Chapter 1

The Strategic Management Process

Chapter Outline

Strategic Snapshot: Evolution of the Restaurant Industry

Introduction

The Strategy Concept
- The Basis of Strategy
- The Strategic Management Process
- Business and Corporate Strategies
- Strategic Imperatives

The Role of Strategic Competencies in Crafting an Effective Strategy
- Vision Competency: Determining and Setting Strategic Goals
- Value Creation Competency: Defining What We Do Best
- Planning and Administration Competency: Getting Everything to Fit
- Global Awareness Competency: Competing in a Smaller World
- Leveraging Technology Competency: Staying on the Cutting Edge
- Stakeholder Competency: What Decision Criteria Are Used?

Responsibility for Strategic Management
- Who Are Strategic Managers?
- Characteristics of Strategic Decisions
- Difficulties in Reconciling Stakeholders’ Needs

Why Study Strategy?
- Candidate Seeking Employment
- Employee or Manager

What you will learn

- The importance of strategy and why it matters to organizations
- The key roles of vision, value creation, planning and administration, global awareness, leveraging technology, and stakeholders
- The four stages of the strategic management process
- The concept of a SWOT analysis
- The concepts of corporate and business strategies
- The central role of ethics in strategy
- The different stakeholders of an organization
Evolution of the Restaurant Industry

Broadly speaking, there are two main segments of the restaurant industry—full-service restaurants and fast-food restaurants. In 2004, it is expected that Americans will spend about $440 billion eating out. The restaurant industry employs more people in the United States—12 million—than any other industry—with the exception of the federal government. Let us take a look at some developments on the fast-food side of the industry.

Ever since Ray Kroc purchased the rights to use the McDonald brothers’ idea of serving fast-cooked, low-cost hamburgers, French fries, and chocolate shakes to customers in 1955, the restaurant industry has never been the same. Since that time, the McDonald’s restaurant chain has grown to become a $17 billion business (2003 systemwide sales) and will celebrate its fiftieth anniversary in 2005. Its famous golden arches are a familiar sight across the United States and increasingly much of the world. More broadly speaking, the fast-food restaurant has become a highly complex industry in its own right. Companies such as McDonald’s, Burger King, Wendy’s, KFC (formerly Kentucky Fried Chicken), Taco Bell, and Domino’s Pizza are well-known American and global brand names. All of these restaurant firms typically target customers willing to pay for a low-cost meal with a minimum of service and maximum convenience.

The Fast-Food Restaurant Environment

Despite its continued high growth, competition in the fast-food restaurant industry remains fierce; newer rivals enter the picture to serve both existing tastes and the rise of new segments. For example, restaurant chains such as Bennigan’s, Brinker International (better known for its flagship chain, Chili’s Bar & Grill), and TGI Friday’s are trying to capture customers who want larger and more “deluxe” gourmet hamburgers with table service and a more diversified menu. Their offerings are significantly different (and more expensive) from those provided by McDonald’s, Burger King, Wendy’s, and Jack in the Box—all of which compete fiercely for the fast-food hamburger segment of the restaurant industry. Local hamburger chains that offer quality burgers in a fast-food setting, such as Steak n Shake, are moving beyond their traditional midwestern locations to expand to the South. Other firms, such as Cracker Barrel, KFC, Pizza Hut, Domino’s Pizza, La Madeleine, Papa John’s International, Little Caesar’s, Sbarro, and Taco Bueno, are attempting to stake out positions in the nonhamburger segment of the industry, where they do not have to compete directly with industry giant McDonald’s and other established hamburger-based chains with long-standing market positions.

Behind the rapid rise in the number of fast-food restaurants are some important trends that may change the way the industry competes. Two key macroeconomic factors are redefining this industry. First, most people are becoming more health-conscious and selective about what and how they eat. In particular, newer forms of “leaner” cuisine that emphasize balanced nutrition and good taste are dramatically changing the way restaurants are preparing and marketing their offerings. The baby-boom generation that grew up after World War II powered the enormous growth of McDonald’s and other
hamburger joints. As this generation grows older, it is increasingly turning away from hamburgers and more toward healthier diets. Likewise, many of these same people are choosing ethnic foods also, such as Chinese, Italian, or Tex-Mex. Even McDonald’s has begun to offer salads in a recognition of this trend’s effect on its core hamburger offering.

The second major trend defining this industry is that the average American family continues to eat about half of its meals outside of home—an ongoing trend that became entrenched during the 1990s. Although this development would seem to suggest that the restaurant industry can continue to grow at a rapid pace, Americans are becoming much more selective about what they want. In general, not only are people becoming more health conscious, but they are seeking value from their meals as well. This has been particularly more evident with the recent economic downturn in 2001–2002.

In response to these broader changes in population demographics and economic spending patterns, the more traditional fast-food chains have persisted in trying to conceive new “value-based meals,” or “value pricing,” that seek to bundle different food offerings under one lower price. At the same time, restaurants have offered a new selection on their menus, featuring items that are claimed to be “heart-healthy,” or “lighter fare” for those who are watching their weight. Many existing and newly entering restaurant chains find these changes in demand and tastes an opportunity because it means that more health- and value-conscious customers are willing to try new types of leaner food, such as rotisserie-cooked chicken as opposed to fried chicken. Thus, the numerous changes in the way people choose their meals are having a significant impact on how these restaurant chains formulate their strategies and compete with new rivals.

**Sample Competitors**

Let us now look at three different competitors in the fast-food restaurant industry and see how they deal with both their competitors and the larger changes taking place among their customers.

**McDonald’s.** McDonald’s is one of the oldest and perhaps the best known of all fast-food restaurant companies. Some of its most popular food offerings range from small hamburgers to such market hits as the Big Mac, the Quarter Pounder, its great-tasting French fries, and rich chocolate shakes. In recent years, it has experimented with a variety of healthier menu items, including its recent line of salads. In many ways, McDonald’s is considered the bellwether industry leader because of its enormous reach within the United States and around the world. Many Wall Street analysts view McDonald’s as a proxy for the overall restaurant industry, since it is viewed as the “price leader” in defining value for customers. When McDonald’s offers a special promotion, all of its fast-food rivals must respond by matching a lower price.

McDonald’s competes by offering the same basic types of food offerings in each of its restaurants, all prepared to the same exact specifications of heat, time, weight, size, and presentation. By requiring each restaurant to follow standardized procedures in cooking food and serving customers, McDonald’s can ensure a consistent level of quality and service throughout its system. The McDonald’s operations manual specifies every step and process used in each McDonald’s restaurant are interchangeable with outlets in other parts of the country. Thus, a customer eating a hamburger at a McDonald’s in San Francisco will notice little difference from a hamburger served at a McDonald’s in New York or elsewhere.

To compete against such rivals as Burger King, Jack in the Box, and Wendy’s, McDonald’s focuses on providing fast service with consistent quality and generally low prices. This formula has made McDonald’s the largest fast-food provider in the United States. However, McDonald’s realized that it could not grow its hamburger business at
the same double-digit growth rates of years past. In 2000, McDonald’s sought to expand by purchasing Boston Market, Donatos Pizza, and Chipotle Mexican Grill to capture growth in new markets. After three years of disappointing results, McDonald’s decided to sell off its interest in these nonhamburger restaurant chains.

**Brinker International.** Brinker International is better known for the growing variety of restaurants that it operates, including Chili’s Bar & Grill, Romano’s Macaroni Grill, Corner Bakery Café, Big Bowl Asian Kitchen, Rockfish Seafood Grill, and On The Border, to name a few. However, Chili’s is the largest restaurant chain under Brinker management, making up 70 percent of the company’s profit and 65 percent of its nearly 1,500 restaurants. It is probably best known for its deluxe hamburgers, and it certainly competes very differently than McDonald’s in trying to win customers. Instead of copying McDonald’s formula for low-priced, standardized food with no table service, Chili’s has taken the opposite approach. Founded by legendary restaurateur Norman Brinker, Chili’s was designed to make eating out a fun and warm experience. Although people pay more to eat at Chili’s, customers receive friendly table service with a menu that highlights the many different ways a hamburger can be cooked and served. Its famous gourmet hamburgers are offered with various cheeses, mushrooms, and sauces, generous servings of French fries, and other extras that make for a distinctive, satisfying, but reasonably priced meal.

Despite its high-quality offering, Chili’s is certainly not just a hamburger-only restaurant. A customer’s selection is not limited solely to hamburgers; large salads, small steaks, grilled chicken dishes, seafood, pasta, and its increasingly popular baby back ribs are also available. These offerings cater to customers who still want the fun of eating at Chili’s without the high calories or fat content of hamburgers. Still, if customers should feel the need, generous portions of desserts are also offered to round out the meal. Chili’s wants to make its customers feel that eating out can be a fun and relaxing experience. The company emphasizes customer service by training its people to be extremely responsive to customer needs and to get to know their regular customers better.

**Yum! Brands.** Yum! Brands was formerly known as Tricon Global Restaurants. Before its name change, Yum! Brands was best known for its three core restaurant chains: Pizza Hut, KFC (formerly Kentucky Fried Chicken), and Taco Bell. Once a part of PepsiCo, Yum! Brands (then known as Tricon) became an independent firm in 1997 when PepsiCo decided to exit from the fiercely competitive restaurant business. Although Yum! Brands is not a familiar name to most customers, its restaurants most certainly are. All three units have decades of experience competing with McDonald’s and other restaurant chain giants. Instead of competing directly with McDonald’s or Chili’s, Yum! Brands’ three different businesses—KFC, Taco Bell, and Pizza Hut—target three nonhamburger segments of the restaurant industry.

For example, KFC offers its traditional, distinctive-tasting fried chicken recipes, along with its golden rotisserie-cooked chicken to serve both the conventional fast-food and the growing health-conscious segments. Although KFC is a leader in the chicken segment of the restaurant industry, it faces consistently tough competition from Chick-Fil-A, Church’s, Popeye’s, and other smaller chicken-based restaurants. To meet these competitive threats, KFC has now begun to offer value-priced meals that feature fried chicken with mashed potatoes or biscuits for a new lower price. In 2003, KFC began to offer roasted boneless chicken. It also periodically introduces new chicken-based products, such as popcorn chicken, spicy wings, and other similar items.

Yum! Brands’ Taco Bell unit seeks to carve out a position in the growing Tex-Mex fast-food segment. The higher population growth in the Southwest and the Sunbelt has contributed to making Tex-Mex food more popular throughout the United States. In turn, Taco Bell has benefited by offering different types of tacos, enchiladas, fajitas, and other similar foods through its convenience-oriented outlets. Taco Bell competes with other
Mexican-style food chains, such as Taco Bueno and numerous smaller Mexican restaurant chains found in the Southwest. For much of the 1990s, Taco Bell was one of Yum! Brands’ fastest-growing and most profitable businesses, although in recent years its growth has slowed considerably as competition in this market segment intensified.

Pizza Hut has traditionally competed by offering restaurant-style, sit-down pizza meals. Pizza Hut’s most distinctive food offering is its specialty pan pizza, which has a special taste and texture. In recent years, Pizza Hut has been a strong performer for both previous owner PepsiCo and current owner Yum! Brands. In fact, Pizza Hut is now experimenting with a variety of different types of pizzas in different parts of the country in order to satisfy more local tastes. Although Pizza Hut retains the largest market share in this segment, it faces fierce competition from new companies such as Domino’s Pizza and Little Caesar’s. Most recently, Pizza Hut’s toughest competitor appears to be Papa John’s International, a small company that has grown rapidly over the past decade. All of Pizza Hut’s competitors try to offer a different approach to customers. To carve out its own market, Domino’s Pizza competes against Pizza Hut by offering only home delivery of pizza, rather than sit-down service. Little Caesar’s, on the other hand, competes primarily through innovative advertisements and specially priced pizzas for both pickup and delivery; it does not offer sit-down service, either. Papa John’s International offers home delivery, advertises aggressively, and claims to use only the freshest ingredients. To meet these competitive challenges, Pizza Hut refocused its operations more on home delivery service and offers free breadsticks, salads, and even soft drinks in order to win over more customers. Pizza Hut even took Papa John’s International to court in 1999 and 2000 in a dispute over food claims and the luring away of existing restaurant franchise owners.

