Knowledge Objectives

Reading and studying this chapter should enable you to:

1. Define strategic management.
2. Discuss why firms use the industrial organization model to analyze their external environment.
3. Discuss why firms use the resource-based view of the firm model to analyze their internal environment.
4. Define stakeholders and understand their importance.
5. Explain the work of strategic leaders.
Integrating Solutions to Handle Cash: The Foundation for Loomis’s Continuing Success

“People talk about a cash-free world. I see cash never going away.” (Calvin Murri, Chief Operating Officer, Loomis)

Launched more than 100 years ago in Portland, Oregon, Loomis got its start by using dog sleds to haul gold from Alaska to other parts of the United States. In addition to transporting gold in its early life, Loomis has focused on making certain that its customers “have the right amount of cash, in the right place at the right time.” To meet this goal today, Loomis uses 5,800 secure vehicles from its 440 branch offices in 11 different countries to serve three core customer groups: banks, multilocation retailers, and other commercial enterprises. (In actuality, Loomis, as we know the firm today, is the name commonly used in the United States for Loomis, Fargo & Co. This company was created in 1997 when Loomis and competitor Wells Fargo Armored merged their operations. Subsequently, Loomis, Fargo & Co. merged with Sweden-based Securitas in 2001.)

Loomis’s vision is to “manage the public flow of cash.” Banks, cash-handling centers, and ATMs (automated teller machines) are examples of the variety of participants involved with managing the public flow of cash. On occasions, the viability of Loomis’s vision has been challenged by changes in conditions that emerge in the external environment. (We explain the parts of a firm’s external environment and their effects in Chapter 3.) The changes affecting Loomis occur mainly in the economic part of the external environment. For example, some thought that the appearance of written checks would put armor car companies (such as Loomis) out of business in that checks do not require the movement of cash. This expectation has not come true. The growth of ATMs brought additional “the sky is falling warnings” from investors and other observers of the armor car business, this warning too proved untrue.

However, those leading Loomis and responsible for forming its strategies do recognize that even though the odds of cash ever becoming obsolete are indeed slim, paper money and coins are being used less frequently in today’s economies across the globe. In light of this understanding, Loomis is busy recasting itself and altering its strategy, using technology as the means of doing so. The major objective of these efforts is for Loomis to differentiate itself from competitors by providing customers with broader cash logistics services. The fact that banks (a key customer group for Loomis) are trying to outsource more of their activities (in order to increase their efficiency and reduce their costs) creates opportunities for Loomis to provide cash logistics services. For example, Loomis now stocks ATMs for many of its bank customers. Additionally, the company processes and sorts cash, rolls and wraps coins, scans and processes checks, weeding out counterfeit and deteriorated bills in the process, and sells safes “that can scan for counterfeits and verify deposit amounts to save time and money for retailers.”

As these examples illustrate, Loomis seeks to use technology as the foundation for integrating the activities of virtually all players involved with managing the public flow of cash. To increase the scale of its operations, Loomis selectively acquires firms such as Guardian Armored Security, Inc., a Michigan-based cash handling services provider. With this transaction, Loomis became the largest cash-handling services provider in the state of Michigan.

Do you sometimes wonder why some firms are more adaptive and successful than others? Why, for example, is Loomis able to alter its strategy in ways that allow it to remain successful? Why is Best Buy continuing to outperform Circuit City, its closest competitor? (The performance gap between these two firms is wide. Circuit City lost $300 million in 2007. In contrast, Best Buy posted net income of $228 million in the third quarter alone.)\(^1\) Why is Helicopter Services of Houston, Texas (a pilot training school), successful at a time when Silver State Helicopters of Las Vegas, Nevada, filed for bankruptcy? (Hint: Some believe that the success of Helicopter Services is a function of the firm’s ability to control its costs while providing highly personal attention to each of its customers.)\(^2\)

Although the reasons for Loomis’s, Best Buy’s, and Helicopter Services’ success as well as the successes of many other firms sometime seem mysterious, they really aren’t a secret. As with these three companies, firms use the strategic management process to achieve success. The purpose of this book is to explain each part of the strategic management process—vision, analysis, and strategy. We think you will enjoy learning about the strategic management process and know that you will benefit from doing so.

**What Is Strategic Management?**

**Strategic management** is the ongoing process companies use to form a *vision*, *analyzye* their external environment and their internal environment, and select one or more *strategies* to use to create value for customers and other stakeholders, especially shareholders. Let’s define the parts of the strategic management process so we can see the differences among them. In this chapter, we will merely introduce you to the parts of this important process. You’ll learn more about each part in the book’s remaining chapters. We’ll also define a number of terms that are used throughout the book.

