STRATEGIC MANAGEMENT
Competitiveness & Globalization

Concepts and Cases

13e

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***Strategic Management: Competitiveness & Globalization: Concepts and Cases,* 13th Edition**

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To Frankie:

You are my partner in life. I love you and look forward to our future together.

—Michael

To Mary Ann:

We have reached that place we want to go and we will now walk in the sun. I love you.

—Duane

To Kathy:

You are the best and my love for you is eternal. Thanks for all the support and love you've given me and our children throughout our life together.

—Robert

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Preface

Our goal in writing each edition of this book is to present a new, up-to-date standard for explaining the strategic management process. To reach this goal with the 13th edition of our market-leading text, we again present you with an intellectually rich yet thoroughly practical analysis of strategic management.

With each new edition, we work hard to achieve the goal of maintaining our standard of presenting strategic management knowledge in a readable style. To prepare for each new edition, we carefully study the most recent academic research to ensure that the content about strategic management we present to you is up to date and accurate. In addition, we continuously read articles appearing in many different business publications (e.g., *Wall Street Journal*, *Bloomberg Businessweek*, *Fortune*, *Financial Times*, *Fast Company*, and *Forbes*, to name a few). We also study postings through social media (such as blogs) given their increasing use as channels of information distribution. By studying a wide array of sources, we are able to identify valuable examples of how companies across the world are using (or not using) the strategic management process. Though many of the hundreds of companies that we discuss in the book will be quite familiar, some will likely be new to you. One reason for this is that we use examples of companies from around the world to demonstrate the globalized nature of business operations. Some of these firms are quite large and known to many while others are small and known primarily to the customers they serve. To maximize your opportunities to learn as you read and think about how actual companies use strategic management tools, techniques, and concepts (based on the most current research), we emphasize a lively and user-friendly writing style. To facilitate learning, we use an Analysis–Strategy–Performance framework; we explain this framework in Chapter 1 and reference it throughout the book.

Several *characteristics* of this 13th edition of our book are designed to enhance your learning experience:

- First, we are pleased to note that this book presents you with the most comprehensive and thorough coverage of strategic management that is available in the market.
- We draw the research used in this book from the "classics" as well as the most recent contributions to the strategic management literature. The historically significant "classic" research provides the foundation for much of what we know about strategic management, while the most recent contributions reveal insights about how to use strategic management effectively in the complex, global business environment in which firms now compete. Our book also presents you with a large number of up-to-date examples of how firms use the strategic management tools, techniques, and concepts that prominent researchers and business practitioners have developed. Indeed, although the relevant theory and current research are the foundation for this book, it also is strongly application oriented and presents you, our readers, with a large number of examples and applications of strategic management concepts, techniques, and tools. In this edition, for example, we examine more than 600 companies to describe

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the use of strategic management. Collectively, no other strategic management book presents you with the *combination* of useful and insightful *research* and *applications* in the variety of organizations as does this text.

Company examples you will find in this edition include large U.S.-based firms such as Apple, Amazon.com, McDonald's, FedEx, Starbucks, Walmart, Walt Disney, General Electric, Intel, American Express, Coca-Cola, Netflix, Google, Tesla, Target, UPS, Kellogg, 3M, DuPont, and Marriott. In addition, we examine firms based in countries other than the United States such as AXA, Airbus, Deutche Bank, LafargeHolcim, Sony, Softbank, Kering, Anbang Insurance, Teva, ChemChina, Bayer, Tokyo Electric Power Company, Nestlé, Mahindra, Air France-KLM, Toyota, Aldi, Honda, Ahold, Tata Consultancy, Alibaba, IKEA, Lenova, Volkswagen, and Samsung. As these lists suggest, the firms examined in this book compete in a wide range of industries and produce a diverse set of goods and services.

- We use the ideas of many prominent scholars (e.g., Ron Adner, Rajshree Agarwal, Ruth Aguilera, Gautam Ahuja, Raffi Amit, Africa Arino, Jay Barney, Paul Beamish, Peter Buckley, Alfred Chandler, Ming-Jer Chen, Russ Coff, Brian Connelly, Rich D'Aveni, Kathy Eisenhardt, Nicolas Foss, Gerry George, Javier Gimeno, Luis Gomez-Mejia, Melissa Graebner, Ranjay Gulati, Don Hambrick, Connie Helfat, Amy Hillman, Tomas Hult, Dave Ketchen, Ryan Krause, Dovev Lavie, Haiyang Li, Yadong Luo, Shige Makino, Costas Markides, Anita McGahan, Danny Miller, Will Mitchell, Margie Peteraf, Michael Porter, Nandini Rajagopalan, Jeff Reuer, Joan Ricart, Richard Rumelt, Wei Shi, David Sirmon, Ken Smith, Steve Tallman, David Teece, Rosalie Tung, Michael Tushman, Eero Vaara, Margarethe Wiersema, Oliver Williamson, Mike Wright, Anthea Zhang, Shaker Zahara, and Ed Zajac among others) to shape the discussion of *what* strategic management is. We describe the practices of prominent executives and practitioners (e.g., Thomas Buberl, Tim Cook, Brian Cornell, James Dyson, Steve Easterbrook, Reed Hastings, Jan Jenisch, Jack Ma, Elon Musk, James Park, Chuck Robbins, Howard Schultz, Hock Tan, Meg Whitman, and many others) to help us describe *how* strategic management is used in many types of organizations.

The authors of this book are also active scholars. We conduct research on a number of strategic management topics. Our interest in doing so is to contribute to the strategic management literature and to enhance our understanding of how to apply strategic management tools, techniques, and concepts effectively as a means of increasing organizational performance. Thus, we integrate our own research in the appropriate chapters along with the research of numerous other scholars, some of whom we list above.

In addition to our book's *characteristics,* there are some specific *features* and *revisions* that we have made in this 13th edition that we are pleased to highlight for you:

- **New Opening Cases and Strategic Focus Segments** We continue our tradition of providing virtually all-new Opening Cases and Strategic Focus segments! Almost all of these features are new to this edition; we updated completely the few remaining from the 12th edition because of their continuing relevance and importance. Many of these application-oriented features deal with companies located outside North America. In addition, all of the *company-specific examples* included in each chapter are either new or substantially updated. Through all of these venues, we present you with a wealth of examples of how actual organizations, most of which compete internationally as well as in their home markets, use the strategic management process for the purpose of outperforming rivals and increasing their performance.
- **Twenty Cases** are included in this edition. Offering an effective mix of organizations headquartered or based in North America and a number of other countries as well, the cases deal with contemporary and highly important topics. Many of the cases have

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full financial data (the analyses of which are in the Case Notes that are available to instructors). These timely cases present active learners with opportunities to apply the strategic management process and understand organizational conditions and contexts and to make appropriate recommendations to deal with critical concerns. These cases also appear in MindTap.

- **New Mini-Cases** appear at the end of each chapter. In these cases, we describe how companies deal with major issues highlighted in the text. There are 13 of these cases, one for each chapter, although some of them can overlap with other chapter content. Students will like their conciseness, but they likewise provide rich content that can serve as a catalyst for individual or group analysis and class discussion. A set of questions, which guide analysis and discussion, follows each Mini-Case.
- **More than 1,200 new references** from 2017 and 2018 appear in the chapters' endnotes. We used the materials associated with these references to support new material added or current strategic management concepts that are included in this edition. In addition to demonstrating the classic and recent research from which we draw our material, the large number of references supporting the book's contents allow us to integrate cutting-edge research and thinking into a presentation of strategic management tools, techniques, and concepts.
- **New content** appears in several chapters. Examples include: (1) the discussion of digitalization and its link with the forming and execution of strategies in Chapter 1; (2) a description of the changing competitive landscape due to new technology development, changing government policies (political landscape), and global competition in Chapter 2; (3) the importance and use of big data analytics and artificial intelligence in Chapter 3; (4) the analysis of digital strategies in Chapter 4's Opening Case; (5) the description of business models and their relationship with business-level strategies in Chapter 4; and (6) our discussion and analysis of the emergence and competitive significance of Amazon's acquisition of Whole Foods in several chapters.
- **Updated information** appears in several chapters. Examples include updates about the rapid pace of technology diffusion (Chapter 1), all new and current demographic data (e.g., ethnic mix, geographic distribution) that describe the economic environment (Chapter 2), the general partner strategies of private equity firms (Chapter 7), information from the *World Economic Forum Competitiveness Report* regarding political risks of international investments (Chapter 8), updates about corporate governance practices being used in different countries (Chapter 10), updated data about the number of internal and external CEO selections occurring in companies today (Chapter 12), a ranking of countries by the amount of their entrepreneurial activities (Chapter 13), and a ranking of companies on their total innovation output (Chapter 13).
- **An Exceptional Balance** between current research and up-to-date applications of that research in actual organizations located throughout the world. The content has not only the best research documentation but also the largest number of effective real-world examples to help active learners understand the different types of strategies organizations use to achieve their vision and mission and to outperform rivals.

Supplements to Accompany This Text

MindTap. MindTap is the digital learning solution that helps instructors engage students and helps students become tomorrow's strategic leaders. All activities are designed to teach students to problem-solve and think like leaders. Through these activities and

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real-time course analytics, and an accessible reader, MindTap helps you turn cookie cutter into cutting edge, apathy into engagement, and memorizers into higher-level thinkers.

Customized to the specific needs of this course, activities are built to facilitate mastery of chapter content. We've addressed case analysis from cornerstone to capstone with a functional area diagnostic of prior knowledge, guided cases, branching activities, multimedia presentations of real-world companies facing strategic decisions, and a collaborative environment in which students can complete group case analysis projects together synchronously.

Instructor Website. Access important teaching resources on this companion website. For your convenience, you can download electronic versions of the instructor supplements from the password-protected section of the site, including Instructor's Resource Manual, Comprehensive Case Notes, Cognero Testing, and PowerPoint® slides. To access these additional course materials and companion resources, please visit www.cengage.com.

- **Instructor's Resource Manual.** The Instructor's Resource Manual, organized around each chapter's knowledge objectives, includes teaching ideas for each chapter and how to reinforce essential principles with extra examples. This support product includes lecture outlines and detailed guides to integrating the MindTap activities into your course with instructions for using each chapter's experiential exercises, branching, and directed cases. Finally, we provide outlines and guidance to help you customize the collaborative work environment and case analysis project to incorporate your approach to case analysis, including creative ideas for using this feature throughout your course for the most powerful learning experience for your class.
- **Case Notes.** These notes include directed assignments, financial analyses, and thorough discussion and exposition of issues in the case. Select cases also have assessment rubrics tied to National Standards (AACSB outcomes) that can be used for grading each case. The Case Notes provide consistent and thorough support for instructors, following the method espoused by the author team for preparing an effective case analysis.
- **Cognero Test Bank.** This program is easy-to-use test-creation software that is compatible with Microsoft Windows. Instructors can add or edit questions, instructions, and answers, and select questions by previewing them on the screen, selecting them randomly, or selecting them by number. Instructors can also create and administer quizzes online, whether over the Internet, a local area network (LAN), or a wide area network (WAN). Thoroughly revised and enhanced, test bank questions are linked to each chapter's knowledge objectives and are ranked by difficulty and question type. We provide an ample number of application questions throughout, and we have also retained scenario-based questions as a means of adding in-depth problem-solving questions. The questions are also tagged to National Standards (AACSB outcomes), Bloom's Taxonomy, and the Dierdorff/Rubin metrics.
- **PowerPoints®.** An updated PowerPoint presentation provides support for lectures, emphasizing key concepts, key terms, and instructive graphics.

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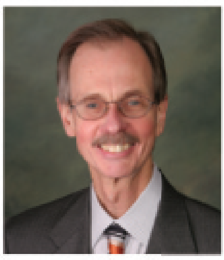

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Case Title	Manu-facturing	Service	Consumer Goods	Food/ Retail	High Technology	Internet	Transportation/ Communication	International Perspective	Social/ Ethical Issues	Industry Perspective
Alphabet (Google)		•			•	•	•	•		
Baidu		•			•	•		•		•
BMW	•		•		•		•		•	
CrossFit		•							•	•
Healthcare Industry (Long-Term)		•							•	•
Heise Medien		•				•	•			•
Illinois Tool Works	•				•					
Kone	•				•			•		•
MatchMove		•			•	•		•		
Movie Exhibition Industry		•	•							•
Pacific Drilling	•				•			•		•
Pfizer	•				•			•	•	
Publix	•		•	•		•				•
Starbucks		•		•				•		•
Sturm, Ruger and Co.	•								•	•
Trivago		•			•	•	•			
Volkswagen	•		•					•	•	
Wells Fargo		•							•	
ZF Fried-richshafen	•				•			•	•	
ZO-Rooms		•			•	•			•	•

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Case Title	Chapters												
	1	2	3	4	5	6	7	8	9	10	11	12	13
Alphabet (Google)						●	●			●	●		●
Baidu				●		●		●	●				●
BMW	●	●		●	●								●
CrossFit	●	●	●	●	●							●	
Healthcare Industry (Long-Term)		●		●	●					●			
Heise Medien		●		●	●								
Illinois Tool Works						●	●				●	●	●
Kone				●				●					●
MatchMove	●		●	●	●								●
Movie Exhibition Industry		●	●	●	●								
Pacific Drilling						●			●				●
Pfizer	●	●				●	●		●	●	●	●	●
Publix	●	●		●	●					●			
Starbucks		●	●									●	●
Sturm, Ruger and Co.		●	●	●	●								
Trivago								●			●	●	●
Volkswagen	●									●		●	
Wells Fargo	●									●		●	
ZF Friedrichshafen					●		●	●			●		
ZO-Rooms		●		●	●		●		●				●

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1

Strategic Management and Strategic Competitiveness

Studying this chapter should provide you with the strategic management knowledge needed to:

1-1 Define strategic competitiveness, strategy, competitive advantage, above-average returns, and the strategic management process.

