

Essentials of  
**STRATEGIC MANAGEMENT**

THE QUEST FOR COMPETITIVE ADVANTAGE **Fifth Edition**

GAMBLE | PETERAF | THOMPSON



**Mc  
Graw  
Hill**  
Education



Essentials of  
**Strategic Management**  
The Quest for Competitive Advantage

**John E. Gamble**

*Texas A&M University–Corpus Christi*

**Margaret A. Peteraf**

*Dartmouth College*

**Arthur A. Thompson, Jr.**

*The University of Alabama*





ESSENTIALS OF STRATEGIC MANAGEMENT: THE QUEST FOR COMPETITIVE ADVANTAGE,  
FIFTH EDITION

Published by McGraw-Hill Education, 2 Penn Plaza, New York, NY 10121. Copyright © 2017 by McGraw-Hill Education. All rights reserved. Printed in the United States of America.

Previous editions © 2015, 2013, and 2011. No part of this publication may be reproduced or distributed in any form or by any means, or stored in a database or retrieval system, without the prior written consent of McGraw-Hill Education, including, but not limited to, in any network or other electronic storage or transmission, or broadcast for distance learning.

Some ancillaries, including electronic and print components, may not be available to customers outside the United States.

This book is printed on acid-free paper.

1 2 3 4 5 6 7 8 9 0 DOW/DOW 1 0 9 8 7 6

ISBN 978-1-259-54698-3

MHID 1-259-54698-5

Senior Vice President, Products & Markets: *Kurt L. Strand*

Vice President, Content Design & Delivery: *Kimberly Meriwether David*

Director: *Michael Ablassmeir*

Lead, Product Development: *Kelly Delso*

Freelance Product Developer: *Michelle Houston*

Marketing Manager: *Casey Keske*

Digital Product Analyst: *Sankha Basu*

Director, Content Production: *Terri Schiesl*

Program Manager: *Mary Conzachi*

Content Project Manager: *Mary Powers (Core), Keri Johnson (Assessment)*

Buyer: *Laura Fuller*

Design: *Matt Diamond*

Cover Image: *John Lund/Getty Images*

Content Licensing Specialists: *Michelle Whitaker (Image), DeAnna Dausener (Text)*

Compositor: *SPi Global*

Printer: *R. R. Donnelley*

All credits appearing on page or at the end of the book are considered to be an extension of the copyright page.

**Library of Congress Cataloging-in-Publication Data**

Names: Gamble, John (John E.) author. | Thompson, Arthur A., 1940- author. | Peteraf, Margaret Ann, author.

Title: Essentials of strategic management : the quest for competitive advantage / John Gamble, Texas A&M University Corpus Christi, Arthur Thompson, Jr., The University of Alabama TUSCALOOSA, Margaret Peteraf, DARTMOUTH COLLEGE.

Description: Fifth Edition. | Dubuque : McGraw-Hill Education, 2016. | Revised edition of the authors' Essentials of strategic management, 2015.

Identifiers: LCCN 2015045630 | ISBN 9781259546983 (alk. paper)

Subjects: LCSH: Strategic planning. | Business planning. | Competition. | Strategic planning—Case studies.

Classification: LCC HD30.28 .G353 2016 | DDC 658.4/012—dc23 LC record available at <http://lccn.loc.gov/2015045630>

The Internet addresses listed in the text were accurate at the time of publication. The inclusion of a website does not indicate an endorsement by the authors or McGraw-Hill Education, and McGraw-Hill Education does not guarantee the accuracy of the information presented at these sites.

## About the Author

**John E. Gamble** is a Professor of Management and Dean of the College of Business at Texas A&M University–Corpus Christi. His teaching and research for nearly 20 years has focused on strategic management at the undergraduate and graduate levels. He has conducted courses in strategic management in Germany since 2001, which have been sponsored by the University of Applied Sciences in Worms.

Dr. Gamble’s research has been published in various scholarly journals and he is the author or co-author of more than 75 case studies published in an assortment of strategic management and strategic marketing texts. He has done consulting on industry and market analysis for clients in a diverse mix of industries.

Professor Gamble received his Ph.D., Master of Arts, and Bachelor of Science degrees from The University of Alabama and was a faculty member in the Mitchell College of Business at the University of South Alabama before his appointment to the faculty at Texas A&M University–Corpus Christi.



**Margaret A. Peteraf** is the Leon E. Williams Professor of Management at the Tuck School of Business at Dartmouth College. She is an internationally recognized scholar of strategic management, with a long list of publications in top management journals. She has earned myriad honors and prizes for her contributions, including the 1999 Strategic Management Society Best Paper Award recognizing the deep influence of her work on the field of strategic management. Professor Peteraf is on the Board of Directors of the Strategic Management Society and has been elected as a Fellow of the Society. She served previously as a member of the Academy of Management’s Board of Governors and as Chair of the Business Policy and Strategy Division of the Academy. She has also served in various editorial roles and is presently on nine editorial boards, including the *Strategic Management Journal*, the *Academy of Management Review*, and *Organization Science*. She has taught in Executive Education programs around the world and has won teaching awards at the MBA and Executive level.

Professor Peteraf earned her Ph.D., M.A., and M.Phil. at Yale University and held previous faculty appointments at Northwestern University’s Kellogg Graduate School of Management and at the University of Minnesota’s Carlson School of Management.





**Arthur A. Thompson, Jr.**, earned his B.S. and Ph.D. degrees in economics from The University of Tennessee, spent three years on the economics faculty at Virginia Tech, and served on the faculty of The University of Alabama's College of Commerce and Business Administration for 25 years. In 1974 and again in 1982, Dr. Thompson spent semester-long sabbaticals as a visiting scholar at the Harvard Business School.