Yum! Brands has continued to grow in the past few years. Under CEO David Novak, Yum! Brands is pushing restaurants to improve food quality and counter service. Employees now are evaluated on how well they treat customers, and they are expected to attend training four times a year. Yum! Brands also expanded beyond its three core restaurants by purchasing Long John Silver’s and A&W All-American Food Restaurants.

Multiple Strategic Issues

As an example of some of the different issues facing each type of company, we can look at how the major competitors view and manage their restaurant operations. For both McDonald’s and Brinker International, restaurants are their primary business. However, the two companies differ in some important ways. For the most part, McDonald’s defines its business through its hamburger-focused offerings to customers, with a particular focus on consistency, good value, and a standardized approach to managing operations. In this sense, McDonald’s has a much more targeted approach to growing its business. Brinker International, however, operates a number of different restaurant chains—each designed to reach a different type of customer who wants to satisfy a different type of meal preference or taste. What people want from Chili’s may indeed be different from what they want from Romano’s Macaroni Grill, Corner Bakery Café, or On The Border. Thus, Brinker International must formulate a strategy for each of its restaurant chains in order to reach out to multiple markets.

When Yum! Brands was part of PepsiCo, restaurants were just one portion of a larger company that also includes Frito-Lay snacks and its traditional soft drinks. Thus, PepsiCo did not actually compete in the restaurant industry; its various units (KFC, Taco Bell, and Pizza Hut) did. Consequently, the strategic issues confronting PepsiCo’s senior management differed from those facing McDonald’s top management. Senior management at PepsiCo were asking themselves how well did their various restaurant businesses fit with their other snack food and soft drink units. PepsiCo’s management faced the additional task of ensuring that the restaurant business worked well with its beverage (cola and non-cola) and snack food (Frito-Lay) units. Throughout much of the 1980s and 1990s, the restaurant business was an important part of PepsiCo’s overall strategy. Increasing competitive
pressures and slowing of the restaurant industry’s overall growth rate, however, made it increasingly difficult for PepsiCo to compete effectively in the industry. The strategic benefits that PepsiCo could once bring to the restaurant industry—marketing prowess, low-cost source of beverages, shared advertising expenditures, and shared management—became difficult to sustain when PepsiCo’s beverage business began to lose significant market share to rival Coca-Cola, especially in markets outside the United States. By the mid- to late 1990s, severe competition and declining profit margins on both fronts—beverages and restaurants—made it increasingly difficult for PepsiCo to compete effectively in both businesses simultaneously. Deciding that it needed to sharpen its competitive focus and to raise capital for its beverage business, PepsiCo’s senior management decided to sell its restaurant operations as a way to exit the restaurant business.

McDonald’s appears to be refocusing on its core hamburger business. Although it attempted to transfer much of its restaurant-based expertise to Chipotle, Boston Market, and Donatos Pizza, it faced considerable difficulty in doing so. At the same time, McDonald’s neglected its vast hamburger restaurant system for a few years, costing it valuable market share as customers grumbled about the quality of food and service. As it tries to sell off its interests in Chipotle, Boston Market, and Donatos Pizza, McDonald’s faces some key strategic issues that are very different from how it previously managed its hamburger-focused business in past years.

Introduction

As the preceding examples illustrate, firms must compete with each other to gain their customers’ business. Yet, not all firms will necessarily compete with one another in the same way. Each firm is likely to devise its own strategy to deal with its competitive rivals, to serve its particular base of customers, and to act on the changes that impact the way it operates. Each firm needs to develop a competitive advantage in its strategy that enables it to compete effectively.

Strategy refers to the ideas, plans, and support that firms employ to compete successfully against their rivals. Strategy is designed to help firms achieve competitive advantage. In the broadest sense, competitive advantage is what allows a firm to gain an edge over its rivals. Competitive advantage enables a firm to generate successful performance over an extended period. Throughout this book, which focuses on the concepts of strategy and competitive advantage, you will learn how firms from a variety of different industries, settings, and situations develop strategies to achieve competitive advantage. Activities undertaken to achieve this end form the basis of the strategic management process.

Competitive rivalry characterizes economic activity not only in our own country but throughout the free world as well, and it is rapidly replacing government planning across most of the globe. Much organized activity outside the realm of business and commerce is also highly competitive. Nonprofit enterprises such as colleges, churches, and charities, for example, generally face numerous rivals eagerly seeking the same students, parishioners, and contributors. Because rivalry is such a pervasive aspect of so many different kinds of activity, the concepts developed in this text will be useful to managers operating in a wide range of settings. How to construct an effective strategy to deal with competitive rivalry is the primary question addressed in this book.

In our book, we believe that the key to formulating and implementing an effective strategy that builds competitive advantage depends on the firm’s attention to a core set of six strategic ingredients:

- vision
- value creation
Each of these ingredients contributes to an organization’s strategy in its own special way. However, an organization must ensure that these six ingredients work together to form the basis of an effective, coherent strategy. For each strategic ingredient, a particular set of attributes defines its contribution to the organization’s strategy. Thus, each strategic ingredient requires the development of a corresponding strategic competency that represents a particular combination of skills and perspectives that enables a firm to construct a strategy that is centered on competitive advantage. We use the term strategic competency because we believe that every organization can steadily enrich its capability to compete. Exhibit 1-1 identifies several important skills and perspectives associated with each strategic competency. In practice, it is difficult to isolate where
PART 1 Building Competitive Advantage

one strategic competency begins and another ends. An organization cannot ignore any one of them, nor can it concentrate its efforts on one or two competencies to the exclusion of the others. Laying out these strategic competencies is valuable primarily for helping you to see how the task of strategy formulation and implementation can be complex for any organization. Later in this chapter, we will describe each strategic competency in greater detail.

The Strategy Concept

From a traditional or historical perspective, the term strategy reflects strong military roots. Military commanders employ strategy in dealing with their opponents. Throughout human history, numerous military theorists, including Sun Tzu, Alexander the Great, Karl von Clausewitz, Napoleon, Stonewall Jackson, and Douglas MacArthur, have contemplated and written about strategy from many different perspectives. The fundamental premise of strategy is that an adversary can defeat a rival—even a larger, more powerful one—if it can maneuver a battle or engagement onto terrain favorable to its own capabilities and skills.

In this book, we use the term distinctive competence to describe those special capabilities, knowledge, skills, technologies, or other resources that enable a firm to distinguish itself from its rivals and create competitive advantage. Ideally, a firm’s competence or skill is so distinctive (and even unique) that others will not be able to copy it readily. Capabilities and skills that are valuable in business include such activities as innovative product design, low-cost manufacturing, proprietary technology, superior quality, cultivating organizational practices that facilitate quick response to change, and superior distribution. Thus, a firm may have several skills, areas of activity, or organizational attributes that work in tandem to create competitive advantage. Competitors in the restaurant industry, for example, use a variety of methods for building competitive advantage, including warm and friendly service and special, proprietary recipes (Brinker International’s units, including Chili’s), consistent quality and low-cost operation (McDonald’s), and identification of new marketing segments (Yum! Brands).

Terrain refers to the environmental setting in which an engagement with an adversary takes place. In the military realm, terrain may be a plain, a forest, a marsh, an urban environment, or the mountains. The characteristics of each of these settings influence which type of troops or deployments can be used most effectively. In the world of business, competitors do not confront each other directly on a battlefield as armies do. Rather, they compete with each other in an industry environment by targeting market segments and attempting to win customers. It is customers who determine, each time they make a purchase, which competitors “win” and which ones “lose.” The industry environment thus constitutes the ultimate terrain on which business competition takes place. Accordingly, each firm needs to develop its own set of special capabilities, or distinctive competence, that enables it to win customers in the industry and market environment (terrain) that it chooses.

Because most industries contain numerous customers displaying different needs, firms generally have many different possible terrains from which to choose. Consider the restaurant industry, for example. It contains a number of different groups of customers: those wanting low-cost meals, people desiring gourmet hamburgers, and individuals preferring ethnic or health-conscious menus, as well as those who prefer a special dining experience. Each group thus constitutes a different segment or terrain on which rivals compete. Furthermore, each of these groups can be further divided into smaller subgroups of customers with even more specific needs and characteristics. For example, ethnic food runs the entire range from Chinese to French to Mexican. Each of these individual segments has somewhat different competitive characteristics that define the subterrain.
The Basis of Strategy

The essence of strategy is to match strengths and distinctive competence with terrain in such a way that one’s own business enjoys a competitive advantage over rivals competing on the same terrain. In the military realm, the strategic imperative for commanders is to select a battlefield favorable to their force’s particular strengths/capabilities and unfavorable to the adversary. A cavalry or highly mobile armored force, for example, should try to fight on flat, open ground where its speed and maneuverability can be put to good use. Units skilled in guerrilla tactics, by contrast, should try to encounter the enemy in dense woods, urban areas, or in the mountains—terrains that favor a hide-and-strike capability. Military strategy thus aims at achieving a favorable match between a military force’s internal strengths and the external terrain on which it operates (see Exhibit 1-2).

Military Strategy

<table>
<thead>
<tr>
<th>Internal</th>
<th>External</th>
</tr>
</thead>
<tbody>
<tr>
<td>Special capabilities</td>
<td>Battle terrain</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Internal</th>
<th>External</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strength</td>
<td>Opportunity</td>
</tr>
</tbody>
</table>

Competitive strategy for organizations likewise aims at achieving a favorable match between a firm’s distinctive competence and the external environment in which it competes. However, the nature of this match is more complex in the business sphere. Unlike military conflict, competition in business does not always have to result in a win-lose situation. Industry rivals frequently have the opportunity to improve their strengths or skills as competition unfolds. In addition, the value of a firm’s distinctive competence that leads to competitive advantage can also decline over time as a result of environmental change. Because of these possibilities, competitive strategy involves not just one but several different imperatives. The most important of these are to discover new opportunities, avert potential threats, overcome current weakness, sustain existing strength, and apply strength to new fields (see Exhibit 1-3).
Every firm faces the need to deal with these strategic imperatives on a continuous basis. However, some imperatives will be more dominant at a given point in time, depending on the individual firm’s particular situation. Before a firm can determine which imperatives are most important, managers must have a strong sense of how the firm can use its distinctive competence to build competitive advantage to succeed in the marketplace.

**The Strategic Management Process**

A management process designed to satisfy strategic imperatives for building competitive advantage is called a strategic management process. It consists of four major steps: analysis, formulation, implementation, and adjustment/evaluation (see Exhibit 1-4).

### Exhibit 1-4 Strategy Management Process

<table>
<thead>
<tr>
<th>Analysis</th>
<th>External environment</th>
<th>Opportunities, Threats</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal environment</td>
<td>Strengths, Weaknesses</td>
<td></td>
</tr>
<tr>
<td>Formulation</td>
<td>Mission</td>
<td>Customers to be served</td>
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<td></td>
<td></td>
<td>Capabilities to be developed</td>
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<td></td>
<td>Policies</td>
<td>Goals, guidelines</td>
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<tr>
<td></td>
<td></td>
<td>for major activities</td>
</tr>
<tr>
<td>Implementation</td>
<td>Organization structure, systems, culture, etc.</td>
<td></td>
</tr>
<tr>
<td>Adjustment/Evaluation</td>
<td>(Cycle to earlier steps)</td>
<td></td>
</tr>
</tbody>
</table>

**Analysis.** The strategic management process begins with careful analysis of a firm’s internal strengths and weaknesses and external opportunities and threats. This effort is commonly referred to as SWOT analysis (strengths, weaknesses, opportunities, and threats). McDonald’s uses SWOT analysis regularly to assess consumer desire for new types of foods. This analysis identified increasing customer desire for new types of food and hamburgers that are “healthier” or have a lower fat content as compared to McDonald’s current offerings. McDonald’s top management recognizes the rising health consciousness of the American public as a potential opportunity to expand its service to customers. To exploit this opportunity, McDonald’s developed, tested, and then marketed a variety of new offerings, including at one point a fat-free hamburger, chicken sandwiches, and different salads that would be instrumental in meeting this need. Had McDonald’s not continued its efforts to undertake these modifications, its sales would likely have suffered as a consequence. Consumers’ rising health consciousness also represents a potential threat to McDonald’s as well as a potential opportunity. Failure to respond to this development could erode McDonald’s competitive position in the industry.

