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part 1 Strategic Analysis

Chapter 1

Chapter 1

Strategic Management:

Creating Competitive Advantages

Summary/Objectives

PowerPoint Slide 2: Learning Objectives

At the heart of strategic management is the question: "How and why do some firms outperform others?" The challenge to managers is to develop and implement strategies that will provide competitive advantages that will be sustainable over time. This chapter is divided into five sections.

1. The first section addresses the broad question: "What is strategic management?" Here, we define strategic management as "consisting of the analysis, decisions, and actions an organization undertakes to create and sustain competitive advantages." We also address the four key attributes of strategic management: concern with overall objectives; involvement of multiple stakeholders; incorporation of short- and long-term perspectives; and recognition of tradeoffs between effectiveness and efficiency. We also introduce the concept of "ambidextrous behaviors"—the need to combine alignment and adaptability.

2. The second section discusses the strategic management process. Here, we present the three processes—analysis, formulation, and implementation—that provide the framework for the overall organization of the thirteen chapters of the book.

3. The third section focuses on the vital role of corporate governance, which is essential to ensuring that the actions of a firm's management are consistent with the goals of its owners—the shareholders. We also address stakeholder management. It must be taken into account throughout the strategic management process. Although the interests of stakeholders may, at times, conflict, we discuss how firms are able to achieve "symbiosis" among stakeholders wherein various interests are considered interdependent and can be attained simultaneously. We address the importance of social responsibility, including environmental sustainability, as well as challenges associated with making the case for sustainability initiatives.

4. The fourth section addresses today's greater need for a strategic management perspective throughout the organization. With the emergence of the knowledge of economy and globalization, leaders must mobilize people throughout the organization.

5. The fifth section discusses the need for organizations to attain consistency in their vision, mission, and strategic objectives. Collectively, they form a hierarchy of goals.

Lecture/Discussion Outline

We begin the chapter in LEARNING FROM MISTAKES with a clever quote from Arthur Martinez, Sears's former chairman: "Today's peacock is tomorrow's feather duster" to help illustrate the rapid turnover among the Fortune 500 firms over a period of time. With rapid changing technologies and intensified global competition success can be temporary, and new entrants can shake up long-standing industries.

The SUPPLEMENT below, from a website provides an interesting perspective on the digital economy.

Extra Example: The Digital Disruption Has Already Happened

- World's largest taxi company owns no taxis. (Uber)
- Largest accommodation provider owns no real estate. (Airbnb)
- Largest phone companies own no telco infrastructure. (Skype, WeChat)
- World's most valuable retailer has no inventory. (Alibab)
- Most popular media owner owns no content. (Facebook)
- Fastest growing banks have no actual money. (SocietyOne)
- World's largest movie house owns no cinemas. (Netflix)
- Largest software vendors don't write the apps. (Apple and Google)

Source: *www.ibmforentreprenuers.com.*

Discussion Question 1: *What are the implications for your careers? (This is a rather general question, but it might help remind students that they must be sensitive to changes in industry dynamics that could provide new opportunities—as well as, perhaps, erode opportunities that they may have thought they had in a particular industry.)*

Teaching Tip: *By raising the "career implications" question, you will have the opportunity to briefly introduce the concept of the sustainability of competitive advantage(s), i.e., the criteria of rare, valuable, difficult to copy (imitate and substitute) that we will address at length in Chapters 3 and 5. The point that can be made is that students should strive to develop skills and capabilities that satisfy these four criteria to enjoy greater career success. This helps to illustrate some very practical implications of strategy concepts and heighten student interest.*

The opening case is about a company, Mattress Firm, which failed because of (1) some of the strategic actions that it undertook, and (2) strong competition that emerged—principally from online rivals who had some rather significant competitive advantages. Thus, it helps to illustrate both the romantic view as well as the external control view of leadership, respectively.

Discussion Question 2: *What actions should Mattress Firm have taken when it became apparent that there were some nimble, online rivals entering the industry?*

Response Guidelines: This question should result in some interesting perspectives. Some students may feel that the situation was rather "hopeless" and that nothing could be done—in view of the rather significant advantages that rivals such as Casper enjoyed. But, others may come up with some constructive ideas such as creating some online options themselves to help blunt these new rivals. To do that, of course, would require investment—which would mean that Mattress Firm should have reduced the investment that was the result of their ambitious growth plans. Further, management could have been more introspective in what some of their customers (and potential customers!) believed were negative aspects of the brick-and-mortar companies in this industry, e.g., salespersons "rushing" to have them make a decision on a major purchase that needs to last many years, complicated and expensive delivery options, etc. Thus, Mattress Firm could have endeavored to explore ways in which they could have enhanced the customer buying experience.

Discussion Question 3: *Casper Sleep Inc. has certainly become a strong competitor in this industry. In your view, what could they do to further strengthen their position?*

Response Guidelines: Part of the answer, of course, is revealed in the last sentence in the case, i.e., expand into other products such as bed frames, sheets, pillow, and dog mattresses. Such related products would provide additional revenues and margins—and, ideally, there would be rather minimal transportation costs because some of these products could be shipped along with the mattress purchase. Casper could also conduct marketing surveys to determine how they could further improve the customer experience as well as generate ideas on what additional products they could add to their portfolio. Additionally, Casper could explore partnerships with other producers of similar products as well as joint marketing initiatives.

I. What Is Strategic Management?

PowerPoint Slide 3: The Importance of Leadership
PowerPoint Slide 4: Two Perspectives of Leadership
PowerPoint Slide 5: Leaders Can Make a Difference
PowerPoint Slide 6: Defining Strategic Management
PowerPoint Slide 7: Two Fundamental Questions
PowerPoint Slide 8: Strategic Management
PowerPoint Slide 9 Strategic Management Trade-offs

We point out that it is very important for managers to see their jobs as more than just custodians of the "status quo." Rather, they must proactively anticipate change and continually refine, as well as, when necessary, make significant changes to their strategies. This has become particularly important as competitive environments become characterized by increasing rates of unpredictable change.

A. Defining Strategic Management

We define strategic management as "*consisting of the analysis, decisions, and actions an organization undertakes in order to create and sustain competitive advantages*." We believe this definition captures two main elements of the field of strategic management.

First, strategic management entails three on-going processes: analysis, decisions, and actions. That is, managers must analyze the internal and external environment as well as their hierarchy of goals in order to formulate and implement strategies.

Second, the essence of strategic management is the study of why some firms outperform others. We draw on Michael Porter's work to make the important distinction between strategy and operational effectiveness. Managers must create advantages that are sustainable over a period of time, instead of merely temporary. That is: *How can we create competitive advantages in the marketplace that are not only unique and valuable but also difficult for competitors to copy or substitute?* (This perspective, of course, draws upon the resource base view of the firm that we address in detail in Chapters 3 and 5.)

Discussion Question 4: *Are you familiar with some firms that created advantages in the marketplace that were very temporary?*

B. The Four Key Attributes of Strategic Management

Here, we address four key attributes of strategic management. Strategic management is directed toward organizational goals and objectives; includes multiple stakeholders in decision making; incorporates both short-term and long-term perspectives; and, recognizes trade-offs between effectiveness and efficiency.

EXHIBIT 1.1 provides our definition of strategic management and these four attributes.

Discussion Question 5: *What are some examples of leaders who failed to incorporate some of these attributes in their decision making? What were the implications?*

The SUPPLEMENT below points out the importance of a key attribute of strategic management: recognizing trade-offs between efficiency and effectiveness.

Extra Example: When a Firm Needs Farmers and Vikings

Executives who excel at execution resemble Nordic Vikings, who attacked when they saw an unprotected spot and retreated when they realized they could not win, maneuvering their longboats toward the next opportunity. Once Vikings seized a bit of land, however, they often remained to farm it. Over time, they came to value the security of protecting what they had, more than the adventure of pursuing new opportunities.

Organizations are susceptible to a similar dynamic. As a business matures, early entrepreneurs leave for new adventures or settle into safe routines at the firm. New employees join the company for its perceived stability, not for adventure. What started as a Viking outpost becomes a farming community. Companies with too few Vikings on the payroll struggle to execute with sufficient urgency. That is why soon after assuming control of a portfolio company, Garantia's (a producer of rainwater tanks) executives would implement a trainee program to attract the best and brightest college graduates, a practice the firm has continued as it has expanded. These graduates provide a steady stream of Vikings and exert constant pressure on executives who might otherwise lapse into the comfort of farm life.

Source: Sull, D. 2010. Are you ready to rebound? *Harvard Business Review.* 88(3): 74

Discussion Question 6: *Are companies you are familiar with or work at comprised of Vikings or farmers? Would your answer vary over time?*

Discussion Question 7: *When should firms hire more Vikings? How about farmers?*

We also discuss an interesting insight regarding the types of challenges that managers face. Here, we address three "paradoxes" based on a 2016 *HBR* article by Wendy Smith and her colleagues. They are:

- The *innovation paradox* reflects the tension between existing products and new ones, i.e., stability and change.
- The *globalization paradox* is about the conflict between global connectedness and local needs.
- The *obligation paradox* reflects the tension between social responsibility/a broader stakeholder perspective and short-term shareholder demands.

Discussion Question 8: *What are some examples of companies that have faced such paradoxes? What actions were taken? Were they successful?*

We close the section with a brief introduction of the concept of "ambidextrous behaviors"—the ability to both be proactive in taking advantage of future opportunities, as well as in exploiting an existing resource base. STRATEGY SPOTLIGHT 1.1 illustrates this concept by providing four examples of ambidextrous behaviors. We also provide some suggestions on how one can become an ambidextrous leader. Ask:

Discussion Question 9: *Do you know of any managers or executives who have exhibited ambidextrous behaviors? How?*

II. The Strategic Management Process

PowerPoint Slide 11: Intended vs. Realized Strategies. PowerPoint Slide 12: Strategic Management Process
PowerPoint Slide 13, 14, 15: Strategy Analysis
PowerPoint Slide 16, 17, 18: Strategy Formulation
PowerPoint Slide 19, 20, 21, 22, 23: Strategy Implementation

We restate the three ongoing processes in strategic management—analysis, decisions, and actions—that are typically referred to as analysis, formulation, and implementation.

A. Intended Versus Realized Strategies

EXHIBIT 1.2 draws on the influential work of Henry Mintzberg of McGill University. He distinguishes between "intended" and "realized" strategies, and we provide the example of how Superdry PLC, a British clothing brand, had to change their product mix due to unseasonably warm weather.

Discussion Question 10: *What are some other examples of "unrealized" or emergent strategies?*

EXHIBIT 1.3 depicts the strategic management process and indicates how it ties into the chapters in the book. And, consistent with the discussion in the text, the two-way arrows convey the interactive nature of the process.

Teaching Tip: *Refer back to the opening case of Mattress Firm's poor performance. When discussing EXHIBIT 1.3, it would be helpful to ask the class to illustrate how this exhibit can be useful in outlining the issues surrounding this case and how some of the problems may have been avoided with careful attention to these aspects of analysis, formulation, and implementation.*

The next three subsections address each of the three key strategic management processes: analysis, formulation, and implementation.

B. Strategy Analysis

Strategy analysis consists of, in effect, the "advance work" that must be done in order to effectively formulate and implement strategies. Many strategies fail because managers may want to formulate and implement strategies without a careful analysis of the overarching goals of the organization, as well as a thorough analysis of its external and internal environment.

1. Analyzing Organization Goals and Objectives (Chapter 1)
2. Analyzing the External Environment (Chapter 2)
3. Assessing the Internal Environment (Chapter 3)
4. Assessing a Firm's Intellectual Assets (Chapter 4)

C. Strategy Formulation

A firm's strategy is formulated at several levels. First, business-level strategy addresses the issue of how firms compete in an industry to gain competitive advantage. Second, corporate-level strategy focuses on two issues: (1) what businesses to compete in, and (2) how businesses can be managed to achieve synergy, that is, create more value by working together than if they operated as a stand-alone entity. Third, firms must develop international strategies as they expand beyond their national boundaries. And fourth, managers must develop entrepreneurial strategies and be aware of the competitive dynamics in their industry.

1. Formulating Business Level Strategies (Chapter 5)
2. Formulating Corporate Level Strategies (Chapter 6)
3. Formulating International Level Strategies (Chapter 7)
4. Entrepreneurial Strategy and Competitive Dynamics (Chapter 8)

D. Strategy Implementation

Clearly, effective strategies are of little value if they are not properly implemented. Implementing strategies involves strategic controls and organizational designs; coordination and integration among activities within the firm, as well as with customers and suppliers; and effective leadership.

1. Strategic Control and Corporate Governance (Chapter 9)
2. Creating Effective Organizational Designs (Chapter 10)
3. Strategic Leadership: Excellence, Ethics and Change (Chapter 11)
4. Fostering Corporate Entrepreneurship (Chapter 12)
5. Analyzing Strategic Management Cases (Chapter 13)

For the Tenth Edition, Mr. Usman Ghani, an international consultant, has added a new feature: “Executive Insights: The Strategic Management Process.” We are very pleased to have his perspective on this central topic to our text. In addition to many insights on leadership at high levels in both business and consulting, he addresses challenges associated with the three core elements of the strategic management process (analysis, formulation, and implementation).

> ***Discussion Question 11:*** *For your organization (or the organization that you would like to work with) what do you feel are the most important points that he makes that can enhance its strategy and operational effectiveness? (You might address such concepts as leveraging both success and failure for active learning, attitudinal and behavioral pitfalls, experimenting with inclusive ideas, developing self-awareness, the role of ethics and values, etc.)*

III. The Role of Corporate Governance and Stakeholder Management

PowerPoint Slide 24: Corporate Governance and Stakeholder Management
PowerPoint Slide 25: Corporate Governance
PowerPoint Slide 26: Stakeholder Management
PowerPoint Slide 27: Two Views of Stakeholder Management
PowerPoint Slide 29: Social Responsibility and Environmental Sustainability
PowerPoint Slide 30: Empowered Strategic Management
PowerPoint Slide 31, 32, 33, 34, 35: Coherence in Strategic Direction

We discuss three important and related concepts: corporate governance, stakeholder management, and social responsibility. Clearly, these topics (especially corporate governance) have generated quite a bit of controversy and the topic should lead to some spirited discussion.

Corporate governance addresses the relationship between various participants in determining the overall direction and performance of corporations. It consists of three primary participants—shareholders, management, and the board of directors.

EXHIBIT 1.4 illustrates these three participants.

(Corporate governance is discussed in much more detail in Chapter 9. However, it is such a "hot" topic, that we wanted to introduce it in the text's opening chapter.)

Discussion Question 12: *What are some other recent examples of poor corporate governance? (Examples would include Bank of America, Wells Fargo, Volkswagen, Uber, etc.)*

Discussion Question 13: *What are the* ***causes*** *of such poor governance?*

We address some examples of extremely high executive pay—in many cases the pay is disproportionate to how well the CEO's firm performed (see examples from the financial industry).

The SUPPLEMENT below provides some information on the increased rapid turnover of CEOs among large firms and the growing pressure that CEOs face from investors and other stakeholders.

Extra Example: Increasing Turnover Among CEOs of U.S. Corporations

The rate of turnover among CEOs of large corporations has increased as corporate directors and activist investors demand strong results—and rapidly seek management changes if they don't happen quickly. Thus, more pressure is placed on CEOs and other C-level staff. Grace periods are being shortened and top executives must quickly tackle challenges and demonstrate their capabilities.

In 2018, 1,452 CEOs of public and private companies and nonprofit groups left their position—25 percent more than those who departed in 2017 (and this was just shy of the highest annual CEO departures recorded during the 2008 financial crisis)—according to executive recruiting company, Challenger, Gray & Christmas. Although 27 percent of these departures were retirements, many CEOs resigned amid board questions about performance—and some because of professional or sexual misconduct allegations.

As noted by Ken Freeman, former dean of Boston University's Questrom School of Business, "CEOs and other top executives must start earning their stripes from Day 1 on new jobs, and there's little margin for error." And, social media and the availability of data about firms' performance compound the pressure, adding "constant, up-to-the minute scrutiny of CEOs," he says.

Source: Hymowitz, C. 2019. Prove yourself now. *Bloomberg Businessweek*. April 1: 44.

Teaching Tip: As we note, executive compensation is a very "hot" topic and might be a subject that you would like to spend some time on (even though we address corporate governance issues in much more detail in Chapter 9). It is early in the term and this might get many students' "blood pressure" up and lead to spirited debates. You might also ask "How much is too much?" Some students may argue "whatever the market conditions are, because of the market for scarce talent," others may state that "it should depend on how much others make—such as the next highest executive at a firm (or a multiple of the lowest paid in the corporation—such as the case at Whole Foods, Inc.)," and still others may believe that "managers should not receive entrepreneurial rewards without taking entrepreneurial risks (e.g., the case of Welch at GE and Eisner at Disney who earned around $1 billion during their tenures)—since such executives joined the company when it was already very successful and there was little employment risk—not to mention the risk of one's personal financial assets (i.e., "skin in the game")." Or, of course, you could take one of these positions and see how the class reacts—consider asking individual students to take a position and others to rebut it, etc.

Given the usual student interest in executive pay, the SUPPLEMENT below should stimulate additional discussion, i.e., do students agree with the "sentiment" below.

Extra Example: Executive Compensation

The Rock Center for Corporate Governance at Stanford University posed the question (response was 1,202 people): How much does the average CEO of a major corporation make? The answer was quite surprising: $1 million, which is both a round number and seems like a lot of money.

The real answer is quite a bit higher: $10.3 million (according to a 2015 report from the compensation trackers at Equilar).

Approximately three-quarters of those surveyed said that CEOs are not "paid the correct amount relative to the average worker"—and this view held up across political affiliations, i.e., 25 percent of Republicans felt they were paid appropriately, only slightly higher than 16 percent of Democrats and 11 percent of Independents.

Not surprisingly, David F. Larcker, a professor at the Stanford Graduate School of Business, said in the report: "While we find that members of the public are not particularly knowledgeable about how much CEOs actually make in annual pay, there is a general sense of outrage fueled by the political environment."

Source: Rosenberg, R. 2016. Their CEO got $142 million more than he deserved. *financeyahoo.com*. February 17: np.

The SUPPLEMENT below provides some interesting insights on surveys of capitalism versus socialism among younger Americans. It might be interesting to ask your students why such perspectives are so pervasive.

Extra Example: Americans' Positive Image of Capitalism Is Eroding…

One would have to go back to the 1960s—or 1930s—to find a time when the primacy of the free market system was being so widely questioned. According to a recent Gallup poll, merely 56 percent of Americans state that they have a positive image of capitalism. Similarly, in a Fox News poll, 36 percent of adults approved of a shift in the United States "away from capitalism and more toward socialism"—a significant increase from 2012 when just 20 percent said so.

Among Millennials and Gen Z, skepticism about free markets is actually the majority view. In Gallup's poll, 51 percent of those 18 to 29 had a positive view of socialism—perhaps more the largely fuzzy Scandinavian/Bernie Sanders version as opposed to the Soviet/Berlin Wall hard stuff—compared to 45% for capitalism. Such a finding is consistent with a Harvard survey of young adults in which 51 percent said they did not support capitalism—and only

19 percent said they "identify as a capitalist." Perhaps, surprisingly, such sentiments come amid an economy that is by all traditional indicators booming with full employment and 3 percent growth.

Although many still believe that America is still the land of opportunity, a 2019 Fox News agency found that just 42 percent of Americans did not think "the way capitalism works in the United States these days give them a fair shot." And, in a country that has always held true to the premise that one could make it through hard work—or at least your children could—18 percent thought that the American Dream is out of reach for their family. Perhaps, the perception of the lack of upward mobility fuels much of such populist anger: Despite all of the anecdotal success stores, if you were born in the wrong zip code, to the wrong parents, the road to The Forbes 400 has never looked longer or narrower.

Source: Lane, R. 2019. Reimagining capitalism. *Forbes,* March 31: 30-35.

A. Alternative Perspectives on Stakeholder Management

In this section we recognize, of course, that there are often conflicting demands among an organization's stakeholders. However, managers need to acknowledge the interdependence among stakeholders and strive to achieve symbiosis, that is, the recognition that stakeholders are interdependent upon one another for their success and well-being.

EXHIBIT 1.5 lists seven key stakeholder groups and the nature of their claims.

1. Zero-Sum or Symbiosis

We address the many stakeholder challenges faced by Wal-Mart.

Discussion Question 14: *What are some ways Wal-Mart's stakeholder demands may conflict? How might they be highly interdependent and positively (or negatively) related to each other?*

Discussion Question 15: *Can you give other examples of other such collective initiatives? And, in your example, have all stakeholders benefitted (or been penalized) equally?*

B. Social Responsibility and Environmental Sustainability: Moving Beyond the Immediate Stakeholders

1. Social Responsibility

Managers must consider the needs of the broader community-at-large and act in a socially responsible manner. Social responsibility is the expectation that businesses or individuals will strive to improve the overall welfare of a society.

The following SUPPLEMENT summarizes some of the central points in the debate as to the value of corporations to devote significant resources to corporate social responsibility:

Extra Example: Stakeholders Versus Shareholders

Although corporate social responsibility may appear to be an "apple-pie virtue," it is quite controversial. Below are some of the chief arguments for and against it:

Proponents will claim that it…

BURNISHES A COMPANY'S REPUTATION. In the wake of corporate scandals, corporate social responsibility builds goodwill—and can pay off when scandals or regulatory scrutiny inevitably arise.

ATTRACTS TALENT. Many young professionals expect their employers to be active in social issues. Membership in Netimpact.org, a network of socially-conscious MBA graduates, jumped from 4,000 in 2002 to 10,000 in 2004.

On the other hand, Detractors will argue that it…

COSTS TOO MUCH. Giving by corporate foundations reached an all-time high of $3.6 billion last year. However, it can come at the expense of other priorities, such as research and development, and is rarely valued by Wall Street.

IS MISGUIDED. Many corporate executives believe, as economist Milton Friedman does, that the role of business is to generate profits for shareholders—not to spend others' money for some perceived social benefit.

Source: Grow, B., Hamm, S. & Lee, Louise. 2005. The debate over doing good. *Business Week*, August 15: 76-78.

Teaching Tip: *You could likely generate some interesting debate by asking students to take alternative positions on this issue. Perhaps, assign one student to the "pro" position and one to the "con" position. Also, give them a chance to rebut the other person's perspective. You could then ask a few others to join the debate by taking their preferred side on this issue. (The debate could become more spirited by raising very "intense" issues such as natural disasters, including the tsunami that hit Japan on March 11, 2011.)*

2. The Triple Bottom Line: Incorporating Financial as well as Environmental and Social Costs

Next, we state that many companies are measuring what they call the "triple bottom line." Such a technique involves an assessment of environmental, social, and financial performance. We state that environmental sustainability is now a value embraced by most successful corporations.

