Strategic Management

A Practical Guide

Linda L. Brennan and
Faye A. Sisk

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—LLB

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—FAS

SECTION 1

Setting the Course of the Organization

To paraphrase Lewis Carroll's Cheshire Cat, "if you don't know where you are going, it does not much matter how you get there." In the same way, strategic management starts with defining a target.

CHAPTER 1

The Strategic Management Process

"The great virtue of free enterprise is that it forces existing businesses to meet the test of the market continuously, to produce products that meet consumer demands at lowest cost, or else be driven from the market. . . . Naturally, existing businesses generally prefer to keep out competitors in other ways."

—Milton Friedman

Opening Vignette

Richard Branson, the British billionaire, is arguably a man with style and vision who understands free enterprise and market forces. He recently dedicated Virgin Galactic's Spaceport America in New Mexico. The facility will be used as the base for his new space tourism venture. The plan is to conduct test flights through 2012, and begin offering commercial suborbital flights once the testing is completed and the Federal Aviation Administration licenses the company.

Branson knows how to leverage resources to build a business model and create a competitive advantage. He negotiated with the State of New Mexico to build the $209 million taxpayer-financed spaceport. Tickets, selling for $200,000 for a two and a half hour flight, are already being sold. And NASA has already signed a $4.5 million contract for up to three chartered research flights.

Based on a report from the Associated Press, reported on October 18, 2011, in *The Wall Street Journal*. Accessed November 4, 2011, at http:online.wsj.com.

It seems fitting that a book about strategy should provide a vision of the journey you will take through its pages. Ultimately, this is a book about achieving desired results in the marketplace, setting targets and reaching them in a competitive environment. If you want a theoretical perspective of strategy, you have the wrong book. *Principles and Practices of Strategic Mansgement* is designed to be a practical guide.

We will begin with a "helicopter view" of strategic management. You do not want to be in the clouds and only have a vague idea of what you are seeing from the airplane. You want to be high enough to get the big picture, but close enough to focus on some specific building blocks. As you proceed through the book, the chapters will land you closer so that you can see the details.

Now we want to establish a general framework and relate it to the organization of the book. Successful mastery of this material will enable you to:

- identify characteristics of a strategy
- describe the strategic management process
- understand the economics underlying competition
- define a business model
- identify different types of business models

Introduction

The term "strategy" is an endangered word. Unlike endangered animals that are over-hunted and are becoming scarce, endangered words are overused and are becoming vague. Go through a typical day and you will hear it used for a range of applications, e.g., "what's your strategy for getting this stain out," or "what's your strategy for finishing the report," or "what's your strategy to hire more people?" "Strategy" has been diluted to be synonymous with "plan."

Here is a simple definition: a strategy is a plan that creates or sustains a competitive advantage. Strategies are plans, but not all plans are strategies. The key difference is the focus on competition. If you are ahead of the competition, how are you going to stay (i.e., sustain) that way? If you are not, how are you going to create a strategy that meets the competition and creates an advantage?

Getting a stain out of your favorite jeans is probably not creating a competitive advantage. Finishing a report may be important, but generally does not create or sustain a competitive advantage. Likewise, hiring more people might be a good thing—and yes, you might be competing for scarce resources—but just hiring more people is not a good or a complete strategy.

Strategies are important. Not all important activities are strategic. For example, to be on an approved vendor list, your company might have to be ISO 9000-certified. That certification is certainly important, but is it strategic? To enter certain markets it may be, or it may not be, since your competitors can become (and possibly, already are) certified.

A strategy is a plan to create or sustain a competitive advantage. The plan may be long-term but does not have to be. In sports, competition is at the heart of any game. If you are a coach you may have a particular strategy going into a game, but as the team or individual faces the competition and deploys the strategy, you may find that you have to adjust it during a thirty-second time out.

Market conditions can also change quickly. It is not enough to just have a plan; the plan needs to be part of an overall process whereby the plan is developed, executed, adjusted, and evaluated. That process is what we call "strategic management."

Effective strategic management is characterized by 4 Ds: it is a Dynamic, Data-Driven process, led by Determined leaders.

Figure 1.1 Example of different smartphones

Illustration

An example of a dynamic company that is driven by data and sets the market through determination is Apple. Steve Jobs had the ability to "see" the future and set a strategy before major competitors could respond. A specific example was the ability of Apple with its iPhone to use technology and strategic partnerships with cell phone companies to usurp RIM, the leader in "smart phone" technology, and to replace the Blackberry as the singular choice in the wave of intelligent devices in cellular phones. The responses by both RIM and Google with alternative technologies and devices failed to offset the wave of consumer allegiance and the technological criteria established by Apple.

The Strategic Management rocess

A process is a sequence of activities intended to produce a desired result. Sometimes the sequence is straightforward and linear. Sometimes a sequence may be iterative, or require several repetitions and reworks, before it is successful. A good process has feedback mechanisms in place to ensure that the process is working.

In the same way, strategic management is a sequence of activities intended to produce a desired result. In general, the first activity is to define the desired result, or your vision of a successful state. As you improve your organization's competitive ability, what will that look like?

The next step is to put your vision in context. There are a lot of things, current and future, known and unknown, which can have a bearing on your ability to achieve your vision. You will want to survey the external environment to reduce the uncertainty in your planning.

Before you start identifying strategies, you will want to understand your starting position. That may sound unimportant, but if I want to drive cross-country to San Francisco, it makes a big difference if I am starting in Miami or if I am starting in Boston. You cannot develop strategies until you understand your current capabilities as well as your future needs, while recognizing what is happening around you.

Now you can start discussing strategies. You may have some over-arching, company-wide strategies; you may have divisional or

departmental initiatives that may or may not be strategic for the whole company. Strategies can be simple or can be quite complicated. Global efforts are complex. Stakeholder expectations can complicate matters.

You weigh your options and select your strategies. Now it is time for a reality check—do you really have a strategy? Will it work?

Strategic Execution

After you have validated the completeness of the strategy, it is time to start leading strategic execution. It takes a special kind of leader to get an organization mobilized for change, to execute the plans. A big part of execution is communication.

One way to clearly communicate is to be specific and to develop metrics or measurements. Measurement systems help employees to understand the vision in more concrete terms. They also help management to determine how well the organization is progressing toward the vision. Through measurement, you may determine that adjustments to the strategy are warranted, and you may need to reassess the environment, or use a different approach, or adjust the measurement system.

As we said before, strategic management is dynamic, it is data-driven, and it is intense. While the chapters of the book are presented in the sequence we have just described, the process does not always flow that smoothly. Before we begin the next chapter with defining the vision, we want to emphasize an important fundamental.

The Economics Underlying Competition

One of the key components of a sound strategy is its economic logic, or business model. There are a variety of different business models, or economic logic that answers the question, "how can we make money and compete by doing this," or "does the strategy make economic sense?" For example, like Netflix, you might want a steady stream of revenue, with regular payments by customers, such as licensing or subscription fees. n example of this type of model . Alternatively, your business model might be based on a low initial investment by customers, with profit coming from the ongoing use of the product or service. This approach is

exemplified by the replacement ink cartridges that cost far more than the initial outlay for a desktop printer.

Creating and sustaining a competitive advantage in business means that you need to make money now and in the future (Goldratt and Cox 1984). Understanding the economic logic to your company's ability to compete is a pre-requisite for strategic management. In the abstract, competitive advantage arises from an imperfection in the market system—either on the production or consumption side. The imperfections can be categorized as: information economics, inimitability considerations, preemptive conditions (e.g., lock-in), regulatory barriers, or market size versus investment cost (i.e., scale) (Goodman and Lawless 1994, pp. 29–31).

Anyone who has purchased a car has a sense of information economics. The more a buyer knows about the dealer's cost structure, the better the deal that the buyer is able to negotiate. In the case of home electronics (e.g., trying to figure out how to stream movies from the Internet onto my television), the harder or more costly it is for a consumer to get information about a desired capability, the more important firm reputation and friends' recommendations become. Some companies compete by making information readily available, such as Sears.com offers options to compare refrigerators side-by-side (and they do not have to be side-by-side refrigerators!). In this vein, Google has made a lot of money by selling the top of its lists' results. Its clients want to gain a competitive advantage by being at the top of the list.

Information imperfections can be a competitive advantage when one company knows how to do something valuable that its competitors do not. Patents or copyrights might protect this information. Sometimes the information asymmetry is also manifest as a first-mover advantage, as in the case of Apple Computer's iPhone; it might also make the company "in-the-know" harder to imitate, i.e., inimitable.

Inimitability arises from other situations as well. Instead of information, an organization might have exclusive access to a particular resource, such as land or mineral rights. Wal-Mart started by providing access to low-cost goods in remote locations. Oil-producing nations exert a great deal of power in this way.

Alternatively, the sequence of developments that led to inimitability might be hard to replicate, creating path dependency. One example might

be the Walt Disney Company, which started as a couple of artists making animations, one frame at a time, gradually building to full-length feature films that provided material for theme parks and merchandise. This subsequently generated enough cash to buy other media companies to create cross-marketing synergies.

Casual ambiguity is another source of inimitability: it may be unclear as to how a certain advantage was created. This is often the case when a strong corporate culture undergirds the delivery of goods and services. Southwest Airlines provides a distinctive flying experience, due in some part to the personality of its founder.

The economic logic behind preemptive conditions is essentially interfering with free markets. This might result from a contractual agreement, e.g., iPhones were only available for use on the AT&T network for the first five years of their availability. Preemptive conditions can also result from a "lock-in" situation, which makes switching to a competitor costly. In the information technology industry, companies create lock-in by having proprietary technologies, i.e., certain types of software only work with certain types of hardware. With open source code, international standards, and industry conventions, this type of lock-in is gradually declining.

Similarly, government regulations interfere with free markets. There are numerous ways in which this can happen. For example, tariffs might be used to create a domestic advantage over foreign imports. Government subsidies can make local products artificially more affordable, as has been the case with cotton in the United States and Africa.

Economies of scale are an easily identified source of competitive advantage. It can be too expensive to profitably enter a market and vie against existing competitors. We see this in capitalintensive industries, such as steel production. Pharmaceutical companies also face this challenge; as expensive as it is to develop a new drug or treatment, will there be enough of a demand to recoup the costs?

Illustration

The Coca-Cola Company, arguably the world's most recognized brand, has leveraged several different market imperfections in its history. The "secret formula" is an example of information asymmetry. The inimitability of

the company is somewhat path-dependent (Carpenter and Sanders 2009, pp. 82–83):

> *in order to build troop morale during World War II, General Dwight D. Eisenhower requested that Coca-Cola be available to all American servicemen and service women. To ensure that GIs could buy Coke for five cents a bottle, the government and Coca-Cola cooperated to build 64 bottling plants around the world.*

This unusual set of circumstances was amplified by the government subsidy that created an extensive international presence. Coke has continued to leverage this advantage and enjoys econo mies of scale against its competitors, even PepsiCo, on a global scale.

CHAPTER 2

Establish A Vision

Begin with the end in mind.

—Stephen Covey

Opening Vignette

Take a simple idea, prompted by a vision for social good, add entrepreneurial energy, stir gently, and soak overnight, and you have a recipe for a successful enterprise. TOMS Shoes started as such an idea. Blake Mycoskie, an entrepreneur from Texas, returned from a trip to Argentina where he witnessed poverty and the surprising number of people who were "shoeless," particularly children. Why did this trouble him?

From www.toms.com/our-movement/:

> *A leading cause of disease in developing countries is soil-transmitted diseases, which can penetrate the skin through bare feet. Wearing shoes can help prevent these diseases, and the long-term physical and cognitive harm they cause.*
>
> *Wearing shoes also prevents feet from getting cuts and sores. Not only are these injuries painful, they also are dangerous when wounds become infected.*
>
> *Many times children can't attend school barefoot because shoes are a required part of their uniform. If they don't have shoes, they don't go to school. If they don't receive an education, they don't have the opportunity to realize their potential.*

Based on B. Mycoskie and T. Schweitzer. "I'm so used to traveling that I can sleep anywhere." *Inc.* 32 no. 5 (2010): 112–114.

Founded in 2006, TOMS Shoes manufactures shoes inspired by the Argentine *alpargata* design. Through its *One for One* program and its nonprofit subsidiary and with the help of 501© nonprofits, for every pair of shoes sold, the company donates a pair of shoes to someone who is shoeless. The goal is not only to provide shoes but also to educate concerning shoes' health benefits. The company has given away 600,000 pairs of shoes, which sell from 45–65 USD in upscale stores.

In chapter 1, we saw that the strategic management process begins with defining a vision. In this chapter, we focus on vision statements. Successful mastery of this material will enable you to:

- distinguish between vision and mission statements
- explain what meaningful vision statements should and should not contain
- evaluate others' vision and mission statements
- define your desired end results

Introduction

When you plan a vacation, how do you start? If you are like most people, you start with an idea of the kind of vacation you want and refine that idea by selecting a destination. You have to know where you are going in order to figure out how to get there.

In the same way, in order to create and sustain a competitive advantage, an organization needs to define a future state that describes its ideal competitive position. Then the organization will be better situated to determine how to get to there by developing strategies that will move the organization in the right direction.

Meaningful visions provide coherence across an organization. A vision statement is a unifying concept for employees, managers, and executives to understand the strategic direction of the organization.

Collins and Portas (1991) emphasize the importance of a vision to unify a company and provide direction. In their work "Organizational Vision and Visionary Organizations," they identify the differentiation between companies that are driven by their visions from those that are not. They identify two components of a vision: a guiding philosophy and

a tangible image. They credit Thomas Watson, former CEO of IBM, with first understanding the importance of a guiding philosophy. These are Watson's words:

> *I firmly believe that any organization, in order to survive and achieve success, must have a sound set of beliefs on which it premises all its policies and actions. Next, I believe that the most important single factor in corporate success is faithful adherence to those beliefs. And, finally, I believe [the organization] must be willing to change everything about itself except those beliefs as it moves through corporate life. (p. 35)*

The tangible image provides a picture of what the company will look like when the vision is achieved. This image makes the intangible a tangible that once conceptualized can be achieved. The mission of a company should be more than the who, what, where, and why. It should also distinguish the firm and how it makes a *fundamental* difference in the lives of others, thus the difference between organizational vision and visionary organizations.

Illustration

Leadership is crucial in setting the direction of a company and in achieving the vision. When leaders fail in this very important objective, they sometimes "have to go." An example of this is the termination of Yahoo's CEO Carol Bartz, even though she had more than a year remaining on

Figure 2.1 Carol Bartz, former Yahoo! CEO

her contract. The reason given by the Board of Directors was that Ms. Bartz failed to accomplish the vision to reestablish Yahoo's predominance on the Internet (*Daily Technician* 2011).

Defining Visions and Missions

Like strategy, "vision" is also becoming an endangered word, often overused and vague. Naysayers think defining a vision is a waste of time. If it is not done well, than it probably is a waste of time!

So, let's start with distinguishing between a vision and a mission. A vision is a desired future state. For an organization, that state describes its competitive position at some time in the future.

A mission statement describes the organization's current state. It defines what the business is, not necessarily what it will become. In essence, a mission statement describes the scope and purpose of the organization, as it is, in terms of what it does in the present, for whom and where.

Illustration

Netflix, Inc., in their 2010 proxy statement for the Securities and Exchange Commission (SEC), described their vision in terms of the future and their mission in terms of the business's scope:

> *We believe delivery of entertainment video over the Internet will be a very large global market opportunity, and that our focus on one segment of that market—consumer-paid, commercial-free streaming subscription of TV shows and movies—will enable us to continue to grow rapidly and profitably.*
>
> *With 20 million subscribers as of December 31, 2010, Netflix, Inc. ("Netflix", "the Company", "we", or "us") is the world's leading Internet subscription service for enjoying TV shows and movies. Our subscribers can instantly watch unlimited TV shows and movies streamed over the Internet to their TVs, computers and mobile devices and, in the United States, subscribers can also receive standard definition DVDs, and their high definition successor, Blu-ray discs (collectively referred to as "DVD"), delivered quickly to their homes.*

Shaping Meaningful Visions

What makes something meaningful to you? The way it is presented or how you experience it? That it is heartfelt? How it influences your thinking or actions?

A vision statement is meaningful if it matters to the organization. For it to matter, it should be clear, compelling, and concise to everyone in the company. The vision should also be complete enough to guide decision-making and operational activities, and it must be to the point. Increasingly, vision statements also address the social responsibility of the organization to its stakeholders and the environment. This is a topic that we will explore in later chapters.

To be *clear*, the vision should be communicated frequently, in a variety of media, to all levels of the organization. Clarity also comes from the use of concrete language, not from abstract ideas. Vagueness sands the clarity off of a vision (Stanley 2006). For a vision to be clear it must be understood and stated in a way that is easily understood. It cannot be vague or subject to interpretation.

To be *compelling*, a vision statement should be aspirational and attainable. Too much ambition is daunting. Not enough ambition supports inertia.

To be *complete*, there should be ways to gauge progress toward the vision. Sometimes, the vision is accompanied with goal statements that have measurable outcomes. They can also contribute to the clarity of the vision.

And to be *concis*e, a meaningful vision contains only words that are necessary for it to matter. Sentence structure should be simple. Concise does not prescribe a specific length, although shorter statements tend to be more memorable.

Illustration

According to Amazon.com (see www.amazon.com investor relations),

> *Our vision is to be earth's most customer-centric company; to build a place where people can come to find and discover anything they might want to buy online.*

Do you find it *clear*? *Compelling*? *Complete? Concise*? For the most part, it is. What does it mean to be "customer-centric?" As an Amazon customer, you may have the sense that customer-centric means that your online shopping experience is customized to you; another person, with different interests and purchasing history, will see a different version of Amazon.

Amazon's mission is "to be Earth's most customer-centric company for three primary customer sets: consumer customers, seller customers, and developer customers." (At least for now; wait until they start streaming content to the moon!) The description of what Amazon does is implicit; they will sell anything to anyone who is a customer, and they will make it easy for customers to buy. While there is some overlap in the mission and vision statements, you can see that the vision statement is clearly future oriented and aspirational.

According to another company's[1] website, "Our vision is to be the world leader in transportation products and related services. In order to achieve this vision, we recognize that many issues must be addressed and many goals attained. It is imperative that economic, environmental and social objectives be integrated into our daily business objectives and future planning activities so that we can become a more sustainable company." Clear? The term "related services" is vague. In general, the word choice is not very concrete. Compelling? Becoming a "world leader" is certainly aspirational, but there is also reference to "many issues that must be addressed." Concise? Because the statement is so vague, it is hard to say. Complete? It is too broad to be helpful in guiding the company, which has struggled in recent years. How would you improve this statement?

Avoiding Visioning Pitfalls

There are plenty of bad vision statements around. What makes them bad? The primary reason is that they don't matter to their organizations. Another is that the words do not compel. The statements may be trite, vague, poorly written, overly wordy, flowery, uninspiring, or even overwhelming. Baldoni (2006, p. 3) suggests that, "to craft a meaningful

[1]General Motors website, www.gm.com.

vision, leaders must strike a careful balance between ambition and actionability, grandeur and simplicity."

Collins and Portas (1991, p. 51) caution against the myth that "building a visionary organization requires the presence of a charismatic leader who is somehow blessed with super-human mystical visionary skills . . . the leader is to catalyze a clear and shared vision of the organization and to secure commitment to and vigorous pursuit of that vision." Visionary organizations are able to create a preferred future, rather than be simply reactive to future events.

While editing "by committee" can be a painful experience, it is a good idea to involve other people in the visioning process. Multiple perspectives can enhance clarity and provide a reality check on aspirations. Having a critical mass of people who understand and support the vision will also help communicate the vision and broaden the support required for the future state of the vision to be reached.

It is also important to revisit the vision and mission statements periodically. While you may not expect them to change, it is certainly possible that the organization's focus may have softened or shifted altogether. Crotts et al. (2005) suggest an audit process to ensure organizational processes support mission and vision. This audit can be part of the strategic management process on an ongoing basis.

SECTION 2

Environmental Issues: The Organization in Context

You cannot compete in a vacuum. A strategy might work in one context, but not another. In this section, we examine the facts that contribute to an organization's context, looking for the "weather" ahead.

