PART 1

STRATEGIC MANAGEMENT INPUTS

PowerPoint Presentation by Charlie Cook
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CHAPTER 1

Strategic Management

Management of Strategy

Concepts and Cases

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KNOWLEDGE OBJECTIVES

Studying this chapter should provide you with the strategic management knowledge needed to:

1. Define strategic competitiveness, strategy, competitive advantage, above-average returns, and the strategic management process.
2. Describe the 21st-century competitive landscape and explain how globalization and technological changes shape it.
3. Use the industrial organization (I/O) model to explain how firms can earn above-average returns.
4. Use the resource-based model to explain how firms can earn above-average returns.

KNOWLEDGE OBJECTIVES *(cont'd)*

Studying this chapter should provide you with the strategic management knowledge needed to:

5. Describe vision and mission and discuss their value.
6. Define stakeholders and describe their ability to influence organizations.
7. Describe the work of strategic leaders.
8. Explain the strategic management process.

Important Definitions

- Strategic Competitiveness
  - When a firm successfully formulates and implements a value-creating strategy.
- Strategy
  - An integrated and coordinated set of commitments and actions designed to exploit core competencies and gain a competitive advantage.
- Competitive Advantage
  - When a firm implements a strategy that its competitors are unable to duplicate or find too costly to try to imitate.

Important Definitions (cont’d)

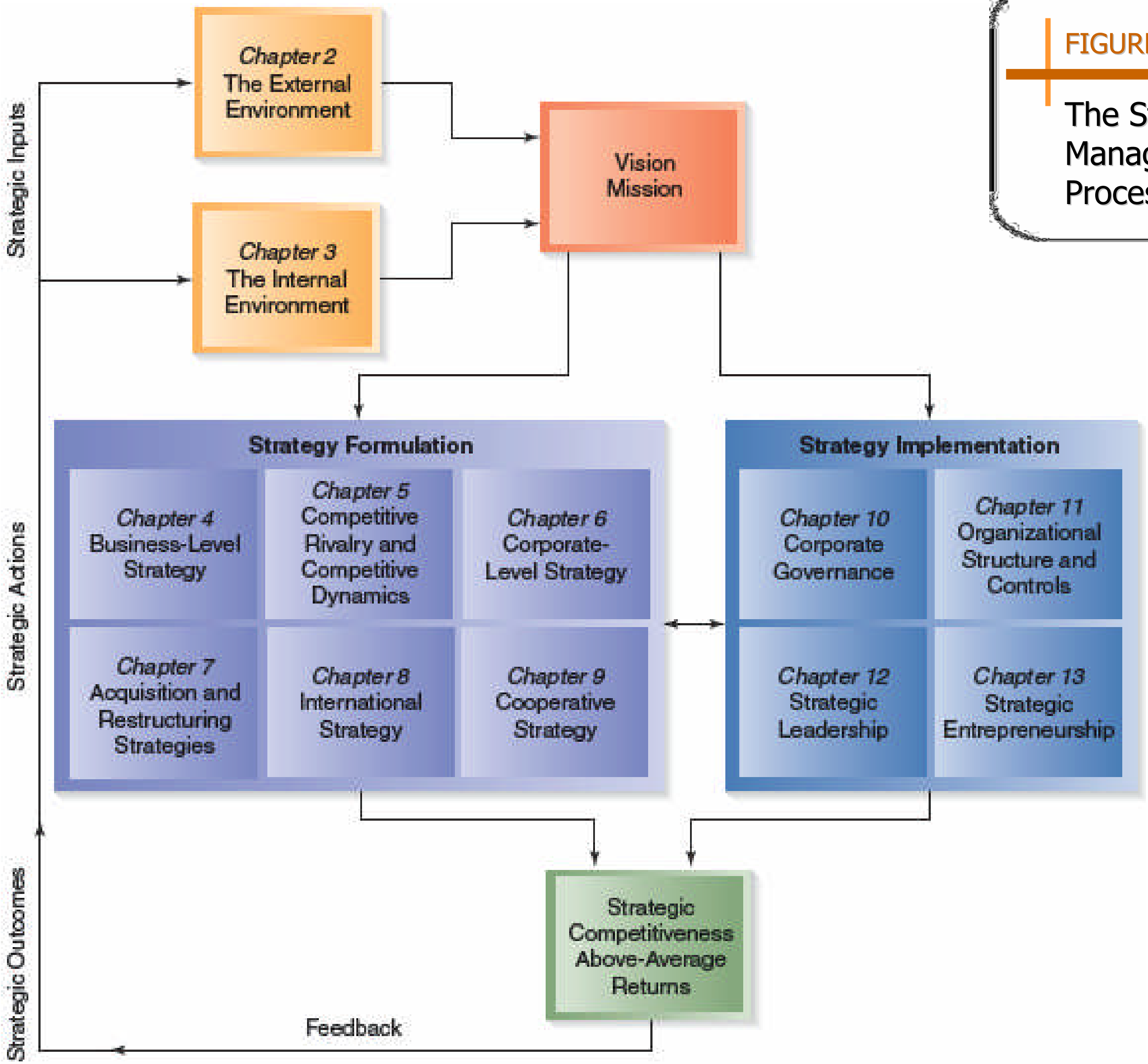
- Risk
  - An investor’s uncertainty about the economic gains or losses that will result from a particular investment.
- Average Returns
  - Returns equal to those an investor expects to earn from other investments with a similar amount of risk.
- Above-average Returns
  - Returns in excess of what an investor expects to earn from other investments with a similar amount of risk.

