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SEVENTH EDITION

Essentials of
**STRATEGIC
MANAGEMENT**

The Quest for Competitive Advantage

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**GAMBLE
PETERAF
THOMPSON**



Essentials of
**Strategic
Management**
The Quest for Competitive Advantage **7e**

JOHN E. GAMBLE

Texas A&M University-Corpus Christi

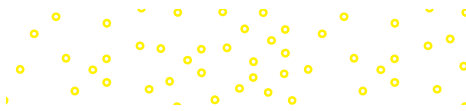
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ESSENTIALS OF STRATEGIC MANAGEMENT

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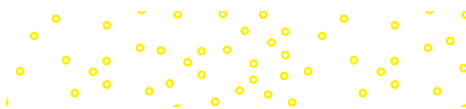
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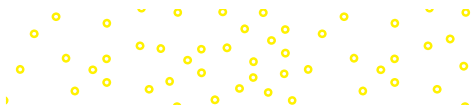
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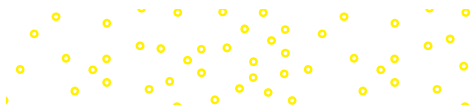
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Dedication

*To our families and especially our spouses:
Heather, Paul, and Hasseline.*



About the Authors



John E. Gamble
Courtesy of John E. Gamble

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 have 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.



Margaret A. Peteraf
Courtesy of Margaret A. Peteraf

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.



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 59 years have two daughters, two grandchildren, and a Yorkshire terrier.



Arthur A. Thompson, Jr.
Courtesy of Arthur A.
Thompson, Jr.



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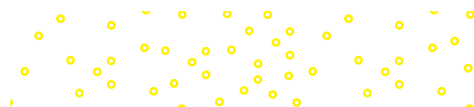
Preface

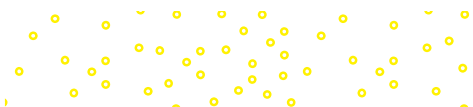
The standout features of this seventh edition of *Essentials of Strategic Management* are its concisely written and robust coverage of strategic management concepts and its compelling collection of cases. The text presents a conceptually strong treatment of strategic management principles and analytic 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 seventh 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. Six 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 and integrated into the *Connect*[®] package for the text, 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 seventh 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 are 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 Connect[®].* Your students will be able to use *Connect* to (1) complete two of the Assurance of Learning Exercises appearing at the end of each of the 10 chapters, (2) complete Exercises for Simulation Participants, (3) complete chapter-end quizzes, and (4) 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 and Exercises for Simulation Participants, all of the *Connect* exercises are automatically graded, thereby enabling you to easily assess the learning that has occurred.

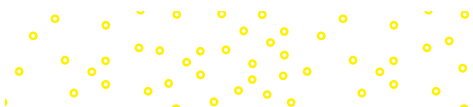
In addition, both of the companion strategy simulations have a built-in Learning Assurance Report that quantifies how well each member of your class performed on nine skills/learning measures *versus tens of thousands of other students worldwide* who completed the simulation in the past 12 months. We believe the chapter-end Assurance of Learning Exercises, the 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.

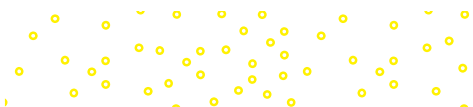
Taken together, the various components of the seventh edition package and the supporting set of Instructor Resources available in *Connect* provide you with enormous course design flexibility and a powerful kit of teaching/learning tools. We've done our very best to ensure that the elements comprising this edition will work well for you in the classroom and help you economize on the time needed to be well prepared for each class; students will 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.

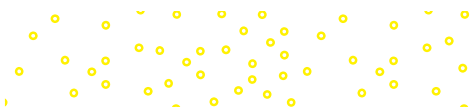


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2. *Our coverage of business ethics, core values, social responsibility, and environmental sustainability is unsurpassed by any other leading strategy text.* Chapter 9, “Ethics, Corporate Social Responsibility, Environmental Sustainability, and Strategy,” 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 seventh 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. *Connect is tightly linked to the text chapters, business simulation, and case lineup.* The *Connect* package for the seventh edition allows professors to assign autograded quizzes and select chapter-end Assurance of Learning Exercises to assess class members’ understanding of chapter concepts. The *Connect* package for the seventh edition also includes open-ended and autograded Exercises for Simulation Users. In addition, our texts have pioneered the extension of *Connect* 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 seventh edition give you unmatched capability to employ a text-case-simulation model of course delivery.

