Chapter 1
Strategic Management and Strategic Competitiveness

LEARNING OBJECTIVES

1. Define strategic competitiveness, strategy, competitive advantage, above-average returns, and the strategic management process.
2. Describe the competitive landscape and explain how globalization and technological changes shape it.
3. Use the industrial organization (I/O) model to explain how firms can earn above-average returns.
4. Use the resource-based model to explain how firms can earn above average-returns.
5. Describe vision and mission and discuss their value.
6. Define stakeholders and describe their ability to influence organizations.
7. Describe the work of strategic leaders.
8. Explain the strategic management process.

CHAPTER OUTLINE

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LECTURE NOTES

Chapter Introduction: You may want to begin this lecture with a general comment that Chapter 1 provides an overview of the strategic management process. This chapter introduces a number of key terms and models that students will study in more detail in Chapters 2 through 13. Stress the importance of students paying careful attention to the concepts introduced in this chapter so that they are well-grounded in strategic management concepts before proceeding further.

OPENING CASE
Alibaba: An Online Colossus in China Goes Global

China now has world's largest number of internet users and Alibaba is China's largest ecommerce company (23 percent owned by Yahoo and 36 percent by Japan's SoftBank). In 2014, when Alibaba completed its initial public offering (IPO) on the New York Stock Exchange, it immediately became worth more than Amazon and eBay combined, and has a larger market capitalization than Wal-Mart. Transactions of goods on Alibaba's websites account for more than two percent of China's GDP in 2012.

Teaching Note

To initiate discussion, ask how Alibaba has achieved strategic competitiveness as described in this chapter. In addition, ask students how Alibaba top management has used the strategic management process as the foundation for the commitments, decisions, and the actions they took to pursue strategic competitiveness and above-average returns.

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

DEFINING STRATEGY

Strategic competitiveness is achieved when a firm successfully formulates and implements a value-creating strategy. By implementing a value-creating strategy that current and potential competitors are not *simultaneously* implementing and that competitors are *unable* to duplicate, or find too costly to imitate, a firm achieves a ***competitive advantage***.

Strategy can be defined as an integrated and coordinated set of commitments and actions designed to exploit core competencies and gain a competitive advantage.

So long as a firm can sustain (or maintain) a competitive advantage, investors will earn above-average returns. ***Above-average returns*** represent returns that exceed returns that investors expect to earn from other investments with similar levels of ***risk*** (investor uncertainty about the economic gains or losses that will result from a particular investment). In other words, above average-returns exceed investors' *expected* levels of return for given risk levels.

> ***Teaching Note***
> Point out that in the long run, firms must earn at least average returns and provide investors with average returns if they are to survive. If a firm earns below-average returns and provides investors with below-average returns, investors will withdraw their funds and place them in investments that earn at least average returns. At this point it may be useful to highlight the role institutional investors' play in regulating above average performances.

In smaller new venture firms, performance is sometimes measured in terms of the amount and speed of growth rather than more traditional profitability measures - new ventures require time to earn acceptable returns.

A framework that can assist firms in their quest for strategic competitiveness is the ***strategic management process***, the full set of commitments, decisions and actions required for a firm to systematically achieve strategic competitiveness and earn above-average returns. This process is illustrated in *Figure 1.1*.

FIGURE 1.1
The Strategic Management Process

Figure 1.1 illustrates the dynamic, interrelated nature of the elements of the strategic management process and provides an outline of where the different elements of the process are covered in this text.

Feedback linkages among the three primary elements indicate the dynamic nature of the strategic management process: strategic inputs, strategic actions, and strategic outcomes.

- **Analysis**, in the form of information gained by scrutinizing the internal environment and scanning the external environment, are used to develop the firm's vision and mission.

- **Strategic actions** are guided by the firm's vision and mission, and are represented by strategies that are formulated or developed and subsequently implemented or put into action.

- Desired **performance** - strategic competitiveness and above-average returns - result when a firm is able to successfully formulate and implement value-creating strategies that others are unable to duplicate.

- **Feedback** links the elements of the strategic management process together and helps firms continuously adjust or revise strategic inputs and strategic actions in order to achieve desired strategic outcomes.

In addition to describing the impact of globalization and technological change on the current business environment, this chapter also discusses two approaches to the strategic management process. The first, the *industrial organization model,* suggests that the external environment should be considered as the primary determinant of a firm's strategic actions. The second is the *resource-based model*, which perceives the firm's resources and capabilities (the internal environment) as critical links to strategic competitiveness. Following the discussion in this chapter, as well as in Chapters 2 and 3, students should see that these models must be integrated to achieve strategic competitiveness.

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

THE COMPETITIVE LANDSCAPE

The ***competitive landscape*** can be described as one in which the fundamental nature of competition is changing in a number of the world's industries. Further, the boundaries of industries are becoming blurred and more difficult to define.

Consider recent changes that have taken place in the telecommunication and TV industries - e.g., not only cable companies and satellite networks compete for entertainment revenue from television, but telecommunication companies also are stepping into the entertainment business through significant improvements in fiber-optic lines. Partnerships further blur industry boundaries (e.g., MSNBC is co-owned by NBC, which itself is owned by General Electric and Microsoft).

The contemporary competitive landscape thus implies that traditional sources of competitive advantage - economies of scale and large advertising budgets - may not be as important in the future as they were in the past. The rapid and unpredictable technological change that characterizes this new competitive landscape implies that managers must adopt new ways of thinking. The new competitive mind-set must value flexibility, speed, innovation, integration, and the challenges that evolve from constantly changing conditions.