1-2 Describe the competitive landscape and explain how globalization and technological changes shape it.

1-3 Use the industrial organization (I/O) model to explain how firms can earn above-average returns.

1-4 Use the resource-based model to explain how firms can earn above-average returns.

1-5 Describe vision and mission and discuss their value.

1-6 Define stakeholders and describe their ability to influence organizations.

1-7 Describe the work of strategic leaders.

1-8 Explain the strategic management process.

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THE HONEST CO.: CAN IT BECOME AN ICONIC GLOBAL BRAND?

Launched on 2011, The Honest Co. is an eco-friendly consumer goods company co-founded by actress Jessica Alba. According to Alba, a desire as a parent to be able to purchase safe, effective products that perform as promised drove the decision to establish Honest. The firm says that it is a "wellness brand with values rooted in consciousness, community, transparency and design. We're on a mission to empower people to live happy, healthy lives."

Over the years, Honest has offered consumers products in a number of categories including diapering, vitamins, feeding, personal care, and cleaning among others. Essentially, this firm's strategy calls for it to provide unique products to customers who value that uniqueness and are willing to pay for it in the form of prices that exceed those of "mainstream" products. Implementing this strategy successfully would be the foundation for the firm achieving strategic competitiveness (we define strategy and strategic competitiveness in this chapter).

According to the firm's CEO, for the near future at least, Honest intends to concentrate on its baby and beauty products categories as a means of making progress to reach its objective of becoming an iconic global brand. Expansion into Europe in 2019 was an important strategic action taken to reach this objective. To avoid the highly competitive and low-margin diaper category, part of Honest's European expansion strategy includes its partnership with "German cosmetics and perfume chain Douglas to sell its beauty products in Germany, France, Spain, Italy, Poland, the Netherlands, and Austria."

Stefanie Keenan/WireImage/Getty Images

Co-founder of The Honest Company Jessica Alba at a special ribbon cutting ceremony in Beverly Hills, California.

The path to achieving strategic competitiveness has not been challenge- and error-free for The Honest Co. In terms of challenges, the firm has direct competitors such as Zulily (a firm offering always-fresh products for families with new babies including home décor items, clothing, gifts, etc.) and Giggle, a one-stop source for new parents seeking unique baby products. Additionally, large consumer-goods companies such as Unilever and Procter & Gamble offer products to consumers with some of the features associated with Honest's items, sometimes at a lower price. A series of lawsuits filed against The Honest Co. suggest mistakes made by the firm. In 2016, for example, a lawsuit alleged false labelling of some of the ingredients of the firm's cleaning products. Other allegations include one that the firm's sunscreen product does not work effectively. Honest also had to recall its organic baby powder for potential contamination and its baby wipes because of contamination with mold.

Recently, Honest received a $200 million dollar minority investment from L. Catterton, a private equity firm. The Honest Co. believes this investment provides the capital required to expand its supply chains and global reach. Honest thinks of L. Catterton as a perfect investment partner because of its expertise with global supply chains. The Honest Co. is the type of firm in which L. Catterton typically invests, as shown by its involvement with well-known American beauty product businesses such as Bliss, Elemis, and Tula.

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Going forward, will The Honest Co. be able to use its resources to outcompete rivals as a means of reaching its objective to become an iconic global brand by offering consumers eco-friendly and effective products? While committed to regaining consumers' trust and confidence by producing products they want to buy, reaching this objective is challenging, especially in light of the competition the firm faces. On the other hand, some analysts believe Honest will succeed because the firm has three valuable capabilities (we define capabilities in this chapter): "tremendous brand equity, innovative and quality products, and a loyal customer following." Time will tell if The Honest Co. will be able to execute with these capabilities in a way that yields competitive success in the form of strategic competitiveness.

Sources: 2018, The Honest Co., About us, www.honest.com, August, 8; 2018, Jessica Alba's Honest Co. gets $200 million investment from L. Catterton, *Fortune*, www.fortune.com, June 6; A. Black, 2018, The right way for food companies to buy their way to growth, *Wall Street Journal*, www.wsj.com, June 6; W. Colville, 2018, Jessica Alba's Honest Co. gets $200 million investment, *Wall Street Journal*, www.wsj.com, June 6; A. Gasparro & J. Bunge, 2018, Food companies churn through CEOs, desperate for fresh ideas, *Wall Street Journal*, www.wsj.com, May 29; A. Stych, 2018, Jessica Alba's Honest Company gets $200M investment, *bizwomen*, www.bizwomen.com, June 7; J. Valinsky, 2018, Jessica Alba's Honest Co. just got a $200 million lifeline, *CNNMoney*, www.cnnmoney.com, June 6; A. C. Wischhover, 2018, Jessica Alba's Honest Company is relaunching products and trying to put bad PR drama behind it, *Racked*, www.racked.com, June 7.

As we see from the Opening Case, achieving strategic competitiveness by implementing a firm's chosen strategy successfully is challenging. Founded as a wellness brand with a grounding in the values of consciousness, community, transparency, and design, Honest is struggling to reach its mission and the founders' desired level of competitive success. An eco-friendly consumer goods company, Honest seeks to provide customers with unique products for which they are willing to pay a higher price, compared to the prices for consumer goods products with relatively standard features and capabilities. Honest's top management team, including Jessica Alba, is using the strategic management process (see Figure 1.1) as the foundation for the commitments, decisions, and actions the team is taking to pursue strategic competitiveness and above-average returns. Given the firm's challenges, some of its decisions and actions going forward will likely differ from some made previously. In this book, we explain the strategic management process The Honest Co. and multiple other firms use to implement a chosen strategy successfully and to achieve strategic competitiveness by doing so. We introduce you to this process in the next few paragraphs.

Firms achieve **strategic competitiveness** by formulating and implementing a value creating strategy.

A **strategy** is an integrated and coordinated set of commitments and actions designed to exploit core competencies and gain a competitive advantage.

A firm has a **competitive advantage** when by implementing a chosen strategy, it creates superior value for customers and when competitors are not able to imitate the value the firm's products create or find it too expensive to attempt imitation.

Firms achieve **strategic competitiveness** by formulating and implementing a value-creating strategy. A **strategy** is an integrated and coordinated set of commitments and actions designed to exploit core competencies and gain a competitive advantage. When choosing a strategy, firms make choices among competing alternatives as the pathway for deciding how they will pursue strategic competitiveness. In this sense, the chosen strategy indicates what the firm *will do* as well as what the firm *will not do*.

A firm has a **competitive advantage** when by implementing a chosen strategy, it creates superior value for customers and when competitors are not able to imitate the value the firm's products create or find it too expensive to attempt imitation.[1] An organization can be confident that its strategy yields a competitive advantage after competitors' efforts to duplicate it have ceased or failed. In addition, firms must understand that no competitive advantage is permanent.[2] The speed with which competitors are able to acquire the skills needed to duplicate the benefits of a firm's value-creating strategy determines how long the competitive advantage will last.[3] The Honest Co. seeks to create a competitive advantage, as do all organizations. We discuss competitive advantages and provide a few firm-specific examples of them in the Strategic Focus.

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Strategic Focus

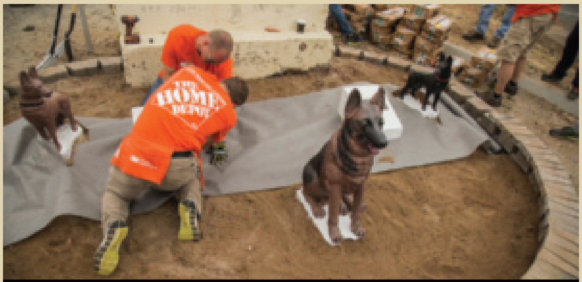
Competitive Advantage as a Source of Strategic Competitiveness

Possessing a competitive advantage, and understanding how to use it effectively in marketplace competitions, is foundational to all firms' efforts to achieve strategic competitiveness and outperform rivals in the process of doing so. Strategic leaders influence choices firms make to develop a competitive advantage. (We define strategic leaders later in this chapter and discuss strategic leadership in detail in Chapter 12.) In essence, a firm creates a competitive advantage by being as different as possible from competitors in ways that are important to customers and in ways that competitors cannot duplicate. Important differences are ones for which customers are willing to pay. Having and exploiting a competitive advantage successfully finds a firm creating superior value for its customers and superior profits for itself.

The competitive advantages firms possess differ among companies across and within industries. Drawing from Michael Porter's work, we explain in Chapter 4 that firms have a competitive advantage when they deliver the same value to customers as competitors deliver but at a lower cost, or when they deliver benefits for which customers are willing to pay that exceed the benefits competitors offer. Facilitating a firm's efforts to develop a competitive advantage is its ability to make the value its products offers customers as clear, concise, and easily recognizable as possible. In slightly different words, firms must convey effectively the value of their products, relative to competitors' offerings, to their customers. The larger is the "gap" between the value a firm's products creates for customers and the value competitors' products bring to customers, the more significant is a firm's competitive advantage.

The competitive dimensions on which firms are able to establish a competitive advantage are virtually endless. In a general sense, technological developments, which continue at a rapid pace, may be a source of competitive advantage for firms in multiple industries. Salesforce.com, the customer relationship management (CRM) firm that uses cloud computing extensively, recently "debuted a CRM solution that uses machine learning to build comprehensive data-based customer profiles, identify crucial touch points and uncover additional sales opportunities." Adaptability and flexibility are additional potential sources of competitive advantage for firms learning how to exploit newly developing technologies quickly and successfully. Netflix is building competitive advantages in terms of its original programming and its customer interface platform that creates unique experiences for individual users. Some analysts feel that trust is an important source of competitive advantage. In a recent survey, a group reported that "Unlike other online retailers, 67% of Amazon customers trust the company to protect their privacy and personal data." Home Depot officials cite the firm's culture as a competitive advantage. The culture emphasizes "excellent customer service, an entrepreneurial spirit, building strong relationships, taking care of its people, and doing the right thing." In today's globalized competitive environment, firms that learn how to develop an effective balance among economic growth, ecological balance, and social growth may have a viable competitive advantage. Finally, some argue that in the final analysis, a firm's people are the most important source of competitive advantage. The reason for this is that a firm's people think of ways to create differences between their firm and competitors; a firm's people then execute in ways that bring those differences to life.

AB Forces News Collection/Alamy Stock Photo



Volunteers with The Home Depot's Building Materials Department help to restore the memorial of Sergeant Adam Cann during the K9 upgrade project at Camp Pendleton.

We note in Chapter 4 that no competitive advantage is sustainable permanently. In some instances, a firm's advantage no longer creates value for which customers are willing to pay. In other cases, competitors will learn how to create more value for customers with respect to a valued competitive dimension for which they are willing to pay. Thus, to achieve strategic competitiveness across time, a firm must concentrate simultaneously on exploiting the competitive advantage it possesses today while contemplating decisions to make today to ensure that it will possess a competitive advantage in the future.

Sources: A. Bylund, 2018, What is Netflix, Inc.'s competitive advantage? *The Motley Fool*, www.fool.com, July 21; I. Hunkeler, 2018, How to turn digital disruption into a competitive advantage, *Small Business Daily*, www.smallbizdaily.com, January 26; L. Lent, 2018, Strategic sustainability focus delivers competitive advantages, *PHYS.ORG*, www.phys.org, February 8; I. Linton, 2018, Strategic moves to build a competitive advantage, *Houston Chronicle*, www.smallbusiness.chron.com, June 29; G. Pickard-Whitehead, 2018, What is competitive advantage? *Small Business Trends*, www.smallbiztrends.com, April 10; A. Rogers, 2018, Innovation case studies: How companies use technology to solidify a competitive advantage, *Forbes*, www.forbes.com, April 13; J. Silver, 2018, Culture as a competitive advantage, *Hispanic Executive*, www.hispanicexecutive.com, May 1; G. Sterling, 2018, Survey: Consumer trust may be Amazon's true competitive advantage, *Search Engine Land*, www.searchengineland.com, June 7; R. Wartzman & L. Crosby, 2018, A company's performance depends first of all on its people, *Wall Street Journal*, www.wsj.com, August 12.

