated them into their financial reports.
- **Chapter 2 discusses the importance of the digital economy as a fundamental shift in the business environment.** The term *digital economy* refers to economic transactions and business operations that are based on digital computing technologies. We highlight how the rise of the digital economy has disrupted existing industries by, for instance, reducing the asset intensity of business operations. Embracing the opportunities created by the digital economy has allowed entrepreneurs to create new business models such as ride sharing services and social networks.
- **Chapter 3 discusses how firms are leveraging artificial intelligence to increase the sustainability of their competitive advantages.** Firms are beginning to use artificial intelligence (AI) to better assess the preferences of their customers, how customers use their products, and how to best structure the firm's operations to build and maintain competitive advantages. Using AI, these firms are able to build sustainable advantages because their resource sets are built on path dependent and socially complex processes, making imitation difficult.
- **Chapter 4 discusses some of the challenges that women face when it comes to networking, an activity that is vital for career advancement.** Given that there are relatively fewer women in positions of leadership, it often becomes more difficult for them to find sponsors in order to make introductions and referrals. Professor Herminia Ibarra, of the London Business School, has proposed some suggestions on how women can more successfully engage in networking activities. These include making connections across diverse circles, investing time in extracurricular activities, and joining a professional women's network. We also provide examples of how companies have overcome the geographic preferences of talented professionals by building dispersed facilities and creating and maintaining formal relationships with research institutions.
- **Chapter 5 introduces the concept of unscaling and how firms are using it to create a combination strategy.** While firms have traditionally built large-scaled operations to run as efficiently as possible in order to dominate markets, firms that pursue unscaling turn things on their head. Unscaled firms look to build small scale operations that meet the needs of particular customers as efficiently as possible, at times even more efficiently than scaled competitors. Unscaling involves both the leveraging of technology, such as artificial intelligence, and the reliance on suppliers or customers to provide critical inputs to the process. We illustrate the concept by showing how Waze, P&G, and Indochino all use unscaling to efficiently offer differentiated products and services.
- **Chapter 6 discusses how CEO underpayment can be a trigger for acquisitions.** Research shows that when CEOs are underpaid relative to their peer CEOs, they undertake acquisitions to grow the size of the firm and increase their compensation. Further, it appears to work for the acquiring CEOs. They do benefit by seeing their pay rise. Thus, this research provides evidence that CEOs sometimes undertake acquisitions to benefit themselves, not the stockholders of the firm.

- **Chapter 7 illustrates the potential of reverse innovation for the health care sector in high-income countries such as the United States.** Reverse innovation refers to innovations that flow from low-income to high-income countries rather than the other way around. We illustrate how Indian hospital groups reconfigured their healthcare delivery to achieve high quality care at prices that are much lower than in the United States. These heathcare innovations subsequently found great success in parts of the United States that resemble the problems found in low-income countries.
- **Chapter 8 challenges the conventional view that entrepreneurial firms are typically started by tech savvy college students or young adults.** Research shows that the average age at which entrepreneurs start businesses is in their early forties. Further, the fastest growing firms were started by entrepreneurs who were even older, with founders of fast growing firms almost three times more likely to be over fifty than under thirty.
- **Chapter 9 outlines disadvantages associated with outsider dominated boards of directors**. The dominant view of boards of directors is that having boards that are primarily populated with outsiders, those not employed by or tied to the firm, is beneficial since the board will then be able to better monitor the firm's CEO. However, we outline a number of disadvantages that arise with outsider dominated boards. First, the board receives less information about the firm's operations since all information is filtered through the CEO. Second, the board has greater difficulty identifying who should be the next CEO of the firm since they don't regularly interact with any executives other than the current CEO. Third, non-CEO executives miss out on opportunities to develop their strategic decision making skills by being part of the board.
- **Chapter 10 discusses the power of small, independent teams in keeping the firm innovative and agile.** We draw on consultants' insights on how to structure and manage teams to make them more effective. Recommendations include keeping the size of the team small, staffing the team with top performers, empowering the team to spend their budget, holding the team accountable for their goals, and having an engaged manager.
- **Chapter 11 delves into the attributes of superbosses.** Superbosses not only build strong firms but also help those around them accomplish more than they ever thought possible. How do they do it? First, they strive to hire the best employees and surround themselves with unusually gifted people. They have no desire to be the smartest person in the room. Instead, Lorne Michaels, the producer of Saturday Night Live, reflected the mindset of a superboss when he said, "If you look around the room and think, 'God, these people are amazing,' then you're probably in the right room." Once they have these highly skilled individuals on their team, superbosses also figure out how to develop employees. We discuss several actions managers can take to identify the best candidates for their firm and ways they can act to best develop their employees.
- **Chapter 12 discusses the mindset needed to leverage the value of technologies in different markets.** Firms often struggle in their efforts to leverage their existing technologies in new markets. We discuss a four-step process firms can employ to increase their effectiveness in leveraging their technologies in new markets. The steps redefine the technology or competency in general terms, identify new applications of the technology, select the most promising applications, and choose the best entry mode. We discuss these steps in more detail and provide an example of each in the chapter.

- **Chapter 13 updates our Appendix: Sources of Company and Industry Information.** As always, the authors owe a huge debt of gratitude to Ms. Ruthie Brock, of the University of Texas at Arlington. She has provided us with comprehensive and updated information for the Tenth Edition that is organized on a wide range of issues. These include competitive intelligence, annual report collections, company rankings, business websites, as well as strategic and competitive analysis. She has always been very gracious when we impose on her every two years!

