

GAMBLE
PETERAF
THOMPSON

6e

Essentials of
**STRATEGIC
MANAGEMENT**

The Quest for Competitive Advantage

Mc
Graw
Hill
Education





ESSENTIALS OF
**STRATEGIC
MANAGEMENT**

The Quest for Competitive Advantage

John E. Gamble

Texas A&M University-Corpus Christi

Margaret A. Peteraf

Dartmouth College

Arthur A. Thompson, Jr.

The University of Alabama



**Mc
Graw
Hill
Education**



ESSENTIALS OF STRATEGIC MANAGEMENT: THE QUEST FOR COMPETITIVE ADVANTAGE,
SIXTH EDITION

Published by McGraw-Hill Education, 2 Penn Plaza, New York, NY 10121. Copyright © 2019 by McGraw-Hill Education. All rights reserved. Printed in the United States of America. Previous editions © 2017, 2015, and 2013. No part of this publication may be reproduced or distributed in any form or by any means, or stored in a database or retrieval system, without the prior written consent of McGraw-Hill Education, including, but not limited to, in any network or other electronic storage or transmission, or broadcast for distance learning.

Some ancillaries, including electronic and print components, may not be available to customers outside the United States.

This book is printed on acid-free paper.

1 2 3 4 5 6 7 8 9 0 LWI 21 20 19 18

ISBN 978-1-259-92763-8 (bound edition)

MHID 1-259-92763-6 (bound edition)

ISBN 978-1-260-13956-3 (loose-leaf edition)

MHID 1-260-13956-5 (loose-leaf edition)

Portfolio Director: *Michael Ablassmeir*

Lead Product Developer: *Kelly Delso*

Product Developer: *Anne Ehrenworth*

Executive Marketing Manager: *Debbie Clare*

Content Project Managers: *Harvey Yep (Core), Keri Johnson (Assessment)*

Buyer: *Laura Fuller*

Design: *Matt Diamond*

Content Licensing Specialists: *DeAnna Dausener (Image and Text)*

Compositor: *SPi Global*

Cover Image: ©*view stock/getty images*

Printer: *LSC Communications*

All credits appearing on page or at the end of the book are considered to be an extension of the copyright page.

Library of Congress Cataloging-in-Publication Data

Names: Gamble, John (John E.) author. | Thompson, Arthur A., 1940- author. | Peteraf, Margaret Ann, author.

Title: Essentials of strategic management: the quest for competitive advantage/
John E. Gamble, Texas A&M University-Corpus Christi, Margaret A. Peteraf,
Dartmouth College, Arthur A. Thompson, Jr., The University of Alabama.

Description: Sixth Edition. | Dubuque : McGraw-Hill Education, 2019. |
Revised edition of the authors' Essentials of strategic management, [2017]

Identifiers: LCCN 2017059878 | ISBN 9781259927638 (paperback)

Subjects: LCSH: Strategic planning. | Business planning. | Competition. |
Strategic planning--Case studies. | BISAC: BUSINESS & ECONOMICS /
Management.

Classification: LCC HD30.28 .G353 2018 | DDC 658.4/012--dc23

LC record available at <https://lcn.loc.gov/2017059878>

ABOUT THE AUTHORS

John E. Gamble is a Professor of Management and Dean of the College of Business at Texas A&M University–Corpus Christi. His teaching and research has focused on strategic management at the undergraduate and graduate levels. He has conducted courses in strategic management in Germany since 2001, which have been sponsored by the University of Applied Sciences in Worms.

Dr. Gamble’s research has been published in various scholarly journals, and he is the author or co-author of more than 75 case studies published in an assortment of strategic management and strategic marketing texts. He has done consulting on industry and market analysis for clients in a diverse mix of industries.

Professor Gamble received his PhD, Master of Arts, and Bachelor of Science degrees from the University of Alabama and was a faculty member in the Mitchell College of Business at the University of South Alabama before his appointment to the faculty at Texas A&M University–Corpus Christi.



John E. Gamble
©Richard’s Photography LLC

Margaret A. Peteraf is the Leon E. Williams Professor of Management at the Tuck School of Business at Dartmouth College. She is an internationally recognized scholar of strategic management, with a long list of publications in top management journals. She has earned myriad honors and prizes for her contributions, including the 1999 Strategic Management Society Best Paper Award recognizing the deep influence of her work on the field of strategic management. Professor Peteraf is on the Board of Directors of the Strategic Management Society and has been elected as a Fellow of the Society. She served previously as a member of the Academy of Management’s Board of Governors and as Chair of the Business Policy and Strategy Division of the Academy. She has also served in various editorial roles and is presently on nine editorial boards, including the *Strategic Management Journal*, the *Academy of Management Review*, and *Organization Science*. She has taught in Executive Education programs around the world and has won teaching awards at the MBA and Executive level.

Professor Peteraf earned her PhD, MA, and MPhil at Yale University and held previous faculty appointments at Northwestern University’s Kellogg Graduate School of Management and at the University of Minnesota’s Carlson School of Management.



Margaret A. Peteraf
©Heather Gere



Arthur A. Thompson, Jr.
Photo provided by the author.

Arthur A. Thompson, Jr. earned his BS and PhD degrees in economics from The University of Tennessee, spent three years on the economics faculty at Virginia Tech, and served on the faculty of The University of Alabama's College of Commerce and Business Administration for 25 years. In 1974 and again in 1982, Dr. Thompson spent semester-long sabbaticals as a visiting scholar at the Harvard Business School.

His areas of specialization are business strategy, competition and market analysis, and the economics of business enterprises. In addition to publishing over 30 articles in some 25 different professional and trade publications, he has authored or co-authored five textbooks and six computer-based simulation exercises that are used in colleges and universities worldwide.

Dr. Thompson spends much of his off-campus time giving presentations, putting on management development programs, working with companies, and helping operate a business simulation enterprise in which he is a major partner.

Dr. Thompson and his wife of 57 years have two daughters, two grandchildren, and a Yorkshire terrier.

BRIEF CONTENTS

PART ONE CONCEPTS AND TECHNIQUES FOR CRAFTING AND EXECUTING STRATEGY

Section A: Introduction and Overview

1. Strategy, Business Models, and Competitive Advantage 1
2. Strategy Formulation, Execution, and Governance 13

Section B: Core Concepts and Analytical Tools

3. Evaluating a Company's External Environment 36
4. Evaluating a Company's Resources, Capabilities, and Competitiveness 64

Section C: Crafting a Strategy

5. The Five Generic Competitive Strategies 88
6. Strengthening a Company's Competitive Position: Strategic Moves, Timing, and Scope of Operations 111
7. Strategies for Competing in International Markets 132
8. Corporate Strategy: Diversification and the Multibusiness Company 154
9. Ethics, Corporate Social Responsibility, Environmental Sustainability, and Strategy 182

Section D: Executing the Strategy

10. Superior Strategy Execution—Another Path to Competitive Advantage 199

Appendix Key Financial Ratios: How to Calculate Them and What They Mean 231

PART TWO CASES IN CRAFTING AND EXECUTING STRATEGY

- Case 1** Airbnb, Inc., in 2017 233
- Case 2** Costco Wholesale in 2017: Mission, Business Model, and Strategy 238
- Case 3** Competition in the Craft Brewing Industry in 2017 261
- Case 4** Fitbit, Inc., in 2017: Can It Revive Its Strategy and Reverse Mounting Losses? 271
- Case 5** lululemon athletica, inc., in 2017: Is the Company on the Path to Becoming a High Performer Once Again? 279
- Case 6** Gap Inc.: Can It Develop a Strategy to Connect with Consumers in 2017? 298
- Case 7** GoPro in 2017: Will Its Turnaround Strategy Restore Profitability? 307
- Case 8** Ricoh Canada 322
- Case 9** Mondelez International's Diversification Strategy in 2017: Has Corporate Restructuring Benefited Shareholders? 335
- Case 10** Robin Hood 346
- Case 11** Rosen Hotels & Resorts 348
- Case 12** TOMS Shoes in 2016: An Ongoing Dedication to Social Responsibility 360

Glossary 369

Indexes 373



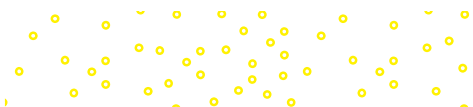
PREFACE

The standout features of this sixth edition of *Essentials of Strategic Management* are its concisely written and robust coverage of strategic management concepts and its compelling collection of cases. The text presents a conceptually strong treatment of strategic management principles and analytic approaches that features straight-to-the-point discussions, timely examples, and a writing style that captures the interest of students. While this edition retains the 10-chapter structure of the prior edition, every chapter has been reexamined, refined, and refreshed. New content has been added to keep the material in line with the latest developments in the theory and practice of strategic management. Also, scores of new examples have been added, along with fresh Concepts & Connections illustrations, to make the content come alive and to provide students with a ringside view of strategy in action. The fundamental character of the sixth edition of *Essentials of Strategic Management* is very much in step with the best academic thinking and contemporary management practice. The chapter content continues to be solidly mainstream and balanced, mirroring *both* the penetrating insight of academic thought and the pragmatism of real-world strategic management.

Complementing the text presentation is a truly appealing lineup of 12 diverse, timely, and thoughtfully crafted cases. All of the cases are tightly linked to the content of the 10 chapters, thus pushing students to apply the concepts and analytical tools they have read about. Seven of the cases were written by the coauthors to illustrate specific tools of analysis or distinct strategic management theories. Cases not written by the coauthors were included because of their exceptional pedagogical value and linkage to strategic management concepts presented in the text. We are confident you will be impressed with how well each of the 12 cases in the collection will work in the classroom and the amount of student interest they will spark.

For some years now, growing numbers of strategy instructors at business schools worldwide have been transitioning from a purely text-cases course structure to a more robust and energizing text-cases-simulation course structure. Incorporating a competition-based strategy simulation has the strong appeal of providing class members with *an immediate and engaging opportunity to apply the concepts and analytical tools covered in the chapters in a head-to-head competition with companies run by other class members*. Two widely used and pedagogically effective online strategy simulations, *The Business Strategy Game* and *GLO-BUS*, are optional companions for this text. Both simulations, like the cases, are closely linked to the content of each chapter in the text. The Exercises for Simulation Participants, found at the end of each chapter, provide clear guidance to class members in applying the concepts and analytical tools covered in the chapters to the issues and decisions that they have to wrestle with in managing their simulation company.

Through our experiences as business school faculty members, we also fully understand the assessment demands on faculty teaching strategic management and business



policy courses. In many institutions, capstone courses have emerged as the logical home for assessing student achievement of program learning objectives. The sixth edition includes Assurance of Learning Exercises at the end of each chapter that link to the specific Learning Objectives appearing at the beginning of each chapter and highlighted throughout the text. *An important instructional feature of this edition is the linkage of selected chapter-end Assurance of Learning Exercises and cases to the publisher's Connect® web-based assignment and assessment platform.* Your students will be able to use the online *Connect* supplement to (1) complete two of the Assurance of Learning Exercises appearing at the end of each of the 10 chapters, (2) complete chapter-end quizzes, and (3) complete case tutorials based upon the suggested assignment questions for all 12 cases in this edition. With the exception of some of the chapter-end Assurance of Learning exercises, all of the *Connect* exercises are automatically graded, thereby enabling you to easily assess the learning that has occurred.

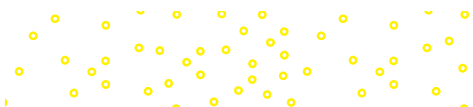
In addition, both of the companion strategy simulations have a built-in Learning Assurance Report that quantifies how well each member of your class performed on nine skills/learning measures *versus tens of thousands of other students worldwide* who completed the simulation in the past 12 months. We believe the chapter-end Assurance of Learning Exercises, the all-new online and automatically graded *Connect* exercises, and the Learning Assurance Report generated at the conclusion of *The Business Strategy Game* and *GLO-BUS* simulations provide you with easy-to-use, empirical measures of student learning in your course. All can be used in conjunction with other instructor-developed or school-developed scoring rubrics and assessment tools to comprehensively evaluate course or program learning outcomes.