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Above-average returns are returns in excess of what an investor expects to earn from other investments with a similar amount of risk. **Risk** is an investor's uncertainty about the economic gains or losses that will result from a particular investment. The most successful companies learn how to manage risk effectively;[4] doing so reduces investors' uncertainty about the outcomes of their investment.[5] Firms often use accounting-based metrics, such as return on assets, return on equity, and return on sales to assess their performance. Alternatively, firms can assess their performance in terms of stock market returns, even monthly returns. (Monthly returns are the end-of-the-period stock price minus the beginning stock price divided by the beginning stock price, yielding a percentage return.) In smaller, new venture firms, returns are sometimes measured in terms of the amount and speed of growth (e.g., in annual sales) rather than more traditional profitability measures[6] because new ventures require time to earn acceptable returns (in the form of return on assets and so forth) for investors.[7]

Understanding how to exploit a competitive advantage is important for firms seeking to earn above-average returns.[8] Firms without a competitive advantage or those that do not compete in an attractive industry earn, at best, average returns. **Average returns** are returns equal to those an investor expects to earn from other investments possessing a similar amount of risk. Over time, an inability to earn at least average returns results first in decline and, eventually, failure.[9] Failure occurs because investors withdraw their investments from those firms earning less-than-average returns.

As previously noted, there are no guarantees of permanent success. Companies succeeding at a point in time must not become overconfident. Research suggests that overconfidence can lead to excessive risk taking.[10] Used as an example several times in this book, Amazon.com today continues growing and increasing its sales revenue. This firm too though must avoid assuming that success today is a guarantee of success tomorrow. Using the strategic management process effectively facilitates firms' efforts to achieve success across time.

The **strategic management process** is the full set of commitments, decisions, and actions firms take to achieve strategic competitiveness and earn above-average returns (see Figure 1.1).[11] The process involves analysis, strategy, and performance (the A-S-P model—see Figure 1.1). The firm's first step in the process is to *analyze* its external environment and internal organization to identify external opportunities and threats and to recognize its internal resources, capabilities, and core competencies. The results of these analyses influence the selection of the firm's strategy or strategies. The *strategy* portion of the model entails strategy formulation and strategy implementation.

With the information gained from external and internal analyses, the firm develops its vision and mission and formulates one or more *strategies*. To implement its strategies, the firm takes actions to enact each one with the intent of achieving strategic competitiveness and above-average returns (*performance*). Effective actions that take place in the context of integrated strategy formulation and implementation efforts result in positive performance. Firms seek to maintain the quality of what is a dynamic strategic management process as a means of dealing successfully with ever-changing markets and evolving internal conditions.[12]

In the remaining chapters of this book, we use the strategic management process to explain what firms do to achieve strategic competitiveness and earn above-average returns. We demonstrate why some firms achieve competitive success consistently while others do not. Today, global competition is a critical part of the strategic management process and influences firms' performances.[13] Indeed, learning how to compete in the globalized world is one of the most significant challenges firms face.[14]

We discuss several topics in this chapter. First, we describe the current competitive landscape. Several realities, including the emergence of a global economy, globalization

Above-average returns are returns in excess of what an investor expects to earn from other investments with a similar amount of risk.

Risk is an investor's uncertainty about the economic gains or losses that will result from a particular investment.

Average returns are returns equal to those an investor expects to earn from other investments possessing a similar amount of risk.

The **strategic management process** is the full set of commitments, decisions, and actions firms take to achieve strategic competitiveness and earn above-average returns.

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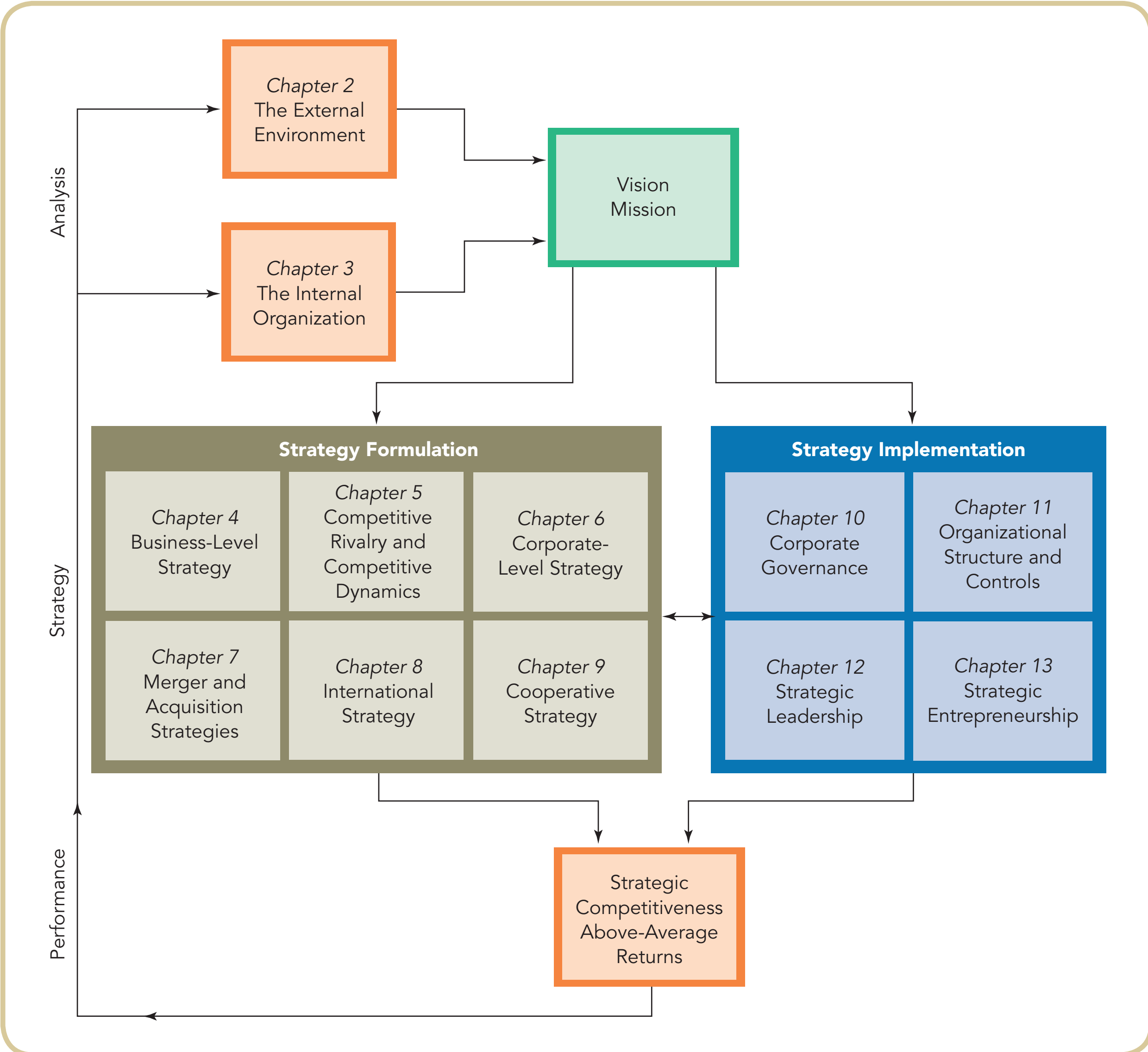
Figure 1.1 The Strategic Management Process



resulting from that economy, and rapid technological changes, influence this landscape. Next, we examine two models firms use to gather the information and knowledge required to choose and then effectively implement their strategies. The insights gained from these models also serve as the foundation for forming the firm's vision and mission. The first model (industrial organization or I/O) suggests that the external environment is the primary determinant of a firm's strategic actions. According to this model, identifying and then operating effectively in an attractive (i.e., profitable) industry or segment of an industry are the keys to competitive success.[15] The second model (resource-based) suggests that a firm's unique resources and capabilities are the critical link to strategic competitiveness.[16] Thus, the first model is concerned primarily with the firm's external environment while the second model is concerned primarily with the firm's internal organization. After discussing vision and mission, direction-setting statements that influence the choice and use of strategies, we describe the stakeholders that organizations serve.

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The degree to which stakeholders' needs can be met increases when firms achieve strategic competitiveness and earn above-average returns. Closing the chapter are introductions to strategic leaders and the elements of the strategic management process.

1-1 The Competitive Landscape

The fundamental nature of competition in many of the world's industries is changing. Digitalization, for example, which is the process of converting something to digital form, is a new competitive dimension that is affecting competition in multiple industries throughout the world. The Apple watch demonstrates "digitalization at its best where technology has taken an ordinary watch and introduced technology into it with phone capabilities, messaging, and even Internet capabilities."[17]

The full array of possibilities flowing from digitalization as a means of competition among companies remains unspecified. Recent evidence, though, suggests that firms understanding digitalization and its capabilities may be able to outperform their rivals. Headquartered in London, PricewaterhouseCoopers (doing business as PwC) is a multinational professional services firm. Based on a survey of 1,155 manufacturing executives located in 26 countries, PwC concluded that "Distinct from Industry 3.0, which involved the automation of single machines and processes, Industry 4.0 encompasses end-to-end digitization and data integration of the value chain: offering digital products and services, operating connected physical and virtual assets, transforming and integrating all operations and internal activities, building partnerships, and optimizing customer-facing activities."[18] An analysis of its survey results found PwC concluding that firms committed to becoming digital leaders are able to distinguish themselves from competitors by producing innovative products that unique groups of customers value. Indeed, a significant benefit of digitalization is that it allows firms to identify specific customer groups and then serve their personalized and unique needs.[19]

The number of customers interested in digitalization as a source for product development and subsequent use is huge and increasing. "There are two-and-a-half billion digital customers globally who are under 25 years of age. What characterizes this group is the fact that they are 'always on' and that they show a different usage behavior compared to that of the traditional 'analog' consumer."[20] Thus, in today's competitive landscape, a challenge is for firms to understand the strategic implications associated with digitalization and to integrate digitalization effectively into their strategies.

Other characteristics of the current competitive landscape are noteworthy. Conventional sources of competitive advantage such as economies of scale and large advertising budgets are not as effective as they once were (e.g., because of social media advertising) in terms of helping firms earn above-average returns. Moreover, the traditional managerial mind-set is unlikely to lead a firm to strategic competitiveness. Managers must adopt a new mind-set that values flexibility, speed, innovation, integration, and the challenges flowing from constantly changing conditions.[21] The conditions of the competitive landscape result in a perilous business world—a world in which the investments necessary to compete on a global scale are enormous and the consequences of failure are severe.[22] Effective use of the strategic management process reduces the likelihood of failure for firms while competing against their rivals.

Hypercompetition is a condition where competitors engage in intense rivalry, markets change quickly and often, and entry barriers are low.

Hypercompetition is a condition where competitors engage in intense rivalry, markets change quickly and often, and entry barriers are low. In these environments, firms find it difficult to maintain a competitive advantage.[23] Rivalry in hypercompetitive environments tends to occur among global competitors who innovate regularly and successfully.[24] It is a condition of rapidly escalating competition based on price-quality positioning, competition to create new know-how and establish first-mover advantage, and competition to

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protect or invade established product and/or geographic markets. In a hypercompetitive market, firms often challenge their competitors aggressively to strengthen their market position and ultimately, their performance.[25] Specifically how firms challenge each other in hypercompetitive markets varies across time. Recently, for example, Internet giant Tencent Holdings Ltd. of China has become one of the world's largest technology investors. Between 2013 and mid-2018, the firm took stakes in 277 startups. Analysts believe this is a calculated strategy to crowd out rivals and to increase profits.[26]

Several factors create hypercompetitive environments and influence the nature of the current competitive landscape. The emergence of a global economy and technology, specifically rapid technological change, are two primary drivers of hypercompetitive environments and the nature of today's competitive landscape.

1-1a The Global Economy

A **global economy** is one in which goods, services, people, skills, and ideas move freely across geographic borders. Relatively unfettered by artificial constraints, such as tariffs, the global economy significantly expands and complicates a firm's competitive environment.[27]

The global economy, which changes rapidly and constantly,[28] increases the scope of the competitive environment in which companies compete. Because of this, firms must study the global economy carefully as a foundation for learning how to position themselves successfully for competitive purposes.