His areas of specialization are business strategy, competition and market analysis, and the economics of business enterprises. In addition to publishing over 30 articles in some 25 different professional and trade publications, he has authored or co-authored five textbooks and six computer-based simulation exercises that are used in colleges and universities worldwide.

Dr. Thompson spends much of his off-campus time giving presentations, putting on management development programs, working with companies, and helping operate a business simulation enterprise in which he is a major partner.

Dr. Thompson and his wife of 54 years have two daughters, two grandchildren, and a Yorkshire terrier.

# Brief Contents

## **PART ONE CONCEPTS AND TECHNIQUES FOR CRAFTING AND EXECUTING STRATEGY**

---

### **Section A: Introduction and Overview**

- 1.** Strategy, Business Models, and Competitive Advantage **1**
- 2.** Strategy Formulation, Execution, and Governance **13**

---

### **Section B: Core Concepts and Analytical Tools**

- 3.** Evaluating a Company's External Environment **36**
- 4.** Evaluating a Company's Resources, Capabilities, and Competitiveness **65**

---

### **Section C: Crafting a Strategy**

- 5.** The Five Generic Competitive Strategies **89**
- 6.** Strengthening a Company's Competitive Position: Strategic Moves, Timing, and Scope of Operations **111**
- 7.** Strategies for Competing in International Markets **132**
- 8.** Corporate Strategy: Diversification and the Multibusiness Company **153**
- 9.** Ethics, Corporate Social Responsibility, Environmental Sustainability, and Strategy **181**

---

### **Section D: Executing the Strategy**

- 10.** Superior Strategy Execution—Another Path to Competitive Advantage **198**
- Appendix** Key Financial Ratios: How to Calculate Them and What They Mean **228**

## **PART TWO CASES IN CRAFTING AND EXECUTING STRATEGY**

- Case 1** BillCutterz.com: Business Model, Strategy, and the Challenges of Exponential Growth **231**
- Case 2** Whole Foods Market in 2014: Vision, Core Values, and Strategy **237**
- Case 3** Apple Inc. in 2015 **268**
- Case 4** Sirius XM Satellite Radio, Inc. in 2014: On Track to Succeed After a Near-Death Experience? **279**
- Case 5** Panera Bread Company in 2015—What to Do to Rejuvenate the Company's Growth? **300**
- Case 6** Vera Bradley in 2015: Can Its Turnaround Strategy Reverse Its Continuing Decline? **320**
- Case 7** Tesla Motors' Strategy to Revolutionize the Global Automotive Industry **333**
- Case 8** Deere & Company in 2015: Striving for Growth in a Weakening Global Agricultural Sector **366**
- Case 9** PepsiCo's Diversification Strategy in 2015 **377**
- Case 10** Robin Hood **390**
- Case 11** Southwest Airlines in 2014: Culture, Values, and Operating Practices **392**
- Case 12** TOMS Shoes: A Dedication to Social Responsibility **430**

Glossary **439**

Indexes **443**

# Preface

**T**he standout features of this fifth edition of *Essentials of Strategic Management* are its concisely written and robust coverage of strategic management concepts and its compelling collection of cases. The text presents a conceptually strong treatment of strategic management principles and analytic approaches that features straight-to-the-point discussions, timely examples, and a writing style that captures the interest of students. While this edition retains the 10-chapter structure of the prior edition, every chapter has been reexamined, refined, and refreshed. New content has been added to keep the material in line with the latest developments in the theory and practice of strategic management. Also, scores of new examples have been added, along with fresh Concepts & Connections illustrations, to make the content come alive and to provide students with a ringside view of strategy in action. The fundamental character of the fifth edition of *Essentials of Strategic Management* is very much in step with the best academic thinking and contemporary management practice. The chapter content continues to be solidly mainstream and balanced, mirroring *both* the penetrating insight of academic thought and the pragmatism of real-world strategic management.

Complementing the text presentation is a truly appealing lineup of 12 diverse, timely, and thoughtfully crafted cases. All of the cases are tightly linked to the content of the 10 chapters, thus pushing students to apply the concepts and analytical tools they have read about. Eleven of the 12 cases were written by the coauthors to illustrate specific tools of analysis or distinct strategic management theories. The Robin Hood case was not written by the coauthors but was included because of its exceptional pedagogical value and linkage to strategic management concepts presented in the text. We are confident you will be impressed with how well each of the 12 cases in the collection will work in the classroom and the amount of student interest they will spark.

For some years now, growing numbers of strategy instructors at business schools worldwide have been transitioning from a purely text-cases course structure to a more robust and energizing text-cases-simulation course structure. Incorporating a competition-based strategy simulation has the strong appeal of providing class members with *an immediate and engaging opportunity to apply the concepts and analytical tools covered in the chapters in a head-to-head competition with companies run by other class members*. Two widely used and pedagogically effective online strategy simulations, *The Business Strategy Game* and *GLO-BUS*, are optional companions for this text. Both simulations, like the cases, are closely linked to the content of each chapter in the text. The Exercises for Simulation Participants, found at the end of each chapter, provide clear guidance to class members in applying the concepts and analytical tools covered in the chapters to the issues and decisions that they have to wrestle with in managing their simulation company.