A term often used to describe the new realities of competition is ***hypercompetition***, a condition that results from the dynamics of strategic moves and countermoves among innovative, global firms: a condition of rapidly escalating competition that is based on price-quality positioning, efforts to create new know-how and achieve first-mover advantage, and battles to protect or to invade established product or geographic markets (discussed in more detail in Chapter 5).

The Global Economy

A ***global economy*** is one in which goods, services, people, skills, and ideas move freely across geographic borders.

The emergence of this global economy results in a number of challenges and opportunities. For instance, Europe is now the world's largest single market (despite the difficulties of adapting to multiple national cultures and the lack of a single currency. The European Union has become one of the world's largest markets, with 700 million potential customers.

Today, China is seen as an extremely competitive market in which local market-seeking MNCs (multinational corporations) fiercely compete against other MNCs and local low-cost producers. China has long been viewed as a low-cost producer of goods, but here's an interesting twist. China is now an exporter of local management talent. Procter & Gamble actually exports Chinese management talent; it has been dispatching more Chinese abroad than it has been importing expatriates to China.

> ***Teaching Note***
> The relative competitiveness of nations can be found in the World Economic Forum's *Global Competitiveness Report*, which can be accessed for free on the Internet. It is useful to assemble these data into an overhead or PowerPoint slide and show it in class. Students find it interesting to see where their country stands relative to the others listed. Allow enough time for them to see these numbers and sort out what it all means.

The March of Globalization

Globalization is the increasing economic interdependence among countries as reflected in the flow of goods and services, financial capital, and knowledge across country borders. This is illustrated by the following:

- Financial capital might be obtained in one national market and used to buy raw materials in another one.
- Manufacturing equipment bought from another market produces products sold in yet another market.
- Globalization enhances the available range of opportunities for firms.

Global competition has increased performance standards in many dimensions, including quality, cost, productivity, product introduction time, and operational efficiency. Moreover, these standards are not static; they are exacting, requiring continuous improvement from a firm and its employees. Thus, companies must improve their capabilities and individual workers need to sharpen their skills. In the twenty-first century competitive landscape, only firms that meet, and perhaps exceed, global standards are likely to earn strategic competitiveness.

Teaching Note

As a result of the new competitive landscape, firms of all sizes must re-think how they can achieve strategic competitiveness by positioning themselves to ask questions from a more global perspective to enable them to (at least) meet or exceed global standards:

- Where should value-adding activities be performed?
- Where are the most cost-effective markets for new capital?
- Can products designed in one market be successfully adapted for sale in others?
- How can we develop cooperative relationships or joint ventures with other firms that will enable us to capitalize on international growth opportunities?

Although globalization seems an attractive strategy for competing in the current competitive landscape, there are risks as well. These include such factors as:

- The "liability of foreignness" (i.e., the risk of competing internationally)
- Over-diversification beyond the firm's ability to successfully manage operations in multiple foreign markets

A point to emphasize: entry into international markets requires proper use of the strategic management process.

Though global markets are attractive strategic options for some companies, they are not the only source of strategic competitiveness. In fact, for most companies, even for those capable of competing successfully in global markets, it is critical to remain committed to and strategically competitive in the domestic market. And domestic markets can be testing grounds for possibly entering an international market at some point in the future.

Teaching Note
Indicate that the risks that often accompany internationalization and strategies for minimizing their impact on firms are discussed in more detail in Chapter 8.

Teaching Note
As a result of globalization and the spread of technology, competition will become more intense. Some principles to consider include the following:

- Customers will continue to expect high levels of product quality at competitive prices.
- Global competition will continue to pressure companies to shorten product development-introduction time frames.
- Strategically competitive companies successfully leverage insights learned both in domestic and global markets, modifying them as necessary.
- Before a company can hope to achieve any measure of success in global markets, it must be strategically competitive in its domestic market.

Technology and Technological Changes

Three technological trends and conditions are significantly altering the nature of competition:

- Increasing rate of technological change and diffusion
- The information age
- Increasing knowledge intensity

Technologic Diffusion and Disruptive Technologies

Both the rate of change and the introduction of new technologies have increased greatly over the last 15 to 20 years.

A term that is used to describe rapid and consistent replacement of current technologies by new, information-intensive technologies is ***perpetual innovation***. This implies that innovation - discussed in more detail in Chapter 13 - must be continuous and carry a high priority for all organizations.

The shorter product life cycles that result from rapid diffusion of innovation often means that products may be replicated within very short time periods, placing a competitive premium on a firm’s ability to rapidly introduce new products into the marketplace. In fact, speed-to-market may become the sole source of competitive advantage. In the computer industry during the early 1980s, hard disk drives would typically remain current for four to six years, after which a new and better product became available. By the late 1980s, the expected life had fallen to two to three years. By the 1990s, it was just six to nine months.

The rapid diffusion of innovation may have made patents a source of competitive advantage only in the pharmaceutical and chemical industries. Many firms do not file patent applications to safeguard (for at least a time) the technical knowledge that would be disclosed explicitly in a patent application.

Disruptive technologies (in line with the Schumpeterian notion of "creative destruction") can destroy the value of existing technologies by replacing them with new ones. Current examples include the success of iPods, PDAs, and Wi-Fi.

The Information Age

Changes in information technology have made rapid access to information available to firms all over the world, regardless of size. Consider the rapid growth in the following technologies: personal computers (PCs), cellular phones, computers, personal digital assistants (PDAs), artificial intelligence, virtual reality, and massive databases. These examples show how information is used differently as a result of new technologies. The ability to access and use information has become an important source of competitive advantage in almost every industry.