The size of parts of the global economy is an important aspect of studying this competitive arena. In 2018 for example, the United States was the world's largest economy at a value of $20.4 trillion. At that time, China was the world's second largest economy with a value of $14 trillion while Japan was the third largest at $5.1 trillion. Following Japan were three European countries (Germany at $4.2 trillion, United Kingdom at $2.94 trillion, and France at $2.93 trillion). In observing economies' values in 2018, the World Economic Forum noted that the size of the United States economy was "larger than the combined economies of numbers four to 10 on the list. Overall, the global economy (was) worth an estimated $79.98 trillion, meaning the United States accounts for more than one-quarter of the world total."[29] Thus, companies scanning the global economy for opportunities in 2018 might conclude that markets in the United States, China, and Japan yield potentially significant opportunities for them. Of course, such an analysis also must consider entry barriers to various economies in the form of tariffs. This type of analysis must also be forward looking in that in 2018, for example, the World Economic Forum estimated that China and India's economies would exceed the size of the U.S. economy by 2050 and that the economies of Germany, United Kingdom, and France would decline in size by this time as well. Companies should study carefully predictions such as these when determining the parts of the world in which growth opportunities as well as threats to their competitive global positions may exist in future years.

U.S.-based Netflix continues studying the global economy to identify opportunities in countries and regions in which it can grow. In mid-2018, the firm continued adding subscribers, reaching 125 million globally. At that time, analysts predicted the firm would have 360 million subscribers by 2030. International markets were to be the source of much of the growth in subscribers.[30] Informing this prediction was the expectation that Netflix would achieve reasonable levels of market penetration internationally, including reaching penetration in 35 percent of all broadband households worldwide, excluding China.[31] To fuel its international plans, Netflix offers some of its original movies in languages other than English. In 2018 alone, the firm allocated $8 billion to develop original programming, with some of those programs targeted to international customers.[32]

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During the global recession of roughly 2007 and 2008, General Motors (GM) identified what it thought was a significant international opportunity in China. The fact that GM and its Chinese joint venture partners are now the leading manufacturers in the world's largest automobile market seems to validate GM's assessment and the actions it took in light of it. GM and its partners' decision to launch the Baojun brand is foundational to the firm's success in China. With expectations of continuing growth, "Baojun is an entry-level brand targeted at consumers who live in (China's) smaller cities and rural areas."[33] In recent times, the competitive actions GM is taking in China result in the firm outperforming its rival Ford Motor Co. in this key global market.[34]

The March of Globalization

Globalization is the increasing economic interdependence among countries and their organizations as reflected in the flow of products, financial capital, and knowledge across country borders.[35] Globalization is a product of a large number of firms competing against one another in an increasing number of global economies.

In globalized markets and industries, firms might obtain financial capital in one national market and use it to buy raw materials in another. Firms might then use manufacturing equipment purchased in a third national market to produce and deliver products that it sells in a fourth market. Thus, globalization increases the range of opportunities for companies competing in the current competitive landscape.[36]

Firms operating globally must make culturally sensitive decisions when using the strategic management process, as is the case in Starbucks' operations in European countries (we discuss additional aspects of this firm's recent decisions and actions in this Chapter's Mini-Case). Additionally, highly globalized firms must anticipate ever-increasing complexity in their operations as goods, services, people, and so forth move freely across geographic borders and throughout different economies.

Overall, globalization has led to higher performance standards with respect to multiple competitive dimensions, including quality, cost, productivity, product introduction time, and operational efficiency. In addition to firms competing in the global economy, these standards affect firms competing on a domestic-only basis. Customers will choose to buy a global competitor's product when it creates superior value for them relative to the value created by the domestic firm's product. Workers now flow rather freely among global economies. This is important in that employees are a key source of competitive advantage.[37] Firms must learn how to deal with the reality that in today's competitive landscape, only companies capable of meeting, if not exceeding, global standards typically earn above-average returns.

Although globalization offers potential benefits to firms, it is not without risks. "Liability of foreignness" is the term describing the risks of competing outside a firm's domestic markets.[38] The amount of time firms usually require to learn to compete in markets that are new to them is one risk of entering a global market. A firm's performance can suffer until it gains the knowledge needed to compete successfully in a new global market.[39] In addition, a firm's performance may suffer by entering too many global markets either simultaneously or too quickly. When this happens, the overall organization may lack the skills required to manage effectively all of its diversified global operations.[40]

The increasing opportunities available in emerging economies is a major driver of growth in the size of the global economy. Important emerging economies include the BRIC countries (Brazil, Russia, India, and China),[41] the VISTA countries (Vietnam, Indonesia, South Africa, Turkey, and Argentina),[42] as well as Mexico and Thailand.

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Demonstrating the growth in size of some of these economies is the 2018 prediction that by 2050, Indonesia, Brazil, Russia, and Mexico will be the fourth, fifth, sixth, and seventh largest economies in the world by size. If this were to happen, by 2050, the size of these emerging economies would exceed those of Japan, Germany, the United Kingdom, and France.[43] Emerging economy firms now compete in global markets, some with increasing success.[44] Indeed, the emergence of emerging-market multinational corporations (MNCs) in international markets forces large MNCs based in developed markets to enrich their own capabilities to compete effectively in global markets.[45]

Thus, entry into international markets, even for firms with substantial experience in the global economy, requires effective use of the strategic management process. Moreover, while global markets are an attractive strategic option for some companies, they are not the only source of strategic competitiveness. In fact, most companies, even those capable of competing successfully in global markets, should commit to remaining competitive in their home market and in the international markets in which they choose to compete. Firms do this by remaining in tune with technological opportunities and potential disruptions innovations might create. As indicated in this chapter's Mini-Case, Starbucks is emphasizing both product innovation and international expansion as means of growing profitably.

1-1b Technology and Technological Changes

Increasingly, technology affects all aspects of how companies operate and as such, the strategies they choose to implement. Boston Consulting Group analysts describe technology's impact as follows: "No company can afford to ignore the impact of technology on everything from supply chains to customer engagement, and the advent of even more advanced technologies, such as artificial intelligence (AI) and the Internet of Things, portends more far-reaching change."[46]

There are three categories of technology-related trends and conditions affecting today's firms: technology diffusion and disruptive technologies, the information age, and increasing knowledge intensity. As noted in the paragraph above, these categories have a significant effect on the nature of competition in many industries.

Technology Diffusion and Disruptive Technologies

The rate of technology diffusion, which is the speed at which new technologies become available to firms and when firms choose to adopt them, is far greater than was the case a decade or two ago. Consider the following rates of technology diffusion:

It took the telephone 35 years to get into 25 percent of all homes in the United States. It took TV 26 years. It took radio 22 years. It took PCs 16 years. It took the Internet 7 years.[47]

The impact of technological changes on individual firms and industries is broad and significant. For example, in the not-too-distant past, people rented movies on videotapes from retail stores such as Blockbuster. (Dish Network acquired Blockbuster in 2011.) Today, customers on a global basis use electronic means almost exclusively to rent movies and games. The publishing industry (books, journals, magazines, newspapers) is moving rapidly from hard copy to electronic format. Many firms in these industries, operating with a more traditional business model, are suffering. These changes are also affecting other industries, from trucking to mail services.

Perpetual innovation is a term used to describe how rapidly and consistently new, information-intensive technologies replace older ones. The shorter product life cycles

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resulting from these rapid diffusions of new technologies place a competitive premium on being able to introduce quickly new, innovative products into the marketplace.[48]

In fact, when products become hard to distinguish because of the widespread and rapid diffusion of technologies, speed to market with innovative products may be the primary source of competitive advantage (see Chapter 5).[49] Indeed, some argue that continuous innovations occurring in the global economy drive much of today's rapid and substantial change. Not surprisingly, an understanding of global standards and of the expectations customers have regarding a product's functionality inform the nature of these innovations. Although some argue that large established firms may have trouble innovating, evidence suggests that today these firms are developing radically new technologies that transform old industries or create new ones.[50] In 2018, for example, Boston Consulting Group identified the 50 most innovative companies in the world. The first five firms on this list are large companies—Apple, Google, Microsoft, Amazon, and Samsung.[51] Wireless AirPods, ARKit (the firm's augmented-reality framework), and HomePod (an intelligent speaker) are some of the innovative products Apple introduced recently and for which some recognize it as the most innovative company in the world.[52]

Another indicator of rapid technology diffusion is that commonly, firms gather information quickly about their competitors' research and development (R&D) and product decisions, sometimes even within days.[53] In this sense, the rate of technological diffusion has reduced the competitive benefits of patents.[54] Today, patents may be an effective way of protecting proprietary technology in a small number of industries such as pharmaceuticals. Indeed, many firms competing in the electronics industry often do not apply for patents to prevent competitors from gaining access to the technological knowledge included in the patent application.

Disruptive technologies—technologies that destroy the value of an existing technology and create new markets[55]—surface frequently in today's competitive markets. Think of the new markets created by the technologies underlying the development of products such as Wi-Fi, iPads, and the web browser and the markets advances in artificial intelligence will create. Some believe that these types of products represent radical or breakthrough innovations (we discuss radical innovations in Chapter 13).[56] A disruptive or radical technology can create what is essentially a new industry or can harm industry incumbents. However, some industry incumbents adapt to radical innovations from competitors based on their superior resources, experience, and ability to gain access to the new technology through multiple sources (e.g., alliances, acquisitions, and ongoing internal research).[57]

The Information Age

Dramatic changes in information technology (IT) continue occurring in the global economy. Personal computers, cellular phones, artificial intelligence, virtual reality, massive databases ("big data"), data analytics, and multiple social networking sites are a few examples of how technological developments permit different uses of information. Data and information are vital to firms' efforts today to understand customers and their needs and to implement strategies in ways that satisfy those needs as well as the interests of all other stakeholders. For today's firms in virtually all industries, IT is an important capability that contributes positively to product innovation efforts[58] and may be a source of competitive advantage as well. Firms failing to harness the power of data and information are disadvantaged compared to their competitors.[59]

Both the pace of change in IT and its diffusion continue increasing on a global scale. Consider that in 2018, 36 percent of the world's population owned a smartphone. With respect to personal computers, expectations are that the number of personal

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computers sold annually will decline from 258.8 million in 2017 to 215.8 million in 2023. On the other hand, indications are that during the same time, technology innovations such as touch-enabled PCs, ultra-slim and convertible laptops, and hybrid machines will stimulate revenue growth among technology companies.[60] Technology-based innovations also stimulate additional markets. For example, predictions are that the global video streaming market will reach $70 billion by 2021. Contributing to this market's growth is the fact that in 2018, the percentage of Internet and mobile audiences watching live video continued to expand.[61] Trends such as these inform the work firms complete to select and implement their strategies in the global economy. The most successful firms envision information technology-derived innovations as opportunities to identify and serve new markets rather than as threats to the markets they serve currently.[62]

Increasing Knowledge Intensity

Knowledge (information, intelligence, and expertise) is the basis of technology and its application. Today, knowledge is a critical organizational resource and an increasingly valuable source of competitive advantage.[63] The shifting of the basis of competition being on tangible assets to intangible ones such as knowledge began in the early 1980s. For example, "Walmart transformed retailing through its proprietary approach to supply chain management and its information-rich relationships with customers and suppliers."[64] Relationships with customers and suppliers, such as those characterizing Walmart, are an example of an intangible resource requiring managerial attention.[65]

Individuals acquire knowledge through experience, observation, and inference. Knowledge is an intangible resource (we describe tangible and intangible resources fully in Chapter 3). The value of firms' intangible resources, including knowledge, continues increasing as a proportion of total shareholder value.[66] Some believe that "intangibles have grown from filling 20% of corporate balance sheets to 80%, due in large part to the expanding nature, and rising importance, of intangibles as represented by intellectual capital vs. bricks-and-mortar, research and development vs. capital spending, services vs. manufacturing, and the list goes on."[67] Overall, U.S. firms may hold over $8 trillion in intangible assets on their balance sheets. This amount is roughly one-half of the market capitalization of companies comprising the S&P 500 index.[68] Knowledge is a key intangible asset that when diffused quickly throughout a firm contributes to efforts to outperform rivals.[69] Therefore, firms must develop (e.g., through training programs) and acquire (e.g., by hiring educated and experienced employees) knowledge, integrate it into the organization to create capabilities, and then apply it to gain a competitive advantage.[70]

A strong knowledge base is necessary to create innovations. In fact, firms lacking appropriate internal knowledge resources are less likely to allocate sufficient financial resources to R&D.[71] Firms must continue to use learning to build their knowledge base because of the common occurrence of knowledge spillovers to competitors. Rival companies hiring personnel from a firm results in the knowledge from one firm spilling over to another company.[72] Because of the potential for spillovers, firms must move quickly to use their knowledge productively. In addition, firms must find ways for knowledge to diffuse inside the organization such that it becomes available in all places where its use creates value.[73] Strategic flexibility helps firms reach these objectives.