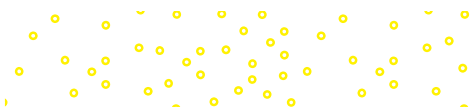
Taken together, the various components of the sixth edition package and the supporting set of Instructor Resources provide you with enormous course design flexibility and a powerful kit of teaching/learning tools. We've done our very best to ensure that the elements comprising this edition will work well for you in the classroom, help you economize on the time needed to be well prepared for each class, and cause students to conclude that your course is one of the very best they have ever taken—from the standpoint of both enjoyment and learning.

Differentiation from Other Texts

Five noteworthy traits strongly differentiate this text and the accompanying instructional package from others in the field:

1. *Our integrated coverage of the two most popular perspectives on strategic management positioning theory and resource-based theory is unsurpassed by any other leading strategy text.* Principles and concepts from both the positioning perspective and the resource-based perspective are prominently and comprehensively integrated into our coverage of crafting both single-business and multibusiness strategies. By highlighting the relationship between a firm's resources and capabilities to the activities it conducts along its value chain, we show explicitly how these two perspectives relate to one another. Moreover, in Chapters 3 through 8, it is emphasized repeatedly that a company's strategy must be matched not only to its external market circumstances but also to its internal resources and competitive capabilities.



- 
2. *Our coverage of business ethics, core values, social responsibility, and environmental sustainability is unsurpassed by any other leading strategy text.* Chapter 9, “Ethics, Corporate Social Responsibility, Environmental Sustainability, and Strategy,” is embellished with fresh content so that it can better fulfill the important functions of (1) alerting students to the role and importance of ethical and socially responsible decision making and (2) addressing the accreditation requirements that business ethics be visibly and thoroughly embedded in the core curriculum. Moreover, discussions of the roles of values and ethics are integrated into portions of other chapters to further reinforce why and how considerations relating to ethics, values, social responsibility, and sustainability should figure prominently into the managerial task of crafting and executing company strategies.
 3. *The caliber of the case collection in the sixth edition is truly unrivaled* from the standpoints of student appeal, teachability, and suitability for drilling students in the use of the concepts and analytical treatments in Chapters 1 through 10. The 12 cases included in this edition are the very latest, the best, and the most on-target that we could find. The ample information about the cases in the Instructor’s Manual makes it effortless to select a set of cases each term that will capture the interest of students from start to finish.
 4. *The publisher’s Connect assignment and assessment platform is tightly linked to the text chapters and case lineup.* The *Connect* package for the sixth edition allows professors to assign autograded quizzes and select chapter-end Assurance of Learning Exercises to assess class members’ understanding of chapter concepts. In addition, our texts have pioneered the extension of the *Connect* platform to case analysis. The autograded case exercises for each of the 12 cases in this edition are robust and extensive and will better enable students to make meaningful contributions to class discussions. The autograded *Connect* case exercises may also be used as graded assignments in the course.
 5. The two cutting-edge and widely used strategy simulations—*The Business Strategy Game* and *GLO-BUS*—that are optional companions to the sixth edition give you unmatched capability to employ a text-case-simulation model of course delivery.

Organization, Content, and Features of the Sixth Edition Text Chapters

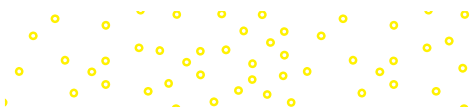
The following rundown summarizes the noteworthy features and topical emphasis in this new edition:

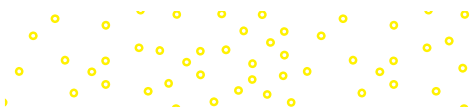
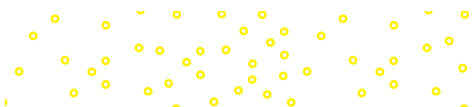
- Chapter 1 serves as an introduction to the topic of strategy, focusing on the managerial actions that will determine why a company matters in the marketplace. We introduce students to the primary approaches to building competitive advantage and the key elements of business-level strategy. Following Henry Mintzberg’s pioneering research, we also stress why a company’s strategy is partly planned and partly reactive and why this strategy tends to evolve. The chapter also discusses why it is important for a company to have a *viable business model* that outlines the company’s customer value proposition and its profit formula. This brief chapter is the

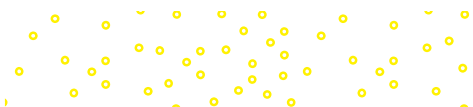




perfect accompaniment to your opening-day lecture on what the course is all about and why it matters.

- Chapter 2 delves more deeply into the managerial process of actually crafting and executing a strategy. It makes a great assignment for the second day of class and provides a smooth transition into the heart of the course. The focal point of the chapter is the five-stage managerial process of crafting and executing strategy: (1) forming a strategic vision of where the company is headed and why, (2) developing strategic as well as financial objectives with which to measure the company's progress, (3) crafting a strategy to achieve these targets and move the company toward its market destination, (4) implementing and executing the strategy, and (5) evaluating a company's situation and performance to identify corrective adjustments that are needed. Students are introduced to such core concepts as strategic visions, mission statements and core values, the balanced scorecard, and business-level versus corporate-level strategies. There's a robust discussion of why *all managers are on a company's strategy-making, strategy-executing team* and why a company's strategic plan is a collection of strategies devised by different managers at different levels in the organizational hierarchy. The chapter winds up with a section on how to exercise good corporate governance and examines the conditions that led to recent high-profile corporate governance failures.
 - Chapter 3 sets forth the now-familiar analytical tools and concepts of industry and competitive analysis and demonstrates the importance of tailoring strategy to fit the circumstances of a company's industry and competitive environment. The standout feature of this chapter is a presentation of Michael Porter's "five forces model of competition" *that has long been the clearest, most straightforward discussion of any text in the field*. Chapter revisions include an improved discussion of the macro-environment, focusing on the use of the PESTEL analysis framework for assessing the *political, economic, social, technological, environmental, and legal* factors in a company's macro-environment. New to this edition is a discussion of Michael Porter's Framework for Competitor Analysis used for assessing a rival's likely strategic moves.
 - Chapter 4 presents the resource-based view of the firm, showing why resource and capability analysis is such a powerful tool for sizing up a company's competitive assets. It offers a simple framework for identifying a company's resources and capabilities and explains how the VRIN framework can be used to determine whether they can provide the company with a sustainable competitive advantage over its competitors. Other topics covered in this chapter include dynamic capabilities, SWOT analysis, value chain analysis, benchmarking, and competitive strength assessments, thus enabling a solid appraisal of a company's relative cost position and customer value proposition vis-à-vis its rivals.
 - Chapter 5 deals with the basic approaches used to compete successfully and gain a competitive advantage over market rivals. This discussion is framed around the five generic competitive strategies—low-cost leadership, differentiation, best-cost provider, focused differentiation, and focused low-cost. It describes when each of these approaches works best and what pitfalls to avoid. It explains the role of *cost drivers* and *uniqueness drivers* in reducing a company's costs and enhancing its differentiation, respectively.
- 

- 
- Chapter 6 deals with the *strategy options* available to complement a company's competitive approach and maximize the power of its overall strategy. These include a variety of offensive or defensive competitive moves, and their timing, such as blue ocean strategy and first-mover advantages and disadvantages. It also includes choices concerning the breadth of a company's activities (or its scope of operations along an industry's entire value chain), ranging from horizontal mergers and acquisitions, to vertical integration, outsourcing, and strategic alliances. This material serves to segue into that covered in the next two chapters on international and diversification strategies.
 - Chapter 7 explores the full range of strategy options for competing in international markets: export strategies, licensing, franchising, establishing a subsidiary in a foreign market, and using strategic alliances and joint ventures to build competitive strength in foreign markets. There is also a discussion of how to best tailor a company's international strategy to cross-country differences in market conditions and buyer preferences; how to use international operations to improve overall competitiveness; the choice between multidomestic, global, and transnational strategies; and the unique characteristics of competing in emerging markets.
 - Chapter 8 introduces the topic of corporate-level strategy—a topic of concern for multibusiness companies pursuing diversification. This chapter begins by explaining why successful diversification strategies must create shareholder value and lays out the three essential tests that a strategy must pass to achieve this goal (*the industry attractiveness, cost of entry, and better-off tests*). Corporate strategy topics covered in the chapter include methods of entering new businesses, related diversification, unrelated diversification, combined related and unrelated diversification approaches, and strategic options for improving the overall performance of an already diversified company. The chapter's analytical spotlight is trained on the techniques and procedures for assessing a diversified company's business portfolio—the relative attractiveness of the various businesses the company has diversified into, the company's competitive strength in each of its business lines, and the *strategic fit* and *resource fit* among a diversified company's different businesses. The chapter concludes with a brief survey of a company's four main post-diversification strategy alternatives: (1) sticking closely with the existing business lineup, (2) broadening the diversification base, (3) divesting some businesses and retrenching to a narrower diversification base, and (4) restructuring the makeup of the company's business lineup.
 - Although the topic of ethics and values comes up at various points in this textbook, Chapter 9 brings more direct attention to such issues and may be used as a standalone assignment in either the early, middle, or late part of a course. It concerns the themes of ethical standards in business, approaches to ensuring consistent ethical standards for companies with international operations, corporate social responsibility, and environmental sustainability. The contents of this chapter are sure to give students some things to ponder, rouse lively discussion, and help to make students more ethically aware and conscious of *why all companies should conduct their business in a socially responsible and sustainable manner*.
 - Chapter 10 is anchored around a pragmatic, compelling conceptual framework: (1) building dynamic capabilities, core competencies, resources, and structure
- 



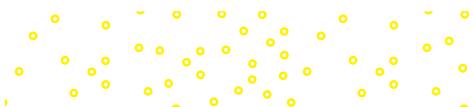
necessary for proficient strategy execution; (2) allocating ample resources to strategy-critical activities; (3) ensuring that policies and procedures facilitate rather than impede strategy execution; (4) pushing for continuous improvement in how value chain activities are performed; (5) installing information and operating systems that enable company personnel to better carry out essential activities; (6) tying rewards and incentives directly to the achievement of performance targets and good strategy execution; (7) shaping the work environment and corporate culture to fit the strategy; and (8) exerting the internal leadership needed to drive execution forward. The recurring theme throughout the chapter is that implementing and executing strategy entails figuring out the specific actions, behaviors, and conditions that are needed for a smooth strategy-supportive operation—the goal here is to ensure that students understand that the strategy implementing/strategy executing phase is a make-it-happen-right kind of managerial exercise that leads to operating excellence and good performance.

In this latest edition, we have put our utmost effort into ensuring that the 10 chapters are consistent with the latest and best thinking of academics and practitioners in the field of strategic management and hit the bull's-eye in topical coverage for senior- and MBA-level strategy courses. The ultimate test of the text, of course, is the positive pedagogical impact it has in the classroom. If this edition sets a more effective stage for your lectures and does a better job of helping you persuade students that the discipline of strategy merits their rapt attention, then it will have fulfilled its purpose.

The Case Collection

The 12-case lineup in this edition is flush with interesting companies and valuable lessons for students in the art and science of crafting and executing strategy. There is a good blend of cases from a length perspective—about one-third are under 10 pages yet offer plenty for students to chew on; about a third are medium-length cases; and the remaining one-third are detail-rich cases that call for sweeping analysis.

At least 11 of the 12 cases involve companies, products, people, or activities that students will have heard of, know about from personal experience, or can easily identify with. The lineup includes at least four cases that will provide students with insight into the special demands of competing in industry environments where technological developments are an everyday event, product life cycles are short, and competitive maneuvering among rivals comes fast and furious. All of the cases involve situations where the role of company resources and competitive capabilities in the strategy formulation, strategy execution scheme is emphasized. Scattered throughout the lineup are seven cases concerning non-U.S. companies, globally competitive industries, and/or cross-cultural situations; these cases, in conjunction with the globalized content of the text chapters, provide abundant material for linking the study of strategic management tightly to the ongoing globalization of the world economy. You will also find five cases dealing with the strategic problems of family-owned or relatively small entrepreneurial businesses and 10 cases involving public companies and situations where students can do further research on the Internet. A number of the cases have accompanying videotape segments.