Discussion Question 16: *Do you know of organizations that may have, in effect, used the "triple bottom line" approach to assess environmental, social, and financial performance?*

It is important to stress that when considering the "triple bottom line," there are *not* always tradeoffs. At times, firms can attain symbiosis—that is increase their effectiveness in attaining multiple bottom lines simultaneously. STRATEGY SPOTLIGHT 1.2 addresses how Inditex (the company that owns Zara and other brands) can increase revenues and cut costs via sustainability initiatives.

We provide a brief discussion of SRI (Socially Responsible Investing). SRI recognizes that corporate responsibility and societal concerns are important considerations in investment decisions. And, investors can "do well by doing good," as the cliché goes.

The SUPPLEMENT below provides some figures on the favorable views of environmental sustainability by CEOs and the public at large.

Extra Example: Favorable Views on Environmental Sustainability

Data (obtained from research by American Express, Davos, Deloitte, Maritz Research and Price Waterhouse Coopers) shows how positively CEOs and the general public view environmental sustainability:

- 87 percent of Fortune 1000 CEOs believe sustainability is important to a company's profits.
- 73 percent of CEOs believe sustainability results in costs savings.
- 90 percent of the U.S. population says it is important for companies to be mindful of their impact on the environment and society.
- 46 percent of consumers say they would shop at a retailer more if it was environmentally friendly.

Source: Kubala, D. Apparel Technology & Business Insight—From Concept to Consumer (unpublished manuscript).

We also provide a perspective on how corporate social responsibility (CSR) can be viewed in terms of three "theaters" which are:

- Theater 1: Focusing on Philanthropy
- Theater 2: Improving Operational Effectiveness
- Theater 3 Transforming the Business Model

Discussion Question 17: *What examples have you read about in which companies have succeeded (or failed) with such initiatives? What were the outcomes?*

We close this section with discussion of "Making the Business Care for Sustainability Initiatives." This becomes a challenge because companies want to know returns on their investments—and the ROI on sustainability initiatives are typically very difficult to quantify. Among the reasons are:

1. The data necessary to calculate ROI accurately are often not available when it comes to sustainability projects.
2. Many of the benefits from such projects are intangible.
3. The payback period is on a different time frame.

We then provide examples of how companies such as 3M, Diversey, and IKEA are addressing these challenges.

The SUPPLEMENT below addresses some of the challenges associated with implementing some “good-sounding” and seemingly valuable environment sustainability initiatives.

Extra Example: It’s not easy to implement what may seem like reasonable environmental initiatives.

Starbucks has plans to do away with plastic straws by the year 2020. Lyft has dedicated itself to become “carbon neutral.” Candy producer Mondelez claims that all of its wrappers will be recyclable by 2025, and Goldman Sachs has banished the use of paper cups. However, there is rather scant evidence that such gestures truly benefit customers, shareholders, employees—or the environment.

Let’s take a closer look at Starbucks. It plans to reduce plastic waste by eliminating plastic straws for recyclable lids. However, straws are a tiny share of waste, accounting for about 0.025 percent of the eight million tons of plastic that flow annually into the ocean. That aside, the new lids contain more plastic than the straws! Although the lids are ostensibly recyclable, consumers have to separate them for the cups and throw them into recycling bins. Are many people—realistically—going to go to that trouble?

Then, there are other practical concerns. In 2008, Starbucks set a “bold goal” to serve 25 percent of its beverages in reusable cups by 2015. It later dropped the goal to only 5 percent. Why? Mainly because it was inefficient for baristas to wash dirty cups while other customers waited. And, to top off, cleaning mugs required water and paper towels—which also end up in the trash.

Source: Finley, A. 2019. Would you like guilt with your latte? *The Wall Street Journal*, May 28: A19.

IV. The Strategic Management Perspective: An Imperative throughout the Organization

There is an emerging need for empowerment and a strategic management perspective throughout organizations. This is primarily due to today’s increasingly complex, interconnected, and ever-changing global economy. We reinforce this point with the quotation from MIT’s Peter Senge, perhaps the best-known writer in the area of organizational learning.

To develop and mobilize people and other organizational assets, leaders are required throughout the organization. Clearly, there is a need for three types of leaders: *local line leaders, executive leaders,* and *internal networkers*.

The SUPPLEMENT below provides and interesting and colorful perspective on the need for empowerment throughout organizations.

Extra Example: Avoid the heroes and drones imagery in organizations!

Sally Helgesen, author of *The Web of Inclusion: A new Architecture for Building Great Organizations*, expresses the need for leaders throughout the organization. She asserts that many organizations “fall prey to the heroes-and-drones syndrome, exalting the value of those in powerful positions while implicitly demeaning the contributions of those who fail to achieve top rank. Culture and processes in which leaders emerge at all levels, both up and down as well as across the organization, typify today’s high performing firms.”

Source: Helgesen, S. 1996. Leading from the grassroots. In Hesselbein, F. Goldsmith, M. & Beckhard, R. (Eds.) *The leader of the future*: 19-24, San Francisco: Jossey-Bass.

We provide examples of empowerment at both the Virgin Group that is well known for its culture and informal structure, as well insights as from Netflix.

Discussion Question 18: *With regard to the Virgin Group, what do you think would be some of the key challenges in bringing about change?*

We close this section with STRATEGY SPOTLIGHT 1.3 that further reinforces the benefits of broad involvement throughout the organization in the strategic management process. It is about the filming of the movie *Gorillas in the Mist*, and it points out the value of *in*experience.

The SUPPLEMENT below emphasizes the importance of empowering people throughout the organization. At USA Mortgage, the CEO realized, belatedly, the importance of having his middle managers involved in planning sessions.

Extra Example: The Value of Bringing in Middle Level Managers for Planning Sessions

Doug Schukar was very excited when his residential mortgage bank in St. Louis, USA Mortgage, increased the loans it funded from $113 million in January 2009 to $1.2 billion by the end of the year. While other lenders struggled, he boosted his sales efforts. However, by failing to keep key middle managers informed of growth plans such as acquisitions, he let them get blindsided by the huge volume of work that came from the company's rapid expansion. Result: Almost all resigned, and he had to hire replacements. Today, he includes middle managers in annual and quarterly planning sessions.

Source: Harnish, V. 2011. Five ways to get your strategy right. *Fortune*. April 11: 42.

V. Ensuring Coherence in Strategic Direction

Successful organizations express priorities through stated goals and objectives that form a hierarchy of goals that include its vision, mission, and strategic objectives. What visions lack in specificity, they make up for in their ability to evoke powerful and compelling mental images. On the other hand, strategic objectives tend to be more specific and provide a more direct means of determining if the organization is moving toward broader, overall goals.

EXHIBIT 1.6 depicts the hierarchy of goals and its relationship to two attributes: general versus specific and time horizon.

We also address some of the benefits that firms may obtain when they communicate their long-term perspectives and priorities. Among these are:

1. Investor presentations of long-term plans provide an opportunity for discussions to take place regarding the continuing corporate performance on two critical elements: a long-time value creation *story* (drawing on the past) and a long-term value creation *plan* (drawing on the future).

2. Investors are increasingly seeing ESG (environmental, social, governance) issues as financially material and expect sound management in order to deliver better performance over the long term.
3. A corporation can obtain many collateral benefits when it communicates its long-term purpose. Among these are the ability to inspire—and retain—talented managers and employees.

A. Organizational Vision

An organizational vision has been described as a goal that is "massively inspiring, overarching, and long-term." It should represent a destination and evoke passion.

We review a study of executives from 20 countries that points out the importance of "a strong sense of vision" as well as "strategy formulation to achieve a vision."

We state the visions of three organizations—Medtronic, McDonald's, and Intel, as well as Microsoft's initial vision: "A computer on every desk in every home."

The SUPPLEMENT below (going back in history nearly one hundred years) provides an example of a vision emerging from the middle levels of the organization. Unfortunately, the top executives ignored it.

Extra Example: David Sarnoff's Visionary Leadership

In 1906, a young Russian immigrant found work as an office boy at Marconi Wireless Telegraph Company. He clawed his way up to Chief Inspector at the age of 22. And, ever watchful for ways to advance his career, he decided to attend a demonstration of a new kind of circuit—one that could generate continuous electromagnetic waves. The young man returned to work, convinced he had seen the future. Memos flew. He described how music could be broadcast to hundreds of thousands of homes at once, and from a single transmitter. Every family in America would buy a "radio box." And Marconi would manufacture and sell every one. He wondered why executives couldn't see that there would be millions of dollars to be made. The company's more senior managers thought he had lost his mind. After all, they were in the telegraph business.

Years later, Marconi Wireless became RCA, the Radio Corporation of America. And former office boy David Sarnoff became its president. As for those fellows he worked with, history lost track of them.

Source: Provided by CSX Intermodal (undated). We acknowledge their contribution.

Discussion Question 19: *Would executives in companies with which you are familiar been more receptive to such initiatives by lower-ranking executives? Why? Why not?*

STRATEGY SPOTLIGHT 1.4 discusses how the change of Alibaba's vision served to create a more expansive view of the future.

We close the section with a brief discussion of some of the reasons that visions fail:

- The Walk Doesn't Match the Talk
- Irrelevance
- Not the Holy Grail
- Too Much Focus Leads to Missed Opportunities

- An Ideal Future Not Reconciled with the Present

The SUPPLEMENT below is another example of a well-known firm—Komatsu—which faltered when it missed opportunities because it placed too much focus on its vision.

Extra Example How Komatsu "Encircled" Caterpillar

Faced with the challenge of rival Caterpillar's entry into Komatsu's protected home market, Ryoichi Kawai, then CEO of Komatsu, focused the whole company on beating Caterpillar. "Maru-C" became the rally cry, which meant "Encircle Caterpillar." And, to make the enemy visible and omnipresent, Kawai purchased the largest Caterpillar bulldozer available and placed it on the roof of Komatsu headquarters. The story is well-known of how Kawai leveraged his aggression against Caterpillar into a highly disciplined and effective process of building up Komatsu's strengths and market position. (In fact, it became the most-used Harvard case study.)

However, there was a lesser-known downside. The two decades of focusing on a "life-and-death battle" with Caterpillar prevented Komatsu from identifying new opportunities in related areas of business and from pursuing genuine breakthrough innovations in its core earthmoving-equipment business. Eventually, Tetsuya Katada took over and formally abolished the "Maru-C" slogan and removed all the symbols Kawai had built to represent the Caterpillar battle. The result was successful expansion into related areas, such as robotics, and several fundamentally different and highly innovative products, such as earthmoving equipment for undersea operations.

Source: Bruch, H. & Ghoshal, S. 2004. *A bias for action*. Boston: Harvard Business School.

Discussion Question 20: *What are some effective (or ineffective) organization visions with which you are familiar? Why are they successful (or unsuccessful? (We have found that many students—especially those with a fair amount of work experience—may be somewhat cynical, primarily because the "walk doesn't match the talk".)*

B. Mission Statements

A company's mission statement differs from its vision in that it encompasses both the purpose of the company as well as the basis for competition and competitive advantages.

Teaching Tip: *Many students may have a very "cynical" perspective about mission statements. They may view them as empty platitudes or public relations statements. And, they may have been in organizations where managers did not "walk the talk." You might, for example, ask students to critique the university's mission statement. Alternatively, you may ask if any of them have worked in organizations that had mission statements and ask them if the mission statements were effective and if management "walked the talk."*

EXHIBIT 1.7 contains the Vision Statement and Mission Statement of The Walt Disney Company, the $60 billion entertainment and media enterprise. This exhibit helps to distinguish between these two strategy concepts.

Effective mission statements incorporate the concept of stakeholder management, and suggest that organizations must respond to multiple constituencies if they are to survive and prosper. They have the greatest impact when they are used to reflect an organization's enduring, overarching strategic priorities and competitive positioning.

We provide the mission statements of Federal Express and Brinker International (whose restaurant chains include Chili's and On the Border). The two examples serve to illustrate how mission statements can vary in length and detail.

Few mission statements identify profit or any financial indicator as the sole purpose of the firm. Good mission statements must communicate why an organization is special and different.

The SUPPLEMENT below points out how Haier Group, a large Chinese appliance manufacturer, eliminates distance to customers by adopting various measures and strategies. "Serving customers with quality" became part of their mission statement.

Extra Example: The Mission of Haier Group's CEO: Getting Closer to Customers

Zhang Ruimin, CEO of the Haier Group, realized that having a sole focus on generating huge profits today could not ensure his company's survival tomorrow. He chooses to focus on quality instead. He did so by following insights from Peter Drucker's management book, whose words Zhang took to heart: "There is only one valid definition of business purpose: to create a customer."

This insight prompted Haier Group to explore opportunities to create customers in the era of cyberspace and the Internet. The result was an Internet and telephone marketing network and a physical logistics and services network that allows Haier to excel in determining customers' needs, rapidly delivering products, and after-sales services in both rural and urban areas all over China. Another step Zhang has taken is to invert Haier's organizational pyramid. He truly believes that only people on the front lines can have a deep understanding of customer's needs. Therefore, employees who directly face customers should be at the top, and senior executives should support them so that they can deliver on their commitments to customers. Zhang eloquently expresses his philosophy by drawing on Peter Drucker: "All decisions I make must be consistent with the ever-changing external environment. If they aren't, the consequences may not emerge right away, but once danger shows up, it will be too late; like the Titanic, my company will have no time to change course."

Source: Zhang, R. 2009. What I learned from Peter Drucker: Distance has been eliminated. *www.hbr.org*. November: np.

***Discussion Question 21:** Can you think of other measures to eliminate the distance between a company and its customers?*

***Discussion Question 22:** Can inverting the organizational pyramid really work? What would companies gain by doing so? What would they lose?*

C. Strategic Objectives

Strategic objectives are used to operationalize the mission statement. That is, they help to provide guidance on how the organization can fulfill or move toward the "higher goals" in the goal hierarchy—the mission and vision.

EXHIBIT 1.8 lists several strategic objectives divided into financial and nonfinancial objectives. While most of these objectives are directed toward generating greater profits and returns for the owners of the business, others are directed at customers or the society-at-large (such as BP Amoco's objective to reduce greenhouse gases over an extended period of time).

For objectives to be meaningful, they must satisfy several criteria. They must be:

- Measurable
- Specific
- Appropriate
- Realistic
- Timely

Objectives that satisfy such criteria provide many benefits to the organization. These include: (1) channel employees throughout the organization toward common goals, (2) motivate and inspire employees to higher levels of commitment and effort, (3) help to resolve conflicts when they arise, and (4) provide a yardstick for rewards and incentives.

There are, of course, other objectives that are even more specific that are often referred to as short-term objectives. These are essential components of "action plans" that are vital in the implementation of a firm's strategy. (We address these in more detail in Chapter 9.) We provide the example of how Textron implements its strategic objectives.

Organizations must ensure consistency throughout the organization when it implements strategic objectives. The SUPPLEMENT below discusses how Textron, a conglomerate with $14 billion in 2014 revenues, ensures that its corporate goals are effectively implemented.

Extra Example: How Textron Implements its Strategic Objectives

At Textron, each business unit identifies "improvement priorities" that it must act upon to realize the performance outlined in the firm's overall strategic plan. Each improvement priority is translated into action items with clearly defined accountabilities, timetables, and key performance indicators (KPIs) that enable executives to tell how a unit is delivering on a priority. Improvement priorities and action items cascade to every level at the firm—lowest levels in each of the firm's 10 business units. Says Lewis Campbell, Textron's CEO: "Everyone needs to know: 'If I have only one hour to work, here's what I'm going to focus on.' Our goal deployment process makes each individual's accountabilities and priorities clear."

Source: Mankins, M. M. & Steele, R. 2005. Turning great strategy into great performance. *Harvard Business Review*, 83(5): 66–73.

VI. Issue for Debate

This is an issue that should generate a lot of student interest—given the importance of values in the formulation and implementation of strategies. The issue should evoke some spirited debate because Seventh Generation is faced with a dilemma. That is, if they cross the picket line they will be violating, in effect, a key part of their company values. On the other hand, if they refuse to provide product to the grocers, they would likely destroy relationships with valuable customers.

To begin the discussion, you might consider asking two students to take a side (i.e., cross or not cross the picket line) on the debate. This helps, in effect, to polarize the class. Have the students debate the points of why their course of action would be preferred. After hearing the two sides, take a vote to see where the class stands on the issue. You'll likely find a split within the class.

At this point, introduce the concept of dialectical inquiry, which we discuss in Chapter 13. Here, identify what might be considered the "thesis" (cross the picket line and provide the grocers with your product) and "antithesis" (don't cross the picket line and "honor" your company values—after all, Seventh Generation felt the strikers had a just cause). Ask the class who the stakeholders are (customers, employees, suppliers, union, owners/shareholders, etc.), and how they are affected by each of these two options (many of these are mentioned in the second paragraph of the case—you might also address the importance of attracting and retaining talent as an important consideration in making such decisions).

SEVEN GENERATION'S SOLUTION: You will probably get some creative ideas and, perhaps, even something close to Seventh Generation's creative resolution to the apparent dilemma: A group called the "Values and Operating Principles Committee" (VOPS) was formed within Seventh Generation to solve the issue. While likely using a dialectic inquiry approach, they decided to continue to send their merchandise to the store but take the profits attributable to the sales at those stores and donate them to the union's strike fund. This allowed for shelf space to be maintained, as well as the relationship with both the strikers and their customers (grocers).

The broader learning point to reiterate with this "debate" is for students to strive to avoid the "tyranny of the 'go'/'no go'" and instead seek more creative solutions. Dialectical inquiry is a useful means to this end—this decision-making process helps to address how various stakeholders are affected by the "thesis" and "antithesis" and a more creative solution "synthesis" is often likely to emerge. During the course, especially when analyzing cases, it is helpful to draw on this example to encourage students to employ this decision-making approach when faced with two opposing alternatives. There can often be a third synthesis of ideas that will meet more stakeholder needs and desires.

QUESTIONS:

1. *How important should Seventh Generation*'s *values be considered when deciding what to do?*

Students may have a variety of perspectives on this issue—often reflecting how important they feel that non-economic factors should be in making important decisions. You might point out that Seventh Generation's mission is very specific regarding its sensitivity to broader stakeholder groups.

2. *How can Seventh Generation solve this dilemma?*

This, of course, is addressed above in the "Summary." It will be most interesting to see what "synthesis" students come up with—and, again, emphasize the usefulness of dialectical inquiry in decision making.

VII. Reflecting on Career Implications

Below, we provide some suggestions on how you can lead the discussion on the career implications for the material in Chapter 1.

- **Attributes of Strategic Management:** The attributes of strategic management described in this chapter are applicable to your personal careers as well. What are your overall goals and objectives? Who are the stakeholders you have to consider in making your career decisions (family, community, etc.)? What tradeoffs do you see between your long-term and short-term goals?

Students should be aware of the context of their jobs and future careers. Ask students to describe their jobs, and they are likely to list the tasks they complete each day. Now ask them why their jobs are successful for them, and do not accept the salary as an answer. They should be trying to establish a base for the kind of career they want. Do they want to travel a lot or stay in their community? Do they want to raise children? Do they want to improve the world? How so? I enjoy telling stories of friends who took jobs right out of college that paid a high salary but were very challenging. Some of these friends burned out at a young age. The goal here is to get students to think about their careers as part of their life plans—to be balanced with their other goals of marriage, family, and service. You may not get an overwhelmingly positive response, but you will likely plant seeds that some students will appreciate.

- **Intended versus Emergent Strategies:** While you may have planned your career trajectory carefully, don't be too tied to it. Strive to take advantage of new opportunities as they arise. Many promising career opportunities may "emerge" that were not part of your intended career strategy or your specific job assignment. Take initiative by pursuing opportunities to get additional training (e.g., learn a software or a statistical package), volunteering for a short-term overseas assignment, etc. You may be in a better position to take advantage of such emergent opportunities if you make the effort to prepare for them. For example, learning a foreign language may position you better for an overseas opportunity.

It may be useful to ask students how they chose their major. Was this major the same one they initially considered after high school? Some students will probably have changed their major at some point. You may get some stories about how hard their original choice was, or that there were unexpected challenges along the way. Now you can use the discussion as an analogy. Future career paths are likely to be filled with unexpected challenges, and it may be advisable to consider alternatives. Most executives have worked in a variety of jobs and organizations during their careers.

An alternative and supplemental approach may be to share your own career path, or the choice of your major in college, if either has evolved in unexpected ways. Students usually appreciate knowing this about their instructors.

The point with these discussions is to get students to expect or even plan for unexpected job changes during their careers. They should be exploring activities to learn what they like and what they are good at.

- **Ambidexterity:** In Strategy Spotlight 1.1, we discussed the four most important traits of ambidextrous individuals. These include looking for opportunities beyond the description of one's job, seeking out opportunities to collaborate with others, building internal networks, and multitasking. Evaluate yourself along each of these criteria. If you score low, think of ways in which you can improve your ambidexterity.

Ask students to list examples of how they have exhibited these traits in their employment histories. Then ask them to share these with a classmate, a think-pair-share type of activity. The sharing with a classmate may spark a discussion of various ways that each student could pursue ambidextrous capabilities. The main value is awareness. Students will probably understand the need for ambidextrous capabilities, but may not think about them very deeply or understand how to apply them to their work life.

- **Strategic Coherence:** What is the mission of your organization? What are the strategic objectives of the department or unit you are working for? In what ways does your own role contribute to the mission and objectives? What can you do differently in order to help the organization attain its mission and strategic objectives?

Students should understand how their efforts are helping their employers to succeed. One approach would be to have students list three or four activities they do in their jobs. Then rank the activities according to the strategic importance to their firm. I would ask students to share their rankings. Ask how each of their work activities contributes to their employers' competitive advantage. Then I would ask them to think of ways to increase the time and energy they spend on such strategic activities and decrease their time and energy investment in other activities. One caveat is that all of us have to spend some time and energy on non-strategic activities, but students should be aware of the difference.

- **Strategic Coherence:** Setting strategic objectives is important in your personal career as well. Identify and write down three or four important strategic objectives you want to accomplish in the next few years (finish your degree, find a better paying job, etc.). Are you allocating your resources (time, money, etc.) to enable you to achieve these objectives? Are your objectives measurable, timely, realistic, specific, and appropriate?

It may be useful to ask students if they spend any time and energy in activities that do **not** contribute to their strategic objectives. Then ask why these activities are not productive. This line of questioning may help to clarify the difference between the productive and unproductive activities, and it clarifies the types of activities that are productive. After this discussion, then the students are more likely to be ready for a discussion of objectives that are measurable, timely, realistic, specific, and appropriate.

VIII. Summary

We began this introductory chapter by defining strategic management and articulating some of its key attributes. Strategic management is defined as “consisting of the analysis, decisions, and actions an organization undertakes to create and sustain competitive advantages.” The issue of how and why some firms outperform others in the marketplace is central to the study of strategic management. Strategic management has four key attributes: it is directed at overall organizational goals, includes multiple stakeholders, incorporates both short-term and long-term perspectives, and incorporates trade-offs between efficiency and effectiveness.