The *vision* contains at least two components—a mission that describes the firm’s DNA and the “picture” of the firm as it hopes to exist in a future time period.\(^3\) DNA includes the core information and characteristics necessary for the firm to function. The vision is intended to inspire the firm’s employees to realize or “picture” the future aspirations of what the firm can become and to help establish a framework for ethical behavior. The vision for Intoweb Design is “to become the best Web Developers in South Africa.”\(^4\) The vision for this Internet service provider should inspire the firm’s employees in their daily work. A *strategy* is an action plan designed to move an organization toward achievement of its vision. The mission of the firm is focused on the markets it serves and the products (either goods or services) it provides. The *mission* defines the firm’s core intent and the business or businesses in which it intends to operate. Loomis’s mission, for the firm to “Be a world class provider in delivering quality, secure services for managing cash in society,” demonstrates these characteristics.\(^5\) The *external environment* is a set of conditions outside the firm that affect the firm’s performance. Changes in population trends and income levels, competition between firms, and economic changes are examples of the many conditions in a firm’s external environment that can affect its performance. For example, think of the effect of the home mortgage crisis in the United States in 2008 and beyond on homeowners, home builders, and local communities among others. (Mortgage rates and institutional lending practices are a part of the *economic* segment of the external environment.) The *internal environment* is the set of conditions (such as strengths, resources, capabilities, and so forth) inside the firm affecting the choice and use of strategies.

**Strengths** are resources and capabilities that allow the firm to complete important tasks. Being able to effectively manage the flow of its inventory is one of Best Buy’s strengths that help it complete the important task of having the right merchandise on its shelves for customers to buy. (This strength also helps Best Buy
outperform Circuit City.) **Resources** are the tangible and intangible assets held by the firm. A strong balance sheet is one of Coca-Cola’s tangible assets, while the knowledge held by its employees is one of Microsoft’s intangible assets. **Capabilities** result when the firm integrates several different resources to complete a task or a series of related tasks. 6 3M integrates the knowledge of its scientists (an intangible asset) with other resources, including its sophisticated scientific equipment (a tangible asset), to create its innovation capability.

**Core competencies** are capabilities the firm emphasizes and performs especially well while pursuing its vision. Sony Corporation’s ability to miniaturize components as the foundation for developing small, value-creating products is an important core competence for this global giant. The Walkman is an example of a successful product introduction resulting from Sony’s miniaturization core competence.

Core competencies that differ from those held by competitors are called **distinctive competencies**. Miniaturization is a distinctive competence for Sony as is innovation for Gillette. An example of a product Gillette developed by using its innovative competence is the Sensor razor. Introduced in 1990, the Sensor gave way to Gillette’s newer innovation (the Mach3) in 1998. 7 When core competencies allow the firm to create value for customers by performing a key activity (such as innovation at Gillette) **better** than competitors, it has a **competitive advantage**. Today, Lenovo Group Ltd. is trying to develop a competitive advantage in design and style. Lenovo believes that developing design and style competencies that are superior to those of firms such as Dell, Acer, and Hewlett-Packard can be a source of differentiation (and competitive advantage) for its personal computers compared to the products its competitors are producing. 8 A firm can also have a competitive advantage when a distinctive competence allows it to perform an activity that creates value for customers that competitors can’t perform.

Figure 1.1 presents a diagram of the strategic management process, while the key characteristics of strategic management are listed in Table 1.1. We continue our introduction of the parts of the strategic management process in the next few sections.
Part 1: Vision

The Three Parts of the Strategic Management Process
As suggested in Figure 1.1, strategic leaders are responsible for forming a firm’s vision and mission (which we talk about in greater detail in Chapter 2). As noted earlier, an effective mission provides direction to the firm, while an effective vision inspires people to ethical actions. We present additional vision statements and mission statements from different organizations in Table 1.2. Which of the vision statements shown in Table 1.2 inspire you? Which mission statement does the best job of telling you about the direction a firm is taking? Would you make changes to any of the vision or mission statements shown in Table 1.2? If so, why and what would those changes be?

Figure 1.1 also suggests that firms must analyze their external environment and their internal environment before strategies can be chosen and implemented. Here’s an example of how this process is taking place today at Circuit City.

Table 1.1 Key Characteristics of Strategic Management

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<th>Strategic management is:</th>
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<tr>
<td>• Performance oriented</td>
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<td>• Ongoing in nature</td>
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<td>• Dynamic rather than static</td>
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<td>• Oriented to the present and the future</td>
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<td>• Concerned with conditions both outside and inside the firm</td>
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<td>• Concerned with performing well and satisfying stakeholders</td>
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Table 1.2 Vision and Mission Statements