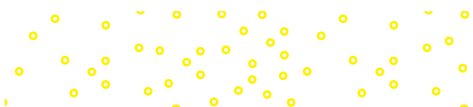
The Two Strategy Simulation Supplements: *The Business Strategy Game* and *GLO-BUS*

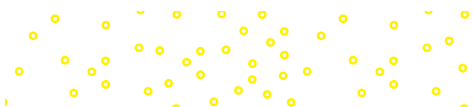
The Business Strategy Game and *GLO-BUS: Developing Winning Competitive Strategies*—two competition-based strategy simulations that are delivered online and that feature automated processing and grading of performance—are being marketed by the publisher as companion supplements for use with the sixth edition (and other texts in the field). In both *The Business Strategy Game (BSG)* and *GLO-BUS*, class members are divided into teams of one to five persons and assigned to run a company that competes head-to-head against companies run by other class members. In *BSG*, the teams run an athletic footwear company; in *GLO-BUS*, teams run a company that produces wearable action cameras and camera-equipped copter drones used for commercial purposes. In both simulations, companies compete in a global market arena, selling their products in four geographic regions—Europe-Africa, North America, Asia-Pacific, and Latin America. Each management team is called upon to craft a strategy for their company and make decisions relating to plant operations, workforce compensation, pricing and marketing, social responsibility/citizenship, and finance.

Company co-managers are held accountable for their decision making. Each company's performance is scored on the basis of earnings per share, return-on-equity investment, stock price, credit rating, and image rating. Rankings of company performance, along with a wealth of industry and company statistics, are available to company co-managers after each decision round to use in making strategy adjustments and operating decisions for the next competitive round. You can be certain that the market environment, strategic issues, and operating challenges that company co-managers must contend with are *very tightly linked* to what your class members will be reading about in the text chapters.

We suggest that you schedule 1 or 2 practice rounds and anywhere from 4 to 10 regular (scored) decision rounds (more rounds are better than fewer rounds). Each decision round represents a year of company operations and will entail roughly two hours of time for company co-managers to complete. In traditional 13-week, semester-long courses, there is merit in scheduling one decision round per week. In courses that run 5 to 10 weeks, it is wise to schedule two decision rounds per week for the last several weeks of the term (sample course schedules are provided for courses of varying length and varying numbers of class meetings).

When the instructor-specified deadline for a decision round arrives, the simulation server automatically accesses the saved decision entries of each company, determines the competitiveness and buyer appeal of each company's product offering relative to the other companies being run by students in your class, and then awards sales and market shares to the competing companies, geographic region by geographic region. The unit sales volumes awarded to each company are *totally governed by*:

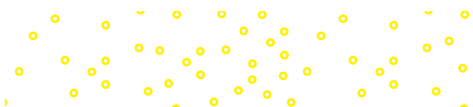
- How its prices compare against the prices of rival brands.
 - How its product quality compares against the quality of rival brands.
 - How its product line breadth and selection compare.
 - How its advertising effort compares.
 - And so on, for a total of 11 competitive factors that determine unit sales and market shares.
- 

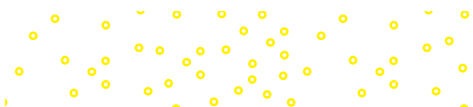


The competitiveness and overall buyer appeal of each company's product offering *in comparison to the product offerings of rival companies* is all-decisive—this algorithmic feature is what makes *BSG* and *GLO-BUS* “competition-based” strategy simulations. Once each company's sales and market shares are awarded based on the competitiveness and buyer appeal of its respective overall product offering vis-à-vis those of rival companies, the various company and industry reports detailing the outcomes of the decision round are then generated. Company co-managers can access the results of the decision round 15 to 20 minutes after the decision deadline.

The Compelling Case for Incorporating Use of a Strategy Simulation

There are *three exceptionally important benefits* associated with using a competition-based simulation in strategy courses taken by seniors and MBA students:

- *A three-pronged text-case-simulation course model delivers significantly more teaching and learning power than the traditional text-case model.* Using both cases and a strategy simulation to drill students in thinking strategically and applying what they read in the text chapters is a stronger, more effective means of helping them connect theory with practice and develop better business judgment. What cases do that a simulation cannot is give class members broad exposure to a variety of companies and industry situations and insight into the kinds of strategy-related problems managers face. But what a competition-based strategy simulation does far better than case analysis is thrust class members squarely into *an active, hands-on managerial role* where they are totally responsible for assessing market conditions, determining how to respond to the actions of competitors, forging a long-term direction and strategy for their company, and making all kinds of operating decisions. Because they are held fully accountable for their decisions and their company's performance, *co-managers are strongly motivated* to dig deeply into company operations, probe for ways to be more cost-efficient and competitive, and ferret out strategic moves and decisions calculated to boost company performance. *Consequently, incorporating both case assignments and a strategy simulation to develop the skills of class members in thinking strategically and applying the concepts and tools of strategic analysis turns out to be more pedagogically powerful than relying solely on case assignments: there is stronger retention of the lessons learned and better achievement of course learning objectives.* To provide you with quantitative evidence of the learning that occurs with using *The Business Strategy Game* or *GLO-BUS*, there is a built-in Learning Assurance Report showing how well each class member performs on nine skills/learning measures versus tens of thousands of students worldwide who have completed the simulation in the past 12 months.
 - *The competitive nature of a strategy simulation arouses positive energy and steps up the whole tempo of the course by a notch or two.* Nothing sparks class excitement quicker or better than the concerted efforts on the part of class members during each decision round to achieve a high industry ranking and avoid the perilous consequences of being outcompeted by other class members. Students really enjoy taking on the role of a manager, running their own company, crafting strategies, making all kinds of operating decisions, trying to outcompete rival companies, and
- 



getting immediate feedback on the resulting company performance. Co-managers become *emotionally invested* in running their company and figuring out what strategic moves to make to boost their company's performance. All this stimulates learning and causes students to see the practical relevance of the subject matter and the benefits of taking your course.

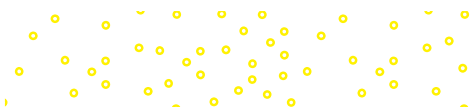
- *Use of a fully automated online simulation reduces the time instructors spend on course preparation, course administration, and grading.* Since the simulation exercise involves a 20- to 30-hour workload for student-teams (roughly 2 hours per decision round times 10 to 12 rounds, plus optional assignments), simulation adopters often compensate by trimming the number of assigned cases from, say, 10 to 12 to perhaps 4 to 6. This significantly reduces the time instructors spend reading cases, studying teaching notes, and otherwise getting ready to lead class discussion of a case or grade oral team presentations. Course preparation time is further cut because you can use several class days to have students meet in the computer lab to work on upcoming decision rounds or a three-year strategic plan (in lieu of lecturing on a chapter or covering an additional assigned case). Not only does use of a simulation permit assigning fewer cases, but it also permits you to eliminate at least one assignment that entails considerable grading on your part. Grading one less written case or essay exam or other written assignment saves enormous time. With *BSG* and *GLO-BUS*, grading is effortless and takes only minutes; once you enter percentage weights for each assignment in your online grade book, a suggested overall grade is calculated for you. You'll be pleasantly surprised—and quite pleased—at how little time it takes to gear up for and to administer *The Business Strategy Game* or *GLO-BUS*.

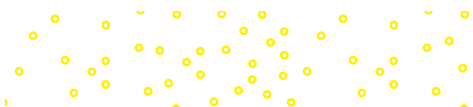
In sum, incorporating use of a strategy simulation turns out to be *a win-win proposition for both students and instructors*. Moreover, a very convincing argument can be made that a competition-based strategy simulation is *the single most effective teaching/learning tool that instructors can employ to teach the discipline of business and competitive strategy, to make learning more enjoyable, and to promote better achievement of course learning objectives*.

Administration and Operating Features of the Two Simulations

The Internet delivery and user-friendly designs of both *BSG* and *GLO-BUS* make them incredibly easy to administer, even for first-time users. And the menus and controls are so similar that you can readily switch between the two simulations or use one in your undergraduate class and the other in a graduate class. If you have not yet used either of the two simulations, you may find the following of particular interest:

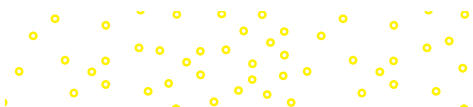
- Setting up the simulation for your course is done online and takes about 10 to 15 minutes. Once setup is completed, no other administrative actions are required beyond that of moving participants to a different team (should the need arise) and monitoring the progress of the simulation (to whatever extent desired).
- Participant's Guides are delivered electronically to class members at the website—students can read it on their monitors or print out a copy, as they prefer.
- There are two- to four-minute Video Tutorials scattered throughout the software (including each decision screen and each page of each report) that provide

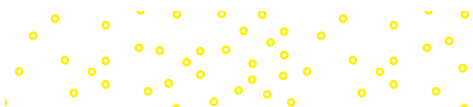




on-demand guidance to class members who may be uncertain about how to proceed.

- Complementing the Video Tutorials are detailed and clearly written Help sections explaining “all there is to know” about (a) each decision entry and the relevant cause-effect relationships, (b) the information on each page of the Industry Reports, and (c) the numbers presented in the Company Reports. *The Video Tutorials and the Help screens allow company co-managers to figure things out for themselves, thereby curbing the need for students to ask the instructor “how things work.”*
- Team members running the same company who are logged-in simultaneously on different computers at different locations can click a button to enter Collaboration Mode, enabling them to work collaboratively from the same screen in viewing reports and making decision entries, and click a second button to enter Audio Mode, letting them talk to one another.
 - When in “Collaboration Mode,” each team member sees the same screen at the same time as all other team members who are logged in and have joined Collaboration Mode. If one team member chooses to view a particular decision screen, that same screen appears on the monitors for all team members in Collaboration Mode.
 - Team members each control their own color-coded mouse pointer (with their first-name appearing in a color-coded box linked to their mouse pointer) and can make a decision entry or move the mouse to point to particular on-screen items.
 - A decision entry change made by one team member is seen by all, in real time, and all team members can immediately view the on-screen calculations that result from the new decision entry.
 - If one team member wishes to view a report page and clicks on the menu link to the desired report, that same report page will immediately appear for the other team members engaged in collaboration.
 - Use of Audio Mode capability requires that team members work from a computer with a built-in microphone (if they want to be heard by their team members) and speakers (so they may hear their teammates) or else have a headset with a microphone that they can plug into their desktop or laptop. A headset is recommended for best results, but most laptops now are equipped with a built-in microphone and speakers that will support use of our new voice chat feature.
 - Real-time VoIP audio chat capability among team members who have entered both the Audio Mode and the Collaboration Mode is a tremendous boost in functionality that enables team members to go online simultaneously on computers at different locations and conveniently and effectively collaborate in running their simulation company.
 - In addition, instructors have the capability to join the online session of any company and speak with team members, thus circumventing the need for team members to arrange for and attend a meeting in the instructor’s office. Using the standard menu for administering a particular industry, instructors can connect with the company desirous of assistance. Instructors who wish not only to talk but also enter Collaboration (highly recommended because all attendees



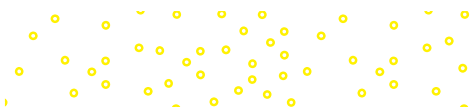


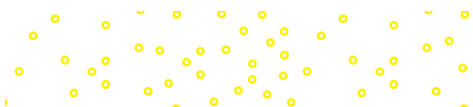
are then viewing the same screen) have a red-colored mouse pointer linked to a red box labeled Instructor.

Without a doubt, the Collaboration and Voice-Chat capabilities are hugely valuable for students enrolled in online and distance-learning courses where meeting face-to-face is impractical or time-consuming. Likewise, the instructors of online and distance-learning courses will appreciate having the capability to join the online meetings of particular company teams when their advice or assistance is requested.