Important Definitions (cont'd)

- Strategic Management Process
  - The full set of commitments, decisions, and actions required for a firm to achieve strategic competitiveness and earn above-average returns.

FIGURE 1.1

The Strategic Management Process



The 21st-Century Competitive Landscape

- A Perilous Business World
  - Rapid changes in industry boundaries and markets
  - Conventional sources of competitive advantage losing effectiveness
  - Enormous investments required to compete globally
  - Severe consequences for failure
- Developing and Implementing Strategy
  - Allows for planned actions rather than reactions
  - Helps coordinate business unit strategies

The Competitive Landscape

Hypercompetition

A condition of rapidly escalating competition based on:

- Price-quality positioning
- Competition to create new know-how and establish first-mover advantage
- Competition to protect or invade established product or geographic markets

Global Economy

- The Global Economy
  - Goods, people, skills, and ideas move freely across geographic borders.
  - Movement is relatively unfettered by artificial constraints.
  - Expansion into global arena complicates a firm's competitive environment.
    - Short-term: Where is the fastest growth likely to occur?
    - Long-term: Where will sustainable growth occur?

Global Economy (cont'd)

- The March of Globalization
  - Increased economic interdependence among countries—the flow of goods and services, financial capital, and knowledge across country borders
    - Higher performance levels—quality, cost, productivity, product introduction time, and operational efficiency
  - Increased range of opportunities for companies competing in the 21st-century competitive landscape
    - Liability of foreignness—the risks of participating outside of a firm's domestic country in the global economy
    - The amount of time required for firms to learn how to compete in markets that are new to them.

Technology and Technological Changes

- Technology Diffusion
  - The speed at which new technologies become available
- Disruptive Technologies
  - Technologies that destroy the value of existing technology and create new markets
- Perpetual Innovation
  - The rapidity and consistency with which new, information-intensive technologies replace older ones

Technological Changes

- The Information Age
  - The ability to effectively and efficiently access and use information has become an important source of competitive advantage.
  - Technology includes personal computers, cellular phones, artificial intelligence, virtual reality, massive databases, electronic networks, internet trade.

Technological Changes (cont'd)

- Increasing Knowledge Intensity
  - Knowledge as a critical organizational resource for creating an intangible competitive advantage
  - **Strategic flexibility:** the set of capabilities used to respond to various demands and opportunities in dynamic and uncertain competitive environments
  - **Organizational slack:** slack resources that allow the firm flexibility to respond to environmental changes
  - Organizational capacity to learn

I/O Model of Above-Average Returns

- Dominance of the External Environment
  - The industry in which a firm competes has a stronger influence on the firm's performance than do the choices managers make inside their organizations.
- Industry Properties Determining Performance
  - Economies of scale
  - Barriers to market entry
  - Diversification
  - Product differentiation
  - Degree of concentration of firms in the industry