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<th>VISION STATEMENTS</th>
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<tr>
<td>McDonald’s</td>
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<tr>
<td>To give each customer, every time, an experience that sets new standards in value, service, friendliness, and quality.</td>
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<tr>
<td>NASDAQ</td>
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<tr>
<td>To build the world’s first truly global securities market . . . A worldwide market of markets built on a worldwide network of networks . . . linking pools of liquidity and connecting investors from all over the world . . . assuring the best possible price for securities at the lowest possible cost.</td>
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<tr>
<td>Petsmart</td>
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<tr>
<td>To be the premier organization in nurturing and enriching the bond between people and animals.</td>
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<tr>
<td>Wachovia</td>
</tr>
<tr>
<td>Wachovia’s vision is to be the best, most trusted and admired financial services company.</td>
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<table>
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<th>MISSION STATEMENTS</th>
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<tr>
<td>Bristol-Myers Squibb</td>
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<td>Our mission is to extend and enhance human life by providing the highest-quality pharmaceuticals and health care products.</td>
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<tr>
<td>GlaxoSmithKline</td>
</tr>
<tr>
<td>GSK’s mission is to improve the quality of human life by enabling people to do more, feel better and live longer.</td>
</tr>
<tr>
<td>Merck</td>
</tr>
<tr>
<td>The mission of Merck is to provide society with superior products and services by developing innovations and solutions that improve the quality of life and satisfy customer needs, and to provide employees with meaningful work and advancement opportunities, and investors with a superior rate of return.</td>
</tr>
<tr>
<td>Wipro</td>
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<tr>
<td>The mission is to be a full-service, global outsourcing company.</td>
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Recall that Circuit City’s performance today is falling short of expectations. In fact, the firm’s shares lost 76 percent of their value in 2007.9 Spotting an opportunity in the external environment to offer customers deep insights about individual products, the firm is opening new concept stores called City. Smaller (20,000 square feet compared to 34,000 square feet in a typical Circuit City store) and more focused in terms of product lines (a City store is restricted to five main product areas—photo, computer, games, home entertainment, and portable gear), each City unit has highly trained staff members. Carrying tablet PCs with them at all times, employees are capable of providing in-depth knowledge to customers about a focused array of products. Circuit City is using the skills of its workforce and its product purchasing competence to serve customers seeking in-depth knowledge about products before deciding to make a purchase. Will the City stores help to reverse Circuit City’s fortunes? Only time will tell. However, one customer’s reaction to shopping at a City store, as follows, is encouraging: “It’s pretty neat. I was very impressed with the overall process and the intelligence of the people I was involved with.” 10

As mentioned earlier, a strategy is an action plan designed to move an organization toward achievement of its vision. Strategy is about finding ways for the firm to be different from its competitors. The most effective companies avoid using “me-too” strategies—strategies that are the same as those of their competitors. A firm’s strategy should allow it to deliver a unique mix of value to customers. 11

As shown in Figure 1.1, firms use business-level strategies, multiproduct strategies, and merger and acquisition strategies to directly compete with rivals. With product names such as Mastiff and Pitbull, Big Dog Motorcycles uses its focused differentiation business-level strategy to build premium, heavyweight motorcycles that are targeted for customers with needs for this unique product. (We discuss five types of business-level strategies in Chapter 5.) Big Dog competes directly against Harley-Davidson with its business-level strategy. Procter & Gamble uses a related diversification multiproduct strategy (discussed in Chapter 6) in battles with global competitors such as Unilever, Kimberly Clark, and Johnson & Johnson. We won’t provide examples here of companies using the other strategy (mergers and acquisitions) that is a means of competing directly with competitors or of the three strategies (see Figure 1.1) firms use to compete against competitors by entering additional markets. We will, however, provide examples of how firms use these strategies in the relevant chapters (Chapters 7 through 10).

Once chosen, strategies must be put into use. Strategy implementation is the set of actions firms take to use a strategy after it has been selected. Advertising itself as “America’s Largest Pet Pharmacy,” 1-800-PetsMed.com offers the largest selection of prescription and nonprescription pet medications to consumers at competitive prices. Using the Internet and telemarketing to sell products to customers is a critical part of how the firm implements its cost leadership (see Chapter 5) strategy.12

In Understanding Strategy: Learning from Success, we describe Wal-Mart’s success as a grocer. (You will learn more about Wal-Mart and other parts of its operations in Focusing on Strategy that opens Chapter 5.) The world’s largest public corporation by revenue, Wal-Mart uses its famous and widely recognized inventory management and distribution core competencies to drive its continuing success. Because Wal-Mart’s inventory management and distribution core competencies are superior to those of its competitors, they are competitive advantages for the firm.

After reading the Understanding Strategy about Wal-Mart as a grocer, are you able to conclude that the company is effectively using the strategic management process? What future do you envision for Wal-Mart as a grocer? Can you anticipate Wal-Mart taking its grocery store concepts to other countries? Might Wal-Mart choose to enter Tesco’s core market in order to compete directly against its
British rival on its home turf? What about CompUSA? Read Understanding Strategy: Learning from Failure to learn about this company’s situation. What is your assessment of CompUSA’s use of the strategic management process? What might you have done differently if you were leading CompUSA? In your opinion, did CompUSA ever find a unique way to pursue a unique opportunity in its external environment?

As the CompUSA example shows, organizational success (certainly success over time) is not guaranteed for any firm. Indeed, success is strongly influenced by how well a firm uses the strategic management process. In your opinion, was this process used successfully and consistently at CompUSA?

Moreover, even for successful companies, success can be transitory. Firms must always be aware of their surroundings and about what is happening in the global business world. Patricia Sueltz, executive vice president of Salesforce.com, believes...
that she has to keep looking over her shoulder to see what competitors are doing to determine whether those actions are a threat to her firm’s performance.13

We’ve now introduced you to the strategic management process, provided examples of vision statements and mission statements, and described in some detail how Wal-Mart is using the strategic management process. We also examined CompUSA as an example of a situation in which more effective use of the strategic management process might have had a positive effect on the firm’s performance.