- Both simulations are quite suitable for use in distance-learning or online courses (and are currently being used in such courses on numerous campuses).
- Participants and instructors are notified via e-mail when the results are ready (usually about 15 to 20 minutes after the decision round deadline specified by the instructor/game administrator).
- Following each decision round, participants are provided with a complete set of reports—a six-page Industry Report, a one-page Competitive Intelligence report for each geographic region that includes strategic group maps and bulleted lists of competitive strengths and weaknesses, and a set of Company Reports (income statement, balance sheet, cash flow statement, and assorted production, marketing, and cost statistics).
- Two “open-book” multiple-choice tests of 20 questions are built into each simulation. The quizzes, which you can require or not as you see fit, are taken online and automatically graded, with scores reported instantaneously to participants and automatically recorded in the instructor’s electronic grade book. Students are automatically provided with three sample questions for each test.
- Both simulations contain a three-year strategic plan option that you can assign. Scores on the plan are automatically recorded in the instructor’s online grade book.
- At the end of the simulation, you can have students complete online peer evaluations (again, the scores are automatically recorded in your online grade book).
- Both simulations have a Company Presentation feature that enables each team of company co-managers to easily prepare PowerPoint slides for use in describing their strategy and summarizing their company’s performance in a presentation to either the class, the instructor, or an “outside” board of directors.
- *A Learning Assurance Report provides you with hard data concerning how well your students performed vis-à-vis students playing the simulation worldwide over the past 12 months.* The report is based on nine measures of student proficiency, business know-how, and decision-making skill and can also be used in evaluating the extent to which your school’s academic curriculum produces the desired degree of student learning insofar as accreditation standards are concerned.

For more details on either simulation, please consult Section 2 of the Instructor’s Manual accompanying this text or register as an instructor at the simulation websites (www.bsg-online.com and www.globus.com) to access even more comprehensive information. You should also consider signing up for one of the webinars that the simulation authors conduct several times each month (sometimes several times weekly) to demonstrate how the software works, walk you through the various features and menu options,





and answer any questions. You have an open invitation to call the senior author of this text at (205) 722-9145 to arrange a personal demonstration or talk about how one of the simulations might work in one of your courses. We think you'll be quite impressed with the cutting-edge capabilities that have been programmed into *The Business Strategy Game* and *GLO-BUS*, the simplicity with which both simulations can be administered, and their exceptionally tight connection to the text chapters, core concepts, and standard analytical tools.

Resources and Support Materials for the Sixth Edition for Students

Key Points Summaries


At the end of each chapter is a synopsis of the core concepts, analytical tools, and other key points discussed in the chapter. These chapter-end synopses, along with the core concept definitions and margin notes scattered throughout each chapter, help students focus on basic strategy principles, digest the messages of each chapter, and prepare for tests.

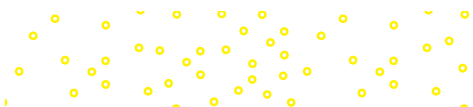
Two Sets of Chapter-End Exercises

Each chapter concludes with two sets of exercises. The Assurance of Learning Exercises can be used as the basis for class discussion, oral presentation assignments, short written reports, and substitutes for case assignments. The Exercises for Simulation Participants are designed expressly for use by adopters who have incorporated use of a simulation and wish to go a step further in tightly and explicitly connecting the chapter content to the simulation company their students are running. The questions in both sets of exercises (along with those Concepts & Connections illustrations that qualify as “mini cases”) can be used to round out the rest of a 75-minute class period, should your lecture on a chapter only last for 50 minutes.

The Connect Web-Based Assignment and Assessment Platform

The *Essentials of Strategic Management* sixth edition takes full advantage of the publisher's innovative *Connect* assignment and assessment platform. The *Connect* package for this edition includes several robust and valuable features that simplify the task of assigning and grading three types of exercises for students:

- There are autograded chapter tests consisting of 20 multiple-choice questions that students can take to measure their grasp of the material presented in each of the 10 chapters.
 - *Connect Management* includes interactive versions of two Assurance of Learning Exercises for each chapter that drill students in the use and application of the concepts and tools of strategic analysis. There is both an autograded and open-ended short-answer interactive exercise for each of the 10 chapters.
 - The *Connect Management* platform also includes fully autograded interactive application exercises for each of the 12 cases in this edition. The exercises require students to work through tutorials based upon the analysis set forth in the assignment
- 



questions for the case; these exercises have multiple components such as resource and capability analysis, financial ratio analysis, identification of a company's strategy, or analysis of the five competitive forces. The content of these case exercises is tailored to match the circumstances presented in each case, calling upon students to do whatever strategic thinking and strategic analysis is called for to arrive at pragmatic, analysis-based action recommendations for improving company performance. The entire exercise is autograded, allowing instructors to focus on grading only the students' strategic recommendations.

All of the *Connect* exercises are automatically graded (with the exception of a few exercise components that entail student entry of essay answers), thereby simplifying the task of evaluating each class member's performance and monitoring the learning outcomes. The progress-tracking function built into the *Connect* system enables you to

- View scored work immediately and track individual or group performance with assignment and grade reports.
- Access an instant view of student or class performance relative to learning objectives.
- Collect data and generate reports required by many accreditation organizations, such as AACSB International.

For Instructors

Connect Management

Connect's Instructor Resources includes an Instructor's Manual and other support materials. Your McGraw-Hill representative can arrange delivery of instructor support materials in a format-ready Standard Cartridge for Blackboard, WebCT, and other web-based educational platforms.

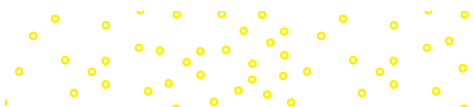
Instructor's Manual

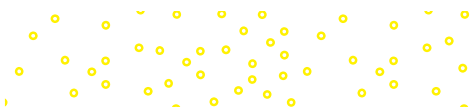
The accompanying IM contains:

- A section on suggestions for organizing and structuring your course.
- Sample syllabi and course outlines.
- A set of lecture notes on each chapter.
- Answers to the chapter-end Assurance of Learning Exercises.
- A comprehensive case teaching note for each of the 12 cases. These teaching notes are filled with suggestions for using the case effectively, have very thorough, analysis-based answers to the suggested assignment questions for the case, and contain an epilogue detailing any important developments since the case was written.

A Comprehensive Test Bank and TestGen Software

There is a 600+-question test bank, consisting of both multiple-choice questions and short-answer/essay questions. All of the test bank questions are also accessible via **TestGen**.





TestGen is a complete, state-of-the-art test generator and editing application software that allows instructors to quickly and easily select test items from McGraw Hill's TestGen testcontent and to organize, edit, and customize the questions and answers to rapidly generate paper tests. Questions can include stylized text, symbols, graphics, and equations that are inserted directly into questions using built-in mathematical templates. TestGen's random generator provides the option to display different text or calculated number values each time questions are used. With both quick-and-simple test creation and flexible and robust editing tools, TestGen is a test generator system for today's educators.

Test Bank and EZ Test Online

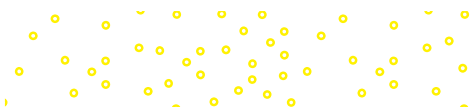
There is a test bank containing over 700 multiple-choice questions and short-answer/essay questions. It has been tagged with AACSB and Bloom's Taxonomy criteria. All of the test bank questions are accessible within Connect. All of the test bank questions are also accessible within a computerized test bank powered by McGraw-Hill's flexible electronic testing program, EZ Test Online (www.eztestonline.com). Using EZ Test Online allows you to create paper or online tests and quizzes. With EZ Test Online, instructors can select questions from multiple McGraw-Hill test banks or author their own and then either print the test for paper distribution or give it online.

PowerPoint Slides

To facilitate delivery preparation of your lectures and to serve as chapter outlines, you'll have access to approximately 350 colorful and professional-looking slides displaying core concepts, analytical procedures, key points, and all the figures in the text chapters.

The Business Strategy Game and GLO-BUS Online Simulations

Using one of the two companion simulations is a powerful and constructive way of emotionally connecting students to the subject matter of the course. We know of no more effective way to arouse the competitive energy of students and prepare them for the challenges of real-world business decision making than to have them match strategic wits with classmates in running a company in head-to-head competition for global market leadership.





ACKNOWLEDGMENTS

We heartily acknowledge the contributions of the case researchers whose case-writing efforts appear herein and the companies whose cooperation made the cases possible. To each one goes a very special thank-you. We cannot overstate the importance of timely, carefully researched cases in contributing to a substantive study of strategic management issues and practices. From a research standpoint, strategy-related cases are invaluable in exposing the generic kinds of strategic issues that companies face in forming hypotheses about strategic behavior and in drawing experienced-based generalizations about the practice of strategic management. From an instructional standpoint, strategy cases give students essential practice in diagnosing and evaluating the strategic situations of companies and organizations, in applying the concepts and tools of strategic analysis, in weighing strategic options and crafting strategies, and in tackling the challenges of successful strategy execution. Without a continuing stream of fresh, well-researched, and well-conceived cases, the discipline of strategic management would lose its close ties to the very institutions whose strategic actions and behavior it is aimed at explaining. There's no question, therefore, that first-class case research constitutes a valuable scholarly contribution to the theory and practice of strategic management.

A great number of colleagues and students at various universities, business acquaintances, and people at McGraw-Hill provided inspiration, encouragement, and counsel during the course of this project. Like all text authors in the strategy field, we are intellectually indebted to the many academics whose research and writing have blazed new trails and advanced the discipline of strategic management.

We also express our thanks to Todd M. Alessandri, Michael Anderson, Gerald D. Baumgardner, Edith C. Busija, Gerald E. Calvasina, Sam D. Cappel, Richard Churchman, John W. Collis, Connie Daniel, Christine DeLaTorre, Vickie Cox Edmondson, Diane D. Galbraith, Naomi A. Gardberg, Sanjay Goel, Les Jankovich, Jonatan Jelen, William Jiang, Bonnie Johnson, Roy Johnson, John J. Lawrence, Robert E. Ledman, Mark Lehrer, Fred Maidment, Frank Markham, Renata Mayrhofer, Simon Medcalfe, Elouise Mintz, Michael Monahan, Gerry Nkombo Muuka, Cori J. Myers, Jeryl L. Nelson, David Olson, John Perry, L. Jeff Seaton, Charles F. Seifert, Eugene S. Simko, Karen J. Smith, Susan Steiner, Troy V. Sullivan, Elisabeth J. Teal, Lori Tisher, Vincent Weaver, Jim Whitlock, and Beth Woodard. These reviewers provided valuable guidance in steering our efforts to improve earlier editions.

As always, we value your recommendations and thoughts about the book. Your comments regarding coverage and contents will be taken to heart, and we always are grateful for the time you take to call our attention to printing errors, deficiencies, and other shortcomings. Please e-mail us at john.gamble@tamucc.edu, or athomps@cba.ua.edu, or margaret.a.peteraf@tuck.dartmouth.edu.