Four Assumptions of the I/O Model

1. External environment imposes pressures and constraints that determine strategies leading to above-average returns.

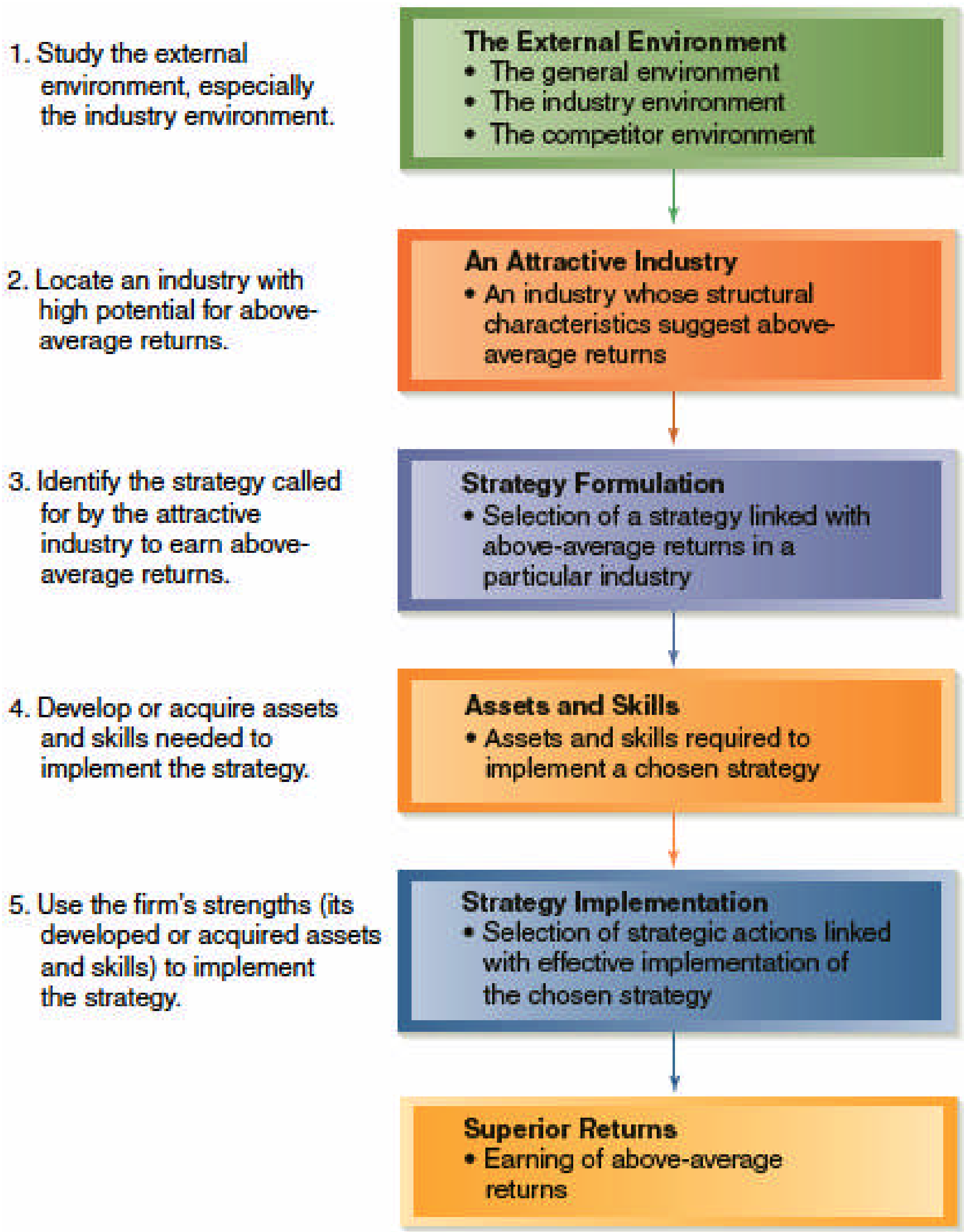
2. Most firms competing in an industry control similar strategically relevant resources and pursue similar strategies.