We’ll use the remainder of this chapter to tell you a bit more about how firms analyze their external environment and their internal environment. Decision makers use the information gathered from the analyses of their firm’s external and internal environments to select one or more strategies (see Figure 1.1). Before closing the chapter with a brief discussion of the contents of the book’s remaining chapters, we’ll introduce you to stakeholders and strategic leaders. In essence, stakeholders are the individuals and groups that firms try to satisfy when using the strategic management process, while strategic leaders are responsible for making certain their firms use the process effectively.

The Industrial Organization Model

Firms use what is called the industrial organization (I/O) model to analyze their external environment. We introduce you to this model here and provide you with a fuller discussion of it and its use in Chapter 3.

“CompUSA Is Closing All of Its Stores,” the Headlines Read. What Happened?

With the name Soft Warehouse, the firm that came to be known as CompUSA was founded in 1984 as a seller of software. The firm then expanded its operations in order to sell consumer electronics products and personal computers. In 1991, when it went public, the company’s name was changed to CompUSA.

During the 1990s, CompUSA struggled to find its identity. Was it primarily a seller of software or of products using software applications and consumer electronics products? Continuing declines in the prices of personal computers as well as competition from direct seller Dell, Inc., damaged the company as did intense competition from big box retailers Best Buy and Circuit City and from Wal-Mart as well. Because of their size, these three competitors were able to offer greater selection and lower prices on consumer electronics products (e.g., televisions) that CompUSA was carrying.

Throughout its turbulent history though, some saw value in CompUSA. In 1999, for example, Mexican telephone and retailing magnate Carlos Slim took a stake in the firm and then acquired other companies to increase its size. Slim later spent roughly $800 million to take the firm private. Over time, Slim’s total investment in CompUSA was close to $2 billion.

Although “the chain went through several CEOs and tried different turnaround strategies such as a move (in 2007) to focus on core customers such as gadget lovers and small business owners,” nothing really worked. As a result, Slim decided in late 2007 to close the firm’s remaining stores (severely underperforming units were previously closed). CompUSA was then sold to retail-store liquidator Gordon Brothers Group.

But all may not be lost! Saying that “We believe the value of the CompUSA brand remains very high,” Systemax CEO Richard Leeds announced about a month after Gordon Brothers took control of CompUSA’s assets that his firm was purchasing CompUSA’s brand, trademarks, and e-commerce business. The intention was to integrate CompUSA with Systemax’s TigerDirect, which is a popular computer parts reseller. Primarily an online seller for computer enthusiasts, TigerDirect will replace the CompUSA name with its own name in retail stores as a means of expanding its presence in retail storefronts.

Firms use the I/O model to identify opportunities and threats. **Opportunities** are conditions in the firm’s external environment that may help the firm reach its vision. **Threats** are conditions in the firm’s external environment that may prevent the firm from reaching its vision. Performance often declines in firms that do not carefully study the threats and opportunities in their external environment. Firms use their resources to pursue environmental opportunities and to overcome environmental threats.

The experiences of Levi Strauss demonstrate how important it is for firms to recognize threats (and opportunities as well) in their external environment. During the late 1980s and into the 1990s, Levi failed to detect changes in its external environment such as those in customers’ preferences. Changing preferences mandated that the firm begin to produce more fashionable jeans and related clothing items. Additionally, in contrast to competitors such as Jordache, Ralph Lauren, and Gloria Vanderbilt, Levi chose to remain focused on traditional distribution channels, avoiding discounters Target and Wal-Mart in the process. Thus, changes in Levi’s external environment (in the form of customer demand and retail distribution patterns)—changes that had negative effects on the firm’s financial performance—threatened the success of the world-famous branded products company.

In response to the challenges facing it, Levi decided to change virtually every aspect of how it conducts business. The firm now interacts with customers more frequently and with greater intensity to understand their product preferences. Levi also enhanced its product innovation capabilities and “implemented a new business planning and performance model that clarifies roles, responsibilities, and accountabilities and improves [the firm’s] operational effectiveness.” These efforts are proving worthwhile in that the firm’s financial performance continues to improve compared to the 1980s and 1990s.

Similar to Levi Strauss, the global airline industry illustrates the influence of the external environment on a firm’s choice of strategy. Let’s describe this influence.

Economic conditions, which as we said before are part of the firm’s external environment, influence travel decisions. During poor economic times, for example, people might choose not to travel at all or to reduce the number of times they travel by air. Unrest in the global environment created by war and international tensions also affect the demand for airline services. The cost of fuel can have a dramatic effect on each airline company’s profitability; in mid-2008, for example, increasing fuel costs were exerting an extremely negative effect on airline firms’ ability to earn profits.

To deal with influences in their external environment, several carriers continue to contemplate the possibility of using a different strategy to compete. Essentially, many carriers are evaluating the use of a merger strategy (described in Chapter 7) in which firms agree to combine their operations on a relatively equal basis as the foundation for forming a single company. In early 2008, Delta and Northwest announced their intention to merge. Recognizing this possibility, US Airways officials commented that the industry needed to consolidate to reduce the number of major carriers from six to four. The compelling rationale for merging “in the airline executives’ and analysts’ views is how much money they believe they could save by combining their jet fleets, workforces, airport facilities, frequent-flyer programs, and headquarters.”

In Figure 1.2, we diagram how firms use the I/O model to analyze their external environment. The information gained from this analysis is used to help strategic leaders choose one or more strategies.