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—for both individuals and organizations—come from studying what goes wrong."* We'll see how, for example, Mattress Firm grew to more than 3,200 stores and $3 billion in annual revenue—but then crashed into bankruptcy. Clearly, the advent of nimble internet rivals, such as Casper Sleep, Inc., led to their downfall. However, their demise was hastened by their aggressive expansion and the accumulation of excessive debt to fund it. We'll also explore the bankruptcy of storied law firm Dewey & LeBoeuf LLP. Their failure can be attributed to three major issues: a reliance on borrowed money, making large promises about compensation to incoming partners (which didn't sit well with their existing partners!), and a lack of transparency about the firm's financials.
- **Issue for Debate at the end of each chapter.** We find that students become very engaged (and often animated!) in discussing an issue that has viable alternate points of view. It is an exciting way to drive home key strategy concepts. For example, in Chapter 4, we ask whether or not providing financial incentives to employees to lose weight actually works. And, in Chapter 10 we address a trend that is taking place in many large corporations: the flattening of hierarchical organizational structures. In fact, one survey found that 93 percent of polled firms indicate that they intend to flatten their organization in the near future. On the one hand, such restructuring has its advantages—it can offer cost savings, flexibility, and quicker response times. However, some of these

*Personal Communication, June 20, 2005.

benefits may be offset by some negative consequences that can occur. These include the overstretching of management attention, additional friction among managers at various levels since there are fewer middle managers to resolve conflicts, and demotivating effects caused by reduced opportunities for managers to advance through the management ranks. Clearly, one size does not fit all. Firms must consider the relative benefits and costs of flattening their structures as well as take into account such factors as a firm's size, technology, and culture as well as the industry in which it competes.

- **Insights from Research.** We include six of these features in the Tenth Edition—and half of them are entirely new. Here, we summarize key research findings on a variety of issues and, more importantly, address their relevance for making organizations (and managers!) more effective. For example, in Chapter 2 we discuss findings from a meta-analysis (research combining many individual studies) to debunk several myths about older workers—a topic of increasing importance, given the changing demographics in many developed countries. In Chapter 4, we address a study that explored the viability of re-hiring employees who had previously left the organizations. Such employees, called "boomerangs" may leave an organization for several reasons and such reasons may strongly influence their willingness to return to the organization. And in Chapter 6, we explore a study that investigates how closely CEOs attend to media assessments of actions that they take. Using a large database of 745 large acquisitions undertaken by S&P 500 firms, researchers find that CEOs do pay attention to media evaluations of acquisitions. However, the extent to which they are future- or past-focused influences whether and how they learn from the media.
- **Reflecting on Career Implications . . .** We provide 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 believe this will be very valuable to students' professional development.
- **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 list of 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 Internet in implementing a firm's strategy.

- **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, data analytics, and entrepreneurship.
- **Extensive use of sidebars.** We include 60 sidebars (or about five 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 product, 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.

TEACHING RESOURCES

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 is 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. The Tenth Edition 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. 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. *Test Builder*, an easy-to-use, cloud-based 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.** McGraw-Hill is a proud corporate member of AACSB International. Understanding the importance and value of AACSB accreditation, the Tenth Edition has sought to recognize the curricula guidelines detailed in the AACSB standards for business accreditation by connecting selected questions in Dess 10e and the test bank to the

general knowledge and skill guidelines found in the AACSB standards. The statements contained in this new edition 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 this new edition and the teaching package make no claim of any specific AACSB qualification or evaluation, we have labeled selected questions within the title according to the six general knowledge and skills areas.

- **Test Builder.** A comprehensive bank of test questions is provided within a computerized test bank powered by *Test Builder,* a cloud-based tool that enables instructors to format tests that can be printed or administered within a LMS. Available in Connect, *Test Builder* offers a modern, streamlined interface for easy content configuration that matches course needs, without requiring a download. *Test Builder* allows you to:
  - access all test bank content from a particular title.
  - easily pinpoint the most relevant content through robust filtering options.
  - manipulate the order of questions or scramble questions and/or answers.
  - pin questions to a specific location within a test.
  - determine your preferred treatment of algorithmic questions.
  - choose the layout and spacing.
  - add instructions and configure default settings.

Test Builder provides a secure interface for better protection of content and allows for just-in-time updates to flow directly into assessments.

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 the text to promote class discussion.

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.bsg-online.com or www.glo-bus.com.**

COURSE DESIGN AND DELIVERY RESOURCES

Craft your teaching resources to match the way you teach! With McGraw-Hill *Create, www.mcgrawhillcreate.com*, you can easily rearrange chapters, combine material from other content sources, and quickly upload content you have written, like your course syllabus or teaching notes. Find the content you need in Create by searching through thousands of leading McGraw-Hill textbooks. Arrange your book to fit your teaching style. *Create* even allows you to personalize your book's appearance by selecting the cover and adding your name, school, and course information. Order a *Create* book and you'll receive a complimentary print review copy in three to five business days or a complimentary electronic review copy (eComp) via email in about one hour. Go to *www.mcgrawhillcreate.com* today and register. Experience how McGraw-Hill *Create* empowers you to teach *your* students your way.

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Strategic Management represents far more than just the joint efforts of the four co-authors. Rather, it is the product of the collaborative input of many people. Some of these individuals are academic colleagues, others are the outstanding team of professionals at McGraw-Hill, and still others are those who are closest to us—our families. It is time to express our sincere gratitude.