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

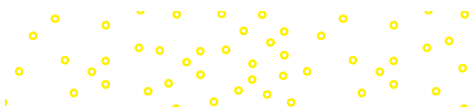
The following rundown summarizes the noteworthy features and topical emphasis in this new edition:

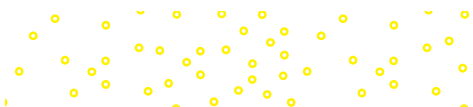
- Chapter 1 serves as an introduction to the topic of strategy, focusing on the managerial actions that will determine why a company matters in the marketplace. We introduce students to the primary approaches to building competitive advantage and the key elements of business-level strategy. Following 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 *value drivers* in reducing a company's costs and enhancing its differentiation, respectively.

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- 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



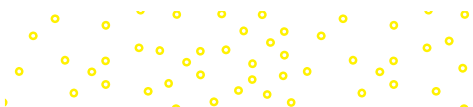
necessary for proficient strategy execution; (2) allocating ample resources to strategy-critical activities; (3) ensuring that policies and procedures facilitate rather than impede strategy execution; (4) pushing for continuous improvement in how value chain activities are performed; (5) installing information 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 10 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 eight 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 two 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. All 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 7th edition.


- *The Business Strategy Game* is the world’s most popular strategy simulation, having been used by nearly 3,500 different instructors for courses involving some 950,000 students at 1,270+ university campuses in 77 countries. It features global competition in the athletic footwear industry, a product/market setting familiar to students everywhere and one whose managerial challenges are easily grasped. A freshly updated and much-enhanced version of *The Business Strategy Game* was introduced in August 2018.
- *GLO-BUS*, a newer and somewhat simpler strategy simulation first introduced in 2004 and freshly revamped in 2016 to center on competition in two exciting product categories—wearable miniature action cameras and unmanned camera-equipped drones suitable for multiple commercial purposes—has been used by 1,800+ different instructors for courses involving over 330,000 students at 750+ university campuses in 53 countries.

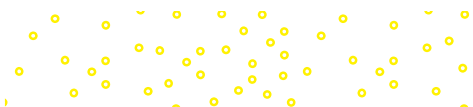
How the Strategy Simulations Work

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 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 production 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. The circumstances that co-managers face in running their simulation company embrace the very concepts, analytical tools, and strategy options they encounter in the text chapters (this is something you can quickly confirm by skimming through some of the Exercises for Simulation Participants that appear at the end of each chapter).

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).

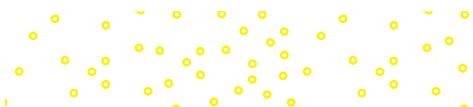
When the instructor-specified deadline for a decision round arrives, the simulation server automatically accesses the saved decision entries of each company, determines the competitiveness and buyer appeal of each company's product offering relative to the other companies being run by students in your 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-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
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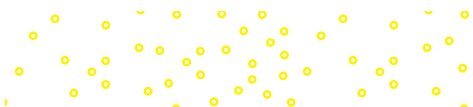
they are held fully accountable for their decisions and their company's performance, *co-managers are strongly motivated* to dig deeply into company operations, probe for ways to be more cost-efficient and competitive, and ferret out strategic moves and decisions calculated to boost company performance. *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's 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 at 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. Lots of back-and-forth chatter occurs when the results of the latest simulation round become available and co-managers renew their quest for strategic moves and actions that will strengthen 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. Interest levels climb. All this stimulates learning and causes students to see the practical relevance of the subject matter and the benefits of taking your course.

As soon as your students start to say “Wow! Not only is this fun but I am learning a lot,” *which they will*, you have won the battle of engaging students in the subject matter and moved the value of taking your course to a much higher plateau in the business school curriculum. This translates into *a livelier, richer learning experience from a student perspective and better instructor-course evaluations.*

- *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 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 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*.