John E. Gamble
Margaret A. Peteraf
Arthur A. Thompson



TABLE OF CONTENTS

PART ONE CONCEPTS AND TECHNIQUES FOR CRAFTING AND EXECUTING STRATEGY 1

Section A: Introduction and Overview

Chapter 1 Strategy, Business Models, and Competitive Advantage 1

- The Importance of a Distinctive Strategy and Competitive Approach 3
- The Relationship Between a Company's Strategy and Business Model 3
- Strategy and the Quest for Competitive Advantage 4

CONCEPTS & CONNECTIONS 1.1: PANDORA, SIRIUS XM, AND OVER-THE-AIR BROADCAST RADIO: THREE CONTRASTING BUSINESS MODELS 5

- The Importance of Capabilities in Building and Sustaining Competitive Advantage 6

CONCEPTS & CONNECTIONS 1.2: STARBUCKS' STRATEGY IN THE SPECIALTY COFFEE MARKET 7

- Why a Company's Strategy Evolves over Time 8
- The Three Tests of a Winning Strategy 9
- Why Crafting and Executing Strategy Are Important Tasks 10
- The Road Ahead 10
- Key Points 11
- Assurance of Learning Exercises 11
- Exercises for Simulation Participants 11
- Endnotes 12

Chapter 2 Strategy Formulation, Execution, and Governance 13

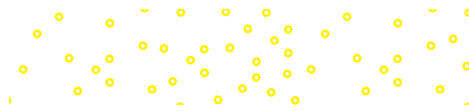
- The Strategy Formulation, Strategy Execution Process 14
- Stage 1: Developing a Strategic Vision, a Mission, and Core Values 16

CONCEPTS & CONNECTIONS 2.1: EXAMPLES OF STRATEGIC VISIONS—HOW WELL DO THEY MEASURE UP? 18

- The Importance of Communicating the Strategic Vision 18
- Developing a Company Mission Statement 19
- Linking the Strategic Vision and Mission with Company Values 20

CONCEPTS & CONNECTIONS 2.2: PATAGONIA, INC.: A VALUES-DRIVEN COMPANY 21

- Stage 2: Setting Objectives 22
- The Imperative of Setting Stretch Objectives 22
- What Kinds of Objectives to Set 22



CONCEPTS & CONNECTIONS 2.3: EXAMPLES OF COMPANY OBJECTIVES 24

Stage 3: Crafting a Strategy 25

Strategy Formulation Involves Managers at All Organizational Levels 25

A Company's Strategy-Making Hierarchy 26

Stage 4: Implementing and Executing the Chosen Strategy 28

Stage 5: Evaluating Performance and Initiating Corrective Adjustments 28

Corporate Governance: The Role of the Board of Directors in the Strategy Formulation, Strategy Execution Process 29

CONCEPTS & CONNECTIONS 2.4: CORPORATE GOVERNANCE FAILURES AT VOLKSWAGEN 31

Key Points 32

Assurance of Learning Exercises 33

Exercises for Simulation Participants 34

Endnotes 34

Section B: Core Concepts and Analytical Tools

Chapter 3 Evaluating a Company's External Environment 36

Assessing the Company's Industry and Competitive Environment 37

Question 1: What Are the Strategically Relevant Components of the Macro-Environment? 37

Question 2: How Strong Are the Industry's Competitive Forces? 40

The Competitive Force of Buyer Bargaining Power 41

The Competitive Force of Substitute Products 43

The Competitive Force of Supplier Bargaining Power 43

The Competitive Force of Potential New Entrants 45

The Competitive Force of Rivalry Among Competing Sellers 47

The Collective Strengths of the Five Competitive Forces and Industry Profitability 50

Question 3: What Are the Industry's Driving Forces of Change, and What Impact Will They Have? 51

The Concept of Industry Driving Forces 51

Identifying an Industry's Driving Forces 51

Assessing the Impact of the Industry Driving Forces 53

Determining Strategy Changes Needed to Prepare for the Impact of Driving Forces 54

Question 4: How Are Industry Rivals Positioned? 54

Using Strategic Group Maps to Assess the Positioning of Key Competitors 54

CONCEPTS & CONNECTIONS 3.1: COMPARATIVE MARKET POSITIONS OF SELECTED COMPANIES IN THE CASUAL DINING INDUSTRY: A STRATEGIC GROUP MAP EXAMPLE 56

The Value of Strategic Group Maps 56

Question 5: What Strategic Moves Are Rivals Likely to Make Next? 57

Question 6: What Are the Industry Key Success Factors? 58

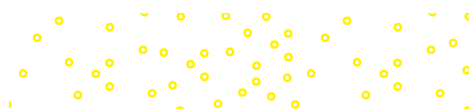
Question 7: Does the Industry Offer Good Prospects for Attractive Profits? 60

Key Points 61

Assurance of Learning Exercises 62

Exercises for Simulation Participants 62

Endnotes 63



Chapter 4 Evaluating a Company's Resources, Capabilities, and Competitiveness 64

Question 1: How Well Is the Company's Strategy Working?	65
Question 2: What Are the Company's Competitively Important Resources and Capabilities?	66
Identifying Competitively Important Resources and Capabilities	66
Determining the Competitive Power of a Company's Resources and Capabilities	67
The Importance of Dynamic Capabilities in Sustaining Competitive Advantage	69
Is the Company Able to Seize Market Opportunities and Nullify External Threats?	69
Question 3: Are the Company's Cost Structure and Customer Value Proposition Competitive?	70
Company Value Chains	72
CONCEPTS & CONNECTIONS 4.1: THE VALUE CHAIN FOR BOLL & BRANCH	74
Benchmarking: A Tool for Assessing Whether a Company's Value Chain Activities Are Competitive	74
The Value Chain System for an Entire Industry	76
Strategic Options for Remediating a Cost or Value Disadvantage	76
How Value Chain Activities Relate to Resources and Capabilities	79
Question 4: What Is the Company's Competitive Strength Relative to Key Rivals?	79
Interpreting the Competitive Strength Assessments	80
Question 5: What Strategic Issues and Problems Must Be Addressed by Management?	80
Key Points	82
Assurance of Learning Exercises	83
Exercises for Simulation Participants	85
Endnotes	86

Section C: Crafting a Strategy

Chapter 5 The Five Generic Competitive Strategies 88

The Five Generic Competitive Strategies	89
Low-Cost Provider Strategies	90
The Two Major Avenues for Achieving Low-Cost Leadership	91
When a Low-Cost Provider Strategy Works Best	93
CONCEPTS & CONNECTIONS 5.1: AMAZON'S PATH TO BECOMING THE LOW-COST PROVIDER IN E-COMMERCE	94
Pitfalls to Avoid in Pursuing a Low-Cost Provider Strategy	95
Broad Differentiation Strategies	95
Approaches to Differentiation	96
Managing the Value Chain in Ways That Enhance Differentiation	96
Delivering Superior Value via a Differentiation Strategy	99
Perceived Value and the Importance of Signaling Value	99
CONCEPTS & CONNECTIONS 5.2: HOW BMW'S DIFFERENTIATION STRATEGY ALLOWED IT TO BECOME THE NUMBER-ONE LUXURY CAR BRAND	100
When a Differentiation Strategy Works Best	100
Pitfalls to Avoid in Pursuing a Differentiation Strategy	101



Focused (or Market Niche) Strategies	102
A Focused Low-Cost Strategy	102
A Focused Differentiation Strategy	103
When a Focused Low-Cost or Focused Differentiation Strategy Is Viable	103

CONCEPTS & CONNECTIONS 5.3: CANADA GOOSE'S FOCUSED DIFFERENTIATION STRATEGY 104

The Risks of a Focused Low-Cost or Focused Differentiation Strategy	105
Best-Cost Provider Strategies	105
When a Best-Cost Provider Strategy Works Best	106
The Danger of an Unsound Best-Cost Provider Strategy	106
Successful Competitive Strategies Are Resource Based	106

CONCEPTS & CONNECTIONS 5.4: AMERICAN GIANT'S BEST-COST PROVIDER STRATEGY 107

Key Points	108
Assurance of Learning Exercises	109
Exercises for Simulation Participants	110
Endnotes	110

Chapter 6 Strengthening a Company's Competitive Position: Strategic Moves, Timing, and Scope of Operations 111

Launching Strategic Offensives to Improve a Company's Market Position	112
Choosing the Basis for Competitive Attack	112
Choosing Which Rivals to Attack	114
Blue Ocean Strategy—A Special Kind of Offensive	114

CONCEPTS & CONNECTIONS 6.1: BONOBOS' BLUE OCEAN STRATEGY IN THE U.S. MEN'S FASHION RETAIL INDUSTRY 115

Using Defensive Strategies to Protect a Company's Market Position and Competitive Advantage	115
Blocking the Avenues Open to Challengers	116
Signaling Challengers That Retaliation Is Likely	116
Timing a Company's Offensive and Defensive Strategic Moves	116

CONCEPTS & CONNECTIONS 6.2: UBER'S FIRST-MOVER ADVANTAGE IN MOBILE RIDE-HAILING SERVICES 118

The Potential for Late-Mover Advantages or First-Mover Disadvantages	118
Deciding Whether to Be an Early Mover or Late Mover	119
Strengthening a Company's Market Position via Its Scope of Operations	119
Horizontal Merger and Acquisition Strategies	120
Why Mergers and Acquisitions Sometimes Fail to Produce Anticipated Results	122
Vertical Integration Strategies	122
The Advantages of a Vertical Integration Strategy	123
The Disadvantages of a Vertical Integration Strategy	124



CONCEPTS & CONNECTIONS 6.3: KAISER PERMANENTE'S VERTICAL INTEGRATION STRATEGY 125

- Outsourcing Strategies: Narrowing the Scope of Operations **125**
- Strategic Alliances and Partnerships **127**
 - Failed Strategic Alliances and Cooperative Partnerships **128**
 - The Strategic Dangers of Relying on Alliances for Essential Resources and Capabilities **128**
- Key Points **128**
- Assurance of Learning Exercises **129**
- Exercises for Simulation Participants **130**
- Endnotes **130**

Chapter 7 Strategies for Competing in International Markets 132

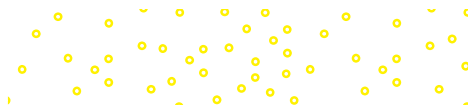
- Why Companies Expand into International Markets **133**
- Factors That Shape Strategy Choices in International Markets **134**
 - Cross-Country Differences in Demographic, Cultural, and Market Conditions **134**
 - Opportunities for Location-Based Cost Advantages **135**
 - Industry Cluster Knowledge Sharing Opportunities **136**
 - The Risks of Adverse Exchange Rate Shifts **136**
 - The Impact of Government Policies on the Business Climate in Host Countries **137**
- Strategy Options for Entering Foreign Markets **138**
 - Export Strategies **138**
 - Licensing Strategies **138**
 - Franchising Strategies **139**
 - Foreign Subsidiary Strategies **139**
 - Alliance and Joint Venture Strategies **140**

CONCEPTS & CONNECTIONS 7.1: WALGREENS BOOTS ALLIANCE, INC.: ENTERING FOREIGN MARKETS VIA ALLIANCE FOLLOWED BY MERGER 141

- International Strategy: The Three Principal Options **142**
 - Multidomestic Strategy—A Think Local, Act Local Approach to Strategy Making **143**
 - Global Strategy—A Think Global, Act Global Approach to Strategy Making **144**
 - Transnational Strategy—A Think Global, Act Local Approach to Strategy Making **145**

CONCEPTS & CONNECTIONS 7.2: FOUR SEASONS HOTELS: LOCAL CHARACTER, GLOBAL SERVICE 146

- Using International Operations to Improve Overall Competitiveness **147**
 - Using Location to Build Competitive Advantage **147**
 - Using Cross-Border Coordination to Build Competitive Advantage **148**
- Strategies for Competing in the Markets of Developing Countries **148**
 - Strategy Options for Competing in Developing-Country Markets **149**
- Key Points **150**
- Assurance of Learning Exercises **151**
- Exercises for Simulation Participants **152**
- Endnotes **152**