CHAPTER 3

Governance and Social Responsibility of the Firm

There is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.[1]

—Milton Friedman

Opening Vignette

What is the value of a company's mission, or more importantly, what is the significance of a company's value system? What is a company creed? Just ask Johnson & Johnson about the importance of their *Credo to corporate success and in directing company strategy.*

The J&J *Credo (*http://www.jnj.com/connect/about-jnj/jnj-credo/) was written by Robert Wood Johnson, former Chairman (1932–63) and a member of the company's founding family. The *Credo, its development, and its influence on the company's value system occurred long before "corporate social responsibility" came into vogue.*

The Credo is a recipe for business success. The fact that J&J is one of only a handful of companies that have flourished for more than a century of change is proof. The Credo drives every dimension of company

---

[1] Milton Friedman quoted in Chemtech (February 1974): 72, and found in Patrick & Charnov, Management, 2/e. Barron's Educational Series.

Based on P. Jones and L. Kahaner. *Say It and Live It: The 50 Corporate Mission Statements That Hit the Mark.* New York, NY: Doubleday, 1995. Accessed online at http://www.kahaner.com/johnson_johnson.shtml

performance, from research and development (R&D) decisions to responses to customers. It provides a clear roadmap to direction and decision-making. There are no deviations. Consider when J&J pulled the thousands of Tylenol® bottles from shelves. There was no question; the Credo was the answer.

More recently, J&J is seemingly on a detour around the Credo. According to The Wall Street Journal,2 J&J and the Justice Department are close to settling a protracted investigation into the company's promotion of the antipsychotic Risperdal, for what would be one of the highest sums to date in a drug-marketing case. . . . A settlement could allow J&J to finally move past the probes and litigation as new CEO Alex Gorsky tackles other pressing issues, including manufacturing problems that led to several product recalls. . . In last year's fourth quarter, J&J . . . took a $1.1 billion charge to cover potential legal settlements. To further bolster its legal reserves the company announced . . . setting aside an additional $600 million. . ." With so much running against the company's value system, if Mr. Johnson were alive, he might be reaching for a dose of Risperdal.

After defining the corporate vision, the next question is how to achieve the vision. In later chapters we will examine a variety of different strategies that companies follow as paths to the vision. In this chapter we will examine the question of how the organization will interact with its various stakeholders. Specifically, this chapter explains corporate social responsibility and the importance of governance in strategic planning. With greater demands for accountability by stakeholders, companies must be intentional and specific about their corporate policies, values, and consideration for their stakeholders. Upon successful completion of this chapter you should be able to:

- define corporate governance and social responsibility (CSR)
- identify ways to protect the interests of shareholders
- identify the drivers that are raising the importance of companies' CSR policies
- explain governance and its role in company strategic planning

In addition, companies that decide to become "strategically responsible" may drive competitors to include sustainability concerns in their

strategic plans as they compete for financial resources from the investment community as well as field questions from stakeholders, including customers and suppliers.

Introduction

Corporate governance is the area of study that addresses who makes decisions, how they are made, and why. Topics include: policies, controls, regulations, stakeholder relationships, corporate responsibility, ownership structure, and incentive systems. As you might imagine, these topics have a profound impact on the results an organization achieves.

Corporate governance is a fairly recent concern. In early civilizations, authority was generally quite clear; he who owned the resources made the decisions. Military hierarchies followed a command and control model. Owners ran their own business enterprises, sometimes referred to as "cottage industries."

During the Industrial Revolution, organizations became larger, joint-stock ownership became possible, and a managerial class (i.e., educated, but not wealthy) emerged. As a result, stock-holding owners did not necessarily manage the day-to-day operations of the companies in which they were invested. However, as investors, they wanted assurance of getting a return on their investments. The difficulty was that because of self-interest, owners' and managers' interests did not always coincide.

Therefore, corporate governance policies and procedures were established to protect the investors' interests. In those days, the only social responsibility of the firm was to make money for its stockholders, without violating the law. Economic thinking was that the markets would correct for anti-social behavior; employees would leave for better working conditions, and customers would buy from suppliers they liked and respected. The stock price, as a predictor of future earnings, would therefore implicitly incorporate these types of concerns. The challenge, then, was to align owners' and managers' (also called "agents") interests so that decision-making served the stockholders' interests.

[2]Posted in the WSJ Health Industry column on June 20, 2012, by Jonathan D. Rockoff and Joann S. Lublin at http://online.wsj.com.

Protecting the Interests of Stockholders

Governance protects the stockholders' interests through controls, oversight, and incentives. These methods have evolved, and the expectation of corporate accountability has grown commensurately.

Controls can be implemented with procedural methods. For example, think about how a large company orders its materials for manufacturing. Based on sales forecasts and production schedules, a purchasing agent with an "authority to approve" will place an order for a shipment of materials. When that shipment arrives, the receiving clerk verifies that the bill of lading accurately represents what is in the shipment. The purchasing agent will also inspect the bill of lading to ensure that it matches what was ordered. The next control in the process is comparison of the invoice to the order and the delivery. If all is in order, then payment is remitted. Depending on the amount to be paid, multiple signatures may be required. These procedures are intended to prevent fraud.

Computerized controls can also deter fraud and prevent mistakes. Data "masks" (i.e., specifications of allowable content and format of data entry) can ensure that data are entered fully and correctly. Reconciliation reports can compare general ledger accounts with transactions recorded each day. Database systems can provide different levels of access (e.g., view, alter) to different areas of data (e.g., payroll, order entry), based on the needs of the business.

Oversight in governance comes in many forms: internal and external auditors, boards of directors, and government agencies. Internal auditors check that the controls in place are followed and adequate. External auditors are concerned that the accounting statements accurately and fully reflect the state of the business in the company's report to stockholders. The key is to have truly independent auditors. An example of this lack of independence was Arthur Andersen's culpability in Enron's misrepresentations due to its role as both auditor and consultant to the firm.

As representatives of the shareholders, a committed and involved Board of Directors can also provide oversight, generally at a more strategic level. Typically a board, comprised of inside (employee) and outside (independent) directors, works on matters such as Chief Executive Officer (CEO)

selection, executive compensation, review of strategic plans and financial performance, and provision of counsel and advice to management.

However, board members tend to be busy people running their own organizations, so the need to be committed, involved, and informed may be a higher standard than can realistically be met. Also, there have been issues with board interlock, i.e., when members of various boards overlap. The integrity of the oversight is comprised. For example, Sandy is CEO of company A and on the Board's compensation committee for company Z, while Teddy is the CEO of Z and on the Board's compensation committee for A.

The last type, and arguably the last defense, of governance oversight comes from regulatory bodies, such as the Securities and Exchange Commission (SEC) in the United States. Reporting requirements, accounting conventions, and fiduciary laws all shape corporate governance. Unfortunately, though, regulations tend to be lagging indicators of issues in governance; they are the proverbial "barn doors" that shut after the horses have been stolen. Toffler (2003, p. 36) laments, "the sad fact is that all the oversight in the world is not going to change what happens behind company doors."

Perhaps the most effective or at least the most proactive tool of corporate governance is incentive systems that are intended to guarantee that the goals of the agents and the shareholders are aligned. That is, executives are rewarded for good performance in both the short- and long-term. Variable compensation, bonuses, and stock options are ways to increase the stake that the managers have in the shareholders/owners' business. Unfortunately, it may also encourage managers to engage in market manipulation, as we have seen in the reported financial malfeasance of companies such as Tyco, Enron, Global Crossing, and HealthSouth. Failures in corporate governance are not unusual, nor are they a solely an American problem. Nor are they likely to be solved until cost and benefit imbalances are righted.

Drivers of Increased Corporate Social Responsibility

While governance has been a concern since the industrial revolution and the advent of joint stock ownership, the emphasis on corporate social responsibility (CSR) is a more recent development. With the availability of 24/7 news cycles, the ability of social media to "go viral," and the

increasing concern about depleting the planet's resources, the forces driving corporations toward CSR are inexorable. You have unprecedented access to information about corporate performance. You have new channels of communication to build a coalition around issues. You have heightened awareness of your dependence on fossil fuels, your usage of non-renewable resources, and your access to alternative approaches.

Moving from the Industrial Age into the Information Age, the expectations of corporations and their roles in society are changing. Globalization and technology have provided a greater awareness of what companies are doing and what impact those actions have. With increased transparency comes increased accountability. Markets are more responsive to social and environmental considerations. Employment practices, environmental impact, community engagement, and fiscal governance are under examination by shareholder activists and other stakeholders. As shown in Figure 3.1, stakeholders are people who have a stake (personal, financial, and/or altruistic) in the actions of a firm. Corporate Social Responsibility (CSR) is the extent to which an organization holds itself accountable to stakeholders, in addition to shareholders.

Illustration

Accountability may be a defensive measure in response to stakeholder scrutiny. And scrutiny it is—most of us can envision the underwater video of gushing crude during the British Petroleum (BP) oil spill in the

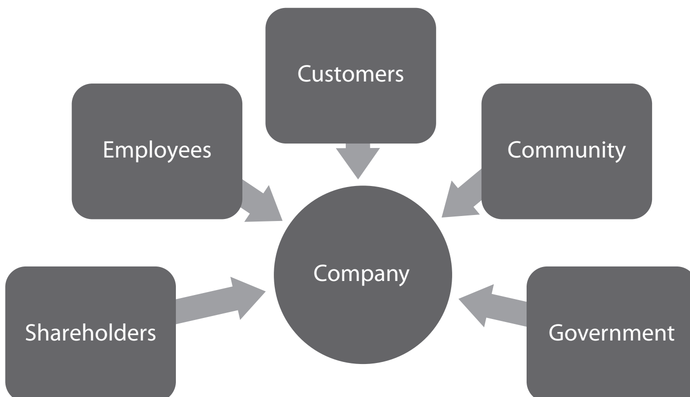

Figure 3.1 Stakeholder Model

Gulf of Mexico in 2010. Since then, the accountability demanded of BP has been fierce. The United States government imposed fines, with a restoration fund mandated. The CEO was fired because of shareholder and board dissatisfaction with his handling of the situation. Suppliers were impacted because there was an injunction against deep-sea drilling. Customers, the gas stations' owners, had to advertise to explain to consumers that the gas stations were independent entities of BP, and boycotting BP gas was hurting the local owners, not BP corporate. In this case, you can clearly see the stake that a community has in a corporation's activities. Health hazards, environmental damage, and livelihoods lost were serious and widespread concerns in this case.

Intentional Approaches to CSR

It has been often said in sports that the best defense is a good offense. The same may be said of corporate social responsibility and strategic management. Being intentional about the corporation's relationships with its stakeholders will go a long way to handling difficult situations—and the situations are only going to become more difficult.

The web of accountability is increasing in complexity. You are not only responsible for how and what you produce, but also how it is used and discarded. In this world of global supply chains, that is a lot of responsibility.

In addition, the stakes are growing higher. Mistakes can have catastrophic consequences. Consider the consequences experienced by the astronauts on the Challenger shuttle who relied on rubber "O-rings" that had not been tested at low launch temperatures. Or, think about the employees of Enron who no longer have retirement savings and have lost their homes. In both cases, those affected were relying on the social responsibility of the agents making the decisions.

It seems clear that with the stakes so high, a company has no choice but to be intentional about its commitment to CSR. There is a range of possible choices, starting with the social obligation approach (i.e., maximize shareholder's ROI and do not violate the law). Many organizations now engage in philanthropy, donating funds and resources to social causes. While admirable, philanthropy can be viewed as public relations.

Enlightened self-interest is a level of CSR that provides a social or environmental benefit that also is strategic for the company involved. For example, the Internet service provider (ISP) America Online (AOL) sponsored a project to extend Internet access to rural and other underserved areas. The communities benefited from crossing the digital divide (the education disparity between served and underserved areas) and AOL benefited from a new set of loyal customers (Brennan and Johnson 2003).

Social responsiveness is similar to enlightened self-interest, but has a broader impact. For example, several years ago, Starbucks was excoriated for buying coffee beans from plantations with horrible working conditions and sub-standard wages. The company has since led the vanguard for ethical sourcing, with a goal to ensure 100% of their coffee is from ethical sources by 2015:

> *We define ethical sources as coffee that is third-party verified or certified, either through C.A.F.E. Practices, Fairtrade, or another externally audited system . . . 84% of our coffee was sourced under C.A.F.E. Practices in 2010, up from 81% in 2009. (Starbucks 2010)*

The most emphatic commitment to corporate social responsibility comes from social entrepreneurs: people who start a business to address a social cause with a self-sustaining business model. Social causes range from public health, safety, literacy, and empowerment to economic or infrastructure development.

Illustration

One of the earliest examples of this business model was in the area of micro-finance, i.e., lending money in small amounts to empower poor people. With the earnings they are able to achieve, they pay back the money with interest.

> *The origin of Grameen Bank can be traced back to 1976 when Professor Muhammad Yunus, Head of the rural Economics Program at the University of Chittaagong, launched an action research project to examine the possibility of designing a credit delivery system to provide*

> *banking services targeted at the rural poor. The Grameen Bank Project (Grameen means "rural" or "village" in Bangla language) came into operation with the following objectives: extend banking facilities to poor men and women; eliminate the exploitation of the poor by money lenders; create opportunities for self-employment for the vast multitude of unemployed people in rural Bangladesh; bring the disadvantaged, mostly the women from the poorest households, within the fold of an organizational format which they can understand and manage by themselves; and reverse the age-old vicious circle of "low income, low saving & low investment", into (sic) virtuous circle of "low income, injection of credit, investment, more income, more savings, more investment, more income. (Grameen Bank 2011)*

Professor Yunnus was named a Nobel Laureate in 2006.

CHAPTER 4
Sustainability

I never had given a thought as to how I was affecting the environment.
—Ray Anderson, CEO, Interface

Opening Vignette

Nau (pronounced "now") is a designer/retailer of "sustainable urban+outdoor apparel." Based in Portland, Oregon, the company was founded by executives of other apparel manufacturers. According to their website (www.nau.com), they wanted to "redesign fashion and to redefine business so that each become a powerful force for change."

To those ends, they have several unique business practices. First, they design their clothing for sustainability, avoiding trendy colors and using long-lasting fabrics that do not require dry cleaning and can be washed in cold water. As they describe it, "We design for lasting beauty—product colors, details, and shapes are minimalist, modern, and timeless."

They also handle logistics differently. Customers visit a Nau store, try on the items, and determine what sizes are needed—and then receive their orders directly from the distribution center. This allows Nau to have smaller store space (they only need one of each product in every size—no other inventory), reduces returns, eliminates cross-shipments, and requires less transportation overall. Nau uses recycled shipping materials, energy efficient transportation modes, and supply chain visibility to minimize the life cycle cost of its goods.

In addition, while fabrics are not strictly speaking, sustainable, Nau makes fabric selections based on what it calls a "Beginning of Life and End of Life (BOL/EOL) model that examines the "energy and resources to create a fabric, and the opportunities and systems to deal with a product at the end of its useful life." It has a restricted substances list to avoid toxins and uses systems to trace the fibers and fabrics for its products.

One other interesting practice: Nau donates 2% of every sale to one of five strategic partners for change. During the checkout process, the customer selects the recipient. Options are Ashoka, an organization that promotes social entrepreneurship; Breakthrough Institute, a think tank devoted to affordable clean energy; Ecotrust, a venture capital firm dedicated to "building resilient economies;" Kiva, a microlending cooperative; and Mercy Corps, a relief organization.

Something that Nau did that is *not* recommended as a good business practice is going out of business. Founded in 2003, it closed its doors and sold off its inventory in 2008. "The irony of Nau's demise is that a company so committed to sustainability was ultimately unsustainable. But not because of its principles."[1] Overexpansion and overspending were its downfall. They were purchased and relaunched in 2009 and are now growing more slowly, even . . . organically.

Stockholders and stakeholders are important factors for understanding the context in which an organization operates. In this chapter, we develop the context further by understanding sustainability, from stockholders' *and* stakeholders' perspectives. Will an effective execution of a strategic plan assure that the company will endure in a way that is sustainable? And, is the company's success at the expense of others, the environment, or the community?

The definition of sustainability has evolved dramatically in the past several years, but it means that the actions taken today will enable the company to be an ongoing concern and to continue to deliver the return on investment (ROI) that investors expect. In addition it means that companies will be able to access the necessary resources in the future. In this chapter, we examine both meanings of sustainability. Successful mastery of this material will enable you to:

- understand the history of sustainability and the reasons for its inception
- identify the drivers that are raising questions of sustainability
- recognize organizational sustainability stages and sustainability "maturity"

[1]L. O'Brien. "What Nau? GOOD Business." (November/December 2008): 18–24.

Although there is a lot of media "buzz" over green, this is not a new idea but one that has reemerged. But the definition has evolved beyond shortsighted marketing hype to a real concern as to how a company operates and the strategic decisions it makes.

Introduction

What company does not want to be "sustainable?" It sounds like common sense, right? But in reality, pressures and incentives in the business world as well in the public sector tend to concentrate on short-term rather than long-term considerations. Often, this short-term perspective overlooks the more pragmatic considerations of the long run. There is a tension about time horizon in strategic decision-making, about what is more important: short-term profitability or long-term sustainability.

In recent years, sustainability concerns have expanded from financial viability to resource availability. Much of this concern originated from conversations in the United Nations, some in reaction to disasters directly impacting the environment. These include *Chernobyl,* the *Love Canal* disaster, and the *Exxon Valdez* spill. All of these manmade disasters resulted in significant environmental impact.

It was the Brundtland Commission in 1987 that first coined the term sustainability, meaning the capacity to endure without harming future generations, specifically, "meeting the needs of the present without compromising the ability of future generations to meet their own needs." Then in 1997, John Elkington developed the concept of the "Triple Bottom Line," also known as the "three-legged stool." The three-legged stool balances people (social), place (environment) and profit (economic) concerns in a company. Again, there is a tension among these priorities that must be addressed strategically. As Carroll (2000, p. 41) warned more than a decade ago, "Companies will be expected to be profitable, abide by the law, engage in ethical behavior, and give back to their communities through philanthropy, though the tensions between and among these responsibilities will become more challenging as information technology continues to push all enterprises toward a globallevel frame of reference and functioning."

The Past, Present, AND Future of Sustainability

Famed economist Joseph Schumpeter (1883–1950) coined the term, "the creative disruption of capitalism." "Believing that capitalist economic success, because it is incomplete and interrupted, breeds its own backlash" (Samuelson 1992, p. 61), the economist was arguing that the turmoil of capitalism was what made corporate sustainability unlikely. Innovations from outside the companies would unseat them.

In the 1970s, the renowned "Chicago School" of economic thinking, led by Nobel Laureate Milton Friedman, advocated for the benefits of free markets and innovation as the true source of wealth. For a corporation to be sustainable, executives must conduct their businesses so as to maximize profitability. This line of thinking assumes market corrections for anti-societal behaviors or a lack of innovation.

This thinking continued through the 80s and 90s, led by then Federal Reserve Chairman Alan Greenspan and supported by several presidential administrations. Things began to change, however, when large companies began to fail, the housing market crashed under a consumptive culture,[2] and environmental disasters became recurrent.

These days, we see an increasing emphasis on corporate social responsibility, even as businesses are trying to recover from a widespread economic recession. "Sustainability" is a double entendre, with companies showcasing their efforts to improve profits as well as minimize their environmental impact.

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[2]See J. DeGraf, D. Wann, and T. H. Naylor. "Affluenza: The All-Consuming Epidemic." San Francisco, CA: BerrettKoehler Publishers, Inc., 2001:

> In each of the past four years more Americans declared personal bankruptcy than graduated from college (p. 4) . . . 70% of us visit malls each week, more than attend houses of worship (p. 13). . . . Americans spend six hours per week shopping and only forty minutes playing with our kids (p. 14). . . . Average house sizes ("starter castles") in the US (p. 24): 50's, 950 sq. ft.; 70's, 1350 sq. ft.; 90's, 2300 sq. ft. . . . We drive twice as much per capita as we did 50 years ago, and fly . . . 25 times as much (p. 28). . . . "Possession Overload" results when you find your life is being taken up by maintaining and caring for things instead of people (p. 39). . . . Everything we watch . . . is always promoting dissatisfaction. The whole idea of using a thing and then throwing it away is affecting us all (p. 47). . . . A recent study showed that while the average American can identify fewer than ten types of plants, he or she recognizes hundreds of corporate logos (p. 150).

Illustrations

The Coca-Cola Company is working with the World Wildlife Federation, an unlikely pairing, to advance technologies and practices for wastewater reclamation (http://www.thecoca-colacompany. com/citizenship/), as a result of issues raised by an Indian community when its water table was being depleted by a bottling plant's operations. Wal-Mart Stores has several environmental initiatives that are cost saving as well as environmentally conscious. They are installing solar panels on the roofs of their stores to move toward renewable energy. Wal-Mart is also collaborating with its suppliers to reduce packaging waste (http://walmartstores.com/Sustainability/9125.aspx). One of those suppliers is Proctor & Gamble, which is following a strategy of "compaction," selling smaller packages of more concentrated products: less material cost, less transportation cost, and less waste (http://www.pg.com/innovatingsustainability/innovating/).