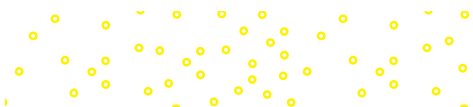
A Bird's-Eye View of *The Business Strategy Game*

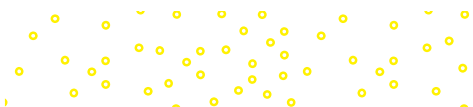
The setting for *The Business Strategy Game* (*BSG*) is the global athletic footwear industry (there can be little doubt in today's world that a globally competitive strategy simulation is *vastly superior* to a simulation with a domestic-only setting). Global market demand for footwear grows at the rate of 7 to 9 percent annually for the first five years and 5 to 7 percent annually for the second five years. However, market growth rates vary by geographic region—North America, Latin America, Europe-Africa, and Asia-Pacific.

Companies begin the simulation producing branded and private-label footwear in two plants, one in North America and one in Asia. They have the option to establish production facilities in Latin America and Europe-Africa. Company co-managers exercise control over production costs on the basis of the styling and quality they opt to manufacture, plant location (wages, incentive compensation, and import tariffs vary from region to region), the use of best practices and Six Sigma programs to reduce the production of defective footwear and to boost worker productivity, and compensation practices.

All newly produced footwear is shipped in bulk containers to one of four geographic distribution centers. All sales in a geographic region are made from footwear inventories in that region's distribution center. Costs at the four regional distribution centers are a function of inventory storage costs, packing and shipping fees, import tariffs paid on incoming pairs shipped from foreign plants, and exchange rate impacts. At the start of the simulation, import tariffs average \$4 per pair in North America, \$6 in Europe-Africa, \$8 per pair in Latin America, and \$10 in the Asia-Pacific region. Instructors have the option to alter tariffs as the game progresses.

Companies market their brand of athletic footwear to footwear retailers worldwide and to individuals buying online at the company's website. Each company's sales and market share in the branded footwear segments hinge on its competitiveness on 13 factors: attractive pricing, footwear styling and quality, product line breadth, advertising, use of mail-in rebates, appeal of celebrities endorsing a company's brand, success in convincing footwear retailers to carry its brand, number of weeks it takes to fill retailer orders, effectiveness of a company's online sales effort at its website, and brand reputation. Sales of private-label footwear hinge solely on being the low-price bidder.





All told, company co-managers make as many as 57 types of decisions each period that cut across production operations (up to 11 decisions per plant, with a maximum of four plants), the addition of facility space, equipment, and production improvement options (up to 8 decisions per plant), worker compensation and training (up to 6 decisions per plant), shipping and distribution center operations (5 decisions per geographic region), pricing and marketing (up to 9 decisions in four geographic regions), bids to sign celebrities (2 decision entries per bid), financing of company operations (up to 8 decisions), and corporate social responsibility and environmental sustainability (up to 8 decisions). Plus, there are 10 entries for each region pertaining to assumptions about the upcoming-year actions and competitive efforts of rival companies that factor directly into the forecasts of a company's unit sales, revenues, and market share in each of the four geographic regions.

Each time company co-managers make a decision entry, an assortment of on-screen calculations instantly shows the projected effects on unit sales, revenues, market shares, unit costs, profit, earnings per share, ROE, and other operating statistics. The on-screen calculations help team members evaluate the relative merits of one decision entry versus another and put together a promising strategy.

Companies can employ any of the five generic competitive strategy options in selling branded footwear—low-cost leadership, differentiation, best-cost provider, focused low cost, and focused differentiation. They can pursue essentially the same strategy worldwide or craft slightly or very different strategies for the Europe-Africa, Asia-Pacific, Latin America, and North America markets. They can strive for competitive advantage based on more advertising, a wider selection of models, more appealing styling/quality, bigger rebates, and so on.

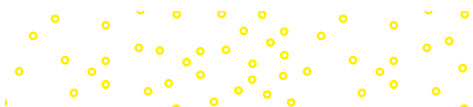
Any well-conceived, well-executed competitive approach is capable of succeeding, provided it is not overpowered by the strategies of competitors or defeated by the presence of too many copycat strategies that dilute its effectiveness. The challenge for each company's management team is to craft and execute a competitive strategy that produces good performance on five measures: earnings per share, return on equity investment, stock price appreciation, credit rating, and brand image.