Through our experiences as business school faculty members, we also fully understand the assessment demands on faculty teaching strategic management and business

policy courses. In many institutions, capstone courses have emerged as the logical home for assessing student achievement of program learning objectives. The fifth edition includes Assurance of Learning Exercises at the end of each chapter that link to the specific Learning Objectives appearing at the beginning of each chapter and highlighted throughout the text. *An important instructional feature of this edition is the linkage of selected chapter-end Assurance of Learning Exercises and cases to the publisher's Connect web-based assignment and assessment platform.* Your students will be able to use the online *Connect* supplement to (1) complete two of the Assurance of Learning Exercises appearing at the end of each of the 10 chapters, (2) complete chapter-end quizzes, and (3) complete case tutorials based upon the suggested assignment questions for all 12 cases in this edition. With the exception of some of the chapter-end Assurance of Learning exercises, all of the *Connect* exercises are automatically graded, thereby enabling you to easily assess the learning that has occurred.

In addition, both of the companion strategy simulations have a built-in Learning Assurance Report that quantifies how well each member of your class performed on nine skills/learning measures *versus tens of thousands of other students worldwide* who completed the simulation in the past 12 months. We believe the chapter-end Assurance of Learning Exercises, the all-new online and automatically graded *Connect* exercises, and the Learning Assurance Report generated at the conclusion of *The Business Strategy Game* and *GLO-BUS* simulations provide you with easy-to-use, empirical measures of student learning in your course. All can be used in conjunction with other instructor-developed or school-developed scoring rubrics and assessment tools to comprehensively evaluate course or program learning outcomes and measure compliance with AACSB accreditation standards.

Taken together, the various components of the fifth edition package and the supporting set of Instructor Resources provide you with enormous course design flexibility and a powerful kit of teaching/learning tools. We've done our very best to ensure that the elements comprising this edition will work well for you in the classroom, help you economize on the time needed to be well prepared for each class, and cause students to conclude that your course is one of the very best they have ever taken—from the standpoint of both enjoyment and learning.

## Differentiation from Other Texts

Five noteworthy traits strongly differentiate this text and the accompanying instructional package from others in the field:

1. *Our integrated coverage of the two most popular perspectives on strategic management positioning theory and resource-based theory is unsurpassed by any other leading strategy text.* Principles and concepts from both the positioning perspective and the resource-based perspective are prominently and comprehensively integrated into our coverage of crafting both single-business and multibusiness strategies. By highlighting the relationship between a firm's resources and capabilities to the activities it conducts along its value chain, we show explicitly how these two perspectives relate to one another. Moreover, in Chapters 3 through 8, it is emphasized repeatedly that a company's strategy must be matched not only to its external market circumstances but also to its internal resources and competitive capabilities.



2. *Our coverage of business ethics, core values, social responsibility, and environmental sustainability is unsurpassed by any other leading strategy text.* Chapter 9, “Ethics, Corporate Social Responsibility, Environmental Sustainability, and Strategy,” is embellished with fresh content so that it can better fulfill the important functions of (1) alerting students to the role and importance of ethical and socially responsible decision making and (2) addressing the accreditation requirements that business ethics be visibly and thoroughly embedded in the core curriculum. Moreover, discussions of the roles of values and ethics are integrated into portions of other chapters to further reinforce why and how considerations relating to ethics, values, social responsibility, and sustainability should figure prominently into the managerial task of crafting and executing company strategies.
3. *The caliber of the case collection in the fifth edition is truly unrivaled* from the standpoints of student appeal, teachability, and suitability for drilling students in the use of the concepts and analytical treatments in Chapters 1 through 10. The 12 cases included in this edition are the very latest, the best, and the most on-target that we could find. The ample information about the cases in the Instructor’s Manual makes it effortless to select a set of cases each term that will capture the interest of students from start to finish.
4. *The publisher’s Connect assignment and assessment platform is tightly linked to the text chapters and case lineup.* The *Connect* package for the fifth edition allows professors to assign autograded quizzes and select chapter-end Assurance of Learning Exercises to assess class members’ understanding of chapter concepts. In addition, our texts have pioneered the extension of the *Connect* platform to case analysis. The autograded case exercises for each of the 12 cases in this edition are robust and extensive and will better enable students to make meaningful contributions to class discussions. The autograded *Connect* case exercises may also be used as graded assignments in the course.
5. The two cutting-edge and widely used strategy simulations—*The Business Strategy Game* and *GLO-BUS*—that are optional companions to the fifth edition give you unmatched capability to employ a text-case-simulation model of course delivery.

## Organization, Content, and Features of the Fifth Edition Text Chapters

The following rundown summarizes the noteworthy features and topical emphasis in this new edition:

- Chapter 1 serves as a introduction to the topic of strategy, focusing on the managerial actions that will determine why a company matters in the marketplace. We introduce students to the primary approaches to building competitive advantage and the key elements of business-level strategy. Following Henry Mintzberg’s pioneering research, we also stress why a company’s strategy is partly planned and partly reactive and why this strategy tends to evolve. The chapter also discusses why it is important for a company to have a *viable business model* that outlines the company’s customer value proposition and its profit formula.

This brief chapter is the perfect accompaniment to your opening-day lecture on what the course is all about and why it matters.