- There have been dramatic changes in information technology in recent years.
- The number of PCs is expected to grow to 2.3 billion by 2015.
- The declining cost of information technology.
- The Internet provides an information-carrying infrastructure available to individuals and firms worldwide.

The ability to access a high level of relatively inexpensive information has created strategic opportunities for many information-intensive businesses. For example, retailers now can use the Internet to provide shopping to customers virtually anywhere.

Increasing Knowledge Intensity

It is becoming increasingly apparent that knowledge - information, intelligence, and expertise - is a critical organizational resource, and increasingly, a source of competitive advantage. As a result,

- Many companies are working to convert the accumulated knowledge of employees into a

corporate asset;
- Shareholder value is increasingly influenced by the value of a firm's intangible assets, such as knowledge;
- There is a strong link between knowledge and innovation.

Note: Intangible assets are discussed more fully in Chapter 3.

> ***Teaching Note***
> This means that to achieve competitive advantage in the information-intensive competitive landscape, firms must move beyond accessing information to exploiting information by:
> - Capturing intelligence
> - Transforming intelligence into usable knowledge
> - Embedding it as organizational learning
> - Diffusing it rapidly throughout the organization

The implication of this discussion is that to achieve strategic competitiveness and earn above-average returns, firms must develop the ability to adapt rapidly to change or achieve strategic flexibility.

Strategic flexibility represents the set of capabilities - in all areas of their operations - that firms use to respond to the various demands and opportunities that are found in dynamic, uncertain environments. This implies that firms must develop certain capabilities, including the capacity to learn continuously, that will provide the firm with new skill sets. However, those working within firms to develop strategic flexibility should understand that the task is not an easy one, largely because of inertia that can build up over time. A firm's focus and past core competencies may actually slow change and strategic flexibility.

> ***Teaching Note***
> Firms capable of rapidly and broadly applying what they learn achieve strategic flexibility and the resulting capacity to change in ways that will increase the probability of succeeding in uncertain, hypercompetitive environments. Some firms must change dramatically to remain competitive or return to competitiveness. How often are firms able to make this shift? Overall, does it take more effort to make small, periodic changes, or to wait and make more dramatic changes when these become necessary?

STRATEGIC FOCUS
Starbucks is "Juicing" Its Earnings per Store through Technological Innovations

In 2015, Kevin Johnson, a former Chief Executive of Juniper Networks and 16 year veteran of Microsoft will take over as CEO of Starbucks succeeding Howard Schultz. Mr. Johnson has engaged with the company's digital operations and will supervise information technology and supply chain operations. 2014 Starbuck sales store operations have risen five percent in the latest quarter; this 5 percent came from increased traffic (two percent from growth is sales and three percent in increased ticket size). The driver of this increase in sales is mainly due to an increase in applications of technology. To facilitate this increase in sales per store, Starbucks has been ramping up its digital tools such as mobile-payment platforms.

Teaching Note
Firms that pay attention to technology-related trends are more likely to succeed in rapidly changing business environment. Technology-related trends and conditions can be placed into three categories: technology diffusion and disruptive technologies, the information age, and increasing knowledge intensity. Through these categories, technology is significantly altering the nature of competition and contributing to highly dynamic competitive environments as a result of doing so.

Two models describing key strategic inputs to a firm's strategic actions are discussed next: the Industrial Organization (or externally focused) model and the Resource-Based (or internally focused) model.

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

THE I/O MODEL OF ABOVE AVERAGE RETURNS

Teaching Note
The recommended teaching strategy for this section is to first discuss the assumptions underlying the I/O model. Then use *Figure 1.2* to introduce linkages in the I/O model and provide the background for an expanded discussion of the model in Chapter 2.

The I/O or Industrial Organization model adopts an *external* perspective to explain that forces outside of the organization represent the dominant influences on a firm's strategic actions. In other words, this model presumes that the characteristics of and conditions present in the external environment determine the appropriateness of strategies that are formulated and implemented in order for a firm to earn above-average returns. In short, the I/O model specifies that the choice of industries in which to compete has more influence on firm performance than the decisions made by managers inside their firm.

The I/O model is based on the following four assumptions:

1. The external environment - *the general, industry, and competitive environments impose pressures and constraints on firms and determine strategies that will result in superior returns*. In other words, the external environment pressures the firm to adopt strategies to meet that pressure while simultaneously constraining or limiting the scope of strategies that might be appropriate and eventually successful.

2. Most firms competing in an industry or in an industry segment control similar sets of strategically relevant resources and thus pursue similar strategies. This assumption presumes that, given a similar availability of resources, most firms competing in a specific industry (or industry segment) have similar capabilities and thus follow strategies that are similar. In other words, there are few significant differences among firms in an industry.

3. Resources used to implement strategies are highly mobile across firms. Significant differences in strategically relevant resources among firms in an industry tend to disappear because of resource mobility. Thus, any resource differences soon disappear as they are observed and acquired or learned by other firms in the industry.

4. Organizational decision-makers are assumed to be rational and committed to acting only in the best interests of the firm. The implication of this assumption is that organizational decision-makers will consistently exhibit profit-maximizing behaviors.

According to the I/O model, which was a dominant paradigm from the 1960s through the 1980s, firms must pay careful attention to the structured characteristics of the industry in which they choose to compete; searching for one that is the most attractive to the firm, given the firm's strategically relevant resources. Then, the firm must be able to successfully implement strategies required by the industry's characteristics to be able to increase their level of competitiveness. The *five forces model* is an analytical tool used to address and describe these industry characteristics.

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

Based on its four underlying assumptions, the I/O model prescribes a five-step process for firms to achieve above-average returns:

1. Study the external environment - general, industry, and competitive - to determine the characteristics of the external environment that will both determine and constrain the firm's strategic alternatives.