The second section discussed the strategic management process. Here, we paralleled the above definition of strategic management and focused on three core activities in the strategic management process—strategy analysis, strategy formulation, and strategy implementation. We noted how each of these activities is highly interrelated to and interdependent on one another. We also discussed how each of the 12 chapters fit into the three core activities and provided a summary of the opening vignettes in each chapter.

Next, we introduced two important and interrelated concepts—corporate governance and stakeholder management. Corporate governance consists of three primary elements—management, boards of directors, shareholders (owners)—which play the key role in determining a corporation’s strategic direction. Stakeholder management addresses the individuals (and organizations) that must be taken into account throughout the strategic management process. We identified several key stakeholders in all organizations, and the nature of their claims. Successful firms go beyond an overriding focus on satisfying solely the interests of owners. Rather, they recognize the inherent conflicts that arise among the demands of the various stakeholders, as well as the need to endeavor to attain “symbiosis”—that is, interdependence and mutual benefit—among the various stakeholder groups. We also addressed environmental sustainability and some of the challenges associated with “selling” environmental sustainability initiatives to management.

In the fourth section, we discussed the rate of unpredictable change that managers face today. Managers and employees throughout the organization must have a strategic management perspective and become more empowered.

The final section addressed the need for consistency between a firm’s vision, mission, and strategic objectives. Collectively, they form an organization’s hierarchy of goals. Visions should evoke powerful and compelling mental images. However, they are not very specific. Strategic objectives, on the other hand, are much more specific and are vital to ensuring that the organization is striving toward fulfilling its vision and mission.

Chapter 1: Strategic Management: Creating Competitive Advantages

Analyze your university (or college) from the stakeholder concept. Identify the stakeholders and the nature of their claims on the organization. What are the implications for administrators?

Teaching suggestions:

You might want to begin by asking the students to identify the difference between shareholders and stakeholders in the context of the university.

Discussion should be oriented towards identifying the various stakeholder groups mentioned in the text, such as:

***Customers:**	students, alumni, recruiting organizations, organizations using research outputs from the university,
***Employees:**	teaching staff including faculty, research associates, teaching associates and the non-teaching or administrative staff, operational staff,
***Suppliers:**	funding organizations and donors, stationery and teaching equipment suppliers, suppliers of utilities, etc.,
***Community:**	taxpayers and the general public who have expectations from the university and can influence its functioning and funding and, of course, the state would be the owner in the case of a state university.

You might then want to ask whether stakeholder management is zero sum or symbiotic?

This would be an interesting issue with which to generate discussion. You can play the role of a devil's advocate to enliven the discussion. It can be argued that if faculty and other employees desire higher salaries, this would require that the "customers" have to pay more for their services. Similarly, more funds for research would mean lesser funds for the administrative and support staff. Taxpayers would want to pay less, which means increased tuition burden to the students and so on. This would bring out the competing and conflicting nature of the claims of the various stakeholder groups.

You might want to then highlight the value of stakeholder symbiosis. Stakeholders are dependent upon each other for their success and well-being.

1. Top quality research needs excellent financial and support facilities. And administrators must recognize that in order to ensure the effective functioning of the university, neither the teaching staff nor the support staff should be starved. Further, research can also enhance the ability of the university to generate external funds.
2. Similarly, customers cannot expect to have better quality education unless they are prepared to pay for it. Alternatively, taxpayers need to pay a certain level of taxes in order to maintain the university at a reasonable level of performance.

3. Universities also have the social responsibility of inculcating right attitude, and shaping the integrity and character of the students, so that they become good citizens in all walks of life.

You might then want to ask the students to give examples of other social responsibilities of universities. Some of the social responsibilities that can be discussed, to mention a few, are setting examples in terms of waste recycling, promoting environment friendly campus and research lab facilities, being involved with community services, ensuring diversity in the recruiting of students, staff, and faculty.

Conclusion: The expectations of various stakeholder groups are not constant over time and keep changing with changes in technology, globalization and other societal changes. An administrator would have to recognize this dynamic nature of stakeholder management and strive toward achieving mutual benefit through stakeholder symbiosis.

End-of-Chapter Teaching Notes

Chapter 1: Strategic Management, Creative Competitive Advantages

Summary Review Questions

1. How is "strategic management" defined in the text, and what are its four key attributes? **(In text, What Is Strategic Management?, LO 1-1)**

Response:

Strategic management is the analyses, decisions, and actions an organization undertakes in order to create and sustain competitive advantages. The four key attributes of strategic management are that it

- Directs the organization toward overall goals and objectives
- Includes multiple stakeholders in decision making
- Needs to incorporate short-term and long-term objectives
- Recognizes trade-offs between efficiency and effectiveness

2. Briefly discuss the three key activities in the strategic management process. Why is it important for managers to recognize the interdependent nature of these activities? **(In text, The Strategic Management Process, LO 1-2)**

Response:

The three key attributes in the strategic management process are analyses, decisions, and actions. Analyses, also called strategy analysis, refer to managers' development of an understanding of the organization's internal and external environment, and the organization's overarching goals. These understandings are an important prerequisite for the strategic management process.

Decisions, also called strategy formulation, refer to the overall plans that firms develop to compete and outperform their rivals. These plans exploit the results of analyses, in that firms try to use their strengths, limit weaknesses, exploit opportunities, and defend against threats simultaneously.

Actions, also called strategy implementation, refer to ensuring that proper strategic controls and organizational designs are put in place to carry out the strategy.

The interdependent nature of these activities stems from various feedback mechanisms that occur as managers implement their firms' strategies. Unforeseen environmental developments, unanticipated resource constraints, and/or changes in managerial preferences will force firms to modify their intended strategy, combining it with an emergent strategy, and resulting in a realized strategy. The realized strategy will in turn be modified by further unforeseen events. The continually modified realized strategy will consist of refined analyses, decisions, and actions that are constantly being updated.

3. Explain the concept of "stakeholder management." Why shouldn't managers be solely interested in stockholder management, that is, maximizing the returns for owners of the firm—its shareholders? (in text, The Role of Corporate Governance and Stakeholder Management, LO 1-3)

Response:

Stakeholder management is where multiple individuals or groups, who have a stake in or can influence an organization's performance, are included in the strategic management process. So, top managers will be interested in satisfying the needs of shareholders and other stakeholders such as customers, suppliers, employees, creditors, government, and the community.

Managers who are interested solely in stockholder management are likely to make decisions that satisfy short-term profit objectives. These decisions might include downsizing, neglect of asset maintenance, or put pressure on suppliers to lower prices. However, these decisions are likely to adversely affect long-term performance. Top managers who pay attention to all stakeholders are less likely to make decisions counter to the firm's objective of long-term profit maximization.

4. What is "corporate governance"? What are its three key elements and how can it be improved? (In text, The Role of Corporate Governance and Stakeholder Management, LO 1-3)

Response:

Corporate governance is defined in the text as the relationship among various participants in determining the direction and performance of corporations. The primary participants are (1) the shareholders, (2) the management (led by the chief executive officer), and (3) the board of directors. Corporate governance is designed to focus the efforts of the CEO on maximizing long-term shareholder wealth. The board of directors is elected or chosen by shareholders, and is charged with monitoring and evaluating CEO performance.

Corporate governance can be improved by including other stakeholder representatives on the board of directors. These other members would ensure that top management will respond to these interests and become more socially responsible in addition to earning profits. Managers will respond to and exploit overlapping stakeholder interests, which can lead to increased long-term profits.

Another way to improve corporate governance is to align managerial incentives with organizational performance. This alignment is often done through incentive-based pay or compensation through stock options. Rather than pursuing self-interest such as perks and salary, top managers will be motivated to make their organizations succeed.

5. How can "symbiosis" (interdependence, mutual benefit) be achieved among a firm's stakeholders? (In text, The Role of Corporate Governance and Stakeholder Management, LO 1-3)

Response:

Stakeholder management will, in part, be tricky because of competing interests. For example, customers may want lower prices while shareholders might want higher prices (which may lead to higher profits). However, stakeholder symbiosis can also result because stakeholders depend on each other for success and well-being. Firms can achieve stakeholder symbiosis by learning stakeholder interests and looking for overlaps. For example, Outback Steakhouse discovered that employees and customers both benefited by employing staff who agreed with the company's principles and beliefs. Such staffs tended to have lower turnover and more satisfied customers.

Inclusion of stakeholders such as the community, government, and environmental groups can also increase a firm's reputation. For example, firms that use a triple bottom line and evaluate their performance in financial, social, and environmental dimensions are likely to have good reputations with customers, governments, and the community at large.

6. Why do firms need to have a greater strategic management perspective and empowerment in the strategic management process throughout the organization? (In text, The Strategic Management Perspective: An Imperative throughout the Organization, LO 1-5)

Response:

In today's complex and dynamic business environment, top managers do not have all the answers. Rather, top managers will be responsible for communicating their firms' strategies to lower-level managers, and in turn empower these managers with discretion to respond quickly and appropriately to opportunities as they arise. Such empowerment enables a firm to respond more quickly to the needs of customers and stakeholders, thus improving competitiveness.

7. What is meant by a "hierarchy of goals"? What are the main components of it, and why must consistency be achieved among them? (In text, Ensuring Coherence in Strategic Direction, LO 1-6)

Response:

An organization's hierarchy of goals refers to goals ranging from, at the top, those that are less specific yet able to evoke powerful and compelling mental images, to, at the bottom, those that are more specific and measurable. The main components are, at the top, the *organizational vision*, which evokes powerful and compelling mental images, the *mission statement*, which includes both the purpose of the organization, its scope of operations, and the basis of its competitive advantage, and the *strategic objectives*, which include shorter-term and measurable goals that guide middle-level managers as they implement the mission statement.

There must be consistency among these goals in order to maximize employee motivation and a sense of equity and fairness when rewards are allocated. Inconsistency among the goals between any level can result in confusion among employees as to what the firm values, and subsequently to loss of identification with the firm, loss of motivation, and turnover.

Experiential Exercise

Using the Internet or library sources, select four organizations—two in the private sector and two in the public sector. Find their mission statements. Complete the following exhibit by identifying the stakeholders that are mentioned. Evaluate the differences between firms in the private sector and those in the public sector.

Response:

This exercise is intended to highlight the differences between private and public sector organizations. Students are likely to discover that private sector organizations will focus more on customers and employees. Public sector organizations are likely to focus more on the community at large or broader groups such as taxpayers, the government, or people with a common problem or interest.

An interesting extension of this exercise is to reverse it. Offer a couple of other stakeholder groups, such as the Rainforest Coalition, an organization promoting higher ethical standards for lawyers, or Greenpeace, and ask students what organizations will have these as stakeholders. Then ask why. This exercise is designed to allow students to appreciate some of the advantages to organizations of having multiple diverse stakeholders.

Application Questions and Exercises

1. Go to the Internet and look up one of these company sites: www.walmart.com, www.ge.com, or www.ford.com. What are some of the key events that would represent the "romantic" perspective of leadership? What are some of the key events that depict the "external control" perspective of leadership?

Response:

For these companies, students may have to look a bit to get to the information on company leadership. Usually at the bottom of the first page is a link to "about us." Interestingly, for Ford, the link to "The Ford story" takes you to social media, not information about Ford. There, customers can share their stories about their experiences with Ford products.

For www.walmart.com, the Wal-Mart story includes information related to the romantic perspective of leadership, in which the leader determines organizational success. Sam Walton had a vision about retailing as a way to satisfy customers, and his idealistic vision is repeated throughout the website. You have to look a bit for this information, though. It's buried in links placed at the bottom of the page. For the external control perspective, Wal-Mart simply satisfied a latent demand of consumers for a wide assortment of goods at the lowest possible prices.

For http://www.ge.com, the GE website includes information on the romantic perspective of leadership. There is a link to all the early leaders of GE, back to 1892. No link to Thomas Edison, though, was easily available. There were also links to various leaders and what they are doing to make GE successful. For the external control perspective, GE claims to be responding to market and society needs in various ways, from products to corporate hiring practices, although their performance in recent years has been very poor.

For www.ford.com, the Ford website includes information on its historical roots, which is linked to the romantic perspective of leadership. It takes a couple of clicks, but you can get to Henry Ford's vision of paying workers $5 a day in 1914. The company still carries the Ford name, which suggests that a long-standing corporate culture drives decision making. There are also links to corporate governance and the members of the board of directors. These emphasize the importance of these leaders for representing Ford's perspective to outside interests. For the external control perspective, Ford offers a number of explanations for its organizational success, such as great styling, a strong presence in social media, and descriptions of competitive advantages such as flexible, global production, and cost savings. And Ford's sustainability report emphasizes its responsiveness to various stakeholders and social responsibility.

2. Select a company that competes in an industry in which you are interested. What are some of the recent demands that stakeholders have placed on this company? Can you find examples of how the company is trying to develop "symbiosis" (interdependence and mutual benefit) among its stakeholders? (Use the Internet and library resources.)

Response:

This exercise enables students to see how stakeholders other than shareholders are affecting corporate governance. To extend students' findings, ask them to look up legislative issues related to other issues such as global warming, fair trade (in agricultural goods), and conflict-free diamonds.

3. Provide examples of companies that are actively trying to increase the amount of empowerment in the strategic management process throughout the organization. Do these companies seem to be having positive outcomes? Why? Why not?

Response:

Students may come up with numerous examples of empowerment. A Google search of “employee empowerment” will yield more than 800,000 hits, and lots of good examples. Most of the information is positive, but for the negative side, check the infamous stories of Nick Leeson, who brought down Barings Bank, and Jerome Kerviel, who hurt Societe Generale. And the recent downfall of AIG has been linked to the poor monitoring, and excess empowerment, of its division that get involved in credit default swaps and collateralized debt obligations. In these cases, lower-level managers were empowered but not supervised, made poor decisions, and cost their firms dearly. The lesson is that empowerment has associated risks, and managers have to strive for a most effective balance between empowerment and control.

4. Look up the vision statements and/or mission statements for a few companies. Do you feel that they are constructive and useful as a means of motivating employees and providing a strong strategic direction? Why? Why not? (Note: Annual reports, along with the Internet, may be good sources of information.)

Response:

Students will likely come up with a few examples. An interesting exercise is to first ask students if they are excited by the statements. If not, then ask how the statements should be changed to increase interest. It would then be useful to steer students into a discussion of what the firm is all about—what does the firm do that is interesting. Then to how a firm can back up its claims. The result of the discussion is that mission and vision statements relate to firm policies.

Ethics Questions

1. A company focuses solely on short-term profits to provide the greatest return to the owners of the business (i.e., the shareholders in a publicly held firm). What ethical issues could this raise?

Response:

Short-term focus may result in long-term loss. For example, look at Arthur Anderson. That company is alleged to have increased short-term profits by linking consulting contracts with favorable auditing opinions. The increase in short-term profits was balanced by bankruptcy in the longer run. Other examples are the banking industry’s focus on exploiting the home mortgage industry in the 2000s, and the Bernie Madoff scandal.

2. A firm has spent some time—with input from managers at all levels—in developing a vision statement and a mission statement. Over time, however, the behavior of some executives is contrary to these statements. Could this raise some ethical issues?

Response:

From the perspective of lower-level managers, the inconsistency between the mission and vision statements—and the behavior of the executives—will cause cognitive dissonance. The lower-level managers will wonder what the firm really values and will possibly lose motivation, identification with the firm, pride, and desire to stay with the firm.

CONNECT RESOURCES

Case Analysis.

Coming from Behind, Lego Becomes Number One.
Suntory—A Japanese Beer Company

Chapter 2

Chapter 2

Analyzing the External Environment of the Firm: *Creating Competitive Advantages*

Summary/Objectives

PowerPoint Slide 2: Learning Objectives

The purpose of this chapter is to familiarize students with techniques for evaluating a firm's external environment. This chapter focuses on the value managers add when they have a sense of events outside the company. By focusing on external events, managers are able to stay a step ahead of competitors by accurately anticipating and promptly responding to actions that can impact the organization. The chapter is organized into three sections.

1. The environmentally aware organization. Emphasize that managers use scanning, monitoring, and competitive intelligence to develop forecasts. Also, the role of scenario planning is discussed.

2. The influence of the six broad segments (demographic, sociocultural, political/legal, technological, economic, global) of the general environment of the firm.

3. The role of the competitive (also called the task or industry) environment and its analysis through the application of Porter's five-forces model. We address how industry and competitive practices are being affected by the Internet and digital technologies. We also address the concept of strategic groups. Managers use strategic groups to identify who its main competitors are and how a company fits in with the overall industry in which it competes.

Lecture/Discussion Outline

We lead off the chapter with the opening case of Airbus in LEARNING FROM MISTAKES. Here's a firm that had a different vision of how to exploit an opportunity than its closest competitor, Boeing. Airbus did misjudge this particular market opportunity. Ask:

> ***Discussion Question 1:*** *Given that it is difficult to predict future market needs and trends in industries with long product life-cycles (such as jetliners), how should managers deal with this uncertainty?*

Response guidelines: Students should understand that effective strategy is often an opportunity-driven process, meaning effective strategy starts with identifying changes in the environment. Airbus saw a market opportunity for extra-large jumbo jets and focused on "perks" (such bars and beauty salons) while Boeing saw a market opportunity for smaller jumbo jets and focused on efficiency and comfort. While both companies made a bet on an uncertain future, Boeing better predicted the needs of customers and airlines. Specifically, filling a large A380 with passengers is a daunting task for airlines, while filling a fuel-efficient Boeing Dreamliner is much more manageable for airlines. Students should understand that it is not only the end-consumer that determines the success of a product or service (passengers loved the A380) but also the service providers (airlines) must be able to operate the airliner effectively and efficiently. Companies must therefore consider a broad range of important stakeholders and use effective strategy tools (such as the tools we introduce in chapter 2) to predict changes in the general and competitive environment. Students should also realize that strategic analysis of the general and competitive environment becomes increasingly important when the life-cycle of the product or service is very long as changes or adjustment become infeasible.

Discussion Question 2: *How should Airbus compete against Boeing going forward?*

Response guidelines: Students may come up with a few intriguing suggestions. After they do, instructors may want to group the responses into external and internal categories. It is expected that some students focus on perceived internal strengths and weaknesses (such as improving Airbus' R&D competence) while others focus on opportunities (such as investing in the market for short-haul airplanes or space travel). The instructor should illustrate that competition between two large (and in many aspects similar) competitors is often driven by taking a position and seize external opportunities effectively.

Of course, taking a position is uncertain and risky (as we saw with the A380) so the key is not to avoid uncertainty and risk, but to manage it effectively (with the tools we introduce in chapter 2). The instructor may also point out that if executives want certainty and clarity, they can just wait for other firms to take a position and see how they do. Then they will know what works, but it will be too late to profit from the knowledge.

I. Enhancing Awareness of the External Environment

PowerPoint Slide 4: The Importance of External Environment
PowerPoint Slide 5: Enhancing Awareness of the External Environment
PowerPoint Slide 6: Environmental Scanning and Monitoring
PowerPoint Slide 7: Competitive Intelligence
PowerPoint Slide 8: Environmental Forecasting
PowerPoint Slide 9: SWOT Analysis

We address three important processes—scanning, monitoring, and gathering competitive intelligence—which managers use to develop environmental forecasts. EXHIBIT 2.1 depicts relationships among these activities. Also, we address scenario analysis and its role in anticipating future major changes in the external environment as well as the role of SWOT analysis.

We lead off the section with a discussion of Ram Charan's concept of "perceptual acuity"—the ability to sense what is coming before the fog clears. We give three examples of what three CEOs have done to improve their perceptual acuity: met with key managers periodically to discuss what is going on, met with the CEOs of other organizations four times a year, and asked outsiders to critique their firm's strategy.

> ***Teaching Tip:*** *Most students in your class will not likely be CEOs or top executives. So, one way to help them apply this idea is to ask them how they could apply it in their present position—or in a job to which they immediately aspire. Hopefully, they will come up with ideas such as spending time with people in their organization to address issues outside of their immediate job, describing how their efforts affect other areas/departments in the firm, and seeking perspectives of colleagues and friends who work in a different organization. The key point, of course, is to encourage them to look at issues from a broader perspective instead of focusing on their immediate work responsibilities.*

A. The Role of Scanning, Monitoring, Competitive Intelligence, and Forecasting

1. Environmental Scanning

Environmental scanning involves surveillance of the firm's external environment to predict environmental changes to come and detect changes that are already underway. We discuss the example of how Procter & Gamble, with its wide range of household products, can be a good barometer of household spending.

> ***Discussion Question 3:*** *Would these "tips" be equally appropriate for all industries? Why? Why not?*

> ***Discussion Question 4:*** *Could such an approach be used in other industries? What investments would be required?*

Environmental scanning can also involve obtaining information from your customer base. The SUPPLEMENT below provides an example of how this was effectively used by an online contact-lens retailer, Coastal Contacts.

Extra Example: Ask your Customers for Ideas

Coastal Contacts, one of the largest online contact-lens retailers in North America, came out of its two-day planning session with few ideas about how to spur growth. Thus, over the next six months CEO Roger Hardy and his senior team called customers each week to see whether they had any ideas. To the company's surprise, one recurring theme emerged—customers wanted to get their lenses the next day. "We started overnighting everything," he reports. Sales in the U.S., where he recently made the change, were up 41 percent for the year, bringing company sales to $155 million.

Source: Harnish, V. 2011. Five ways to get your strategy right. *Fortune*. April 11: 42.

> ***Discussion Question 5:*** *What are some other examples of firms that got excellent ideas by simply asking their customers for input?*

2. Environmental Monitoring

Environmental monitoring tracks the evolution of trends, events, or streams of activities in the external environment. In this section, we present some of the factors monitored by three organizations: Motel 6, Pier 1 Imports, and Johnson and Johnson Medical Products. Such factors are vital for managers in determining their firm's strategic direction and resource allocations.

The SUPPLEMENT below represents the factors that the Director of Planning of Vought Aircraft considered critical. You may initially ask the students:

Discussion Question 6: *What indicators do you believe a firm should monitor that produces both (1) weapon systems for the military, and, (2) key components for the commercial aircraft industry?*

Extra Example: Factors to Monitor—Vought Aircraft

Commercial Aircraft:
1. Oil prices
2. Age of fleet of airlines
3. Profitability of airlines

Defense Department:
1. Where weapons are in the life cycle
2. Mission requirements of the military

Source: Authors' interviews.

The SUPPLEMENT below discusses how Cisco, the $47 billion (2014 revenues) networking giant, learned from its mistakes during the Internet bust in 2001—and now carefully it monitors its inventory levels. It points out that managers must monitor key aspects of the firm's internal environment—as well as the firm's external environment.