- Chapter 2 delves more deeply into the managerial process of actually crafting and executing a strategy. It makes a great assignment for the second day of class and provides a smooth transition into the heart of the course. The focal point of the chapter is the five-stage managerial process of crafting and executing strategy: (1) forming a strategic vision of where the company is headed and why, (2) developing strategic as well as financial objectives with which to measure the company's progress, (3) crafting a strategy to achieve these targets and move the company toward its market destination, (4) implementing and executing the strategy, and (5) evaluating a company's situation and performance to identify corrective adjustments that are needed. Students are introduced to such core concepts as strategic visions, mission statements and core values, the balanced scorecard, and business-level versus corporate-level strategies. There's a robust discussion of why *all managers are on a company's strategy-making, strategy-executing team* and why a company's strategic plan is a collection of strategies devised by different managers at different levels in the organizational hierarchy. The chapter winds up with a section on how to exercise good corporate governance and examines the conditions that led to recent high-profile corporate governance failures.
- Chapter 3 sets forth the now-familiar analytical tools and concepts of industry and competitive analysis and demonstrates the importance of tailoring strategy to fit the circumstances of a company's industry and competitive environment. The standout feature of this chapter is a presentation of Michael Porter's "five forces model of competition" *that has long been the clearest, most straightforward discussion of any text in the field*. Chapter revisions include an improved discussion of the macro-environment, focusing on the use of the PESTEL analysis framework for assessing the *political, economic, social, technological, environmental, and legal* factors in a company's macro-environment. New to this edition is a discussion of Michael Porter's Framework for Competitor Analysis used for assessing a rival's likely strategic moves.
- Chapter 4 presents the resource-based view of the firm, showing why resource and capability analysis is such a powerful tool for sizing up a company's competitive assets. It offers a simple framework for identifying a company's resources and capabilities and explains how the VRIN framework can be used to determine whether they can provide the company with a sustainable competitive advantage over its competitors. Other topics covered in this chapter include dynamic capabilities, SWOT analysis, value chain analysis, benchmarking, and competitive strength assessments, thus enabling a solid appraisal of a company's relative cost position and customer value proposition vis-à-vis its rivals.
- Chapter 5 deals with the basic approaches used to compete successfully and gain a competitive advantage over market rivals. This discussion is framed around the five generic competitive strategies—low-cost leadership, differentiation, best-cost provider, focused differentiation, and focused low-cost. It describes when each of these approaches works best and what pitfalls to avoid. It explains the role of *cost drivers* and *uniqueness drivers* in reducing a company's costs and enhancing its differentiation, respectively.

- Chapter 6 deals with the *strategy options* available to complement a company's competitive approach and maximize the power of its overall strategy. These include a variety of offensive or defensive competitive moves, and their timing, such as blue ocean strategy and first-mover advantages and disadvantages. It also includes choices concerning the breadth of a company's activities (or its scope of operations along an industry's entire value chain), ranging from horizontal mergers and acquisitions, to vertical integration, outsourcing, and strategic alliances. This material serves to segue into that covered in the next two chapters on international and diversification strategies.
- Chapter 7 explores the full range of strategy options for competing in international markets: export strategies; licensing; franchising; establishing a subsidiary in a foreign market; and using strategic alliances and joint ventures to build competitive strength in foreign markets. There's also a discussion of how to best tailor a company's international strategy to cross-country differences in market conditions and buyer preferences, how to use international operations to improve overall competitiveness, the choice between multidomestic, global, and transnational strategies, and the unique characteristics of competing in emerging markets.
- Chapter 8 introduces the topic of corporate-level strategy—a topic of concern for multibusiness companies pursuing diversification. This chapter begins by explaining why successful diversification strategies must create shareholder value and lays out the three essential tests that a strategy must pass to achieve this goal (*the industry attractiveness, cost of entry, and better-off tests*). Corporate strategy topics covered in the chapter include methods of entering new businesses, related diversification, unrelated diversification, combined related and unrelated diversification approaches, and strategic options for improving the overall performance of an already diversified company. The chapter's analytical spotlight is trained on the techniques and procedures for assessing a diversified company's business portfolio—the relative attractiveness of the various businesses the company has diversified into, the company's competitive strength in each of its business lines, and the *strategic fit* and *resource fit* among a diversified company's different businesses. The chapter concludes with a brief survey of a company's four main post-diversification strategy alternatives: (1) sticking closely with the existing business lineup, (2) broadening the diversification base, (3) divesting some businesses and retrenching to a narrower diversification base, and (4) restructuring the makeup of the company's business lineup.
- Although the topic of ethics and values comes up at various points in this textbook, Chapter 9 brings more direct attention to such issues and may be used as a stand-alone assignment in either the early, middle, or late part of a course. It concerns the themes of ethical standards in business, approaches to ensuring consistent ethical standards for companies with international operations, corporate social responsibility, and environmental sustainability. The contents of this chapter are sure to give students some things to ponder, rouse lively discussion, and help to make students more ethically aware and conscious of *why all companies should conduct their business in a socially responsible and sustainable manner*.
- Chapter 10 is anchored around a pragmatic, compelling conceptual framework: (1) building dynamic capabilities, core competencies, resources, and structure

necessary for proficient strategy execution; (2) allocating ample resources to strategy-critical activities; (3) ensuring that policies and procedures facilitate rather than impede strategy execution; (4) pushing for continuous improvement in how value chain activities are performed; (5) installing information and operating systems that enable company personnel to better carry out essential activities; (6) tying rewards and incentives directly to the achievement of performance targets and good strategy execution; (7) shaping the work environment and corporate culture to fit the strategy; and (8) exerting the internal leadership needed to drive execution forward. The recurring theme throughout the chapter is that implementing and executing strategy entails figuring out the specific actions, behaviors, and conditions that are needed for a smooth strategy-supportive operation—the goal here is to ensure that students understand that the strategy-implementing/strategy executing phase is a make-it-happen-right kind of managerial exercise that leads to operating excellence and good performance.

In this latest edition, we have put our utmost effort into ensuring that the 10 chapters are consistent with the latest and best thinking of academics and practitioners in the field of strategic management and hit the bull's-eye in topical coverage for senior- and MBA-level strategy courses. The ultimate test of the text, of course, is the positive pedagogical impact it has in the classroom. If this edition sets a more effective stage for your lectures and does a better job of helping you persuade students that the discipline of strategy merits their rapt attention, then it will have fulfilled its purpose.