2. Locate an industry (or industries) with a high potential for returns based on the structural characteristics of the industry. A model for assessing these characteristics, the *Five Forces Model of Competition*, is discussed in Chapter 2.

3. Based on the characteristics of the industry in which the firm chooses to compete, strategies that are linked with above-average returns should be selected. A model or framework that can be used to assess the requirements and risks of these strategies (the *generic strategies are* called *cost leadership & differentiation)* are discussed in detail in Chapter 4.

4. Acquire or develop the critical resources - skills and assets - needed to successfully implement the strategy that has been selected. A process for scrutinizing the internal environment to identify the presence or absence of critical skills is discussed in Chapter 3. Skill-enhancement strategies, including training and development, are discussed in Chapter 11.

5. The I/O model indicates that above-average returns will accrue to firms that successfully implement relevant strategic actions that enable the firm to leverage its strengths (skills and resources) to meet the demands or pressures and constraints of the industry in which it has elected to compete. The implementation process is described in Chapters 10 through 13.

The I/O model has been supported by research indicating:

- 20% of firm profitability can be explained by industry characteristics
- 36% of firm profitability can be attributed to firm characteristics and the actions taken by the firm
- Overall, this indicates a reciprocal relationship - or even an interrelationship - between industry characteristics (attractiveness) and firm strategies that result in firm performance

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

THE RESOURCE-BASED MODEL OF ABOVE-AVERAGE RETURNS

Teaching Note

The recommended teaching strategy for this section is similar to that suggested for the I/O model. First explain the assumptions of the resource-based model. Then use

Figure 1.3 to introduce linkages in the resource-based model and provide the background for an expanded discussion of the model in Chapter 3.

The resource-based model adopts an *internal* perspective to explain how a firm's unique bundle or collection of internal resources and capabilities represent the foundation on which value-creating strategies should be built.

Resources are inputs into a firm's production process, such as capital equipment, individual employee's skills, patents, brand names, finance, and talented managers. These resources can be tangible or intangible.

Capabilities are the capacity for a set of resources to perform - in combination - a task or activity.

Teaching Note
Thus, according to the resource-based model, a firm's resources and capabilities - found in its internal environment - are more critical to determining the appropriateness of strategic actions than are the conditions and characteristics of the external environment. So, strategies should be selected that enable the firm to best exploit its core competencies, relative to opportunities in the external environment. One example of this is the experience of Amazon that used its capabilities to market and distribute books using the Internet successfully to capture a 20-month first-mover advantage in this new marketplace. However, Amazon’s capabilities may be imitable. In fact, many experts expect that Barnes & Noble will continue to be a formidable competitor due to its extensive resources.

Core competencies are resources and capabilities that serve as a source of competitive advantage for a firm. Often related to functional skilld, core competencies - when developed, nurtured, and applied throughout a firm - may result in strategic competitiveness.

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

The resource-based model of above-average returns is grounded in the uniqueness of a firm's internal resources and capabilities. The five-step model describes the linkages between resource identification and strategy selection that will lead to above-average returns.

1. Firms should identify their internal **resources** and assess their strengths and weaknesses. The strengths and weaknesses of firm resources should be assessed relative to

competitors.

2. Firms should identify the set of resources that provide the firm with **capabilities** that are unique to the firm, relative to its competitors. The firm should identify those capabilities that enable the firm to perform a task or activity better than its competitors.

3. Firms should determine the potential for their unique sets of resources and capabilities to outperform rivals in terms of returns. Determine how a firm’s resources and capabilities can be used to gain competitive advantage.

4. Locate an attractive industry. Determine the industry that provides the best fit between the characteristics of the industry and the firm’s resources and capabilities.

5. To attain a sustainable competitive advantage and earn above-average returns, firms should formulate and implement strategies that enable them to exploit their resources and capabilities to take advantage of opportunities in the external environment better than their competitors.

Resources and capabilities can lead to a competitive advantage when they are valuable, rare, costly to imitate, and non-substitutable.

- Resources are *valuable* when they support taking advantage of opportunities or neutralizing external threats.
- Resources are *rare* when possessed by few, if any, competitors.
- Resources are *costly to imitate* when other firms cannot obtain them inexpensively (relative to other firms).
- Resources are *non-substitutable* when they have no structural equivalents.

5 Describe vision and mission and discuss their value.

VISION AND MISSION

Teaching Note

Refer students to *Figure 1.1* that indicates the link or relationship between identifying a firm's internal resources and capabilities and the conditions and characteristics of the external environment with the development of the firm's vision and mission.

Vision

Vision is a picture of what the firm wants to be, and in broad terms, what it wants to ultimately achieve. Vision is "big picture" thinking with passion that helps people *feel* what they are supposed to be doing.

Vision statements:

- Reflect a firm's values and aspirations
- Are intended to capture the heart and mind of each employee (and hopefully, many of its other stakeholders)
- Tend to be enduring, whereas its mission can change in light of changing environmental conditions
- Tend to be relatively short and concise, easily remembered
- Rely on input from multiple key stakeholders

Examples of vision statements:

- *Our vision is to be the world's best quick service restaurant. (McDonald's)*
- *To make the automobile accessible to every American (Ford's vision when established by Henry Ford)*

The CEO is responsible for working with others to form the firm's vision. However, experience shows that the most effective vision statement results when the CEO involves a host of people to develop it.

A vision statement should be clearly tied to the conditions in the firm's external and internal environments and it must be achievable. Moreover, the decisions and actions of those involved with developing the vision must be consistent with that vision.