3. Resources used to implement strategies are highly mobile across firms.

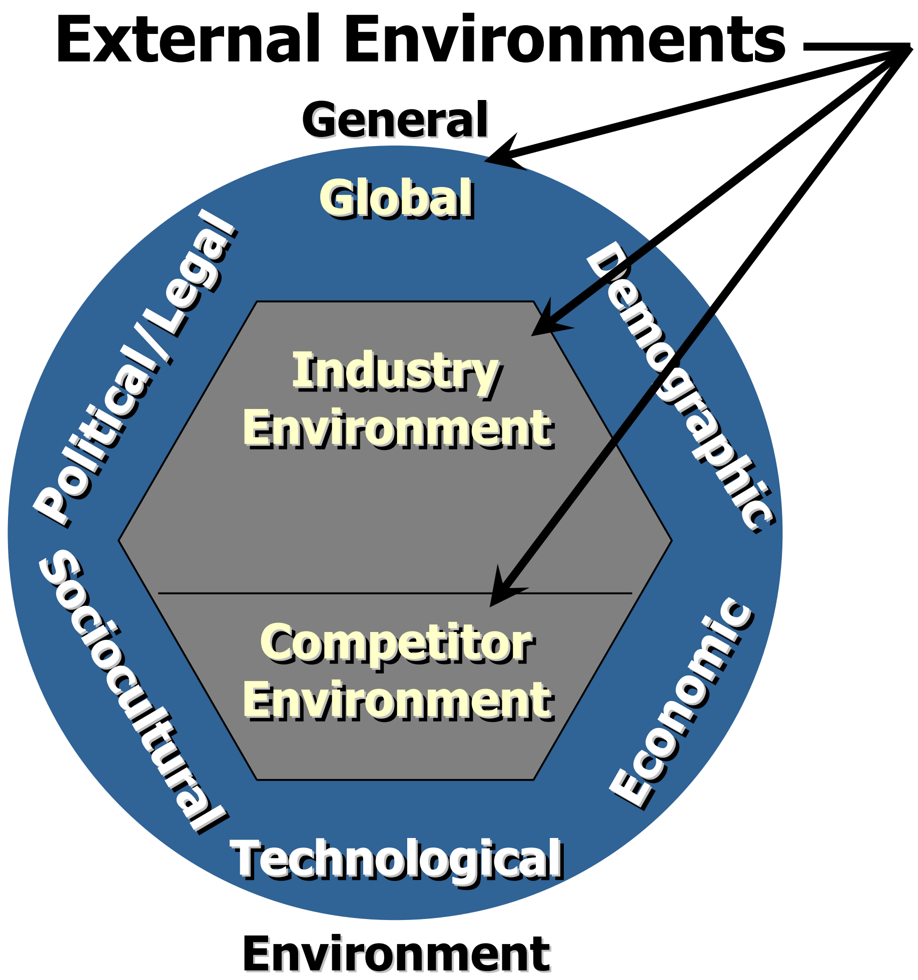
4. Organizational decision makers are assumed to be rational and committed to acting in the firm's best interests (profit-maximizing).

FIGURE 1.2

The I/O Model of Above-Average Returns



I/O Model of Above-Average Returns



1. Strategy is dictated by the external environment of the firm—*what opportunities exist in these environments?*
2. Firm develops internal skills required by external environment—*what can the firm do about the opportunities?*

Industrial Organization Model

The External Environment

1. Study the external environment, especially the industry environment:
   - Economies of scale
   - Barriers to market entry
   - Diversification
   - Product differentiation
   - Degree of concentration of firms in the industry

Industrial Organization Model

The External Environment
Attractive Industry

2. Locate an attractive industry with a high potential for above-average returns.

Attractive industry: One whose structural characteristics suggest above-average returns.

Industrial Organization Model

The External Environment

Attractive Industry

Strategy Formulation

3. Identify the strategy called for by the attractive industry to earn above-average returns.

Strategy formulation: Selection of a strategy linked with above-average returns in a particular industry.

Industrial Organization Model

The External Environment
Attractive Industry
Strategy Formulation
Assets and Skills

4. Develop or acquire assets and skills needed to implement a chosen strategy.

   Assets and skills: those assets and skills required to implement a chosen strategy.