## **The Case Collection**

The 12-case lineup in this edition is flush with interesting companies and valuable lessons for students in the art and science of crafting and executing strategy. There's a good blend of cases from a length perspective—about one-third are under 10 pages, yet offer plenty for students to chew on; about a third are medium-length cases; and the remaining one-third are detail-rich cases that call for sweeping analysis.

At least 11 of the 12 cases involve companies, products, people, or activities that students will have heard of, know about from personal experience, or can easily identify with. The lineup includes at least four cases that will provide students with insight into the special demands of competing in industry environments where technological developments are an everyday event, product life cycles are short, and competitive maneuvering among rivals comes fast and furious. All of the cases involve situations where the role of company resources and competitive capabilities in the strategy formulation, strategy execution scheme is emphasized. Scattered throughout the lineup are six cases concerning non-U.S. companies, globally competitive industries, and/or cross-cultural situations; these cases, in conjunction with the globalized content of the text chapters, provide abundant material for linking the study of strategic management tightly to the ongoing globalization of the world economy. You'll also find three cases dealing with the strategic problems of family-owned or relatively small entrepreneurial businesses and 10 cases involving public companies and situations where students can do further research on the Internet. A number of the cases have accompanying videotape segments.

## The Two Strategy Simulation Supplements: The Business Strategy Game and GLO-BUS

*The Business Strategy Game* and *GLO-BUS: Developing Winning Competitive Strategies*—two competition-based strategy simulations that are delivered online and that feature automated processing and grading of performance—are being marketed by the publisher as companion supplements for use with the fifth edition (and other texts in the field). *The Business Strategy Game* is the world’s most popular strategy simulation, having been used by more than 2,500 instructors in courses involving over 750,000 students at 1050+ university campuses in 66 countries. *GLO-BUS*, a somewhat simpler strategy simulation introduced in 2004, has been used by more than 1,450 instructors in courses involving over 180,000 students at 640+ university campuses in 48 countries. Both simulations allow students to apply strategy-making and analysis concepts presented in the text and may be used as part of a comprehensive effort to assess undergraduate or graduate program learning objectives.

### The Compelling Case for Incorporating Use of a Strategy Simulation

There are *three exceptionally important benefits* associated with using a competition-based simulation in strategy courses taken by seniors and MBA students:

- *A three-pronged text-case-simulation course model delivers significantly more teaching and learning power than the traditional text-case model.* Using both cases and a strategy simulation to drill students in thinking strategically and applying what they read in the text chapters is a stronger, more effective means of helping them connect theory with practice and develop better business judgment. What cases do that a simulation cannot is give class members broad exposure to a variety of companies and industry situations and insight into the kinds of strategy-related problems managers face. But what a competition-based strategy simulation does far better than case analysis is thrust class members squarely into *an active, hands-on managerial role* where they are totally responsible for assessing market conditions, determining how to respond to the actions of competitors, forging a long-term direction and strategy for their company, and making all kinds of operating decisions. Because they are held fully accountable for their decisions and their company’s performance, *co-managers are strongly motivated* to dig deeply into company operations, probe for ways to be more cost-efficient and competitive, and ferret out strategic moves and decisions calculated to boost company performance. *Consequently, incorporating both case assignments and a strategy simulation to develop the skills of class members in thinking strategically and applying the concepts and tools of strategic analysis turns out to be more pedagogically powerful than relying solely on case assignments: there’s stronger retention of the lessons learned and better achievement of course learning objectives.*
- *The competitive nature of a strategy simulation arouses positive energy and steps up the whole tempo of the course by a notch or two.* Nothing sparks class excitement quicker or better than the concerted efforts on the part of class members

during each decision round to achieve a high industry ranking and avoid the perilous consequences of being outcompeted by other class members. Students really enjoy taking on the role of a manager, running their own company, crafting strategies, making all kinds of operating decisions, trying to outcompete rival companies, and getting immediate feedback on the resulting company performance. Co-managers become *emotionally invested* in running their company and figuring out what strategic moves to make to boost their company's performance. All this stimulates learning and causes students to see the practical relevance of the subject matter and the benefits of taking your course.

- *Use of a fully automated online simulation reduces the time instructors spend on course preparation, course administration, and grading.* Since the simulation exercise involves a 20- to 30-hour workload for student-teams (roughly 2 hours per decision round times 10-12 rounds, plus optional assignments), simulation adopters often compensate by trimming the number of assigned cases from, say, 10 to 12 to perhaps 4 to 6. This significantly reduces the time instructors spend reading cases, studying teaching notes, and otherwise getting ready to lead class discussion of a case or grade oral team presentations. Course preparation time is further cut because you can use several class days to have students meet in the computer lab to work on upcoming decision rounds or a three-year strategic plan (in lieu of lecturing on a chapter or covering an additional assigned case). Not only does use of a simulation permit assigning fewer cases, but it also permits you to eliminate at least one assignment that entails considerable grading on your part. Grading one less written case or essay exam or other written assignment saves enormous time. With *BSG* and *GLO-BUS*, grading is effortless and takes only minutes; once you enter percentage weights for each assignment in your online grade book, a suggested overall grade is calculated for you. You'll be pleasantly surprised—and quite pleased—at how little time it takes to gear up for and to administer *The Business Strategy Game* or *GLO-BUS*.