As we look to the future, we see an emerging management practice called "life cycle assessment" (LCA). LCA tracks a product's ecological negatives, quantifying its environmental and public health downsides at each link in its supply chain (e.g., natural resources depleted, pollutants emitted into air, toxins dumped into water, or contaminants buried in landfills) (Goleman 2009).

It may be astounding to know, for example, that producing a hamburger takes 4,000–18,000 gallons of water. "Estimates vary a lot due to different conditions of raising cows and to the extent of the production chain of water that is used. It takes a lot of water to grow grain, forage, and roughage to feed a cow, as well as water to drink and to service the cow" (http://www.worldwater.org/data. html. And that's just getting the raw material, not processing the meat, transporting it, packaging it, selling it, preparing it (hopefully, with hands that have been washed), and disposing of waste.

LCA can be very detailed, even for simple products. Figure 4.1 shows the general considerations that comprise a full analysis. Companies are working now to establish "transparent supply chains," not only for shipment tracking but for LCA, using advanced technologies such as wireless computing and radio frequency identification tags (RFIDs). "RFID tags, well established for inventory management and other purposes, are becoming smaller, cheaper, and more flexible. New generations of

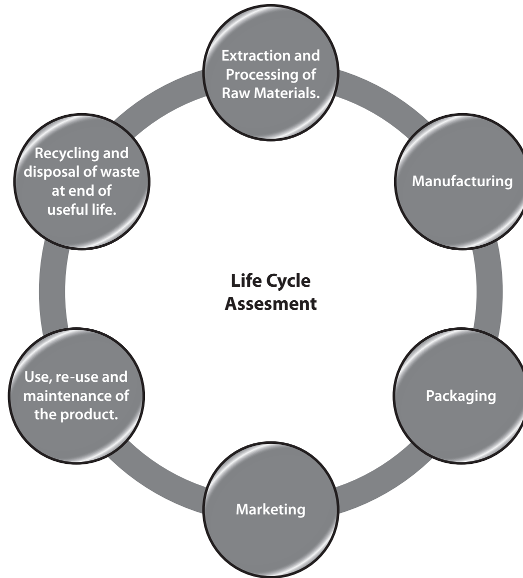

Figure 4.1 Life Cycle Assessment

tags . . . can even be embedded in paper and plastic, making the product's provenance data part of the material itself" (New, 2010, p. 78).

Daniel Goleman (2009), known for his work in managerial, emotional, and social intelligence is now concerned with the development of ecological intelligence and ways to understand how the products we buy, use, and discard affect the environment.

Illustration

Social media, Internet-based applications with user-created content, also provide transparency. For example, www.goodguide.com has a mission to "help consumers make purchasing decisions that reflect their preferences and values. We believe that better information can transform the marketplace: as more consumers buy better products, retailers and manufacturers face compelling incentives to make products that are safe, environmentally sustainable and produced using ethical sourcing of raw materials and labor." Currently, they have over 120,000 consumer goods (toys, personal care, and household products) scientifically analyzed.

In the future, we can expect more of the same information to inform decisions. Scan a barcode on your smartphone and find out if it is "good"

or not, according to your values. For now, the options are limited—and the claims of "goodness" may be marketing. "Green-washing" is the selective display of one or two virtuous aspects of a product; for example, a label on a t-shirt might read "100% organic cotton: it makes a world of difference." That claim is both right and wrong (Goleman, pp. 22–24). The cotton may have been grown organically (and cotton is one of the most water-intensive crops), but the manufacturing process may have included colorful dyes, many of which are toxic.

Drivers of Sustainability

When and what drives a company to consider sustainability in its strategic decision-making? Much of this can be determined from where the company finds itself on the sustainability "journey" or its maturity in understanding the value of sustainability on its strategy. In fact, many companies are forced into considering sustainability reactively, due to a violation of pollution laws. An example of this is Exxon following the oil spill in Alaska that required the company to "clean up its act." Another driver is when companies are forced into a compliance with a regulation or requirement, governmental or organizational, such as building "Leadership in Engineering and Environmental Design," LEED-only buildings, or restricting CO2 emissions by automobiles, thus driving companies to produce more fuel efficient cars.

Some companies think that "going green" will be a good marketing ploy and attract a segment of the market that is concerned with environmental issues. In these cases it may simply be "green washing," a ploy to convince buyers of a company's environmental consciousness (www.stopgreenwash.org). But some companies have moved beyond the reactive and short sighted view of sustainability into a more integrated strategic approach in which there is a direct payback on the investment in more sustainable decisions, such as enhanced productivity, efficiency, resource or asset maximization, and, as a result, more profit!

The Open Compliance and Ethics Group (OCEG) has been a leader in assisting companies to understand the value of sustainability. More and more companies are working to reposition themselves, including Wal-Mart, PricewaterhouseCoopers, and IBM. Why? Because these strategic

initiatives get results. Not only are companies reducing their environmental impact, they are often experiencing significant cost savings.

One example is 3M, where they eliminated more than three billion pounds of pollution and saved nearly 1.4 billion USD through their Pollution Prevention Program (http://solutions.3m.com/ wps/portal/3M/en_US/3M-Sustainability/Global/Environment/3P/).

Other drivers of sustainability include not only customers, but also investors. As a result, many companies are providing annual reports on their social responsibility and sustainability efforts. For example, Johnson & Johnson began adding sustainability and responsibility reports to their company publications in 2009 (http://www.jnj.com/connect/about-jnj/publications/). The Dow Jones Sustainability Indexes (DJSI) have become a major "barometer" for investors as they evaluate potential investment in companies for their sustainability practices as well as their social and environmental responsibility. Socially responsible investing is a trend that attracts investors interested in sustainable and responsible business practices.

CHAPTER 5

Monitoring the External Environment

Good anticipation is the result of good strategic exploration.[1]

—Joel Barker

Opening Vignette

According to *The Wall Street Journal*, it's a "miracle" that US airlines are still in business. Domestic airfares have fallen 21% (in inflation-adjusted dollars) since 1995. The industry is subject to a wide range of external forces, i.e., factors beyond its control that have an impact on its ability to operate. The commercial carrier industry is very competitive, giving customers the power to switch. It is also a labor-intensive industry, so employees are also a strong factor. New entrants, termed "ultra low cost" airlines, such as Spirit Airlines, Inc., sell tickets for almost nothing, basing their business model on fees for seat assignments and baggage. Substitutes such as driving or taking high-speed rail are also competition in certain markets.

Airlines are subject to "external shocks, including terrorism, oil-price spikes, waning consumer confidence and high taxes." Buying more fuel-efficient planes is one strategy some are pursuing; others are cutting costs, reducing seat availability to charge higher fares for remaining seats, and charging extra fees for services such as baggage checking and meals. Not

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[1] Barker, op. cit.

Based on an article by Susan Carey, reported on October 5, 2011, in *The Wall Street Journal*. Accessed November 4, 2011, at http:online.wsj.com.

only should airlines survey their external environment, they must continually make adjustments to their business model and strategies in order to remain viable and attract investors.

Stockholders and stakeholders are important factors in the context of an organization. It is important to be intentional in how the organization holds itself accountable to them. However, it is also vitally important to understand the environmental factors that are largely beyond the organization's control. A ship's captain wants to understand the currents and conditions under which he is sailing; a pilot needs to know the topography and meteorological conditions into which she is flying. In the same way, you need to understand your company's external environment.

The external environment is comprised of a variety of factors—most are beyond the control of the organization—that can have an impact on how well the company achieves the desired results, its vision. *Scanning* the environment is crucial to identify the factors that will impact success. As we scan the external environment, you will see that successful mastery of this material will enable you to:

- understand paradigms and how to leverage them
- employ a variety of paradigms to examine the external environment
- identify those environmental factors that have the most impact on an organization's strategy
- analyze trends to identify potential opportunities and threats

Introduction

The general environment really represents society at large. What is going on in the world around you that could affect your organization's ability to execute its strategy and achieve the desired results? Do you see opportunities, or do you see threats?

To begin your scan of the environment, it is helpful to understand the power of paradigms. A paradigm is a mental model. Very often, a paradigm is a lens through which we interpret what our senses perceive. We also have to be careful not to be limited by our paradigms.

On a personal level, our paradigms often determine what we should or should not do. For example, he should avoid processed sugars and carbohydrates (paradigm: "white" foods cause obesity). She should avoid credit card debt (paradigm: financial security comes from living within one's means).

Paradigms can change over time. The change may arise from political, legal, technological, economic, or social trends. An example is the role women "should" play in the workforce. The paradigm shift may also occur as new knowledge debunks the previous paradigm, such as when smoking cigarettes was deemed sexy until it was determined that smoking causes cancer.

Paradigms also vary across cultures. The norms of behavior can be very different, as any international traveler can see. The way you dress for a business meeting in Texas is likely to be very different than how you would dress for a business meeting in Milan. The difference between when a meeting is scheduled and when it starts is important in Germany but insignificant in Spain.

Being aware of paradigms is advantageous in environmental scanning. Being able to shift paradigms and use multiple lenses to understand the environment is even more so. These practices alert one to critical conditions that may mean you need to change course.

Doing so also reminds one that there can be more than one way to interpret a situation, e.g., an opportunity or a threat. Think of shifting paradigms like changing a pair of glasses; if you wore the glasses of your competitor, what would you see? Your customer? Your supplier?

Illustration

For centuries, since the development of the printing press, most written information has been conveyed through paper books. With the merging of technologies, books are now available electronically in a 24/7 world, with instantaneous access not limited by time or place. Those book publishers and sellers who saw this immediately included in their offerings the ability for customers to purchase books electronically and then to read them on a device that overcomes the limitations of the computer screen but offers the benefits of accessibility. Examples of these *e-readers* include Amazon's Kindle and Barnes and Noble's Nook. Other companies,

Figure 5.1 Example of several e-readers

such as Borders, have suffered dire consequences for their inability to "shift" their paradigm.

Leveraging Paradigms

Paradigms are most useful when you are trying to anticipate the future. In particular, being able to identify paradigm shifts can identify profound market opportunities. Note that a paradigm shift is not a trend per se, but represents an entirely different trajectory into the future.

For example, the aging of the population in the United States is a trend. People are living longer, with better healthcare, safer working conditions, and more comfortable lifestyles. This trend has been anticipated since the arrival of the "baby boom." We have seen the development of senior communities, progressive care retirement homes, and a wide array of dietary supplements targeted for the older adult market (which is no longer considered "elderly").

The paradigm shift comes when you think about the careers of this generation, and the ones to follow. Mandatory retirement is generally no longer mandatory. The Internal Revenue Service (IRS 2011) allows for individuals to withdraw from their retirement accounts at 59 and a half years old, and requires that they do so at 70 and a half. The typical age of eligibility for Medicare health insurance is 65, according to the Social Security Administration (SSA 2011). This seems to imply that people will retire in their 60s. Yet they are living another 20 years or more. Whether

it is out of boredom, from a desire to maintain mental acuity, or an economic need due to diminished retirement savings, people are going back to work. These "twilight" careers represent a paradigm shift.

How might you leverage this shift? You might restructure your workforce to include the availability of part-time, educated, highly skilled workers. You could start an employment agency that caters to and places these workers in short term assignments. You may even develop a product or financial service that targets this segment of the population. These are just a few examples.

Futurist Joel Barker (1996, pp. 21–23) asserts, "We have been living in a time when fundamental rules, the basic ways we do things, have been altered dramatically. That is what was right and appropriate in the early 1960s is now, in many cases, *wrong*." He continues with a long list of such paradigm shifts, such as the vast amount of data exchanged via computers worldwide, deregulation, terrorism, cellular phones, "safe" sex, and the number of people getting regular aerobic exercise every day.

Illustration

Part urban legend and part truth, one of the top executives of Sony Corporation was credited with the idea for a personal music player after visiting the United States and seeing people carry around large sound systems, referred to as "ghetto blasters." According to www.who-invented-it.net, the first Walkman® was created for the personal use of the company's co-chairman, a portable music player that he could use to listen to classical songs during his trips. Because of the efficiency and high quality performance of the product, Sony decided to introduce the music player to the public. The first batch of Sony Walkmans was released in Japan in 1979.

Employing Paradigms

In strategic management, paradigms are helpful frameworks by which to scan the external environment of the organization. There are many, but for our purposes here we will go into detail on two frameworks: one that focuses on key factors in the general environment and one that focuses specifically on industry-based factors.

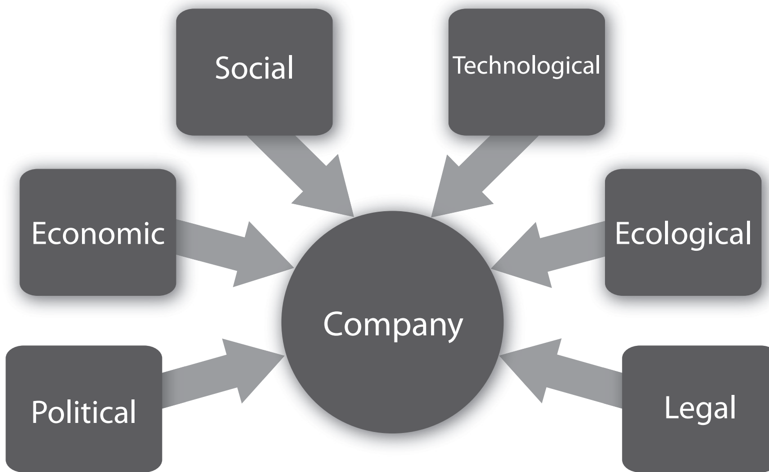


Figure 5.2 PESTEL framework

General Environmental Factors

The PESTEL framework can help you to systematically examine the general environment. PESTEL stands for Political, Economic, Social, Technological, Ecological, and Legal factors. The framework is an extension of earlier versions of the PEST, or STEP, model, which did not cover the ecological or legal factors, the last two factors. Let's examine each factor individually.

Political. The political environment represents the government structure, stability, and foreign policies that pertain to the organization. If operating in multiple countries, the political system of each country should be considered. Social unrest, political strife, opposing groups, and the government's policy toward foreign firm investment can also be considerations. For example, with the 2011 "Arab Spring" and ensuing unrest in the Middle East, the price of crude oil has increased dramatically based on speculation of an interruption in the supply. Not only has this raised the price of fuel for consumers, it has raised transportation costs for companies and direct material costs for petroleum-based products (such as nylon rope and insect repellant).[2] Another example is the rush to purchase

[2]See http://www.ranken-energy.com/Products%20from%20Petroleum.htm for a partial—but extensive—list of petroleum-based products.

handguns in the time period before President Obama was inaugurated, with the expectation of stronger gun control under a Democratic administration (Johnson 2008).

Economic. Exchange rates, monetary policy, and taxation systems can have a significant impact on how an organization can operate. For example, Fallows (2010) asserts that:

> *the Chinese government's insistence on holding the RMB's value steady against the dollar—rather than letting it rise, as it naturally would because of China's huge trade surpluses—has become pernicious and destructive for the world economy. . . . During a worldwide economic slowdown like the one of the past two years, the immediate problem is a failure of demand. There is too much productive capacity, relative to private and public purchases. Thus factories—and, more important, workers—stand idle. The point is elementary, and is the reason governments around the world, from China to Britain to the US, have been pumping new "stimulus" (demand) into their economies. But it also means that anything one government does to depress demand—or to shift some other nation's demand to its own factories—has a beggar-thy-neighbor effect and slows down recovery world wide.*

Another significant macro-economic factor is the increasing number of regional trade agreements. They are particularly relevant to location and outsourcing decisions. For example, *maquiladoras* (manufacturing plants in Mexico that typically import US inputs, process them, and ship them back to the United States) have increased significantly, arguably as a result of the North American Free Trade Agreement (NAFTA) (Gruben and Kiser 2001).

On a micro-economic level, per capita income, unemployment rates, and wage, salary, and compensation levels also affect firms' demand levels, cost structure, and employment decisions. Sales of consumer goods and restaurant meals decrease as per capita income decreases and/or unemployment increases.

Social. Demographic trends, cultural considerations, literacy levels, social infrastructure, consumer confidence, and religious beliefs are external factors that are beyond the firm's control, but can fundamentally

affect its operation. As we will discuss in a later chapter, the effect of this aspect of the environment is even more profound when crossing international borders. Domestically, in the United States, our traditional melting pot of immigrants is increasingly Hispanic. El Nasser (2003) reported that Hispanics are the largest minority group, and the fastest growing part of the population. The ripple effect of this demographic shift is still being felt, whether it is how to reach the Hispanic demographic in a marketing plan, where to find bilingual employees, or if an Englishonly workplace rule is appropriate.

Technological. Entire books have been written about the impact of technology on governments, businesses, and individuals. The amount of business transacted electronically is staggering. The pace of technological change is accelerating, as is the volume of information available. Social media, i.e., Internet sites with user-created content, have exacerbated the acceleration. They have also provided new opportunities for businesses to recruit employees, identify prospects, engage customers, share information, and solve problems (Shih 2009). The expansion of e-commerce illustrates the impact on business.

Ecological. Climate and weather may be an important consideration, especially for companies with supply chains that start with agriculture. Flooded fields or a hard freeze could ruin a crop's harvest and disrupt the supply chain. Protected habitats, endangered species, and local regulations may constrain an organization's operation because of wastewater disposal, toxic emissions, or non-renewable extraction. An increasing issue is a company's concern for the environment and ecological sustainability.

Legal. Regulations, property rights, and liability concerns must be an ongoing concern for businesses. Mistakes in the legal environment can be quite costly. Witness the Enron debacle and the implosion of Arthur Andersen, a long-respected accounting and auditing firm. As a result of Enron's poor strategic decisions and short-sightedness, there are now another series of regulations requiring companies to attest to the validity of their financial statements to protect their shareholders and which require considerations as companies decide how to comply with these regulatory requirements.

Industry Factors

Another paradigm that is useful for examining the environment is the industry in which a firm or organization operates. This directly determines the firm's immediate competitive environment. An approach to scanning industry factors for the firm is known as the Five Forces model, developed by Harvard Professor Michael Porter and illustrated in Figure 5.3. This model looks at the immediate competitors, potential new entrants, and substitutes, as well as the powers of the suppliers and customers, in examining a company's immediate environment. The powers of these forces are then evaluated as to their strength and the concern with inclusion into the strategic plan. The more powerful a force, the more the strategic plan must accommodate or shift the strategy to overcome or mitigate the force.

Analyzing Trends

Of course it is necessary to understand the *current* external environment. The *future* environment is perhaps more important to a company's ability to achieve its desired results and achieve its vision. Therefore, your understanding of external factors should lead to analysis of future trends and possible scenarios.

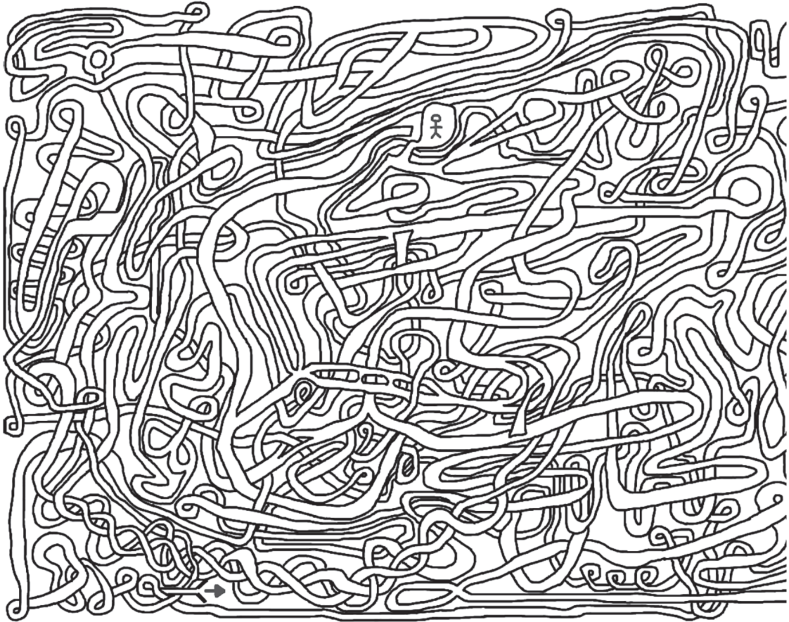
Figure 5.3 Porter's Five Forces Model

In some cases, it is enough to use mathematical models such as regression analysis to predict a trend's progression. To consider alternate futures, you might use a decision tree with branches to different expected values. While decision trees are helpful in decisions such as, "should I expand capacity," and evaluating the probability of demand increases, the future environment is generally more complex. When the data are not available, more subjective techniques may be required, such as Delphi studies, where experts and other professionals offer their perspectives based on their professional expertise.