Extra Example: How Cisco Learned from Its Mistakes

In April 2001, Cisco made one of the more painful confessions of the Internet bust: It had so much networking gear piled up that it had to take a $2.5 billion write-off for equipment that it figured nobody would ever buy. It has been working hard ever since to make sure that such a thing never happens again.

Supply chain chief Angel Mendez is grilled at monthly reviews by CEO John Chambers and other top executives. Now, Cisco has half the inventory it did in 2001—even though its revenues are twice as large. Says Mendez: "It didn't take John eight years to start asking questions (about inventory levels). He asks about every eight minutes."

Source: Burrows, P. 2009. Tech: Lean and Ready to Spring. *BusinessWeek*. April 27: 14-16.

Discussion Question 7: *Are you aware of other firms that have failed to effectively monitor key aspects of their internal environment (e.g., excessive numbers of employees and layers of management; high levels of inventory that became obsolescent; insufficient sales, marketing, engineers, etc. to meet increasing demand for goods/services and innovations, etc.)?*

The SUPPLEMENT below discusses why Caterpillar may serve as a macroeconomic early-warning system.

Extra Example: Caterpillar—A Macroeconomic Early-Warning System?

Although it is hard to confuse a 40-ton excavator with a crystal ball, forecasters could do worse than tracking retail sales of the huge, yellow machines sold by Caterpillar Inc. Being the largest seller of equipment used to build stuff or extract the stuff from the ground used to build that stuff, Caterpillar's customers' appetite is sort of a macroeconomic early-warning system.

Two big worries—the slowdown in China's property market and a related slump in demand for commodities from crude oil to iron ore—show up quickly in its monthly sales reports, helpfully broken down by region and type of machinery.

2014 has, not surprisingly, been a tough year for the firm's shareholders. Its stock price trailed the S&P 500 by 31 percent.

Source: Jakab, S. 2015. Caterpillar is stuck in its cocoon. *Wall Street Journal*. April 23: C1.

3. Competitive Intelligence

Competitive intelligence helps firms define and understand their industry and identify rivals' strengths and weaknesses. Done properly, competitive intelligence helps a company to avoid surprises by effectively anticipating and responding to competitors' moves.

We briefly address the importance of competitive intelligence to firms in the banking, airline, and automobile industry.

Discussion Question 8: *What are other industries where competitive intelligence is extremely important? How might such information be collected?*

We address how the Internet has accelerated the speed at which firms can find competitive intelligence.

STRATEGY SPOTLIGHT 2.1 discusses some of the ethical guidelines that United Technologies has implemented.

Discussion Question 9: *Are you aware of ethical guidelines that other companies have developed? Were they effective? Why? Why not?*

Teaching Tip: *The discussion of Competitor Intelligence provides the instructor with an opportunity to introduce the subject of ethics into the classroom. We suggest presenting scenarios that are not "black and white." For example, a firm advertises a position in order to get a chance to interview employees of a rival company with no intention to hire them. While this may not be illegal, clearly it is difficult to justify morally. The ensuing discussion will help to clarify the distinction between illegal and unethical behavior.*

4. Environmental Forecasting

Environmental scanning, monitoring, and competitive intelligence are important inputs for analyzing the external environment. However, they are of little use unless they provide raw material that is accurate enough to help managers make accurate forecasts.

We address the twin problems of either assuming that the world is certain and open to precise predictions, or the assumption that it is uncertain and totally unpredictable. And, we provide the famous example of poor forecasting by Digital Equipment Corp., which caused it to ignore the potential of personal computers. We also provide several other predictions about the future of technology which did not pan out.

Discussion Question 10: *What are some other errors in forecasting with which you are familiar?*

It should be interesting to ask students to provide a few more examples of technology forecasts that really missed the mark—some of them go farther back in time than the ones listed in the text. A few of them are listed in the SUPPLEMENT below.

You might even ask them what forecasts/predictions for the future of technology that they have.

Extra Example: Technology Forecasts That Missed the Mark

1946: "Television won't be able to hold on to any market it captures after the first six months. People will soon get tired of staring at a plywood box every night." —20th Century Fox Studio executive Darryl Zanuck

1959: "Before man reaches the moon, your mail will be delivered within hours from New York to Australia by guided missiles. We stand on the threshold of rocket mail."—U.S. Postmaster General Arthur Summerfield

1961: "There is practically no chance communications space satellites will be used to provide better telephone, telegraph, television, or radio service inside the United States."—Federal Communications Commission (FCC) commissioner T.A.M. Craven

1966: "Remote shopping, while entirely feasible, will flop." —Time Magazine

Source: Dunn, M. 2016. 20 tech predictions that failed. *www.news.com.au*. March 8: np.

5. Scenario Analysis

Scenario analysis provides a set of tools that enable managers to imagine threats and opportunities the future may bring. As a general rule, scenarios should be used by businesses whose external environments are prone to fundamental or sudden change and whose anticipation of such change is of vital strategic importance.

It is important to note that scenario analysis draws on a wide range of disciplines and interests, among them economics, psychology, sociology, and demographics.

Discussion Question 11: *Why must scenario analysis and scenario planning draw on a variety of disciplines and interests?*

We provide a detailed example of how PPG Industries has benefited from the use of scenario analysis and planning.

We address the value of a firm in creating an environmentally aware organization—which includes environmental scanning and monitoring, as well as competitive intelligence, forecasting, and scenario planning. In contrast, the late Steve Jobs (Apple's former Chairman) took a far different approach to determining what customers *really* wanted. We discuss Jobs' distaste for sophisticated approaches to market research.

Discussion Question 12: *Would such a mindset work for other organizations? Why? Why not? (Firms in commodity industries—which experience much less uncertainty than technology industries have less need for such "intuition" since these industries face much less dramatic change in market demand and technologies. And, of course, very few firms have the visionary genius of a Steve Jobs! Also, you might point out how Ron Johnson (who was fired as CEO of J.C. Penney in early April 2013) relied too much on his intuition and drove the firm into the ground—and almost into bankruptcy.*

B. SWOT Analysis

We briefly address SWOT Analysis at this point. SWOT stands for strengths, weaknesses, opportunities, and threats. SWOT analysis provides a framework for analyzing these four elements of a company's internal and external environment.

It is important to note that SWOT analysis provides the "raw material," that is, a basic listing of conditions and factors inside and outside of a company.

Discussion Question 13: *What do you consider to be some of the major advantages and disadvantages of SWOT analysis? (This issue is addressed in more detail in Chapter 3, but you should point out that a key disadvantage is that strengths may not necessarily convert to sources of competitive advantage that are sustainable in the marketplace.)*

II. The General Environment

PowerPoint Slide 11: The General Environment
PowerPoint Slide 12: The Demographic Segment
PowerPoint Slide 13: The Social Segment
PowerPoint Slide 14: The Political/Legal Segment
PowerPoint Slide 15: The Technological Segment
PowerPoint Slide 16: The Economic Segment
PowerPoint Slide 17: The Global Segment
PowerPoint Slide 18: General Environment: Relationships among Elements

The general environment consists of factors that can have a dramatic effect on a firm's strategy. Typically, a firm has little ability to predict trends and events in the general environment, and even less ability to control them.

We divide the general environment into six segments: demographic, sociocultural, political/legal, technological, economic, and global.

EXHIBIT 2.2 provides examples of key trends and events in each of the six segments of the general environment

Discussion Question 14: *How will the factors in Exhibit 2.3 affect specific industries?*

Discussion Question 15: *Which factors are more difficult to predict than others? (e.g., macroeconomic changes are typically more difficult to predict than demographic changes)*

Discussion Question 16: *How are these factors interrelated?*

Discussion Question 17: *What factors that are not listed in this exhibit do you feel are important?*

A. The Demographic Segment

Demographics are the most easily understood and quantifiable elements of the general environment. Demographics include elements such as the aging population, rising or declining affluence, changes in ethnic composition, geographic distribution of the population, and income level disparities.

Discussion Question 18: *What are the implications of ethnic diversity for the work place?*

Discussion Question 19: *What implications does the migration to the South and West in the United States have for individual businesses?*

> ***Discussion Question 20:*** *How does the "graying of America" affect U. S. companies?*

Among the trends we discuss are the aging of the population and how it may differentially affect a wide variety of industries. We also discuss the increasing number of older Americans and its importance for attracting and retaining older workers.

Ask:

> ***Discussion Question 21:*** *It might be interesting to ask what the implications (of the aging of the population) are for today's organization (e.g., how can firms attract and retain older workers, changes in financial and non-financial incentives, etc.) as well as for public policy (e.g., changes in tax policies, increasing the number of immigrants, etc.).*

We also provide INSIGHTS FROM RESEARCH: New Tricks: Research Debunks Myths about Older Workers (in text, The General Environment section). Here, results from a meta-analysis points out some findings about older workers many people would find counterintuitive. The findings concluded older workers are NOT less motivated, more resistant to change, less trusting, less healthy, or more valuable to work-family issues. The only "myth" supported by the data was older workers are less willing to participate in training and career development.

> ***Discussion Question 22:*** *What are the practical implications of these findings*

As noted in the IFR: provide more opportunities for younger and older workers to work together; promote positive attributes of older workers; and, engage employees in open discussions about stereotypes. The broader learning point would be to encourage students to always question their assumption bases—they might be wrong, at times!

B. The Sociocultural Segment

Sociocultural forces influence the values, beliefs, and lifestyles of a society. Examples include a higher percentage of women in the workforce, dual-income families, increases in the number of temporary workers, greater concern for healthy diets and physical fitness, greater interest in the environment, and families postponing having children.

> ***Discussion Question 23:*** *Name two industries that have benefited from the growing awareness about health and fitness. Also name two that have been adversely affected by this trend.*

> ***Discussion Question 24:*** *What must firms do to attract and retain women employees? Why are such efforts becoming increasingly important?*

The section also addresses how values and beliefs shaped changes in consumer preferences. Traditionally, values and beliefs affect the demand for *types* of products (e.g., more environmentally friendly products), but values and beliefs may also influence the *amount* of products and services customers demand. Younger generations often have different attitudes towards owning products, leading to more cautious and frugal consumer spending.

Ask:

Discussion Question 25: *Can you think of an industry that may need to respond to the values and beliefs (such as environmental concerns and product ownership) of younger customers?*

The SUPPLEMENT below provides some perspective on the consumer preferences of the Generation Z.

Extra Example: Consumer Preferences of the Gen Z

Consumers of the Generation Z (born in the mid-1990s and early-2000s) are about to become the most sought-after target market in countries around the world. However, these consumers may be more frugal than earlier generations because their early life experiences shaped their values and beliefs when it comes to consuming. Specifically, kids of the Gen Z experienced economic downturns or saw their parents struggle during recessions (such as the global financial crisis of 2008). These early life experiences have shaped the consumer attitudes of Gen Z consumers and imprinted a thrifty attitude.

For example, Japan had five recessions in the past 20 years, transforming Japanese consumers into one of the most frugal consumers in the world. These frugal attitudes learned at a young age also persist and hardly change when economic conditions brighten. In Japan, recent economic conditions are more positive and wages are growing. Fast Retailing Co. (the owner of the fashion company Uniqlo), for instance, is raising entry level pay by 20% to win the war for talent in the tight Japanese labor market. However, young Japanese are not increasing their spending, but stick to buying necessities.

Executives around the world adjust their strategies to effectively address frugal consumer attitudes and broader preferences for sustainable consumption. For instance, fashion company "Urban Outfitters" recently started a subscription clothing rental business called Nuuly. For a fee of $88 dollars per month, consumers get six clothing pieces, a reusable bag, and a prepaid return envelope to return the clothes (or pay full price in case you love and want to keep them). The hope is that young consumers will find this new clothing business model not only attractive for its reduced environmental impact but also for meeting the broader values of beliefs regarding product ownership of Gen Z consumers.

Sources: Du, L., & Milligan, E. 2019. In regions hit by recession, Gen Z is turning out to be frugal. *Bloomberg.com*. April 25: np. Naughton, K., Dawson, C., Welch, D., & Coppola, G. 2019. Gen Zero. *Bloomberg BusinessWeek*. April 29: 18–19; Safdar, K. 2019, May 21. Urban Outfitters to start renting clothes. *Wall Street Journal*. June 21: np.

C. The Political/Legal Segment

Political processes and legislation influence the regulations with which industries must comply. Some important elements of the political/legal arena include tort reform, the Americans with Disabilities Act (ADA), deregulation of utilities and other industries, and increases in the federally mandated minimum wage.

Discussion Question 26: *What do you see as some of the pros/cons of the Americans with Disabilities (ADA) Act?*

We close this section with a brief discussion of how legislation in the U.S. has restricted the number of H-1B visas for highly skilled professionals.

Discussion Question 27: *Should the U.S. Congress increase the number of H-1B visas? Why? Why not?)*

STRATEGY SPOTLIGHT 2.2 addresses how advocacy groups and public opinion can put pressure on companies to address environmental sustainability concerns such as waste reduction in a proactive manner.

Discussion Question 28: *What are some of the challenges associated with companies facing increasing pressure for sustainable business practices? Do you have ideas about how companies could use eco-friendly business practices and models to differentiate themselves in the market?*

D. The Technological Segment

Developments in technology lead to new products and services and improve how they're produced and delivered to the end user. Innovations can create entirely new industries and alter existing industries.

Discussion Question 29: *Ask students to speculate on the impact of the following technologies on American industry: (1) the Internet, (2) manufacturing innovations (e.g., robotics), (3) genetic engineering/designer genes. (The last items may provoke some heated discussion regarding the ethical implications.)*

We also address a fascinating issue: some of the promising future applications of nanotechnology and how it will impact some industries.

The SUPPLEMENT below discusses how SkyMall, the inflight magazine was forced into bankruptcy by technology—smartphones and tablets.

Extra Example: It Seems That Technology Killed SkyMall

The firm behind the inflight catalog, SkyMall, filed for bankruptcy protection. It is clearly a victim of evolving rules and technology that now permit airline passengers to keep their smartphones and tablets powered up during flights.

For 25 years it sold quirky products like a Darth Vader toaster or a paper-towel holder with USB ports. However, SkyMall is now seeking a court supervised sale of its assets, according to papers filed on January 22, 2015 with the Phoenix Bankruptcy Court.

CEO Scott Wiley cited a "crowded, rapidly evolving and intensely competitive" retail environment as the reason for the firm's recent struggles. And, he said, "With the increased use of electronic devices on planes, fewer people browsed the SkyMall inflight catalog."

SkyMall had revenue of $33.7 million in 2013. But, its sales sank to only 15.8 million for the nine months ending on September 28, 2014.

Source: Corrigan, T. 2015. SkyMall Succumbs to a New Jet Age. *Wall Street Journal*. January 24–25: B3.

Discussion Question 30: *Are you aware of other cases where technology is a key factor that is reshaping—or adversely affecting—an industry? What industries are most likely to be influenced by technological changes?*

E. The Economic Segment

The economy has an impact on all industries, from suppliers of raw materials to manufacturers of finished goods and services, as well as all organizations in the service, wholesale, retail, government, and nonprofit sectors of economies. Key indicators include interest rates, unemployment rates, the consumer price index (CPI), the Gross Domestic Product (GDP), and net disposable income.

Discussion Question 31: *Compare the impact of rising (or declining) interest rates on the overall demand for the following industries: (1) housing (will have a significant impact), (2) automobiles (will have a significant impact), (3) fast food (will have very little effect).*

F. The Global Segment

Globalization provides both opportunities to access larger potential markets and a broad base of factors of production such as raw materials, labor, skilled managers, and technical professionals. However, such endeavors carry many political, social, and economic risks. Examples of important elements in the global segment include currency exchange rates, increasing global trade, the economic emergence of India, and China's admittance to the World Trade Organization.

Discussion Question 32: *Provide examples of firms that have succeeded (stumbled) in their efforts to expand into international markets. What factors can explain their success (failure)?*

We also address the rising middle class in emerging countries and how it has led to increased employment in those countries by multinationals.

Discussion Question 33: What are the risks associated with accessing a larger potential market overseas as a result of the process of globalization? Do the risks of globalization outweigh its benefits?

G. Relationships among Elements of the General Environment

In our discussion of the general environment, we have addressed many relationships among the various elements.

EXHIBIT 2.3 provides many examples of how the impact of trends or events in the general environment can vary across industries.

The SUPPLEMENT below provides some insights on how many elements of the General Environment are interrelated. It is a rather interesting context—Cairo, Egypt after the Arab Spring.

Extra Example: Entrepreneurship in Cairo after the Arab Spring

A different type of grassroots revolution has begun in the aftermath of the Arab Spring. According to Ramez Mohamed, CEO of Flat6Labs, a Cairo-based startup accelerator, entrepreneurship has thrived over the past two years. He contends that Egypt's youth feel empowered to make a difference, one venture at a time.

Here are some of his firm's most promising startups and the opportunity that they are tackling:

- **Ekshef**: With an Arabic-only platform and Yelp-like rating system, the service enables Egyptians to search, review, and recommend doctors from the directory. *Opportunity:* The country has more than 75,000 health care clinics, but it is hard for patients to find the right physician.
- **Nafham**: The service condenses the country's public-school curriculum into online, crowdsourced lessons. Users can vote up or down based on quality. Its staff also produces video content. *Opportunity:* Egypt's rising population is putting a squeeze on classroom space.
- **Eshtery:** The utility lets users shop by scanning codes on signs around town and having the items delivered to them. The business was inspired by Home Plus, a supermarket that offers a similar service in South Korea. *Opportunity:* It is hard to buy groceries if you work two hours from the market.
- **Ogra:** A mobile app, a la Uber, which connects passengers with reliable drivers. *Opportunity:* With social tensions spilling onto the street, public transportation that is dependable is hard to find.

Source: Anonymous. 2013. Emerging tech scene: Cairo. *Fast Company*. March: 31.

For the Tenth Edition, we have added the topic of "Digital Economy" as one of the new features with numerous examples and "Strategy Spotlights" throughout the text. Here, we introduce the topic and provide Spotlight 2.3 as an example of how it can be applied to monitor federal, state, and local government expenditures.

As we note in the text, corporations are increasingly collecting and analyzing data on their customers, including data on customer characteristics, purchasing patterns, employee productivity, and physical asset utilization. Such efforts have the potential to help firms better customize their product and service offerings to customers as well as more efficiently use the resources of the company. We provide examples of Pepsi and Kaiser Permanente as well as some figures on how its use has dramatically increased in recent years—as well as how it can improve a firm's performance.

STRATEGY SPOTLIGHT 2.3 provides an example of how big data can be used in the public sector, i.e., how to monitor governmental expenditures. Examples, which should be of particular interest to students, is how it can help detect malfeasance and acts of corruption by public officials.

> ***Discussion Question 34:*** *How can governments—as well as "public watchdogs"—effectively use big data to monitor governmental expenditures? (It might be interesting to see how students can come up with ideas/insights about how to avoid problems associated with the proverbial "fox guarding the henhouse."*

III. The Competitive Environment

PowerPoint Slide 19: The Competitive Environment
PowerPoint Slide 20: Porter's Five Forces Model of Industry Competition
PowerPoint Slide 21: The Threat of New Entrants
PowerPoint Slide 23: The Bargaining Power of Buyers
PowerPoint Slide 24: The Bargaining Power of Suppliers
PowerPoint Slide 25: The Threat of Substitute Products and Services
PowerPoint Slide 26: The Intensity of Rivalry among Competitors in an Industry
PowerPoint Slide 27: How the Internet and Digital Technologies Affect Competitive Forces
PowerPoint Slide 28: Using Industry Analysis: A Few Caveats
PowerPoint Slide 29: The Value Net
PowerPoint Slide 30: Doing a Good Industry Analysis
PowerPoint Slide 31: Strategy Groups within Industries
PowerPoint Slide 32: Strategy Groups as an Analytic Tool
PowerPoint Slide 33: Example: Strategic Groups within Industries

Here, we draw upon a well-known analytic tool, Michael Porter's five-forces model of industry competition. We introduce this model and discuss examples of each force. We then address the impact of the Internet on the five forces and the strategic groups concept and its implications for studying rivalry and competition.

A. Porter's Five-Forces Model of Industry Competition

EXHIBIT 2.4 illustrates Porter's five-forces model of industry competition

When introducing this model, it is useful to show how the model provides insight into an industry's dynamics and expected profit levels. The SUPPLEMENT below provides such an analysis on the paint and allied products industry. The analysis is restricted to the trade sales (i.e., house paint) segment of the industry. The competitive forces are very different for other segments such as the specialized high-tech automobile finishes.

Note: For our purposes of illustrating the "basics" of the "five forces," the analysis has been simplified. We assume buyers to be consumers, although there are, of course, other distinct groups such as hardware stores, and large discounters such as Wal-Mart. Obviously firms' bargaining power vis-à-vis paint manufacturers vary significantly. Similarly, our analysis assumes the industry's products to be commodity products. However, there are exceptions, such as Olympic Stain, that have successfully differentiated their products on the basis of quality.

Extra Example: The Paint and Allied Products (PAP) Industry

An analysis of the Paints and Allied Products industry (SIC 2851), using the five-forces model, demonstrates why this industry has traditionally been caught in a price-cost squeeze and is unable to pass on rising raw material costs to its customers.

To illustrate the price-cost squeeze that this industry is facing, consider that between the years 1995 to 2000, the PPI (producer price index—the price for which it sells its output) of the PAP industry increased an average of only 2 percent. The PPI for petroleum refining and related products—a key supplier to this industry—increased at a rate of 6 percent over this same period of time. Hence the price of this key raw material was roughly twice the rate of inflation (about 3 percent); whereas, the PAP industry was lower than the rate of inflation. Thus, the PAP industry has been unable—due to unfavorable industry competitive forces—to pass on cost increases to their suppliers; thus eroding profitability.

Consider the PAP industry in terms of each of Porter's Five Forces:

Threats of Entry: Very High (minimal capital investment needed, little proprietary technology, regional firms can compete in local markets due to high transportation costs, little brand identification of existing competitors)

Buyer Power: Very High (low brand loyalty, relatively little product differentiation, relatively low switching costs)

Supplier Power: High (especially for petroleum derivative raw materials—a key input in industry)

Substitute Products: High (plastics, wood paneling, wallpaper coverings, etc.)

Rivalry: High (competition is based mostly on price competition, because of little brand loyalty and product differentiation; easy entry and exit from the industry gives rise to frequent price wars; little price leadership exhibited by larger firms)

Sources: www.bls.gov (Bureau of Labor Statistics); www.ita.doc.gov (International Trade Administration)

It is useful to point out that there can also be very profitable opportunities to compete in industries that have overall low profits. For example, in the paint industry, Olympic Stain has typically been a very successful and highly profitable firm because they have found an attractive niche in the market and developed a differentiated product (through product development and advertising).

We also provide a brief discussion of some of the competitive forces affecting the hotel industry.