In sum, incorporating use of a strategy simulation turns out to be *a win-win proposition for both students and instructors*. Moreover, a very convincing argument can be made that a competition-based strategy simulation is *the single most effective teaching/learning tool that instructors can employ to teach the discipline of business and competitive strategy, to make learning more enjoyable, and to promote better achievement of course learning objectives*.

## **Administration and Operating Features of the Two Simulations**

The Internet delivery and user-friendly designs of both *BSG* and *GLO-BUS* make them incredibly easy to administer, even for first-time users. And the menus and controls are so similar that you can readily switch between the two simulations or use one in your undergraduate class and the other in a graduate class. If you have not yet used either of the two simulations, you may find the following of particular interest:

- Setting up the simulation for your course is done online and takes about 10 to 15 minutes. Once setup is completed, no other administrative actions are required beyond that of moving participants to a different team (should the need arise) and monitoring the progress of the simulation (to whatever extent desired).

- Participant's Guides are delivered electronically to class members at the website—students can read it on their monitors or print out a copy, as they prefer.
- There are two- to four-minute Video Tutorials scattered throughout the software (including each decision screen and each page of each report) that provide on-demand guidance to class members who may be uncertain about how to proceed.
- Complementing the video tutorials are detailed and clearly written Help sections explaining “all there is to know” about (a) each decision entry and the relevant cause-effect relationships, (b) the information on each page of the Industry Reports, and (c) the numbers presented in the Company Reports. *The Video Tutorials and the Help screens allow company co-managers to figure things out for themselves, thereby curbing the need for students to ask the instructor “how things work.”*
- Team members running the same company who are logged-in simultaneously on different computers at different locations can click a button to enter Collaboration Mode, enabling them to work collaboratively from the same screen in viewing reports and making decision entries, and click a second button to enter Audio Mode, letting them talk to one another.
  - When in “Collaboration Mode,” each team member sees the same screen at the same time as all other team members who are logged in and have joined Collaboration Mode. If one team member chooses to view a particular decision screen, that same screen appears on the monitors for all team members in Collaboration Mode.
  - Team members each control their own color-coded mouse pointer (with their first-name appearing in a color-coded box linked to their mouse pointer) and can make a decision entry or move the mouse to point to particular on-screen items.
  - A decision entry change made by one team member is seen by all, in real time, and all team members can immediately view the on-screen calculations that result from the new decision entry.
  - If one team member wishes to view a report page and clicks on the menu link to the desired report, that same report page will immediately appear for the other team members engaged in collaboration.
  - Use of Audio Mode capability requires that team members work from a computer with a built-in microphone (if they want to be heard by their team members) and speakers (so they may hear their teammates) or else have a headset with a microphone that they can plug into their desktop or laptop. A headset is recommended for best results, but most laptops now are equipped with a built-in microphone and speakers that will support use of our new voice chat feature.
  - Real-time VoIP audio chat capability among team members who have entered both the Audio Mode and the Collaboration Mode is a tremendous boost in functionality that enables team members to go online simultaneously on computers at different locations and conveniently and effectively collaborate in running their simulation company.
  - In addition, instructors have the capability to join the online session of any company and speak with team members, thus circumventing the need for

team members to arrange for and attend a meeting in the instructor's office. Using the standard menu for administering a particular industry, instructors can connect with the company desirous of assistance. Instructors who wish not only to talk but also enter Collaboration (highly recommended because all attendees are then viewing the same screen) have a red-colored mouse pointer linked to a red box labeled Instructor.

Without a doubt, the Collaboration and Voice-Chat capabilities are hugely valuable for students enrolled in online and distance-learning courses where meeting face-to-face is impractical or time-consuming. Likewise, the instructors of online and distance-learning courses will appreciate having the capability to join the online meetings of particular company teams when their advice or assistance is requested.

- Both simulations are quite suitable for use in distance-learning or online courses (and are currently being used in such courses on numerous campuses).
- Participants and instructors are notified via e-mail when the results are ready (usually about 15 to 20 minutes after the decision round deadline specified by the instructor/game administrator).
- Following each decision round, participants are provided with a complete set of reports—a six-page Industry Report, a one-page Competitive Intelligence report for each geographic region that includes strategic group maps and bulleted lists of competitive strengths and weaknesses, and a set of Company Reports (income statement, balance sheet, cash flow statement, and assorted production, marketing, and cost statistics).
- Two “open-book” multiple-choice tests of 20 questions are built into each simulation. The quizzes, which you can require or not as you see fit, are taken online and automatically graded, with scores reported instantaneously to participants and automatically recorded in the instructor's electronic grade book. Students are automatically provided with three sample questions for each test.
- Both simulations contain a three-year strategic plan option that you can assign. Scores on the plan are automatically recorded in the instructor's online grade book.
- At the end of the simulation, you can have students complete online peer evaluations (again, the scores are automatically recorded in your online grade book).
- Both simulations have a Company Presentation feature that enables each team of company co-managers to easily prepare PowerPoint slides for use in describing their strategy and summarizing their company's performance in a presentation to either the class, the instructor, or an “outside” board of directors.
- *A Learning Assurance Report provides you with hard data concerning how well your students performed vis-à-vis students playing the simulation worldwide over the past 12 months.* The report is based on nine measures of student proficiency, business know-how, and decision-making skill and can also be used in evaluating the extent to which your school's academic curriculum produces the desired degree of student learning insofar as accreditation standards are concerned.