Mission

A firm's ***mission*** is an externally focused application of its vision that states the firm's unique purpose and the scope of its operations in product and market terms.

As with the vision, the final responsibility for forming the firm's mission rests with the CEO, though the CEO and other top-level managers tend to involve a larger number of people in forming the mission. This is because middle- and first-level managers and other employees have more direct contact with customers and their markets.

A firm's vision and mission must provide the guidance that enables the firm to achieve the desired strategic outcomes - strategic competitiveness and above-average returns - illustrated in *Figure 1.1* that enable the firm to satisfy the demands of those parties having an interest in the firm's success: organizational stakeholders.

Earning above-average returns often is not mentioned in mission statements. The reasons for this are that all firms want to earn above-average returns and that desired financial outcomes result from properly serving certain customers while trying to achieve the firm’s intended future. In fact, research has shown that having an effectively formed vision and mission has a positive effect on performance (growth in sales, profits, employment, and net worth).

6	Define stakeholders and describe their ability to influence organizations.

STAKEHOLDERS

Stakeholders are the individuals and groups who can affect and are affected by the strategic outcomes achieved and who have enforceable claims on a firm's performance.

Classification of Stakeholders

The stakeholder concept reflects that individuals and groups have a "stake" in the strategic outcomes of the firm because they can be either positively or negatively affected by those outcomes and because achieving the strategic outcomes may be dependent on the support or active participation of certain stakeholder groups.

***Figure Note*:** Students can use *Figure 1.4* to visualize the three stakeholder groups.

FIGURE 1.4
The Three Stakeholder Groups

Figure 1.4 provides a definition of a stakeholder and illustrates the three general classifications and members of each stakeholder group:
- Capital market stakeholders
- Product market stakeholders
- Organizational stakeholders

Note: Students can use *Figure 1.4* while you discuss the challenges of meeting conflicting stakeholder expectations.

Teaching Note
The following table was developed from the text’s presentation (and more) to assist

you in organizing a discussion of each stakeholder group's expectations or demands, potential conflicts, and stakeholder management strategies.

Stakeholder Groups, Membership and Primary Expectation or Demand

Stakeholder group	***Membership***	***Primary expectation/demand***
Capital market	Shareholders	Wealth enhancement
	Lenders	Wealth preservation
Product market	Customers	Product reliability at lowest possible price
	Suppliers	Receive highest sustainable prices
	Host communities	Long-term employment, tax revenues, minimum use of public support services
	Unions	Ideal working conditions and job security for membership
Organizational	Employees	Secure, dynamic, stimulating, and rewarding work environment

Teaching Note

From reviewing the primary expectations or demands of each stakeholder group, it becomes obvious that a potential for conflict exists. For instance, shareholders generally invest for wealth-maximization purposes and are therefore interested in a firm's maximizing its return on investment or ROI. However, if a firm increases its ROI by making short-term decisions, the firm can negatively affect employee or customer stakeholders.

If the firm is strategically competitive and earns above-average returns, it can afford to simultaneously satisfy all stakeholders. When earning average or below-average returns, tradeoffs must be made. At the level of average returns, firms must at least minimally satisfy all stakeholders. When returns are below average, some stakeholders can be minimally satisfied, while others may be dissatisfied.

For example, reducing the level of research and development expenditures (to increase short-term profits) enables the firm to pay out the additional short-term profits to shareholders as dividends. However, if reducing R&D expenditures results in a decline in the long-term strategic competitiveness of the firm's products or services, it is possible that employees will not enjoy a secure or rewarding career environment (which violates a primary union expectation or demand for job security for its membership). At the same time, customers may be offered products that are less reliable at unattractive prices, relative to those offered by firms that did not reduce R&D expenditures.

Thus, the stakeholder management process may involve a series of tradeoffs that is dependent on the extent to which the firm is dependent on the support of each affected stakeholder and the firm's ability to earn above-average returns.

Teaching Note

Stakeholder management has introduced some interesting notions into business practice. For example, business schools typically teach that there are three main stakeholder groups (owners, customers, and employees) and that they should be tended to in that order. That is, it is important to begin with the idea that the primary purpose of the firm is to maximize shareholder wealth (i.e., tend to the interests of the owners first). Then it is common to introduce notions such as, “The customer is always right.” This suggests that customer interests are to be tended to next. Finally, we get around to looking to the needs of employees, if resources make that possible. This is the standard approach, but some firms have turned this idea on its head. For example, Southwest Airlines has been extremely successful by taking great efforts to select the right employees and treat them well, which then spills over into appropriate treatment of the customer. As you might guess, the company assumes that these emphases will naturally lead to positive outcomes for stockholders as well (as has been the case). This issue can lead to interesting discussions with students about their thoughts on the topic.

STRATEGIC FOCUS
The Failure of BlackBerry to develop an Ecosystem of Stakeholders

In 2007 the Apple iPhone was introduced as a consumer product which became known as the smartphone. At the time, the dominant player in this category was Research in Motion (RIM) and later known as BlackBerry. As late as 2010, BlackBerry held 43 percent of the commercial and government communications sectors. Consumers soon realized the smartphone was a superior as far as utility. BlackBerry’s market share began to decrease precipitously. Because BlackBerry had remarkably loyal customers and a strong product, it failed to recognize the importance of Apple’s ecosystem innovation which allowed it to expand and diversify its range of applications for its handheld computers.

Teaching Note

BlackBerry’s big failure was that it did not pay attention to the complementary software that became available on other ecosystems. A big lesson is that managing supplier and stakeholder value creation also creates strong support from customers because it creates value for the all stakeholders and likewise draws financial capital and an associated increasing stock price. Discuss the classifications of stakeholders and why they're important.