McDonald’s strengths are its fast, efficient service and its low-cost operations. These strengths give the company a well-known, commanding reputation among many segments of the U.S. population. Moreover, McDonald’s spans the entire nation with its golden arches and distinctive restaurant architecture, giving each outlet a special, recognizable presence. McDonald’s value-pricing policies instituted several years ago offer a combination of large
sandwich, French fries, and large drink for a lower price than if these items were purchased individually. They were designed to overcome a weakness that customers perceived McDonald’s food as becoming more expensive over time. These numerous sources of strength, together with aggressive pricing, allow McDonald’s to compete effectively with other national hamburger-based chains, such as Burger King and Wendy’s, and regional hamburger outlets, such as Carl’s Jr. in California and Sonic in the South.

Formulation. Information derived from SWOT analysis is used to construct a strategy that will enable the firm to use its distinctive competence to build competitive advantage. A strategy must be formulated that matches the external opportunities found in the environment with the firm’s internal strengths. For each firm, this matchup or coalignment is likely to be different. To gain maximum competitive advantage, individual firms need to identify the activities they perform best and seek ways to apply these strengths to maximum effect. Effective strategy formulation is based on identifying and using the firm’s distinctive competence and strengths in ways that other firms cannot duplicate. This is key to building competitive advantage.

McDonald’s strategy has long been based on the firm’s distinctive competence in serving its customers quality food at reasonable prices. That has enabled McDonald’s to become an extremely formidable player in the restaurant industry. The Chili’s unit of Brinker International, on the other hand, has formulated a strategy based on providing highly personalized and warm service to each customer. Its approach is designed to make each dining experience memorable with the hope that customers will return frequently. A sit-down meal at Chili’s is, however, more costly than a meal at McDonald’s. Yet, both firms are prospering in the industry by formulating strategies that use their strengths to pursue somewhat different opportunities in the environment.

Implementation. An organization must commit itself to develop and refine its distinctive competence and strengths. Once an organization has made such a commitment, it must then take steps to implement this choice. Implementation measures or requirements include organizing the firm’s tasks, incorporating new technologies to better monitor value-creating activities, hiring individuals to perform designated activities, assigning them responsibility for carrying out such activities, training them to perform activities properly, and rewarding them if they carry out responsibilities effectively. At McDonald’s corporate headquarters, implementation involves determining such issues as the franchising fees and compensation policies for its restaurants, hiring policies that individual McDonald’s restaurants will use, and an organizational structure that facilitates efficient operations. In the case of individual McDonald’s restaurants within the network, implementation focuses on such matters as rolling out new menu items smoothly, hiring able-bodied individuals, training employees to perform specific tasks, motivating employees to perform tasks properly, and treating customers courteously and efficiently.

Adjustment/Evaluation. The industry environment within which a firm operates inevitably changes over time. Also, a firm’s performance may fall below desired levels. Either event compels a firm to reexamine its existing approach and make adjustments that are necessary to regain high performance. Mechanisms must be put into place to monitor potential environmental changes and alert managers to developments that require a change in strategy and implementation practices.

For example, competition and growth in the restaurant industry may change significantly with the advent of an economic recession that limits people’s disposable income. Although fancier restaurants are more likely to suffer from an economic downturn than McDonald’s, such a change will also affect McDonald’s, though in different ways. More people may initially be
inclined to eat at McDonald’s because of its value-pricing policies. However, a prolonged recession may lead to a reduction in volume, causing McDonald’s to slow down expansion of new restaurants. This development, in turn, will lead to a slower growth of McDonald’s earnings in the future.

The issues that managers confront when conducting the strategic management process will differ according to the competitive environments their firms face, the internal strengths and weaknesses they possess, and the number of other businesses their firms operate. Consequently, each firm needs to tailor its strategic management process in ways that best suit its own specific context and situation. In addition, firms that operate in more than one industry face strategic issues beyond those firms that compete in only one industry. These issues can be highly complex, as we will see in later chapters. Thus, firms need to remain constantly attuned to developments and changes in the environment that may warrant further adjustment of their strategies.

**Business and Corporate Strategies**

To appreciate the comprehensiveness of the analytic approach we will take, consider the organizational chart in Exhibit 1-5. It shows the organizational arrangement used by many firms that operate multiple businesses that span multiple industries. For example, General Electric runs businesses in the power generation, medical equipment, plastics, lighting, water treatment, financial services, home appliances, and transportation industries, to name a few. This type of company is known as a diversified or multibusiness firm. Diversified or multibusiness firms manage and operate businesses in more than one industry. In contrast, firms such as Domino’s Pizza and Papa John’s International are known as single-business or undiversified firms. Undiversified firms limit their activities to products and services in one industry. As indicated in Exhibit 1-5, the major subunits of a diversified, multibusiness firm are entire businesses. Each individual business generally operates in its own specific competitive environment and thus requires a separate business strategy. Business strategy attempts to answer the question “How do we build competitive advantage for this particular business?”

Exhibit 1-5  **Multibusiness Enterprise**

**multibusiness firm:**  A firm that operates more than one line of business. Multibusiness firms often operate across several industries or markets, each with a separate set of customers and competitive requirements (also known as a diversified firm). Firms can possess many business units in their corporate portfolio.

**single-business firm:**  A firm that operates only one business in one industry or market (also known as an undiversified firm).

**undiversified firm:**  A firm that operates only one business in one industry or market (also known as a single-business firm).

**business strategy:**  Plans and actions that firms devise to compete in a given product/market scope or setting; addresses the question “How do we compete within an industry?”
should we compete?” For example, the business strategy pursued by KFC, which is part of Yum! Brands, is to provide different types of food based on its famous chicken recipes. By limiting itself to offering primarily chicken-centered recipes, KFC does not compete directly with McDonald’s in the larger restaurant industry. Thus, KFC can focus its efforts on competing for an attractive but separate segment that matches its distinctive competence. Some ways that KFC builds competitive advantage include its highly memorable advertising (“finger-lickin’ good”), its proprietary recipes (original, extra crispy, skin-free, rotisserie golden chicken), and its ability to share marketing expenses and skills with its sister units Pizza Hut, Taco Bell, Long John Silver’s, and A&W All-American Food Restaurants.

Diversified, multibusiness firms also need a higher-level strategy that applies to the organization as a whole. Strategy at this higher level is known as corporate strategy. Corporate strategy deals with the question “What set of businesses or industries should the organization operate?” For example, when beverage and packaged foods company PepsiCo owned KFC, Taco Bell, and Pizza Hut for much of the 1980s and 1990s, PepsiCo’s allocation of resources and management of the restaurant chains were issues of corporate strategy. When PepsiCo decided to eventually exit the restaurant industry in 1997, that decision also represented an issue of corporate strategy. Thus, corporate strategy was a dominant issue in the minds of PepsiCo’s senior management when it considered and acted on such questions as these: Should PepsiCo even have a presence in the restaurant business? If so, what new restaurant (or other) businesses should PepsiCo enter? If not, how should PepsiCo exit the restaurant business to sharpen its focus on its beverage and Frito-Lay snack food businesses? PepsiCo’s managers are still asking themselves many of the same corporate strategy questions as related to their current businesses, which include carbonated beverages, snack foods (Frito-Lay), fruit juices (for example, Tropicana), bottled drinks and water (for example, Gatorade), and cereals (Quaker Oats). What resources can PepsiCo’s various businesses usefully share to apply and sustain competitive advantage? How can the marketing skills developed at Frito-Lay, for example, be used to help the beverage unit and vice versa?

**Strategic Imperatives**

Firms facing different strategic situations generally must deal with quite different strategic imperatives. Three common strategic situations and their corresponding strategic imperatives are summarized in Exhibit 1-6.

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**Corporate strategy:** Plans and actions that firms need to formulate and implement when managing a portfolio of businesses; an especially critical issue when firms seek to diversify from their initial activities or operations into new areas. Corporate strategy issues are key to extending the firm’s competitive advantage from one business to another.

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**Different Strategic Imperatives**

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<th>Internal</th>
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<tr>
<td>Strength</td>
<td>Opportunity</td>
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<td>Weakness</td>
<td>Threat</td>
</tr>
</tbody>
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1. Apply or Extend Advantage (Strength/Opportunity)
2. Sustain Advantage (Weakness/Opportunity)
3. Build Advantage (Strength/Threat)
**Sustain Advantage.** In many industries, large established firms possess substantial knowledge, a highly refined distinctive competence, knowledge of their customers' needs, and considerable experience in competing in their respective industries and individual segments. However, changes in the environment can seriously erode these advantages. Consequently, environmental change represents a potential threat to established firms. A major strategic imperative facing such firms is to sustain advantage in the face of environmental threat.

In recent years, McDonald’s (as well as its larger rivals, such as Burger King and Wendy’s) has had to deal with this kind of strategic imperative. First, the growing health consciousness of American consumers means that McDonald’s cannot rely solely on its traditional hamburger-centered menus for sustained growth. Second, the rise of new competitors makes expansion for McDonald’s difficult without considering consumers’ response. These developments compel McDonald’s to devise alternative strategies to sustain high performance and profitability in the fast-food restaurant industry. These include offering salads and lower-priced “value” meals to halt the erosion of its market base.

**Build Advantage.** Chili’s situation is very different for McDonald’s. As a much smaller competitor, it lacks McDonald’s enormous size, pervasive market presence, and extensive operating experience. The strategic imperative it faces is to build advantage to overcome this initial weakness. To satisfy this imperative, a firm must generally seek market opportunities that do not force it to compete directly with its larger and more powerful rivals. It will generally need to achieve some type of distinction in customers’ eyes by offering innovative product features, providing superior service, creating a unique experience, using novel distribution channels, or promoting an unusual image. Such an approach may enable it to satisfy some customers without triggering massive retaliation from well-established rivals. Chili’s has adopted this approach by focusing on sit-down customers who want fun, friendly service and good food. Although its restaurant menus initially had a strong hamburger-oriented focus, Chili’s now offers alternative meals—such as grilled chicken, salads, and other foods—designed to appeal to different tastes and health-conscious consumers. Chili’s has also differentiated itself from McDonald’s by offering superior customer service. These modifications enable it to operate without subjecting itself to head-on competition from McDonald’s for customers that want a hamburger-based meal. Strong competitive advantage results when firms are able to formulate and implement strategies that make it difficult for rivals to imitate and copy them.

**Extend Advantage.** Some firms discover that the capabilities they have developed in one business can be used in another. Entry into the new arena enables them to extend advantage beyond their original domain. Yum! Brands found itself in this situation when it concluded that the capabilities developed in its line of pizza, Mexican food, and chicken restaurants could be applied to other fast-food restaurant concepts. These capabilities include extensive knowledge of customer buying habits, market segmentation skills, and market research and advertising prowess. Acting on this belief, Yum! Brands acquired two other fast-food restaurant chains, Long John Silver’s and A&W All-American Food Restaurants, in 2002. This strategic move gives Yum! Brands huge exposure to become the world’s largest restaurant chain with over 32,000 locations.

McDonald’s also believed that its highly refined capabilities for managing a highly disciplined, nationwide system of hamburger restaurants would enable it to enter new restaurant ventures. The 2000 purchases of Chipotle Mexican Grill, Donatos Pizza, and Boston Market Corporation were designed to broaden the company’s market reach.

Over time, like many other firms that sought growth by moving into new areas, McDonald’s discovered that transferring skills from one restaurant format to another is a very
complicated organizational task. Frequently, senior management cannot implement the sharing of skills or capabilities from one line of business to another very effectively or quickly. The economic and organizational costs of managing multiple business units can often outweigh the potential benefits. In recent years, McDonald’s suffered from this difficulty. By 2003, growing competition in the hamburger business hurt McDonald’s. Earnings dropped and the capabilities and operational processes that work best in the hamburger business did not apply as well to Mexican food and take-home American food. By March 2003, McDonald’s was pursuing steps that would allow it to sell its controlling stakes in its nonhamburger restaurant operations.