For more details on either simulation, please consult Section 2 of the Instructor's Manual accompanying this text or register as an instructor at the simulation websites



([www.bsg-online.com](http://www.bsg-online.com) and [www.globus.com](http://www.globus.com)) to access even more comprehensive information. You should also consider signing up for one of the webinars that the simulation authors conduct several times each month (sometimes several times weekly) to demonstrate how the software works, walk you through the various features and menu options, and answer any questions. You have an open invitation to call the senior author of this text at (205) 722-9145 to arrange a personal demonstration or talk about how one of the simulations might work in one of your courses. We think you'll be quite impressed with the cutting-edge capabilities that have been programmed into *The Business Strategy Game* and *GLO-BUS*, the simplicity with which both simulations can be administered, and their exceptionally tight connection to the text chapters, core concepts, and standard analytical tools.

## Resources and Support Materials for the Fifth Edition for Students

### Key Points Summaries

At the end of each chapter is a synopsis of the core concepts, analytical tools, and other key points discussed in the chapter. These chapter-end synopses, along with the core concept definitions and margin notes scattered through out each chapter, help students focus on basic strategy principles, digest the messages of each chapter, and prepare for tests.

### Two Sets of Chapter-End Exercises

Each chapter concludes with two sets of exercises. The Assurance of Learning Exercises can be used as the basis for class discussion, oral presentation assignments, short written reports, and substitutes for case assignments. The Exercises for Simulation Participants are designed expressly for use by adopters who have incorporated use of a simulation and wish to go a step further in tightly and explicitly connecting the chapter content to the simulation company their students are running. The questions in both sets of exercises (along with those Concepts & Connections illustrations that qualify as “mini cases”) can be used to round out the rest of a 75-minute class period, should your lecture on a chapter only last for 50 minutes.

### The Connect Web-Based Assignment and Assessment Platform

The *Essentials of Strategic Management*, Fifth Edition takes full advantage of the publisher's innovative *Connect* assignment and assessment platform. The *Connect* package for this edition includes several robust and valuable features that simplify the task of assigning and grading three types of exercises for students:

- There are autograded chapter tests consisting of 20 multiple-choice questions that students can take to measure their grasp of the material presented in each of the 10 chapters.
- *Connect Management* includes interactive versions of two Assurance of Learning Exercises for each chapter that drill students in the use and application of the concepts and tools of strategic analysis. There is both an autograded and open-ended short-answer interactive exercise for each of the 10 chapters.

- The *Connect Management* platform also includes fully autograded interactive application exercises for each of the 12 cases in this edition. The exercises require students to work through tutorials based upon the analysis set forth in the assignment questions for the case; these exercises have multiple components such as resource and capability analysis, financial ratio analysis, identification of a company's strategy, or analysis of the five competitive forces. The content of these case exercises is tailored to match the circumstances presented in each case, calling upon students to do whatever strategic thinking and strategic analysis is called for to arrive at pragmatic, analysis-based action recommendations for improving company performance. The entire exercise is autograded, allowing instructors to focus on grading only the students' strategic recommendations.

All of the *Connect* exercises are automatically graded (with the exception of a few exercise components that entail student entry of essay answers), thereby simplifying the task of evaluating each class member's performance and monitoring the learning outcomes. The progress-tracking function built into the *Connect* system enables you to

- View scored work immediately and track individual or group performance with assignment and grade reports.
- Access an instant view of student or class performance relative to learning objectives.
- Collect data and generate reports required by many accreditation organizations, such as AACSB International.

## For Instructors

### Connect Management

Connect's Instructor Resources includes an Instructor's Manual and other support materials. Your McGraw-Hill representative can arrange delivery of instructor support materials in a format-ready Standard Cartridge for Blackboard, WebCT, and other web-based educational platforms.

### Instructor's Manual

The accompanying IM contains:

- A section on suggestions for organizing and structuring your course.
- Sample syllabi and course outlines.
- A set of lecture notes on each chapter.
- Answers to the chapter-end Assurance of Learning Exercises.
- A comprehensive case teaching note for each of the 12 cases. These teaching notes are filled with suggestions for using the case effectively, have very thorough, analysis-based answers to the suggested assignment questions for the case, and contain an epilogue detailing any important developments since the case was written.

## **Test Bank and EZ Test Online**

There is a test bank containing over 700 multiple-choice questions and short-answer/essay questions. It has been tagged with AACSB and Bloom's Taxonomy criteria. All of the test bank questions are accessible within Connect. All of the test bank questions are also accessible within a computerized test bank powered by McGraw-Hill's flexible electronic testing program, EZ Test Online ([www.eztestonline.com](http://www.eztestonline.com)). Using EZ Test Online allows you to create paper or online tests and quizzes. With EZ Test Online, instructors can select questions from multiple McGraw-Hill test banks or author their own and then either print the test for paper distribution or give it online.

## **PowerPoint Slides**

To facilitate delivery preparation of your lectures and to serve as chapter outlines, you'll have access to approximately 350 colorful and professional-looking slides displaying core concepts, analytical procedures, key points, and all the figures in the text chapters.

## ***The Business Strategy Game and GLO-BUS Online Simulations***

Using one of the two companion simulations is a powerful and constructive way of emotionally connecting students to the subject matter of the course. We know of no more effective way to arouse the competitive energy of students and prepare them for the challenges of real-world business decision making than to have them match strategic wits with classmates in running a company in head-to-head competition for global market leadership.

# Acknowledgments

We heartily acknowledge the contributions of the case researchers whose case-writing efforts appear herein and the companies whose cooperation made the cases possible. To each one goes a very special thank-you. We cannot overstate the importance of timely, carefully researched cases in contributing to a substantive study of strategic management issues and practices. From a research standpoint, strategy-related cases are invaluable in exposing the generic kinds of strategic issues that companies face in forming hypotheses about strategic behavior and in drawing experienced-based generalizations about the practice of strategic management. From an instructional standpoint, strategy cases give students essential practice in diagnosing and evaluating the strategic situations of companies and organizations, in applying the concepts and tools of strategic analysis, in weighing strategic options and crafting strategies, and in tackling the challenges of successful strategy execution. Without a continuing stream of fresh, well-researched, and well-conceived cases, the discipline of strategic management would lose its close ties to the very institutions whose strategic actions and behavior it is aimed at explaining. There's no question, therefore, that first-class case research constitutes a valuable scholarly contribution to the theory and practice of strategic management.