SECTION 3

How to Decide Which Strategy is Best

At this point, you are nearly ready to begin considering your strategic options. Before navigating through the maze of possibilities, you want to make sure you are prepared with the right resources and capabilities.



CHAPTER 6

Assessing Organizational Strengths and Weaknesses

My goal has been to get Apple healthy enough so that if we do figure out the next big thing, we can seize the moment. . . . You have to rebuild some organizations, clean up others that don't make sense, and build up new engineering capabilities.[1]

—Steve Jobs, 2000

Opening Vignette

Ford Motor Company has executed quite a turnaround: a new product portfolio and a 180 degree change in corporate culture. So how does a long-established company reinvent itself, and how has its portfolio contributed to this revival?

The Ford Motor Company, founded by Henry Ford, told customers that "you can have any color of Ford as long as it is black"—so much for product portfolio and choice! It took generations of slow evolution for this company to produce a portfolio of products responsive to customer demands. In recent years, Ford reported substantial losses, but unlike its two Detroit rivals, has not declared bankruptcy nor accepted government funds to bail out the troubled automobile industry. Instead, the company renewed its emphasis on product portfolio development to better meet customer demands and environmental needs.

In addition to the Ford and Lincoln lines of automobiles, Ford now owns a stake in Mazda in Japan and Aston Martin in the United Kingdom.

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[1]Interview with Brent Schlender, reported in *Fortune's* January 24, 2000, issue.

Ford's former Jaguar and Land Rover divisions were sold to Tata Motors of India. In addition, Ford sold Volvo and discontinued production of Mercury automobiles.[2]

Ford further moved to introduce a range of new vehicles, including crossover SUVs, and is developing the hybrid electric power train technologies for its Escape Hybrid SUV. Ford actually licensed Toyota hybrid technologies to avoid patent infringements and is now exploring plug-in electric hybrids, the very technology it once discontinued to make market space for the traditional carbon based fueled automobiles. The need for these changes was driven by competition, primarily from higher quality, lower cost global competitors. By shedding divisions and redirecting product development, Ford is beginning to resemble Toyota, with the mass-market appeal that made Toyota, a global competitor, successful.

The new CEO of Ford strives to change the culture of Ford, to question the assumptions and the traditions of the past, and to admit mistakes. This has profoundly changed how Ford's capabilities are assessed. Named *Automobile Magazine's* 2010 Man of the Year, Alan Mulally has almost singlehandedly saved the automaker.[3]

Before deciding what you *should* do to achieve the vision, you have to understand what you *can* do. Are there resources that you need to develop? Are there distractions holding you back? Can you create and/or sustain your competitive advantage?

When facing a competitor, a coach determines the game plan based on the strengths of the team in light of the playing conditions. A commander facing an armed conflict builds the combat strategy around the people and weapons available to fight in the expected battle conditions. A mayor needs to garner the resources provided by the citizens of the community to react to an emergency. Are you ready for the challenge? The competition?

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[2]From an AOL posting. "Is Ford really going to cut its product lines?" http://autos.aol.com/article/ ford-cut-product-line/

[3]2010 Man of the Year: Alan Mulally, CEO Ford Motor Company. http://www.automobilemag.com/features/awards/1001_2010_man_of_the_year_alan_mulally_ceo_ford_motor_company/viewall.html#ixzz1ibEoR700

Upon successful completion of this chapter you should be able to:

- explain why internal assessment is key to strategy development
- apply a portfolio view to a product set
- select among the different approaches to resource and capability assessment
- interpret financial measures with a strategic perspective

Once you have established your vision, including your governance practices and stakeholder relationships, you have surveyed the external environment, and you have conducted an internal assessment, you will be ready to begin your consideration of strategic options.

Introduction

Internal assessment is more than asking, "How are we doing?" It is a deliberate analytical process that is fundamental to strategic planning. If you do not understand your current state, you are unlikely to select the right strategy to achieve your vision or desired future state. Think about trying to give someone navigational directions:

"Hi! How do I get to the convention center for the exhibition?"

"Hi, mom. Where are you?"

"Well, I don't know. I'm lost—that's why I called you for directions!"

Your starting point strongly determines your strategic options. Internal assessment often identifies potential strategies to be considered. It might point to a product capability that could be improved, an underutilized asset that could be leveraged, a particular technology that could be acquired, or a vulnerability that should be mitigated.

There is also internal communication and development that makes this assessment so valuable. Undergoing the assessment exercise as a management team helps to create a shared understanding of the company's current state. Without this common view, it would be extremely difficult to gain consensus on priorities, strategic options, or next steps.

In the following segments, you will read about a variety of approaches to assess corporate capabilities. If you only use one type of assessment, you are likely to overlook important considerations.

Product Portfolio Evaluation

A portfolio is typically a collection viewed as a whole. Sometimes a portfolio is used to provide a "big picture" from individual components. For example, a commercial artist will bring several different examples of his work for an interview at an advertising agency. Other times, a portfolio concept is used to assess the diversity of its contents, such as when a financial advisor encourages her client to diversify his or her investments to reduce the overall investment risk.

In the same vein, companies should look at their products—goods and services—as a collective. There are several different ways to analyze a product portfolio; we will focus on three. One is based on life cycle, one is based on project risk, and one is based on future potential.

Product Life Cycle

A product life cycle analysis considers where each product is in its product life cycle. Typically, the product life cycle is depicted as an S-curve, as shown in

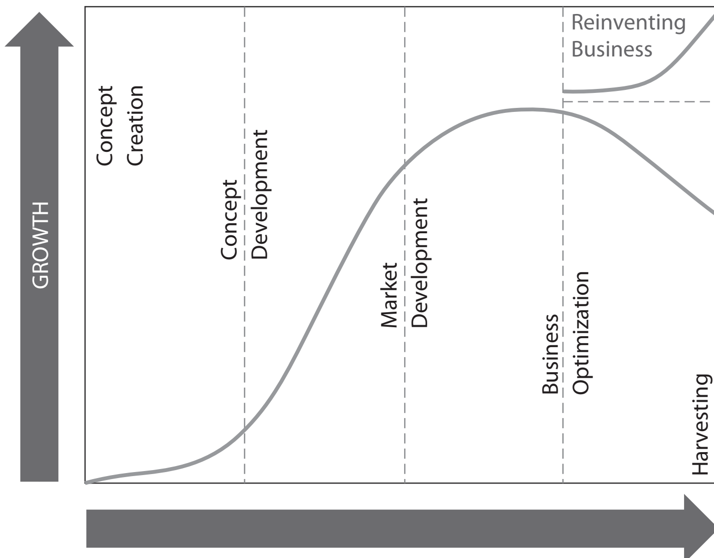

Figure 6.1 Product Life Cycle

Figure 6.1. The early stages of the product are characterized by slow growth, low customization in production factors, and a propensity to change in response to market feedback. The next stage is the growth stage; a company may choose to invest in customized technology, e.g., manufacturing automation, to respond to the growth in demand. As the growth levels off, a product is considered to be in its maturity phase; the focus is on extending this phase for as long as possible. This might be accomplished by entering new markets, e.g., international ventures, or by developing minor modifications to the existing product to make it "new and improved." Once a product enters a decline phase or a stall, it is extremely difficult to recover (Christensen and Raynor 2003).

Illustration

There are a number of examples of the impact of product life cycle on a company's strategy and market position. One of these is Sears & Roebuck. For over 50 years, Sears was the household word for catalog sales and family appliances. Due to changes in demographics and consumer trends, the company was unable to match the competition or adapt to changes in buying patterns, and it lost market position, especially in its central business, catalog sales. Replaced by emerging retailers using the big box store models, such as Wal-Mart, Costco, and the do-it-yourself home improvement retailers such as Home Depot and Lowe's, Sears lost its position in the emerging competitive landscape. Internally, Sears did not have the resources required to scan the competitive landscape and react quickly enough to fend off its competitors.

Project Risk

The next type of portfolio development centers on project risk. How much change is being undertaken by the organization, specifically in the area of development projects? Steele (1989) describes a suicide square, where change is introduced in three dimensions: product, technology, and customer. This is illustrated in Figure 6.2. For example, a company might implement a completely new enterprise-wide system, such as customer relationship management (CRM). Perhaps the database technology underlying the application (i.e., product) is one that is new to the

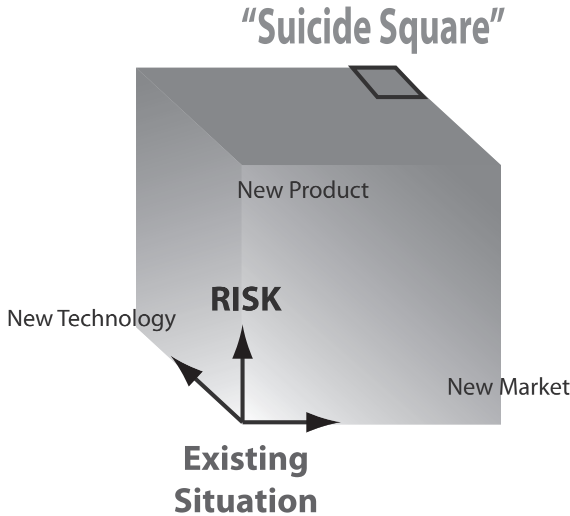

Figure 6.2 Suicide Square

company. In addition, perhaps new departments and users (i.e., customers) are expected to use the system. This project is extremely risky and can be considered in the suicide square.[4]

In a similar vein, Wheelwright and Clark (2003) suggested using an aggregate project plan to evaluate risk. Specifically, considering all research and advanced development projects that are—or could be—in process, consider the amount of *process* change and the amount of *product* change being undertaken. Are you doing too many things at once? Are the key people focused on the right priorities? Can projects be sequenced so as to best utilize resources? The authors suggest that managers map the different types of development projects (pp. 2–4):

Derivative projects range from cost-reduced versions of existing projects to enhancements to an existing production process (low change). *Breakthrough* projects establish core products and processes that differ fundamentally from previous generations (high change). *Platform* projects fall somewhere in between the derivative and breakthrough projects, perhaps an addition to a product family, or a significant change to an

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[4]Since it is a three-dimensional model, it should really be a suicide "cube," but "square" is the given title by the author.

existing process (medium change). The remaining two types of projects are "research and development, which is the precursor to commercial development, and alliances and partnerships which can be either commercial or basic research" (p. 2).

Future Potential

The last type of product portfolio analysis that we will describe was developed by the Boston Consulting Group, and is known as the "BCG Matrix." The two-dimensional matrix, shown in Figure 6.3, categorizes products by their potential for growth and their relative market share. As with all portfolio analyses, balance among the categories is recommended. In addition, the matrix factors in trends and competitive positions (Allan and Hammond 1975, p. 6):

> *Cash cows are products that characteristically generate large amounts of cash—far more than they can profitably reinvest—and typically have high market share and low growth. Dogs are products with low market and slow growth . . . often called "cash traps." Question Marks are products with high growth but low share that require large amounts of cash to maintain market share, and still larger amounts to gain share. Stars are high-growth, highshare products which . . . promise a much larger net cash generation in the future.*

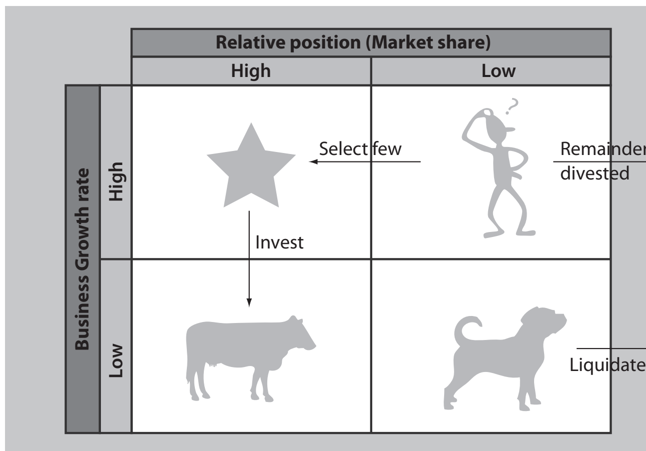

Figure 6.3 BCG Matrix

The challenge for companies is to maintain the cash cows, fund the stars, and figure out the reason why the question marks are not producing the expected results, while divesting the dogs.

Market analyses should be data-based, using market research and consulting expert industry analysts. Companies need to honestly appraise their position as compared to their competitors on these criteria as well as to weigh their importance.

Resources and Capabilities Appraisal

Product portfolio analysis is a good way to "see the forest for the trees." As you appraise resources and capabilities, you will focus more on the individual trees. Which are healthy? Which need more sunlight? Which should be cut down? Which should be propagated?

As with product portfolio analysis, there are many different ways to appraise a company's resources and capabilities. The ones in the following sections have been selected based on their popularity and/or their usefulness. Either way, you should be familiar with these approaches.

Core Competencies

The unique combination of capabilities that are central to a firm's main business operations and which allow it to generate new products and services might be considered core competencies. They tend to be very narrow and hard to identify. Prahalad and Hamel (1990, pp. 83–84) caution, however, that:

> *At least three tests can be applied to identify a core competency in a company. First, [it] provides potential access to a wide variety of markets. . . . Second, [it] should make a significant contribution to the perceived customer benefits of the end product. . . . Finally, a core competence should be difficult for competitors to imitate.*

Illustration

The owner of automated car washes is interested in investing in an ice dispensing operation because he views his core competency as "coin-operated, unattended vending," not as car washing.

The term *core competency* is often misused and tends to be a buzz phrase. There is no established technique for evaluating core competencies, beyond the three tests, although some have been suggested (c.f., Gallon et. al. 1995; Hamel and Prahalad 1996). The bottom line is that using this framework requires a deep understanding of your business and ability for lateral thinking.

Resource Based View

As with the core competency approach, a resource based view (RBV) is an internal assessment of what gives—or can give—a company its competitive advantage. A RBV is perhaps more straightforward and "useful" (Barney 1991), as it starts with an inventory of key tangible and intangible assets and capabilities, i.e., resources. Wal-Mart's locations are tangible resources. Coca-Cola brand recognition is an intangible resource. Warren Buffet's investing savvy is a capability.

Then you determine whether these resources are (V)aluable, (R) are, (IN)imitable, and/or (E) xploitable, using the "VRINE" model.[5] A resource that is valuable and rare may help you to establish a competitive advantage; when that resource is also inimitable and exploitable, it can enable you to sustain that advantage.

For example, consider when Xerox's Palo Alto Research Center (PARC) was working on developing a pointing device for mini and microcomputers in the early 1980s. This was a very valuable technology, as it was different from other human–computer interfaces that were available at the time. It was rare, because these were still the early days of personal computing. It was hard to imitate, because patents protected it. However, PARC was not prepared to organize or exploit it, which is why we usually associate the origin of the mouse with Apple.

The idea of inimitability is at the heart of competitive advantage. How does one achieve inimitability?

A capability may be difficult to imitate because of its path dependency, meaning it was accumulated over time. The "magic" of Disney is

[5]This model is sometimes called the VRIO model, with "O" standing for "organized."

hard for others to imitate because of its unusual history, starting with cartoons, moving into feature films, commercializing characters, and building theme parks.

Inimitability may also result because it is unclear to competitors how this capability was created (known as "casual ambiguity"), as in the case of Dell Computer's material handling technology. Or it may be socially complex in a way that is hard to copy, as when key personalities or a distinctive corporate culture are in play—consider Chik-fil-A or Southwest Airlines (Brennan 2010, pp. 7–8).

By conducting an RBV assessment, you can identify opportunities and prioritize investments in strategic resources.

SWOT Analysis

This is a popular but often misused approach that assesses positives and negatives, from an internal and external perspective. Simply listing the internal (S)trengths and (W)eaknesses and the external (O)pportunities and (T)hreats is not very useful. The real value of SWOT is when you consider strengths and how they might be used to take advantage of opportunities and avoid threats. Similarly, you should consider weaknesses and how you need to address them to mitigate threats and possibly pursue opportunities (David 1997). An example of a SWOT matrix is presented in Table 6.1 on the following page.

Illustration

Partners of a management consulting company are working on their strategic plan. They develop a SWOT matrix, which includes the following thoughts, shown in Table 6.1.

Value Chain Analysis

Developed by Michael Porter (1995), the concept of a value chain applies a systemic view to an organization that transcends its boundaries. The key to this conceptual view is to consider the organization as a system (i.e., a "chain" of activities) by which value is added through primary

Table 6.1 Sample SWOT Matrix

	Strengths (S)	**Weaknesses (W)**
	Net income is 10% ahead of last year. *Firm has a national reputation for process improvement.* . . .	*Partners are over-extended with billable activities and do not have time for business development.* *Affiliates have not been a good source of new business.* . . .
Opportunities (O)	**SO Strategies**	**WO Strategies**
Concerns about companies' environmental impact are increasing. *A few clients have expressed interest in "lean consumption," making it easier for customers to do business with them.* . . .	*Invest in hiring associates with experience in Life Cycle Analysis (S1,O1)* *Extend process improvement practice to market a lean consumption practice (S1, S2, O2).* . . .	*Subcontract some work to part-time (contract) consultants so the partners can cross-sell lean consumption to existing clients (W1, O2).* *Release non-productive affiliates; recruit local ones with environmental expertise (W2, O1).* . . .
Threats (T)	**ST Strategies**	**WT Strategies**
The economy has been stagnant. Manufacturing applications for process improvement are declining. . . .	*Increase cash reserves (S1, T1). Prospect past manufacturing clients to apply process improvement to other departments (S2, T2).* . . .	*Leverage resources such as part-time local consultants to avoid over-extending salary base in firm (W1, T1).* . . .

activities that are supported by secondary activities. Value chain analysis can be used to identify opportunities for differentiation as well as sources of waste (i.e., where value is not added). This topic is covered in more detail in the following chapters.

CHAPTER 7

The Value Chain

The value chain disaggregates a firm into its strategically relevant activities in order to understand the behavior of costs and the existing and potential sources of differentiation.[1]

—Michael E. Porter

Opening Vignette

Starbucks CEO Howard Schultz continues to enrich the "experience" for customers as he continually refines and expands the Starbucks brand. The expansion is not only in the geographic placement of stores around the globe, but also in product line offerings. Taking a page from Pine & Gilmore's book *The Experience Economy* (1999), Schultz understands that "businesses that relegate themselves to the diminishing world of goods and services will be rendered irrelevant. To avoid this fate, you must learn to stage a rich, compelling experience."

Starbucks has been able to leverage the core competency of experience and change the coffee retail shop modeled on Italian coffee bars into a global consumer phenomenon. But in order to guarantee the continuity and richness of this experience, the basic ingredient of his company, the coffee bean, had to be protected.

Shultz realized early on that although he could not "backward integrate" and become a coffee bean producer, he could protect the integrity of the tangible part of the intangible experience, the bean. He did this by investing in and supporting the bean growers: "we work on-the-ground

[1]M. E. Porter. *Competitive Advantage: Creating and Sustaining Superior Performance.* New York, NY: The Free Press, 1985. The quotation is from p. 33.

with farmers to help improve coffee quality and invest in loan programs for coffee-growing communities. It's not just the right thing to do; it's the right thing to do for our business."[2]

Not only has Starbucks ensured the consistency of the brand and preserved the experience for customers, but it also has leveraged this effort into support for the bean growers' communities and furthered endorsement of social and environmental responsibility, a "win-win-win" for the firm, the customer, and the supplier of the bean.

In this chapter, we examine generic strategies for an organization's value chain—the sequence of activities and functions by which value is added to inputs to create desired results. Here we examine models and strategies that simply provide more specific direction, e.g., how will you become a low-cost provider in a broad market? Successful mastery of this material will enable you to:

- define generic strategies and the forces of competition
- describe the value chain concept
- explain strategies for differentiation in the value chain
- understand waste and lean operations

We close this chapter with a short overview of lean practices across the value chain.

Introduction

When you think of a sports team, it is clear that competitive advantage is what enables the team to win. How does a sports team create a competitive advantage? It could be better, faster, stronger, specialized, for example. It is differentiating itself on quality characteristics. Perhaps the general manager thinks that competitive advantage comes from creating a loyal base of fans and a steady set of ticket subscribers. This may call for a strategy based on cost savings and profitability. You win by being different and/or providing a cost advantage.