**Text Overview: The Key Challenge of Competitive Advantage.** These three challenges provide the primary organizing framework for this text. These strategic imperatives apply to all firms in all industries. See Exhibit 1-7 for a summary of how the different chapters in this book fit into this framework.

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**Focus on Competitive Advantage**

<table>
<thead>
<tr>
<th>Strategic Challenge</th>
<th>Key Strategic Management Issues</th>
</tr>
</thead>
<tbody>
<tr>
<td>Building Competitive Advantage</td>
<td>Ch. 2 Assessing Industry Attractiveness and the Competitive Environment</td>
</tr>
<tr>
<td></td>
<td>Ch. 3 Matching Firm Capabilities with Opportunities</td>
</tr>
<tr>
<td></td>
<td>Ch. 4 Building Competitive Advantage through Distinction</td>
</tr>
<tr>
<td></td>
<td>Ch. 5 Responding to Shifts in Competitive Advantage</td>
</tr>
<tr>
<td>Extending Competitive Advantage</td>
<td>Ch. 6 Corporate Strategy: Leveraging Resources</td>
</tr>
<tr>
<td></td>
<td>Ch. 7 Global Strategy: Harnessing New Markets</td>
</tr>
<tr>
<td></td>
<td>Ch. 8 Strategic Alliances: Partnering for Advantage</td>
</tr>
<tr>
<td>Organizing for Sustainable Advantage</td>
<td>Ch. 9 Designing Organizations for Advantage</td>
</tr>
<tr>
<td></td>
<td>Ch. 10 Organizing and Learning to Sustain Advantage</td>
</tr>
<tr>
<td>Corporate Governance</td>
<td>Ch. 11 Corporate Governance: Instilling Long-Term Value</td>
</tr>
</tbody>
</table>

Chapter 2 begins as the first of four chapters that focus on building advantage. It examines the issue of the business environment. Firms compete in two basic types of environment: the general environment and the more specific industry-competitive environment. We discuss the five forces that determine an industry’s structure and how that structure influences the potential for profitability.

In Chapter 3, we present tools to analyze internal strengths and weaknesses. The concept of the value chain is presented, and we discuss some general capabilities that firms use to compete in their industry.

In Chapter 4, we consider how firms develop their competitive strategies. Although each firm must formulate its own set of competitive strategies that best match its situation, most business is developed using one of the three basic strategies: low-cost leadership, differentiation, and focus. The crucial role of the Internet and how the product/market life cycle influences these generic competitive strategies are also presented.
Chapter 5 examines the impact of environmental changes and driving forces on sources of competitive advantage. A competitive advantage developed in one period may often not be as valuable in later time periods. Potential changes in technology, distribution channels, government regulations, and other factors require firms to formulate strategies to deal with change.

Chapter 6 is the first of three chapters that focuses on extending advantage. It introduces the three basic routes firms can take to expand their scope of operations: vertical integration, related diversification, and unrelated diversification. However, not all attempts to extend a firm’s competitive advantage to other businesses and activities will be successful. This chapter stresses the point that diversification strategies must be based on the extent to which the firm’s distinctive competence can be used to enter new lines of businesses. We also examine some steps that firms can take to reinvigorate their core businesses and operations through restructurings and other measures designed to enhance competitive advantage.

Chapter 7 presents the crucial topic of global strategy. Firms can expand their operations abroad by using global strategies. The economic basis of global strategies and their benefits and costs are analyzed.

Chapter 8 focuses on strategic alliances. In many industries, firms can no longer afford to assume all the risks of developing new products or entering new markets on their own. In fact, almost every large and medium-sized organization will use alliances in some way during its existence. Strategic alliances enable firms to share the risks and costs of new commercial endeavors, but they also raise important trade-offs that management needs to consider.

Chapter 9 is the first of two chapters that focuses on sustaining competitive advantage through the creation of vibrant and responsive organization designs. In this chapter, we examine the basic dimensions and types of organizational structure. A well-formulated strategy needs a well-designed structure to execute it. In the second part of the chapter, we focus on the emergence of networked and virtual organizations. These new formats are designed to help firms become more responsive to fast-changing technologies and customer needs.

Chapter 10 examines the pivotal roles of reward and performance measurement systems, shared values, and corporate culture in sustaining competitive advantage. These management practices, or organization designs, strongly influence and may even constrain the implementation of a firm’s current and future strategy. We also consider the process of managing organizational change. We focus more specifically on how firms can become learning organizations. Learning organizations use change as an opportunity to create new sources of competitive advantage, especially as industry environments become faster moving. Because most companies find organizational change a difficult process to manage, we present some steps senior management can take to make the change process easier.

Chapter 11 addresses the vital issue of corporate governance. We analyze some of the most recent trends that are redefining the practices of boards of directors and consider the impact of the new Sarbanes-Oxley Act on corporate financial reporting and board structure. Corporate governance issues are becoming important issues in other nations as well, as we take a brief look at what trends appear to be surfacing in Europe and Asia.

The Role of Strategic Competencies in Crafting an Effective Strategy

At the beginning of this chapter, we defined a strategic competency as a particular combination of skills and perspectives that enable a firm to craft a strategy best suited to its own needs. For each of the six core ingredients of an effective strategy, there is a corresponding strategic...
competency: vision, value creation, planning and administration, global awareness, managing stakeholders, and leveraging technology.

Although the strategic competency framework is applicable to all types of organizations, the specific makeup and application of each competency is unique to each firm. For example, the way that an automotive firm leverages new types of technology to improve the quality and fuel efficiency of cars and trucks is going to be very different from how a restaurant uses technology to make food better tasting and faster to prepare. Equally important, for all the automotive companies competing in the same industry (for example, General Motors, Toyota, BMW, Hyundai), how each firm leverages technology to create a competitive advantage for itself will depend on factors that are specific to each firm (for example, the way it develops products, the way it works with suppliers, the reputation it has with customers, the way it trains and organizes its workforce, the ability to learn new electronics quickly).

Within each chapter, we will examine how organizations from a variety of industries have sought to build competitive advantage or deal with a key strategic/organizational challenge by managing the issues that surround a particular strategic competency. These sections are labeled as “Strategic Competency in Action.” A portrait of how a firm cultivates or uses the skills and perspectives associated with a given competency in its own unique way will provide you with a sense of how complex, and yet dynamic, strategy really can be.

**Vision Competency: Determining and Setting Strategic Goals**

Any organization needs an underlying purpose from which to chart its future. If organizations are to compete effectively and serve their customers well, they need to establish a series of guideposts that focus their efforts over an extended time period. These guideposts will help the firm clarify the purpose of its existence, where it is going, and where it wants to be. Strategies are unlikely to be effective without a sense of direction.

**Vision.** A vision relates to the firm’s broadest and most desirable goals. A vision describes the firm’s aspirations of what it really wants to be. Visions are important because they are designed to capture the imagination of the firm’s people and galvanize their efforts to achieve a higher purpose, cause, or ideal. Some of the most effective visions are those in which the firm seeks to excel or lead in some activity that bonds all of its people together with a common purpose. Visions should have a strong emotional appeal that encourages people to commit their full energies and minds to achieving this ideal. A powerful vision, if fully embraced and executed by the organization, can position the firm for industry-wide leadership. In some cases, a vision may enable the firm to “change the rules” of the industry to one’s favor.

Examples of powerful visions that have changed and redefined entire industries include that of Cable News Network (CNN), now a part of Time Warner. Founded in 1981 by Ted Turner to provide twenty-four-hour news coverage, CNN prospered by aggressively pushing forward its new television format that would ultimately become the fastest news source for corporations and even national governments. Even under recently restructured Time Warner, CNN’s vision remains to be the best and most reliable news source on any topic, anywhere, anytime. For example, during the First Gulf War of 1990-1991, world leaders, including Iraq’s Saddam Hussein, reportedly tuned in to CNN to receive the most accurate and up-to-date coverage of Operation Desert Storm.

In the restaurant industry example, McDonald’s and Brinker International have prospered by pursuing their own visions of what they think the restaurant industry should offer to consumers. The founder of McDonald’s Corporation, Ray Kroc, promoted a vision of McDonald’s...
as being the leading provider of moderately priced, quality food to anyone, anywhere. Brinker International, on the other hand, has prospered by pushing forward a different vision of restaurant service; it believes each meal should be a fun and exciting experience.

In the beverage industry, Coca-Cola has a powerful vision that has galvanized the firm’s efforts in defining much of the beverage and soft drink industry. Coke wants to make sure that “a Coke is in arm’s reach” of any customer, no matter where that customer is around the world. This simple but mighty vision has defined the essence of Coke’s purpose and its strategy of entering and serving many markets around the world. No market is too small for Coke to carry out its vision.

In the telecommunications and computer networking industries, Cisco Systems leads in developing state-of-the-art equipment that brings the Internet to everyone—businesses, governments, large organizations, and consumers in the home. A company that is barely twenty years old, Cisco Systems has grown to become one of America’s technology leaders and most valuable companies. Under CEO John Chambers, Cisco has a vision that all of the world’s activities will eventually be strongly influenced and impacted by the Internet. Over the next few years, Cisco envisions that most business transactions will occur over the Internet, as will a significant portion of job training and education, stock trading and investments for individuals, as well as even health care through telemedicine. Cisco’s vision of the Internet can be summarized in its often-quoted commercials: “Are You Ready?” To make its vision happen, Cisco has been extremely aggressive in growing its businesses, especially by acquiring a vast number of promising start-up firms that are developing cutting-edge technologies.

Corporate visions are often lofty and even surrounded by a high level of idealism or romanticism. They provide a consistency of purpose that gives the organization a reason to exist. However, visions do not lay out the actual strategies, steps, or methods by which the firm will pursue its purpose. Missions, on the other hand, are intended to provide the basis for fulfilling a vision.

**Mission.** A firm’s mission describes the organization in terms of the business it is in, the customers it serves, and the skills it intends to develop to fulfill its vision. Missions that capture the organization’s purpose and ideals become more concrete and “real” in an organization’s mission. Missions are more specific than visions in that they establish the broad guidelines of how the firm will achieve or fulfill its vision over a certain time period. Firms will translate their vision into a mission statement that sets the firm’s boundaries and provides a sense of direction. Mission statements spell out in a general way some key pillars of building a strategy—the firm’s customers, the firm’s principal products or services, and the direction that a firm intends to move over a future time period.

For example, the mission at McDonald’s can be summarized in four letters originally conceived by founder Ray Kroc and his earliest franchises: QSCV (quality, service, cleanliness, and value). The mission of McDonald’s (both at corporate headquarters and in individual restaurants) is to implement each of these four policies to satisfy its customers. High quality of food, fast and courteous service, clean restaurants, and affordable prices are guiding pillars that lay the foundation for all of McDonald’s Corporation’s strategies and organizational practices. By carrying out this simple mission statement, McDonald’s can translate its vision into reality.

**Goals and Objectives.** Mission statements are designed to make the organization’s vision more concrete and real to its people. However, mission statements still do not provide the tangible goals or objectives that must be met to achieve a firm’s broader purpose. Thus, goals and objectives are needed to provide a series of direct, measurable tasks that contribute to the
organization’s mission. Goals and objectives are the results to be achieved within a specific time period. Unlike the mission statement that describes the firm’s purpose more generally, goals and objectives designate the time period in which certain actions and results are to be achieved. Examples of goals and objectives include the following: achieving a 30 percent market share gain in two years, increasing profitability by 15 percent in three years, and developing a new product in six months. Goals and objectives are powerful tools that break down the mission statement into very specific tasks, actions, and results throughout the organization. Each part of the organization is likely to have its own set of goals and objectives to accomplish within a specified time period. When put together, all of these smaller goals and objectives should bring the organization’s mission into fruition.