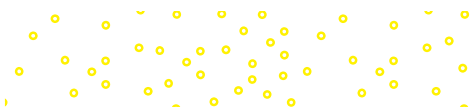
All activity for *The Business Strategy Game* takes place at www.bsg-online.com.

A Bird's-Eye View of GLO-BUS

In *GLO-BUS*, class members run companies that are in a neck-and-neck race for global market leadership in two product categories: (1) wearable video cameras smaller than a teacup that deliver stunning video quality and have powerful photo capture capabilities (comparable to those designed and marketed by global industry leader GoPro and numerous others) and (2) sophisticated camera-equipped copter drones that incorporate a company designed and assembled action-capture camera and that are sold to commercial enterprises for prices in the \$850 to \$2,000+ range. Global market demand for action cameras grows at the rate of 6 to 8 percent annually for the first five years and 4 to 6 percent annually for the second five years. Global market demand for commercial drones grows briskly at rates averaging 20 percent for the first two years, then gradually slows over eight years to a rate of 4 to 6 percent.

Companies assemble action cameras and drones of varying designs and performance capabilities at a Taiwan facility and ship finished goods directly to buyers in North



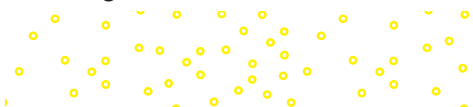


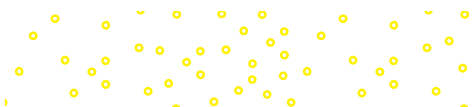
America, Asia-Pacific, Europe-Africa, and Latin America. Both products are assembled usually within two weeks of being received and are then shipped to buyers no later than two to three days after assembly. Companies maintain no finished goods inventories and all parts and components are delivered by suppliers on a just-in-time basis (which eliminates the need to track inventories and simplifies the accounting for plant operations and costs).

Company co-managers determine the quality and performance features of the cameras and drones being assembled. They impact production costs by raising/lowering specifications for parts/components and expenditures for product R&D, adjusting work force compensation, spending more/less on worker training and productivity improvement, lengthening/shortening warranties offered (which affects warranty costs), and how cost-efficiently they manage assembly operations. They have options to manage/control selling and certain other costs as well.

Each decision round, company co-managers make some 50 types of decisions relating to the design and performance of the company's two products (21 decisions, 10 for cameras and 11 for drones), assembly operations and workforce compensation (up to 8 decision entries for each product), pricing and marketing (7 decisions for cameras and 5 for drones), corporate social responsibility and citizenship (up to 6 decisions), and the financing of company operations (up to 8 decisions). In addition, there are 10 entries for cameras and 7 entries for drones involving assumptions about the competitive actions of rivals; these entries help company co-managers to make more accurate forecasts of their company's unit sales (so they have a good idea of how many cameras and drones will need to be assembled each year to fill customer orders). Each time co-managers make a decision entry, an assortment of on-screen calculations instantly shows the projected effects on unit sales, revenues, market shares, total profit, earnings per share, ROE, costs, and other operating outcomes. All of these on-screen calculations help co-managers evaluate the relative merits of one decision entry versus another. Company managers can try out as many different decision combinations as they wish in stitching the separate decision entries into a cohesive whole that is projected to produce good company performance.

Competition in action cameras revolves around 11 factors that determine each company's unit sales/market share:

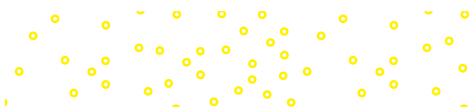
1. How each company's average wholesale price to retailers compares against the all-company average wholesale prices being charged in each geographic region.
 2. How each company's camera performance and quality compare against industry-wide camera performance/quality.
 3. How the number of week-long sales promotion campaigns a company has in each region compares against the regional average number of weekly promotions.
 4. How the size of each company's discounts off the regular wholesale prices during sales promotion campaigns compares against the regional average promotional discount.
 5. How each company's annual advertising expenditures compare against regional average advertising expenditures.
 6. How the number of models in each company's camera line compares against the industry-wide average number of models.
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7. The number of retailers stocking and merchandising a company's brand in each region.
 8. Annual expenditures to support the merchandising efforts of retailers stocking a company's brand in each region.
 9. The amount by which a company's expenditures for ongoing improvement and updating of its company's website in a region is above/below the all-company regional average expenditure.
 10. How the length of each company's camera warranties compares against the warranty periods of rival companies.
 11. How well a company's brand image/reputation compares against the brand images/reputations of rival companies.