1. Threat of New Entrants

After summarizing the major barriers to entry, ask students to provide examples of industries characterized by each of these entry barriers. This may help them to understand what initially may appear to be rather complex ideas.

We discuss the concept of "the era of Lego innovation." Here, valuable advances in technology can be attained by imaginatively combining components and software available to everyone. Clearly, this serves to lower entry barriers.

Teaching Tip: *The chapter explains how economies of scale and economies of experience (learning curve) erect significant entry barriers. In the auto industry, U.S. manufacturers such as Ford and G.M. have high economies of scale (being the large producers) and all the benefits of learning curve (having been in the business for almost a century). Despite these advantages, foreign auto producers have entered the U.S. market and have increasingly gained market share over the past few decades. Ask the students why this happened? Does this prove that the concepts we discussed are wrong? Or does it point out that additional factors have to be considered? Point out that foreign producers have the benefits of lower labor costs and/or have developed better manufacturing technologies (such as Toyota's lean manufacturing).*

2. Bargaining Power of Buyers

It may be interesting to discuss when a group of buyers becomes powerful. For instance, organizations that produce "talent" (i.e., business schools) may have varying power against groups of organizations that hire business school graduates. For instance, large employers may require changes to the curriculum or shift talent production in house (see Apple University).

Moreover, Apple uses its buyer power to negotiate very low rental rates—compared to other stores—for its stores in shopping malls. This is because its powerful brand/products can help drive customers to the mall and increase overall sales in a mall by as much as 10 percent. Roughly speaking, Apple pays 2 percent of sales—compared to other tenants who may pay as much as 15 percent of sales.

Discussion Question 35: *Can you think of other tenants that would be able to negotiate low rental rates? Why?*

The SUPPLEMENT below explains that many huge consumer product firms are going to cut the amount of money they will spend on advertising. Clearly, this will enhance their buyer power.

Extra Example: Large Consumer Product Firms Cut Advertising Budgets

Procter & Gamble is planning to make deep cuts in its number of advertising agencies. It hopes to save up to half-a-billion dollars in fees that it now pays to outside firms to help pitch its wide variety of everyday items—from Gillette razors, to Tide detergent, to Pantene hair care, to Bounty paper towels.

Needless to say, this worries Madison Avenue. P&G is joining other companies—such as Unilever, L'Oreal SA, Coca-Cola Co, S.C. Johnson, and Visa—that are all trying to force advertisers to either lower prices or risk losing the business altogether. These firms are striving to offset slow growth with cost cuts.

P&G CFO Jon Moeller said the household-products giant plans to "significantly simplify and reduce" the number of agencies it works with on ads, media buying, public relations, package design and in-store marketing. Similarly, Unilever, which spent about $7 billion on advertising and marketing in 2014, is currently reviewing its global media-buying business. A person familiar with the issue said the process is driven in part by the need to find "cost savings and efficiencies."

Such pressures have prompted extensive industry consolidation. For example, giants Publicis Groupe SA and Omnicom Group Inc. tried—but failed—to merge in 2014. The agencies remain at the behest of clients that are in an increasingly frugal mood.

Source: Tadena, N. & Ng, Serena, A. S. 2015. P&G Joins the Movement to Reduce Costs. *Wall Street Journal*. April 27: B1-B2.

3. Bargaining Power of Suppliers

Briefly discuss some of the conditions under which a supplier group may become powerful. The bargaining power of suppliers can be presented as the mirror opposite of the bargaining power of suppliers. For example, the relative sizes and concentrations largely determine the bargaining power of the two parties involved in the transaction.

The section discusses how catfish farmers in Mississippi increased their power by forming a cooperative—Delta Pride Catfish.

The SUPPLEMENT below discusses how hotel companies in "tight" housing markets such as San Francisco raise their profits by exploiting the limited supply of housing, highlighting potentially negative consequences of supplier power. Clearly, raising prices benefits hotel firms in the short run, but is it prudent in the long run?

Extra Example: Risk your reputation if you have strong bargaining power?

J.P. Morgan organizes one of the leading annual healthcare conference in San Francisco, which attracts thousands of attendees who are linked to 450 companies every year. It is no secret that San Francisco's housing market is one of the most expensive in the world. But that is not all. San Francisco is also famous for a lack of hotel rooms, meaning hotels operate in a seller's market. It is therefore no surprise that the arrival of around 9,000 travelers leads to exorbitant hotel rates because hotels flex their muscles and exploit their powerful supplier position. In 2018, for instance, a room at a Holiday Inn Express close to the conference venue was $527 a night. Other hospitality providers such as restaurants also join in on the high-price game. For instance, cold lunch buffets at some establishments close to the conference venue were offered for more than $70 dollars a head and came with a mandatory 25% service charge.

While these high prices are a consequence of market principles such as "supply and demand," hotels and other hospitality firms should also consider the wider consequences of excessively high prices. For instance, smaller healthcare and biotech startups may not be able to attend the conference, which may be perceived as stifling entrepreneurship. In addition, people living in close proximity to the conference venue or travelers that visit San Francisco for unrelated business reasons may protest against the high costs of hospitality services. The media may have an open ear to these outcries over high prices.

Overall, hospitality providers may expose themselves to reputational penalties if they charge the highest possible price. While these reputational penalties are likely to be lower than price gauging in events of natural disasters (e.g., Hurricane Harvey destroying much of the Houston metropolitan area in 2017), hotel chains and other hospitality providers may be well-advised to consider ways to address any potential backlash.

Source: Grant, C. 2018. The real winners in biotech. *Wall Street Journal*. December 28: np.

4. The Threat of Substitute Products and Services

Emphasize that the viability of a substitute product depends largely on its relative price-performance trade-off, i.e., more value for the same price or the same value for a lower price. Examples are electronic security systems versus security guards, and the use of steel versus plastic for components in the manufacture of automobiles.

We discuss substitutes and give the example of how the use of teleconferencing poses a threat to the airline industry.

5. The Intensity of Rivalry among Competitors in an Industry

After discussing the factors that lead to intense rivalry in an industry, provide an example of an industry in which competition has recently been intense. For example, most students are familiar with the recurring price wars in the U. S. airline industry. Ask them to explain this using the factors discussed (e.g., undifferentiated service, low switching costs, slow industry growth, numerous competitors, etc.) You might point out that this industry was expected to report huge losses in 2001 even before the September 11, 2001 terrorist attack. Beginning in late 2005, the airlines' problems were further aggravated by extremely high fuel costs.

In this section, we discuss the intense rivalry among U.S. grocers (see STRATEGY SPOTLIGHT 2.4).

The SUPPLEMENT below is Michael Porter's response to a question as to whether or not he would add a "sixth force" if he were developing his framework today.

Extra Example: Should There Be a "Sixth Force?" Michael Porter's Perspective

"There have been two nominees for the sixth force. One is government. After much further work using and teaching the framework, I have reaffirmed my original conclusion that government is not a sixth force because there is no monotonic (direct linear) relationship between the strength and influence of government and profitability of an industry. You can't say that 'government is low, industry profitability is high.' It all depends on exactly what government does. Also, there are many different parts of government, each with its own distinct impacts. And, how do you assess the consequence of what government does? Well, you look at how it affects the five forces.

"The other, more recent, candidate for a sixth force involves organizations whose products and services are complementary to the primary organization's products and services. Again, there is no monotonic relationship between the extent of complements and profitability. Sometimes having many complements is consistent with high industry profitability, sometimes with low profitability. It has to do with how complements affect the five forces…. Clearly, complements have much to do with the size of the pie, but their role in the division of the pie is independent of other factors."

Source: Argyres, N. & McGahan, A. M. 2002. An interview with Michael Porter. *Academy of Management Executive*. 16 (2): 43-52.

EXHIBIT 2.5 provides a summary of key points from the discussion of industry five-forces analysis.

B. How the Internet and Digital Technologies Are Affecting the Five Competitive Forces

The changes caused by the Internet economy have made strategizing more challenging. Strategic analysis, informed formulation, and successful implementation may be even more difficult in the Internet era because of the uncertainty surrounding the new technology. In this section, we address the impact of the Internet and digital technologies in terms of Porter's five-forces model of competition.

1. The Threat of New Entrants

In most industries, new entrants will be a bigger threat because the Internet lowers barriers to entry. Thus, scale economies may be less important in an Internet context, and new entrants can go to market with lower capital costs.

Businesses launched on the Internet may enjoy savings on traditional expenses such as office rent, salaries, and postage. Thus, a new entrant could use the savings to charge lower prices and compete on price despite an incumbent competitor's scale advantages. Alternatively, a new entrant may be able to serve a market more effectively, with more personalized services and greater attention to product details. Then they could build a reputation in their niche and charge premium prices.

Another potential benefit for Internet-based businesses is access to distribution channels. Manufacturers or distributors that can reach potential outlets for their products via the Internet may be encouraged to enter markets that were previously closed to them. Such access is not guaranteed, however.

Discussion Question 36: *What are some examples of industries where there have been a lot of new entrants because of the Internet? Have these new entrants been successful? How have incumbent firms reacted?*

2. The Bargaining Power of Buyers

The Internet may increase buyer power by providing consumers with more information to make buying decisions and lowering switching costs. But, by giving buyers new ways to access sellers, the Internet may also suppress the power of traditional buyer channels that have concentrated buying power in the hands of a few. In this section, we address two types of buyers: end users and buyer channel intermediaries.

End users are the final customers in a distribution channel. Internet sales activity that is labeled "B2C" is concerned with end users. Because a large amount of consumer information is available on the Internet, end users can easily shop for quality merchandise and bargain for price concessions. Switching costs are also potentially lower because the cost of switching may involve only a few clicks of the mouse to find and view a competing product or service online.

Buyer channel intermediaries are the wholesalers and distributors who serve as "middlemen" between manufacturers and end users. In some industries buyer channels are dominated by powerful players. The Internet, however, makes it easier and less expensive for businesses to reach customers directly. Thus, the Internet may increase the power of incumbent firms relative to these traditional buyer channels.

Discussion Question 37: *What are some other ways that end users can increase their buying power by using the Internet?*

STRATEGY SPOTLIGHT 2.5 addresses the role of the Internet in shaking up the legal services industry. It has clearly led to an increase in the power of buyers.

Discussion Question 38: *What are some examples of other companies that have used the Internet to enhance their buying power?*

3. The Bargaining Power of Suppliers

The Internet has streamlined and quickened the process of acquiring supplies. But the extent to which the Internet is a benefit or a detriment to suppliers may depend on where the supplier is positioned along the supply chain.

Suppliers provide products or services to other businesses. The term "B2B" is used to refer to businesses that supply or sell to other businesses. On the one hand, the Internet makes it possible for suppliers to access more customers at a relatively lower cost per customer. On the other hand, because buyers can comparatively shop more easily and negotiate prices faster, suppliers may not be able to hold on to them. This is especially damaging to supply chain intermediaries, such as product distributors, who may not be able to stop suppliers from directly accessing other potential business customers.

Discussion Question 39: *What can supply chain intermediaries do to strengthen their position, that is, make it worthwhile for their customers in the supply chain to continue using their services?*

Discussion Question 40: *What are some examples of companies that have abandoned their traditional method of reaching customers and are using the Internet to reach customers directly?*

One of the greatest threats to supplier power is that the Internet inhibits a supplier's ability to offer highly differentiated products or unique services. Other factors may, in contrast, contribute to stronger supplier power:

1. The growth of Web-based business in general may create more downstream outlets for suppliers to sell to.

2. Suppliers may be able to create Web-based purchasing arrangements that make purchasing easier and discourages their customers from switching.

3. The use of proprietary software that links buyers to a supplier's website may create a rapid, low-cost ordering capability that discourages the buyer from seeking other sources of supply.

4. Suppliers will have greater power to the extent that they can reach end users directly without intermediaries.

A process known as **disintermediation** is removing organizations or business process layers responsible for intermediary steps in the value chain in many industries. The Internet is also creating an opening for new functions. These new activities are entering the value chain by a process known as **reintermediation**, the introduction of new types of intermediaries. Electronic delivery is an example.

Discussion Question 41: *What are some examples of new companies that have emerged to offer new types of electronic intermediary functions?*

Discussion Question 42: *If you were Home Depot, what would you do if one of your major suppliers responded that they intended to sell directly to consumers online anyway?*

4. The Threat of Substitutes

In general, the threat of substitutes is heightened because the Internet introduces new ways to accomplish the same tasks.

The primary factor that leads to substitution is economic—consumers will use a product or service until a substitute that meets the same need becomes available at a lower cost. The economies created by Internet technologies have led to the development of numerous substitutes for traditional ways of doing business. An example is provided:

1. Online electronic storage by companies such as Dropbox and Amazon Web Services.

Discussion Question 43: *What are some other examples of Internet companies that are offering products or services that are viable substitutes for existing products or services?*

5. The Intensity of Competitive Rivalry

Because the Internet provides more tools and means for competing, rivalry among competitors is likely to be more intense. The Internet increases rivalry by making it difficult for firms to differentiate themselves and by shifting customers' attention to issues of price.

Discussion Question 44: *What do you think the impact of diminishing brand loyalty will be on the intensity of competitive rivalry? Explain.*

Discussion Question 45: *What are some examples of companies that still rely heavily on brand loyalty to maintain their market power and sales?*

Rivalry is more intense when switching costs are low and product or service differentiation is minimized. The Internet has "commoditized" products that might previously have been regarded as rare or unique. The Internet also eliminates the importance of location making products that were previously distant readily available online. This makes competitors more equally balanced, thus intensifying rivalry.

The problem is made worse for marketers because of shopping infomediaries that search the Web for the best prices. Such infomediary services may be good for consumers, but they increase business rivalry by consolidating the marketing messages that consumers use to make purchases to a few key pieces of information that the selling company has little control over.

Discussion Question 46: *What steps can companies take to make their online business more distinctive or unique?*

Discussion Question 47: *What are some examples of companies that have maintained the distinctiveness of their online business? What features make them distinct? Are these features sustainable?*

C. Using Industry Analyses: A Few Caveats

This section was written as a "caveat" to address some limitations of Porter's five-forces model. First, managers should not always avoid low profit industries. We provide the example of WellPoint Health Networks (now Anthem, Inc.).

Teaching Tip: *Even when industry analysis shows that an industry is unattractive, there are a few firms that seem to be able to earn high returns. For example, Southwest Airlines has been consistently profitable in an otherwise unattractive industry over the past several years. Does this mean that industry analysis is misleading? You may point out that industry analysis is useful to predict an industry's average profitability, but not necessarily, a single firm's profitability. This is a good opportunity to introduce the role of the strategist in outperforming industry norms.*

Second is the idea that business is not always a zero-sum game— which is an assumption that is implicit in Porter's five-forces model. We discuss how companies can collaborate with suppliers for mutually beneficial outcomes.

The SUPPLEMENT below provides a rather counterintuitive perspective on rivalry in an industry. With examples from Yoplait and McDonald's, sometimes a firm can benefit from a rival's new product.

Extra Example: Firms Can Benefit from a Rival's New Product

Conventional wisdom that a rival's launch can hurt a firm's profits is often correct. But not always. Research has shown that companies sometimes see profits increase after a rival's rollout—even when they don't aggressively seek ways to undermine the new product's sales.

The underlying mechanism is rather straightforward: When a firm extends a product line, it often raises the prices of its existing products. These hikes may be designed to make the new product look cheaper and thus more attractive by comparison or to capture the value customers place on a broader line of offerings. As the company adjusts its pricing, its competitors can follow suit without risking customer defections over price.

For example, consider what happened with Yoplait became the first major producer to market low-fat yogurt in the United States. Although Dannon took a 5 percent hit in units sold during the new product's initial year, the vast majority of its customers did not defect to Yoplait. Instead, they preferred Dannon's style of yogurt. And, since Yoplait had raised prices across its product line, Dannon raised its prices as well, by more than 10 percent. Thus, despite the 5 percent decrease in volume, Dannon's revenue increased by 5 percent.

A similar dynamic plays out in fast food. My research shows that McDonald's franchisees who open additional outlets (a type of horizontal product extension) often price the menu items in all their locations higher than before. This allows competing Burger Kings to raise their prices as well. At independent Burger Kings in Silicon Valley, this has led to increase margins more than 10 percent of the time.

Source: Thomadsen, R. 2013. You can benefit from a rival's new product. *Harvard Business Review*. 91(4): 24.

The third issue we raise is that the five-forces analysis has often been criticized for being a static, rather than a dynamic, analysis. Brandenberger and Nalebuff introduced the concept of the value net, which we include in EXHIBIT 2.6.

The concept of complementors is often considered to be the single most important contribution of value net analysis. Complements typically are products or services that have a potential impact on the value of the firms' own product and services. We provide the examples of complements (software and microprocessors) in the personal computer industry and the video game industry. (As we noted in an earlier supplement, Professor Michael Porter would not add complements to the "five forces" because they don't have a *direct linear relationship* to industry profitability. However, they clearly can have an impact on an industry's profitability.)

D. Strategic Groups within Industries

Most of your students are probably very interested in the automobile industry. EXHIBIT 2.7 provides a strategic grouping of the worldwide automobile industry. It is rather clear from the discussion in the text that the intensity of competition within strategic groups is much more intense than competition across groups.

Point out four benefits of strategic groups as an analytical tool:

1. Strategic groupings help a firm identify mobility barriers that protect a group from attacks by other groups.

2. It helps a firm to identify groups whose competitive position may be marginal or tenuous.

3. It helps chart the future directions of firms' strategies.

4. It helps in thinking through the implications of each industry trend for the strategic group as a whole.

It may be interesting to ask the students what dynamics they envision in the automobile industry, i.e., how membership in strategic groups may change and if new strategic groups may emerge.

Discussion Question 48: *What are some of the strategic groups in other industries with which you may be familiar? What are the implications? (e.g., retailing)*

We close with an example with an industry closely related to the one addressed in this section—motorcycles. The SUPPLEMENT below discusses the two major clusters in this industry and how the basis for competition is quite different.

Extra Example: The Two Key Strategic Groups in the Motorcycle Industry

In most industries, firms cluster around a relatively small number of strategic positions and within each cluster hold similar ideas about how to compete. In the motorcycle industry, there are two major clusters of firms.

The Japanese producers—Honda, Yamaha, Suzuki, and Kawasaki—compete on technical innovation and lower costs. The Harley-Davidsons and Ducatis, in contrast, view their business through a very different lens—as entertainment. Here's how Federic Minoli, the CEO and chairman of Ducati from 1996 to 2007 described his decision to build a museum celebrating the firm before he repaired a damaged factory: "Ducati is not, or not only, a motorcycle company. We sell something more: a dream, passion, a piece of history."

Analyze most industries, and you will find a similar situation: two or three groups of firms jostling for position upon the same two or three competitive mountaintops. Now consider the major U.S. airlines. They all struggled for many years in cutthroat competition around the same position until Herb Kelleher of Southwest Airlines saw a different, low-cost way to compete.

Source: Gavetti, G. 2011. The new psychology of strategic leadership. *Harvard Business Review*. 89 (7/8): 118-125.

IV. Issue for Debate

The topic should be of great interest because many students are familiar with drones (or perhaps own a drone or use drones for fun). What may be less well known is that drones are also extremely prevalent and effective in commercial applications such as building inspections. In effect, this is a good example of a new technology that has great potential for business (e.g., reducing costs) and workers (e.g., improving safety), but also faces challenges (e.g., privacy concerns). This tension between benefits and costs is certainly not unusual when new technologies get introduced into established markets. The instructor can point to other industries that have seen great efficiency benefits but also faced much opposition from various stakeholders (such as ridesharing).

Discussion Question 1: *If you were a local regulator, would you permit the use of drones?*

Response Guideline: The benefits of drones seem to outweigh potential costs. In 2016, the White House estimated that drones could lead to $82 billion in economic growth by 2025 and support up to 100,000 jobs. Less obvious benefits include increased safety in many professions such as building inspectors (less risk for slipping on roofs or ladders). Drones also have a lot of potential to assist first responders. This question can direct the discussion to the risk aversion of regulators. It also pushes students to think about how to balance the costs and benefits of new technologies that have the potential to revolutionize a range of commercial applications.

Discussion Question 2: *How should regulators respond to drone accidents?*

Response guideline: This would be a good application of stakeholder management and can be tied to the commercialization of other novel technologies. For instance, Elon Musk tweeted in 2013 following media coverage of a Tesla on fire: “Why does a Tesla fire [with] no injury get more media headlines than 100,000 gas car fires that kill [hundreds] of people per year?” A potential solution for regulators may be to allow commercial drone use (since the benefits are quite clear) and restrict private drone use (as the benefits are more experimental and uncertain).

Discussion Question 3: *Do you think drone use could be successful in other commercial applications such as package delivery?*

Response guideline: Students should think about how the nature of the business may affect adaptation. Building inspections are generally seen as a public service whereas the “package delivery” sector is mostly privately organized (USPS being the exception of course). Private companies such as Amazon that want to break into the “drone delivery market” may engage in political strategies and sophisticated PR strategies (the following article illustrates nicely how Amazon tries to educate and lobby the public and politicians: https://goo.gl/1P5aUK).

V. Reflecting on Career Implications

Below, we provide some suggestions on how you can lead the discussion on the career implications for the material in Chapter 2.

- **Creating the Environmentally Aware Organization:** Advancing your career requires constant scanning, monitoring, and intelligence gathering to find out not only about future job opportunities but also to understand how employers' expectations are changing. Consider using websites such as LinkedIn to find opportunities. Merely posting your resume on a site such as LinkedIn may not be enough. Instead, consider in what ways you can use such sites for scanning, monitoring, and intelligence gathering.

Students will likely be very interested in the topic of learning about new job opportunities and their associated skill requirements and compensation. Later in the course, there will be specific advice related to finding jobs through networking. Here, the point is to raise in students a general awareness of the types of career options available to them. On LinkedIn, job postings are grouped in various ways. Employers list desired skills and experience. Students should browse a number of these postings in order to identify trends concerning the types of skills that are currently in demand. To find compensation levels, students can join LinkedIn and ask experts. Compensation is a very tricky topic, though, because companies will tailor it to the specific skills of their chosen candidate. The point here is that students will gain from learning about the job market in their fields and how their specific skills and capabilities match up with what the market values. A related topic to consider is the value of experience. Ask students why employers value experience in addition to skills and training. The question does not have an obvious answer. Students should appreciate that as they progress through their careers, they will gain subtle and powerful capabilities related to, for example, leadership, handling complex situations, and stakeholder relations

- **SWOT Analysis:** As an analytical method, SWOT analysis is applicable for individuals as it is for firms. It is important for you to periodically evaluate your strengths and weaknesses as well as potential opportunities and threats to your career. Such analysis should be followed by efforts to address your weaknesses by improving your skills and capabilities.