7	Describe the work of strategic leaders.

STRATEGIC LEADERS

Teaching Note
One way of covering this section is through a series of questions and answers as presented in the following format.

Who are strategic leaders?

Although it depends on the size of the organization, all organizations have a CEO or top manager and this individual is the *primary* organizational strategist in every organization. `Small organizations may have a single strategist: the CEO or owner. Large organizations may have few or several top-level managers, executives, or a top management team. All of these individuals are organizational strategists.

What are the responsibilities of strategic leaders?

Top managers play decisive roles in firms' efforts to achieve their desired strategic outcomes. As organizational strategists, top managers are responsible for deciding how resources will be developed or acquired, at what cost, and how they will be used or allocated throughout the organization. Strategists also must consider the risks of actions under consideration, along with the firm's vision and managers' strategic orientations.

Organizational strategists also are responsible for determining *how* the organization does business. This responsibility is reflected in the ***organizational culture***, which refers to the complex set of ideologies, symbols, and core values shared throughout the firm and that influences the way it conducts business. The organization's culture is the social energy that drives - or fails to drive - the organization.

The Work of Effective Strategic Leaders

Though it seems simplistic, performing their role effectively requires strategists to work hard, perform thorough analyses of available information, be brutally honest, desire high performance, exercise common sense, think clearly, ask questions, and listen. In addition, strategic leaders must be able to "think seriously and deeply … about the purposes of the organizations they head or functions they perform, about the strategies, tactics, technologies, systems, and people necessary to attain these purposes and about the important questions that always need to be asked." Additionally, effective strategic leaders work to set an ethical tone in their firms.

Strategists work long hours and face ambiguous decision situations, but they also have opportunities to dream and act in concert with a compelling vision that motivates others in creating competitive advantage.

Predicting Outcomes of Strategic Decisions: Profit Pools

Top-level managers try to predict the outcomes of their strategic decisions before they are implemented, but this is sometimes very difficult to do. Those firms that do a better job of anticipating the outcomes of strategic moves will obviously be in a better position to succeed. One way to do this is by mapping out the profit pools of an industry. ***Profit pools*** are the total profits earned in an industry at all points along the value chain. Four steps are involved:

1. Define the pool's boundaries
2. Estimate the pool's overall size
3. Estimate the size of the value-chain activity in the pool
4. Reconcile the calculations

8 Explain the strategic management process.

THE STRATEGIC MANAGEMENT PROCESS

Teaching Note
The final section of this chapter reviews *Figure 1.1* (The Strategic Management Process), providing both an outline of the process and the framework for the next 12 chapters. Thus, students should refer back to *Figure 1.1* as you present the material to come next.

Chapters 2 and 3 provide more detail regarding the strategic inputs to the strategic management process: *analysis* of the firm's external and internal environments that must be performed so that sufficient knowledge is developed regarding external opportunities and internal capabilities. This enables the development of the firm's vision and mission.

Chapters 4 through 9 discuss the *strategy* formulation stage of the process. Topics covered

include:
- Deciding on business-level strategy, or how to compete in a given business (Chapter 4)
- Understanding competitive dynamics, in that strategies are not formulated and implemented in isolation but require understanding and responding to competitors' actions (Chapter 5)
- Setting corporate-level strategy, or deciding in which industries or businesses the firm will compete, how resources will be allocated, and how the different business units will be managed (Chapter 6)
- The acquisition of business units and the restructuring of the firm’s portfolio of businesses (Chapter 7)
- Selecting appropriate international strategies that are consistent with the firm's resources, capabilities and core competencies, and external opportunities (Chapter 8)
- Developing cooperative strategies with other firms to gain competitive advantage (Chapter 9)

The final sections of the text, Chapters 10–13, examine actions necessary to effectively implement strategies. Effective implementation has a significant impact on firm *performance*. Topics covered include:
- Methods for governing to ensure satisfaction of stakeholder demands and attainment of strategic outcomes (Chapter 10)
- Structures that are used and actions taken to control a firm's operations (Chapter 11)
- Patterns of strategic leadership that are most appropriate given the competitive environment (Chapter 12)
- Linkages among corporate entrepreneurship, innovation, and strategic competitiveness (Chapter 13)

Teaching Note

Students should realize that none of the chapters stand alone, just as no single step or facet of the strategic management process stands alone. If the strategic management process is to result in a firm being strategically competitive and earning above-average returns, all facets of the process must be treated as both interdependent and interrelated.

ANSWERS TO REVIEW QUESTIONS

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

Strategic competitiveness is achieved when a firm successfully formulates and implements a value-creating strategy.

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

A competitive advantage is achieved when a firm's current and potential competitors either are not able to simultaneously formulate and implement its value-creating strategy, are unable to duplicate the benefits of the strategy, or find the strategy too costly to imitate.

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

The ***strategic management process*** (see *Figure 1.1*) is the full set of commitments, decisions, and actions required for a firm to achieve strategic competitiveness and earn above-average returns.

2. What are the characteristics of the current competitive landscape? What two factors are the primary drivers of this landscape?

In the current competitive landscape, the nature of competition has changed. As a result, managers making strategic decisions must adopt a new mind-set that is global in orientation. Firms must learn to compete in highly chaotic environments that produce disorder and a great deal of uncertainty.

The two primary factors that have created the current competitive landscape are *globalization of industries and markets* and *rapid and significant technological change*. The implication for business firms is that to be successful, they must be able to meet or exceed global performance standards (in terms of such factors as quality, price, product features, speed to market) and be able to keep up with both the rapid pace of technological change as well as the rapid diffusion of innovation.