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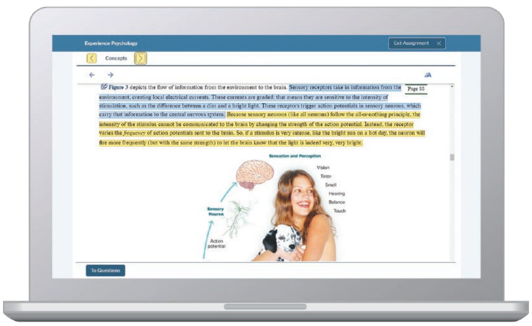

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a guided tour

Strategic Management
Creating Competitive Advantages

Learning Objectives

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

We encourage you to reflect on how the concepts presented in this chapter can enhance your career success (see "Reflecting on Career Implications..." at the end of the chapter).

LEARNING OBJECTIVES

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

LEARNING FROM MISTAKES

What makes the study of strategic management so interesting? Things can change so rapidly! Some start-ups can disrupt industries and become globally recognized names almost overnight and the rankings of the world's most valuable firms can dramatically change in a brief period of time. On the other hand, many impressive, high-flying firms can struggle to reclaim past glory—or fail altogether. As colorfully (and ironically!) noted by Arthur Martinez, Sears's former Chairman: "Today's peacock is tomorrow's feather duster."[1]

Consider the following:[2]

- The 33-year average tenure of companies on the S&P 500 in 1962 narrowed to 24 years by 2016 and is forecast to shrink to merely 12 years by 2027.
- At the beginning of 2000, the four firms in the world with the highest market values were General Electric, Exxon Mobil, Pfizer, and Citigroup. By late 2019, four tech firms headed the list: Apple, Alphabet (parent of Google), Amazon, and Microsoft.
- Record private equity activity, a strong M&A market, and the growth of start-ups with billion dollar market caps (called "unicorns") are often viewed as leading factors to increase disruptions in a wide variety of industries.
- A quarter century ago, few would have predicted that a South Korean firm would be a global car giant, an Indian firm would be one of the world's largest technology firms, and a huge Chinese Internet firm would list on an American stock exchange.
- In 1995, only about 3 percent of the companies on the Fortune 500 list were from emerging markets. This number has increased to 26 percent in 2013, and is predicted to grow to 45 percent by 2025.
- With the emergence of the digital economy, new entrants are shaking up long-standing industries. After all, Alibaba has become the world's most valuable retailer—but holds no inventory; Airbnb is the world's largest provider of accommodations—but owns no real estate; and Uber is the world's largest car service—but owns no cars.

Retail has become one of the prime examples of an industry that has been impacted by the digital disruption and the emergence of online competitors. Many brick-Bath & Beyond, Urban Outfitters, Sears, Radio Shack, and J.C. Penney have either filed for bankruptcy, or have become mere shadows of their former selves.

Let's take a closer look at another retailer, Mattress Firm, which filed for bankruptcy on October 5, 2018.[3]

Houston-based Mattress Firm was founded in 1986 and eventually grew to more than 3,200 stores and $3 billion in annual revenues. However, its pursuit of growth and dominance—largely via acquisition—in the industry led to its eventual demise.

A turning point came in 2015 when it purchased one of its chief rivals, Sleepy's, for $780 million. Steve Stagner, Mattress Firm's CEO at the time asserted, "This transformational acquisition unites the nation's two largest mattress specialty retailers providing customers with convenience, value, and choice."

However, things certainly didn't turn out as he had hoped. Acquiring Sleepy's 1,000 stores left Mattress Firm severely over-retailed. As store traffic slowed, costly leases turned into an albatross around the firm's neck. In bankruptcy court filings, the rapid expansion led to the "cannibalization" of stores that were clustered too closely and put them in direct competition with each other. This was poignantly stated by Hendre Ackermann, the firm's CFO: "There are many examples of a Mattress Firm store being located literally across the street from another Mattress Firm store."

Mattress Firm's fortunes were also eroded by a set of more nimble competitors: online upstarts, including Casper, Lessa, Tuft & Needle, and Sapira. For example, Casper Sleep, Inc., founded in 2014, raised $240 million to sell mattresses directly to consumers. It provided easy online ordering, hassle-free delivery, and returns of reasonably affordable mattresses. Within a year, Casper booked sales of $100 million.

The online rivals also had another major advantage over Mattress Firm: Shoppers had grown weary of the traditional mattress-buying experience. This involved going into a store, testing out a slew of mattresses for a few minutes, and rushing into a decision on an expensive item

LEARNING FROM MISTAKES

Learning from Mistakes vignettes 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.

1.1 STRATEGY SPOTLIGHT

AMBIDEXTROUS BEHAVIORS: COMBINING ALIGNMENT AND ADAPTABILITY

A study involving 41 business units in 10 multinational companies identified four ambidextrous behaviors in individuals. Such behaviors are the essence of ambidexterity, and they illustrate how a dual capacity for alignment and adaptability can be woven into the fabric of an organization at the individual level.

They take time and are alert to opportunities beyond the confines of their own jobs. A large computer company's sales manager became aware of a need for a new software module that nobody currently offered. Instead of selling the customer something else, he worked up a business case for the new module. With management's approval, he began working full time on its development.

They are cooperative and seek out opportunities to combine their efforts with others. A marketing manager for Italy was responsible for supporting a newly acquired subsidiary. When frustrated about the limited amount of contact she had with her peers in other countries, she began discussions with them. This led to the creation of a European marketing forum

They are multitaskers who are comfortable wearing more than one hat. Although an operations manager for a major coffee and tea distributor was charged with running his plant as efficiently as possible, he took it upon himself to identify value-added services for his clients. By developing a dual role, he was able to manage operations and develop a promising electronic module that automatically reported impending problems inside a coffee vending machine. With corporate funding, he found a subcontractor to develop the software, and he then piloted the module in his own operations. It was so successful that it was eventually adopted by operations managers in several other countries.