Strategic flexibility is a set of capabilities firms use to respond to various demands and opportunities existing in today's dynamic and uncertain competitive environment. Strategic flexibility involves coping with uncertainty and its accompanying risks.[74] Firms should try to develop strategic flexibility in all areas of their operations. However, building strategic flexibility is not an easy task, largely because of inertia that can build

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over time. A firm's focus and past core competencies may actually slow change and strategic flexibility.[75]

To be strategically flexible on a continuing basis and to gain the competitive benefits of such flexibility, a firm must develop the capacity to learn. Continuous learning provides the firm with new and up-to-date skill sets, which allow it to adapt to its environment as it encounters changes.[76] Firms capable of applying quickly what they have learned exhibit the strategic flexibility and the capacity to change in ways that will increase the probability of dealing successfully with uncertain, hypercompetitive environments.

1-2 The I/O Model of Above-Average Returns

From the 1960s through the 1980s, those leading organizations believed that the external environment rather than the internal organization was the strongest influence on the choice of strategy.[77] The industrial organization (I/O) model of above-average returns explains the external environment's dominant influence on the choice of strategy and the actions associated with it. The logic of the I/O model is that a set of industry characteristics, including economies of scale, barriers to market entry, diversification, product differentiation, the degree of concentration of firms in the industry, and market frictions, determine the profitability potential of an industry or a segment of it as well as the actions firms should take to operate profitably.[78] We examine these industry characteristics and explain their influence in Chapter 2.

Grounded in economics, four underlying assumptions explain the I/O model. First, the model assumes that the external environment imposes pressures and constraints that determine the strategies that would result in above-average returns. Second, most firms competing within an industry or within a segment of that industry are assumed to control similar strategically relevant resources and to pursue similar strategies in light of those resources. Third, firms assume that their resources are highly mobile, meaning that any resource differences that might develop between firms will be short-lived. Fourth, the model assumes that organizational decision makers are rational individuals who are committed to acting in the firm's best interests, as shown by their profit-maximizing behaviors.[79]

The I/O model challenges firms to find the most attractive industry in which to compete. An assumption supporting the need to find the most attractive industry is that firms possess the same types of resources with value and that these resources are mobile across companies. This means that a firm is able to increase its performance only when it competes in the industry with the highest profit potential and learns how to use its resources to implement the strategy required by the industry's structural characteristics. The competitive realities associated with the I/O model find firms imitating each other's strategies and actions taken to implement them.[80]

The five forces model of competition is an analytical tool firms use to find the industry that is the most attractive for them. The model (explained in Chapter 2) encompasses several variables and tries to capture the complexity of competition. The five forces model suggests that an industry's profitability (i.e., its rate of return on invested capital relative to its cost of capital) is a function of interactions among five forces: suppliers, buyers, competitive rivalry among firms currently in the industry, product substitutes, and potential entrants to the industry.[81]

Firms use the five forces model to identify the attractiveness of an industry (as measured by its profitability potential) as well as the most advantageous position for the firm to take in that industry, given the industry's structural characteristics.[82] The model

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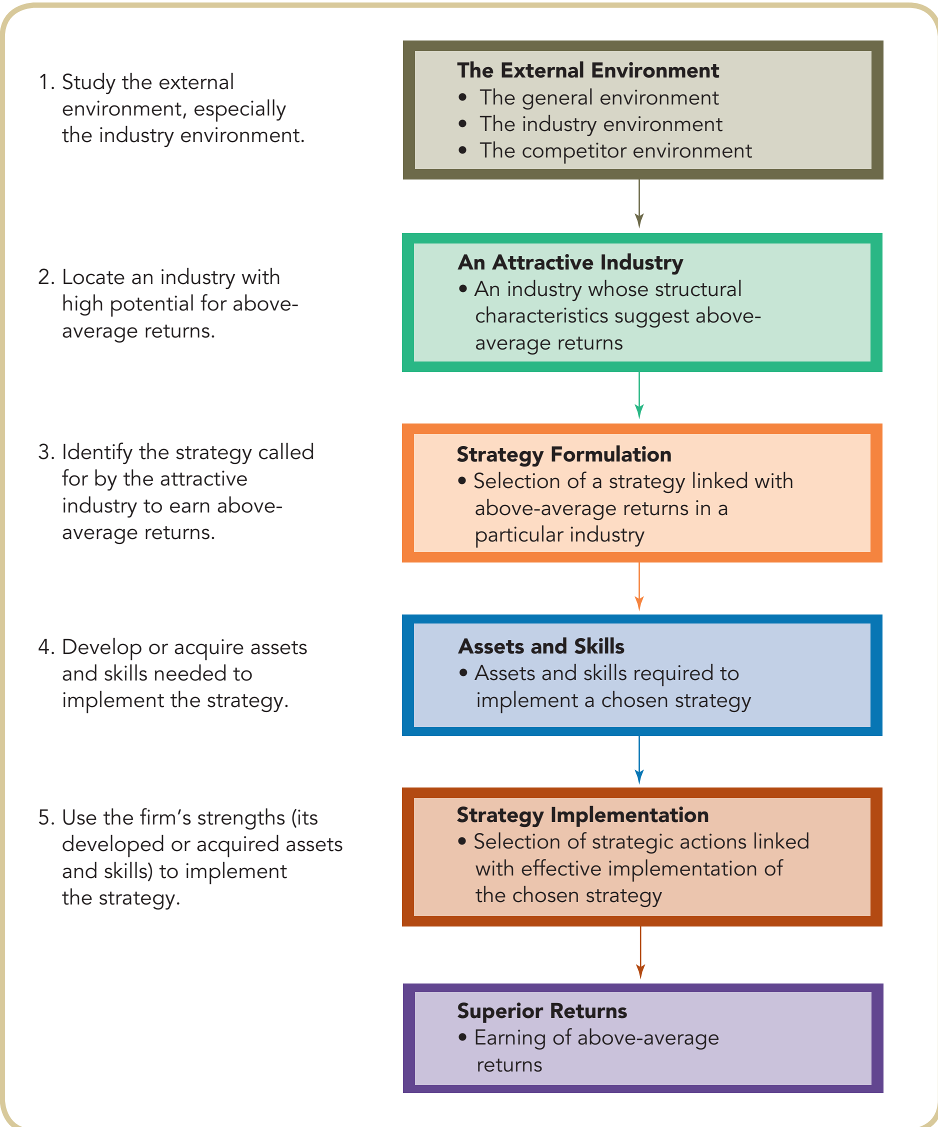
suggests that firms can earn above-average returns by producing either standardized products at costs below those of competitors (a cost leadership strategy) or by producing differentiated products for which customers are willing to pay a price premium (a differentiation strategy). We discuss the cost leadership and product differentiation strategies fully in Chapter 4.

As shown in Figure 1.2, the I/O model suggests that firms earn above-average returns by studying the external environment effectively as the foundation for identifying an attractive industry and implementing an appropriate strategy in it. For example, in some industries, firms can reduce competitive rivalry and erect barriers to entry by forming joint ventures. In turn, reduced rivalry increases the profitability potential of firms that are collaborating.[83] Companies that develop or acquire the internal skills needed to implement strategies required by the external environment are likely to succeed, while those that do not are likely to fail.[84] Hence, this model suggests that the characteristics

Figure 1.2 The I/O Model of Above-Average Returns



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of the external environment influence returns more so than do a firm's unique internal resources and capabilities.

Research findings support the I/O model because the industry in which a firm competes explains approximately 20 percent of its profitability. However, research also shows that the firm's resources and capabilities and the actions taken by using them accounts for 36 percent of the variance in firm profitability.[85] Thus, managers' strategic actions affect the firm's performance as do the characteristics of the environment in which the firm competes.[86] These findings suggest that the external environment and a firm's resources, capabilities, core competencies, and competitive advantages (see Chapter 3) influence the company's ability to achieve strategic competitiveness and earn above-average returns.

As shown in Figure 1.2, the I/O model assumes that a firm's strategy is a set of commitments and actions flowing from the characteristics of the industry in which the firm chose to compete. The resource-based model, discussed next, takes a different view of the major influences on a firm's choice of strategy.

1-3 The Resource-Based Model of Above-Average Returns

The resource-based model of above-average returns assumes that each organization is a collection of unique resources and capabilities. The *uniqueness* of resources and capabilities is the basis of a firm's strategy and its ability to earn above-average returns.[87]

Resources are inputs into a firm's production process, such as capital equipment, the skills of individual employees, patents, finances, and talented managers. Firms use three categories to classify their resources: physical, human, and organizational capital. Described fully in Chapter 3, resources are either tangible or intangible in nature.

Individual resources alone may not yield a competitive advantage; resources have a greater likelihood of being a source of competitive advantage when integrated to form a capability. A **capability** is the capacity for a set of resources to perform a task or an activity in an integrative manner.[88] **Core competencies** are capabilities that serve as a source of competitive advantage for a firm over its rivals.[89] Core competencies are often visible in the form of organizational functions. For example, Apple's R&D function is one of its core competencies, as is its ability to produce innovative new products that create value for customers. Amazon's distribution function is a core competence while information technology is a core competence for Walmart.

According to the resource-based model, differences in firms' performances across time are due primarily to their unique resources and capabilities rather than the industry's structural characteristics. This model also assumes that firms acquire different resources and develop unique capabilities based on how they combine and use the resources; that resources and certainly capabilities are not highly mobile across firms; and that the differences in resources and capabilities are the basis of competitive advantage.[90] Through continued use, capabilities become stronger and more difficult for competitors to understand and imitate. As a source of competitive advantage, a capability must not be easily imitated but also not too complex to understand and manage.[91]

We show the resource-based model of superior returns in Figure 1.3. This model suggests that the strategy the firm chooses should allow it to use its competitive advantages in an attractive industry (firms use the I/O model to identify an attractive industry).

Not all of a firm's resources and capabilities have the potential to be the foundation for a competitive advantage. This potential is realized when resources and capabilities are valuable, rare, costly to imitate, and non-substitutable.[92] Resources are *valuable* when they allow a firm to take advantage of opportunities or neutralize threats in

Resources are inputs into a firm's production process, such as capital equipment, the skills of individual employees, patents, finances, and talented managers.

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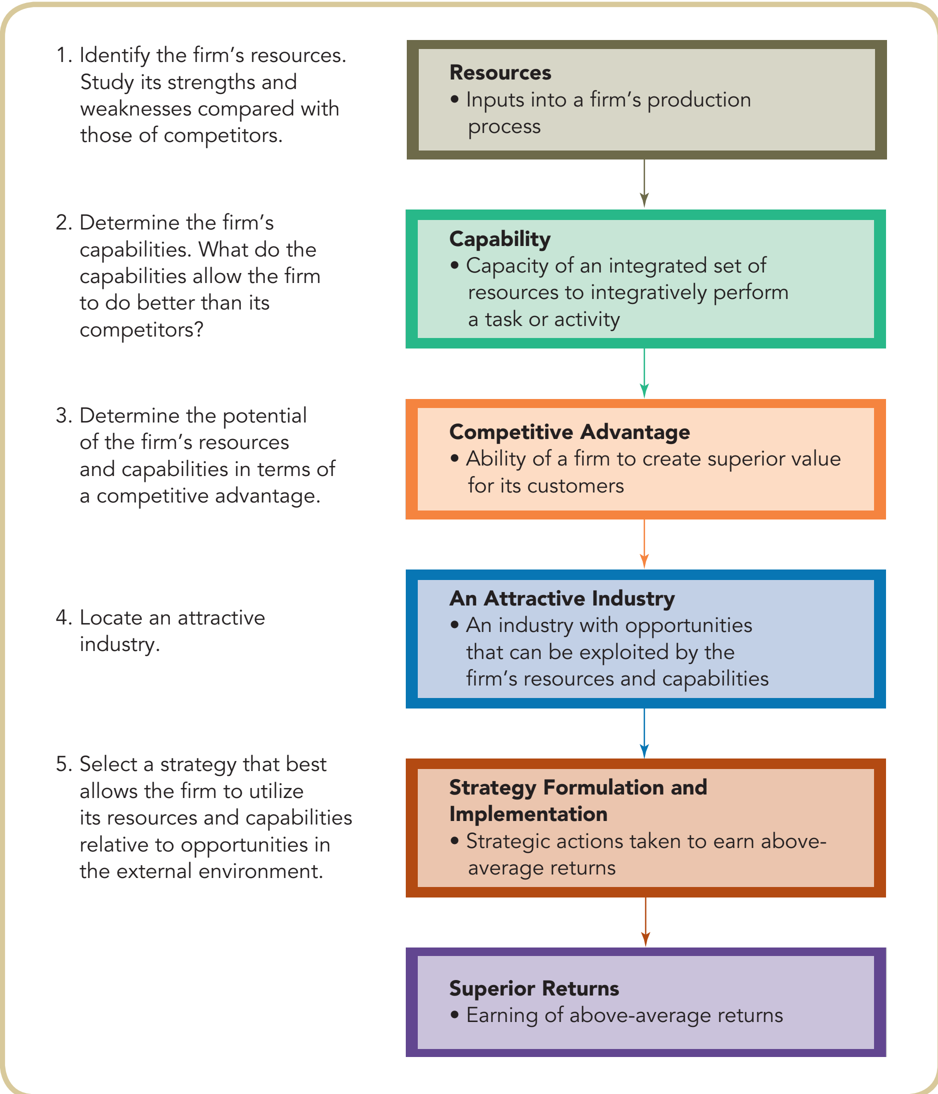
Figure 1.3 The Resource-Based Model of Above-Average Returns



its external environment. They are *rare* when possessed by few, if any, current and potential competitors. Resources are *costly to imitate* when other firms either cannot obtain them or are at a cost disadvantage in obtaining them compared with the firm that already possesses them. They are *non-substitutable* when they have no structural equivalents. Over time, competitors find ways to imitate value-creating resources or to create new resources that yield a different type of value that creates value for customers. Therefore, it is difficult to achieve and sustain a competitive advantage based on resources alone. Firms integrate individual resources to develop configurations of resources with the potential to build capabilities. Capabilities developed in this manner have a stronger likelihood of becoming a core competence and of leading to a source of competitive advantage.[93]

Previously, we noted that research shows that both the industry environment and a firm's internal assets affect its performance over time.[94] Thus, to form a vision and mission, and subsequently to select one or more strategies and determine how to implement them,

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firms use both the I/O and resource-based models. In fact, these models complement each other in that one (I/O) focuses outside the firm while the other (resource-based) focuses inside the firm. Next, we discuss the formation of a firm's vision and mission—actions taken after the firm understands the realities of its external environment (Chapter 2) and internal organization (Chapter 3).