Competition among rival makers of commercial copter drones is more narrowly focused on just nine sales-determining factors:

1. How a company's average retail price for drones at the company's website in each region compares against the all-company regional average website price.
2. How each company's drone performance and quality compare against the all-company average drone performance/quality.
3. How the number of models in each company's drone line compares against the industry-wide average number of models.
4. How each company's annual expenditures to recruit/support third-party online electronics retailers in merchandising its brand of drones in each region compare against the regional average.
5. The amount by which a company's price discount to third-party online retailers is above/below the regional average discounted price.
6. How well a company's expenditures for search engine advertising in a region compare against the regional average.
7. How well a company's expenditures for ongoing improvement and updating of its website in a region compare against the regional average.
8. How the length of each company's drone warranties in a region compares against the regional average warranty period.
9. How well a company's brand image/reputation compares against the brand images/reputations of rival companies.

Each company typically seeks to enhance its performance and build competitive advantage via its own custom-tailored competitive strategy based on more attractive pricing, greater advertising, a wider selection of models, more appealing performance/quality, longer warranties, a better image/reputation, and so on. The greater the differences in the overall competitiveness of the product offerings of rival companies, the bigger the differences in their resulting sales volumes and market shares. Conversely, the smaller the overall competitive differences in the product offerings of rival companies, the smaller the differences in sales volumes and market shares. This algorithmic approach is what makes *GLO-BUS* a "competition-based" strategy simulation and





accounts for why *the sales and market share outcomes for each decision round are always unique to the particular strategies and decision combinations employed by the competing companies.*

As with *BSG*, *all the various generic competitive strategy options*—low-cost leadership, differentiation, best-cost provider, focused low-cost, and focused differentiation—*are viable choices for pursuing competitive advantage and good company performance.* A company can have a strategy aimed at being the clear market leader in either action cameras or drones or both. It can focus its competitive efforts on one or two or three geographic regions or strive to build strong market positions in all four geographic regions. It can pursue essentially the same strategy worldwide or craft customized strategies for the Europe-Africa, Asia-Pacific, Latin America, and North America markets. Just as with *The Business Strategy Game*, *most any well-conceived, well-executed competitive approach is capable of succeeding, provided it is not overpowered by the strategies of competitors or defeated by the presence of too many copycat strategies that dilute its effectiveness.*

The challenge for each company's management team is to craft and execute a competitive strategy that produces good performance on five measures: earnings per share, return on equity investment, stock price appreciation, credit rating, and brand image.


All activity for *GLO-BUS* occurs at www.glo-bus.com.

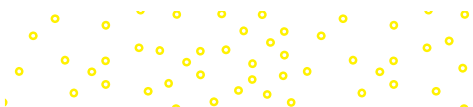
Special Note: The time required of company co-managers to complete each decision round in *GLO-BUS* is typically about 15 to 30 minutes less than for *The Business Strategy Game* because

- (a) there are only 8 market segments (versus 12 in *BSG*),
- (b) co-managers have only one assembly site to operate (versus potentially as many as 4 plants in *BSG*, one in each geographic region), and
- (c) newly assembled cameras and drones are shipped directly to buyers, eliminating the need to manage finished goods inventories and operate distribution centers.