The SWOT analysis directly pertains to individuals, and students will usually grasp how it applies to them personally. A useful exercise is to have students complete a SWOT analysis on themselves and then pair with another and share reviews. As a check, ask student volunteers to share an element from each part to ensure that students are correctly classifying the elements. The next step is to ask students to make a plan to address their weaknesses. Plans may be of two types. One is to develop weak skills to the point they are not weaknesses. Two is to make a plan to avoid the weakness. For example, if a student were weak at quantitative analysis, then he or she could pursue a career, such as copywriting, that does not rely on that skill so much. The point here is that students should be aware of their SWOT profile and plan their careers accordingly.

- **General Environment:** The general environment consists of several segments, such as the demographic, sociocultural, political/legal, technological, economic, and global environments. It would be useful to evaluate how each of these segments can affect your career opportunities. Identify two or three specific trends (e.g., rapid technological change, aging of the population, increase in minimum wages) and their impact on your choice of careers. These also provide possibilities for you to add value to your organization.

When students choose a segment, they should identify a trend within that segment. Then they should be able to identify an industry that would benefit from that trend. This industry is therefore likely to be a growth industry that may provide good career opportunities. It also may be useful to identify some weaknesses in this logic, such as reversal of a trend, or having an industry become a magnet for workers, such as computer programming, where the labor supply may exceed demand. Within industries, there may be specific functions that will offer growth in areas that firms can exploit. An example may be e-business, where firms in many industries are revolutionizing their distribution channels in response to the increasing acceptance by consumers of e-tailing.

- **Five-Forces Analysis:** Before you go for a job interview, consider the five forces affecting the industry within which the firm competes. This will help you to appear knowledgeable about the industry and increase your odds of landing the job. It also can help you to decide if you want to work for that organization. If the "forces" are unfavorable, the long-term profit potential of the industry may be unattractive, leading to fewer resources available and—all other things being equal— fewer career opportunities.

It is good advice to do due diligence of a firm and its industry prior to a job interview. It helps job candidates to appear knowledgeable about their prospective employers, which may be a differentiator. In class discussions, it is probably less important to make a general conclusion of "favorableness" vs. "unfavorableness." Better is to identify the specific forces that are the strongest threats to the industry. Then develop an argument as to how students, the candidates, can help firms to address these threats. Later, provided that students have offers from firms in multiple industries, students may use the assessment of industry overall attractiveness in their decision as to which offer to accept. In discussions of this issue, it may be useful to remind students that firm characteristics are a stronger explanation of firm success than industry environment. It may be better to work for a strong firm in an unattractive industry than for a weak firm in an attractive industry.

VI. Summary

Managers must analyze the external environment to minimize or eliminate threats and exploit opportunities. This involves a continuous process of environmental scanning and monitoring, as well as obtaining competitive intelligence on present and potential rivals. These activities provide valuable inputs for developing forecasts. In addition, many firms use scenario planning to anticipate and respond to volatile and disruptive environmental changes.

We identified two types of environment: the general environment and the competitive environment. The six segments of the general environment are demographic, sociocultural, political/legal, technological, economic, and global. Trends and events occurring in these segments, such as the aging of the population, higher percentages of women in the workplace, governmental legislation, and increasing (or decreasing) interest rates, can have a dramatic effect on your firm. A given trend may have a positive impact on some industries and a negative or neutral impact, or none at all on others.

The competitive environment consists of industry-related factors and has a more direct impact than the general environment. Porter's five-forces model of industry analysis includes the threat of new entrants, buyer power, supplier power, threat of substitutes, and rivalry among competitors. The intensity of these factors determines, in large part, the average expected level of profitability in an industry. A sound awareness of such factors, both individually and in combination, is beneficial not only for deciding what industries to enter but also for assessing how a firm can improve its competitive position. We also address how industry and competitive practices are being affected by Internet technologies. We also addressed some of the limitations of Porter's five-forces model, including its zero-sum perspective and its omission of the key role of complements. Although we discussed the general environment and competitive environment in separate sections, they are quite interdependent. A given environmental trend or event, such as changes in the ethnic composition of a population or a technological innovation, typically has a much greater impact on some industries than on others.

The concept of strategic groups is also very important to the external environment of a firm. No two organizations are completely different nor are they exactly the same. The question is how to group firms in an industry on the basis of similarities in their resources and strategies. The strategic groups concept is valuable for determining mobility barriers across groups, identifying groups with marginal competitive positions, charting the future directions of firm strategies, and assessing the implications of industry trends for the strategic group as a whole.

Chapter 2: Analyzing the External Environment of the Firm

Explain the profitability of an industry (of your choice) by applying the tools that you learned in this chapter (five-forces analysis). How can the five-forces zero-sum perspective be a disadvantage?

Teaching Suggestions:

You can organize the discussion on this topic around the following sub-questions:

★ What are the five forces that drive the profitability in an industry?

The five forces are:
1. The threat of new entrants
2. The bargaining power of suppliers
3. The bargaining power of buyers
4. The threat of substitute products and services

5. The intensity of rivalry among competitors in an industry

★ What are the barriers to entry into a particular industry? Are they high or low? What are the implications?

Six major sources of entry barriers as outlined in the text are:
1. Economies of scale
2. Product differentiation
3. Capital requirements
4. Switching costs (one-time costs that the buyer faces when switching from one supplier's product or service to another)
5. Access to distribution channels
6. Cost disadvantages independent of scale (These derive from: proprietary product, favorable access to raw materials, government subsidies and, favorable government policies)

★ Who are the buyers in this industry? Are they powerful? What makes the buyers powerful (not powerful)? Are the buyers likely to engage in backward integration?

★ What are the implications of buyers bargaining power?

★ Who are the suppliers to your industry? Do you think the suppliers are powerful? What makes the suppliers powerful (not powerful) in your industry? Are there any 'switching costs?' What are the implications of high bargaining power of the suppliers in the industry?

★ If you are a firm in this industry, how would you define competition? Would you consider all firms operating in the industry as your competitors? Why/why not?

★ What are "strategic groups?" How would you know the "strategic groups" in your industry? What kind of dimensions should you choose when mapping the "strategic groups"? Why is it important to understand "strategic groups"? *(We provide the example of the worldwide automobile industry.)*

The concept of 'strategic groups' is important because competition would be more intense among firms within the same strategic group as compared to competition with other firms in the industry. Some dimensions that can be used for mapping strategic groups are: breadth of product and geographic scope, price/quality, degree of vertical integration etc.

You should emphasize that for strategic group mapping to serve any meaningful purpose, the dimensions should be chosen in a manner that they reflect the variety of strategic combinations in the industry. For example, in an industry where there is severe price-base competition, price may not be the right dimension to choose. Similarly, if all firms have the same level of product differentiation, then choosing product differentiation as a dimension would not serve the purpose.

★ What are the substitutes to your products or services? How do substitutes impact the profitability of your industry?

You might want to make a point here that identifying substitutes can be quite a difficult task sometimes. Firms in seemingly unrelated industries may be providing products or services that act as substitutes to each other. The example given in the text on the substitution between airline industry and teleconferencing would help highlight this point.

Some more interesting questions to ask would be the following:

★ If two industries have the same profitability levels, can you employ a common strategy in both the industries?

Even though two industries might have the same profitability levels, the underlying industry structures can be entirely different. For example, in both the automobile industry and in the Internet-based businesses, profit margins are quite low. However, while the entry barriers into the automobile industry are very high, the barriers are very low into the Internet-based businesses. Competition is intense in both the industries, whereas supplier and buyer bargaining powers are quite low. On the other hand, threat from substitutes such as the 'brick-and-mortar' stores, is very high in the Internet-based businesses, whereas the threat from substitutes is low in the automobile industry. (Some students might argue that the airline industry is a strong substitute and you would have to deal with that objection.) Thus, even if a firm operates in both these industries, it needs to formulate quite different strategies to suit the particular industry situation.

★ Why is the five-force analysis important?

It is important to understand these five forces because they affect a firm's ability to compete in a given market. This analysis helps in deciding whether or not to remain in a particular industry and also in choosing industries to enter. A sound understanding of the forces operating in an industry helps in assessing how to improve the firm's competitive position with regard to each of the five forces. You can ask students to give their own ideas on what strategies they would employ in the particular industries they have chosen for analysis.

★ Is the five-force analysis "zero sum" in perspective? Is that a disadvantage?

It would often be the case that students, in the position of a company, think about counteracting the effects of each force and blunting it. This is the essence of the zero-sum perspective. You can explain the importance of thinking "win-win" and establishing collaborative partnerships with suppliers and customers. For example, establishing long-term mutually beneficial relationships with suppliers improves a firm's ability to implement just-in-time (JIT) inventory systems, which let it manage inventories better and respond quickly to the market demands.

★ Do the competitive forces remain the same over a period of time? What impact will it have on profitability?

The key point is that in the five-force analysis, we are essentially taking a point in time and trying to understand the industry situation at that point in time. This is a static approach to understanding the competitive environment. However, these external forces and the strategies of the firms within industries change over time and thus change the structure of the industry itself. In order to understand how the profitability changes over time, game theoretic approaches are being used.

★ What is "Value Net?" Who are on the vertical and horizontal dimensions? How are those on the vertical dimension different from those on the horizontal dimension? Who are complementors?" How are complements different from substitutes? *(We provide the example of the video game industry.)*

The value net represents all players in the game and analyzes how their interactions affect a firm's ability to generate and appropriate value.

Suppliers and customers form the vertical dimension of the value net and the firm engages in transactions with them.

Substitutes and complements are on the horizontal dimension of the value net. These are the players with who the firm interacts but does not necessarily transact.

Substitute products or services serve the same purpose that the products and services from a chosen industry serve. Substitutes accentuate competition.

Complements are typically products or services that have a potential impact on the value of a firm's own products or services. The firms that produce complements are referred to as "complementors." For example, very sophisticated cameras may be useless if we do not have high-quality film to produce quality pictures. Powerful hardware might prove useless without software to make it work and highly sophisticated software may be useless if there is no hardware to support its working. Thus, complements in essence help to increase the performance and efficiency of products or services of a particular industry and thus improve their competitive situation vis-à-vis other products and substitutes.

End-of-Chapter Teaching Notes

Chapter 2: Analyzing the External Environment of the Firm

Summary Review Questions

1. Why must managers be aware of a firm's external environment? (in the text, Enhancing Awareness of the External Environment, LO 2-1)

Response:

Being responsive to the external environment enables firms to avoid strategic mistakes. It is possible for firms to become internally focused, efficient producers of obsolete goods and services (e.g. buggy whips, carbon paper). Rather, managers need to respond to opportunities and threats from the external environment in order to develop the most successful products and services.

2. What is gathering and analyzing competitive intelligence and why is it important for firms to engage in it? (in the text, Enhancing Awareness of the External Environment, LO 2-2)

Response:

Competitive intelligence is a firm's activities of collecting and interpreting data on competitors, defining and understanding the industry, and identifying competitors' strengths and weaknesses. It is not spying, fortune-telling, simple data collection, or an isolated activity within a firm. The purpose of competitive intelligence is to increase management's awareness of developments in the external environment, thereby increasing the quality of strategic decisions.

3. Discuss and describe the six elements of the external environment. (in the text, The General Environment, LO 2-4)

Response:

The six elements of the general environment are the demographic segment, the sociocultural segment, the political/ legal segment, the technological segment, the economic segment, and the global segment. The demographic segment refers to the statistics of a population, such as age, income characteristics, ethnic groups, and geographic distribution. The sociocultural segment refers to the values, beliefs, and lifestyles of a country. The political/legal segment refers to the creation and use of power within a country, including the effect of various regulations, including the areas of environmental protection, employment discrimination protection, and taxes.

The technological segment refers to new products and services derived from advances in engineering, applied science, and/or pure science. These new products and services can change manufacturing processes, create new industries, and alter the boundaries between industries. The economic segment refers to the level and change in monetary and macroeconomic factors such as unemployment, inflation, interest rates, and economic growth. The global segment refers to effects on a country's business environment from abroad, and include factors such as foreign competition, foreign market opportunities, foreign supply opportunities, legal changes due to international treaties, and regional economic integration.

4. Select one of these elements and describe some changes relating to it in an industry that interests you. (in text, The Competitive Environment, LO 2-5)

Response:

The answer will vary according to segment and industry chosen. Exhibit 2.5 may summarize some of the possible findings. The purpose of this question is to get students to classify various environmental changes into the segments and articulate why a change belongs in a particular segment. It might be useful to add a major change, the Internet, to the discussion. The Internet, from the technological segment, has wide-reaching impacts (see Strategy Spotlight 2.5).

5. Describe how the five forces can be used to determine the average expected profitability in an industry. (in text, The Competitive Environment, LO 2-5)

Response:

The five-forces model consists of the threat of new entrants, the bargaining power of buyers, the bargaining power of suppliers, the threat of substitute products and services, and the intensity of rivalry among competitors in an industry. Each force can be looked at as a way that the industry environment limits a firm's ability to earn profits through either raising prices or lowering costs.

The threat of new entrants limits a firm's ability to raise prices because then a new entrant may decide to enter the industry and offer a lower price. The bargaining power of buyers directly limits a firm's ability to raise prices. The bargaining power of suppliers directly limits a firm's ability to lower costs. The threat of substitute products and services limits a firm's ability to raise prices because customers would then buy the substitutes. The intensity of rivalry among competitors in an industry limits a firm's ability to raise prices because then customers would buy from a competitor.

6. What are some of the limitations (or caveats) in using five-forces analysis? (in text, The Competitive Environment, LO 2-5)

Response:

Three limitations of the five-forces analysis are 1) the implication that low-profitability industries should be avoided may not be optimal. Low-profitability industries may be profitable opportunities for firms with innovative business models that change the competitive landscape. 2) The five-forces model assumes a zero-sum game, with a firm's loss of profitability associated with another firm's gain. However, through strategic alliances or other forms of collaboration with suppliers, buyers, or other industry players, firms can gain both profitability and competitiveness. 3) The five-forces model is static and does not account for constant changes in competitive position that characterize many industries. Included in the dynamic analyses is the effect of complements, or other products and services that affect the value of a firm's own products and services. For example, software is a complement to hardware. Dynamic interactions between firms and complements can affect the profitability prospects for a firm outside of the five-forces model.

7. Explain how the general environment and industry environment are highly related. How can such interrelationships affect the profitability of a firm or industry? (in text, The General Environment and The Competitive Environment, LO 2-4 and LO 2-5)

Response:

The general environment can affect all of the five forces in various ways. A growing economy can reduce the intensity of rivalry within the industry because firms will be scrambling to meet growing demand. There is a detailed explanation of how the Internet, a development in the technological segment, affects each of the five forces.

8. Explain the concept of strategic groups. What are the performance implications? (in text, The Competitive Environment, LO 2-7)

Response:

Strategic groups are groups of firms, usually within an industry, that share similar strategies. The performance implications are that firms can group themselves with close competitors and 1) identify barriers between groups, 2) identify positions within the industry that are marginal or tenuous, and 3) chart directions for future strategic development. Strategic group analysis is a more fine-grained way to conduct competitor analysis, as the competitive environment of an industry may differ from the competitive environment of the strategic group.

Experiential Exercises and Application Questions

1. Strategy Spotlight 2.2 discusses the growing importance of environmental concerns and illustrates how companies in different industries deal with plastic waste issues. Many other environmental problems such as greenhouse gas emissions and the resulting climate change issues are major concerns for today's businesses and governments. Pick an industry with high greenhouse gas emissions such as electric utilities, air transportation, or livestock agriculture and identify the threats and opportunities facing the industries. Do you think companies with substantial greenhouse gas emissions should proactively address their environmental impact?

Response:

This question should result in a lively discussion. Many students will agree that companies should address environmental concerns related to climate change. What may be more controversial is how companies should be compelled to become more environmentally sustainable.

Some students may favor a regulatory approach. The instructor can point out that this may be an effective way to compel industries to become greener since this may overcome collective action problems and free rider issues in an industry. The strategic drawback of this approach is that it will be very difficult for any company to differentiate its business if regulatory action triggers resource commitments to green technologies for all companies in an industry.

Other students may favor a more proactive approach by individual companies. In other words, companies proactively and voluntarily search for ways to reduce greenhouse emissions. The instructor may point to the strategic benefit of this approach: Given that environmental concerns regarding climate change are here to stay, companies that proactively invest in green technology may establish a first-mover advantage and differentiate their image and brand from the competition. The instructor may offer some examples of companies that have taken a proactive approach. Good examples can be found in the book "Green to Gold" by Daniel Esty and Andrew Winston.

2. Select one of the following industries: personal computers, airlines, or automobiles. For this industry, evaluate the strength of each of Porter's five forces as well as complementors.

Response:

This exercise is very useful for helping students understand the value of the five-forces model. For undergraduate and even graduate classes, it might be useful to work with only one force at a time. In general, students may identify a number of firms and organizations for each of the five forces. To evaluate the strength of each force, it is important to refer to relevant characteristics. The list below shows these:

- Threat of new entrants—you can look at the barriers to entry for the industry, as indicated by economies of scale, product differentiation, capital requirements, and switching costs, as well as other types of cost disadvantages to new entrants, such as proprietary products, favorable access to raw materials, government subsidies, and favorable government policies.

- Bargaining power of buyers—identify buyers who are large or in concentrated buyer industries, standard or undifferentiated products, few buyer switching costs, buyer with low profits, buyer has a credible threat of backwards integration, or the buyer views the firm's products or services as undifferentiated.
- Bargaining power of suppliers—it is often a challenge to find suppliers, but to the extent you can, look for suppliers that are large and concentrated (few in number), suppliers with few substitutes, suppliers that view the firm's industry as a minor proportion of its sales, suppliers that provide an important input, suppliers with differentiated products, and suppliers that pose a credible threat of forward integration.
- Threat of substitute products and services—identify substitutes that are a) outside the industry, and b) that are an economical and feasible alternative for buyers.
- Intensity of rivalry—identify rivals within the industry and evaluate each rival's product offerings for being lower priced or of higher quality than the firm's offerings.

Then have students put them all together and provide a summary evaluation of the overall ability of the firm to set prices and control costs.

3. Imagine yourself as the CEO of a large firm in an industry in which you are interested. Please (1) identify major trends in the general environment, (2) analyze their impact on the firm, and (3) identify major sources of information to monitor these trends. (Use Internet and library resources.)

Response:

Students should respond with a variety of industries and approaches. It may be useful to have students justify their classification of trends into segments of the general environment. It may also be useful to have students justify why the trends they have identified are major trends and not minor trends. And you can ask students to classify their chosen trends as threats or opportunities. If students have focused on one, say, opportunity, then ask them to consider threats.

As for sources of information, there are many good sources from the government. Try the census department, the Bureau of Economic Analysis, Department of Commerce, Department of Labor, and the Central Intelligence Agency. Many of these sources are freely available directly from the government or through libraries. Some libraries of institutions of higher education subscribe to industry analysts reports, which often include analyses of the business environment. In addition, company websites often include information about potential market size and trends, although note that company websites are inherently a biased source of information.

4. Analyze movements across the strategic groups in the U.S. retail industry. How do these movements within this industry change the nature of competition?

Response:

We suggest following these five steps. First, develop a list of retailers. The list may include only local retailers that the students are familiar with, or the stores within a local mall or shopping area, or even a comprehensive list of all retailers in the region.

Second, choose two dimensions for mapping the firms. Depending on the type of stores chosen, we suggest breadth of product line, degree of vertical integration, average store size, pricing strategy, or target market (broad versus niche).

Third, for each store assign a value for each dimension and plot it on the strategic group space. For example, Wal-Mart would have a broad product line, high vertical integration (it often buys directly from suppliers, not wholesalers), large size, low pricing, and broad target market. These assessments will determine its location on the two chosen dimensions. In addition, for at least one firm get a sense of how it has changed in the past year or so.

Fourth, after putting your firms on the strategic group space, look for clusters and spaces between clusters. Evaluate each cluster. Ask students which clusters would be more profitable and which less so. And most important, ask why. Students should be able to articulate the desirability of each cluster, and link their reasoning to the dimensions used for mapping the firms. For the spaces, ask students if any of the spaces would be desirable places. Often, the groupings do not make sense. If that were the case, then challenge students to come up with dimensions that do make sense. You should help students to understand that they have control over how the strategic space is defined.

Fifth, for the firm that has changed in the past year, chart that movement on the strategic group space. No matter what dimensions you use, this firm will be moving away from some competitors and toward others. Ask students how this movement affects the competition between this firm and others. The purpose of the discussion is to get students to appreciate that increasing distance associates with less competition and decreasing distance between firms represents a threat.

5. What are the major trends in the general environment that have impacted the U.S. pharmaceutical industry?

Response:

The U.S. pharmaceutical industry consists of firms that manufacture and market medicines for people. All segments impact this industry. The demographic segment affects demand, as the aging baby-boomers require age-specific medicines and marketing approaches. Also, older people tend to require more medicines than younger people, so market demand in the U.S. is growing. The sociocultural segment affects medicinal preferences. People value their health and trust their doctors rather than use traditional medicines.

The political/legal segment is extremely important due to the regulatory approval process for new medicines, intellectual property right protection, government insurance programs, and price controls. Regulatory approval of new medicines is extremely rigorous and costly. To recoup the costs of obtaining approval, pharmaceutical firms exploit their monopoly power that stems from the patents and trademarks on the medicines. And this monopoly power enables pharmaceutical companies to charge high prices. The recent trend in government support for prescription drugs through Medicare, and the recent and ongoing implementation of near-universal health care and prescription programs has two impacts: 1) more patients will be getting prescriptions, which increases revenues, and 2) more patients will be covered by insurance, which will increase buyer power and decrease revenue to pharmaceutical companies.

The technological segment affects the new product development process. Biotechnology involves the use of living organisms to develop new drugs and has created an explosion in potential new medicines. Other technologies developed by these companies are the ability to test thousands of substances at a time and to map the human genome, which helps us to understand the causes and potential cures of many ailments.

The economic segment affects the industry, as general economic growth affects market potential. The recent recession has therefore hurt the industry. In addition, expected interest rates affect the financial prospects of many biotech firms. These firms often take decades to develop new drugs and bring them to the market. Lower interest rates enable them to make their investors' capital last longer. The global segment affects the industry in a number of ways. Foreign markets offer sales opportunities. Foreign labs are effective partners for collaboration. However, foreign countries often put price controls on medicines, which limit profit potential from foreign sales. And foreign competitors often do not respect the intellectual property of U.S. firms, giving rise to loss through piracy.

6. Go to the Internet and look up www.kroger.com. What are some of the five forces driving industry competition that are affecting the profitability of this firm?

Response:

A couple of clicks first to the "about the Kroger company" at the bottom of the home page, then to the Kroger Fact Books on the right side of the page will get you to the fact books. These include information on the following topics.

The first step is to define Kroger's industry. While Kroger does have jewelry stores and houseware stores, its primary activity is in supermarkets. We will focus on supermarkets.