1-4 Vision and Mission

After analyzing the external environment and the internal organization, the firm has the information required to form its vision and a mission (see Figure 1.1). Stakeholders (those who affect or are affected by a firm's performance, as explained later in the chapter) learn a great deal about a firm by studying its vision and mission. Indeed, a key purpose of vision and mission statements is to inform stakeholders of what the firm is, what it seeks to accomplish, and who it seeks to serve.

1-4a Vision

Vision is a picture of what the firm wants to be and, in broad terms, what it wants to achieve.[95] Thus, a vision statement articulates the ideal description of an organization and gives shape to its intended future. In other words, a vision statement points the firm in the direction of where it would like to be in the years to come. An effective vision stretches and challenges people as well. In her book about Steve Jobs, Apple's former CEO, Carmine Gallo argues that Jobs's vision for the firm was a key reason for Apple's innovativeness during his tenure. She suggests that he thought bigger and differently than do most people. To be innovative, she explains that one has to think differently about the firm's products and customers—"sell dreams not products"—and differently about the story to "create great expectations."[96]

As a reflection of values and aspiration, firms hope that their vision statement will capture the heart and mind of each employee and, hopefully, other stakeholders as well. A firm's vision tends to be enduring while its mission can change with new environmental conditions. A vision statement tends to be relatively short and concise, making it easily remembered. Examples of vision statements include the following:

Our vision is to be the world's best quick service restaurant. (McDonald's)

To make the automobile accessible to every American. (Ford Motor Company's vision when established by Henry Ford)

Delivering happiness to customers, employees, and vendors. (Zappos.com)

As a firm's most important and prominent strategic leader, the CEO is responsible for working with others to form the firm's vision. Experience shows that the most effective vision statement results when the CEO involves a host of stakeholders (e.g., other top-level managers, employees working in different parts of the organization, suppliers, and customers) to develop it.[97] Conditions in the firm's external environment and internal organization influence the forming of a vision statement. Moreover, the decisions and actions of those involved with developing the vision, especially the CEO and the other top-level managers, must be consistent with it.

Vision is a picture of what the firm wants to be and, in broad terms, what it wants to achieve.

A **mission** specifies the businesses in which the firm intends to compete and the customers it intends to serve.

1-4b Mission

The vision is the foundation for the firm's mission. A **mission** specifies the businesses in which the firm intends to compete and the customers it intends to serve.[98] The firm's mission is more concrete than its vision. However, similar to the vision,

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a mission should establish a firm's individuality and should be inspiring and relevant to all stakeholders. Together, the vision and mission provide the foundation the firm needs to choose and implement one or more strategies. The probability of forming an effective mission increases when employees have a strong sense of the ethical standards that guide their behaviors as they work to help the firm reach its vision.[99] Thus, business ethics are a vital part of the firm's discussions to decide what it wants to become (its vision) as well as who it intends to serve and how it desires to serve those individuals and groups (its mission).[100]

Even though the final responsibility for forming the firm's mission rests with the CEO, the CEO and other top-level managers often involve other people to develop the mission statement. The main reason for this is that the mission deals more directly with product markets and customers. Compared to a firm's senior-level leaders, middle- and first-level managers and other employees interact frequently with customers and the markets the firm serves. Examples of mission statements include the following:

Be the best employer for our people in each community around the world and deliver operational excellence to our customers in each of our restaurants. (McDonald's)

Provide the best customer service possible. Deliver WOW through service. (Zappos.com)

McDonald's mission statement flows from its vision of being the world's best quick service restaurant. Zappos.com's mission statement indicates that the firm will reach its vision of delivering happiness to different stakeholder groups by providing service that WOWs them.

Clearly, ineffectively developed vision and mission statements fail to provide the direction a firm needs to take appropriate strategic actions. This is undesirable in that as shown in Figure 1.1, a firm's vision and mission are critical aspects of the *analysis* and the base required to engage in *strategic actions* that help the firm achieve strategic competitiveness and earn above-average returns. Therefore, firms must accept the challenge of forming effective vision and mission statements.

1-5 Stakeholders

Every organization involves a system of primary stakeholder groups with whom it establishes and manages relationships.[101] **Stakeholders** are individuals, groups, and organizations that can affect the firm's vision and mission, are affected by the strategic outcomes achieved, and have enforceable claims on the firm's performance.[102] Their ability to withhold participation that is essential to the firm's survival, competitiveness, and profitability is the source of stakeholders' ability to enforce their claims against an organization. Stakeholders continue to support an organization when its performance meets or exceeds their expectations. Research suggests that firms managing relationships with their stakeholders effectively outperform those that do not.[103] Stakeholder relationships and the firm's overall reputation among stakeholders can therefore be a source of competitive advantage.[104]

Although organizations have dependency relationships with their stakeholders, firms are not equally dependent on all stakeholders at all times. Unequal dependencies means that stakeholders possess different degrees of ability to influence an organization.[105] The more critical and valued is a stakeholder's participation, the greater is a firm's dependency on that stakeholder. Greater dependence, in turn, gives the stakeholder more potential influence over a firm's commitments, decisions, and actions. Managers must find ways to either accommodate or insulate the organization from the demands of stakeholders controlling critical resources.[106]

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1-5a Classifications of Stakeholders

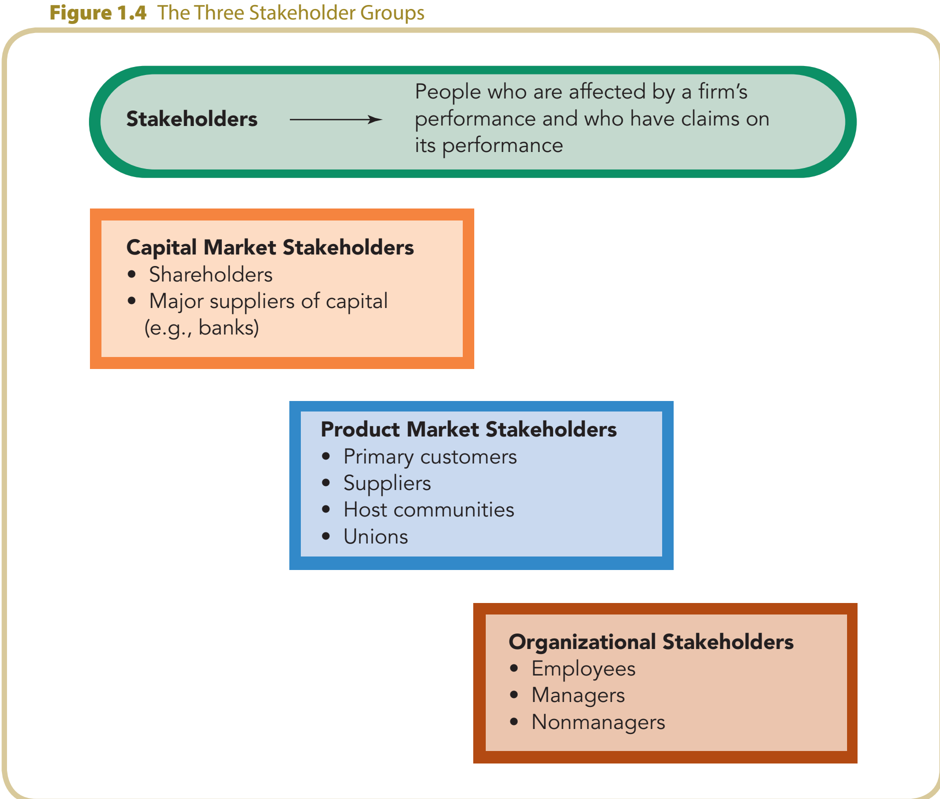
Firms can separate the parties involved with their operations into at least three groups.[107] As shown in Figure 1.4, these groups are the capital market stakeholders (shareholders and the major suppliers of a firm's capital), the product market stakeholders (the firm's primary customers, suppliers, host communities, and unions representing the workforce), and the organizational stakeholders (all of a firm's employees, including both non-managerial and managerial personnel).

Each stakeholder group expects those making strategic decisions in a firm to provide the leadership that will result in the reaching of its valued objectives.[108] The objectives of stakeholder groups often differ from one another, sometimes placing those involved with a firm's strategic management process in situations where trade-offs have to be made. The most obvious stakeholders, at least in U.S. organizations, are *shareholders*—individuals and groups who have invested capital in a firm in the expectation of earning a positive return on their investments. Laws governing private property and private enterprise are the source of shareholders' rights.

In contrast to shareholders, another group of stakeholders—the firm's customers—prefers that investors receive a minimum return on their investments. Customers could have their interests maximized when the quality and reliability of a firm's products are improved, but without high prices. High returns to customers, therefore, might come at the expense of lower returns for capital market stakeholders.

Because of potential conflicts, firms seek to manage stakeholders' expectations. First, a firm must identify and then seek to understand fully each stakeholder group's interests. Second, it must prioritize those interests in case it cannot satisfy all of them. Power

Figure 1.4 The Three Stakeholder Groups



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is the most critical criterion in prioritizing stakeholders; that is to say, the stakeholder group with whom the firm has the greatest dependence for its commitment has the greatest amount of power to influence the firm's actions.[109]

When earning above-average returns, the firm is in a better position to manage stakeholder relationships effectively. With the capability and flexibility provided by above-average returns, a firm can satisfy multiple stakeholders more easily. When the firm earns only average returns, it is unable to maximize the interests of all stakeholders. The objective then becomes that of satisfying each stakeholder group's minimal expectations.

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As a firm formulates its strategy, it must consider all of its primary stakeholders in the product and capital markets as well as organizational shareholders.

Stakeholders receive different levels of attention in light of how dependent the firm is on their support at a point in time. For example, environmental groups may be very important to firms in the energy industry but less important to professional service firms. A firm earning below-average returns lacks the capacity to satisfy the minimal expectations of all stakeholder groups. The managerial challenge in this case is to make trade-offs that minimize the amount of support lost from stakeholders. Societal values also influence the general weightings allocated among the three stakeholder groups shown in Figure 1.4; that is to say that cultural norms and institutional rules, regulations, and laws influence how firms interact with stakeholders in different countries and regions of the world. Next, we present additional details about each of the three major stakeholder groups.

Capital Market Stakeholders

Shareholders and lenders both expect a firm to preserve and enhance the wealth they have entrusted to it. The returns they expect are commensurate with the degree of risk they accept with those investments (i.e., lower returns are expected with low-risk investments while higher returns are expected with high-risk investments). Dissatisfied lenders may impose stricter covenants on subsequent borrowing of capital. Dissatisfied shareholders may reflect their concerns through several means, including selling their stock. Institutional investors too (e.g., pension funds, mutual funds) may choose to sell their stock if the returns fail to meet their expectations.