A recent *Harvard Business Review* article provides some useful insights on how one can become a more ambidextrous leader. Consider the following questions:

- **Do you meet your numbers?**
- **Do you help others?**
- **What do you do for your peers?** Are you just their in-house competitor?
- **When you manage up, do you bring problems—or**

1.2 STRATEGY SPOTLIGHT

ENVIRONMENTAL SUSTAINABILITY IN THE FASHION INDUSTRY

The $3 trillion fashion industry employs over 60 million people along its global value chain. Although it makes 100 billion accessories and garments each year, three-fifths of them are thrown away within a year, according to McKinsey & Company. Further, a vast amount of cotton, water, and power is used to make their products, but less than 1 percent is recycled into new clothes, according to an environmental research group in England. Amazingly, the United Nations Economic Commission for Europe estimates that about 40 percent of clothes in the wardrobes of developed countries are never worn! To provide some perspective, Rob Opsomer, a sustainability researcher asserts that "the equivalent of a dump truck filled with textiles gets landfilled or incinerated every single second."

Inditex SA, the company that owns Zara and several other brands, made 1.6 billion garments in 2016—a scale that has helped its stock price quintuple over a recent 10-year period. However, recently industry growth has slowed, in part because millennials have become sensitive to fast fashion's impact on the environment. (In fact, according to Boston Consulting Group, one-third of this demographic consistently identifies sustainability as a

This situation creates an opportunity for companies to use sustainability to differentiate their brands. With growing concerns over the waste, retailers have begun placing recycling bins prominently in many stores, using greener materials, etc., to help win over customers. Let's look at some of Inditex's initiatives:

- Began disassembling old clothing to spin into yarns for fashions it markets as "garments with a past."
- Grouped many of its sustainability efforts—clothes made from organic cotton and repurposed fabrics into a sub-brand called Join Life.
- To boost the share of greener textiles in its mix, the firm has funded research programs at MIT and universities in Spain. One initiative is to try using 3D printing to make textiles using by-products from timber operations.

Inditex says that for now they're absorbing the extra costs of using recycled or reconstituted garments. The Join Life line is priced competitively with other items in the Zara stores—T-shirts cost less than $10 and jeans are priced under $40. The firm is striving to keep a lid on prices of its greener materials and it expects the cost to fall as production increases. Anna Gedda, an

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 the digital economy, environmental sustainability, and ethical themes.

INSIGHTS

Chapter 1's "Insights from Executive" contains an interview with a worldwide organization about current issues salient to strategic management. "Insights from Research" throughout the text summarize key research findings relevant to maintaining the effectiveness of an organization and its management.

1.1 INSIGHTS from Executives

THE STRATEGIC MANAGEMENT PROCESS

Usman Ghani, Chairman, ConfluCore

Biosketch

Usman Ghani has held leadership roles in strategic planning, marketing, operations, organization development, IT, and executive education, as well as led cross-functional, multicultural core business process teams to effective implementations. He is a former Fortune 100 executive distinguished by his record of developing powerful board policies and business strategies for a variety of industry leaders, including McKinsey & Company, Royal Dutch/Shell Group, Exxon Mobil Corporation, and HP/Electronic Data Systems.

Characterized as a high-energy visionary, Usman is passionat… helping complex organizations… big picture so that they are ca… transformation. He consistently… fresh thinking, refined dynam… egy models, organizational app… and futuristic technologies to re…

Question 2. Looking at it from the other side, what are some of the key pitfalls you've seen firms fall prey to that have resulted in strategic failures?

Beware! While not broadly published, strategic failures outnumber strategic successes in all sizes and types of organizations. It is only when the acclaimed ones (like Borders, GE, Kodak, and Sears) result in large-scale failures that we become aware and then only for a while. Often, it is the dysfunctional strategic management of these organizations that fail them.

Successes and failures occur every day, but only for the attentive. These accumulate and, upon crossing some threshold, successes are cele-

3.1 INSIGHTS from Research

THE BENEFITS OF BALANCE

Overview

Business leaders face strong pressures to produce financial results, but they also know that ignoring other areas of the firm can cause trouble down the line. This study speaks on that topic and shows that having balance in performance pays off for the firm financially.

What the Research Shows

Researchers from the Drucker Institute have compiled a dataset on 693 large, publicly-traded companies from 2012 to 2017. They collected information on 37 indicators of performance in five specific areas: customer satisfaction, employee engagement, innovation, social responsibility, and financial performance. Companies were scored on a range of 0 to 100 in each of these five areas. The scores were standardized so that the mean score on each scale was 50. The researchers were specifically focused on

So, why is consistency beneficial? The researchers suggest that when a firm has uneven performance across these measures, there may be particular areas of weakness that could become major problems for the firm in coming years. The researchers use the metaphor of an elite athlete. If the athlete neglects endurance and focuses exclusively on strength and speed, she will not be able to sustain performance over time.

Key Takeaways

- Five key areas of performance for firms to focus on are customer satisfaction, employee engagement and development, innovation, social responsibility, and financial strength.
- Firms tend to perform better over time if they perform consistently across these five areas.
- Weakness on any of the five areas indicates an issue that could emerge into a crisis for the firm.