For the threat of new entrants, this force is weak. Kroger notes that the industry is consolidating. There are very large barriers to entry due to capital requirements and economies of scale. The bargaining power of buyers is weak. The buyers are the general public, which is an aggregation of very small customers. No customer is a very large part of the market, and customers will not have an information advantage over Kroger. The primary source of buyer power is the ability of customers to shop at the competition. The bargaining power of suppliers is moderate. Some of

Kroger's stated competitive advantages stem from the brand equity of suppliers' products, such as Kitchen Aid, Levis, Dockers, and Nikon. However, Kroger counters supplier power by developing a series of corporate brands, and by backwards integrating into the suppliers' industries. The threat of substitute products and services is limited, as customers have developed a habit of doing most of their food shopping at supermarkets as opposed to farmers' markets, convenience stores, or general stores (although students may note the growing food offerings at retailers such as Wal-Mart or Target). And note that Kroger includes a number of other types of store formats, like marketplace stores and convenience stores, to compete in substitute industries. Alternatives do not have a very high market share. The intensity of rivalry among competitors in the industry is very strong. Kroger competes with Wal-Mart, Meijer, and other chains of supermarkets in every part of the country. These competitors are large, successful, and aggressive. Kroger limits rivalry by acquiring smaller stores and chains where possible. One of Kroger's strategies for dealing with rivalry is to encourage customer loyalty through various programs such as shopper cards and a customer relations management system in conjunction with London-based dunnhumby.

Ethics Questions

1. What are some of the legal and ethical issues involved in collecting competitor intelligence in the following situations?

a. **Hotel A sends an employee posing as a potential client to Hotel B to find out who Hotel B's major corporate customers are.**

Response:

The scheme risks exposure. Hotel B might find out who the employee is and find out that he or she represents Hotel A. Hotel B's list of major corporate customers is likely to be a trade secret, and Hotel A's use of fraud to gain the trade secret is, depending on state law and the specific circumstances, likely to be a crime.

It is likely that Hotel B will share this information with the press, trade publications, or other media. It is also possible that Hotel B will use this information to tarnish Hotel A's reputation. Hotel A's business could be affected and shareholders embarrassed. The cost to Hotel A of overcoming these shortcomings is likely to exceed whatever gain was possible.

b. **A firm hires an MBA student to collect information directly from a competitor while claiming the information is for a course project.**

Response:

It is possible that this action would be a crime, although doubtful. The competitor is not likely to share trade secrets, because the course project is not likely to be kept confidential, but that depends on the circumstances.

However, the scheme is certainly fraudulent and therefore unethical. The firm is using the MBA student as a spy, which is abusive to the MBA student. The student's college or university, though perhaps not directly involved, will have its name associated with the scheme.

In addition, the competitor can use the scheme to discredit the firm and embarrass its shareholders.

c. A firm advertises a nonexistent position and interviews a rival's employees with the intention of obtaining competitor information.

Response:

The scheme is fraudulent. Advertising a position without an intention of hiring is unethical. If the scheme succeeds in obtaining trade secrets, then it is probably a violation of law. And the coercive treatment of the rival's employees is a problem.

The possibility of criminal violations occurs within the purview of many states' trade secret laws. If any individual suffers any harm, then civil damages are possible.

But the unethical nature of this scheme is likely to be the largest problem. The rival can use the firm's actions to discredit the firm and embarrass its shareholders.

2. What are some of the ethical implications that arise when a firm tries to exploit its power over a supplier?

Response:

A monopsonist, or a firm that is the only buyer in a market, has great power over suppliers. It might try to exploit this power by forcing the supplier to reduce prices or provide extra services. In the extreme, suppliers will be forced to cut costs, lay off employees, cut salaries, and forego investments in new technologies or capabilities. The downside of these actions is that the supplier is less capable of contributing to industry development by infusing it with innovations.

CONNECT RESOURCES

Comprehension Case

- Mayo Clinic's Transformation and Adaptation

Case Analysis

- Mayo Clinic's Pursuit of a Health Care-Centric Platform
- Gas versus Hybrids versus Electric: A Battle of Substitutes

Video Case

- Analyzing Industry Forces
- Analyzing the Macro-Environment
- SWOT Analysis

Teaching Note
Case 1 — Robin Hood

Case Objectives

1. To provide an introduction to the conceptual framework of strategic management using a non-business situation.
2. To introduce students to the process of problem identification and potential solution analysis that will be used in case discussions throughout the semester.

See the table below to determine where to use this case:

CASE OBJECTIVES TABLE

Chapter Use	Key Concepts
1: Strategy Concept	Leadership for strategic management; sustainable competitive advantage; vision, mission, strategic objectives; external environment; internal environment; efficiency vs. effectiveness; stakeholder management

Case Synopsis

Robin Hood and his Merry Men are now in trouble because wealthy travelers (their source of revenue) are avoiding the forest. As is often common in an entrepreneurial organization, the Merry Men were highly motivated by Robin Hood's leadership. Therefore, Robin had previously relied on informal communication to organize and implement operations. Robin is pleased with the growing size and influence of his organization. However, growth has meant that specialized duties have begun taking up most of the men's time, leaving a command vacuum between Robin and the first line recruits. In addition, they are now all located in a large encampment that can be seen for miles. This creates the probability of a surprise attack on their position. Growth has also put great pressures on resources, so now they must harvest the forest more thoroughly. Where will additional revenue come from? Rich travelers are avoiding the forest, so in desperation Robin is considering robbing the poorer travelers, which means his lieutenants must now tell their men to rob their brothers and fathers. What started as a rebellion is in danger of being routinized into banditry. Robin must therefore begin to evaluate the Merry Men's mission in view of the changing environment. Should it still be an extension of his private grudges and aspirations? Has the organization acquired a new mission, if so what is it? Who are the key stakeholders here? On whose behalf should the organization formulate its mission?!

Teaching Plan

Most students are familiar with the Robin Hood story, so it's possible to ask them to read this short case in class during the first or second class meeting. Either use the PowerPoint slides or ask the discussion questions directly. As students respond, either write answers on the board or refer to the PowerPoint slide answers.

It's up to the instructor whether or not to assign Chapter 1 prior to discussing the case. If the case is read before the chapter is read, then the instructor has the option to ask students, when they do read the chapter, to identify the concepts in the chapter that they recognize from the case discussion and come to the next class prepared to share what they recognized. If the case is discussed after students have read Chapter 1, the instructor can ask students to identify what concepts apply from the chapter.

Summary of Discussion Questions

Below is a list of the suggested discussion questions. You can decide which questions to assign and which additional readings or exercises to include to augment each discussion. Refer back to the Case Objectives Table at the beginning of this Teaching Note to identify any additional readings and/or exercises so they can be assigned in advance.

1. What is the purpose of strategy?

2. What strategic problems does Robin Hood have?

3. What is the role of the organizational leader as strategist and articulator of global goals?

4. What are some issues in this organization's external environment?

5. What is the relationship of the organization's internal structure to its environment?

6. How do stakeholder values or culture influence strategy making?

7. What strategy can Robin Hood implement?

Discussion Questions and Responses

Chapter 1: Introduction and Analyzing Goals and Objectives

1. ***What is the purpose of strategy?***

Strategy is all about the ideas, decisions, and actions that enable a firm to succeed. See Chapter 1, Exhibit 1.1: *Strategic management consists of the analyses, decisions, and actions an organization undertakes in order to create and sustain competitive advantages:*

- strategy directs the organization toward overall goals and objectives;
- includes multiple stakeholders in decision making;
- needs to incorporate both short-term and long-term perspectives;
- recognizes tradeoffs between efficiency and effectiveness.

Strategic management involves:

- *Analysis* of strategic goals (vision, mission, strategic objectives), and of the internal and external environment;
- *Decisions – Formulation* about what industries to compete in and how to compete in those industries; and
- *Actions – Implementation* to allocate necessary resources and design the organization to bring intended strategies to reality.

An interesting question that the instructor can ask at this point is: *What business is Robin Hood's organization in?* Some students might say philanthropy, some might say robbery. The answers to this question will help students understand the importance of vision and mission: the leader must have a clear idea of the purpose of the business, and with whom it competes, in order to craft strategy. If the business is robbery, there are different competitors, like highwaymen.

2. What strategic problems does Robin Hood have?

If strategy is all about the ideas, decisions, and actions that enable a firm to succeed, what might Robin Hood need to assess as he ponders his likelihood of future success? As Robin Hood's organization has grown, food resources are becoming scarce and it has encountered a profit squeeze: revenue is down, and costs are rising. In addition, there are cracks in the culture of the organization; as the organizational membership has increased, discipline problems have emerged. The original business model of "robbing the rich and giving to the poor" appears to be no longer viable, and the "competition" from the Sheriff is growing stronger as the Sheriff increasingly uses his "alliances" and connections with Prince John to get better organized. In addition, "new entrants" into the Sherwood Forest environment, the barons, are proposing that Robin join with them to restore King Richard. If this happens, Robin Hood's mission may no longer be relevant because the need to restore "justice" may no longer exist.

Issues that need to be addressed include:

- Has Sherwood Forest become too small to sustain operations?
- How to avoid detection of the now "major encampment"?
- What to do about the growing strength of the Sheriff's forces?
- How to address organizational communications and redefine the leadership focus?

Decisions that need to be made include:

- Should Robin Hood impose a fixed transit tax in order to increase revenue?
- Should Robin Hood kill the Sheriff?
- Should Robin Hood accept the barons' offer to join in freeing King Richard?

Consequences to be considered include:

- What might happen if Robin expanded operations beyond Sherwood Forest?
- Does the change in the external environment mean that the original mission is no longer valid?
- If Robin Hood decides to kill the Sheriff, accept the barons' offer or impose a tax on travelers, how do each of those actions link to the original mission?

- If the mission changes, to what degree does Robin Hood have to worry about the loyalty of stakeholders?

If Robin Hood expands operations beyond Sherwood Forest, that may solve his revenue and resource problems, but it will create issues with organizational communications – he can't keep track of his men now, so what will happen if the physical environment changes even further? Would his existing organizational structure still work with a larger group? It appears as if the changing conditions might also mean a shift in the original mission, especially if Robin decides to impose a fixed transit tax. Killing the Sheriff might satisfy Robin's "personal thirst for revenge," but it wouldn't improve the situation, especially because someone else might take up the Sheriff's role. Likewise, if Robin decided to align with the barons, his group would have to accept amnesty, and how many of his "men" would feel good about this? There was no assurance that the barons' plan would work, plus this would require a real shift in overall mission from banditry to court political intrigue, and multiple stakeholders might object (how would the poor people feel?).

The major issue concerns the rapid growth of the organization and the changing external environmental conditions. In the space of two years the organization grew from fragmentation and obscurity to a strong regional presence. Competitive strategy is about *sustaining* a position in the industry. Growth implies that strategy has to be flexible enough to adapt. Does Robin have a *sustainable* strategy?

3. ***What is the role of the organizational leader as strategist and articulator of global goals?***

Leaders face a large number of complex challenges. Leaders must be proactive, anticipate change and continually refine changes to their strategies. This requires a certain level of "ambidextrous behavior", where leaders are alert to opportunities beyond the confines of their own jobs and are also cooperative and seek out opportunities to combine their efforts with others. *Leaders must make strategic management both a process and a way of thinking throughout the organization.*

See Chapter 1, Exhibit 1.6. The primary role of the organizational leader is to articulate vision, mission, and strategic objectives. Robin Hood needs to evaluate his initial *vision* of the organization's purpose: what was the original goal that *evokes a powerful and compelling mental image of a shared future,* one that would be massively inspiring, overarching, and long-term, that represented a destination that is driven by and evokes passion? Is the original vision irreconcilable with the present circumstances?

Robin Hood's organizational mission may have to change: a *mission* encompasses both *the purpose of the company as well as the basis for competition and competitive advantages.* Organizations must respond to multiple constituencies—multiple stakeholders—if they are to survive and prosper, and the mission provides a means of communicating to these diverse organizational stakeholders.

If the vision and mission have to change, Robin Hood must establish *strategic objectives* to operationalize the mission statement. That is, objectives help *to operationalize the mission statement with specific yardsticks*, and they provide guidance on how the organization can fulfill or move toward the "higher goals" in the goal hierarchy—the mission and vision.

Therefore, Robin Hood needs to redefine the organizational vision and mission because it may have changed—rebellion may have become routinized into banditry. He must also identify the key stakeholders, broadening his focus beyond his own private grudge to include the needs of the district, the region, or the nation. And he must establish new goals and strategic objectives. Depending on the stakeholders, these new goals may include replacing the Sheriff or changing the political order. Robin should remember that short-term objectives can become essential components of a firm's "action plan" and therefore can be critical in implementing the firm's chosen strategy.

4. ***What are some issues in this organization's external environment?***

Strategy analysis is the first step in the strategic management process. It precedes effective formulation and implementation of strategies, involves careful analysis of the overarching goals of the organization, and requires a thorough analysis of the organization's external and internal environment. To begin with, Robin must take a look at the issues in the organization's external environment.

There are obvious resource constraints. Sherwood Forest has finite resources: the inputs into the organization (travelers to rob) have dwindled, especially because the rich travelers have started avoiding it. Robin Hood's band is spending past gains on present problems in the assumption that future revenues will continue to grow at the same pace as in the past. This assumption, one that is often pervasive in successful organizations, may be unwarranted. The Merry Men are reduced to robbing poorer travelers. The poor travelers are their mainstay of political support. Here is a common pitfall of success, the tendency of organizations to take their best and most important customers for granted, to extract from them the highest return for least effort in the belief that they have no practical alternative. In addition, trained manpower is scarce.

Regarding the physical environment, the current growth of the organization has created a large encampment that can be seen for miles and is therefore now a target for attack. The nature of the Merry Men's environment and operations requires stealth and flexibility. The current physical facility does not provide for this.

5. What is the relationship of the organization's internal structure to its environment?

See the Chapter discussion of the *tradeoffs between effectiveness and efficiency*. Given the growth of the operation and other changes in the external environment, Robin Hood's previous structure may no longer be effective. He may no longer be able to achieve the goals of the organization. He might need to make tradeoffs.

His current structure is functional, with each lieutenant a specialist. Communication has been informal, and Robin currently has no direct link to his first line recruits. This structure performed well in the early days of the band. However, with the growth of the organization, this has become problematic, resulting in lack of coordination.

Robin might want to consider a possible new structure: his lieutenants could do double time as staff and line personnel, fulfilling their staff duties in off-peak periods, but available for line duty during field operations. Robin might also want to consider creating a decentralized regional operation, with sub-bands who can operate out of smaller regional headquarters and better coordinate movements. This will increase flexibility of the total organization by moving the organizing of operations closer to those who undertake them. This will also reduce the chance of attack because then only part of the band might be detected and surprised. Decentralization also pushes food gathering down the line, thereby eliminating food distribution problems. Small-scale operations can be carried out with greater economy.

6. How do stakeholder values or culture influence strategy making?

During *strategic analysis*, the leader does "advance work" to anticipate unforeseen environmental developments, identify unanticipated resource constraints, assess changes in his or her preferences for how to manage. During *strategy formation*, depending on the type of organization structure, the leader might include key individuals in a discussion around selecting which strategies might be best to implement at which level within the organization. In *strategy implementation*, the leader must ensure proper strategic controls and organizational design and establish effective means to coordinate and integrate activities within the firm, as well as with suppliers, customers and alliance partners.

Therefore, leaders must pay attention to all stakeholder needs, including the group's values and the organizational culture. See Chapter 1, Exhibit 1.5 for *the diverse stakeholder groups and the claims they make on the organization.*

Regarding the organizational culture, it was based on founding values that embraced a missionary outreach to the community. The original purpose created unity and a spirit of daring among the Merry Men. Robin is considering abandoning the higher (more affluent) segment of his market for a deeper exploitation of a very large segment with limited resources. Here he runs up against organizational traditions and values. If Robin pursues profit maximization now (robbing all travelers, including the poor), the group will become thieves. Group members will resist stealing from their brothers and fathers. The larger community of poor people, who originally supported the Merry Men, will now feel abandoned. Loyalty will be eroded. Robin needs to restore the group members' and larger stakeholders' need for order and purpose. The Merry Men might need to feel that their participation is quasi-voluntary. They may need to feel more involved in strategic decision making so they can see shared value in the organizational efforts.

7. ***What strategy can Robin Hood implement?***

The basic question strategic management tries to answer is: *How can we create competitive advantages in the marketplace that are not only unique and valuable but also difficult for competitors to copy or substitute?* Robin Hood must assess how functional areas and activities "fit together" to achieve goals and objectives.

If the organization is still Robin's extension of a personal grudge, then displacing the Sheriff should be the primary mission of the Merry Men. If the organization is acting on behalf of the district then replacing the Sheriff with a more benign administration should be the priority. If, however, the Merry Men's existence is an expression of widespread dissatisfaction with the present political order, then Robin should consider his potential contributions on a national scale. An analysis of the options confronting Robin ought to lead the students to question the criteria by which strategy is judged. Who is the lead actor in strategy? The chief executive officer? Top management? A coalition of stakeholders? There is clearly no theoretical answer to these questions. A discussion ought to set the ground for an appreciation of the political and structural forces under which strategy emerges.

Robin should have a meeting with the Merry Men to explain the strategic dilemma and long-term issues. He needs to increase organizational discipline, which could be done by creating a clearer organizational structure with strategic controls that enforce the mission. To do this, he needs to recruit qualified leaders for the new decentralized structure and involve lieutenants in the solution. It is always an issue—which functions should be decentralized and which retained at the corporate level. In this case intelligence gathering and finance should probably be kept centralized.

It is crucial for students to appreciate the contradictory pressures that implementation generates. The new decentralized structure will call for more intricate communication and command systems. It increases flexibility but also increases the probability of breakdown and mismanagement. Currently, individual runners must keep the various sub-bands in communication. This is a primitive technology that may be insufficient to ensure coordination. An opportunity exists here for the students to appreciate to what extent sophisticated *organizational forms* are made possible by modern technologies, such as instant messaging systems, which are ordinarily taken for granted.

While restructuring is going on, Robin must begin to consider other aspects of his strategy. He should examine the possibility of diversifying beyond the confines of his traditional forest territory. This is viable if he is decentralized. Operations can be carried on in the countryside by the autonomous sub-bands. He must also resolve the issue of the proposed transit tax. What should be his relationship to the local population? Should he increase their burden of taxation, or not?

Robin must also prepare for the possibility of ceasing operations by providing outplacement training. He should pursue alliances beyond the current band of Merry Men, negotiating a possible change in the political order, negotiating amnesty, returning the band to legality. He should probably avoid contact with the Sheriff!

Finally, Robin should recognize that mistakes will occur. Therefore he should anticipate the costs of implementation, especially the problems of extended communication. Robin must familiarize his lieutenants with his intentions and the projected problems. They must actively become involved in the evolving implementation.

Ultimately, however, Robin Hood must consider the long-term course of action. If the Merry Men were a profit-maximizing organization in the classic sense they would be satisfied with keeping the Sheriff off balance, or perhaps work toward his replacement with a more inexperienced man. They are, however, a missionary organization. To pursue profit maximizing would eventually lead them to thievery. It would also undermine their unity and spirit of daring and affect their relationship with their key community stakeholders. Robin Hood has little choice but to increase his involvement in issues that lie beyond his immediate task environment.

One final question Robin Hood must be prepared to answer: has this organization accomplished its mission so the need for the organization no longer exists? Is it time to disband and reallocate the assets in pursuit of a completely new venture?

Teaching Note
Case 2 — The Global Casino Industry in 2019

Case Objectives

1. To examine industry dynamics and how the structure of an industry has implications for competition.

See the table below to determine where to use this case:

CASE OBJECTIVES TABLE

Chapter Use	Key Concepts	Additional Readings or Exercises
2: External Environment	Porter's five forces model; strategic groups	**NOTE** additional Web-linked reading, view embedded **videos** about the current state of the industry.

Case Synopsis

For well over fifty years the casino business has been on a roll, on its way to becoming a $150 billion–a-year global industry. For much of that period, the United States has been leading the charge, accounting for nearly half the global gambling revenues as recently as 2010. Most of these revenues have come from Las Vegas and Atlantic City, magnets for gamblers from around the world. However, Las Vegas and Atlantic City have had to deal with increased competition from other locales. Revenues in other parts of the United States, from waterfront casinos in over a dozen states and Native American gambling locations, have exceeded those generated in Las Vegas and Atlantic City. More recently, the dominance of Las Vegas and Atlantic City in the global market had been challenged by overseas casino development in places like Macau, Singapore, Australia, South Korea, Malaysia, and Philippines. Other sites in Asia, such as Japan, Vietnam, Taiwan, and Sri Lanka, were in development as well.

In the United States there was a growing tendency to regard casino gambling as an acceptable form of entertainment for a night out. A large part of the growth in casino revenues came from the growing popularity of slot machines, yet facilities in Las Vegas, especially, had spent billions on extravagant and luxurious properties meant to attract the "high rollers" who came often and spent large amounts of money. Las Vegas casinos had tried to move beyond gambling and offer visitors many choices for fine dining, great shopping, and top-notch entertainment. This allowed higher-end casinos to generate revenues from activities other than gambling. Las Vegas, the city, was trying to brand itself as a tourist destination, but would that be enough to stem the flow of Chinese high rollers to Asian destinations? U.S. casino operators were expanding to open facilities in Asia or engage in mergers and acquisitions in an attempt to cash in on this local business, but would it be enough to return significant revenue to U.S. firms? Casinos were also eager to embrace new types of gaming experiences that would attract Millennials who grew up playing video and mobile phone games. Was there enough demand to go around?

Teaching Plan

Most students know what a casino is, and they probably haven't thought much about the industry beyond the glitz and the gambling. Therefore, this case becomes a good way to introduce the importance of defining the industry and examining the dynamics of competition in the industry from the point of view of certain clusters of companies—companies that are part of "strategic groups" who compete in the same way for the same customers. The structure of the casino industry has changed in recent years due to new forms of competition and the presence of substitutes. Students may have not considered this. Therefore, this case can be positioned early in the course, right after discussion of the strategic concept, to alert students to these issues. Because companies are not passive as far as industry structure goes but can take steps to influence the structure to their advantage, this case can be reintroduced during the discussion of competitive strategy, later in the course, to remind students how external environmental analysis is very relevant to strategic formulation.

ICEBREAKER

This case can start with an ***icebreaker***. Starting from the perspective of a customer may make it easier for students to transition to a strategic analysis.

Have you ever visited a casino? If so, where was it located, and what type of casino was it? Why were you there? What did you think of the casino experience?