### The Resource-Based View of the Firm Model

While the I/O model focuses on the firm’s external environment, the resource-based view (RBV) model describes what firms do to analyze their internal environment. The purpose of analyzing the internal environment is to identify the
firm’s strengths, resources, capabilities, core competencies, and distinctive competencies, all of which are the source or foundation of the firm’s competitive advantages. Thus, the I/O and RBV models complement each other; one (the I/O model) deals with conditions outside the firm, and the other (the RBV model) deals with conditions inside the firm. We introduce you to the RBV model here and offer a fuller description of it in Chapter 4.

The RBV model suggests that effective management of the firm’s operations creates resources and capabilities that are unique to that firm. Therefore, the bundle of productive resources across firms can vary quite substantially. Louis Vuitton’s resources and capabilities, for example, differ from those of competitors Prada, Gucci, Hermes, and Coach. With resources and capabilities that differ from its competitors, each of these firms has a chance to develop distinctive competencies that it can use to produce a product that creates value for a group of customers. Let’s describe how Louis Vuitton uses its unique resources and capabilities to develop core competencies and perhaps distinctive competencies that in turn allow the firm to create value for a group of customers.

The world’s most profitable luxury brand, Vuitton has design skills and manufacturing efficiencies that are considered superior to those of its competitors. These distinctive competencies contribute to Louis Vuitton’s ability to generate higher operating margins. Because of this superiority relative to its competitors, its distinctive competencies are the foundation for Vuitton’s competitive advantages in product design and manufacturing that are critical to the firm’s effective use of its focused differentiation strategy (see Chapter 5).
Although expensive, the firm’s products do create value for a group of customers. One customer sees this value as “buying into a dream.” In this particular customer’s words, “You buy into the dream of Louis Vuitton. We’re part of a sect, and the more they put their prices up, the more we come back. They pull the wool over our eyes, but we love it.”

Unlike the external environment, firms have direct control over conditions in their internal environment. Each firm’s strategic leaders make choices about the resources and capabilities the firm wants to control and about how they’ll be nurtured and used. The ability to control the firm’s resources, capabilities, and core competencies and to develop them in ways that differ from those of the competitors increases the number of strategic options. Thus, from the RBV perspective, the uniqueness of the firm’s resources, capabilities, and core competencies influences the choice of one or more strategies.

Figure 1.3 diagrams how firms use the RBV model to analyze their internal environment. Notice how the firm’s resources, capabilities, and core competencies influence the choice of a strategy.

Next, we discuss stakeholders—the individuals and groups the firm seeks to satisfy by using the strategy or strategies it has selected.

**Stakeholders**

Stakeholders are individuals and groups who have an interest in a firm’s performance and an ability to influence its actions. In essence, stakeholders influence firms by deciding the degree to which they will support the firm’s strategy.
Shareholders, customers, and suppliers are stakeholders, as are a firm’s employees and the communities in which the firm conducts business. Shareholders, for example, exercise their influence by deciding whether they will keep their shares in the firm or sell them. Employees decide whether they will remain with their employer or work for another firm, perhaps even a competitor. Not surprisingly, firms use the strategic management process to select and implement strategies that create value for stakeholders.19

As shown in Figure 1.4, firms have three major stakeholder groups: owners (shareholders), external stakeholders, and internal stakeholders. Each stakeholder wants the firm in which it has an interest to satisfy its needs. Generally speaking, stakeholders continue to support firms that satisfy their needs. However, in general, stakeholders withdraw their support from firms failing to meet their needs.

Stakeholders’ interest in performance, coupled with their ability to influence the firm through their decisions to support the firm or not, suggests that companies have important relationships with their stakeholders. These relationships must be managed in a way that keeps the stakeholders committed to the firm. Firms that are able to use their resources and capabilities to manage relationships with their stakeholders better than their competitors may gain a competitive advantage.20 These firms see stakeholders as their partners and keep them well informed about the company’s actions.21

Firms and stakeholders have relationships because they need each other. To launch a company and operate it on a continuing basis, firms need capital (that is, money) provided by investors (such as stockholders) and financial institutions (such as banks), materials from suppliers that are used to produce a good or provide a service, and employees to complete necessary tasks. In addition and importantly, firms need customers to buy their good or service. Similarly, investors (individual stockholders and institutional stockholders such as pension funds) need to find viable businesses in which they can invest and earn a return on their capital. Employees need to work for organizations for income and at least some personal satisfaction. Customers want to buy goods and services from companies that will satisfy their various needs. Thus, firms need stakeholders, but stakeholders also need firms.

Managing relationships between the firm and its stakeholders is difficult because satisfying one stakeholder’s needs may come at the expense of another stakeholder. Consider, for example, employees’ desire to be paid more for their work. If wages are increased without an identical increase in productivity to offset the higher costs, the firm’s cost of goods sold will increase, reducing the return on investment for shareholders. Alternatively, think of customers wanting to buy higher-quality products from a firm at ever-decreasing prices. The net result of the firm’s lowering the price of its good or service without reducing the cost to produce it is fewer resources for wages and salaries and for returns to shareholders.
Although other examples could be offered, the main point here is that firms must manage their relationships with stakeholders in ways that will keep all stakeholders at least minimally satisfied. In other words, the firm wants to retain quality suppliers, loyal customers, and satisfied employees while providing returns to shareholders that cause them to retain their investment in the firm. As these comments show, managing relationships among various stakeholders is a challenging, yet important task for the firm’s strategic leaders.