Value Creation Competency: Defining What We Do Best

Central to any organization’s existence is how well it creates value in the marketplace. Organizations must deliver compelling economic value to their customers by creating and offering desirable products and services. Equally important, organizations only create value to the extent that their efforts distinguish themselves from similar efforts made by rivals. A firm’s strategy is only as valuable to the extent it builds distinction.

Customer Focus. An organization creates competitive advantage only if customers are willing to pay for its products at a price that generates an economic return that is higher than its cost of capital. Indeed, in order to earn the profits necessary to stay in business, firms must identify which customers they can serve best and focus their efforts on developing and commercializing products and services to suit them. This profit-based reality means that it is highly unlikely that a firm can be a provider of all things to all customers. Instead, the firm must develop a value proposition that considers what its customers truly want and which products/services the firm will offer at the appropriate price. Developing and implementing this value proposition (right customers + right products/services = economic return) lays the economic foundation for every firm’s competitive advantage.

Competitor Focus. Building competitive advantage requires the organization to do things differently from its rivals. When competitors in any industry all offer the same products to the same group of customers, profitability disappears. Instead, organizations must continue to find ways to prevent rivals from imitating their efforts to become distinctive. Doing so requires an understanding of not only the industry, but also the nature of competition. An effective strategy also anticipates the possibility, even the likelihood, that new types of competitors may enter the industry. New competitors may do things completely different from existing rivals. This is why understanding your competition is such a central idea behind strategy.

Planning and Administration: Getting Everything to Fit

A powerful vision and a compelling value proposition can provide key elements of a firm’s strategy. However, a strategy will not deliver high performance and other desired results if all parts of the organization do not work well together to move in a unified direction. The broader competency of planning and administration focuses on the issue of achieving co-alignment, or more simply, “fit.” Managers must ensure that all parts of the organization fit together to support the strategy. Some of the most important sources of fit are the following:

Activity Fit. Simply put, do we have all the resources in place to perform the activities necessary to create and deliver the organization’s value proposition? Is the organization up to task?
Are research and development (R&D) laboratories working on the right projects that will develop winning products and improved production processes? Are factories producing the best quality products using the right materials and the right processes? Is the marketing department developing the best message to reach out to our existing and future customers? Are we providing our customers with the level and kind of service that they expect? Should we even be performing some activities that our suppliers might be better doing for us?

**Corporate Fit.** For companies that operate multiple lines of business, this is a core issue. How do we get our business units to work together? What kinds of activities should our businesses share? How do we transfer resources among business units? Can we lower costs by combining certain activities from different businesses together? Can we enhance our value proposition by performing activities from different businesses together?

**Alliance Fit.** If we are working together with other companies, do we have the right partners? Are their strategies compatible with ours? Can our partnerships help us to learn and to do new things better?

**People Fit.** Are our people trained and skilled to perform the tasks they need to accomplish? Are we hiring the right people for our organization? Are we developing our people to do things better?

**Reward Systems Fit.** Are our people sufficiently and appropriately rewarded for their efforts and output? Are we encouraging our people to perform their best?

**Communications Fit.** Do we promote clear and honest communication among our people? Do people understand the purposes of our strategy? Are we communicating effectively with our customers? Are we learning from them? Equally important, are we listening and engaging with our broad base of stakeholders, including key people in the communities we serve?

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**Planning and Administration: Charles Schwab**

In 2000, Charles Schwab Corporation, a leading discount brokerage house, purchased U.S. Trust for $3.2 billion to extend its reach to a new set of customers. U.S. Trust is one of the most exclusive providers of asset management services to the ultra-rich. Facing the prospect that new online brokerages (for example, E*Trade, Ameritrade, TD Waterhouse) were beginning to erode Schwab’s competitive position in serving the mass market, Schwab began to pursue a richer customer base. However, the relationship between Schwab’s core brokerage operation and U.S. Trust has been tense from the very beginning.

During the 1980s and 1990s, Charles Schwab grew by providing investors discounted pricing to trade stocks and other financial instruments. By offering investors the opportunity to pay as little as $30 per transactions, Schwab grew its account base into the millions. Individual investors preferred Schwab because it offered some of the same services as full-service brokerage houses (for example, Merrill Lynch) without the high commissions. The typical Schwab investor belongs to a “mass-affluent” group that has about $100,000 to $1 million to invest, and prefers to make his or her own decisions about how to invest.

When Schwab purchased U.S. Trust, it immediately encountered difficulties in working and communicating with financial advisors who provide a very different type of financial service. The average account size at U.S. Trust is about $7 million. However, the management of U.S. Trust differed substantially from Schwab’s mass-market approach. Founded by wealthy industrialists in the 1850s, U.S. Trust earned a very loyal following among several generations of well-heeled families who rely on it to provide a full range of services, including asset management, trust and estate services, and even financial planning in the event of family changes (for example, divorces, new births). The relationship between a U.S. Trust advisor and a client is very long term.

Schwab wanted many of its top-tier investors to transfer their assets to U.S. Trust. However, because U.S. Trust charges high annual fees on the amount invested, many of Schwab’s customers balked at the idea of paying someone else...
Global Awareness Competency: Competing in a Smaller World

There is little doubt that every firm is competing in an increasingly globalized marketplace. Consumers around the world are becoming smarter and more selective about what they want to buy. New markets are fast opening up in China and India; these countries are also the birthplace of fierce new rivals in a broad array of industries. With few exceptions, trade barriers among countries and regions continue to decline. This opens up enormous opportunities for U.S. firms to sell in places they previously could not easily reach. At the same time, companies are merging across national borders to form truly multinational enterprises. For example, cross-border mergers, acquisitions, and joint ventures have produced such well-known giants as GlaxoSmithKline, Sanofi-Aventis, and AstraZeneca in the pharmaceutical industry, Daimler-Chrysler and Renault/Nissan in the automotive industry, Airbus Industries in aerospace, and WPP Group in advertising. Although managers need to be aware about global developments in a variety of spheres (for example, politics, diplomacy, regional rivalries), our focus is limited to three different aspects:

Opportunities and Threats Exist Anywhere. Globalization presents a double-edged sword. On the one hand, the rapid industrialization and emergence of tens of millions of people into the middle class each year present vast opportunities for companies to reach out to new customers. The huge demand for semiconductors, steel, plastics, and industrial machinery in China, for example, offers an unprecedented opportunity for U.S., European, Japanese, and South Korean firms to serve this huge market. Prices are currently rising for many high-technology products and commodities needed in China. At the same time, the enormous growth of the Chinese economy brings with it the blossoming of thousands of local competitors who in turn will likely challenge firms from more developed countries over the next decade. We are already beginning to witness this trend as China begins exporting television sets, textiles, small appliances, clocks, furniture, and even some types of advanced computer networking equipment and integrated circuits.

In a broader sense, globalization means that companies must always remain vigilant for new types of competitors that may spring up from any region of the world. We have already witnessed the rapid rise and success of such diverse companies as Nokia (Finland), IKEA (Sweden), Toyota (Japan), Samsung (South Korea), Wipro and Infosys Technologies (India), and Embraer (Brazil). These companies have begun to compete for global market share at the same time they compete with the biggest rivals anywhere.
Different Business Practices. Companies coming from different regions of the world often bring with them different expectations about how to do business. In many instances, they bring with them exceptional levels of customer service and some of the highest value products (for example, Singapore Airlines in airlines, BMW in automobiles, Samsung in sleek designed phones). The refinement of Toyota’s legendary just-in-time inventory system, as well as its distinctive approach to quality improvement, has become a real role model for any industrial company located anywhere. However, globalization also means that firms must be aware of business practices that may not be familiar, and in some instances, may be undesirable (for example, the use of bribes for inside information or preferential market access). Corporate governance practices, in particular, can vary widely across different legal traditions and precedents.

Cultural Awareness. There is no doubt that serving customers in new national or regional markets requires a delicate appreciation of local cultures and sensitivities. Because this topic alone could provide the basis for an entire book in its own right, we offer little direct, concrete guidance here. However, cultural awareness is a very salient issue as it relates to working with suppliers, customers, and alliance partners from different parts of the world. Cultural awareness is a major issue as it relates to cross-border mergers and acquisitions also. An appreciation of how people from various national cultures view complex strategic issues can provide a genuine source of competitive advantage for organizations that seek to broaden their scope of knowledge. Cultivating cultural diversity can help organizations “see” opportunities, challenges, and other issues from multiple “strategic lenses.”

Competing in Global Markets: Philips Electronics

Philips Electronics is one of the world’s biggest producers of medical equipment, consumer electronics, semiconductors, flat-screen technologies, and home appliances. A European company with a very proud tradition of innovation (it possesses over 100,000 patents), Philips has consistently led the world in developing many important technologies. For example, it helped pioneer medical X-ray technology, the audiocassette, the electric shaver, and today’s current compact-disc technology (in conjunction with Sony of Japan). Yet, for all of its creative flair in the labs, Philips has struggled to compete with the likes of Matsushita, Sony, and Samsung in the marketplace.

A big factor behind Philips’ outstanding record of innovation is that the company has long encouraged scientific research and big projects that yield potentially big payoffs. While cultivating innovation, Philips has traditionally marketed its products in different parts of the world separately. Although Philips originated in the Netherlands, the company has historically looked to larger markets in the United States, Latin America, Asia, and the rest of Europe for much of its growth. Because the Netherlands by itself provides too small of a home market to expand, Philips was one of the first companies to formulate and implement a worldwide strategy that witnessed the steady growth and profitability of local operations. Many of Philips’ innovations over time came from large laboratories located throughout the United States, Europe, Australia, and Canada. Over time, Philips relied heavily on its regional affiliates to manufacture many of its leading-edge products for sale in national and more local markets.

This innovation-driven strategy worked for Philips for many decades. Ultimately, Philips’ emphasis on developing products for local markets came under severe economic strain from Japanese competition during the 1980s. Able to rely on a much bigger domestic market to provide critical mass, Japanese rivals such as Matsushita Electric, Sony, JVC, and Toshiba began producing consumer electronics and other high-technology products at lower unit costs. Unlike Philips, Matsushita and other Japanese firms were able to construct much larger factories that were ultraefficient. Over time, they were able to overtake Philips’ market position in many markets through the production of quality products at lower costs, even though most production still occurred in Japan. Compared with Sony, Philips also faced considerable difficulties building up a well-recognized brand name with global reach.

Recognizing this competitive challenge, Philips has attempted to restructure its operations to compete more effectively with these rivals over the past two decades. Its current CEO, Gerard Kleisterlee, is overseeing a major reorganization of Philips that seeks to combine disparate operations and organizational practices into a more cohesive system. Kleisterlee
wants Philips’ traditionally separate business units to communicate and to coordinate their activities to achieve significant cost savings and to deliver leading-edge products to market faster. At the same time, the company has decided to allocate more resources to high-growth opportunities in its core medical, electronics, and flat-screen businesses. Philips is also consolidating its highly dispersed marketing and distribution activities to eliminate duplication and high costs. Managers in each of Philips’ regions must now meet and coordinate their strategies and activities more frequently.

In addition, Philips has formed a wide array of technology-sharing relationships with companies throughout the United States and the Far East. With LG Group of South Korea, Philips formed a separate company known as LG Philips LCD, which has become the world’s second largest producer of liquid crystal display (LCD) screens that are found in flat-screen televisions, cell phones, and digital cameras. Philips also recently teamed up with a Chinese maker of medical equipment known as Neusoft. Philips–Neusoft Medical Systems, a newly formed company, will produce medical imaging equipment (for example, CT scanners, X-ray machines) for use in China. In the field of advanced integrated circuits, Philips joined with Taiwan Semiconductor Manufacturing Company to codesign and co-produce leading-edge chips that will power next-generation appliances and consumer electronics. It is also working with Samsung Electronics of Korea to produce state-of-the-art digital phones that will allow people to make financial and other secure transactions through an “electronic wallet.” Philips also has great ambitions to be an important supplier of new digital technologies for future home entertainment centers. For example, Philips hopes to build the chips, flat-panel displays, sound systems, and other critical components that will transform the way that people enjoy free time in their living rooms. Future home appliances will likely be connected to one another through Internet-like technologies that offer greater ease and convenience of use.