It is possible that some students may have visited a Las Vegas or an Atlantic City casino, perhaps on a family vacation. Others may have been to a riverboat or Native American casino venue. It might be interesting to see students' responses regarding the purpose of their visit to a casino location—it might not have been for gambling purposes. Reasons for the visit might include the following: because it was part of my vacation trip; because a convention was held there; to see a sports event; to eat out; to see a show; just to see it, period! The casino industry competes for the family entertainment dollar. If so, it competes with a family trip to, say, Disneyworld. Are the two experiences the same? Might some conservative families not even consider Las Vegas or Atlantic City as a vacation place for their family, because of the gaming or risqué entertainment elements?

The instructor may want to put a chart on the board: *Where* the casino was, and *Why* the visit was made. If there is diversity among responses, it may make it easier for the instructor to then ask: so if you were the owner of a casino, how would you respond to these diverse reasons for visiting? What strategic issues do you need to consider? Who is competing against whom? This flows straight into a discussion of the external environment.

Before engaging in discussion, you might want to ***test students' basic knowledge*** regarding the case and the major concepts. Here are some multiple-choice questions to use. (This will get the student's attention—they can't answer these if they haven't read the case!)

Which statement is most true?

a. A large part of growth in casino revenues comes from slot machines.
b. In the United States, Las Vegas and Atlantic City casinos generate more revenue than all other gambling locations combined.
c. Macau, the gambling "capital" of Asia, is located in Malaysia.
d. At some Las Vegas casinos, revenue from non-gaming activities could account for over 70 percent of net revenues.

ANSWER: See Case Exhibits. a. TRUE. A large part of the growth in casino revenues came from the growing popularity of slot machines. Coin-operated slot machines typically accounted for almost two-thirds of all casino gaming revenues. b. FALSE. When combined with Native American casinos, gambling revenues in other parts of the United States now exceed the amount that is generated by casinos in Las Vegas and Atlantic City. c. FALSE. Macau is a former Portuguese colony, a special administrative region of China, currently under autonomous rule, similar to Hong Kong prior to 1997. d. FALSE. Non-gaming activity at MGM Mirage in recent years accounted for almost 60 percent of net revenue.

Worldwide, the Las Vegas strip generates more casino revenue than anywhere else.

a. Yes
b. No

ANSWER: b. At over $40 billion, Macau generates six times more casino revenue than the U.S. Las Vegas strip. Also see Case Exhibit 2.

Summary of Discussion Questions

Here is a list of the suggested discussion questions. You can decide which questions to assign, and which additional readings or exercises to include to augment each discussion. Refer back to the Case Objectives Table to identify any additional readings and/or exercises so they can be assigned in advance.

Discussion Questions:

1. Examine the structure of the casino industry. What has been the effect of the changing industry structure on U.S. casinos?

Discussion Questions and Responses

1. ***Examine the structure of the casino industry.***

Referencing Chapter 2: Analyzing the External Environment of the Firm

If you recall, strategy is all about the ideas, decisions, and actions that enable a firm to succeed. See Chapter 1, Exhibit 1.1: *Strategic management consists of the analyses, decisions, and actions an organization undertakes in order to create and sustain competitive advantages:*

- strategy directs the organization toward overall goals and objectives
- includes multiple stakeholders in decision making
- needs to incorporate both short-term and long-term perspectives;
- recognizes tradeoffs between efficiency and effectiveness

The basic question strategic management tries to answer is: *How can we create a sustainable competitive advantage in the marketplace that is not only unique and valuable but also difficult for competitors to copy or substitute?*

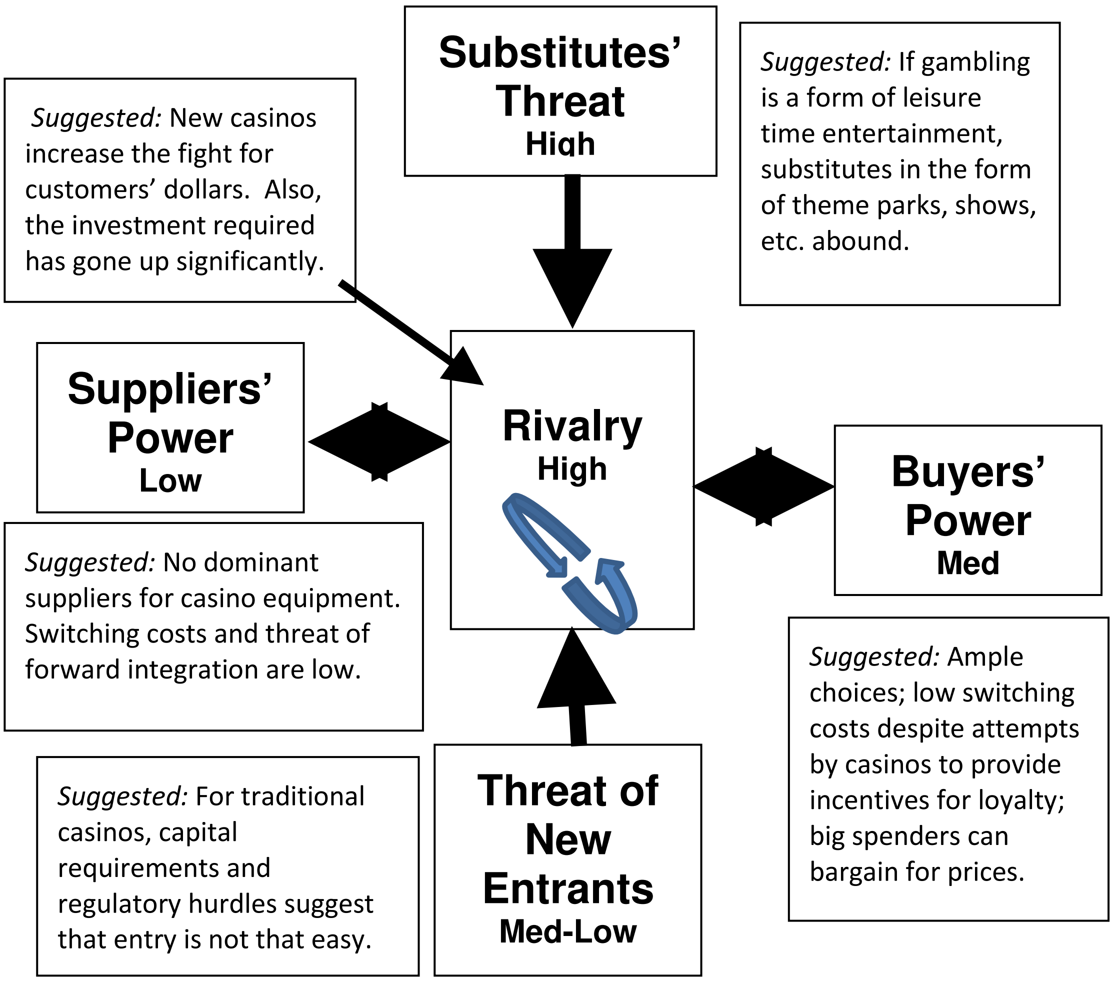
However, an interesting and fundamental question is *How do we define the "marketplace"? Just what business are we in?* Ask students to fill in the blank: *Casinos are in the ________________ industry.* Some students may say "gambling," but some may also say "entertainment." The various answers to this question will help students understand that a firm must have a clear idea of the purpose of its business, and who it competes with, in order to craft strategy.

During *strategic analysis*, the firm does "advance work" through *external scanning* and *monitoring* of the external environment to anticipate unforeseen environmental developments, identify unanticipated resource constraints, assess changes in his or her preferences for how to manage. Evaluating the evolution of environmental trends may be critical to crafting a strategic response. In addition, firms must gather *competitive intelligence* on their rivals in order to anticipate competitor's moves and avoid surprises.

In order to formulate a competitive strategy, it's necessary to assess the segments of the external competitive environment that include competitors, customers or buyers, and suppliers, substitutes and new entrants. Porter's *five forces model* allows strategists to anticipate where the industry might be most vulnerable to competition. The model also helps decide where profits might be best made, or whether there is any chance of further dividing up the profit pie: how attractive *is* this industry?

To answer this question, it is very important to correctly define the industry even further. If we define the casino industry broadly to include any organization that allows people to wager money on events of chance, then we must include Native American casinos, waterborne casinos, and Internet gambling places as incumbents in the industry, along with casinos in Las Vegas and Atlantic City. However, if we define it narrowly to include traditional casinos in Las Vegas and Atlantic City, those that also provide enhanced entertainment, then most Native American casinos, etc. would be substitutes. Either way, the five forces model will capture the impact of all these gambling establishments.

Help students apply Porter's ***five forces of competition*** by drawing a diagram on the board similar to the following, and having students fill in the details:



The following key points emerge from a structural analysis of the casino industry:

- There was industry growth in the United States up until 2010. This should typically ***decrease*** the intensity of rivalry as the potential profit pie grows larger. However, intensity of rivalry had increased due to new investment by industry players—the entrance of Native American gambling resorts and waterborne casinos—as well as the overseas development of casinos in places such as Macau. There were more players to compete for the bigger pie.
- Industry players realized that, typically, customer switching cost was low, in that a gambler could switch from one casino to another and shop for the "best" deal. This would typically ***increase*** the intensity of rivalry. However, casinos tried to maintain the business of customers by providing complimentary rooms, food, beverage, shows, and other perks. Loyalty programs also provided a means to hold on to gamblers.

- The international rivalry from places such as Macau may have been muted among the big players such as Sands and Wynn, as they used this as an opportunity for international expansion. A good deal of consolidation was also occurring in the industry among these big players as they pursued acquisition targets.
- All of Asia-Pacific was under development, with multiple firms hoping to grab a share of the gambling revenues worldwide.

Based on the external environmental factor analysis, the casino business is not that attractive an industry, although opportunities for diversification into other forms of entertainment and tourism may be a way to increase profits among the larger players.

NOTE — ADDITIONAL READING, VIDEO VIEWING:

Regarding sociocultural and demographic trends affecting the industry, read this article about the "what happens here" advertising campaign for Las Vegas, first launched in 2003: http://www.usatoday.com/money/advertising/adtrack/2005-04-11-track-vegas_x.htm. What are the positives and negatives of the campaign for Las Vegas casinos? If you were the manager of a Las Vegas casino, would you be in favor of the campaign? Why or why not?

Gaming continues to be big business, as explained in a report from the American Gaming Association: a 2018 study measures the economic impact of every facet of the casino gaming industry—commercial casinos and manufacturers and Native American casinos—as well as the industry's significant ripple effect on the supply chain, including local businesses. The American Gaming Association "State of Play" study found that the U.S. gaming industry:

- Contributes **$260 billion**—nearly a quarter-trillion—to the U.S. economy
- Supports more than **1.8 million jobs** and generates over **$73 billion in gross revenue**
- Generates over **$40 billion in tax revenues** to local, state and federal governments

In addition, a 2019 national survey found that 67% of American adults think the gaming industry provides high-quality entertainment, and 63 percent say casino entertainment options are innovative. The share of American adults that visited a casino jumped to 44 percent in 2019, up nine percentage points from 2018. This trend will likely continue, as almost 124 million American adults—49 percent of the U.S. adult population—say they will visit a casino to gamble over the next 12 months, up 20 million from 2018.
This research is being used to encourage policymakers to partner with the industry to create more economic growth for all.
See https://www.americangaming.org/state-of-play/.

Consultants have suggestions for firms, reporting trends from 2019:
Cryptocurrency plays an increasing role, reflecting the opinion people have about its security and anonymity. Online gaming is being done on phones, with the free-to-play feature becoming an entry point for many players. Growing popularity of other online options, including virtual reality experiences, means people don't have to leave their homes. This, coupled with the travel time and expense, means land-based casinos may face ongoing decline unless they can innovate. Such innovations include slot machines with a skill component, interactive gaming systems, and new table games. See https://linchpinseo.com/trends-in-the-gambling-casino-industry/.

Increasingly, it appears that the industry doesn't get its revenue from gaming—much of industry revenue comes from non-gaming activity such as lodging, food, retail shopping, shows, and spas. See a two-minute **video** snapshot of the industry in 2010 at https://www.youtube.com/watch?v=71oEugGTfVo. Things haven't changed much since then. What implications might that have for the "players" in this industry? Where should they expect real profits to come from?

And in 2014 a **video** report explains the macroeconomic environment of the Asia-Pacific gaming industry, and that although activity from China regarding anti-corruption efforts is reducing VIP traffic in Macau, the environment remains supportive of the sector's growth and credit quality, underpinning a stable outlook on the sector:
https://www.youtube.com/watch?v=ZpeKMZLnoPk.

Here's one report of the differences between Las Vegas and Macau: Macau has half the casinos of Las Vegas but more than twice the gambling revenue. When you get to Las Vegas or Macau, you'll probably want to enjoy some time gambling. In Las Vegas, of the 42.9 million people who visit each year, 69% of them ended up gambling, even if that wasn't the primary reason for the trip. In comparison, Macau attracts over 30 million visitors, of which 74% gamble. Strangely, the average gambling budget in Las Vegas is $619 compared to Macau's $250, yet the gaming revenue in Las Vegas per year is $11.1 billion, which is easily dwarfed by Macau's $28 billion. Yet in Las Vegas you can drink and see lots of other entertainment not always available in Macau casinos. See https://www.casino.org/blog/las-vegas-vs-macau-comparing-the-worlds-playgrounds/

Since 2013 the biggest competitors, MGM, Wynn Resorts, and Sands, have all created very successful operations in Macau (Caesars did not enter the market initially, and has now been frozen out due to the lack of available gaming licenses). Although there are widespread allegations of fraud and connections to Chinese organized crime, the financial benefits from this global expansion means these major competitors won't back off. According to I. Nelson Rose, a professor at Whittier Law School in California who writes a blog called Gambling and the Law, "Macau forced the casinos to see that they could become like other large U.S. corporations: set up their plants and operations in other nations and make far more than they can being stuck just in Las Vegas." Sheldon Adelson, CEO of Las Vegas Sands, has described Sands as "an Asian company" with a presence in America. He makes far more in China, where a culture in which notions of luck and fate play integral roles, than in Las Vegas. As MGM CEO Jim Murren points out, "The Macau market is now larger than the entire U.S. gaming market. Unfortunately for Atlantic City, it's gone the other way. It's smaller now than when we entered it. The fortunes of the two couldn't be more different." Las Vegas would have to attract six times more gamblers each year than it does now—essentially every adult in America—in order to match the amount of money being taken in via casinos in Macau. Based on estimated numbers from 2012, Wynn Resorts now makes nearly three-quarters of its revenue in Macau. Sands, which owns the Venetian and Palazzo, earns two-thirds of its revenue there. In the United States, companies are tweaking their flagship Las Vegas casinos to look and operate more like Macau-style properties. This is because an increasing number of Asians come to Las Vegas, especially, because of the reduced tax on earnings compared to China. Asian visitors now account for 9 percent of tourists to Las Vegas, up from 2 percent in 2008. See the AP report, "Tiny Chinese enclave remakes gambling world, Vegas" by Hannah Dreier, July 8, 2013. http://lasvegassun.com/news/2013/jul/06/us-casinos-macau-headache-abridged/.

How can you use the above information to do an analysis of the industry? If you were in the casino business, wouldn't you want to keep abreast of this kind of information?

1. ***Continued: What has been the effect of the changing industry structure on U.S. casinos?***

The concept of *Strategic Groups* involves two unassailable assumptions in industry analysis, based on the belief that no two firms are totally different, and no two firms are exactly the same. Strategic groups are clusters of firms that share similar strategies in their:

- Breadth of product and geographic scope
- Price/quality
- Degree of vertical integration
- Type of distribution system

The value of strategic groups as an analytical tool is that they identify barriers to mobility that protect a group from attacks by other groups; identify groups whose competitive position may be marginal or tenuous; chart the future direction of firms' strategies; and allow strategists to think through the implications of each industry trend for the strategic group as a whole.

The casino industry can be used to illustrate the existence of strategic groups. To begin with, casino firms that had a large presence in Las Vegas or Atlantic City were more likely to compete with each other. These firms operated larger resorts, which offered a broad range of entertainment that catered to customers from around the country and even other parts of the world. By contrast, the smaller casinos, such as those on the water and on Native American lands, were more focused on gambling and catered more to local and regional customers. As such, these were less likely to compete with the larger casinos that were based in Las Vegas and Atlantic City. Each of these—the LV and AC large resorts vs. the local waterborne and Native American casinos—could therefore be considered to fall into different strategic groups.

What might Las Vegas casinos do to craft a *sustainable competitive advantage*, given the industry they're in?

In general, the gambling companies in Las Vegas embarked on an aggressive strategy in light of the competition from various sources. They did a number of things:

- Promoted Las Vegas as the *destination* gambling city—in contrast to Atlantic City where gamblers made day trips from cities in the northeast. Las Vegas positioned itself as a magnet for both the overnight casino gambler, and weeklong vacationer, offering more hotel rooms, myriad dining choices, shopping, and top-notch entertainment. The infrastructure also helped in that Las Vegas was linked by air to major U.S. cities and also to countries outside the United States.
- Casinos in Las Vegas positioned themselves as resorts for families by offering circus

performances, etc. However, casinos in Las Vegas did continue to conform to their original "sinful" roots by offering adult-oriented entertainment, further differentiating Las Vegas casinos from casinos in other competing areas. This differentiation strategy was helped by the promotion slogan, "What happens in Vegas, stays in Vegas!"

- Las Vegas casinos constantly invested in refitting and renewal to continue to offer new attractions to customers. This meant that Las Vegas convention facilities competed successfully with Orlando and New York for the corporate meeting business. Las Vegas remained the top destination for overnight visitors looking for a casino experience.

By differentiating its properties, the Las Vegas casinos attracted visitors and retained their business.

Not in the case: On the other hand, casinos in Atlantic City played catch-up with Las Vegas casinos partly because LV had a head start—gambling was legalized in New Jersey a full 45 years *after* Nevada. From the start, Atlantic City casinos realized that they could not compete with Las Vegas's broad range of dining, shopping, and entertainment choices. In addition, AC's location in the Northeast highway corridor meant that the majority of customers could easily come as "day trippers." By promoting its proximity to the beach and the fact that most casinos were located on a boardwalk, AC was originally able to carve out a competitive position in the industry. However, that competitive position eroded. Atlantic City casinos tried to mimic their Las Vegas competitors by sprucing up their establishments. The city attempted a makeover, with the *Borgata* leading the charge. Casinos added wings to attract overnight customers, and some added outdoor bars to take advantage of the beachfront, but additional expansion was on hold during 2009 and most of 2010, waiting for a change in economic conditions. Then, reports of hurricane damage in 2012 kept visitors away. In short, Atlantic City casinos had been trying to move toward a strategy of differentiation by providing a more attractive ambience, but overall environmental conditions were making this difficult to achieve.

The main threats Atlantic City casinos faced (as did Las Vegas casinos) were Native American casinos, slot machines at local racetracks, and Internet gambling. Two of the biggest Native American casinos were in Connecticut, within driving distance of Atlantic City. In addition, several states passed legislation allowing racetracks to provide slot machines for their visitors. Internet gambling had a cost advantage—operators did not have high infrastructure costs, and offshore Web sites were immune to legislation regulating their operation. In addition, competition had grown internationally, especially in the South China Sea city of Macau where casino developers had begun to grow their portfolios. To combat these threats, both Las Vegas and Atlantic City casinos had to continue to try to differentiate themselves. Many industry observers believed that the proliferation of local casinos and the availability of Internet gambling might even be an opportunity for LV and AC, because people who developed a taste for gambling at the local and home venue would probably want to visit LV or AC eventually, to experience the real thing.

Challenges AND opportunities for all major competitors remain. See the additional reading and updates below. The major question is which of these firms, and which of these locations or *strategic groups* do you believe is better positioned for the future?

Wynn Resorts, Las Vegas Sands, and MGM are some of the major players mentioned. Does their diversification into Macao and other world markets give them an edge?

NOTE – ADDITIONAL READING AND VIDEO VIEWING:

In addition to Asia-Pacific, the move to legalize online gaming offers another challenge AND opportunity to the big U.S. casino competitors. Online gambling will be licensed state by state, with New Jersey one of the first to allow this in 2013. As one analyst reported, "Casinos are already positioned to capitalize on the industry's paradigm shift and face the least amount of red tape in doing so. It's not often that you hear the United States associated with any "emerging" opportunity, but in fact this is how online gambling can be characterized. In Boyd Gaming's 2012 annual report, the company (which trades as BYD, and is part owner of Atlantic City's Borgata Hotel Casino) boasts of how it's well positioned to capitalize on the "emerging domestic online gaming industry." http://www.newstimes.com/business/fool/article/Why-Online-Gambling-Will-Crush-the-Candy-4480839.php.
From 2015 here's a report and **video** about mobile gaming. Although not truly gambling, in-app purchases have become a big business, with the heaviest users spending up to $400 per person per transaction on these online games: http://www.cnbc.com/2015/08/03/the-shocking-truth-about-mobile-gaming.html

Regarding the major competitors, on January 28, 2008, Harrah's Entertainment was acquired by affiliates of private-equity firms TPG Capital and Apollo Global Management. As the article below points out, this was a bad time to go private. Harrah's was "drowning in debt": http://www.fool.com/investing/general/2009/06/24/for-casino-companies-this-is-no-panacea.aspx. So to what degree might mergers and acquisitions really help?
Harrah's resurfaced as the public company Caesars Entertainment Group (CZR) in 2010. It operated over 47 casinos, hotels and 4 golf courses under several brands, and held rights to the World Series of Poker tournament. See more at http://caesarscorporate.com/about-caesars/.

Compare the financial status of competitors MGM (MGM), Las Vegas Sands (LVS), Penn National Gaming (PENN), Wynn Resorts (WYNN), Boyd Gaming (BYD), and Caesar's Entertainment (CZR) using these links:
http://finance.yahoo.com/q?s=mgm
http://finance.yahoo.com/q?s=lvs
http://finance.yahoo.com/q?s=PENN
http://finance.yahoo.com/q?s=wynn
http://finance.yahoo.com/q?s=BYD
http://finance.yahoo.com/q?s=CZR&ql=0

During FY 2019, there were 290 casinos in Nevada that grossed $1 million or more in gaming revenue. Together, these casinos generated net income of $2,055,525,922 from total revenues of $24,546,009,009. These results are improved compared to FY18 when a net loss of $1,168,224,369 was recorded on total revenues of $27,107,879,852. "Total revenue" is the money spent by patrons on gaming, rooms, food, beverages, and other attractions. "Net income/loss" is the money retained by casinos after expenses have been paid but prior to deducting federal income taxes and prior to accounting for extraordinary expenses. Gaming revenue accounted for $8,757,658,013 or 35.7% of total revenue. These 290 casinos paid $892,294,136 in gaming taxes and fees, equating to 10.2% of their gaming revenue. Data from the Nevada State Gaming Control Board at https://gaming.nv.gov/Modules/ShowDocument.aspx?documentid=16547.