[2]http://www.starbucks.com/responsibility/sourcing/farmer-support

Generic Strategies

In Michael Porter's (1980) model of generic strategies, he identifies three alternatives: competition on cost, differentiation, or competition in a focused market niche. His model has evolved into the inevitable matrix. Cost leadership and differentiation are the two main ways that a company can compete. He also suggests those two approaches will vary, depending on whether the company is pursuing a narrow market segment or a broad one. For example, consider the different types of shoes a company might produce, as shown in Table 7.1.

Any strategy has risks, but some are more predictable than others. One risk of cost leadership is that there may be too much focus on one or a few activities. Such simplicity exposes the company to easy imitation. Also, there may be an erosion of the cost advantage when pricing information available to customers increases, as is inevitable. The risks of differentiation are, first, that the differentiation is not valuable to the customer. The perception of the difference might vary, or be unattractive because it creates a price premium. And there is always the risk that differentiation can be imitated.

Porter (1979, 2008) has categorized these risks as forces that require consideration of their impact on any strategic decision. The forces are supplier forces, customer forces, new entrants, substitutes, and rivalry among competing firms, as shown in Figure 7.1. Porter's Five Forces can have a direct effect on the success or failure of the strategic choice. For example, in a differentiation strategy, the supplier force may be very strong if the raw materials required are unique. An example is the coffee beans that directly impact product quality. And in order to mitigate that risk, Starbucks has invested in the coffee bean growers. Customers have a strong force in low cost strategy, as the switching costs are minimal and customers can easily choose competitors when competing on price alone.

Table 7.1 Generic Strategies Illustration

	Narrow Market	Broad Market
Differentiated	Cowboy Boots	Work Boots
Low Cost Leadership	Trendy Heels	Flip Flops

Figure 7.1 Porter's Five Forces Model

Customer service may then be a premium differentiator. The strengths of these forces are categorized and tabulated and can be used to determine the likelihood of success of a strategy as well as the favorability of an industry sector.

Illustration

Panera Bread is a company that differentiates itself from other restaurants through its unique menu, service, and an environment in which customers are comfortable. Using a Five Forces analysis to evaluate the strength of their differentiation, we find that its:

- Supplier forces are low, with a strong emphasis on Panera's supply chain to its 1,362 locations in 40 U.S. states.
- Customer forces are high, as there are low switching costs and high price sensitivity.
- Threat of new entrants is low, because of the capital investment required to open a restaurant and the high rate of failure in the restaurant industry.
- Possible substitutes are high, such as eating at home, fast food restaurants, and pre-prepared supermarket meals.
- Direct competition is moderate. Au Bon Pain and Atlanta Bread Company are competitors, but they do not have the

atmosphere or menu alternatives that Panera does, albeit at a slightly higher price point.

The analysis indicates that Panera's competitive position is currently very strong, but that they might be vulnerable when customers are price-sensitive.

Strategic Maps

Another way to look at the direct competition is by using a strategic map. It is a graphical positioning of your product or service as compared to your competitors on one or more dimensions. It is constructed by choosing two important dimensions or key success factors and mapping you and your competitors on these dimensions. The size of the circle on the map can be an indicator of market size, market penetration, or some other indicator of relative positioning.

Once again we use Panera Bread, this time to illustrate positioning in the casual dining restaurant industry. The two variables on which we map this company and their competitors are (1) quality of menu offerings and (2) number of locations and location saturation. We see that Panera is

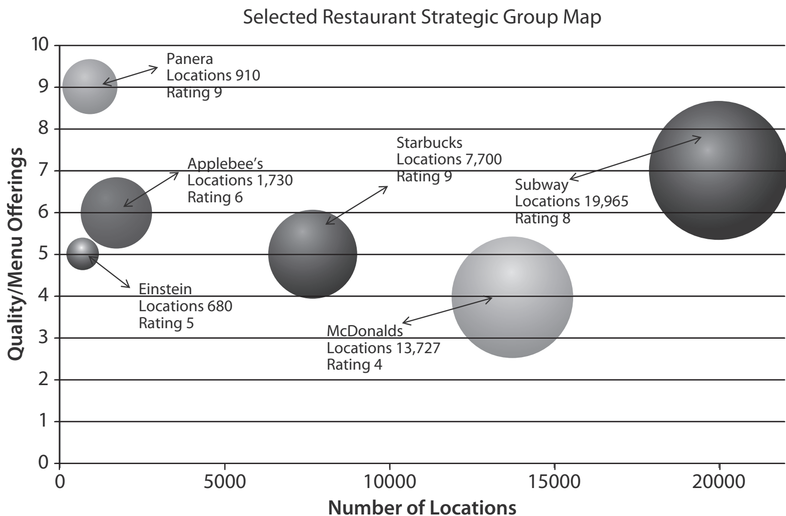

Figure 7.2 Strategic Map for Panera Bread

highest in quality, and might be watching Starbucks which has perceived equal quality, but is more predominant in the market by sheer "footprint," creating superior market awareness and customer accessibility.

Value Chain

The Value Chain, according to Porter (1985), is a model that separates the overall business system into a series of value-generating activities that develop competitive advantage. The value chain distinguishes between primary activities, i.e., inbound/outbound logistics, operations, marketing and sales, and service. The secondary, or support, activities are administration, human resource management, technology development, and procurement, as shown in Figure 7.3. The metaphor of a chain is powerful for two reasons. The first is that it emphasizes the interdependency of the activities. The second is that it transcends organizational boundaries. For example, third party logistics providers (3PL) serve as inbound and outbound logistics providers for other companies—sometimes they will even provide the assembly operation.

Differentiation in the Value Chain

Each link in the value chain can provide opportunities for differentiation as a basis for competitive advantage. Wal-Mart has differentiated itself based upon its inbound logistics and its operational optimization. Toyota, renowned for its lean logistics and operations across its value chain, has also achieved differentiation based upon services used in its Lexus vehicle line to

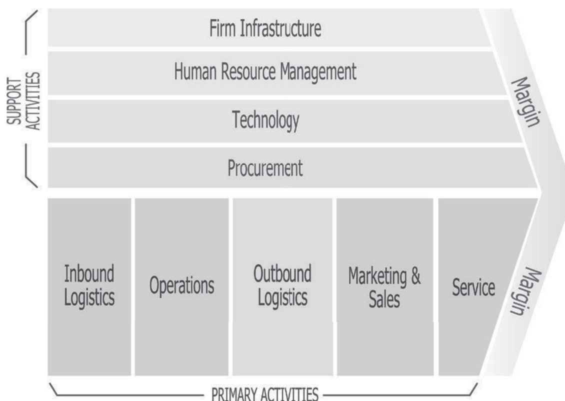

Figure 7.3 Porter's Value Chain Model

guarantee satisfaction, so much so that it has been copied by other luxury vehicles such as BMW and Cadillac. Ryder Systems has renamed itself as a logistics company, understanding the importance of efficiency and economies of scale in moving freight from warehouses or holding centers to transportation such as on-road trucking and rail. Chik-fil-A's marketing and sales, from its infamous cows encouraging us to "Eat Mor Chikin'" to its fast drive-through and well-trained associates who respond to a "thank you" with "my pleasure" has differentiated it from other fast food chains. By focusing on the "value" delivered in its operational or primary chain of activities, a company can differentiate its quality of product or service.

The firm may also gain competitive advantage by driving primary and secondary activities to create a cost advantage. Porter (1985) identified 10 cost drivers related to value chain activities. Table 7.2 gives examples of each and is followed by an illustration.

Information technology application, considered a secondary activity, can offer automation and other efficiencies that reduce costs in the value chain. Caremark, the prescription-by-mail fulfillment company, makes extensive use of technology to receive and process the prescriptions, remind a patient of refills, notify a patient of order status, and receive payments.

Table 7.2 Examples of Low Cost Differentiation

Economies of scale	Wal-Mart's purchasing power
Learning	Apple's product upgrades
Capacity utilization	Seasonal Concept's switch in product lines from holiday décor to patio furniture
Linkages among activities	UPS package tracking and delivery
Interrelationships among business units	Cross-marketing across Proctor & Gamble brands
Degree of vertical integration	Niagara Water's manufacturing its own bottles
Timing of market entry	Toyota's introduction of its compact cars to the US during the 70's oil embargo
Firm's policy of cost or differentiation	Southwest Airlines's decision to not serve meals in-flight
Geographic location	Denver redeveloping the reclaimed land when Stapleton Airport closed to create a series of communities with green spaces and sidewalks
Institutional factors (regulation, union activity, taxes, etc.)	Ford renegotiating with the United Auto Workers union to avoid bankruptcy

Figure 7.4 Automated towel dispenser

Illustration

Georgia Pacific once not only manufactured paper products but also at one time owned the pine forests that were the source of the pulp, the lumber and transport capabilities that cut and transported the trees, and the manufacturing that transformed the raw material into paper. They now also market the containers to dispense their paper products in customer locations through motion sensor devices, such as the one shown in Figure 7.4.

Lean Operations and Waste eduction

Just as the value chain helps managers focus on activities that add value, it is important to understand that most activities that do not add value are waste. Sometimes, an activity is neither value adding or wasteful, as when a patient signs a Health Insurance Portability and Accountability Act (HIPAA) notification; it is necessary because of regulations intended to protect the patient, but the patient does not necessarily perceive its value.

A central component to the operations/manufacturing of a company and an important component in the low cost alternative is the elimination of waste and the decrease in variability. The Toyota Production System (TPS) is acknowledged as a model for decreasing waste and variance in processes to enhance efficiency in operations, while at the same time producing consistency in products and services (Likert and Meier 2005). TPS includes many concepts, including lean manufacturing, which focuses on reducing or eliminating waste.

The seven sources of waste are: overproduction, waiting, unnecessary transport, unnecessary processing, excess inventory, unnecessary movements, and defects. Not only can these types of waste be manifest in manufacturing and service operations, you can apply them to information processing and overload (Brennan 2012) and the customer's experience, also known as "lean consumption" (Womack and Jones 2005).

CHAPTER 8

Creating the Organizational Vision

In real life, strategy is actually very straightforward. You pick a general direction and implement like hell.[1]

—Jack Welch, former Chairman & CEO,
General Electric

Opening Vignette

Taking the path less traveled can be a strategic move. Begun in the 1940s by Sidney Garfield, the "corporate" doctors rode barges up and down the Colorado River to treat injured lumberjacks working for the industrialist Henry Kaiser. In this "Wild West" territory, the relatively sparse population and the distance between towns prevented access to rapid medical care, essential not only to save lives but also to keep Kaiser Construction Company in business.

This early model of the HMO (Health Maintenance Organization) provided the prototype for the future of what we now call managed care, the norm for contemporary medicine in the United States. Doctors were paid "prospectively" per member per month. Kaiser, from its inception, delivered medicine a different way, essentially delivering the birth of prepaid healthcare.

It was President Richard Nixon who, in the 1970s, promoted the California style Kaiser HMO model in the Health Maintenance Organization Act of 1973 as the initial development of market competition into the

[1] J. Welch, with S. Welch, *Winning*. New York, NY: HarperBusiness, 2005.

health care arena. It was not until the passage of the DRG (diagnostically related groupings) of Medicare Prospective Payment in the 1980s that the HMO model was established as a way to attract corporate America into providing health care benefits to employees. HMOs were billed as a way to limit the expense of providing medical benefits to the workforce.[2]

Today Kaiser Permanente has 8.7 million plan members and revenues of 42.1 billion dollars.[3] This ingenious solution, crafted due to necessity, is the largest non-profit managed care organization in the United States. It focuses on standardizing medical care to optimize outcomes; operating under one name, with one set of policies; and creating both economies of scale and enhanced quality of care.

In this chapter, we consider specific strategies that can be used. Think of yourself at a crossroads, trying to decide what path to choose to get you to where you want to go. These paths are like the different strategies from which you can choose.

Organizations may choose to implement these strategies in some combination or in a sequence. Certainly large corporations are following more than one strategy at a time due to the complexity of their products and markets. The strategies you select should be determined based on your starting point, derived from your internal and external environmental assessment, and your destination—your vision and long-term goals.

The generic strategies we discussed in the previous chapter still apply, but these strategies simply provide more specific direction, e.g., how will you become a low-cost provider in a broad market?

Successful mastery of this material will enable you to:

- define a grand strategy
- describe strategies to promote growth internally
- explain strategies to promote growth by leveraging external resources
- identify strategies for retrenchment when a business is in trouble

[2]S. Jonas and A. Kovner. *Health Care Delivery in the United States*, 10e: 207–210. Springer Publishing, 2011.

[3]"Kaiser Permanente." Wikipedia, http://en.wikipedia.org/wiki/Kaiser_Permanente

Following this chapter is a deeper look at the strategy of innovation.

Introduction

The types of strategies covered in this chapter are often referred to as *grand* strategies. The idea of a grand strategy dates back at least to the Roman Empire. Sun Tzu's *The Art of War* is almost certainly the most famous study of strategy ever written and has had an extraordinary influence on the history of warfare; it has been dated back to 512 BCE (Tzu and Sawyer 1994). In the context of business, Hitt et al. (1982) assert that business strategy scholarship began in the 1960s with a variety of terms for corporate strategy at different levels of an organization. They define a grand strategy (p. 262) as "the major plan of action for achieving the sales and earning goals for an industrial firm as a whole" (rather than a product, division, or market segment) and suggest that the "grand strategies pursued by an organization are" (p. 267):

- Stability
- Internal growth
- External acquisitive growth
- Retrenchment

In the last two decades, scholars and executives have expanded the list, but these categories still apply. In our earlier chapter on sustainability, we addressed an organization's need for stability. In this chapter, our focus is on the last three types of grand strategies.

Internal Growth

When a company uses its own capabilities and resources to grow, it has a range of options with different risk/reward ratios. The choice should depend on the results of the internal assessment, e.g., if a product is reaching maturity in its life cycle, you might pursue a concentrated growth or market development strategy. If you find your portfolio of development projects is insufficiently diverse, you might want to devote some additional resources and pursue a product development or innovation strategy.

Concentrated Growth

The simplest and least risky internal growth strategy is for dedicated effort and resources to expand an existing product's market share. This strategy is typically used in mature markets with relatively stable supply sources so that the operation is scalable. One example is when Gillette introduced the Fusion® razor and invested heavily in advertising and promotion, using celebrities such as Roger Federer and Tiger Woods to encourage customers to switch to the more expensive razor.

Market Development

In this strategy, growth comes by introducing an existing product or service into new market segments or channels of distribution. For example, when Microsoft invested in Facebook, it was trying to tap into a younger generation of tech-savvy users. Lumigen®, a treatment for glaucoma, was marketed for cosmetic reasons when the company realized one of the drug's side effects was enhanced eyelash growth. Certainly, when a company decides to become international, it is looking to develop new markets.

Product Development

As you would expect, this strategy involves a substantial modification of an existing product, such as the Apple iPhone 4S, and the introduction of Siri. According to Apple's website (http://www. apple.com/iphone/features/siri.html), "Siri on iPhone 4S lets you use your voice to send messages, schedule meetings, place phone calls, and more. Ask Siri to do things just by talking the way you talk. Siri understands what you say, knows what you mean, and even talks back."

Product development can also take the form of creating related products that can be marketed to existing customers. For example, Amazon.com's Kindle® e-reader leveraged its reading customer base and the fact that most content has a digital format.

Innovation

This is the riskiest approach to internally-driven growth, but it also has the potential for high rewards. Pharmaceutical companies pursue many

different projects to have only one make it through the gauntlet to become approved for sale. 3M is renowned for its research culture, where scientists are encouraged to spend 20% of their time on unsponsored research. Innovative capability is so important, we will devote an entire chapter to it. For now, understand that innovation is the most aggressive way to generate growth from within an organization.

These internal growth strategies can be considered in two dimensions: oriented by products and by markets, whether new or existing. The Ansoff (1957) matrix (shown in Figure 8.1) was intended to help companies, especially those that find themselves in the mature stage of the product lifecycle, to ensure growth through one of four approaches: market penetration, market development, product development, and diversification, the most risky of the four alternatives. Ansoff defined the lowest risk as market penetration, increasing the percentage of consumers using a product or increasing the product usage by existing customers.

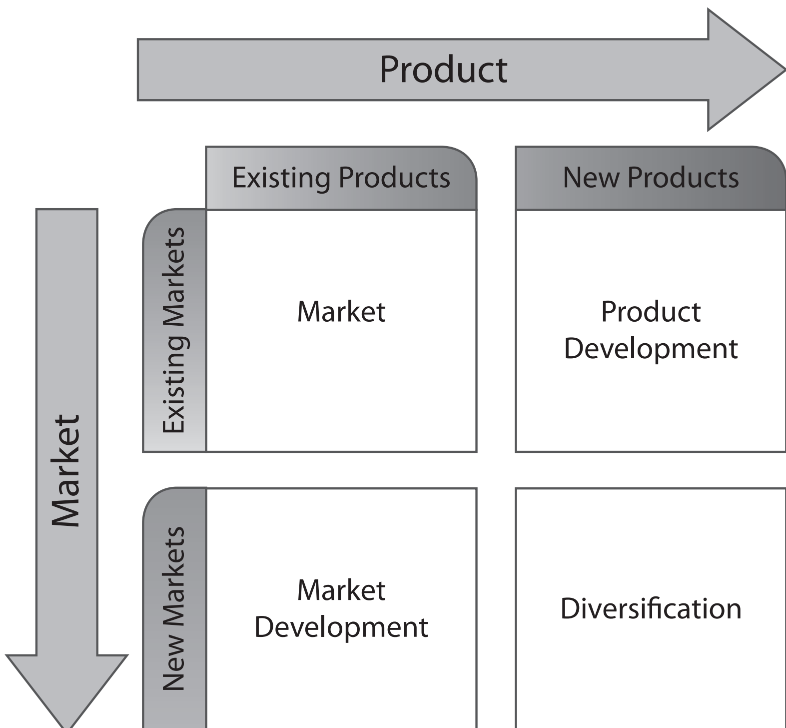

Figure 8.1 Ansoff Matrix

External Acquisitive Growth

Often companies will look outside of their organizations for opportunities to grow by some form of acquisition. The motives for these strategies vary. Rarely is it easy to accomplish acquisitive growth, merging people, processes, products, and information systems.

Horizontal Integration

When two competitors merge, or one acquires the other, it is considered to be a horizontal integration, growing bigger in the same segment of the value chain. Size matters, so firms will do this to dominate a market, create economies of scale, and leverage negotiating power. XM and Sirius Satellite Radio merged in 2008 to become Sirius XM. They still seem to be separate networks, perhaps because of different radio receivers' capabilities (http://www.siriusxm.com/subscriptions).

Vertical Integration

A merger or acquisition is considered to be *vertical* if it involves companies in different parts of the same value chain. Backward, or upstream, integration is when a company acquires a supplier; forward or downstream integration happens when a channel of distribution or customer is acquired. Shaw Industries started its path toward vertical integration in 1972 by acquiring a yarn producer (upstream supplier). It created its own trucking subsidiary to exert greater control over the logistics functions in its value chain. Downstream efforts include the establishment of retail operations with Shaw Design Centers and Shaw Flooring Galleries (http://www.shawfloors.com/ About-Shaw/Timeline).

Concentric or Related Diversification

This is a strategy pursued by businesses to expand within an industry, generally to counterbalance certain weaknesses. For example, when The Quaker Oats Company (TQOC) purchased Stokely Van Camp (SVC), the two companies were in the same core business: consumer groceries. However, the real impetus behind the acquisition was a then little-known product of

SVC called Gatorade®. The intent was to offset the seasonality of the hot cereals division with an offering that would appeal to consumers in the hot weather. With the marketing prowess of TQOC, a new category of beverage was created, and sales initially overwhelmed its distribution capacity.

Conglomerate or Unrelated Diversification

As the onomatopoeic "conglomerate" would indicate, this form of organization combines companies that only fit together as a diversified glob. There is generally no real effort to create synergies among the subsidiaries. A popular approach in the 1980s, it has fallen into disfavor—with a notable exception. Warren Buffet's Berkshire Hathaway has businesses ranging from ice cream and candy to furniture and car insurance. He treats the companies as a stock portfolio and does not get involved in day-to-day operations. In fact Buffet writes in the annual report (2010, p. 7):

> *At Berkshire, managers can focus on running their businesses. They are not subjected to meetings at headquarters nor financing worries nor Wall Street harassment. They simply get a letter from me every two years (it's reproduced on pages 104–105) and call me when they wish. And their wishes do differ: There are managers to whom I have not talked in the last year, while there is one with whom I talk almost daily. Our trust is in people rather than process. A "hire well, manage little" code suits both them and me.*

In 2010, the net earnings per share of BK-A holders were $7,928.