**Strategic Leaders**

**Strategic leaders** are the individuals who practice strategic leadership. (We define and fully discuss strategic leadership in the next chapter.) Strategic leaders make certain that actions are being taken that will lead to their firm’s success. As CEO of Apple Computer, for example, Steve Jobs must make certain that his firm uses the strategic management process to continue benefiting from its highly successful iPod digital music player and the more recently introduced iPhone. Because the iPhone has the power of a computer, the potential software applications are generating enthusiasm among both programmers and consumers. Part of Apple’s product strategy for the iPhone is to develop the array of software applications that creates the most value for customers.

A firm’s board of directors holds the CEO and top management team responsible for ensuring that an effective strategic management process is developed and properly used throughout the organization. When doing their work, top-level managers concentrate on the big picture to envision their firm’s future and the strategies necessary to achieve that vision. Increasingly, CEOs are being drawn from a global talent pool. Currently, the “head of the Altria Group was born in Egypt, PepsiCo’s is from India, the Liberty Mutual Group’s is a native of Ireland, and Alcoa’s was born in Morocco.” Diversity at the helm of companies makes it more likely that an all-important global perspective will be adopted throughout the firm.

In small firms, the CEO may be the sole owner and may not report to a board of directors. In this instance, of course, that person is responsible for both designing and using the strategic management process. Decisions that strategic leaders make when using the strategic management process include determining what resources are acquired, what prices are paid for those resources, and how to manage those resources. Through the firm’s vision statement, strategic leaders try to stimulate their employees’ creativity to develop new products, new processes to produce the firm’s products, and the administrative routines necessary to successfully implement the firm’s strategies.

The CEO and top management team are also responsible for shaping and nurturing the firm’s culture. **Organizational culture** is the set of values and beliefs that are shared throughout the firm. **Values** reflect what is important, while **beliefs** speak to how things should be done. In 3M’s organizational culture, respect for the contribution of each employee and continuous innovation are important values. The most effective organizational cultures let people know that they are appreciated, which provides strong motivation toward excellent performance by employees.

Intangible in nature, culture can’t be touched or seen, but its presence is felt throughout every organization. Think of companies where you’ve worked, university classes you’ve attended, or other groups to which you’ve belonged. Consider the values and beliefs held by each of those groups. How did it feel to be a member of those groups? The groups you are thinking about are different in
terms of their values and beliefs, aren’t they? The same can be said of business organizations.

Increasingly, strategic management is becoming more decentralized in companies. The logic behind this is to have the people who are “closest to the action” making decisions and taking actions.30 Thus, the strategic management process is often shared among many people in an organization.31 As a result, we need to be prepared to take on leadership roles regardless of our position in an organization. Additionally, frequent communication among all involved with the strategic management process helps ensure that changes are made when and where they are needed. Because of changing conditions, adjustments are often necessary when implementing strategies.

However, we should understand that even though many different people may be involved, the final responsibility for effective use of the strategic management process rests with the firm’s top-level strategic leaders (i.e., the chief executive officer and the top management team). In addition, it is important to note that the best strategic leaders as well as all others throughout the firm also act ethically.

Ethics are concerned with the standards for deciding what is good or bad, right or wrong32 as defined by most members of a particular society.33 In an organizational context, ethics reveal a value system that has been widely adopted by the firm’s employees and that other stakeholders recognize as an important driver of decisions and actions. Firms can record their ethics in documents such as a code of conduct. On a daily basis, however, ethics can be inferred by observing the actions of the firm’s stakeholders, especially its employees. Even a brief review of events in the business world shows that an organization’s ethics are of interest to the general society as well as to other stakeholders whose interests can be negatively affected when a firm acts unethically. Thus, as explored further in Chapter 2, ethical practices are a vital part of effective strategic leadership and strategic management.

How the Book Is Organized

The book has three major parts corresponding to the three parts of the strategic management process. Part One of this book comprises two chapters. This first chapter introduces you to the strategic management process. In Chapter 2, we describe leadership from a strategic perspective. Strategic leadership is being effectively practiced when everyone in a firm is aware of the vision being pursued and the important role each person plays in pursuing that vision. We also describe the most important actions strategic leaders take to guide their organizations. Being an effective strategic leader (especially an effective CEO) is challenging. And the fact that CEO turnover continues to increase suggests that stakeholders have high performance expectations of the person serving as the firm’s CEO.36

In Part Two, which also has two chapters, we focus on two analyses firms use to gather and evaluate the information needed to choose strategies for pursuing the firm’s vision. Chapter 3 focuses on the external environment. A firm analyzes the external environment to identify factors outside the company that can affect the strategic actions the firm is taking to achieve its vision. Firms can influence but not control conditions in their external environment. The focus of Chapter 4 is inside the firm. Here, the purpose is to understand how the firm’s unique resources, capabilities, and core competencies can be used to create value for customers. Using resources, capabilities, and core competencies in ways that create value means that the firm has one or more competitive advantages.