Philips’ strategic transition is designed to compete more effectively in an increasingly connected global marketplace. However, the process of changing Philips’ organizational practices represents a long-term, ongoing effort that has already helped the company become more profitable and faster moving.

**Leveraging Technology Competency: Staying on the Cutting Edge**

New technologies and innovations are redefining almost every industry imaginable. Technology by itself has little value; however, technology offers great value and competitive advantage to organizations that can harness it and use it in distinctive ways. Developments in technology occur everywhere everyday. Many people associate the Internet with advanced technology, and businesses are using it to transform their operations and the way they interact with customers, suppliers, and other firms. Yet, technology goes beyond the Internet to include advanced methods to manufacture products with improved quality at lower cost; new ways to treat patients with less pain, risk, and financial costs; new sources of research, information, and knowledge that lay the groundwork for advanced drugs, plastics, environmentally friendly materials, and food products. Remember that technology only produces competitive advantage to the extent that an organization is able to leverage it in a distinctive manner. Some of the most important technology-based impacts on strategy include the following:

**Faster Innovation.** The arrival of cheaper computing power, the omnipresent reach of the Internet, and the wide availability of talent worldwide makes it possible to create, test, produce, and deliver leading-edge products and services with greater speed and quality than ever before.

**Big Companies Act Nimbler.** When creatively used, technology can help large companies become more agile to compete more effectively. Technology can help large companies overcome some of the traditional barriers to fast information flows that sometimes occur when operations become large and complex.
Small Companies Act Big. Likewise, when creatively used, technology can help small upstart companies gain the benefits that usually accrue to much larger companies. The Internet, for example, increasingly enables small companies and even individuals to sell directly to much larger companies to search for the best possible pricing for almost every product and service. For example, eBay thrives by offering a global online auction-based transaction system that allows anyone to set up a virtual shop to sell his or her products and services with little overhead costs.

Leveraging Technology: Innovation at Sony

Sony Corporation is one of the world’s most consistently successful innovators of consumer electronic products. Throughout its history, Sony has consistently surprised and delighted consumers with superbly designed, user-friendly, high-technology products year after year. Many of its legendary innovations (the pocket-sized transistor radio, Walkman portable radio/cassette player, videocassette recorder [VCR], Trinitron system color television set, camcorder, the compact-disc [CD] player [developed in conjunction with Philips Electronics], and the later MiniDisc) defined state-of-the-art consumer electronics from the 1970s through the 1990s. Its most recent innovations, such as the PlayStation 2 and 3 series of video game systems, PSX DVD (digital video disk) recorder, Cybershot and Mavica digital filmless cameras (using charged coupled devices [CCDs] and flash memories), MP3 players, and advanced flat-screen televisions (using LCD and LCOS technologies) demonstrate Sony’s capabilities and commitment to leading innovation. Sony believes that “you don’t research demand—you create demand.”

In the past, Sony has benefited from technological and market-based changes by learning and leading, rather than following competitors in the innovation race. Sony prefers to deploy its innovation prowess and marketing acumen to create entirely new classes of products and technologies that customers have not even anticipated. Sony often assigns several teams, each pursuing a different technology, to work on the same development problem. For example, five teams worked at various times on the company’s CD player and later the MiniDisc project. By encouraging strong competition among teams and product development units, Sony increases the likelihood that a core technology and product idea will emerge as a leader. In addition, working with different technologies helps Sony learn which products are more likely to be easily manufactured and improved over time. By working with different designs and seeing how a customer will likely use a product from different angles, Sony can continuously improve its products over time by incorporating new features and streamlined designs. This innovation approach gives Sony a market edge over its competitors.

Sony’s distinctive approach to creating new products and technologies has worked wonders for the company. However, the company’s preference to develop its own proprietary technology also means that Sony faces greater risks if a product idea does not work out. For example, Apple’s iPod MP3 player has been initially more popular than Sony’s Walkman MP3 player, despite the iPod’s higher price. Sony even encountered difficulties in the television business, when other rivals such as Samsung and Sharp beat the company to market in 2003. Nevertheless, Sony regards its strategy of “creating demand” as central to its competitive advantage. Despite these setbacks, Sony’s latest gadgets incorporate leading-edge technologies and features from once separate products. New Sony flat-screen televisions, for example, allow watchers to surf channels using a tiny joystick and include a 3-D speaker system to bolster sound. The television development team also worked with Sony’s video game division to give the set the feel of a game console. Future versions of the Qualia and Wega brand sets will include image-processing technology that can sharpen picture quality from ordinary standard television to high definition (HD) and even ultrahigh definition.

Sony still believes that it can create future business opportunities by leading customers to entirely new types of products. It competes aggressively with Microsoft’s Xbox video game system and is now working on ways to create a “digital living room.” In its quest for future dominance over next-generation entertainment hardware standards, Sony is also testing an entirely new class of high-definition DVD systems using what is known as “Blu-Ray” technology. Blu-Ray offers up to sixteen times the storage capacity of conventional DVDs, although Sony must compete against the likes of Toshiba and NEC, which are developing their own version of high-definition DVDs. The ongoing escalating cost of technology development has caused Sony’s management to rethink how best to develop leading-edge products in recent years. As Sony attempts to become even faster at innovation, it is seeking new technology and marketing partners, such as Microsoft, to jointly develop new ideas (for example, portable digital music players). Sony is also encouraging its many internal product development teams to work more closely with one another across business units to ensure that good ideas do not get lost.

As next-generation technology products incorporate cutting-edge semiconductors and other display technologies, Sony now works with Toshiba and IBM to develop future
microprocessors that will serve as the electronic brains of its PlayStation 3 video game consoles and other appliances. This chip, known as "The Cell," will likely find its first use in new computer technology that will dramatically enhance the creation of special effects and animation for Hollywood—a feature that may change the way that Sony's movie business uses technology to create films. Future television sets that incorporate "The Cell" may even enable watchers to take a television character and insert him or her into a video game. At a minimum, this same chip is expected to better handle the huge volume of video streams and data beamed from satellite and cable systems onto flat-screen televisions.

**Stakeholder Competency: What Decision Criteria Are Used?**

The strategy concept helps managers deal with competitive realities. However, competition is not the only factor managers must consider. They must also weigh the needs of stakeholders when making strategic decisions. Throughout this book, we will explore some of the dilemmas managers face when attempting to consider the needs of various stakeholders. By way of introduction to this material, let us briefly identify key stakeholders of business organizations and the difficulties senior managers often face when attempting to accommodate stakeholders’ needs.

Among the most important stakeholders of any business organization are shareholders, customers, workers, the communities in which firms operate, and top managers themselves.

**Shareholders.** Shareholders provide the equity capital to finance a firm’s operation. Therefore, they have a vital stake and say in its welfare. Although most shareholders are interested in earning a return on their investment, individual shareholders may have differing preferences for the timing of returns (some being interested in immediate benefits, others in long-term returns), varying tolerances for risk taking (some preferring to strictly limit risk, others to assume more risk to reap potentially higher returns), and differing needs for maintaining control of the firm. Feasible strategic alternatives often will have a different impact on these different dimensions. Senior managers must strive to select an approach that reflects the relative importance shareholders attach to each dimension.

How top managers deal with shareholders’ concerns is becoming increasingly important to the fate of companies and to the careers of top managers. A growing number of chief executive officers (CEOs) at leading firms have been dismissed in recent years because of their inability to generate sufficient return to their shareholders. For example, companies such as General Motors, Ford Motor Company, Sears, J. C. Penney, 3M, Honeywell International, Procter & Gamble, and The Home Depot have sought new CEOs in the past few years to deal with new challenges that face their respective firms. Shareholders exercise important powers, enabling them to oblige top executives to take the necessary steps to maintain or restore profitability of the firms they manage. Senior management owes a fiduciary responsibility to their shareholders. A **fiduciary responsibility** means that managers must act in the financial interest of shareholders, because shareholders directly or indirectly hire the top management of a company.

At the same time, shareholders take on a degree of financial risk by investing in company stock. For example, a number of well-known companies declared bankruptcy in the wake of serious economic difficulties. Companies such as Montgomery Ward (retailing), Finova (financial services), Tower Automotive (auto parts), US Airways Group (airlines), and Global Crossing (telecommunications) are just a few firms that have experienced very grave competitive issues.
Customers. As noted earlier in the discussion of the concept of strategy, competition requires that firms satisfy the needs of customers or go out of business. A firm’s responsibility to customers does not simply end there, however. Customers are often unaware of many aspects of the products and services they buy. Product quality, integrity, and safety are essential issues that managers must consider when designing and selling products or services to the buying public. A firm failing to consider such factors risks loss of reputation, potentially onerous legislation, costly liability litigation, and even imprisonment of managers. To avoid such risks, senior managers must keep their broader responsibilities to customers in mind when making strategic decisions.

Employees. Employees typically seek a wide range of benefits that managers must consider when making strategic decisions. These include adequate compensation, benefits, safe working conditions, recognition for accomplishment, and opportunity for advancement. Careful attention to such needs can sometimes produce spectacular results. Leading high-technology firms such as Cisco Systems, Intel, Microsoft, Xerox Corporation, Dell Computer, EMC, and Apple Computer, for example, treat their employees exceptionally well by giving them generous benefits, flexible work hours, and even day care for their children. These progressive companies have achieved considerable success producing state-of-the-art products and technical solutions that are consistently in high demand. By contrast, many U.S. airline companies (for example, Continental Airlines, Delta Air Lines, and American Airlines) have experienced difficult relations with their employees. High labor costs severely eroded the long-term profitability of almost every major U.S. airline. Over time, management’s initiatives to cut labor costs resulted in decreased employee morale, shoddier service, and poor management-labor relations. Workers crippled some airlines—specifically Eastern Airlines during the late 1980s—with protracted strikes costing the company millions of dollars.

Employees at many companies serve in the dual role of shareholders as well. For example, the retirement plans used in many companies (known as 401[k] plans because of the tax code) are used to provide a means for employees to save for their futures. However, many of these plans contain a significant amount of company stock, thus directly tying the fate of employees to that of their companies. Over time, however, increased government regulation, triggered in part by the Enron scandal, will likely allow employees to take on less risk as they build their retirement assets.

Communities. Communities rely on firms for tax revenue, employee income to sustain the local economy, and financial and other support for charitable and civic organizations. They are also adversely affected when a firm’s facilities pollute the air, burn down, or close down. Thus, communities have a vital stake in the health and integrity of firms operating within their borders. Because communities have legislative authority, they are in a strong position to enforce their wishes. Senior managers must therefore keep community needs in mind when formulating strategies. Cummins Engine, a leading manufacturer of diesel engines for trucks and construction equipment, has paid careful attention to community needs. It traditionally has worked closely with the city of Columbus, Ohio, the site of its corporate headquarters. Cummins is a leading contributor to many civic activities in Columbus; it also is one of the few companies that does not avoid paying a high level of taxes to the city to fund numerous municipal programs. Ben and Jerry’s Ice Cream (now a unit of Anglo-Dutch Unilever PLC) works with neighboring communities in its home state of Vermont to promote a clean environment and social programs. Eastman Kodak works closely with government officials in Rochester,
New York, the site of its corporate headquarters, to design community self-improvement programs that enable people to learn skills through education. Corporate and city/state managers often meet together to discuss vital economic and social issues that affect the needs of workers and people in the larger community.

**Senior Managers.** To lead their organizations and implement strategy effectively, senior executives must be personally ethical, enthusiastic, and committed to the direction of their firms. Managers often have varying preferences for goals such as a firm’s size (over $100 million in annual sales), growth rate (at least 20 percent per year), the areas in which a firm competes (high-tech businesses only), and location of facilities (global operations). Top managers need to consider their own personal skills and experiences in developing strategies so that they can feel committed to the course the firm is pursuing. Above their own needs, of course, must come needs of shareholders when evaluating and developing strategies that affect the long-term value of the firm.