3. According to the I/O model, what should a firm do to earn above-average returns?

The I/O model suggests that conditions and characteristics of the external environment (the general, industry, and competitive environments) are the primary inputs to and determinants of strategies that firms should formulate and implement to earn above-average returns. Assumptions of the I/O model are that: (1) the external environment imposes pressures and constraints that determine which strategies will result in superior profitability, (2) most firms competing in an industry (or industry segment) control similar strategically relevant resources and pursue similar strategies in light of resource similarity, (3) resources used to implement strategies are highly mobile across firms, and (4) decision makers are assumed to be rational and committed to acting in the firm's best interests.

The I/O model thus challenges firms to seek out the industry (or industry segment) with the greatest profit potential and then learn how to use their resources to implement value-creating strategies given the structural characteristics of the industry.

4. What does the resource-based model suggest a firm should do to earn above-average returns?

The resource-based model assumes that each firm is a collection of unique resources and capabilities that provides the basis for its strategy and is the primary source of its profitability. It also assumes that over time, firms acquire different resources and develop unique capabilities. Thus, all firms competing within an industry (or industry segment) may not possess the same strategically relevant resources and capabilities. In addition, resources may not be highly mobile across firms.

Thus, the resource-based model challenges firms to formulate and implement strategies that allow the firm to best exploit its core competencies - capabilities that are valuable, rare, costly to imitate, and non-substitutable - relative to opportunities in the external environment. Resources and capabilities that meet the criteria of core competencies then serve as the basis of a firm's sustainable competitive advantage, enabling it to achieve strategic competitiveness and earn above-average returns.

5. What are vision and mission? What is their value for the strategic management process?

Vision is a picture of what the firm wants to be, and in broad terms, what it wants to ultimately achieve. Vision is "big picture" thinking with passion that helps people *feel* what they are supposed to be doing.

Strategic mission is externally focused and represents a statement of a firm's unique purpose and the scope of its operations in product and market terms. It provides general descriptions of the products a firm intends to produce and the markets it will serve using its internally based core competencies.

The differences between vision and mission are important because of their different focuses. However, they are both highly interdependent and add value to the strategic management process. The externally focused mission provides a sense of purpose for the firm by indicating the products to be provided to specific markets, while the internally set vision indicates what ultimately will be achieved. In other words, taken together, the vision and mission will provide a firm's managers with the insights needed to effectively formulate and implement the firm's strategies.

6. What are stakeholders? How do the three primary stakeholder groups influence organizations?

Stakeholders are individuals and groups who can affect and are affected by strategic outcomes achieved and who have enforceable claims on a firm's performance. In other words, stakeholders have a stake (or a vested interest) in the actions of the firm. Stakeholders can influence organizations because they have the ability to withhold participation that is essential to a firm's survival, competitiveness, and profitability. The three primary stakeholder groups are: (1) capital market stakeholders, e.g., shareholders, lenders, (2) product market stakeholders, e.g., customers, suppliers, host communities, unions, and (3) organizational stakeholders, e.g., employees, managers, and others.

There are many ways that stakeholders can influence organizations. For example, dissatisfied lenders can impose stricter covenants on subsequent borrowing of capital. Dissatisfied stockholders can reflect this sentiment through several means, including selling their stock (which can have a negative effect on its price). Dissatisfied employees can organize for collective bargaining. Dissatisfied community groups could express their disapproval by boycotting the firm's goods. Stakeholder groups each have ways of bringing their influence to bear on the firm.

7. How would you describe the work of strategic leaders?

Strategic leaders are people located in different parts of the firm using the strategic management process to help the firm reach its vision and mission. Regardless of their location in the firm, successful strategic leaders are decisive and committed to nurturing those around them and are committed to helping the firm create value for customers and returns for shareholders and other stakeholders.

Strategic leaders can be described as hard working, thorough, honest, questioning, visionary, persuasive, analytical, and decision makers. They also have a penchant for wanting the firm and its people to accomplish more.

The work of strategists includes scanning the environment - both internally and externally - to seek out information that will assist the firm in achieving its mission and satisfying its vision. Strategists would think about how the resources and capabilities of the firm could be nurtured and exploited to develop core competencies that would enable the firm to exploit environmental opportunities, achieve strategic competitiveness, and attain a competitive advantage that results in above-average returns.

8. What are the elements of the strategic management process? How are they interrelated?

The parts of the strategic management process (illustrated in *Figure 1.1*) are strategic inputs, strategic actions and strategic outcomes. *Strategic inputs* are represented by the firm's vision and mission that result from the assessment of the firm's resources, capabilities, and competencies and conditions in the external environment. These strategic inputs - vision and mission - drive the firm's *strategic actions* or the formulation and implementation of strategy. The strategic outcomes of successfully formulating and implementing value-creating strategies are *strategic competitiveness* and *above-average returns*. A feedback loop links strategic outcomes with strategic inputs.

ADDITIONAL QUESTIONS AND EXERCISES

The following questions and exercises can be presented for in-class discussion or assigned as homework.

Application Discussion Questions

1. Business success is often tied to effectively managed strategies. Using the Internet, study Starbuck's current performance. Based on analysis, do you judge Starbucks to be a success? Why or why not?
2. Choose several firms in your local community with which you are familiar. Describe the twenty-first century competitive landscape to them, and ask for their feedback about how they anticipate that the landscape will affect their operations during the next five years.
3. Select an organization (e.g., school, club, or church) that is important to you. Who are the organization's stakeholders? What degree of influence do you believe each has over the organization and why?
4. Are you a stakeholder at your university or college? If so, of what stakeholder group or groups are you a part?