EXHIBIT 3.2 The Value Chain: Some Factors to Consider in Assessing a Firm's Primary Activities

Inbound Logistics
• Location of distribution facilities to minimize shipping times. • Warehouse layout and designs to increase efficiency of operations for incoming materials.
Operations
• Efficient plant operations to minimize costs. • Efficient plant layout and workflow design. • Incorporation of appropriate process technology.
Outbound Logistics
• Effective shipping processes to provide quick delivery and minimize damages. • Shipping of goods in large lot sizes to minimize transportation costs.
Marketing and Sales
• Innovative approaches to promotion and advertising. • Proper identification of customer segments and needs.
Service
• Quick response to customer needs and emergencies. • Quality of service personnel and ongoing training.

Source: Adapted from Porter, M. E. 1985. *Competitive Advantage: Creating and Sustaining Superior Performance.* New York: Free Press.

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 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 . . .

This chapter addresses the importance of the internal environment for strategic managers. As a strategic manager, you should fully understand how you can leverage your competencies to both bring value to your firm and enhance your career opportunities.

- **The Value Chain:** It is important that you develop an understanding of your firm's value chain. What activities are most critical for attaining competitive advantage? Think of ways in which you can add value in your firm's value chain. How might your firm's support activities (e.g., information technology, human resource practices) help you accomplish your assigned tasks more effectively? How will you bring your value-added contribution to the attention of your superiors?
- **The Value Chain:** Consider the most important linkages …nization with …en your firm and its suppliers, customers, and alliance partners. Understanding and strengthening these linkages can contribute greatly to your career advancement within your current organization.
- **Resource-Based View of the Firm:** Are your skills and talents rare, valuable, and difficult to imitate, and do they have few substitutes? If so, you are in the better position to add value for your firm—and earn rewards and incentives. How can your skills and talents be enhanced to help satisfy these criteria to a greater extent? Get more training? Change positions within the firm? Consider career options at other organizations?
- **Balanced Scorecard:** Can you design a balanced scorecard for your life? What perspectives would you include in it? In what ways would such a balanced scorecard help you attain success in life?

key points

LO3-1 The primary and support activities of a firm's value chain.

- Primary activities include all parts of the organization that are involved in the direct physical creation, distribution, sale, or servicing of the firms products and services, including inbound logistics, operations, outbound logistics, marketing and sales, and service.
- Support activities either add value themselves or in combination with both primary and other support activities, including procurement, technology development, human resource management, and general administration.

LO3-2 How value-chain analysis can help managers create value by investigating relationships among

- Interrelationships improve overall firm value when they involve the effective coordination of actions and exchange of resources, such as information, technology, and people.

LO3-3 The resource-based view of the firm and the different types of tangible and intangible resources, as well as organizational capabilities.

- The resource-based view of the firm considers the firm as a bundle of resources: tangible resources, intangible resources, and organizational capabilities.
- Competitive advantages that are sustainable over time generally arise from the creation of bundles of resources and capabilities.

LO3-4 The four criteria that a firm's resources must

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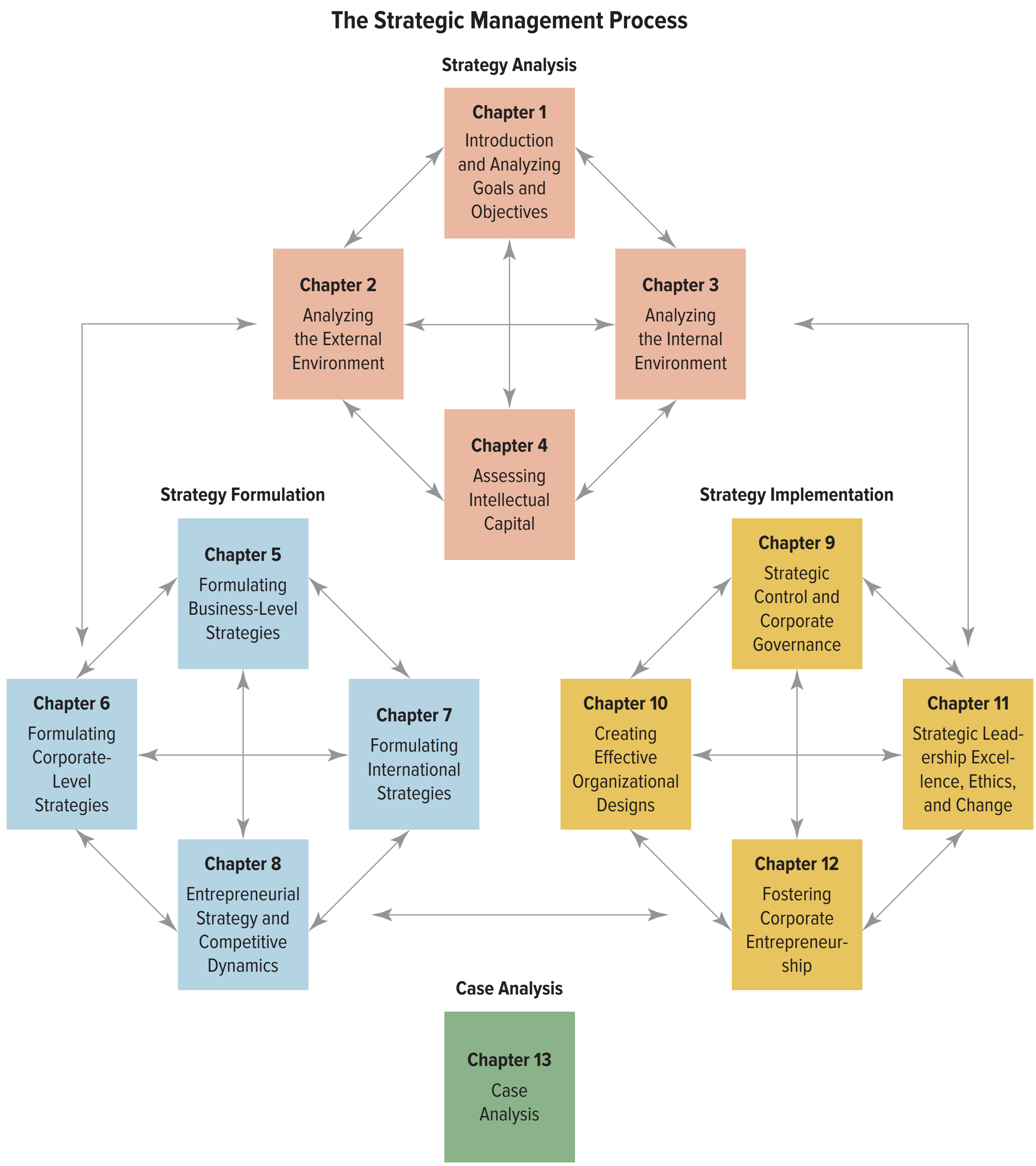
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Case Analysis