*Balancing Stakeholders: IBM and Job Creation*

In early 2004, IBM announced that it would begin to increase the amount of software development and other high-technology work performed outside the United States. Lured by markedly lower labor costs in places such as China, Brazil, and India, IBM believed that it needed to hire thousands of engineers and other skilled personnel in these locations to reduce the overall cost of its business operations. As a result, many American employees would face the likely prospect of unemployment. Although scores of large U.S. companies have farmed out work to overseas locations in the past, what was particularly noteworthy about IBM’s announcement were the great lengths that senior management took to disguise the full impact on the people most affected by this move. In the past, IBM received great praise for its internal policies that promoted high wages and full employment where possible.

In a series of internal company documents uncovered by the *Wall Street Journal*, IBM employees affected by this “offshoring” of software development work will be compelled to train the very individuals that will ultimately replace them. In other words, a highly skilled IBM manager or engineer, facing the likely prospect of unemployment, will face the additional humiliation of teaching another person how to do his or her job before exiting the company. IBM senior executives, aware of the likely difficulties and sensitive nature of this situation, issued a series of memos to managers to be careful in how they describe the transfer of work to foreign locations. For example, if employees were to ask about whether they would be impacted, IBM managers should use carefully phrased, highly nuanced words to avoid direct discussion of the move. If employees were to request anything in written form, then all correspondence should be “sanitized” by the human resources department before anything is communicated back to the employee.

The unrest and controversy surrounding IBM’s decision demoralized a big portion of its workforce. In addition, for a company that has long enjoyed a tradition of being nonunion, employee interest in forming unions to represent them grew. Membership in Alliance @ IBM, a union that is affiliated with the Communications Workers of America, grew from 5,000 to 6,000 in just a span of six months. Put in a larger context, IBM has over 140,000 employees working in the United States. However, over the past few years, IBM has created only 2,000 jobs annually, while significantly boosting the hiring of overseas nationals at a much faster rate.

From a corporate perspective, IBM has avoided discussing this issue openly with its employees. To keep a lid on bad news, senior executives tried to “paper over” the issue with deliberately vague language. From an employee’s perspective, IBM’s decision, as well as its handling of the matter, generates considerable mistrust of the company. The requirement to train a replacement for your job adds to the loss of personal dignity. Yet, IBM and many other large U.S. companies feel they have little long-term choice in the matter. Wages in China and India are as much as three-fourths lower than comparable U.S. wages. IBM’s competitors, such as Intel, Hewlett-Packard, Dell, and Microsoft, have all commenced or further boosted their employment in lower-wage countries to remain competitive over the past several years. Shareholders and financial markets in general are demanding that companies reduce costs as much as possible to compete globally and to remain profitable.
Responsibility for Strategic Management

Lower-level employees in an enterprise often possess considerable specialized expertise about such issues as technology, customers, and marketing. This gives them an excellent vantage point from which to identify opportunities and threats and to assess a firm’s strengths and weaknesses. One might therefore expect senior managers would turn over to them considerable responsibility for conducting the strategic management process. In fact, senior managers do share such responsibility with employees, at least in part. However, top managers generally must play a primary role because of the large financial outlays associated with strategic decisions, the long-term impact of such decisions, and the considerable controversy that such decisions often provoke. Many strategic decisions also bring with them difficult choices on how best to reconcile the needs of various stakeholders.

Who Are Strategic Managers?

There are two kinds of senior managers most directly responsible for strategy: business managers and corporate managers. Business managers are in charge of individual businesses. In a diversified, multibusiness firm (such as IBM), the executives in charge of individual businesses (such as electronic commerce, semiconductors, servers, networking systems, storage systems, and consulting) are business managers. These executives go by a variety of titles, including business manager, general manager, division manager, and strategic business unit manager. The president and chairperson of a single business enterprise (for example, Papa John’s International, Domino’s Pizza) are also business managers.

Corporate managers are responsible for portfolios of businesses. Consequently, corporate managers exist only in multi-business firms (for example, General Electric). The president and chairperson of a multibusiness enterprise are corporate managers. Multibusiness firms containing large numbers of businesses often assign executives to positions midway between individual businesses and these senior executives. Each such individual oversees a subset of the firm’s total portfolio of businesses. Because each of these individuals has supervisory responsibility for several businesses, these executives are considered corporate managers as well. They go by a variety of titles, including group vice president, executive vice president, and sector executive.

Both business and corporate managers play pivotal roles in the strategic management process. They are the key people who bring all other assets into play when competing with other firms. They also represent the highest levels of authority within the firm or subunit. As a result, they exert enormous influence over the company’s capital expenditures to build new plants or to acquire other companies, chart the future direction of the firm’s growth, and direct the firm’s efforts toward emerging market opportunities. Top managers often serve as the spokespersons for their firms when dealing with the media over such issues as breakthrough technologies, new product rollouts, or potential allegations against the company by shareholders, customers, or communities. Thus, top managers perform multiple tasks at the highest level of an organization and bear the highest responsibility for their firm’s strategies and actions.

At the same time, customers, investors, employees, and even the public at large depend on the judgment, experience, and skills of these managers to compete both fairly and within the law. For the vast majority of companies in the United States, senior managers continue to work long hours formulating strategies and action plans that aim to satisfy their customers, reward their investors, develop their employees, and foster a larger sense of public trust. However, business is not immune from scandalous activities that can mar the reputation of entire industries for an extended period.
Characteristics of Strategic Decisions

Large Financial Outlay. Decisions reached through the strategic management process often commit a firm to significant investment of funds. For example, in the high-technology semiconductor (chip) industry, the decision to build a new factory can cost a firm up to $3 billion. In 2001, U.S. semiconductor giant Intel spent over $7.5 billion on capital expenditures alone. Intel sees this huge outlay as a way to learn and apply ever more sophisticated manufacturing techniques to design faster and more powerful chips. In the next few years, a new chip plant will likely cost upwards of $5 billion. Intel continues to invest relentlessly in new manufacturing techniques and scientific breakthroughs to design and produce ever more powerful chips. Other industries face similar situations where high capital expenditures are required to compete in the industry. With its decision to build the Saturn manufacturing plant in Tennessee during the 1990s, General Motors (GM) committed as much as $5 billion over a ten-year period to factory equipment, training, new tools and dyes, robotics, and so forth. Now, GM is trying to use what it learned from the Saturn experience to revolutionize automobile manufacturing in its other divisions; Saturn has already become the “teacher” that shows other GM divisions, such as Chevrolet and Pontiac, how to build small cars effectively. Rolling out a new advertising campaign to promote a new pizza brand at Pizza Hut could cost well over $300 million over several years, with little guarantee that the promotion will be successful. In the pharmaceutical industry, the decision to develop new blockbuster drugs to fight cancer, AIDS, heart disease, diabetes, and other ailments can easily cost upwards of $2 billion. Many leading-edge drugs take over fifteen years to develop before they are considered safe and effective. Pharmaceutical and biotechnology companies must continue to invest in many new technologies to discover new drugs and other compounds that increasingly require more sophisticated methods and techniques. These expenditures also expose the drug maker to great financial risks, and possibly even legal risks. Decisions by Procter & Gamble, Cisco Systems, Citigroup, Microsoft, American Express, Pfizer, Coca-Cola, and PepsiCo to develop new products, launch advertising programs, and acquire other companies often involve very large sums. These are therefore critical strategy issues that fall within the realm of top management.

Long-Term Impact. Decisions reached through the strategic management process are often difficult to reverse. Strategic decisions therefore commit an organization to a particular course of action for an extended period. A decision to build a manufacturing facility, for example, involves choices about location, size, manufacturing technology, training programs, and choice of suppliers. Many factors are difficult to alter once a facility has been built. Investment in physical assets, such as a factory, is just one of many decisions that have a long-term impact. Other hard-to-reverse decisions include acquiring another company, forming a strategic alliance, the creation of industry-wide technical standards for new products, and the amount to spend on research and development to foster innovation.

How a firm allocates resources to strengthen its competitive position thus requires judgment as well as disciplined analysis. Considerable time generally is needed to make changes; during the interim, a firm may not be able to respond to customers’ needs or the challenge brought on by new technologies or rivals. Likewise, a decision not to invest in some key activity can also impose its own set of costs. For example, in the late 1990s, IBM’s initial inability to expand capacity quickly to produce its highly popular ThinkPad notebook computer gave Japanese competitors easy entry into this extremely profitable segment. Similarly, the difficulty that confronts Eastman Kodak as it struggles to convert to digital photography highlights the inherent risks that senior managers face when allocating resources to new products.
in fast-changing environments. In many industries, investments in fixed assets are often con-
sidered “irreversible.” Unsuitable facilities also are often so specialized that they cannot be sold
except at a substantial loss. For example, oil companies such as Chevron Texaco, Royal
Dutch/Shell Group, and ExxonMobil are saddled with numerous refinery operations that are
quickly becoming obsolete because of new technology and numerous environmental regula-
tions that were continuously introduced over the past decade. Cleaning up these refineries will
add tremendous costs to these firms, thus raising the cost of gasoline for consumers. Although
these firms might like to liquidate some of their facilities, doing so may be difficult; few buy-
ers are likely to be interested in these specialized and increasingly obsolescent assets. Not all
strategic decisions are irreversible, but most exert a long-term impact on the organization. Top
managers therefore become involved in strategic decisions in an effort to avoid costly mistakes,
but there is no guarantee of their success.

Controversial Nature. Strategic decisions often engender controversy among the firm’s
managers and employees. Consider a decision by Olympus Optical to customize camera prod-
ucts to meet the needs of individual customers. Sales personnel are likely to favor such a policy,
since customization improves their ability to meet customer needs and thereby increases sales
volume. It would enable customers to buy different types of cameras with different types of
lenses and other features according to their experience level, personal budgets, and color or
model preferences. Manufacturing personnel at Olympus would likely resist this move, how-
ever, because customization of products significantly complicates the production task, thereby
increasing manufacturing costs. Senior managers must oversee and manage controversies of this
sort to prevent disagreements from escalating into time-consuming arguments and to ensure
that decisions ultimately reached reflect the needs of the overall enterprise.

In recent years, the strategic actions of some companies have invited considerable scrutiny
by the government, as well as by investors who question the efficacy of some expenditures. For
example, Microsoft faced an inquiry from the Department of Justice in the United States and
regulatory bodies in Europe in recent years over its economic behavior and massive expendi-
tures to promote the use of Internet Explorer and Microsoft Media Player as part of its software
offerings for personal computers. Competitors such as Sun Microsystems, Time Warner, and
other smaller firms charged that Microsoft deliberately spent prodigious sums of money to en-
courage customers to move away from products offered by rivals, thereby creating a de facto
monopoly in key aspects of the software business.

Likewise, many people have questioned the significant marketing expenditures under-
taken by U.S. pharmaceutical firms to promote products and brand awareness among con-
sumers. Some people in Congress, as well as public interest groups, wonder why companies such
as Pfizer, GlaxoSmithKline, Wyeth, AstraZeneca, Merck, and Schering-Plough advertise their
products so aggressively, yet at the same time they have not reduced the price of their drugs. At
the same time, pharmaceutical firms are fighting price controls and the specter of increasing
government regulation as their profit margins face continued pressures from new competitors,
generic drugs, and the escalating costs of research.

In another realm, investors have increasingly become more vocal about what manage-
ment should do to build competitive advantage. Particularly in the last few years, investors are
becoming more active in voicing their opinions about key strategic decisions. For example,
investors may signal their approval or dislike of a company’s decision to acquire another firm.
Consider the case of Hewlett-Packard (HP) in 2001-2002. Investors responded very coolly to
HP’s announcement that it wanted to merge with Compaq Computer. Believing that the two
companies would not make a suitable fit, investors sold off their shares in Hewlett-Packard, thus
revealing their distaste for the merger. Even though HP ultimately completed its merger with Compaq, many investors remain skeptical of the combined firm's ability to compete with Dell and IBM. CEO Carly Fiorina, who spearheaded H-P’s merger with Compaq, has recently come under greater scrutiny by the company’s Board of Directors as H-P continues to face difficulty in competing with Dell Computer and other rivals. By February 2005, the Board asked Fiorina to resign as the company seeks a new direction to revitalize its growth. Many analysts on Wall Street have increasingly called into the question the rationale for the merger and are calling for a major restructuring of H-P’s operations.