5. Think of an industry in which you want to work. In your opinion, which of the three primary stakeholder groups is the most powerful in that industry today? Why? Which do you expect to be the most powerful group in five years? Why?
6. Do you agree or disagree with the following statement? "I think managers have little responsibility for the failure of business firms." Justify your view.
7. Do vision and mission have any meaning in your personal life? If so, describe it. Are your current actions being guided by a vision and mission? If not, why not?

Ethics Questions

1. Can a firm achieve a competitive advantage and, thereby, strategic competitiveness without acting ethically? Explain.
2. What are a firm's ethical responsibilities if it earns above-average returns?
3. What are some of the critical ethical challenges to firms competing in the global economy?
4. How should ethical considerations be included in analyses of a firm's internal and external environments?
5. Can ethical issues be integrated into a firm's vision and mission? Explain.
6. What is the relationship between ethics and stakeholders?
7. What is the importance of ethics for organizational strategists?

INSTRUCTOR'S NOTES FOR MINDTAP

Cengage offers additional online activities, assessments and resources inside MindTap, our online learning platform. The following activities can be assigned within MindTap for students to complete.

INSTRUCTOR'S NOTES FOR DIRECTED CASE

Directed Case exercises are a series of multiple choice questions designed to focus on the concepts from the chapter utilizing the case study analysis steps, such as gaining familiarity, recognizing symptoms, identifying goals, conducting the analysis, making the diagnosis and doing the action planning.

In order to prepare an oral/written case presentation, an effective case analysis should include general external environmental issues, issues relative to the firm's particular industry, and the firm's direct competitors. This analysis provides the insights needed to identify the firm’s strengths and weaknesses. You must then synthesize information gained from your analysis of the firm’s external environment and internal organization. This allows you to generate alternatives that can resolve significant problems or challenges facing the firm.

Equal Exchange

Equal Exchange is the largest company in the United States selling fair trade products exclusively. Equal Exchange is unique in its mission which is to pay its producers an above market price for their products out of a desire to provide stable income and to more equitably distribute the proceeds of the final sales.

Students will review these concepts:

- Developing a Vision and Mission
- Define Stakeholder Relationships
- Describe the work of Strategic Leaders
- Hypercompetition

INSTRUCTOR'S NOTES FOR EXPERIENTIAL EXERCISES

The Heart of Planning: A Non-profit Organization

In this student team exercise, students will practice analysis and strategy formulation portion of the strategic management process for a non-profit organization. Students will analyze your organizational stakeholders, develop a mission and vision and consider a strategic initiative. Students will have the opportunity to practice valuable strategic management skills, including research, critical thinking, and teamwork. Students have been asked to assist a local community non-profit organization with the development of a strategic plan. The organization has been operating for a few years supported by individual donors who are passionate about the mission and respect the founder. Most of the work of the organization has been done by volunteers and two full-time employees. The founder/executive director is ready to take it to the next level, and there has been request to extend their work for a greater impact. They believe there may be funding sources to support growth. The founder realizes that it is time to reexamine the organization’s vision, mission and strategic initiatives. The founder and Board of Directors want to be sure they’ve identified all of their stakeholders and developed plans to satisfy their needs and create value for them.

Students will be asked to:

- Develop a mission and vision
- Identify stakeholders
- Suggest a strategic initiative
- Prepare a strategic plan I the form of a 3-5 page executive summary and present a stakeholder analysis to the class.

INSTRUCTOR'S NOTES FOR VIDEO EXERCISES

The media quiz offers additional opportunities for students to apply the concepts in the chapter to a real-world scenario as it is described in news reports.

Title: **Lululemon Athletica**
RT: 3:07
Topic Key: Strategic Competitiveness, Strategy, Stakeholders, Strategic Leaders

Recently there was a takeover attempt of Lululemon Athletica, Inc. by its founder and previous chairman of the board, Chip Wilson. Chip was forced to resign as chairman because of his insensitive remarks aimed at his customers that caused a public outcry. At the time of the video, Chip is attempting to reclaim control over the company. The quiz will reinforce topics learned in this chapter, including stakeholder relationships, hostile takeovers, and board of director duties, while relating the to a real world situation.

Suggested Discussion Questions and Answers

- Which stakeholder group did the company fail to satisfy?
    - Primary customers were the least satisfied with this defective product and represent an important constituency among product market stakeholders.

  Stakeholders: The parties involved with a firm's operations can be separated into at least three groups. These groups are the capital market stakeholders (shareholders and the major suppliers of a firm's capital), the product market stakeholders (the firm's primary customers, suppliers, host communities, and unions representing the workforce), and the organizational stakeholders (all of a firm's employees, including both nonmanagerial and managerial personnel).

- The competitive landscape of the women's athletic apparel market is widening with Lululemon at the forefront. A hyper-competition is rising in this industry. The current influx could be due to what?
    - Globalization refers to a product of a large number of firms competing against one another in an increasing number of global economies. Lululemon is facing competition from other apparel and sports companies including Nike to Gap.

    - Hypercompetition: Under conditions of hypercompetition, assumptions of market stability are replaced by notions of inherent instability and change. Several factors create hypercompetitive environments and influence the nature of the current competitive landscape. The emergence of a global economy and technology, specifically rapid technological change, are the two primary drivers of hypercompetitive environments and the nature of today's competitive landscape.

- The strategic management process at Lululemon has been severely compromised with drops in stocks, negative media stories, and changes in leadership. Which part of the A-S-P process should Lululemon reconsider if it wants to truly understand the root of its challenges and determine the best path to stay ahead of emerging competitors?
    - Analyses are used to identify strengths and weaknesses in the internal and external company environment. The team should start here to help with developing strategies.