Part Three examines different types of strategies. The strategies the firm chooses are a product of the vision and the conditions in the firm’s external environment and its internal environment. The insights gained from the topics presented in the book’s first four chapters strongly guide the selection of strategies. In Chapters 5, 6, and 7, our concern is with different strategies (business-level, multiproduct, and mergers
and acquisitions) that firms use to successfully compete in different markets. Each chapter also provides guidelines for implementing different strategies. We follow these discussions with explanations in Chapters 8, 9, and 10 of strategies (international, cooperative alliances, and new ventures) that firms use to enter new markets.

**SUMMARY**

Our primary purpose with this chapter is to introduce you to the strategic management process and to discuss how firms use this important organizational tool to continuously improve their performance for stakeholders. To reach this purpose, we examined the following topics:

- **Strategic management** is the ongoing process firms use to form a vision, analyze their external and internal environments, and select one or more strategies to create value for customers and satisfy other stakeholders. The external and internal environments are analyzed to determine what strategies the firm should use (and how to use those strategies) to achieve the vision. Strategic management is concerned with both formulation (selection of one or more strategies) and implementation (actions taken to ensure that the chosen strategies are used as intended).

- Firms use the industrial organization model (the I/O model) to examine their **external environment** in order to identify opportunities and threats in that environment. Firms use the resource-based view of the firm model (the RBV model) to analyze their **internal environment** in order to identify their resources, capabilities, and core competencies. A firm must use both models to have the knowledge it needs to choose strategies that will enable it to achieve its vision.

- **Stakeholders** are individuals and groups who have an interest in how the firm performs and who can influence the firm’s actions. Firms and their stakeholders are dependent on each other. Firms must operate in ways that satisfy the needs of each stakeholder (such as shareholders, customers, suppliers, and employees). Firms failing to satisfy those needs likely will lose a stakeholder’s support. Owners, external stakeholders, and internal stakeholders are the three primary stakeholder groups with which firms are involved. But stakeholders need firms as well. Consider, for example, that investors (as owners of the firm) want to invest in profitable firms, employees want to work for acceptable wages, and customers want to buy products that create value for them.

- **Strategic leaders** practice strategic leadership when they make certain that their firm is effectively using the strategic management process. Increasingly, effective strategic management results when many people are involved with the strategic management process and when strategic leaders demand that everyone in the firm act responsibly and ethically in all that they do.

**KEY TERMS**

- capabilities, 7
- competitive advantage, 7
- core competencies, 7
- distinctive competencies, 7
- external environment, 6
- internal environment, 6
- mission, 6
- opportunities, 12
- organizational culture, 16
- resources, 7
- stakeholders, 14
- strategic management, 6
- strategy, 6
- strategy implementation, 9
- strengths, 6
- threats, 12
- vision, 6

**DISCUSSION QUESTIONS**

1. What is strategic management? Describe strategic management’s importance to today’s organizations.
2. What is the industrial organization (I/O) model? Why do firms use it to analyze their external environment?
3. What is the resource-based view of the firm model? Why do firms use this model to examine their internal environment?
4. Who are stakeholders? Why are stakeholders important to firms? What does it mean to say that the firm has relationships with its stakeholders?
5. What is the nature of the strategic leader’s work?
Chapter 1: The Foundations of Strategic Management

Introduction

A major problem facing strategic leaders is maintaining focus within a firm given the dynamic and complex nature of today’s competitive environment. Effective strategic leaders use the strategic management process (which we define in this chapter) to increase the probability that their firm will properly conduct an external analysis and an internal analysis—two core activities that are the foundation for selecting the company’s strategy.

Strategic Management Steps

Are Still Better Days Ahead for Hewlett-Packard?

Technology giant Hewlett-Packard (HP) makes computers and printers and provides technology consulting services. Printers are perhaps the firm’s most famous and durable products. In early 2008, HP celebrated the twentieth anniversary of its Deskjet printer, which the firm notes is “the world’s top-selling printer brand,” serving more than 240 million customers worldwide. HP generates more than $100 billion annually in sales revenue, making it one of the world’s largest information technology companies.

Mark Hurd became HP’s CEO in March 2005, following Carly Fiorina in this role. From a financial perspective, HP’s early results during Hurd’s tenure were quite positive as indicated by the fact that from his first day as CEO through the end of 2007, “HP’s stock surged 132%, about five times the return of the Standard & Poor’s 500-stock index.” Results such as this one clearly have the potential to satisfy stakeholders, especially those owning stock in HP.

Known for his operational management skills, Hurd’s cost-cutting and improvements in the firm’s operations techniques were the source of HP’s impressive financial gains during the initial phase of Hurd’s service. But times may be changing for Hurd and HP. As 2008 unfolded and in light of industry-wide predictions of reductions in the amounts companies around the globe would invest in technology in the next several years, some thought that as HP’s key strategic leader, Hurd needed to take different actions. One analyst saw it this way: “The first three years of [Hurd’s] tenure have been about profit growth through cost-cutting and restructuring and raising efficiencies.” Looking to the years ahead, this analyst suggested that “HP is [now] entering a phase

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STRATEGIC MANAGEMENT STEPS

Outcomes:

- Document and prioritize “Threats”
- Document and prioritize “Opportunities”

- Document and link “Strengths” and “Weaknesses” to opportunities
- Identify “Core Competencies”
- Identify current and potential “Distinctive Competencies”

- Establish the “Mission” (who we are)
- Communicate the “Vision” (where we are going)
- Roll out the “Strategies” (how we are going to get there)

Outcomes:

- Successful implementation
- Decision-making alignment
- Motivated employees

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where it needs to get future profit growth from sales growth and not cost cutting.” Another way of capturing the essence of this analyst’s perspective is to say that Hurd needs to display visionary leadership in addition to execution-oriented leadership in order for HP to remain successful.