Joint Ventures

When two (typically) companies agree to create and operate a new entity, it is considered a joint venture (JV). It can take the form of majority/minority JV or be a 50/50 JV. For example, in August 2010, General Electric and Intel Corporation:

> *announced the entry into a definitive agreement to form a 50/50 joint venture to create a new healthcare company focused on telehealth and independent living. The new company will be formed by*

combining assets of GE Healthcare's Home Health division and Intel's Digital Health Group, and will be owned equally by GE and Intel. (Bruner 2010)

In early 2011, the venture achieved regulatory approval and went operational as "Care Innovations" (IntelPR 2011).

Strategic Alliances

Rather than creating an independent venture, strategic alliances tend to be characterized by legal agreements and expiration dates. The general idea of a strategic alliance is to create a shared result that the participants could not otherwise achieve. TiVo, Inc. and Sony Corporation of America announced a strategic alliance to manufacture Sony personal video recorders that enable the TiVo Personal Television Service. It is a non-exclusive agreement that may lead to the integration of Sony products and original content, including games, music, and movies (PRNewswire 2011).

Consortia

Less structured that a strategic alliance, a consortium (the plural form is consortia) represents strong interlocking relationships that are maintained by mutual benefit rather than by legal agreements. Known in Japan as *Keiretsu* and in South Korea as *Chaebois*, these families of companies work together for a common good. For example, the Georgia Research Alliance (www.gra.org) is a consortium of companies, universities, and developers who are working to promote innovation and job creation in the state of Georgia.

Of course, in considering the strategic alternatives that involve collaboration, there is both opportunity and risk. One of the greatest concerns is the amount of control the company has in determining the outcome of the strategy; another is the cost that may or may not result in the desired objectives. Just as in a personal relationship, a business relationship depends upon intangibles such as reputation and trust to make the collaboration successful.

Retrenchment

Our last category of grand strategies falls under retrenchment, i.e., what companies do when business is in decline.

Turnaround

A turnaround strategy is used in the case of a long-term decline and is often characterized by corporate restructuring. An example of this was when Anne Mulcahy was selected to be the CEO of Xerox in 2001, under extremely adverse conditions. Her turnaround strategy was to unbind the product matrix structure of the organization, resurrect the innovative culture of Xerox, and communicate. In a 2006 interview at the MIT Sloan School, she said that two thirds of Xerox's revenue came from products developed in the last two years (Mulcahy 2006).

Divestiture

This type of retrenchment is like throwing ballast out of an air balloon to make it lighter. Companies selectively sell off product lines or divisions to strengthen the financial condition of the remaining businesses. Proctor & Gamble is selling its Pringles snack line, as it is underperforming expectations (Ziobro 2011). In the 1980s, The Quaker Oats Company spun off its subsidiary, Fisher Price, because management believed that the stock market was undervaluing the contribution of the toy company in the overall stock price.

Bankruptcy

There are different forms of bankruptcy, but all involve court action. Like liquidation, some bankruptcies involve selling the assets and distributing the proceeds to creditors, usually at a fraction of what is owed. Another type is a "reorganization bankruptcy," which holds creditors back temporarily. Delta Airlines was declared bankrupt in September 2005. It successfully emerged from bankruptcy after establishing a new route structure, cost-cutting aggressively, merging with Northwest Airlines, and getting creditors to cede 15% ownership to employees (Foust 2009).

Liquidation

When the sum of the parts is greater than the whole, i.e., the pieces of a business are worth more than its market valuation, it makes sense to liquidate. Initially, the Borders chain of bookstores filed for Chapter 11 bankruptcy protection, reorganizing by closing more than 400 stores and letting go of more than 10,000 workers. When these measures were not enough, management sought a buy-out, which fell through. They are currently undergoing liquidation (including a guitar signed by former Beatles guitarist George Harrison, found in the company's headquarters) of its corporate property (Cohen 2011).

Strategy Selection

Firms will use a combination of grand strategies. A large corporation might have a heavy emphasis on innovation in one division, while working on market development and international expansion in another. Proctor & Gamble, for example, has been very engaged in product developm-nent with its Swiffer(r) brand, while concurrently pursuing divestiture of its Folgers(r) and Pringles(r) brands. Other organizations may shift, say from turnaround mode, to horizontal acquisition, once the turnaround is successful.

CHAPTER 9

How to Innovate and How Innovation Fits With Strategy

As a matter of fact, capitalist economy is not and cannot be stationary. Nor is it merely expanding in a steady manner. It is incessantly being revolutionized from within by new enterprise, i.e., by the intrusion of new commodities or new methods of production or new commercial opportunities into the industrial structure.[1]

—Joseph Schumpeter

Opening Vignette

Do you think all basic manufacturing has been sent overseas from the United States? Think again. According to *The Wall Street Journal,* many people are surprised to learn that most of the 11 billion paper clips used in the United States are manufactured domestically. ACCO Brands, Inc. self-described as a "global powerhouse of leading office-product brands," is introducing a new paperclip. The Klix clip is made of stainless steel, comes in a variety of colors, and costs sixteen times more than a conventional paper clip.

Import tariffs have protected (non-plastic) domestic clip makers from competition, especially from China. Product innovation has been almost non-existent, although ACCO puts a strong emphasis on process innovation and lean principles. The new Klix represents a rare innovation in what is considered a commodity product.

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[1]J. Schumpeter. *Capitalism, Socialism, and Democracy.* Part I, Chapter III (1942): 31. Based on an article by James R. Hagerty, reported on August 29, 2011, in *The Wall Street Journal*. Accessed September 15, 2011 at http:online.wsj.com

A key characteristic of strategic management is its dynamic nature. The external environment changes, you adapt your strategies. The competition takes an unexpected turn, you adjust accordingly. If something does not turn out as intended, you modify the approach. A strategy itself represents a plan for change.

Abrahamson (2000) suggests that companies can bring about change without the pain, confusion, cynicism, or burnout that seems inevitable by adopting a process of *dynamic stability*. The idea is that organizational members have a sense of security in a culture of flexibility. The process alternates major change efforts with smaller ones, such as *tinkering*, *kludging*,[2] and *pacing*. While you will not practice tinkering in this chapter, you will understand the need for dynamic stability and an emphasis on innovation. Successful mastery of this material will enable you to:

- articulate the importance of innovation
- identify sources of innovation
- understand disruptive innovation
- explain reverse innovation
- illustrate different ways in which companies innovate

Introduction

One of our grand strategies for internally-generated growth was innovation, specifically as new product development. In this chapter we are taking a broader view of innovation, and we will end with an excerpt, "12 Different Ways for Companies to Innovate," to emphasize that perspective. Innovation is the introduction of new things or methods (www.dictionary.com). More specifically, management authority Peter Drucker (1985) defines innovation as an act that endows resources with a new capacity to create wealth.

The Importance of Innovation

As our opening quote from the renowned economist suggests, innovation is central to being competitive in a capitalist economy. Maintaining a

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[2]According to Abrahamson (2000), kludging is tinkering, but with a college education (i.e., it has more complexity).

company's status quo is likely to result in it falling behind as other companies innovate. This is what Schumpeter and others have termed "the creative destruction of capitalism." Competitive forces drive innovation—and a lack of innovation drives destruction.

OK, so you need to innovate. The problem is that it is easier said than done. In fact, in its 2002 issue devoted to "The Innovative Enterprise," the *Harvard Business Review* suggests that one of the toughest challenges an executive faces is inspiring innovation while keeping everyday operations running smoothly, i.e., maintaining dynamic stability.

One key hurdle is a fear of failure. The adage "nothing ventured, nothing gained" is familiar to all of us, yet we hesitate. Our education tends to train our minds to think there is only one right answer, and if you do not select it, you lose credit. If you make a mistake in business, will it be a career-ending move? Organizational cultures that inspire innovation encourage creative exploration ("there is no such thing as a bad idea") and are not punitive when it comes to innovations that disappoint ("it's OK to make a mistake; just don't make the same mistake twice; learn from it). A climate of safety goes a long way in encouraging people to share their ideas. *The Wall Street Journal* reported that some companies are even rewarding employees' mistakes to spur innovation (Shellenbarger 2011).

Another obstacle to innovation is inflated expectations about what it takes to be creative. Some people think you have to have artistic skills or a radical idea to be innovative; in reality, there are different ways to be creative. For example, Eisner (1966) describes boundary pushing (expanding limits) and boundary breaking (reversing assumptions) as two types of creativity. His view of invention is not limited to the radical idea, but encompasses "useful combinations, congruencies [and] . . . discovery followed by purposeful activity" (p. 327).

Illustration

Who would have ever thought that a snowboarding kid from Utah would not only create a product, but take a company public? Well, the snowboarding founder of Skullcandy, Rick Alden, did. His company specializes in earphones and headphones that fly off the shelf. When Skullcandy stock went public on NASDAQ with an initial price 15% above the

projected IPO ask, Alden was named one of *Spring Capital's* "Top 100 Venture Entrepreneurs." In 2008, the Skullcandy ear bud was named "the world's coolest ear bud" by *Fortune.* The company has quickly jumped to its place as the third most-sold headphone in the U.S. marketplace. Revenues have grown from 9 million in 2006 to 231 million in 2011 (Tillman 2011).

So why did these earphones take off? The combination of focus on the niche market of young athletes listening while participating in action sports with specialized distribution through sports retailers and high tech gear stores, in combination with celebrity sports endorsement, set this company "sailing." Alden, an avid athlete and snowboarder, demonstrated creativity with the combination of musical entertainment and action sports.

This unique combination of needs, followed by purposeful activity such as product development and niche marketing behind a clear vision, drove this entrepreneur to financial and market success. Innovation does not need to be complex, just timely, translatable, and desirable.

In the following section, we discuss ways to overcome these stumbling blocks by being aware of different sources of innovation.

Sources of Innovation

Divine inspiration not withstanding, it is possible to be deliberately analytical in an innovative process. Just as strategic management is a process that leads you to a desired result, innovation is also a course of action that can be accomplished in a progression. As part of understanding the company in context and performing environmental scanning, you can be alert to various sources of innovation.

Drucker

Peter Drucker acknowledges that innovations can spring from a flash of genius, but argues that (2002, p. 4):

> *Most innovations, however, especially the successful ones, result from a conscious, purposeful search for innovation opportunities, which are*

found only in a few situations. Four such areas of opportunity exist within a company or industry: unexpected occurrences, incongruities, process needs, and industry and market changes. Three additional sources of opportunity exist outside a company in its social and intellectual environment: demographic changes, changes in perception and changes in knowledge. [emphasis added]

According to Drucker (1985, p. 35), "the overwhelming majority of successful innovations *exploit* change. . . . There are innovations that in themselves constitute a major change . . . but these are exceptions. . . . Most successful innovations are far more prosaic. . . . Systematic innovation means monitoring *seven* sources for innovative opportunity."

Illustrations

Of the seven sources, we will illustrate three here. *Unexpected occurrences* can be unexpected successes or failures. Pharmaceutical company Pfizer's introduction of Viagra™ might well be considered both. During clinical trials of the medication as a heart medicine, it was found to have an unexpected side effect, increasing blood flow to the penis during sexual stimulation.

Incongruities are disparities between what is and what could be or what should be. Anyone who has carried an infant in a car seat can tell you it *should* be easier. To protect the baby, the car seat is understandably bulky, but this makes it necessary to carry it away from the body. You can take the baby out of the car seat and put it into a stroller, but depending on the child, that process *could* be easier. Graco®, a leading manufacturer of baby strollers, has addressed this incongruity with "travel systems" that allow infant seats to be securely attached to stroller frames, as shown in Figure 9.1.

Process need can point to innovations, particularly in services. Berry et al. (2006, p. 59) categorize four different types of market-creating service innovations, according to type of benefit, i.e., whether they offer a new core benefit or new way of delivering a "core" benefit, and type of service, i.e., if the service consumption is separable or inseparable from its production.

Figure 9.1 3-in-1 stroller

- Flexible solutions—separable service with a new core benefit, e.g., CNN delivering news 24 hours/day.
- Controllable convenience—separable service with new delivery, e.g., Netflix offering movies by mail or via the Internet.
- Comfortable gains—inseparable service with a new core benefit, e.g., Starbucks offering high quality coffee in a relaxing atmosphere at convenient locations.
- Respectful access—inseparable service with a new delivery that respects the customers' time and physical presence, e.g., Southwest Airlines offering affordable, no-frills, short-haul transportation.

Sustainability

In Chapter 4, we introduced the idea of sustainability. Not only is innovation necessary to generally sustain the organization over the long term, the push for environmental sustainability is creating many opportunities for innovation. Nimodumolu et al. (2009, p. 58) assert that sustainability is now the key driver of innovation, and that, "in the future, only companies that make sustainability a goal will achieve competitive advantage. This means rethinking business models as well

as products, technologies, and processes." They present a five stage process, identifying sustainability challenges, competencies, and opportunities (p. 60):

1. Viewing compliance as an opportunity
2. Making value chains sustainable
3. Designing sustainability products and services
4. Developing new business models
5. Creating next-practice platforms

It is important for any kind of innovation process to be forward-thinking, and this is especially true with efforts to become sustainable. Current benchmarks for emissions, for example, are likely to be outdated within the time it takes for a company to become compliant.

In their assessment of successes and failures from other emerging technologies, Day and Schoemaker (2011) propose 10 lessons for green technologies, including: "technology substitution is rarely a zero-sum game" (p. 39), acknowledging that green innovations will not only substitute for but also coexist with existing technologies. They emphasize the importance of collaboration, thinking beyond industry boundaries, and sharing knowledge for innovative synergies.

Base of the Pyramid

The base of the pyramid (BOP) refers to the billions of people who live on less than 2,000 USD per year. This market is a source of innovation:

> *when [multi-national corporations] MNCs provide basic goods and services that reduce costs to the poor and help improve their standard of living—while generating an acceptable return on investment—the results benefit everyone. . . . Businesses can gain three important advantages by serving the poor—a new source of revenue growth, greater efficiency, and access to innovation. (Prahalad and Hammond 2002, p. 51)*

Building on this insight, Anderson and Markides (2007, p. 84) offer that strategic innovation at the BOP is based on four A's:

- affordability, delivering offerings at a price point that enables consumption by even the poorest consumers;
- acceptability, responding to specific cultural issues and local business practices;
- availability, distributing or delivering products and services to the most isolated communities; and
- awareness, learning to use alternative communication modes and methods for marketing.

In India, the influence of Mahatma Gandhi's emphasis on affordability and sustainability has fueled "Gandhian Innovation" by Indian companies, by either creating or sourcing new capabilities, modifying organizational capabilities, or by disrupting business models (Prahalad and Mashelkar 2010). While the first two practices are familiar as a resourcebased view of management, the idea of disruptive models is explained below.

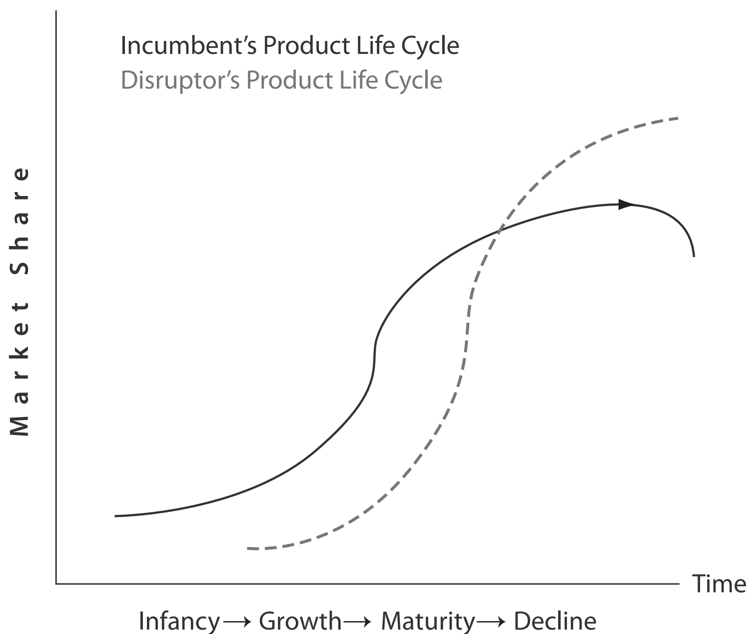

Figure 9.2 Disruptive Innovation

Disruptive Innovation

The term *disruptive innovation* was brought to the forefront of management thinking by Harvard professor Clayton Christensen in his 1997 book, *The Innovator's Dilemma*. In basic terms, market leaders tend to make incremental improvements to extend their products' life cycles. They focus on the needs or expectations of their existing customers[3] and disregard new entrants who typically have an inferior product, which initially garners a small amount of market share. As shown in Figure 9.2, some new entrants become *disruptors*, by displacing the incumbent and becoming dominant in the market.

Illustration

For those of us who can remember the introduction of mobile phones, they were clearly inferior to landline connections. Although bulky, expensive, and unreliable, they did provide a new functionality: untethered communications. As we have witnessed over the last two decades, cell phones have become so far superior and "smart" that many people forgo having a landline telephone number, or have one only for emergencies.

Reverse Innovation

The idea of *reverse innovation*, a term coined by General Electric (GE), is a combination of disruptive innovation and Gandhian innovation. Innovations typically start in industrialized nations, and as the products mature, they are disseminated to other markets to extend the products' life cycles. Reversing that process and innovating for the people at the base of the pyramid can lead to disruptive opportunities:

Developing countries are ideal target markets for disruptive technologies for at least two reasons. First, business models that are forged in low-income markets travel well; that is, they can be profitably applied in more

[3]As Henry Ford is credited with saying, "If I had asked people what they wanted, they would have said faster horses;" customers' demands can be limited by their familiarity with existing capabilities.

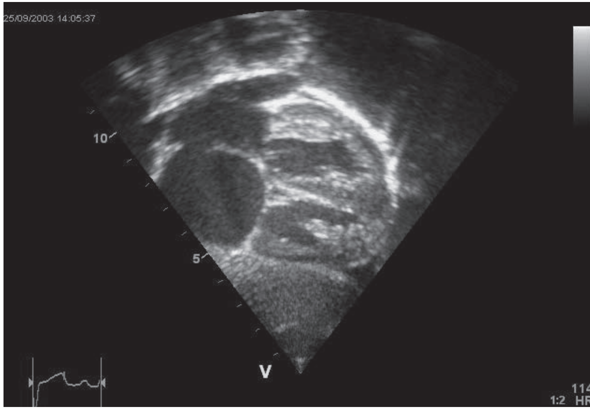

Figure 9.3 Ultrasound Picture of a Heart

places than models defined in high income markets. . . . In addition to having more adaptable business models, disruptive innovators also compete against non-consumption in low-income markets. (Hart and Christensen 2002, p. 53)

What GE is doing is disrupting itself by pursuing reverse innovation—to avoid being displaced by other disruptors. For example, they collaborated with Chinese doctors to develop an inexpensive ultrasound machine. It is inferior to GE's other ultrasound machines in terms of resolution, but available at a fraction of the others' costs. It is affordable and accessible, and provides a service that might not otherwise be available to 90% of China's population (Immelt et. al. 2009). It is also now being sold in the United States.

SECTION 4
Implementation

If 80% of your efforts go into following this process to develop a strategic plan, you will receive approximately 20% of the potential benefits. The rest comes from managing the execution, monitoring progress, and leading the organization to the desired results.

CHAPTER 10

Strategic Clarity: Is Your Plan Complete and Understandable?

Do you think that mere words are strategy and power for war?
—The Bible: 2 Kings, 18:20

This chapter is really a short introduction to the reading that follows. In recognition that "when executives call everything strategy, and end up with a collection of strategies, they create confusion and undermine their own credibility," Hambrick and Fredrickson (2001, p. 49) offer a practical framework, their *strategy diamond*, to ensure that strategies are complete and clear.

Upon successful completion of this reading you should be able to:

- describe the components of the strategy diamond
- apply the strategy diamond to evaluate the completeness of a strategy's plan

Consider this step in the strategic management process as the "reality check." What is the underlying economic logic for this strategy? Will you have enough resources to implement it stage-by-stage? Where will you employ this strategy? How will you employ this strategy?

Too often, we accept statements like, "our strategy is to reach the Hispanic base," or "our strategy is to be the preferred provider for health care services," or "our strategy is to energize new voters" as true strategies. Remember, a strategy is a plan to create and/or sustain a competitive

advantage. It is not a "sound bite." It is a plan that should communicate what is to be done, where, how, and by whom.

It should also be communicated in as simple of terms as possible. "Polysyllabic" is fun to say, but it will obfuscate your intentions. Other unattributed writing tips gleaned from the Internet include:

Verbs *have* to agree with their subjects.