**Difficulties in Reconciling Stakeholders’ Needs**

The task of accommodating stakeholder needs is complicated by several factors. First, stakeholders have a great variety of needs. Second, the relative strength of such needs is often difficult to determine. The willingness of shareholders to accept risk, or a community’s tolerance for pollution, is often exceedingly difficult to judge. Third, individuals within each stakeholder group often have conflicting needs. For example, as noted previously, individual shareholders may have different risk reward preferences: some desiring a risky strategy with high potential returns; others prefer a more conservative approach, even if it offers lower returns. Perhaps most difficult of all are conflicts that arise between stakeholder groups. Shareholders, for example, may favor reducing water pollution control expenditures to increase short-term profitability, whereas the community in which a firm operates disapproves of such a step because of its increased risk of water contamination.

Conflicts such as these are often called ethical dilemmas because they pit the needs of one stakeholder group against those of another. Ethical dilemmas can occur during the strategy selection process and pose some of the most troublesome strategic issues managers confront. To resolve them, managers must carefully weigh the claims of contending parties, a complex task requiring great sensitivity, balance, and judgment. It is not our purpose here to provide definitive guidance in this area. However, it is useful to mention three criteria managers must consider when assessing conflicting stakeholder claims: legal obligations, expectations of society, and personal standards of behavior.

**Legal Obligations.** At the very minimum, managers must devise strategies that are within the law. Failure to do so can lead to severe consequences such as fines, public censure, and even imprisonment. For example, bond traders at several investment banking and securities firms in the United States, Japan, Singapore, and elsewhere engaged in a wide range of speculative illegal activities to corner various commodity markets during the 1990s. Such illegal actions have exerted a high cost on both the firms and their managers. Even more blatant was the wave of corporate corruption cases that plagued the United States over the past few years.

Consider the recent series of events that surround the collapse of the Enron Corporation, an energy giant that had tremendous ambitions to expand into a variety of businesses. When Enron declared bankruptcy in November 2001, it not only cost investors a tidy sum but also inflicted a calamity on its employees. These people believed that they were working for a firm with a bright future. Moreover, almost all employees had their retirement assets tied to the value of Enron stock, and they were prevented from selling their stock at a crucial time when the company’s fortunes were rapidly declining. When Enron ultimately collapsed, all of these employees faced dire financial futures. At the same time, many senior executives were able to sell their stock in the months ahead before the true depth of Enron’s financial troubles surfaced in the news. Scandals such as these put American business on the defensive, because the public becomes more skeptical, and even cynical, about the motives (and even the integrity) of senior management.
Names such as Enron, WorldCom, Tyco International, HealthSouth, Adelphia Communications, and others have become notorious, and even synonymous, with corporate greed, fraud, and outright theft. The disastrous impact of corporate corruption on shareholders, employees, and middle managers triggered increased government regulation to prevent future abuse.

**Societal Expectations.** Managers must also strive to meet the broader expectations of the communities in which they operate, even when such expectations are not explicitly codified into law. Failure to do so can lead to costly litigation. Unfortunately, many companies have taken actions that cost their trust with the public. For example, thousands of patients sued pharmaceutical giant American Home Products (now known as Wyeth) for medical conditions that may well have resulted from the taking of some controversial diet drugs during the 1990s. Now in 2005, patients and shareholders have contemplated and initiated legal action against Merck, a pharmaceutical firm that developed Vioxx to treat arthritic pain. Lawyers for patients claim that Merck allowed Vioxx to remain on the market even when it knew that the drug may well have elevated heart attack risks for some patients. Even more astounding was the constant refusal by tobacco companies to acknowledge a key link between smoking and cancer. Even through much of the 1990s, executives from tobacco companies vociferously defended their companies’ viewpoints that smoking was not a major factor related to the high incidence of lung cancer. As a result, the government began to investigate the marketing, product development, and advertising practices of tobacco companies; public pension and retirement funds sold their shares in tobacco companies as a sign of protest; and numerous states began to sue the companies for reimbursement of smoking-related health costs. Over time, the tobacco companies were forced to change their marketing practices and to pay huge sums to different states as part of a larger tobacco settlement that cost the industry tens of billions of dollars. Yet, the tobacco companies face continued legal difficulties as some cancer patients are suing the same companies in court. In the early part of the 1990s, other companies faced a number of different issues related to societal expectations of corporate behavior. The numerous lawsuits that confronted Dow-Corning over the safety of its silicone breast implants emphasize to all firms the importance of prioritizing such issues as safety, health, due diligence, and other social-responsibility matters. In the early 1990s, Dow-Corning spent hundreds of millions of dollars and precious time in court defending its reputation and safety practices and paying fines.

Repeated failure to meet societal expectations often inspires the public to take corrective action in the form of additional legislation. All too frequently, such regulation imposes an even greater burden on firms than socially responsible behavior would have imposed in the first place. These regulations often subject firms to more detailed disclosure requirements, time-consuming paperwork, and stricter product safety and testing practices.

**Personal Standards.** Senior executives can implement strategy effectively only if they feel comfortable with the actions that the strategy entails. A final ethical criterion for judging strategic decisions is thus managers’ own personal standards of behavior. Such standards are generally influenced by the laws and the expectations of the communities in which organizations operate; however, they also reflect many personal factors, such as each manager’s upbringing, religious convictions, values, and personal life experiences. These, too, must be brought to bear on strategic decisions.

The task of resolving ethical dilemmas is complicated by changes in ethical criteria that occur over time. Legislation governing child labor, worker safety, and job discrimination, for example, has changed markedly over the years; so have societal expectations about such issues as air and water pollution, treatment of minorities, and sexual harassment. To avoid adopting strategies that will soon be obsolete, managers must anticipate rather than simply react to such changes.
Standards of behavior also vary widely across geographic boundaries. German law, for example, requires firms to provide workers formal representation on the board of directors; U.S. law imposes no such requirement. Test requirements for new pharmaceuticals are very onerous in the United States but are significantly less rigorous in many other countries. As a result, drugs whose efficacy and safety have not been fully established by U.S. standards can be legally sold in many other locations. Payoffs to managers and key government officials are illegal in the United States but are common business practice in other locales. Managers operating abroad must decide which standards to apply in resolving ethical dilemmas: those prevailing in their home country or those of the countries within which they operate. The need to consider such differences will be even more critical over the next decade as industries and firms become more global in scope. Meeting the laws, societal expectations, and cultural traditions of regions around the world will be as important to corporate success as meeting the needs of individual communities at home. Becoming a successful global competitor compels firms to think carefully about their actions and the reputations they project in other lands.

Why Study Strategy?

What benefit can you derive from studying strategic management? If you are currently a senior manager, the benefit is clear: you can immediately apply the knowledge you will gain. Individuals on track to move into senior management positions will likewise benefit. For many readers, though, that eventuality may be a long way off. However, there are two roles that most readers will soon assume for which an understanding of strategic management can be useful: a candidate seeking employment and an employee or manager within an organization.

Candidate Seeking Employment

Someone seeking employment must assess the long-term career opportunities offered by potential employers. Strategic management can assist in this task by enabling a candidate to evaluate a prospective employer’s competitive position, the soundness of its strategy, and its future prospects. This knowledge can help a candidate avoid employers that may soon be forced to retrench because of competitive difficulties. It can also provide an edge in the recruitment process; candidates can distinguish themselves from others by showing an interest in and a deep understanding of a company’s strategic situation. Demonstrating an awareness of the competitive dynamics of the industry in which a prospective employer operates, the environmental changes affecting its industry, and the challenges these developments pose improves an individual’s chances of employment success. Likewise, it is important that prospective employees, as well as current managers and employees, understand some of the key factors that drive the basis for competition in their industry. A heightened awareness of how companies compete, how technologies change, and the decisive role of customers in deciding the fate of companies will help all people become more sensitive as to how they contribute value to their employers. This book will provide a foundation for this kind of awareness.

Employee or Manager

Entry- or lower-level employees and managers are often closer to the action in the specialized areas of a firm’s operations than top managers. Consequently, they are in a better position to detect developments with potential implications for strategy. By keeping abreast of such matters, understanding the implications of new developments, and communicating their judgments upward, lower-level employees can provide valuable service to their superiors and senior
managers. An understanding of strategic management will help lower-level employees and managers fulfill this function.

Lower-level employees and managers need to understand strategic management for a second important reason. They are critically responsible for implementing company strategy within their own particular spheres of activity. Although superiors will normally provide some guidance on how to do this, their directives cannot anticipate every possible contingency. As a result, lower-level employees and managers must make many decisions on their own. To do so in a way that reinforces rather than undermines what top management is trying to accomplish, lower-level employees need to understand a company’s strategy and the requirements it imposes for their particular activities.

A growing awareness and appreciation for strategic thinking can help all employees understand how changes in the industry environment can ultimately affect their company’s competitive posture. The need for continuous strategic thinking becomes especially important as every organization in every industry confronts a variety of challenges each day, including new technologies, new forms of competition, changes in regulations, and shifting customer needs. As managers and employees become better versed in understanding the impact of their firms’ strategies, they can also play an even stronger role in helping learn, build, and sustain new sources of competitive advantage. Likewise, a growing familiarity and comfort with strategic thinking can help managers and employees advance within their careers. As managers and employees gain increasing levels of responsibility and authority, they will need to be able to think strategically, especially as it relates to allocating scarce resources, people, and time to complete their projects and tasks. Thus, strategic thinking and strategic concepts are by no means the sole domain of senior management; quite the contrary—anyone in any position can benefit from learning and applying key strategic principles to their own roles and lives.

**Summary**

- Strategy is a powerful concept designed to help firms gain a competitive advantage over rivals. It involves two key choices: the customers a firm will serve and the competences and strengths it will develop to serve customers effectively.
- A firm’s choices must reflect its strengths and weaknesses relative to rivals and the opportunities and threats presented by its external environment. Analysis of these four elements is referred to as SWOT analysis.
- All firms must deal with the strategic imperatives facing them according to their own individual situations.
- The management process designed to satisfy strategic imperatives for building competitive advantage is called a strategic management process. It consists of four major steps: analysis, formulation, implementation, and adjustment/evaluation. The issues that managers confront when carrying out these steps will be unique to each firm, depending on the imperatives and situations it faces.
- Because strategic choices frequently involve a large financial outlay, have long-term impact on an organization, and generate considerable controversy among organizational members, top or senior managers generally play a primary role in determining such decisions.
- Executives most directly responsible for strategic decisions are business managers and corporate managers. A business manager is in charge of an entire business; a corporate manager oversees a portfolio of businesses.
- Competitive advantage is one important criterion by which to assess strategic decisions. It is not the only such criterion, however. Strategic decisions must also
satisfy the numerous and often-conflicting needs of various stakeholders: shareholders, customers, employees, communities in which firms operate, and top managers.

- Knowledge of strategic management is useful not only to those who currently occupy or will soon occupy top management positions but also to individuals seeking employment with organizations operating in a competitive environment and to lower-level personnel employed by such organizations.

Endnotes


2. Many discourses on strategy have evolved over the course of human history. Military history has provided some of the richest sources and “roots” for many concepts underpinning business strategy. Some early examples of discourses on military strategy and history include the following: Sun Tzu’s Art of War, trans. Samuel Griffith (London: Oxford University Press, 1963); The Military Maxims of Napoleon, trans. David G. Chandler (London: Freemantle, 1901; republished, New York: Macmillan, 1987); and Clausewitz’s On War, from the original German version, Vom Krieg (New York: Knopf, 1993). A readable overview of some interesting military strategy concepts with direct relevance to the management of organizations is John Keegan’s The Mask of Command (New York: Viking Penguin, 1988).


5. Data and facts were adapted from the following sources: “Super Cell,” Forbes, February 14, 2005, p. 46; “Microsoft Mulls Sony Partnership to Counter iPod’s