Alternatively, as stakeholders, these investors might take actions to improve the firm's performance. Communicating clearly their expectations regarding performance to the firm's board of directors and top-level managers is an example of such actions.[110] Some institutions owning major shares of a firm's stock may have conflicting views of the actions needed, which can be challenging for the firm's managers. This is because some may want an increase in returns in the short-term while the others desire a focus on building long-term competitiveness.[111] In these instances, managers may need to balance their desires with those of other shareholders or prioritize the importance of the institutional owners with different goals. Clearly, shareholders who hold a large share of stock (sometimes referred to as blockholders, see Chapter 10) are influential, especially in determining the firm's capital structure (i.e., the amount of equity versus the amount of debt used). Large

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shareholders often prefer that the firm minimize its use of debt because of its risk, its cost, and the possibility that debt holders have first call on the firm's assets relative to shareholders in case of default.[112] Because of their importance in terms of supporting needs for capital, firms typically seek to find ways to better satisfy the expectations of capital market stakeholders.

Product Market Stakeholders

Some might think that product market stakeholders (customers, suppliers, host communities, and unions) share few common interests. However, these four groups can benefit as firms engage in competitive battles. For example, depending on product and industry characteristics, marketplace competition may result in lower product prices for a firm's customers and higher prices for its suppliers (the firm might be willing to pay higher supplier prices to ensure delivery of the products linked to its competitive success).[113]

Customers, as stakeholders, seek reliable products at the lowest possible prices. Suppliers seek loyal customers who are willing to pay the highest sustainable prices for the products they receive. Although all product market stakeholders are important, without customers, the other product market stakeholders are of little value. Therefore, the firm must try to learn about and understand current and potential customers.

Host communities include the national (home and abroad), state/province, and local government entities with which the firm interacts. Governments want companies willing to be long-term employers and providers of tax revenue without placing excessive demands on public support services. These stakeholders also influence the firm through laws and regulations. In fact, firms must deal with laws and regulations developed and enforced at the national, state, and local levels (the influence is *polycentric*—multiple levels of power and influence). This means that firms encounter influence attempts from multiple regulatory sources with power.[114] The interests of unions include secure jobs and desirable working conditions for members.

In an overall sense, product market stakeholders are generally satisfied when a firm's profit margin reflects at least a balance between the returns to capital market stakeholders (i.e., the returns lenders and shareholders will accept and retain their interests in the firm) and the returns in which they share.

Organizational Stakeholders

Employees—the firm's organizational stakeholders—expect the firm to provide a dynamic, stimulating, and rewarding work environment. Employees generally prefer to work for a company that is growing and in which they can develop their skills, especially those required to be effective team members and to meet or exceed global work standards. Workers who learn how to use new knowledge productively are critical to organizational success. In a collective sense, the education and skills of a firm's workforce are competitive weapons affecting strategy implementation and firm performance.[115]

Those leading a firm bear responsibility for serving stakeholders' needs on a day-to-day basis. Using the firm's human capital successfully supports leaders' efforts to do this.[116] International assignments facilitate efforts to help a firm's employees understand competition in the global competitive landscape. "Expats" is the title given to individuals engaged in an international assignment for their company. The process of managing expatriate employees so they develop knowledge while working internationally and understand how to bring that knowledge with them upon return has the potential to enhance the firm's performance at the domestic and international levels.[117]

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1-6 Strategic Leaders

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Gary Kelly, CEO of Southwest Airlines, is a recipient of the Tony Jannus Award, which recognizes outstanding contributors to the growth and improvement of the airline industry.

Strategic leaders are people located in different areas and levels of the firm using the strategic management process to select actions that help the firm achieve its vision and fulfill its mission. Regardless of their location in the firm, successful strategic leaders are decisive, committed to nurturing those around them, and committed to helping the firm create value for all stakeholder groups.[118] In this vein, research evidence suggests that employees who perceive that their CEO is a visionary leader also believe that the CEO leads the firm to operate in ways that are consistent with the values of all stakeholder groups rather than emphasizing only maximizing profits for shareholders. In turn, visionary leadership motivates employees to expend extra effort, thereby helping to increase firm performance.

When identifying strategic leaders, most of us tend to think of CEOs and other top-level managers. Clearly, these people are strategic leaders. In the final analysis, CEOs are responsible for making certain their firm uses the strategic management process successfully. The pressure on CEOs today to manage strategically is stronger than ever.[119] However, many others help choose a firm's strategy and the actions to implement it.[120] The reason for this is that the realities of twenty-first century competition mentioned earlier in this chapter (e.g., the global economy, globalization, rapid technological change, and the increasing importance of knowledge and people as sources of competitive advantage) create a need for those "closest to the action" to play a role in choosing and implementing the firm's strategy. In fact, all managers (as strategic leaders) must think globally and act locally.[121] Thus, the most effective CEOs and top-level managers understand how to delegate strategic responsibilities to people throughout the firm who influence the use of organizational resources. Delegation also helps to avoid managerial hubris at the top and the problems it causes, especially in situations allowing significant managerial discretion.[122]

Organizational culture also affects strategic leaders and their work. In turn, strategic leaders' decisions and actions shape a firm's culture. **Organizational culture** refers to the complex set of ideologies, symbols, and core values that individuals throughout the firm share and that influence how the firm conducts business. Organizational culture is the social energy that drives—or fails to drive—the organization.[123] For example, many believe that the culture at Southwest Airlines is unique and valuable. Its culture encourages employees to work hard but also to have fun while doing so. Moreover, its culture entails respect for others—employees and customers alike. The firm also places a premium on service, as suggested by its commitment to provide POS (Positively Outrageous Service) to each customer.

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Organizational culture refers to the complex set of ideologies, symbols, and core value that individuals throughout the firm share and that influence how the firm conducts business.

1-6a The Work of Effective Strategic Leaders

Perhaps not surprisingly, hard work, thorough analyses, a willingness to be brutally honest, a penchant for wanting the firm and its people to achieve success, and tenacity are prerequisites to an individual's success as a strategic leader. Individuals become top-level leaders because of their capabilities (their accumulation of human capital and

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Strategic Focus

Strategic Leaders' Decisions as a Path to Firms' Efforts to Deal Successfully with Their Challenges

The rapid pace of change facing companies and those leading them in today's globalized business environment is a recurring theme in our analysis of the strategic management process. Stated simply, the pace of change organizations throughout the world encounter today is rapid, while the nature of such change induces complexity for firms as they seek strategic competitiveness. Often, change comes to firms in the form of different customer expectations. In the hotel industry for example, Hilton Worldwide Holdings, with 14 brands and more than 5,300 properties, believes that "one of its biggest challenges is keeping up with changing tastes, especially among millennials, who want high-tech amenities, bigger, hipper lobbies and a cleaner, more minimal look." For Hilton's strategic leaders, the "biggest challenge continues to be the pace of change and the rate at which, in the digital space, new capabilities get put in front of consumers."

To deal with changes such as these, top-level strategic leaders typically help their firms form strategic actions and strategic responses. For many of these strategic leaders, a global mind-set and a passion for meeting people's needs inform their decisions.

Defined and discussed in Chapter 5, strategic actions and strategic responses find firms trying to outcompete rivals in marketplace competitions. Strategic actions and responses require significant commitments of organizational resources and are decisions that are difficult for firms to reverse once executed. The strategic actions Hilton is taking to respond to changes include those of refreshing old brands and establishing new ones such as Tru, which emphasizes communal space over room size.

Consumer-goods giant Procter & Gamble (P&G) is facing fundamental challenges in its home U.S. market, including shifts in consumer preferences, retailers pushing for lower prices, and the availability of private label alternatives for consumers. In response, P&G's top-level strategic leaders decided recently to acquire the consumer health business of Germany's Merck KGaA for $4.2 billion. This unit's product portfolio includes an array of specialty dietary supplements as well as a nasal decongestant. One reason for this acquisition is declines in P&G's organic sales growth and in its all-important Gillette razors. Encountering stalling revenue growth, Pfizer's strategic leaders are considering several strategic actions including those of spinning off its consumer-health business, which sells products such as Advil pain pills, ChapStick lip balm, and Centrum vitamins, to splitting the company. Following successful stints with Volkswagen AG and Nissan Infiniti brand, Johan de Nysschen accepted the role of president of Cadillac, a General Motors unit. An indication that he intends to "mold Cadillac in the image of BMW and other luxury brands" suggests the emergence of a string of strategic actions. Global declines in beer consumption finds Dutch brewer Heineken NV engaging in a number of strategic actions. Acquiring a 20.67% stake in China's largest brewer, China Resources Beer Holdings Co., and acquiring several craft brewers are examples of decisions made to expand the firm's customer base.

helen89/iStock Editorial/Getty Images

Tru Hotel; Hilton's response to millennials who want high-tech amenities, bigger, hipper lobbies, and a cleaner, more minimal look.

Recently, the Drucker Institute, founded in 2007 to advance managerial ideals as espoused by Peter Drucker, identified the 250 most effectively managed U.S. companies. Amazon held the top spot with Apple, Google parent Alphabet, IBM, Microsoft, and Cisco rounding out the top five. These firms' positive performance relative to other companies in terms of five areas Drucker said are critical to corporate success—customer satisfaction, employee engagement and development, innovation, social responsibility, and financial strength—earned them the top spots on the list.

One might argue that these firms' strategic leaders, including the top-level leaders, rendered decisions regarding strategic actions and responses that contributed to their firms' excellence. In addition to the characteristics of strategic leaders mentioned in this chapter's text, such as hard work, a commitment to analyze situations thoroughly, and so forth,

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those leading the top five firms as well as the others on the list of 250 companies chosen by the Drucker Institute may have additional qualities. For example, some believe that the success of Sergio Marchionne, the leader credited with turning around Fiat and Chrysler (who recently passed away), is a function of an "unusual blend of vision, technical expertise, analytical rigor, open-mindedness, and candor." As with Steve Jobs, Apple's former CEO, Marchionne's actions earned him a recognition as being a bit of an eccentric, too. Regardless of their characteristics though, the decisions made by strategic leaders inform how their firm will use the strategic management process.

Sources: A. Back, 2018, P&G needs a workout, not vitamins, *Wall Street Journal*, www.wsj.com, April 19; M. Colias, 2018, The 10-year plan to make Cadillac cool again, *Wall Street Journal*, www.wsj.com, October 25; K. Paul, 2018, What millennials want in hotel rooms, *Wall Street Journal*, www.wsj.com, August 12; J. D. Rockoff & W. Colville, 2018, Johnson & Johnson remakes top leadership, *Wall Street Journal*, www.wsj.com, June 22; J. D. Rockoff & C. Lombardo, 2018, Pfizer revenue growth stalls as company mulls OTC unit's future, *Wall Street Journal*, www.wsj.com, May 1; J. D. Rockoff & I. Moise, 2018, Johnson & Johnson raises sales outlook, *Wall Street Journal*, www.wsj.com, April 17; S. Terlap & A. Hufford, 2018, P&G slogs through 'difficult' markets for sales growth, *Wall Street Journal*, www.wsj.com, April 19; S. Terlap & J. D. Rockoff, 2018, P&G to acquire Merck KGaA's consumer-health unit, *Wall Street Journal*, www.wsj.com, April 19; N. Trentmann, 2018, Heineken's strategy in a stagnate beer market, *Wall Street Journal*, www.wsj.com, August 9; S. Walker, 2018, Why the future belongs to 'challenge-driven leaders,' *Wall Street Journal*, www.wsj.com, August 11; S. Walker, 2018, The leader of the future: Why Sergio Marchionne fit the profile, *Wall Street Journal*, www.wsj.com, August 11; V. Fuhrmans & Y. Koh, 2017, The 250 most effectively managed U.S. companies—and how they got that way, *Wall Street Journal*, www.wsj.com, December 6.

skills over time). Effective top management teams (those with better human capital, management skills, and cognitive abilities) make better strategic decisions.[124] In addition, strategic leaders must have a strong strategic orientation while embracing change in today's dynamic competitive landscape.[125] To deal with change effectively, strategic leaders must be innovative thinkers and promote innovation in their organization.[126] A top management team representing different types of expertise and leveraging relationships with external parties promotes firm innovation.[127] Strategic leaders can best leverage partnerships with external parties and organizations when their organizations are ambidextrous; that is, when they are both innovative and skilled at execution.[128] In addition, strategic leaders need to have a global mind-set; some consider this mind-set as an ambicultural approach to management.[129]

Strategic leaders, regardless of their location in the organization, often work long hours, and ambiguous decision situations dominate the nature of their work. However, the opportunities afforded by this work are appealing and offer exciting chances to dream and to act. The following words, given as advice to the late Time Warner chair and co-CEO Steven J. Ross by his father, describe the opportunities in a strategic leader's work:

There are three categories of people—the person who goes into the office, puts his feet up on his desk, and dreams for 12 hours; the person who arrives at 5 a.m. and works for 16 hours, never once stopping to dream; and the person who puts his feet up, dreams for one hour, then does something about those dreams.[130]

As a term, vision describes a dream that challenges and energizes a company. The most effective strategic leaders provide a vision as the foundation for the firm's mission and subsequent choice and use of one or more strategies.[131]

We describe the work of some strategic leaders in the Strategic Focus. While reading this material, notice the relationship between the points mentioned in this part of the chapter about strategic leaders and the actions highlighted in the Strategic Focus. Strategic leaders work in all parts of an organization; however, in this Strategic Focus, top-level leaders are the focus of the discussion.