1. Prepositions are not words to end sentences with.
2. And don't start a sentence with a conjunction.
3. It is wrong to ever split an infinitive.
4. Also, too, never, ever use repetitive redundancies.
5. No sentence fragments.
6. The passive voice is to be ignored.
7. Never use a big word when a diminutive one would suffice.
8. Use words correctly, irregardless of how others use them.
9. Make sure you proofread to make sure you have not any words out.

Kidding aside, even if your strategy *is* complete, if it is not clear, it will not happen.

Illustration

In its strategic plan, the American Cancer Society (ACS 2010) has a formal mission statement, but it also uses phrases such as "to help create a world with less cancer and more birthdays," humanizing its mission. Its strategies are presented with measurable outcomes and a specific timeframe. From helping people to stay well, helping people to get well, and finding cures, the plan becomes very specific about how those strategies will be executed. For example (p. 12), "Improve quality of life of cancer patients, caregivers, and survivors by assisting primarily with service referral, community mobilization, collaboration, advocacy, and, where appropriate, directly providing services," explains what they will do to address quality of life issues and how they will do it.

As you read the following selection, be reminded that results come from complete and clear plans.

The Elements of Strategy

If a business must have a strategy, then the strategy must necessarily have parts. What are those parts? As Figure 10.2 portrays, a strategy has five elements, providing answers to five questions:

- Arenas: "Where will we be active?"
- Vehicles: "How will we get there?"
- Differentiators: "How will we win in the marketplace?"
- Staging: "What will be our speed and sequence of moves?"
- Economic logic: "How will we obtain our returns?"

This article develops and illustrates these domains of choice, emphasizing how essential it is that they form a unified whole. Where others focus on the inputs to strategic thinking (the top box in Figure 10.1), we focus on the output—the composition and design of the strategy itself.

Arenas

The most fundamental choices strategists make are those of where, or in what arenas, the business will be active. This is akin to the question Peter Drucker posed decades ago: "What business will we be in?" The answer, however, should not be one of broad generalities. For instance, "We will be the leader in information technology consulting" is more a vision or objective than part of a strategy. In articulating arenas, it is important to be as specific as possible about the product categories, market segments, geographic areas, and core technologies, as well as the value-adding stages (e.g., product design, manufacturing, selling, servicing, distribution) the business intends to take on.

For example, as a result of an in-depth analysis, a biotechnology company specified its arenas: The company intended to use T-cell receptor technology to develop both diagnostic and therapeutic products for battling a certain class of cancers; it chose to keep control of all research and product development activity, but to outsource manufacturing and a major part of the clinical testing process required for regulatory approvals. The company targeted the United States and major European markets as its geographic scope. The company's chosen arenas were highly specific,

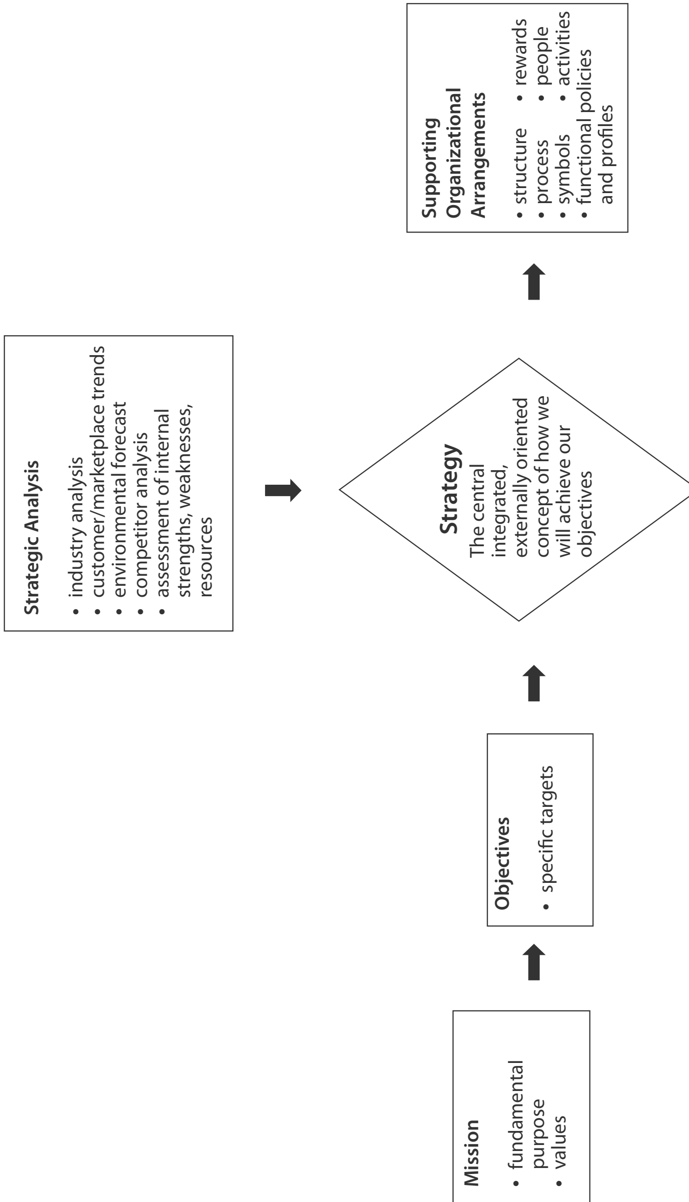

Figure 10.1 Putting Strategy in Its Place

with products and markets even targeted by name. In other instances, especially in businesses with a wider array of products, market segments, or geographic scope, the strategy may instead reasonably specify the classes of, or criteria for, selected arenas—e.g., women's high-end fashion accessories, or countries with per-capita GDP over $5,000. But in all cases, the challenge is to be as specific as possible.

In choosing arenas, the strategist needs to indicate not only where the business will be active, but also how much emphasis will be placed on each. Some market segments, for instance, might be identified as centrally important, while others are deemed secondary. A strategy might reasonably be centered on one product category, with others—while necessary for defensive purposes or for offering customers a full line—being of distinctly less importance.

Vehicles

Beyond deciding on the arenas in which the business will be active, the strategist also needs to decide how to get there. Specifically, the means for attaining the needed presence in a particular product category, market segment, geographic area, or value-creation stage should be the result of deliberate strategic choice. If we have decided to expand our product range, are we going to accomplish that by relying on organic, internal product development, or are there other vehicles—such as joint ventures or acquisitions—that offer a better means for achieving our broadened scope? If we are committed to international expansion, what should be our primary modes, or vehicles—greenfield startups, local acquisitions, licensing, or joint ventures? The executives of the biotechnology company noted earlier decided to rely on joint ventures to achieve their new presence in Europe, while committing to a series of tactical acquisitions for adding certain therapeutic products to complement their existing line of diagnostic products.

The means by which arenas are entered matters greatly. Therefore, selection of vehicles should not be an afterthought or viewed as a mere implementation detail. A decision to enter new product categories is rife with uncertainty. But that uncertainty may vary immensely depending on whether the entry is attempted by licensing other companies' technologies, where perhaps the firm has prior experience, or by acquisitions,

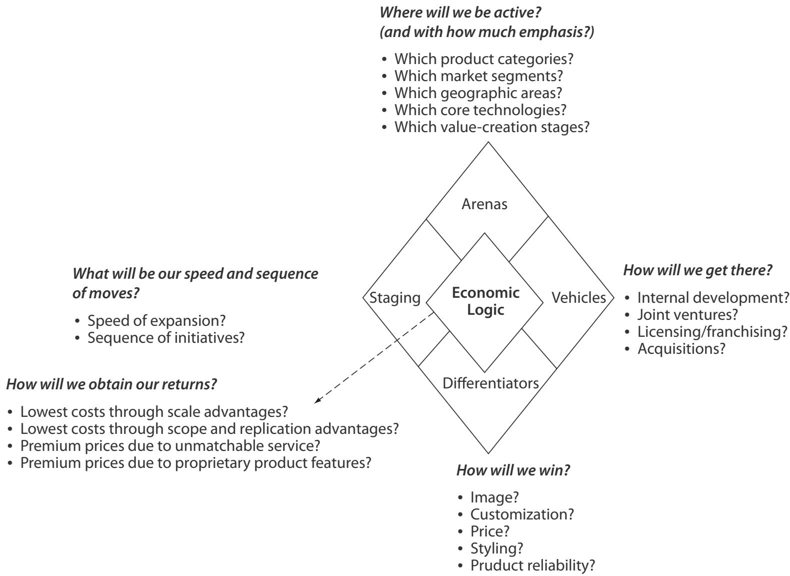

Figure 10.2 The Five Major Elements of Strategy

where the company is a novice. Failure to explicitly consider and articulate the intended expansion vehicles can result in the hoped-for entry's being seriously delayed, unnecessarily costly, or totally stalled.

> **Failure to explicitly consider and articulate the intended expansion vehicles can result in the hoped-for entry's being seriously delayed, unnecessarily costly, or totally stalled.**

There are steep learning curves associated with the use of alternative expansion modes. Research has found, for instance, that companies can develop highly advantageous, well-honed capabilities in making acquisitions or in managing joint ventures. The company that uses various vehicles on an ad hoc or patchwork basis, without an overarching logic and programmatic approach, will be at a severe disadvantage compared with companies that have such coherence.

Differentiators

A strategy should specify not only where a firm will be active (arenas) and how it will get there (vehicles), but also how the firm will win in the

marketplace—how it will get customers to come its way. In a competitive world, winning is the result of differentiators, and such edges don't just happen. Rather, they require executives to make up-front, conscious choices about which weapons will be assembled, honed, and deployed to beat competitors in the fight for customers, revenues, and profits. For example, Gillette uses its proprietary product and process technology to develop superior razor products, which the company further differentiates through a distinctive, aggressively advertised brand image. Goldman Sachs, the investment bank, provides customers with unparalleled service by maintaining close relationships with client executives and coordinating the array of services it offers to each client. Southwest Airlines attracts and retains customers by offering the lowest possible fares and extraordinary on-time reliability.

Achieving a compelling marketplace advantage does not necessarily mean that the company has to be at the extreme on one differentiating dimension; rather, sometimes having the best combination of differentiators confers a tremendous marketplace advantage. This is the philosophy of Honda in automobiles. There are better cars than Hondas, and there are less expensive cars than Hondas; but many car buyers believe that there is no better value—quality for the price—than a Honda, a strategic position the company has worked hard to establish and reinforce.

Regardless of the intended differentiators—image, customization, price, product styling, after-sale services, or others—the critical issue for strategists is to make up-front, deliberate choices. Without that, two unfortunate outcomes loom. One is that, if top management doesn't attempt to create unique differentiation, none will occur. Again, differentiators don't just materialize; they are very hard to achieve. And firms without them lose.

The other negative outcome is that, without up-front, careful choices about differentiators, top management may seek to offer customers across-the-board superiority, trying simultaneously to outdistance competitors on too broad an array of differentiators—lower price, better service, superior styling, and so on. Such attempts are doomed, however, because of their inherent inconsistencies and extraordinary resource demands. In selecting differentiators, strategists should give explicit preference to those few forms of superiority that are mutually reinforcing (e.g., image and

product styling), consistent with the firm's resources and capabilities, and, of course, highly valued in the arenas the company has targeted.

Staging

Choices of arenas, vehicles, and differentiators constitute what might be called the substance of a strategy—what executives plan to do. But this substance cries out for decisions on a fourth element—staging, or the speed and sequence of major moves to take in order to heighten the likelihood of success. Most strategies do not call for equal, balanced initiatives on all fronts at all times. Instead, usually some initiatives must come first, followed only then by others, and then still others. In erecting a great building, foundations must be laid, followed by walls, and only then the roof.

Of course, in business strategy there is no universally superior sequence. Rather the strategist's judgment is required. Consider a printing equipment company that committed itself to broadening its product line and expanding internationally. The executives decided that the new products should be added first, in stage one, because the elite sales agents they planned to use for international expansion would not be able or willing to represent a narrow product line effectively. Even though the executives were anxious to expand geographically, if they had tried to do so without the more complete line in place, they would have wasted a great deal of time and money. The left half of Figure 10.3 shows their two-stage logic.

The executives of a regional title insurance company, as part of their new strategy, were committed to becoming national in scope through a series of acquisitions. For their differentiators, they planned to establish a prestigious brand backed by aggressive advertising and superb customer service. But the executives faced a chicken-and-egg problem: they couldn't make the acquisitions on favorable terms without the brand image in place; but with only their current limited geographic scope, they couldn't afford the quantity or quality of advertising needed to establish the brand. They decided on a three-stage plan (shown in the right half of Figure 10.3): (1) make selected acquisitions in adjacent regions, hence becoming super-regional in size and scale; (2) invest moderately heavily in advertising and brand-building; 3) make acquisitions in additional

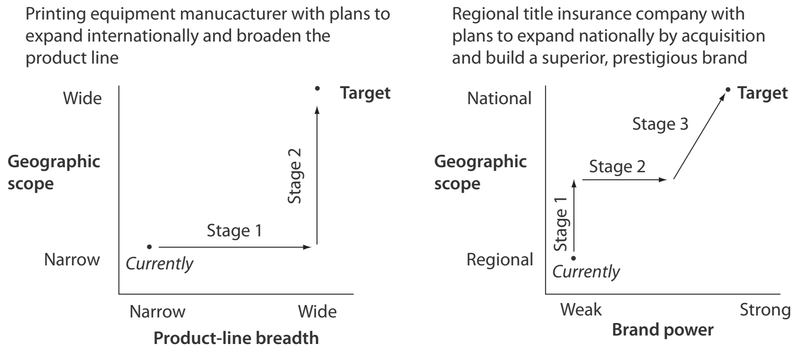

Figure 10.3 Elements of Strategic Staging

regions on more favorable terms (because of the enhanced brand, a record of growth, and, they hoped, an appreciated stock price) while simultaneously continuing to push further in building the brand.

Decisions about staging can be driven by a number of factors. One, of course, is resources. Funding and staffing every envisioned initiative, at the needed levels, is generally not possible at the outset of a new strategic campaign. Urgency is a second factor affecting staging; some elements of a strategy may face brief windows of opportunity, requiring that they be pursued first and aggressively. A third factor is the achievement of credibility. Attaining certain thresholds—in specific arenas, differentiators, or vehicles—can be critically valuable for attracting resources and stakeholders that are needed for other parts of the strategy. A fourth factor is the pursuit of early wins. It may be far wiser to successfully tackle a part of the strategy that is relatively doable before attempting more challenging or unfamiliar initiatives. These are only some of the factors that might go into decisions about the speed and sequence of strategic initiatives. However, since the concept of staging has gone largely unexplored in the strategy literature, it is often given far too little attention by strategists themselves.

Economic Logic

At the heart of a business strategy must be a clear idea of how profits will be generated—not just some profits, but profits above the firm's cost of capital. It is not enough to vaguely count on having revenues that are above

costs. Unless there's a compelling basis for it, customers and competitors won't let that happen. And it's not enough to generate a long list of reasons why customers will be eager to pay high prices for your products, along with a long list of reasons why your costs will be lower than your competitors'. That's a sure-fire route to strategic schizophrenia and mediocrity.

> **It is not enough to vaguely count on having revenues that are above costs. Unless there's a compelling basis for it, customers and competitors won't let that happen.**

The most successful strategies have a central economic logic that serves as the fulcrum for profit creation. In some cases, the economic key may be to obtain premium prices by offering customers a difficult-to-match product. For instance, the *New York Times* is able to charge readers a very high price (and strike highly favorable licensing arrangements with online information distributors) because of its exceptional journalistic quality; in addition, the *Times* is able to charge advertisers high prices because it delivers a large number of dedicated, affluent readers. ARAMARK, the highly profitable international food-service company, is able to obtain premium prices from corporate and institutional clients by offering a level of customized service and responsiveness that competitors cannot match. The company seeks out only those clients that want superior food service and are willing to pay for it. For example, once domestic airlines became less interested in distinguishing themselves through their in-flight meals, ARAMARK dropped that segment.

In some instances, the economic logic might reside on the cost side of the profit equation. ARAMARK—adding to its pricing leverage—uses its huge scale of operations and presence in multiple market segments (business, educational, healthcare, and correctional-system food service) to achieve a sizeable cost advantage in food purchases—an advantage that competitors cannot duplicate. GKN Sinter Metals, which has grown by acquisition to become the world's major powdered-metals company, benefits greatly from its scale in obtaining raw materials and in exploiting, in country after country, its leading-edge capabilities in metal-forming processes.

In these examples, the economic logics are not fleeting or transitory. They are rooted in the firms' fundamental and relatively enduring capabilities.

ARAMARK and the *New York Times* can charge premium prices because their offerings are superior in the eyes of their targeted customers, customers highly value that superiority, and competitors can't readily imitate the offerings. ARAMARK and GKN Sinter Metals have lower costs than their competitors because of systemic advantages of scale, experience, and know-how sharing. Granted, these leads may not last forever or be completely unassailable, but the economic logics that are at work at these companies account for their abilities to deliver strong year-in, year-out profits.

The Imperative of Strategic Comprehensiveness

By this point it should be clear why a strategy needs to encompass all five elements—arenas, vehicles, differentiators, staging, and economic logic. First, all five are important enough to require intentionality. Surprisingly, most strategic plans emphasize one or two of the elements without giving any consideration to the others. Yet, to develop a strategy without attention to all five leaves critical omissions.

> **Surprisingly, most strategic plans emphasize one or two of the elements without giving any consideration to the others.**

Second, the five elements call not only for choice, but also for preparation and investment. All five require certain capabilities that cannot be generated spontaneously.

Third, all five elements must align with and support each other. When executives and academics think about alignment, they typically have in mind that internal organizational arrangements need to align with strategy (in tribute to the maxim that "structure follows strategy"), but few pay much attention to the consistencies required among the elements of the strategy itself.

Finally, it is only after the specification of all five strategic elements that the strategist is in the best position to turn to designing all the other supporting activities—functional policies, organizational arrangements, operating programs, and processes—that are needed to reinforce the strategy. The five elements of the strategy diamond can be considered the hub or central nodes for designing a comprehensive, integrated activity system.

CHAPTER 11

Evaluating Your Strategy in a Global Context

It's a global economy, so quit whining . . .[1]

—Om Malik

Opening Vignette

In his book, *The World Is Flat* (2005), Tom Friedman argues that the proverbial playing field in commerce has been leveled and all competitors have an equal opportunity. He warns that to be competitive in a global market, traditional barriers are becoming increasingly irrelevant, making global positioning a challenge.

One company succeeding in a global context is Coca-Cola Enterprises (CCE). A "first mover," the company first went global during the first World War. Since then, its strategies were not to use cheaper sources of labor to reduce production expense and streamline operations as many manufacturing companies have done. Instead, CCE's global business model has always centered on market expansion.

As such, sensitivity to different cultures, preferences, tastes, and customs has put it way ahead of other U.S. companies trying to go global. Coca-Cola sells over 400 brands in 200 countries. Almost 70% of the company's sales are abroad where Coke is not only a brand, but becomes a way of life due to the strategic involvement of the company in the communities in which it markets its products. For example, the company is expanding into Africa, where distribution is a major obstacle. They are

[1]O. Malik. The new land of opportunity. *Business 2.0* (July 2004): 72–78.

using their sponsorship of the popular pastime of football and linking carbonated soda with spectator tastes.[2]

In this chapter, we add one more dimension to the strategy model. If one dimension is your competitive position and the second dimension is time, then the third dimension is place. In particular, we examine the implications of strategies implemented around the world, i.e., in a global context.

As in mathematics, added dimensions create added complexity. So when we think about "going global," we need new ways of understanding the implications of those strategic choices. This is not to say that you cannot achieve your desired results; rather, you have the opportunity for even greater results (it's a big world out there!), but have to evaluate and execute ever more carefully. Globalization requires awareness, understanding, and response to global development and linkages (Czinkota et. al. 2004).

This chapter does not purport to be an entire course in global management. We will focus on considerations that are largely the purview of strategic management. For example, we do not discuss cultural differences and their marketing implications—which are very important—other than to highlight how those factors may impact your strategic choices. Successful mastery of this material will enable you to:

- extend your understanding of the strategy diamond (Hambrick and Fredrickson 2001) to international business strategies
- evaluate the pros and cons of a host country in terms of distance
- explain the implications of different entry modes
- describe different business configurations for multi-national corporations (MNCs)

Introduction

Unless you have been in a complete media blackout, you must be aware of how interdependent the world has become. The housing market collapse in the United States has, in an extended chain of events, placed economies around the world on the brink of collapse. Take a common item around

[2] R. Irwin. Painting South Africa red. 2001. http://www.brandchannel.com

your home or office; if it had a transparent supply chain, you might be surprised by its provenance. The t-shirt you are wearing might have been grown in Texas, sewn in China, affected cotton prices in Africa, and created trade imbalances along the way (Rivoli 2005).