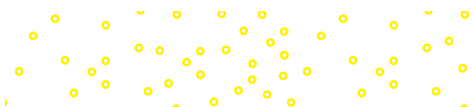
Administration and Operating Features of the Two Simulations

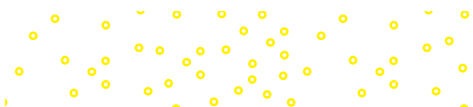
The Internet delivery and user-friendly designs of both *BSG* and *GLO-BUS* make them incredibly easy to administer, even for first-time users. And the menus and controls are so similar that you can readily switch between the two simulations or use one in your undergraduate class and the other in a graduate 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 those 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 the guide 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.
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- 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.
 - Each team member controls 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 each team member 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



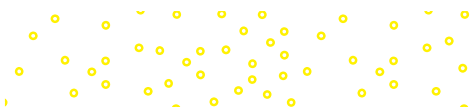


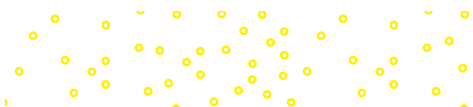
only to talk but also to enter Collaboration (highly recommended because all attendees are then viewing the same screen) have a red-colored mouse pointer linked to a red box labeled Instructor.

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 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.glo-bus.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 Seventh 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.

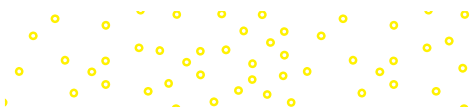
Two Sets of Chapter-End Exercises

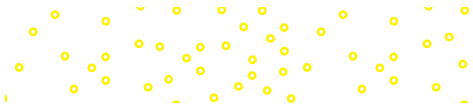
Each chapter concludes with two sets of exercises. The Assurance of Learning Exercises can be used as the basis for class discussion, oral presentation assignments, short written reports, and substitutes for case assignments. The Exercises for Simulation Participants are designed expressly for use by 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.

Connect

The seventh edition of *Essentials of Strategic Management* 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:

- Autograded chapter quizzes consisting of 20 multiple-choice questions that students can take to measure their grasp of the material presented in each of the 10 chapters.
- 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.



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- New integration of Exercises for Simulation Participants into *Connect*. Students are required to apply concepts presented in all 10 chapters to business simulation participation in both autograded and open-ended assignment questions.

The *Connect* package 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.

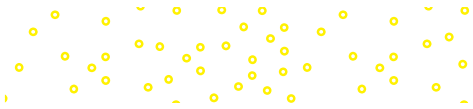
For Instructors

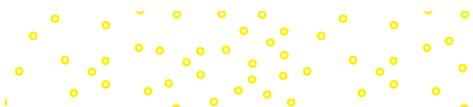
Connect

Connect's Instructor Resources includes an Instructor's Manual, Test Bank, PowerPoint slides, 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.
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- 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 Test Builder 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 Test Builder.

Available within *Connect*, Test Builder is a cloud-based tool that enables instructors to format tests that can be printed or administered within an LMS. Test Builder offers a modern, streamlined interface for easy content configuration that matches course needs, without requiring a download.

Test Builder allows you to:

- access all test bank content from this title.
- easily pinpoint the most relevant content through robust filtering options.
- manipulate the order of questions or scramble questions and/or answers.
- pin questions to a specific location within a test.
- determine your preferred treatment of algorithmic questions.
- choose the layout and spacing.
- add instructions and configure default settings.

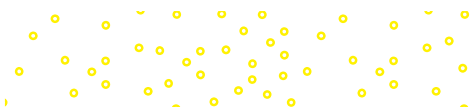
Test Builder provides a secure interface for better protection of content and allows for just-in-time updates to flow directly into assessments.

PowerPoint 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.

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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 athompson@cba.ua.edu, or margaret.a.peteraf@tuck.dartmouth.edu.

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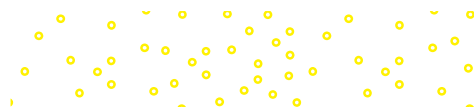
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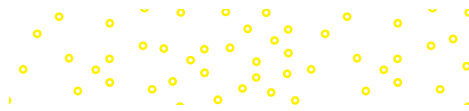
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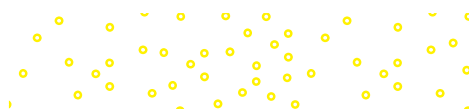