Five Forces Model of Competition

- Industry Profitability
  - The industry's rate of return on invested capital relative to its cost of capital
- An industry's profitability results from interaction among:
  - Suppliers
  - Buyers
  - Competitive rivalry among firms currently in the industry
  - Product substitutes
  - Potential entrants to the industry

Five Forces Model of Competition (cont'd)

- Firms earn above-average returns by:
  - Cost leadership
    - Producing standardized products or services
  - Differentiation
    - Manufacturing differentiated products for which customers are willing to pay a price premium

The Resource-Based Model of Above-Average Returns

- Model Assumptions
  - Each organization is a collection of unique resources and capabilities that provides the basis for its strategy and that is the primary source of its returns.
  - Capabilities evolve and must be managed dynamically.
  - Differences in firms' performances are due primarily to their unique resources and capabilities rather than structural characteristics of the industry.
  - Firms acquire different resources and develop unique capabilities.

FIGURE 1.3

The Resource-Based Model of Above-Average Returns

1. Identify the firm's resources. Study its strengths and weaknesses compared with those of competitors.

Resources
- Inputs into a firm's production process

2. Determine the firm's capabilities. What do the capabilities allow the firm to do better than its competitors?

Capability
- Capacity of an integrated set of resources to integratively perform a task or activity

3. Determine the potential of the firm's resources and capabilities in terms of a competitive advantage.

Competitive Advantage
- Ability of a firm to outperform its rivals

4. Locate an attractive industry.

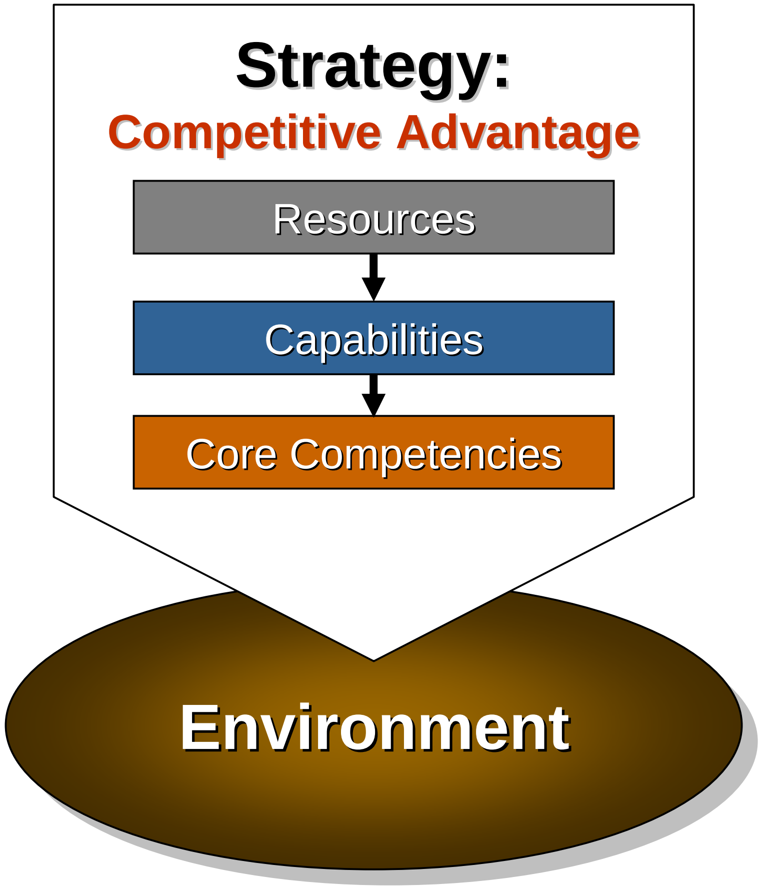
An Attractive Industry
- An industry with opportunities that can be exploited by the firm's resources and capabilities

5. Select a strategy that best allows the firm to utilize its resources and capabilities relative to opportunities in the external environment.

Strategy Formulation and Implementation
- Strategic actions taken to earn above-average returns

Superior Returns
- Earning of above-average returns

Resource-Based Model of Above-Average Returns (cont'd)



1. Strategy is dictated by the firm's unique resources and capabilities.
2. Find an environment in which to exploit these assets (where are the best opportunities?)