As you will see, the work of upper-level strategic leaders is indeed challenging, complex, and ambiguous in nature. On the other hand, these individuals play a major role in the making of a firm's competitive decisions—the types of decisions that are a part of their use of the strategic management process.

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1-7 The Strategic Management Process

As suggested by Figure 1.1, the strategic management process is a rational approach firms use to achieve strategic competitiveness and earn above-average returns. Figure 1.1 also features the topics we examine in this book to present the strategic management process.

We divide this book into three parts—parts that align with the A-S-P process explained in the beginning of the chapter. In Part 1, we describe the *analyses* (A) firms use to develop strategies. Specifically, we explain how firms analyze their external environment (Chapter 2) and internal organization (Chapter 3). Firms complete these analyses to identify marketplace opportunities and threats in the external environment (Chapter 2) and to decide how to use the resources, capabilities, core competencies, and competitive advantages in their internal organization to pursue opportunities and overcome threats (Chapter 3). The analyses explained in Chapters 2 and 3 are the well-known SWOT analyses (strengths, weaknesses, opportunities, threats).[132] Firms use knowledge about their external environment and internal organization to formulate strategies in light of their vision and mission.

The firm's analyses (see Figure 1.1) provide the foundation for choosing one or more *strategies* (S) and deciding which one(s) to implement. As suggested in Figure 1.1 by the horizontal arrow linking the two types of strategic actions, firms simultaneously integrate formulation and implementation as a basis for a successful strategic management process. Integration occurs as decision makers review implementation issues when choosing strategies and when considering potential adaptations to a strategy during the implementation process itself.

In Part 2, we discuss the different strategies firms may choose to use. First, we examine business-level strategies (Chapter 4). A business-level strategy describes actions a firm takes to exploit its competitive advantage(s). A company competing in a single product market (e.g., a locally owned grocery store operating in only one location) has but one business-level strategy, while a diversified firm competing in multiple product markets (e.g., Siemens AG) forms a business-level strategy for each of its businesses. In Chapter 5, we describe the actions and reactions that occur among firms as they engage each other in competition. Competitors typically respond to and try to anticipate each other's actions. The dynamics of competition affect the strategies firms choose as well as how they intend to implement those strategies.[133] For example, one year after Amazon acquired Whole Foods, some analysts felt that this strategic action was "prompting the food industry to retool how it sells fresh food to consumers."[134] You will learn more about Amazon and Whole Foods in Chapter 5's Opening Case.

Determining the businesses in which the company intends to compete as well as how it will manage those businesses is the focus of corporate-level strategy (Chapter 6). Companies competing in more than one business experience diversification in the form of products (Chapter 7) and/or geographic markets (Chapter 8). Other topics vital to strategy formulation, particularly in the diversified company, include acquiring other businesses and, as appropriate, restructuring the firm's portfolio of businesses (Chapter 7) and selecting an international strategy (Chapter 8). With cooperative strategies (Chapter 9), firms form a partnership to share their resources and capabilities to develop a competitive advantage.

To examine actions firms take to implement strategies, we consider several topics in Part 3. First, we examine the different mechanisms companies use to govern themselves (Chapter 10). With different stakeholders (e.g., financial investors and board of directors' members) demanding improved corporate governance today, organizations seek to identify paths to follow to satisfy these demands.[135] In the last three chapters, we address the organizational structure and actions needed to control a firm's operations (Chapter 11), the patterns of strategic leadership appropriate for today's firms and competitive environments (Chapter 12), and strategic entrepreneurship (Chapter 13) as a path to continuous innovation.

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Because they deal with how a firm interacts with its stakeholders, strategic management process decisions have ethical dimensions.[136] Organizational culture reveals the firm's ethics; that is to say, a firm's core values, the ones most or all employees share, influence strongly their decisions. Especially in the global economy's turbulent and often ambiguous competitive landscape, those making decisions as a part of the strategic management process must understand how their decisions affect capital market, product market, and organizational stakeholders differently and regularly evaluate the ethical implications of their decisions.[137] Decision makers failing to recognize these realities accept the risk of placing their firm at a competitive disadvantage.[138]

As you will discover, the strategic management process we present to you in this book calls for disciplined approaches to serve as the foundation for developing a competitive advantage. Therefore, the process has a major effect on the *performance* (P) of the firm.[139] The firm's ability to achieve strategic competitiveness and earn above-average returns reflects the quality of its performance. Mastery of this strategic management process contributes positively to a firm's efforts to outperform competitors and to create value for its stakeholders.

SUMMARY

- Firms use the strategic management process to achieve strategic competitiveness and earn above-average returns. Firms *analyze* the external environment and their internal organization, then formulate and implement a *strategy* to achieve a desired level of *performance* (A-S-P). The firm's level of strategic competitiveness and the extent to which it earns above-average returns reflects its performance. Firms achieve strategic competitiveness by developing and implementing a value-creating strategy. Above-average returns (in excess of what investors expect to earn from other investments with similar levels of risk) provide the foundation for satisfying all of a firm's stakeholders simultaneously.
- The fundamental nature of competition is different in the current competitive landscape. As a result, those making strategic decisions must adopt a different mind-set, one that allows them to learn how to compete in highly turbulent and chaotic environments that produce a great deal of uncertainty. The globalization of industries and their markets along with rapid and significant technological changes are the two primary factors contributing to the turbulence of the competitive landscape.
- Firms use two major models to help develop their vision and mission when choosing one or more strategies to pursue strategic competitiveness and above-average returns. The core assumption of the I/O model is that the firm's external environment has a larger influence on the choice of strategies than does its internal resources, capabilities, and core competencies. Thus, firms use the I/O model to understand the effects an industry's characteristics can have on them when selecting a strategy or strategies to use to compete against rivals. The logic supporting the I/O model suggests that firms earn above-average returns by locating an attractive industry or part of an attractive industry and then implementing the strategy dictated by that industry's characteristics successfully. The core assumption of the resource-based model is that the firm's unique resources, capabilities, and core competencies have more of an influence on selecting and using strategies than does the firm's external environment. When firms use their valuable, rare, costly-to-imitate, and non-substitutable resources and capabilities effectively when competing against rivals in one or more industries, they earn above-average returns. Evidence indicates that both models' insights help firms as they select and implement strategies. Thus, firms want to use their unique resources, capabilities, and core competencies as the foundation to engage in one or more strategies that allow them to compete effectively against rivals.
- The firm's vision and mission guide its selection of strategies based on the information from analyses of its external environment and internal organization. Vision is a picture of what the firm wants to be and, in broad terms, what it wants to achieve ultimately. Flowing from the vision, the mission specifies the business or businesses in which the firm intends to compete and the customers it intends to serve. Vision and mission provide direction to the firm and signal important descriptive information to stakeholders.
- Stakeholders are those who can affect, and are affected by, a firm's performance. Because a firm is dependent on the continuing support of stakeholders (shareholders, customers, suppliers, employees, host communities, etc.), they have enforceable claims on the company's performance. When earning above-average returns, a firm generally has the resources it needs to satisfy the interests of all stakeholders. However, when earning only average returns, the firm must manage its stakeholders carefully to retain their support. A firm earning below-average returns must minimize the amount of support it loses from unsatisfied stakeholders.

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- Strategic leaders are people located in different areas and levels of the firm using the strategic management process to help the firm achieve its vision and fulfill its mission. In general, CEOs are responsible for making certain that their firms use the strategic management process properly. The effectiveness of the strategic management process increases when grounded in ethical intentions and behaviors. The strategic leader's work demands decision trade-offs, often among attractive alternatives. It is important for all strategic leaders, especially the CEO and other members of the top management team, to conduct thorough analyses of conditions facing the firm, be brutally and consistently honest, and work collaboratively with others to select and implement strategies.

KEY TERMS

above-average returns 6
average returns 6
capability 16
competitive advantage 4
core competencies 16
global economy 9
hypercompetition 8
mission 18
organizational culture 23
resources 16
risk 6
stakeholders 19
strategic competitiveness 4
strategic flexibility 13
strategic leaders 23
strategic management process 6
strategy 4
vision 18

REVIEW QUESTIONS

1. What are strategic competitiveness, strategy, competitive advantage, above-average returns, and the strategic management process?
2. What are the characteristics of the current competitive landscape? What two factors are the primary drivers of this landscape?
3. According to the I/O model, what should a firm do to earn above-average returns?
4. What does the resource-based model suggest a firm should do to earn above-average returns?
5. What are vision and mission? What is their value for the strategic management process?
6. What are stakeholders? How do the three primary stakeholder groups influence organizations?
7. How would you describe the work of strategic leaders?
8. What are the elements of the strategic management process? How are they interrelated?

Mini-Case

Starbucks Is "Juicing" Its Earnings per Store through Technological Innovations

The choice of a CEO signals potential actions to stakeholders about a firm's potential actions. Howard Schultz served as Starbucks CEO for many years; the firm achieved multiple successes during his service. As of April 2017, Schulz became executive chairman of Starbucks's board while Kevin Johnson, a former CEO of Juniper Networks and a 16 year veteran of Microsoft, assumed the CEO position for the coffee giant. Johnson's background may find him concentrating on the firm's digital operations, information technology practices and supply chain operations as a means of increasing Starbucks's effectiveness and efficiency.

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Many brick and mortar stores have experienced decreasing sales in the United States as online traffic has increased. Interestingly, 2014 Starbucks sales store operations increased 5 percent in the fourth quarter; this 5 percent uptick in revenue came from increased traffic (2 percent from growth in sales and 3 percent in increased ticket size).

Additional and more sophisticated technology applications may be the driver of this increase in revenues. To stimulate sales, Starbucks is ramping up its digital tools such as mobile payment platforms. Customers now can place online orders and pick them up in about 150 Starbucks outlets in the Portland, OR area. Besides leadership and a focus on technology, Starbucks receives suggestions, ideas, and experimentation from its employees. Starbucks views its employees, called baristas, as partners who blend, steam, and brew the brand's specialty coffee in over 21,000 stores worldwide. Schultz credits the employees as a dominant force in helping it to build its revenue gains.

To incentivize employees further, Starbucks is among the first companies to provide comprehensive health benefits and stock option ownership opportunities to part-time employees. Currently, employees have received more than $1 billion worth of financial gain through the stock option program. An additional benefit for U.S. employees is the firm's program that pays 100 percent of workers' tuition to finish their degrees through Arizona State University. To date, one thousand workers have enrolled in this program. In mid-2018, Walmart offered subsidized college tuition to its employees as a means of attracting and retaining talent in a tight labor market. Walmart's actions may demonstrate the value of Starbucks's approach to supporting employees' efforts to earn a college degree.

When developing new storefront concepts, Starbucks innovates. For instance, it is testing smaller express stores in New York City that reduce client wait times. Today, Starbucks emphasizes online payments as a means of increasing the speed of customer transactions. It now gives Starbucks rewards for mobile payment applications to its 12 million active users. Interestingly, this puts it ahead of iTunes and American Express Serve with its Starbucks mobile payment app in terms of the number of users.

To put its innovation on display, Starbucks opened its first "Reserve Roastery and Tasting Room." This is a 15,000 square foot coffee roasting facility and a consumer retail outlet. According to Schultz, it is a retail theater where "you can watch beans being roasted, talk to master grinders, have your drink brewed in front of you in multiple ways, lounge in a coffee library, order a selection of gourmet brews and locally prepared foods." Schultz calls this store in New York the "Willie Wonka Factory of coffee." Based on this concept, Starbucks opened small "reserve" stores inspired by this flagship roastery concept across New York in 2015. To attract customers in the afternoon, the firm is "rolling out new cold coffee and tea drinks and is introducing happy hour promotions featuring cold beverages."

These technological advances and different store offerings are also taking place internationally. For example, Starbucks is expanding a new store concept in India in smaller towns and suburbs. These new outlets are about half the size of existing Starbucks cafes in India. In China, Starbucks is opening roughly one store daily and is rolling out its Roastery and Reserve brands to penetrate the country further.

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Case Discussion Questions

1. What competitive advantage or competitive advantages do you believe Starbucks seeks to establish? What are the main challenges the firm faces as it tries to maintain the advantage or advantages you identified?
2. Identify three or four capabilities you believe Starbucks possesses. Of these, are any a core competence? If so, explain your reasoning.
3. Starbucks's mission is "To inspire and nurture the human spirit—one person, one cup and one neighborhood at a time." What actions do you recommend the firm take to reach this mission?
4. As Starbucks's new chief executive officer and strategic leader, what key challenges does Kevin Johnson and his firm face?

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