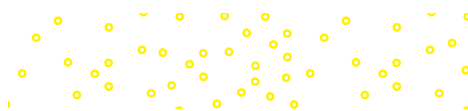


Chapter 8 Corporate Strategy: Diversification and the Multibusiness Company 154

When Business Diversification Becomes a Consideration	156
Building Shareholder Value: The Ultimate Justification for Business Diversification	156
Approaches to Diversifying the Business Lineup	157
Diversification by Acquisition of an Existing Business	157
Entering a New Line of Business Through Internal Development	157
Using Joint Ventures to Achieve Diversification	157
Choosing the Diversification Path: Related Versus Unrelated Businesses	158
Diversifying into Related Businesses	159
Strategic Fit and Economies of Scope	160
The Ability of Related Diversification to Deliver Competitive Advantage and Gains in Shareholder Value	160
CONCEPTS & CONNECTIONS 8.1: THE KRAFT–HEINZ MERGER: PURSUING THE BENEFITS OF CROSS-BUSINESS STRATEGIC FIT	161
Diversifying into Unrelated Businesses	162
Building Shareholder Value Through Unrelated Diversification	162
The Pitfalls of Unrelated Diversification	162
Misguided Reasons for Pursuing Unrelated Diversification	163
Diversifying into Both Related and Unrelated Businesses	164
Evaluating the Strategy of a Diversified Company	164
Step 1: Evaluating Industry Attractiveness	165
Step 2: Evaluating Business-Unit Competitive Strength	167
Step 3: Determining the Competitive Value of Strategic Fit in Multibusiness Companies	171
Step 4: Evaluating Resource Fit	171
Step 5: Ranking Business Units and Setting a Priority for Resource Allocation	174
Step 6: Crafting New Strategic Moves to Improve the Overall Corporate Performance	175
Key Points	178
Assurance of Learning Exercises	179
Exercises for Simulation Participants	180
Endnotes	181

Chapter 9 Ethics, Corporate Social Responsibility, Environmental Sustainability, and Strategy 182

What Do We Mean by Business Ethics?	183
Drivers of Unethical Strategies and Business Behavior	184
The Business Case for Ethical Strategies	185
Ensuring a Strong Commitment to Business Ethics in Companies with International Operations	186
The School of Ethical Universalism	186
CONCEPTS & CONNECTIONS 9.1: IKEA'S GLOBAL SUPPLIER STANDARDS: MAINTAINING LOW COSTS WHILE FIGHTING THE ROOT CAUSES OF CHILD LABOR	187




The School of Ethical Relativism	187
Integrative Social Contracts Theory	188
Strategy, Corporate Social Responsibility, and Environmental Sustainability	189
What Do We Mean by Corporate Social Responsibility?	189
CONCEPTS & CONNECTIONS 9.2: WARBY PARKER: COMBINING CORPORATE SOCIAL RESPONSIBILITY WITH AFFORDABLE FASHION	191
What Do We Mean by Sustainability and Sustainable Business Practices?	192
Crafting Corporate Social Responsibility and Sustainability Strategies	193
The Business Case for Socially Responsible Behavior	194
Key Points	196
Assurance of Learning Exercises	197
Exercises for Simulation Participants	197
Endnotes	198

Section D: Executing the Strategy

Chapter 10 Superior Strategy Execution—Another Path to Competitive Advantage 199

The Principal Managerial Components of Strategy Execution	200
Building an Organization Capable of Good Strategy Execution: Three Key Actions	201
Staffing the Organization	202
Acquiring, Developing, and Strengthening Key Resources and Capabilities	203
CONCEPTS & CONNECTIONS 10.1: ZARA'S STRATEGY EXECUTION CAPABILITIES	204
Matching Organizational Structure to the Strategy	206
Allocating Resources to Strategy-Critical Activities	209
Instituting Strategy-Supportive Policies and Procedures	210
Striving for Continuous Improvement in Processes and Activities	211
CONCEPTS & CONNECTIONS 10.2: CHARLESTON AREA MEDICAL CENTER'S SIX SIGMA PROGRAM	213
The Difference Between Business Process Reengineering and Continuous Improvement Programs	213
Installing Information and Operating Systems	214
Using Rewards and Incentives to Promote Better Strategy Execution	215
Motivation and Reward Systems	215
Guidelines for Designing Monetary Incentive Systems	215
Nonmonetary Rewards	216
Instilling a Corporate Culture That Promotes Good Strategy Execution	217
CONCEPTS & CONNECTIONS 10.3: HOW THE BEST COMPANIES TO WORK FOR MOTIVATE AND REWARD EMPLOYEES	218
High-Performance Cultures	218
CONCEPTS & CONNECTIONS 10.4: STRONG GUIDING PRINCIPLES DRIVE THE HIGH-PERFORMANCE CULTURE AT EPIC	219




Adaptive Cultures	220
Unhealthy Corporate Cultures	220
Changing a Problem Culture	222
Leading the Strategy Execution Process	224
Staying on Top of How Well Things Are Going	225
Putting Constructive Pressure on Organizational Units to Achieve Good Results and Operating Excellence	225
Initiating Corrective Actions to Improve Both the Company's Strategy and Its Execution	226
Key Points	226
Assurance of Learning Exercises	227
Exercises for Simulation Participants	228
Endnotes	229
Appendix Key Financial Ratios: How to Calculate Them and What They Mean	231


PART TWO **CASES IN CRAFTING AND EXECUTING STRATEGY** 233

Cases

- Case 1** **Airbnb, Inc., in 2017** 233
John D. Varlaro, Johnson & Wales University
John E. Gamble, Texas A&M University-Corpus Christi
- Case 2** **Costco Wholesale in 2017: Mission, Business Model, and Strategy** 238
Arthur A. Thompson Jr., The University of Alabama
- Case 3** **Competition in the Craft Brewing Industry in 2017** 261
John D. Varlaro, Johnson & Wales University
John E. Gamble, Texas A&M University-Corpus Christi
- Case 4** **Fitbit, Inc., in 2017: Can It Revive Its Strategy and Reverse Mounting Losses?** 271
Rochelle R. Brunson, Baylor University
Marlene M. Reed, Baylor University
- Case 5** **lululemon athletica, inc., in 2017: Is the Company on the Path to Becoming a High Performer Once Again?** 279
Arthur A. Thompson, The University of Alabama
- Case 6** **Gap Inc.: Can It Develop a Strategy to Connect with Consumers in 2017?** 298
John D. Varlaro, Johnson & Wales University
John E. Gamble, Texas A&M University-Corpus Christi
- Case 7** **GoPro in 2017: Will Its Turnaround Strategy Restore Profitability?** 307
David L. Turnipseed, University of South Alabama
John E. Gamble, Texas A&M University-Corpus Christi
- 



Case 8	Ricoh Canada	322
	<i>Jonathan Fast, Queen's University</i>	
	<i>Prescott C. Ensign, Wilfrid Laurier University</i>	
Case 9	Mondelēz International's Diversification Strategy in 2017: Has Corporate Restructuring Benefited Shareholders?	335
	<i>John E. Gamble, Texas A&M University-Corpus Christi</i>	
Case 10	Robin Hood	346
	<i>Joseph Lampel, Alliance Manchester Business School</i>	
Case 11	Rosen Hotels & Resorts	348
	<i>Randall D. Harris, Texas A&M University-Corpus Christi</i>	
Case 12	TOMS Shoes in 2016: An Ongoing Dedication to Social Responsibility	360
	<i>Margaret A. Peteraf, Tuck School of Business at Dartmouth</i>	
	<i>Sean Zhang and Meghan L. Cooney, Research Assistants, Dartmouth College</i>	
Glossary		369
Indexes		
	Organization	373
	Subject	379
	Name	390





connect[®]

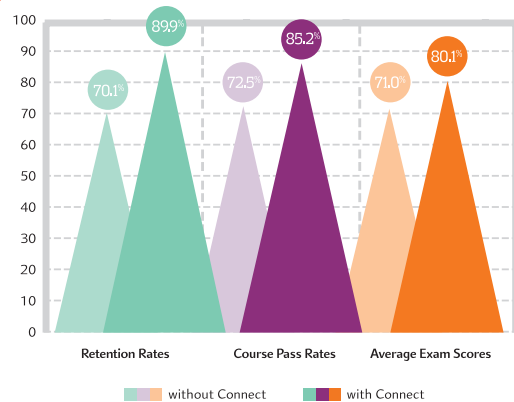
McGraw-Hill Connect[®] is a highly reliable, easy-to-use homework and learning management solution that utilizes learning science and award-winning adaptive tools to improve student results.

Homework and Adaptive Learning

- Connect's assignments help students contextualize what they've learned through application, so they can better understand the material and think critically.
- Connect will create a personalized study path customized to individual student needs through SmartBook[®].
- SmartBook helps students study more efficiently by delivering an interactive reading experience through adaptive highlighting and review.

Over **7 billion** questions have been answered, making McGraw-Hill Education products more intelligent, reliable, and precise.

Connect's Impact on Retention Rates, Pass Rates, and Average Exam Scores

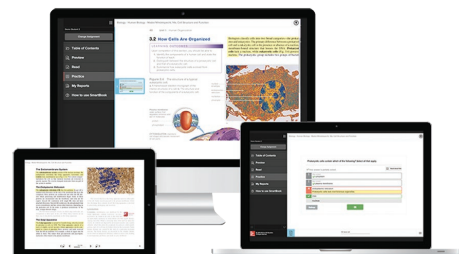


Using **Connect** improves retention rates by **19.8** percentage points, passing rates by **12.7** percentage points, and exam scores by **9.1** percentage points.

73% of instructors who use **Connect** require it; instructor satisfaction increases by **28%** when **Connect** is required.

Quality Content and Learning Resources

- Connect content is authored by the world's best subject matter experts, and is available to your class through a simple and intuitive interface.
- The Connect eBook makes it easy for students to access their reading material on smartphones and tablets. They can study on the go and don't need internet access to use the eBook as a reference, with full functionality.
- Multimedia content such as videos, simulations, and games drive student engagement and critical thinking skills.

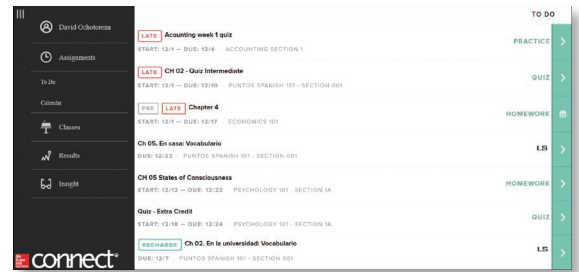


Robust Analytics and Reporting

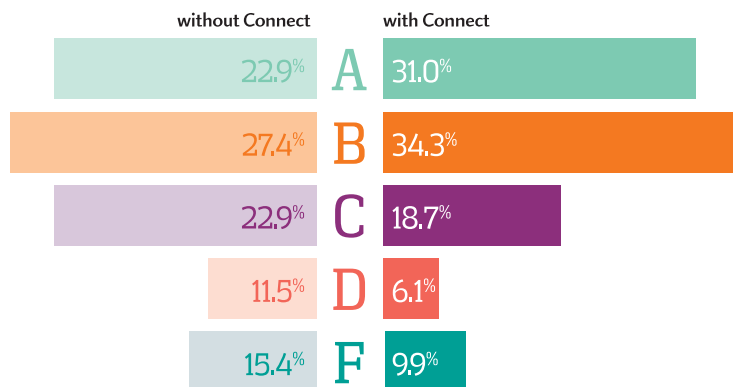
- Connect Insight® generates easy-to-read reports on individual students, the class as a whole, and on specific assignments.
- The Connect Insight dashboard delivers data on performance, study behavior, and effort. Instructors can quickly identify students who struggle and focus on material that the class has yet to master.
- Connect automatically grades assignments and quizzes, providing easy-to-read reports on individual and class performance.



©Hero Images/Getty Images



Impact on Final Course Grade Distribution



More students earn
As and **Bs** when they
use **Connect**.

Trusted Service and Support

- Connect integrates with your LMS to provide single sign-on and automatic syncing of grades. Integration with Blackboard®, D2L®, and Canvas also provides automatic syncing of the course calendar and assignment-level linking.
- Connect offers comprehensive service, support, and training throughout every phase of your implementation.
- If you're looking for some guidance on how to use Connect, or want to learn tips and tricks from super users, you can find tutorials as you work. Our Digital Faculty Consultants and Student Ambassadors offer insight into how to achieve the results you want with Connect.

COURSE DESIGN AND DELIVERY

CREATE



create™

Instructors can now tailor their teaching resources to match the way they teach! With McGraw-Hill Create, www.mcgrawhillcreate.com, instructors can easily rearrange chapters, combine material from other content sources, and quickly upload and integrate their own content, such as course syllabi or teaching notes. Find the right content in Create by searching through thousands of leading McGraw-Hill textbooks. Arrange the material to fit your teaching style. Order a Create book and receive a complimentary print review copy in three to five business days or a complimentary electronic review copy via e-mail within one hour. Go to www.mcgrawhillcreate.com today and register.