Resources and Capabilities

- Resources
  - Inputs into a firm's production process:
    - **Capital equipment**
    - **Skills of individual employees**
    - **Patents**
    - **Finances**
    - **Talented managers**
- Capabilities
  - Capacity of a set of resources to perform in an integrative manner
  - A capability should *not* be:
    - **So simple that it is highly imitable.**
    - **So complex that it defies internal steering and control.**

Resource-Based Model (cont'd)

Resources

Resources: inputs into a firm's production process

1. Identify the firm's resources—strengths and weaknesses compared with competitors

Resource-Based Model (cont'd)

Resources
Capability

Capability: capacity of an integrated set of resources to integratively perform a task or activity.

2. Determine the firm's capabilities—what it can do better than its competitors.

Resource-Based Model (cont'd)

Resources

Capability

Competitive Advantage

Competitive advantage: ability of a firm to outperform its rivals.

3. Determine the potential of the firm's resources and capabilities in terms of a competitive advantage.

Resource-Based Model (cont'd)

Resources
Capability
Competitive Advantage
Attractive Industry

Attractive industry: an industry with opportunities that can be exploited by the firm's resources and capabilities.

4. Locate an attractive industry.

Resource-Based Model (cont'd)

Resources
Capability
Competitive Advantage
Attractive Industry
Strategy Formulation and Implementation

Strategy formulation and implementation: strategic actions taken to earn above average returns.

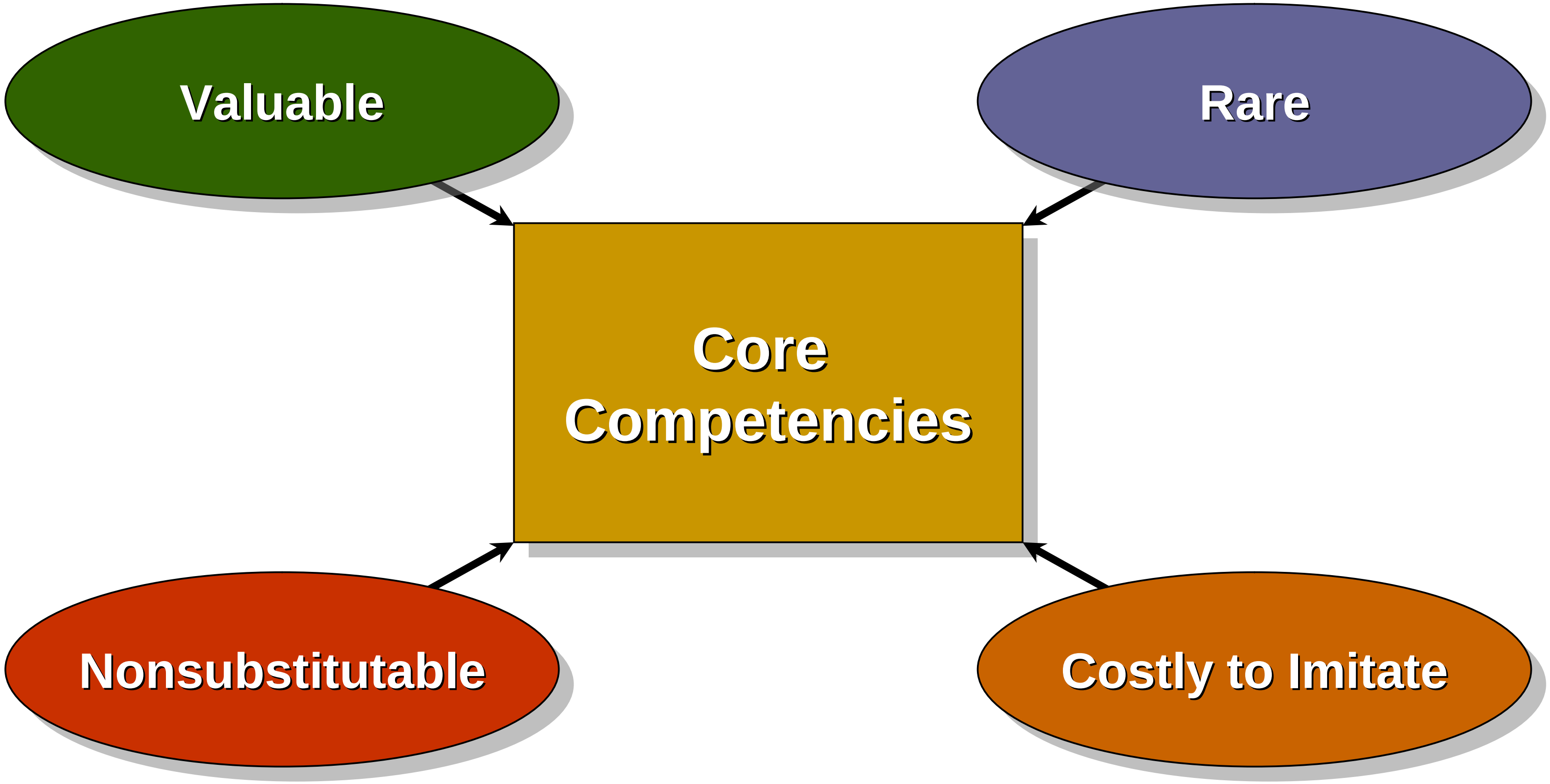
5. Select a strategy that best allows the firm to utilize its resources and capabilities relative to opportunities in the external environment.