Hurd gives every indication that he intends to serve as a visionary leader for HP. Innovation may be the foundation for the HP of the future that Hur factors envisions. With an interest in driving technological innovations for its customers, HP allocated $3.6 billion to research and development (R&D) in 2006. Recently, Hurd stated that he is “determined to keep [HP’s] pipeline stocked with promising new products and services.” More fundamentally, Hurd believes that investing heavily in R&D today is the path to best position HP for long-term success.

One part of the innovation-focused vision Hurd and other strategic leaders at HP have for the company revolves around a strategy to leverage the Internet. Specifically, relying on Hurd’s support and the vision of Vyomesh I. Joshi, the senior vice president in charge of the firm’s printing division, HP is trying to figure out a way to encourage people to print more Web pages, especially when using their home computers. In 2008, HP acquired Tabblo, a privately held developer of Web-based software. HP completed this transaction to gain access to Tabblo’s software application that “creates templates that reorganize the photos and text blocks on a Web page to fit standard sizes of paper.” HP’s interest is to make this software a standard like Adobe’s Flash and Reader or Sun Microsystems’ Java. This intention demonstrates Joshi’s belief that HP is in the “content consumption business” rather than the printing business.

Questions

1. Using materials available to you, including the Internet, learn as much as you can about Mark Hurd as a strategic leader. See if you can determine the type of organizational culture Hurd is developing at HP. Given what you learn and in light of comments included in the case, would you want to work for Hurd? Why or why not?

2. Go to Hewlett-Packard’s Web site (www.hp.com) to discover the firm’s current actions regarding “printing from the Web.” Has HP acquired more companies to support the effort to leverage the Internet? If so, what are those actions and how successful are they?

3. The industrial organization (I/O) model and the resource-based view of the firm model are introduced in this chapter. Find evidence in the case showing that HP was being influenced by its external environment and that the firm has unique capabilities it intends to use to be successful.

EXPERIENTIAL EXERCISES

Exercise One: The Culture, Vision, and Strategy Linkage

Vision and mission statements of firms need to be aligned with organizational culture. Together they give employees direction in any situation by providing them with values and purpose that set key priorities and orient action.

In Small Groups

In a small group, determine what your group thinks is the culture for each of the following companies. Then link that culture to your vision of the firm’s vision or mission as you understand it. How does your concept of the firm’s culture and vision fit with what you understand about its strategy, which is the basis for its success?

• Target
• Mary Kay Cosmetics
• UPS
• Starbucks

Whole Class

Groups should then compare their answers to the question that was answered in small groups. The purpose of this activity is to highlight differences as well as similarities in the small groups’ answers. Finally, go to each firm’s Web site and find its mission or vision statement. How well does the statement align with the culture and strategy you identified?

Exercise Two: Gathering and Assessing External and Internal Information

The industrial organization, or I/O, model discussed in the chapter focuses on the firm’s external environment and helps identify opportunities and threats. In contrast, the resource-based view focuses on the internal environment and helps firms identify strengths and weaknesses. Your instructor will assign you to one of the following firms. For that firm, find one aspect of the external environment that has been an opportunity or threat and one aspect of the internal environment that has been a strength or a weakness. Use sources such as
Chapter 1: The Foundations of Strategic Management

U-571: Setting Strategy

Watch the scene from U-571. It shows several aspects of strategic management and strategic planning described earlier in this chapter.

This action-packed World War II thriller shows a U.S. submarine crew’s efforts to retrieve an Enigma encryption device from a disabled German submarine. After the crew gets the device, a German vessel torpedoes and sinks their submarine. The survivors must now use the disabled German submarine to escape from the enemy with their prize. The film’s almost nonstop action and extraordinary special effects look and sound best with a home theater system.

The scene comes from the “160 meters” segment toward the film’s end. Lt. Andrew Tyler (Matthew McConaughey) is now the submarine’s commander following the drowning death of Lt. Commander Mike Dahlgren (Bill Paxton), the original commander. Lt. Tyler says, “Chief.” Chief Petty Officer (CPO) Henry Klough (Harvey Keitel) approaches the map table. The film continues to its dramatic end with the execution of the strategy Tyler described.

What to Watch for and Ask Yourself

1. Does Lt. Tyler analyze the submarine’s external environment?
2. What is Lt. Tyler’s assessment of the submarine’s resources and competitive advantage?
3. Does Lt. Tyler consider threats and opportunities in forming his strategic plan?
4. What to Watch for and Ask Yourself

ENDNOTES

34. B. W. Heineman, Jr., 2007, Avoiding integrity land mines, Business Horizons, 50: 405–413.