TEGRITY CAMPUS



tegrity®

Tegrity makes class time available 24/7 by automatically capturing every lecture in a searchable format for students to review when they study and complete assignments. With a simple one-click start-and-stop process, you capture all computer screens and corresponding audio. Students can replay any part of any class with easy-to-use browser-based viewing on a PC or Mac. Educators know that the more students can see, hear, and experience class resources, the better they learn. In fact, studies prove it. With patented Tegrity “search anything” technology, students instantly recall key class moments for replay online or on iPods and mobile devices. Instructors can help turn all their students’ study time into learning moments immediately supported by their lecture. To learn more about Tegrity, watch a two-minute Flash demo at <http://tegritycampus.mhhe.com>.

BLACKBOARD® PARTNERSHIP



The Best of Both Worlds

McGraw-Hill Education and Blackboard have teamed up to simplify your life. Now you and your students can access Connect and Create right from within your Blackboard course—all with one single sign-on. The grade books are seamless, so when a student completes an integrated Connect assignment, the grade for that assignment automatically (and instantly) feeds your Blackboard grade center. Learn more at www.domorenow.com.

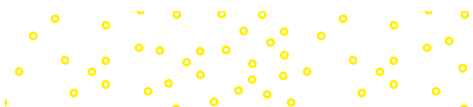


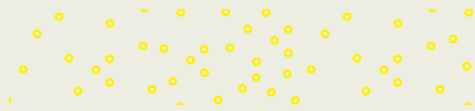
McGraw-Hill CAMPUS™



Campus

McGraw-Hill Campus is a new one-stop teaching and learning experience available to users of any learning management system. This institutional service allows faculty and students to enjoy single sign-on (SSO) access to all McGraw-Hill Higher Education materials, including the award-winning McGraw-Hill Connect platform, from directly within the institution's website. With McGraw-Hill Campus, faculty receive instant access to teaching materials (e.g., eTextbooks, test banks, PowerPoint slides, animations, learning objectives, etc.), allowing them to browse, search, and use any instructor ancillary content in our vast library at no additional cost to instructor or students. In addition, students enjoy SSO access to a variety of free content (e.g., quizzes, flash cards, narrated presentations, etc.) and subscription-based products (e.g., McGraw-Hill Connect). With McGraw-Hill Campus enabled, faculty and students will never need to create another account to access McGraw-Hill products and services. Learn more at www.mhcampus.com.





ESSENTIALS OF
**STRATEGIC
MANAGEMENT**





Strategy, Business Models, and Competitive Advantage



1

chapter

LEARNING OBJECTIVES

After reading this chapter, you should be able to:

- LO1-1** Understand what is meant by a company's strategy.
- LO1-2** Explain why a company needs a creative, distinctive strategy that sets it apart from rivals.
- LO1-3** Explain why it is important for a company to have a viable business model that outlines the company's customer value proposition and its profit formula.
- LO1-4** Identify the five most dependable strategic approaches for setting a company apart from rivals and winning a sustainable competitive advantage.
- LO1-5** Understand that a company's strategy tends to evolve over time because of changing circumstances and ongoing management efforts to improve the company's strategy.
- LO1-6** Identify the three tests of a winning strategy.

According to *The Economist*, a leading publication on business, economics, and international affairs, “In business, strategy is king. Leadership and hard work are all very well and luck is mighty useful, but it is strategy that makes or breaks a firm.”¹ Luck and circumstance can explain why some companies are blessed with initial, short-lived success. But only a well-crafted, well-executed, constantly evolving strategy can explain why an elite set of companies somehow manages to rise to the top and stay there, year after year, pleasing their customers, shareholders, and other stakeholders alike in the process. Companies such as Apple, Samsung, Disney, Emirates Airlines, Microsoft, Alphabet (formerly Google), Berkshire Hathaway, General Electric, and Southwest Airlines come to mind.

In this opening chapter, we define the concept of *strategy* and describe its many facets. We explain what is meant by a competitive advantage, discuss the relationship between a company’s strategy and its business model, and introduce you to the kinds of competitive strategies that can give a company an advantage over rivals in attracting customers and earning above-average profits. We look at what sets a winning strategy apart from others and why the caliber of a company’s strategy determines whether the company will enjoy a competitive advantage over other firms. By the end of this chapter, you will have a clear idea of why the tasks of crafting and executing strategy are core management functions and why excellent execution of an excellent strategy is the most reliable recipe for turning a company into a standout performer over the long term.

LO1-1

Understand what is meant by a company’s strategy.

CORE CONCEPT

A company’s **strategy** is the set of actions that its managers take to outperform the company’s competitors and achieve superior profitability.

A company’s **strategy** is the set of actions that its managers take to outperform the company’s competitors and achieve superior profitability. The objective of a well-crafted strategy is not merely temporary competitive success and profits in the short run, but rather the sort of lasting success that can support growth and

secure the company’s future over the long term. Achieving this entails making a managerial commitment to a coherent array of well-considered choices about how to compete.² These include choices about:

- *How* to create products or services that attract and please customers.
- *How* to position the company in the industry.
- *How* to develop and deploy resources to build valuable competitive capabilities.
- *How* each functional piece of the business (R&D, supply chain activities, production, sales and marketing, distribution, finance, and human resources) will be operated.
- *How* to achieve the company’s performance targets.

In most industries, companies have considerable freedom in choosing the *hows* of strategy. Thus some rivals strive to create superior value for customers by achieving lower costs than rivals, while others pursue product superiority or personalized customer service or the development of capabilities that rivals cannot match. Some competitors position themselves in only one part of the industry’s chain of production/distribution activities, while others are partially or fully integrated, with operations

ranging from components production to manufacturing and assembly to wholesale distribution or retailing. Some competitors deliberately confine their operations to local or regional markets; others opt to compete nationally, internationally (several countries), or globally. Some companies decide to operate in only one industry, while others diversify broadly or narrowly, into related or unrelated industries.

The Importance of a Distinctive Strategy and Competitive Approach

LO1-2

Explain why a company needs a creative, distinctive strategy that sets it apart from rivals.

For a company to matter in the minds of customers, its strategy needs a distinctive element that sets it apart from rivals and produces a competitive edge. A strategy must tightly fit a company's own particular situation, but there is no shortage of opportunity to fashion a strategy that is discernibly different from the strategies of rivals. In fact, competitive success requires a company's managers to make strategic choices about the key building blocks of its strategy that differ from the choices made by competitors—not 100 percent different but at least different in several important respects. A strategy stands a chance of succeeding only when it is predicated on actions, business approaches, and competitive moves aimed at appealing to buyers *in ways that set a company apart from rivals*. Simply trying to mimic the strategies of the industry's successful companies never works. Rather, every company's strategy needs to have some distinctive element that draws in customers and produces a competitive edge. Strategy, at its essence, is about competing differently—doing what rival firms *don't* do or, better yet, what rival firms *can't* do.³

Mimicking the strategies of successful industry rivals—with either copycat product offerings or efforts to stake out the same market position—rarely works. A creative, distinctive strategy that sets a company apart from rivals and yields a competitive advantage is a company's most reliable ticket for earning above-average profits.

The Relationship Between a Company's Strategy and Business Model

LO1-3

Explain why it is important for a company to have a viable business model that outlines the company's customer value proposition and its profit formula.

Closely related to the concept of strategy is the concept of a company's **business model**. While the company's strategy sets forth an approach to offering superior value, a company's business model is management's blueprint for delivering a valuable product or service to customers in a manner that will yield an attractive profit.⁴ The two elements of a company's business model are (1) its *customer value proposition* and (2) its *profit formula*. The customer value proposition is

CORE CONCEPT

A company's **business model** sets forth how its strategy and operating approaches will create value for customers, while at the same time generating ample revenues to cover costs and realizing a profit. The two elements of a company's business model are its (1) customer value proposition and (2) its profit formula.

established by the company's overall strategy and lays out the company's approach to satisfying buyer wants and needs at a price customers will consider a good value. The greater the value provided and the lower the price, the more attractive the value proposition is to customers. The profit formula describes the company's approach to determining a cost structure that will allow for acceptable profits given the pricing tied to its customer value proposition. The lower the costs given the customer value proposition, the greater the ability of the business model to be a moneymaker. The nitty-gritty issue surrounding a company's business model is whether it can execute its customer value proposition profitably. Just because company managers have crafted a strategy for competing and running the business does not automatically mean the strategy will lead to profitability—it may or it may not.⁵

Cable television providers utilize a business model, keyed to delivering news and entertainment that viewers will find valuable, to secure sufficient revenues from subscriptions and advertising to cover operating expenses and allow for profits. Aircraft engine manufacturer Rolls-Royce employs a “power-by-the-hour” business model that charges airlines leasing fees for engine use, maintenance, and repairs based upon actual hours flown. The company retains ownership of the engines and is able to minimize engine maintenance costs through the use of sophisticated sensors that optimize maintenance and repair schedules. Gillette's business model in razor blades involves achieving economies of scale in the production of its shaving products, selling razors at an attractively low price, and then making money on repeat purchases of razor blades. Concepts & Connections 1.1 discusses three contrasting business models in radio broadcasting.

Strategy and the Quest for Competitive Advantage

LO1-4

Identify the five most dependable strategic approaches for setting a company apart from rivals and winning a sustainable competitive advantage.

The heart and soul of any strategy is the actions and moves in the marketplace that managers are taking to gain a competitive edge over rivals.⁶ Five of the most frequently used and dependable strategic approaches to setting a company apart from rivals and winning a sustainable competitive advantage are:

1. **A low-cost provider strategy**—achieving a cost-based advantage over rivals. Walmart and Southwest Airlines have earned strong market positions because of the low-cost advantages they have achieved over their rivals. Low-cost provider strategies can produce a durable competitive edge when rivals find it hard to match the low-cost leader's approach to driving costs out of the business.
2. **A broad differentiation strategy**—seeking to differentiate the company's product or service from rivals' in ways that will appeal to a broad spectrum of buyers. Successful adopters of broad differentiation strategies include Johnson & Johnson in baby products (product reliability) and Apple (innovative products). Differentiation strategies can be powerful so long as a company is sufficiently innovative to thwart rivals' attempts to copy or closely imitate its product offering.

Concepts & Connections 1.1

PANDORA, SIRIUS XM, AND OVER-THE-AIR BROADCAST RADIO: THREE CONTRASTING BUSINESS MODELS

	Pandora	Sirius XM	Over-the-Air Radio Broadcasters
Customer value proposition	<ul style="list-style-type: none"> Through free-of-charge Internet radio service, allowed PC, tablet computer, and smartphone users to create up to 100 personalized music and comedy stations Utilized algorithms to generate playlists based on users' predicted music preferences Offered programming interrupted by brief, occasional ads; eliminated advertising for Pandora One subscribers 	<ul style="list-style-type: none"> For a monthly subscription fee, provided satellite-based music, news, sports, national and regional weather, traffic reports in limited areas, and talk radio programming Also offered subscribers streaming Internet channels and the ability to create personalized, commercial-free stations for online and mobile listening Offered programming interrupted only by brief, occasional ads 	<ul style="list-style-type: none"> Provided free-of-charge music, national and local news, local traffic reports, national and local weather, and talk radio programming Included frequent programming interruption for ads
Profit Formula	<p>Revenue generation: Display, audio, and video ads targeted to different audiences and sold to local and national buyers; subscription revenues generated from an advertising-free option called Pandora One</p> <p>Cost structure: Fixed costs associated with developing software for computers, tablets, and smartphones</p> <p>Fixed and variable costs related to operating data centers to support streaming network content royalties, marketing, and support activities</p> <p>Profit margin: Profitability dependent on generating sufficient advertising revenues and subscription revenues to cover costs and provide attractive profits</p>	<p>Revenue generation: Monthly subscription fees, sales of satellite radio equipment, and advertising revenues</p> <p>Cost structure: Fixed costs associated with operating a satellite-based music delivery service and streaming Internet service</p> <p>Fixed and variable costs related to programming and content royalties, marketing, and support activities</p> <p>Profit margin: Profitability dependent on attracting a sufficiently large number of subscribers to cover costs and provide attractive profits</p>	<p>Revenue generation: Advertising sales to national and local businesses</p> <p>Cost structure: Fixed costs associated with terrestrial broadcasting operations</p> <p>Fixed and variable costs related to local news reporting, advertising sales operations, network affiliate fees, programming and content royalties, commercial production activities, and support activities</p> <p>Profit margin: Profitability dependent on generating sufficient advertising revenues to cover costs and provide attractive profits</p>

Sources: Company documents, 10-Ks, and information posted on their websites.