CHAPTER

1

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Strategic Management

Creating Competitive Advantages

Learning Objectives

LO1-1 Define strategic management and its four key attributes.

LO1-2 Understand the strategic management process and its three interrelated and principal activities.

LO1-3 Identify the vital role of corporate governance and stakeholder management, as well as how "symbiosis" can be achieved among an organization's stakeholders.

LO1-4 Understand the importance of social responsibility, including environmental sustainability, and how it can enhance a corporation's innovation strategy.

LO1-5 Recognize the need for greater empowerment throughout the organization.

LO1-6 Explain how an awareness of a hierarchy of strategic goals can help an organization achieve coherence in its strategic direction.

We encourage you to reflect on how the concepts presented in this chapter can enhance your career success (see "Reflecting on Career Implications..." at the end of the chapter).

LEARNING FROM MISTAKES

What makes the study of strategic management so interesting? Things can change so rapidly! Some start-ups can disrupt industries and become globally recognized names almost overnight and the rankings of the world's most valuable firms can dramatically change in a brief period of time. On the other hand, many impressive, high-flying firms can struggle to reclaim past glory—or fail altogether. As colorfully (and ironically!) noted by Arthur Martinez, Sears's former Chairman: "Today's peacock is tomorrow's feather duster."[1]

Consider the following:[2]

- The 33-year average tenure of companies on the S&P 500 in 1962 narrowed to 24 years by 2016 and is forecast to shrink to merely 12 years by 2027.
- At the beginning of 2000, the four firms in the world with the highest market values were General Electric, Exxon Mobil, Pfizer, and Citigroup. By late 2019, four tech firms headed the list: Apple, Alphabet (parent of Google), Amazon, and Microsoft.
- Record private equity activity, a strong M&A market, and the growth of start-ups with billion dollar market caps (called "unicorns") are often viewed as leading factors to increase disruptions in a wide variety of industries.
- A quarter century ago, few would have predicted that a South Korean firm would be a global car giant, an Indian firm would be one of the world's largest technology firms, and a huge Chinese Internet firm would list on an American stock exchange.
- In 1995, only about 3 percent of the companies on the Fortune 500 list were from emerging markets. This number has increased to 26 percent in 2013, and is predicted to grow to 45 percent by 2025.
- With the emergence of the digital economy, new entrants are shaking up long-standing industries. After all, Alibaba has become the world's most valuable retailer—but holds no inventory; Airbnb is the world's largest provider of accommodations—but owns no real estate; and Uber is the world's largest car service—but owns no cars.

Retail has become one of the prime examples of an industry that has been impacted by the digital disruption and the emergence of online competitors. Many brick-and-mortar (i.e., high asset intensive) firms such as Bed, Bath & Beyond, Urban Outfitters, Sears, Radio Shack, and J.C. Penney have either filed for bankruptcy, or have become mere shadows of their former selves.

Let's take a closer look at another retailer, Mattress Firm, which filed for bankruptcy on October 5, 2018.[3]

Houston-based Mattress Firm was founded in 1986 and eventually grew to more than 3,200 stores and $3 billion in annual revenues. However, its pursuit of growth and dominance—largely via acquisition—in the industry led to its eventual demise.

A turning point came in 2015 when it purchased one of its chief rivals, Sleepy's, for $780 million. Steve Stagner, Mattress Firm's CEO at the time asserted, "This transformational acquisition unites the nation's two largest mattress specialty retailers providing customers with convenience, value, and choice."

However, things certainly didn't turn out as he had hoped. Acquiring Sleepy's 1,000 stores left Mattress Firm severely over-retailed. As store traffic slowed, costly leases turned into an albatross around the firm's neck. In bankruptcy court filings, the rapid expansion led to the "cannibalization" of stores that were clustered too closely and put them in direct competition with each other. This was poignantly stated by Hendre Ackermann, the firm's CFO: "There are many examples of a Mattress Firm store being located literally across the street from another Mattress Firm store."