Infrastructure improvements and technology advancements have been both enablers and drivers of globalization. Not everyone is in favor of globalization, but the trends seem inexorable. We are experiencing converging market wants and needs, regional economic integration, emerging markets, and competitive pressures for cost reductions and extended lifecycles. These phenomena are all forces pressing us toward globalization.

Some view globalization as threat (due to cultural dilution, resource depletion, and exploitation) and others view globalization as an opportunity (for quality of life improvements and new opportunities). Proponents note that business growth opportunities, particularly in mature industries, tend to be outside of the United States. Labor costs also tend to be lower outside of the United States. However, anti-globalization advocates are concerned about becoming "Westernized," i.e., liberal, materialistic, and/or heretical. And since some developing countries are rich in natural resources and low on regulation, they are in danger of resource depletion. Also, since some of the growth stimulated by globalization creates "sweatshop" jobs, increases pollution, and draws people from the countryside into overcrowded cities and slums, concerns about exploitation are raised. We believe that, whether you are a proponent of globalization or not, you should have the ability to consider strategies in a global context.

Strategy Diamond: The Global Edition

In the previous reading, we learned about the importance of a thorough and thoughtful strategy. General business principles apply, but under conditions of greater complexity and uncertainty. Using the Hambrick and Fredrickson (2001) strategy diamond, you learned to consider arenas, vehicles, differentiators, staging, and economic logic, as shown in Figure 11.2 of their article. While it is fundamentally no different in a global context, the questions become slightly more complex.

It is important to note that business risks increase dramatically for a variety of reasons. Consider that even if you have a good product or

service, you might fail because of poor market research or strategy execution, over-extension or over-investment, external forces or operational disruptions, and fraud or corruption. To the questions posed by the strategy diamond, you might add the following as you work through each element of the model:

- How will our offerings fit into the international market?
- Should we enter the market through trade or investment?
- What is the probability of a disruption in supply if we extend our supply chain abroad?
- How do we protect our intellectual, industrial, and other property rights?
- Are we at risk for terrorism, a natural disaster, or government seizure?
- How do we sustain our cash flow?

Staging, or the sequence of events, will be determined as you answer all of the questions.

Economic Logic

For an international expansion to make economic sense, you should be able to generate more revenues or reduce significant costs. On the revenue side, there are "global marketing levers" (Yip 1994) that enable greater:

- market participation,
- product opportunities,
- location of activities, and
- marketing impact

to magnify the impact of competitive moves. Yip acknowledges that all levels of global engagement have coordination costs, but may offer benefits of:

- cost reduction,
- improved quality,

- enhanced customer preference, and
- competitive leverage.

It is interesting to note that these are potential benefits in any market development, one of our grand strategies. An international expansion is, in effect, market development.

Guillen and Garcia-Canal (2009), in their article, "The American Model of the Multinational Firm," suggest that organizations' motivations for foreign direct investment may be more specific, e.g., to:

- create a backward linkage into raw materials,
- achieve forward linkage into foreign markets,
- avoid government curbs in the home country,
- diversify risk,
- move capital abroad,
- follow a home-country customer to foreign markets,
- acquire firm-specific intangibles, or
- leverage firm-specific intangibles.

Again, we can see some correspondence with our grand strategies, e.g., the first two motivations, to create linkages, are essentially vertical integration on a global scale.

Arenas

Deciding where to be active, and what channels of distribution to use, requires a good understanding of the host country's environment. We explained how to use the PESTEL model in Chapter 5; here, we will introduce the CAGE framework (Ghemawat 2003), which examines *distances*, or differences, between the home and prospective host countries according to:

- Cultural distance is created by language barriers and religious differences; social norms can make it especially difficult to market consumer goods, for example. Products with a high linguistic content also suffer.
- Administrative distance is manifest non-normalized relations between governments, different currency valuations, political

hostility, and corruption (euphemistically called "institutional weakness" by Ghemawat). Industries with extensive government involvement, e.g., energy, weaponry, agricultural products, and transportation systems, are likely to be tough customers.

- Geographic distance is defined not only in terms of miles apart, but also by remoteness, lack of access, and weak transportation or communication links; even differences in climate can be detrimental to companies wanting to sell fragile or perishable items. Bulky, inexpensive items—like shipping concrete blocks—are also hard to sell into places that are hard to find.
- Economic distance is generally the disparity in consumer incomes but can also be evaluated in terms of a disparity of natural, human, and capital resources. Big-ticket and luxury items are obviously not well-suited to this environment.

Ghemawat suggests considering a strategy of arbitrage (the forgotten strategy) and offers the example of Molson beer in Brazil (2003, p. 78):

> *The persistent association of Brazil with football, carnival, beaches and sex—which all resonate powerfully in the marketing of youth-oriented products and services—illustrates the unexploited potential of some countries . . . to be realized. Witness Molson's recent launch in the Canadian market of A Marca Bavaria, a superpremium beer imported from its Brazilian subsidiary, which uses its association with Brazil's high-energy and sensual image to target primarily 19 to 24-year old men.*

Once you have decided where you want to go, then you have to decide how to get there.

Vehicles

There are many different ways to approach global markets. In general terms, they are distinguished by whether the company has an equity position or is paid on a per-product basis. In a non-equity mode, you can

choose to export products directly or indirectly (i.e., through a consolidator), or by contractual arrangement. Contracts can range from a specific license for a product or a franchise of the business model to specific functional agreements (such as outsourcing computer programming). With equity investments, you have the option of partial joint ventures or wholly-owned subsidiaries. Of course, with a joint venture, you can be the minority partner, be the majority partner, or opt to go 50/50 (Pan and Tse 2000).

Differentiators

The key question here is whether your existing differentiators will be effective in the new markets. It is also helpful to consider whether, if you do enter a particular country, that will have an impact on other aspects of your business, e.g., are there opportunities for efficiencies?

Bartlett et. al. (2004) suggest different ways to examine these questions, and offer different MNC configurations (i.e., organizational structures) to address the needs, as shown in Table 11.1. In particular, you consider the need for local customization (for differentiation) and the opportunities for efficiencies (for economic logic).

An international configuration can be considered a hub and spoke model, where decisions are centrally controlled and products are sold without localizing the differentiation. This is generally suited to a relatively small operation, in a non-equity mode. Management tends to be biased toward domestic considerations; international opportunities are secondary.

On the other hand, a multinational company (MNC) configuration is more like a radial system, with headquarters at the center providing

Table 11.1 Differentiation and Configurations

	Weak Opportunities for Efficiencies	**Strong Opportunities for Efficiencies**
High Need for Localization	MNC CONFIGURATION	TRANSNATIONAL CONFIGURATION
Low Need for Localization	INTERNATIONAL CONFIGURATION	GLOBAL CONFIGURATION

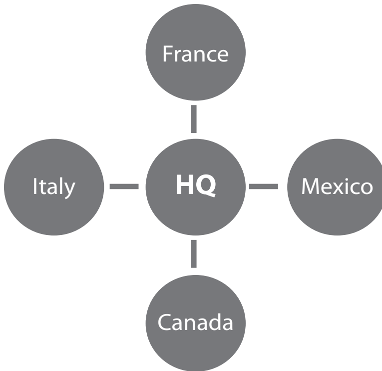

Figure 11.1 International Configuration

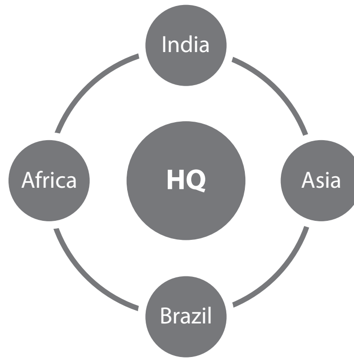

Figure 11.2 Multinational Configuration

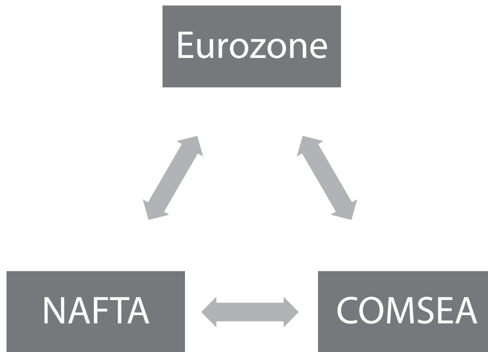

Figure 11.3 Transnational Configuration

strategic and administrative support, and countries or regions being fully integrated business entities, customized/localized/differentiated for local markets. For example, The Quaker Oats Company had two main international divisions, Europe and Latin America. Within those two divisions, countries had their own general managers, product mix, marketers, distributors, and computer systems. Of course, some decisions were made at headquarters in Chicago, e.g., when to launch Gatorade® in Italy. And information systems had to provide financial reports for consolidation. There was no effort made to achieve efficiencies among the countries.

A transnational configuration provides both efficiency and customization, requiring dispersed but interdependent operating units. It looks more like a network diagram and tends to be regionally based; however,

the business units do cross borders, as in free trade zones such as COMSEA in Africa.

The last configuration is global, which has centralized functions around the world. For example, financial services might be in the United Kingdom. Marketing functions are centralized in the United States. Production is in Thailand. The product or services themselves require little to no change for their differentiation. It, too, looks like a network model but is distinguished from the transnational model by global branding. HP and Nike are two such examples.

The Global Context

An unfortunate reality is that where there are potential rewards, there are potential risks. Some risks can be anticipated with a good PESTEL environmental analysis and mitigated or avoided. Others are harder to predict, e.g., terrorism, although risk signals include poor economic conditions, repression of ethnic groups, and radicalism, according to a study done by the International Monetary Fund (www.imf.org). The Dell Theory of Conflict Prevention says trade partners don't wage war on each other (Friedman 2005).

In summary, consider some sound advice from an international trade lawyer (Travis 2007). He advises companies to avoid perpetuating corruption and to maintain high ethical standards. He also stresses the importance of security: protecting your people, your assets, and your brands.

Be careful out here!

CHAPTER 12

How to Provide Strategic Leadership

Leadership is not magnetic personality that can just as well be a glib tongue. . . . Leadership is lifting a person's vision to higher sights, the raising of a person's performance to a higher standard, the building of a personality beyond its normal limitations.

—Peter F. Drucker

Opening Vignette

Does leadership really matter? Can leaders make the tough calls that can turn a flailing company into a market leader? The answer is yes, and the example is Darwin Smith of Kimberly-Clark.

When Smith took responsibility as CEO of Kimberly-Clark, he faced the brutal facts: his company was mediocre and its capital was wastefully tied up in giant paper mills. Smith asked questions. What could Kimberly-Clark be passionate about? What could it be best at in the world? What could improve its economic logic? In his examination of exceptional companies and their leaders, *Good to Great* (2001), Jim Collins noted that the successful ones were willing to face the "brutal facts," just as Smith did. They also combined personal humility with strong determination.

After decades of Smith's leadership, Kimberly-Clark is the world's number one paper-based consumer products company. Smith did make a difference, and it mattered. He has since been named one of the best CEOs by *Fortune*[1] magazine.

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[1]J. Collins. "The 10 greatest CEOs of all time." *Fortune* (July 21, 2003). Accessed at http://money.cnn.com

There are always new ideas and good ideas, but have you ever wondered why some companies can leverage good ideas and gain competitive advantage and other companies can't—or don't? Many believe that this critical difference is leadership.

It is leadership that crafts the vision, provides the resources, and mobilizes the workforce toward the common purpose of the strategy. Good leaders enable good ideas to be implemented by providing the commitment of energy and resources to drive the effort. Perhaps more importantly, it is the culture and the visionary tone that strategic leadership sets that makes the critical difference in achieving the desired results.

In this chapter, we examine the importance of leadership in achieving strategic results. Successful mastery of this material will enable you to:

- distinguish between "levels" and qualities of leadership
- understand best practices in strategic leadership
- avoid potential pitfalls
- explain how a balanced scorecard can support strategic change

This chapter addresses leadership in the context of strategic management; it is not intended as a comprehensive summary of leadership theory.

Strategic Leadership Defined

Why is leadership so important? How is it different from management?

Management versus leadership is an ongoing debate, but the most important result is to acknowledge that both are necessary and complimentary to ensure strategic success.

Leadership as defined by Burns (1978) is transformational and is distinguishable from transactional leadership. Transformational leaders are the visionaries who see the potential in the future, are looking to upset the status quo and to engage others in a purposeful direction. This leader is "charismatic" and, according to Burns, is ethically directed in his or her visionary quest. This is different from the transactional leader who is more of a manager and whose role is to guarantee a steady state and to make sure that operations meet the stated goals. As we discussed earlier,

the ability to see the desired results, to define the direction, is the first step in the process of strategy development. It is the leader who defines the vision; managers implement this vision, with the leader's support.

Bennis and Nanus (1985) identify the four "Is" of transformational leadership. They are: idealized influence, inspirational motivation, intellectual stimulation, and individual consideration. The key words, ideal, inspiration, intellect, and individual, all are descriptive of a charismatic leader. Also, the concept of what makes a good versus a great leader was the basis of studies at Ohio State in the 1970s. Fiedler (1967) and others also found the importance of individual consideration. Consideration for followers was found to be equally as important as directing the task of work and distinguished an effective leader; that is, a concern for followers further differentiated leaders from more task oriented managers.

Daniel Goleman's work (1998) on emotional and social intelligence has implications for leadership. He asserts that time and time again, individuals with the personality characteristics of self-awareness, self-regulation, motivation, social skill, and empathy lead successful companies. These are the characteristics of emotionally intelligent individuals.

More recently, Jim Collins (2001), in his work on leadership in his book *Good to Great,* showed that the leadership of *great* companies was different from the leadership of *good* ones in a surprising way. In his longitudinal study of companies from 1965–1995, those that were great were designated by their exemplary stock performance. The companies that met the criteria all were led by what Collins designated as Level 5 leaders: leaders who were driven by something more, who were exemplary in "getting the right people on the bus," and in getting their companies to the top by making the hard decisions and acknowledging "the brutal facts." These factors contributed to companies that both sustained and endured.

Maxwell (2010) simplifies the power of leadership as the ability to influence, or get people to do what you want them to do when you want them to do it. Like Goleman and Collins, he suggests that although some individuals are more innately meant to be leaders, leadership can be learned and must be practiced.

Leadership's Best Practices and Pitfalls

Although we have discussed the individual leaders' characteristics and importance to successful strategies, there are also some "lessons learned" that help leaders to be successful in moving their organizations toward strategic success.

Fundamentally, leadership is manifest by influencing others. The most successful leaders have the trust of their followers. Trusting in a leader can be risky; his or her trustworthiness can be viewed as a function of three broad factors, as perceived by the trustor: the leader's ability and credibility, his/her benevolence (or inclination to want to do what is in the best interests of the trustor), and integrity. Integrity is a complex idea; some consider it synonymous with ethical behavior, but it also means that a leader's words and actions match. Related to this is credibility, where followers believe in the leader. Pagano (2004) suggests nine behaviors that build credibility, including: being overwhelmingly honest, being composed, keeping promises, and delivering bad news well. The idea is to be *transparent*.

Ethical leadership is not easy. Ethical dilemmas are complex, pitting positive values against one another, e.g., short- versus long-term, justice versus mercy, truth versus loyalty, individual versus community (Kidder 1995). With organizations having multiple stakeholders, it is difficult to define "community" or balance between long- and short-term interests.

Ethical leadership is not all about the leader's integrity, either. According to Trevino and Brown (2004, p. 75), "research has found that certain individual characteristics are necessary but not sufficient for effective ethical leadership." It is also a reputational phenomenon, based on external perceptions. They suggest that executives wanting effective ethics management should understand the existing ethical culture, communicate the importance of ethical standards, focus on the reward system, and promote ethical leadership throughout the firm.

Instituting an ethical culture or implementing a business strategy both involve changing the direction of an organization. Many studies have been done that show that getting individuals to change, especially when times are good, can be extremely difficult. Kotter (1996) is highly regarded for his advice on how to make sure that change initiatives are successful. As shown in Figure 12.1, he suggests steps for successful change management that include creating a sense of urgency, developing a powerful coalition, monitoring of results, allowing for short-term wins, and *communicating!*

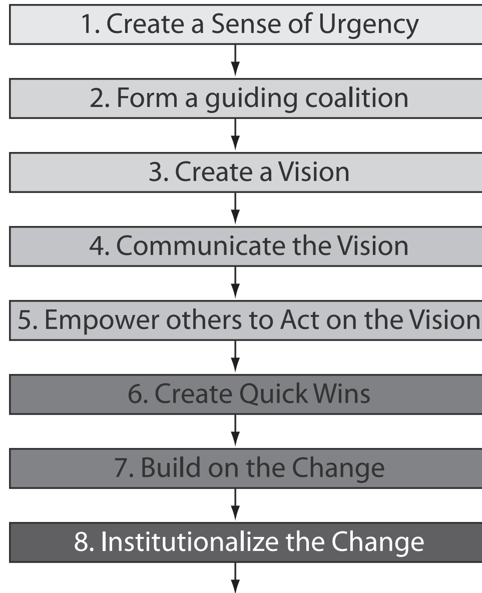

Figure 12.1 Kotter's Eight Steps for Leading Change

All change management is oriented toward getting the organization "over the finish line." Lewin (1947) developed a very popular analogy of change as analogous to the melting of an ice cube and the water refreezing in a new shape. Another popular mental model that explains the change process is that of a "journey" that describes the behavior of employees as well as managers in each stage, in which the past is "let go," the change is "explored," and the "new beginnings" are embraced (Bridges 2003).

Probably the most common mistake in change management is the misalignment of the management team and the employees, where employees are back in the "letting go" or endings phase while the leadership team is already in the "new beginnings."

Of the original Forbes 100 in 1917, 61 of these companies were out of business by 1987, and only 18 stayed in the top 100. Seventy-five percent of joint ventures fall apart after the "honeymoon," and 80% of the intended value from mergers and acquisitions fails to materialize (Beer 2002; Gratton 2007). The message is clear: Change is a must, and leading successful change is an imperative for strategies to be successful and achieve the desired future state.

Balanced Scorecard

So how do you structure the company to ensure strategic success, and also, how do you know if your strategic change is on track and getting the desired results? One of the most popular tools or approaches used to drive an organization toward achieving its strategic goals is the Balanced Scorecard (BSC) developed by Kaplan and Norton (1996).

The BSC provides managers with the instrumentation they need to navigate to the desired results. The BSC translates an organization's mission and strategies into a comprehensive set of performance measures that provides the framework for a strategic measurement and management system. The BSC retains an emphasis on achieving financial objectives but also includes the performance drivers of those financial objectives. Typically, the scorecard measures organizational performance across four perspectives (as shown in Figure 12.2): financial, customers, internal business processes, and learning and growth. In this manner, internal and external perspectives are balanced, as are short- and long-term perspectives. The BSC enables companies to track financial results while simultaneously monitoring progress in building the capabilities and acquiring the intangible assets they need for future growth.

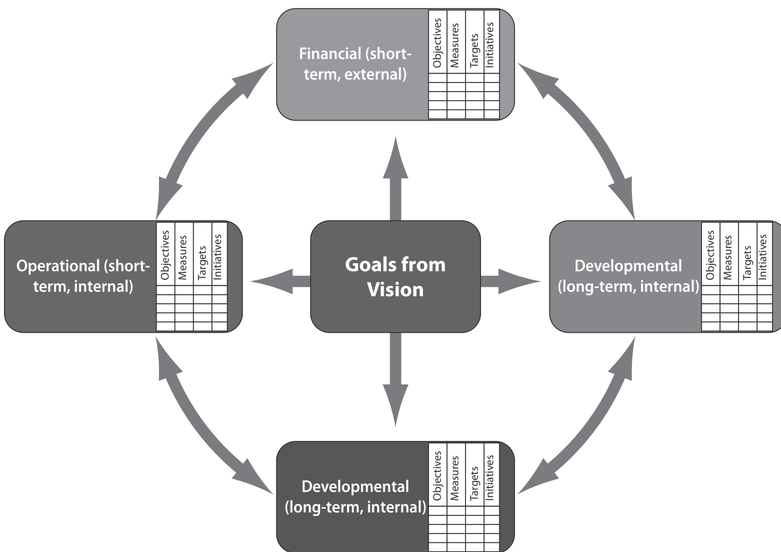

Figure 12.2 Balanced Scorecard

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Strategic Management
A Practical Guide
Linda L. Brennan and Faye A. Sisk

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