3. *A focused low-cost strategy*—concentrating on a narrow buyer segment (or market niche) and outcompeting rivals by having lower costs than rivals and thus being able to serve niche members at a lower price. Private-label manufacturers of food, health and beauty products, and nutritional supplements use their low-cost advantage to offer supermarket buyers lower prices than those demanded by producers of branded products.
4. *A focused differentiation strategy*—concentrating on a narrow buyer segment (or market niche) and outcompeting rivals by offering niche members customized attributes that meet their tastes and requirements better than rivals' products. Louis Vuitton and Rolex have sustained their advantage in the luxury goods industry through a focus on affluent consumers demanding luxury and prestige.
5. *A best-cost provider strategy*—giving customers more value for the money by satisfying buyers' expectations on key quality/features/performance/service attributes, while beating their price expectations. This approach is a hybrid strategy that blends elements of low-cost provider and differentiation strategies; the aim is to have the lowest (best) costs and prices among sellers offering products with comparable differentiating attributes. Target's best-cost advantage allows it to give discount store shoppers more value for the money by offering an attractive product lineup and an appealing shopping ambience at low prices.

In Concepts & Connections 1.2, it is evident that Starbucks has gained a competitive advantage over rivals through its efforts to offer the highest quality coffee-

CORE CONCEPT

A company achieves **sustainable competitive advantage** when an attractively large number of buyers develop a durable preference for its products or services over the offerings of competitors, despite the efforts of competitors to overcome or erode its advantage.

based beverages, create an emotional attachment with customers, expand its global presence, expand the product line, and ensure consistency in store operations. A creative, distinctive strategy such as that used by Starbucks is a company's most reliable ticket for developing a sustainable competitive advantage and earning above-average profits. A **sustainable competitive advantage** allows a company to attract sufficiently large numbers of buyers who have a lasting preference for its products or services over those offered by rivals,

despite the efforts of competitors to offset that appeal and overcome the company's advantage. The bigger and more durable the competitive advantage, the better a company's prospects for winning in the marketplace and earning superior long-term profits relative to rivals.

The Importance of Capabilities in Building and Sustaining Competitive Advantage

Winning a *sustainable* competitive edge over rivals with any of the previous five strategies generally hinges as much on building competitively valuable capabilities that rivals cannot readily match as it does on having a distinctive product offering. Clever rivals can nearly always copy the attributes of a popular product or service, but it is

Concepts & Connections 1.2

STARBUCKS' STRATEGY IN THE SPECIALTY COFFEE MARKET

Since its founding in 1985 as a modest nine-store operation in Seattle, Washington, Starbucks had become the premier roaster and retailer of specialty coffees in the world, with nearly 25,000 store locations in 70 countries as of April 2016 and annual sales that exceed \$21 billion in fiscal 2016. The key elements of Starbucks' strategy in specialty coffees included:

- **Train “baristas” to serve a wide variety of specialty coffee drinks that allow customers to satisfy their individual preferences in a customized way.** Starbucks essentially brought specialty coffees, such as cappuccinos, lattes, and macchiatos, to the mass market in the United States, encouraging customers to personalize their coffee drinking habits. Requests for such items as a “Smoked Butterscotch Latte with Soy Milk” could be served up quickly with consistent quality.
- **Emphasis on store ambience and elevating the customer experience at Starbucks stores.** Starbucks management viewed each store as a billboard for the company and as a contributor to building the company's brand and image. Each detail was scrutinized to enhance the mood and ambience of the store to make sure everything signaled “best-of-class” and reflected the personality of the community and the neighborhood. The thesis was “everything mattered.” The company went to great lengths to make sure the store fixtures, the merchandise displays, the colors, the artwork, the banners, the music, and the aromas all blended to create a consistent, inviting, stimulating environment that evoked the romance of coffee, that signaled the company's passion for coffee, and that rewarded customers with ceremony, stories, and surprise.
- **Purchase and roast only top-quality coffee beans.** The company purchased only the highest quality arabica beans and carefully roasted coffee to exacting standards of quality and flavor. Starbucks did not use chemicals or artificial flavors when preparing its roasted coffees.
- **Commitment to corporate responsibility.** Starbucks was protective of the environment and contributed positively to the communities where Starbucks stores were located. In addition, Starbucks promoted fair trade practices and paid above-market prices for coffee beans to provide its growers/suppliers with sufficient funding to sustain their operations and provide for their families.
- **Expansion of the number of Starbucks stores domestically and internationally.** Starbucks operated stores in high-traffic, high-visibility locations in the United States and abroad. The company's ability to vary store size and format made it possible to locate stores in settings such as downtown and suburban shopping areas, office buildings, and university campuses. Starbucks added 321 new company-owned locations in the United States and another 155 company-owned stores internationally in fiscal 2016. Starbucks also added 330 licensed store locations in the United States and 1,236 licensed stores internationally in 2016. The company planned to open 12,000 new stores globally by fiscal 2021, with 3,400 new units being opened in the United States.
- **Broaden and periodically refresh in-store product offerings.** Noncoffee products offered by Starbucks included teas, fresh pastries and other food items, and coffee mugs and coffee accessories. The company's new Mercato stores would extend food offerings to include grab-and-go salads and sandwiches and novel health-conscious items such as gluten-free smoked Canadian bacon breakfast sandwiches and Sous Vide Egg Bites.
- **Fully exploit the growing power of the Starbucks name and brand image with out-of-store sales.** Starbucks consumer packaged goods division included domestic and international sales of Frappuccino, coffee ice creams, and Starbucks coffees.

Sources: Company documents, 10-Ks, and information posted on Starbucks' website.

substantially more difficult for rivals to match the know-how and specialized capabilities a company has developed and perfected over a long period. FedEx, for example, has superior capabilities in next-day delivery of small packages. And Hyundai has become the world's fastest-growing automaker as a result of its advanced manufacturing processes and unparalleled quality control system. The capabilities of both of these companies have proven difficult for competitors to imitate or best and have allowed each to build and sustain competitive advantage.

Why a Company's Strategy Evolves over Time

LO1-5

Understand that a company's strategy tends to evolve over time because of changing circumstances and ongoing management efforts to improve the company's strategy.

The appeal of a strategy that yields a sustainable competitive advantage is that it offers the potential for an enduring edge over rivals. However, managers of every company must be willing and ready to modify the strategy in response to the unexpected moves of competitors, shifting buyer needs and preferences, emerging market opportunities, new ideas for improving the strategy, and mounting evidence that the strategy is not working well. Most of the time, a company's strategy evolves incrementally as management fine-tunes various pieces of the strategy and adjusts the strategy to respond to unfolding events. However, on occasion, major strategy shifts are called for, such as when the strategy is clearly failing or when industry conditions change in dramatic ways.

Regardless of whether a company's strategy changes gradually or swiftly, the important point is that the task of crafting strategy is not a one-time event but is always a work in progress.⁷

Changing circumstances and ongoing management efforts to improve the strategy cause a company's strategy to evolve over time—a condition that makes the task of crafting a strategy a work in progress, not a one-time event.

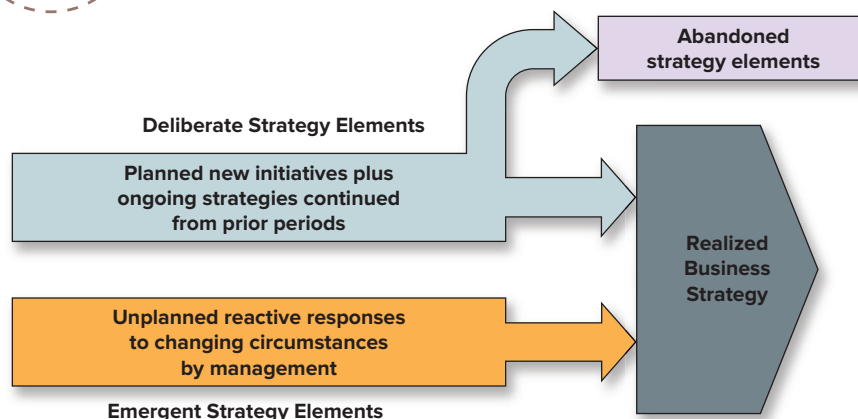
The evolving nature of a company's strategy means the typical company strategy is a blend of (1) *proactive* moves to improve the company's financial performance and secure a competitive edge and (2) *adaptive* reactions to unanticipated developments and fresh market conditions—see Figure 1.1.⁸ The biggest portion of a company's current strategy flows from ongoing actions that have proven themselves in the marketplace and newly launched initiatives aimed at

building a larger lead over rivals and further boosting financial performance. This part of management's action plan for running the company is its proactive, **deliberate strategy**.

At times, certain components of a company's deliberate strategy will fail in the marketplace and become **abandoned strategy elements**. Also, managers must always be willing to supplement or modify planned, deliberate strategy elements with as-needed

FIGURE 1.1

A Company's Strategy Is a Blend of Planned Initiatives and Unplanned Reactive Adjustments



reactions to unanticipated developments. Inevitably, there will be occasions when market and competitive conditions take unexpected turns that call for some kind of strategic reaction. Novel strategic moves on the part of rival firms, unexpected shifts in customer preferences, fast-changing technological developments, and new market opportunities call for unplanned, reactive adjustments that form the company's **emergent strategy**. As shown in Figure 1.1, a company's **realized strategy** tends to be a *combination* of deliberate planned elements and unplanned, emergent elements.

CORE CONCEPT

A company's **realized strategy** is a combination of *deliberate planned elements* and *unplanned emergent elements*. Some components of a company's deliberate strategy will fail in the marketplace and become *abandoned strategy elements*.

The Three Tests of a Winning Strategy

LO1-6 Identify the three tests of a winning strategy.

Three questions can be used to distinguish a winning strategy from a so-so or flawed strategy:

1. ***How well does the strategy fit the company's situation?*** To qualify as a winner, a strategy has to be well matched to the company's external and internal situations. The strategy must fit competitive conditions in the industry and other aspects of the enterprise's external environment. At the same time, it should be tailored to the company's collection of competitively important resources and capabilities. It's unwise to build a strategy upon the company's weaknesses or pursue a strategic approach that requires resources that are deficient in the company. Unless a strategy exhibits a tight fit with both the external and internal aspects of a company's overall situation, it is unlikely to produce respectable, first-rate business results.
2. ***Is the strategy helping the company achieve a sustainable competitive advantage?*** Strategies that fail to achieve a durable competitive advantage over rivals are unlikely to produce superior performance for more than a brief period of time. Winning strategies enable a company to achieve a competitive advantage over key rivals that is long lasting. The bigger and more durable the competitive edge that the strategy helps build, the more powerful it is.
3. ***Is the strategy producing good company performance?*** The mark of a winning strategy is strong company performance. Two kinds of performance improvements tell the most about the caliber of a company's strategy: (1) gains in profitability and financial strength and (2) advances in the company's competitive strength and market standing.

A winning strategy must fit the company's external and internal situation, build sustainable competitive advantage, and improve company performance.

Strategies that come up short on one or more of these tests are plainly less appealing than strategies passing all three tests with flying colors. Managers should use the same questions when evaluating either proposed or existing strategies. New initiatives that don't seem to match the company's internal and external situation should be scrapped before they come to fruition, while existing strategies must be scrutinized on a regular