Mattress Firm's fortunes were also eroded by a set of more nimble competitors: online upstarts, including Casper, Lessa, Tuft & Needle, and Sapira. For example, Casper Sleep, Inc., founded in 2014, raised $240 million to sell mattresses directly to consumers. It provided easy online ordering, hassle-free delivery, and returns of reasonably affordable mattresses. Within a year, Casper booked sales of $100 million.

The online rivals also had another major advantage over Mattress Firm: Shoppers had grown weary of the traditional mattress-buying experience. This involved going into a store, testing out a slew of mattresses for a few minutes, and rushing into a decision on an expensive item designed to last for years. And, customers were often annoyed by complicated and expensive delivery options. As noted by Casper's co-founder and CEO, Philip Krim, "Traditional mattress retailers have been alienating customers for decades and are now buckling under pressure. Casper has turned a tired industry on its head with innovative products and a superior shopping experience." Recently, Casper expanded its direct-to-consumer online business into a wide variety of products including bed frames, sheets, pillows, and dog mattresses.

Discussion Questions

1. What actions should Mattress Firm have taken when it became apparent that there were some nimble, online rivals entering the industry?
2. Casper Sleep Inc. has certainly become a strong competitor in this industry. In your view, what could they do to further strengthen their position?

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

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, Bloomberg Businessweek,* and *Forbes,* wherein the CEO is either lauded for his or her firm's success or chided for the organization's demise.[6] Consider, for example, the credit that has been bestowed on leaders such as Bill Gates, Andrew Grove, and Jeff Bezos for the tremendous accomplishments when they led their firms—Microsoft, Intel, and Amazon, respectively.

Similarly, Apple's emergence as one of the world's most valuable firms 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, is a testament to his genius for developing innovative, user-friendly, and aesthetically pleasing products. In addition to being a perfectionist in product design, Jobs 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] Clearly, the aggressive acquisition of its rival, Sleepy's, by Mattress Firm's CEO, Steve Stagner, led to a steep decline in the firm's performance because of the resulting oversaturation of its retail outlets and the associated costly leases. In contrast, Apple fully capitalized on emerging technology trends with a variety of products, including sophisticated smartphones.

The effect—for good or for bad—that top executives can have on a firm's market value can be reflected in what happens when one of them leaves their firm.[9] For example, look what occurred when Kasper Rorsted stepped down as CEO of the German packaged-goods firm Henkel in January, 2016 to become CEO of Adidas: Henkel immediately lost $2 billion in market capitalization, and Adidas gained $1 billion. On the other hand, when Viacom announced that executive chairman Sumner Redstone was stepping down, the firm gained $1.1 billion of market valuation in 30 minutes!

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

However, such an emphasis on the leader 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, new technologies, governmental legislation, or an outbreak of major internal conflict or war, can greatly restrict the choices that are available to a firm's executives. For example, several book retailers, such as Borders and Waldenbooks, 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.

Looking back at the opening Mattress Firm case, Mr. Stagner faced some challenges from the external environment over which the firm had relatively little control. As noted, the online upstarts, such as Casper Sleep, Inc., had multiple competitive advantages such as lower capital investments and labor costs, as well as a superior customer shopping experience. At the same time, of course, Mattress Firm was encumbered with the high costs associated with physical locations.[10]

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 naive or Pollyannaish. Consider, for example, how one CEO, discussed next, 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.
- 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?

LO 1-1

Define strategic management and its four key attributes.

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.

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.

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

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 environments 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.

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

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:

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

- ***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.

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 innovations is important, but none lead to sustainable competitive advantage because everyone is doing them.

operational effectiveness
performing similar activities better than rivals.

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.

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.

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.

As noted by David Novak, former CEO of Yum Brands:[18]

> I tell people that once you get a job you should act like you run the place. Not in terms of ego, but in terms of how you think about the business. Don't just think about your piece of the business. Think about your piece of the business and the total business. This way, you'll always have a broader perspective.

Second, strategic management *includes multiple stakeholders in decision making.*[19] **Stakeholders** are those individuals, groups, and organizations that 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.

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

Third, strategic management *requires incorporating both short-term and long-term perspectives.*[20] Peter Senge, a leading strategic management author, has referred to this need as a "creative tension."[21] That is, managers must maintain both a vision for the future of the organization and a focus on its present operating needs. However, financial 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.

Andrew Winston addresses this issue in his recent book, *The Big Pivot:*[22]

> Consider the following scenario: You are close to the end of the quarter and you are faced with a project that you are certain will make money. That is, it has a guaranteed positive net present value (NPV). But it will reduce your earnings for this quarter. Do you invest?
>
> A research study posed this question to 400 CFOs and a majority said they would not do it. Further, 80 percent of the executives would decrease R&D spending, advertising, and general maintenance. So, what occurs when you cut back on these investments to prop up short-term earnings *every* quarter? Logically, you don't invest in projects with favorable paybacks and you underspend on initiatives that build longer-term value. Thus, your earnings targets in the future quarters actually get more difficult to hit.

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)**.[23] While managers must allocate and use resources wisely, they must still direct their efforts toward the attainment of overall organizational objectives. As noted by Meg Whitman, Hewlett-Packard's former CEO, "Less than perfect strategy execution against the right strategy will probably work. A 100 percent execution against the wrong strategy won't."[24]

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."

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.

To summarize, leaders typically face many difficult and challenging decisions. In a recent article in the *Harvard Business Review*, Wendy Smith and her colleagues provide some valuable insights in addressing such situations.[25] The author team studied corporations over many years and found that senior executives are often faced with similar sets of opposing goals, which can polarize their organizations. Such tensions or paradoxes fall into three categories, which may be related to three questions that many leaders view as "either/or" choices.