Resource-Based Model (cont’d)

- Resources
- Capability
- Competitive Advantage
- Attractive Industry
- Strategy Formulation and Implementation
- Superior Returns

Superior returns: earning above-average returns

Criteria for Resources and Capabilities That Become Core Competencies



How Resources and Capabilities Provide Competitive Advantage

Valuable	Allow the firm to exploit opportunities or neutralize threats in its external environment
Rare	Possessed by few, if any, current and potential competitors
Costly to imitate	When other firms cannot obtain them or must obtain them at a much higher cost
Nonsubstitutable	The firm is organized appropriately to obtain the full benefits of the resources in order to realize a competitive advantage

Core Competencies

- When the four key criteria of resources and capabilities are met, they become core competencies.
- Managerial competencies are especially important.
- Core competencies serve as a source of competitive advantage, create value, and provide the opportunity for above-average returns.

Why Two Models?

- Industrial Organization (I/O) Model
  - Focuses on the environment outside the firm.
- Resource-Based Model
  - Focuses on the inside of the firm

Successful strategy formulation and implementation actions result only when the firm properly uses both models.

Vision and Mission

- Vision
  - A enduring picture of what the firm wants to be and, in broad terms, what it wants to ultimately achieve.
    - Stretches and challenges people and evokes emotions and dreams.
- Effective vision statements are:
  - Developed by a host of people from across the organization.
  - Clearly tied to external and internal environmental conditions.
  - Consistent with strategic leaders' decisions and actions.

Vision and Mission (cont'd)

- Mission
  - Specifies the business or businesses in which the firm intends to compete and the customers it intends to serve.
  - Is more concrete than the firm's vision.
  - Is more effective when it fosters strong ethical standards.
- Above-average returns are the fruits of the firm's efforts to achieve its vision and mission.

Stakeholders

- Individuals and groups who can affect, and are affected by, the strategic outcomes achieved and who have enforceable claims on a firm's performance.
  - Claims on the firm's performance are enforced by the stakeholder's ability to withhold participation essential to the firm's survival.
  - The more critical and valued a stakeholder's participation, the greater a firm's dependency on it.
  - Managers must find ways to either accommodate or insulate the organization from the demands of stakeholders controlling critical resources.

Stakeholder Involvement

- Two issues affect the extent of stakeholder involvement in the firm:
  - How to divide returns to keep stakeholders involved?
  - How to increase returns so everyone has more to share?