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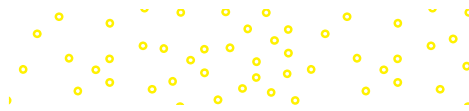
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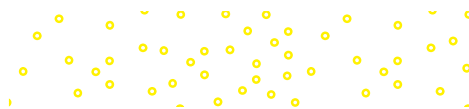


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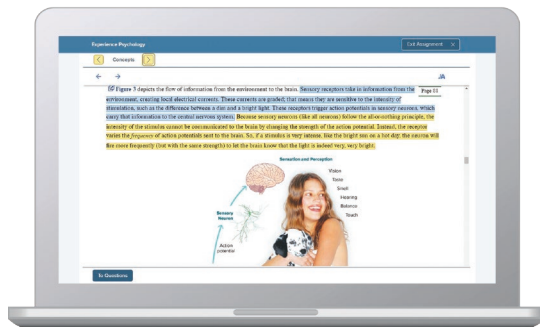
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Essentials of

Strategic Management

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STRATEGY, BUSINESS MODELS, AND COMPETITIVE ADVANTAGE

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.

A company’s **strategy** is the coordinated 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

CORE CONCEPT

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

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



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*.

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.

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

The Relationship Between a Company's Strategy and Business Model



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 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

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.

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 money-maker. 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

L01-4

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.
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,

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.

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 Apple has gained a competitive advantage through its strategy keyed to product innovation, brand image, and reputation for social responsibility. A creative, distinctive strategy such as that used by Apple 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.

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.

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 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.

CONCEPTS & CONNECTIONS 1.2

APPLE INC.'S STRATEGY AND SUCCESS IN THE MARKETPLACE

Apple Inc. is one of the most profitable companies in the world, with revenues of more than \$265 billion and net income of nearly \$60 billion in 2018. For more than 10 consecutive years, it has ranked number one on *Fortune*'s list of the "World's Most Admired Companies." Given the worldwide popularity of its products and services, along with its reputation for superior technological innovation and design capabilities, this is not surprising. The key elements of Apple's successful strategy include:

- **Designing and developing its own operating systems, hardware, application software, and services.** This allows Apple to bring the best user experience to its customers through products and solutions with innovative design, superior ease-of-use, and seamless integration across platforms. The ability to use services like iCloud across devices incentivizes users to join Apple's technological ecosystem and has been critical to fostering brand loyalty.
- **Continuously investing in research and development (R&D) and frequently introducing products.** Apple has invested heavily in R&D, spending upwards of \$11 billion a year, to ensure a continual and timely injection of competitive products, services, and technologies into the marketplace. Its successful products and services include the Mac, iPod, iPhone, iPad, Apple Watch, Apple TV, and Apple Music. It is currently investing in an Apple electric car and Apple solar energy.
- **Strategically locating its stores and staffing them with knowledgeable personnel.** By operating its own Apple stores and positioning them in high-traffic locations, Apple is better equipped to provide its customers with the optimal buying experience. The stores' employees are well versed in the value of the hardware and software integration and demonstrate the unique solutions available on its products. This high-quality sale and after-sale support allows Apple to continuously attract new and retain existing customers.
- **Expanding Apple's reach domestically and internationally.** Apple operates globally in 500 retail stores across 18 countries. During fiscal year 2017, 63 percent of Apple's revenue came from international sales.
- **Maintaining a quality brand image, supported by premium pricing.** Although the computer industry is incredibly price competitive, Apple has managed to sustain a competitive edge by focusing on its inimitable value proposition and deliberately keeping a price premium—thus creating an aura of prestige around its products.
- **Committing to corporate social responsibility and sustainability through supplier relations.** Apple's strict Code of Conduct requires its suppliers to comply with several standards regarding safe working conditions, fair treatment of workers, and environmentally safe manufacturing.
- **Cultivating a diverse workforce rooted in transparency.** Apple believes that diverse teams make innovation possible and is dedicated to incorporating a broad range of perspectives in its workforce. Every year, Apple publishes data showing the representation of women and different race and ethnicity groups across functions.

Note: Developed with Shawnda Lee Duvigneaud.
Sources: Apple 10-K, Company website.

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 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**.

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.

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 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*.

FIGURE 1.1

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