- *Do we manage for today or for tomorrow?* A firm's long-term survival requires taking risks and learning from failure in the pursuit of new products and services. However, companies also need consistency in their products and services. This depicts the tension between existing products and new ones, stability and change. This is the *innovation paradox*. For example, in the late 1990s, IBM's senior leaders saw the Internet wave and felt the need to harness the new technology. However, the firm also needed to sustain its traditional strength in client-server markets. Each strategy required different structures, cultures, rewards, and metrics—which could not easily be executed in tandem.
- *Do we stick to boundaries or cross them?* Global supply chains can be very effective, but they may also lack flexibility. New ideas can emerge from innovation activities that are dispersed throughout the world. However, not having all the talent and brains in one location can be costly. This is the tension between global connectedness and local needs, the *globalization paradox*. In 2009, NASA's director of human health and performance started an initiative geared toward generating new knowledge through collaborative cross-firm and cross-disciplinary work. Not too surprisingly, he faced strong pushback from scientists interested in protecting their turf and their identities as independent experts. Although both collaboration and independent work were required to generate new innovations, they posed organizational and cultural challenges.
- *Whom do we focus on, shareholders or stakeholders?* Clearly, companies exist to create value. But managers are often faced with the choice between maximizing shareholder gains while trying to create benefits for a wide range of stakeholders—employees, customers, society, etc. However, being socially responsible may bring down a firm's share price, and prioritizing employees may conflict with short-term shareholders' or customers' needs. This is the *obligation paradox.* Paul Polman, Unilever's CEO, launched the Unilever Sustainable Living Plan in 2010. The goal was to double the size of the business over 10 years, improve the health and well-being of more than a billion people, and cut the firm's environmental impact in half. He argued that such investments would lead to greater profits over the long term; whereas a singular focus on short-term profits would have adverse effects on society and the environment. His arguments were persuasive to many; however, there have been many challenges in implementing the plan. Not surprisingly, it has caused uncertainty among senior executives that has led to anxiety and fights over resource allocation.

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

Some authors have developed the concept of **"ambidexterity"** (similar to the aforementioned "innovation paradox"), which refers to a manager's challenge to both align resources to take advantage of existing product markets and proactively explore new opportunities.[26] Strategy Spotlight 1.1 discusses ambidextrous behaviors that are essential for success in today's challenging marketplace.

1.1 STRATEGY SPOTLIGHT

AMBIDEXTROUS BEHAVIORS: COMBINING ALIGNMENT AND ADAPTABILITY

A study involving 41 business units in 10 multinational companies identified four ambidextrous behaviors in individuals. Such behaviors are the essence of ambidexterity, and they illustrate how a dual capacity for alignment and adaptability can be woven into the fabric of an organization at the individual level.

They take time and are alert to opportunities beyond the confines of their own jobs. A large computer company's sales manager became aware of a need for a new software module that nobody currently offered. Instead of selling the customer something else, he worked up a business case for the new module. With management's approval, he began working full time on its development.

They are cooperative and seek out opportunities to combine their efforts with others. A marketing manager for Italy was responsible for supporting a newly acquired subsidiary. When frustrated about the limited amount of contact she had with her peers in other countries, she began discussions with them. This led to the creation of a European marketing forum that meets quarterly to discuss issues, share best practices, and collaborate on marketing plans.

They are brokers, always looking to build internal networks. When visiting the head office in St. Louis, a Canadian plant manager heard about plans for a $10 million investment for a new tape manufacturing plant. After inquiring further about the plans and returning to Canada, he contacted a regional manager in Manitoba, who he knew was looking for ways to build his business. With some generous support from the Manitoba government, the regional manager bid for, and ultimately won, the $10 million investment.

They are multitaskers who are comfortable wearing more than one hat. Although an operations manager for a major coffee and tea distributor was charged with running his plant as efficiently as possible, he took it upon himself to identify value-added services for his clients. By developing a dual role, he was able to manage operations and develop a promising electronic module that automatically reported impending problems inside a coffee vending machine. With corporate funding, he found a subcontractor to develop the software, and he then piloted the module in his own operations. It was so successful that it was eventually adopted by operations managers in several other countries.

A recent *Harvard Business Review* article provides some useful insights on how one can become a more ambidextrous leader. Consider the following questions:

- **Do you meet your numbers?**
- **Do you help others?**
- **What do you do for your peers?** Are you just their in-house competitor?
- **When you manage up, do you bring problems—or problems with possible solutions?**
- **Are you transparent?** Managers who get a reputation for spinning events gradually lose the trust of peers and superiors.
- **Are you developing a group of senior managers who know you and are willing to back your original ideas with resources?**

Sources: Birkinshaw, J. and C. Gibson. 2004. Building ambidexterity into an organization. *MIT Sloan Management Review,* 45(4): 47–55; and Bower, J. L. 2007. Solve the succession crisis by growing inside-out leaders. *Harvard Business Review,* 85(11): 90–99.

THE STRATEGIC MANAGEMENT PROCESS

LO 1-2

Understand the strategic management process and its three interrelated and principal activities.

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.

Intended versus Realized Strategies

Henry Mintzberg, a management scholar at McGill University, argues that viewing the strategic management process as one in which analysis is followed by optimal decisions and their subsequent meticulous implementation neither describes the strategic management process accurately nor prescribes ideal practice.[27] He sees the business environment as far from predictable, thus limiting our ability for analysis. Further, decisions are seldom based on optimal rationality alone, given the political processes that occur in all organizations.[28]