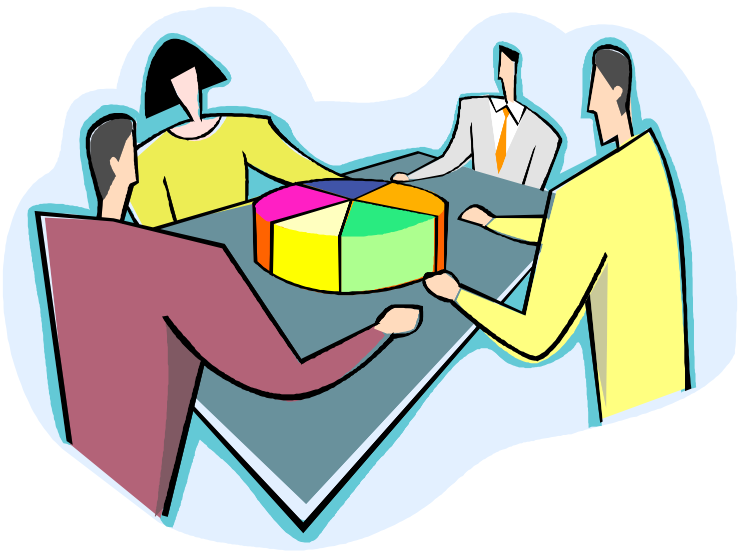


FIGURE 1.4 The Three Stakeholder Groups

Stakeholders → People who are affected by a firm's performance and who have claims on its performance

Capital Market Stakeholders
- Shareholders
- Major suppliers of capital (e.g., banks)

Product Market Stakeholders
- Primary customers
- Suppliers
- Host communities
- Unions

Organizational Stakeholders
- Employees
- Managers
- Nonmanagers

Stakeholders

Capital Market Stakeholders

Capital Market Stakeholders

Shareholders
Major suppliers of capital

- Banks
- Private lenders
- Venture capitalists

Capital Market Stakeholders

- Shareholders and lenders expect the firm to preserve and enhance the wealth they have entrusted to it.
  - Want the return on their investment (and, hence, their wealth) to be maximized.
  - Expect returns to be commensurate with the degree of risk to the shareholder.
- Management must balance the interests of shareholders and lenders with its concerns for the firm's future competitive ability.

Stakeholders (cont'd)

Capital Market Stakeholders

Product Market Stakeholders

Product Market Stakeholders

- Customers
- Suppliers
- Host communities
- Unions

Product Market Stakeholders

- Customers
  - Demand reliable products at low prices
- Suppliers
  - Seek loyal customers willing to pay highest sustainable prices for goods and services
- Host communities
  - Want companies willing to be long-term employers and providers of tax revenues while minimizing demands on public support services
- Union officials
  - Want secure jobs and desirable working conditions

Stakeholders (cont'd)

Capital Market Stakeholders

Product Market Stakeholders

Organizational Stakeholders

Organizational Stakeholders

- Employees
- Managers
- Nonmanagers

Organizational Stakeholders

- Employees
  - Expect a dynamic, stimulating and rewarding work environment.
  - Are satisfied by a company that is growing and actively developing their skills.

Strategic Leaders

- Strategic Leaders
  - People located in different parts of the firm who are using the strategic management process to help the firm reach its vision and mission.
- Prerequisites for Effective Strategic Leadership
  - Hard work
  - Thorough analyses
  - Honesty
  - Desire for accomplishment
  - Common sense

Strategic Leaders (cont'd)

- Organizational Culture
  - The complex set of ideologies, symbols, and core values that are shared throughout the firm and that influence how the firm conducts business.
- The Value of a Functional Organizational Culture
  - Supports effective delegation of strategic responsibilities
  - Provides support for strategic leaders
  - Encourages social energy
  - Fosters of respect for others

Predicting Outcomes of Strategic Decisions: Profit Pools

- Profit Pool
  - The total profits earned in an industry at all points along the value chain
- Identifying the components of a profit pool:
  - Define the pool's boundaries.
  - Estimate the pool's overall size.
  - Estimate size of each value-chain activity in the pool.
  - Reconcile the calculations—which activity provides the most profit potential?

Strategic Management Process

- Study the external and internal environments.
- Identify marketplace opportunities and threats.
- Determine how to use core competencies.
- Use strategic intent to leverage resources, capabilities and core competencies and win competitive battles.
- Integrate formulation and implementation of strategies.
- Seek feedback to improve strategies.