A great number of colleagues and students at various universities, business acquaintances, and people at McGraw-Hill provided inspiration, encouragement, and counsel during the course of this project. Like all text authors in the strategy field, we are intellectually indebted to the many academics whose research and writing have blazed new trails and advanced the discipline of strategic management.

We also express our thanks to Todd M. Alessandri, Michael Anderson, Gerald D. Baumgardner, Edith C. Busija, Gerald E. Calvasina, Sam D. Cappel, Richard Churchman, John W. Collis, Connie Daniel, Christine DeLaTorre, Vickie Cox Edmondson, Diane D. Galbraith, Naomi A. Gardberg, Sanjay Goel, Les Jankovich, Jonatan Jelen, William Jiang, Bonnie Johnson, Roy Johnson, John J. Lawrence, Robert E. Ledman, Mark Lehrer, Fred Maidment, Frank Markham, Renata Mayrhofer, Simon Medcalfe, Elouise Mintz, Michael Monahan, Gerry Nkombo Muuka, Cori J. Myers, Jeryl L. Nelson, David Olson, John Perry, L. Jeff Seaton, Charles F. Seifert, Eugene S. Simko, Karen J. Smith, Susan Steiner, Troy V. Sullivan, Elisabeth J. Teal, Lori Tisher, Vincent Weaver, Jim Whitlock, and Beth Woodard. These reviewers provided valuable guidance in steering our efforts to improve earlier editions.

As always, we value your recommendations and thoughts about the book. Your comments regarding coverage and contents will be taken to heart, and we always are grateful for the time you take to call our attention to printing errors, deficiencies, and other shortcomings. Please e-mail us at [john.gamble@tamucc.edu](mailto:john.gamble@tamucc.edu), or [athompso@cba.ua.edu](mailto:athompso@cba.ua.edu), or [margaret.a.peteraf@tuck.dartmouth.edu](mailto:margaret.a.peteraf@tuck.dartmouth.edu).

**John E. Gamble**  
**Margaret A. Peteraf**  
**Arthur A. Thompson**

# Contents

## **PART ONE** CONCEPTS AND TECHNIQUES FOR CRAFTING AND EXECUTING STRATEGY

### **Section A: Introduction and Overview**

#### **Chapter 1** Strategy, Business Models, and Competitive Advantage 1

- The Importance of a Distinctive Strategy and Competitive Approach 3
- The Relationship Between a Company's Strategy and Business Model 3
- Strategy and the Quest for Competitive Advantage 5
- The Importance of Capabilities in Building and Sustaining Competitive Advantage 7
- Why a Company's Strategy Evolves over Time 7
- The Three Tests of a Winning Strategy 8
- Why Crafting and Executing Strategy Are Important Tasks 9
- The Road Ahead 10
- Key Points 10
- Assurance of Learning Exercises 11
- Exercises for Simulation Participants 11
- Endnotes 12

#### **CONCEPTS & CONNECTIONS 1.1: PANDORA, SIRIUS XM, AND OVER-THE-AIR BROADCAST RADIO: THREE CONTRASTING BUSINESS MODELS 4**

#### **CONCEPTS & CONNECTIONS 1.2: STARBUCKS' STRATEGY IN THE SPECIALTY COFFEE MARKET 6**

#### **Chapter 2** Strategy Formulation, Execution, and Governance 13

- The Strategy Formulation, Strategy Execution Process 14
- Stage 1: Developing a Strategic Vision, a Mission, and Core Values 16
  - The Importance of Communicating the Strategic Vision 18
  - Developing a Company Mission Statement 18
  - Linking the Strategic Vision and Mission with Company Values 20
- Stage 2: Setting Objectives 21
  - What Kinds of Objectives to Set 21
- Stage 3: Crafting a Strategy 25
  - Strategy Formulation Involves Managers at All Organizational Levels 25
  - A Company's Strategy-Making Hierarchy 26
- Stage 4: Implementing and Executing the Chosen Strategy 27
- Stage 5: Evaluating Performance and Initiating Corrective Adjustments 28
- Corporate Governance: The Role of the Board of Directors in the Strategy Formulation, Strategy Execution Process 29
- Key Points 32

Assurance of Learning Exercises **32**

Exercises for Simulation Participants **34**

Endnotes **34**

**CONCEPTS & CONNECTIONS 2.1: EXAMPLES OF STRATEGIC VISIONS—HOW WELL DO THEY MEASURE UP? 19**

**CONCEPTS & CONNECTIONS 2.2: PATAGONIA, INC.: A VALUES-DRIVEN COMPANY 22**

**CONCEPTS & CONNECTIONS 2.3: EXAMPLES OF COMPANY OBJECTIVES 24**

**CONCEPTS & CONNECTIONS 2.4: CORPORATE GOVERNANCE FAILURES AT FANNIE MAE AND FREDDIE MAC 31**

## **Section B: Core Concepts and Analytical Tools**

### **Chapter 3 Evaluating a Company's External Environment 36**

Assessing the Company's Industry and Competitive Environment **37**

Question 1: What Are the Strategically Relevant Components of the Macro-Environment? **37**

Question 2: How Strong Are the Industry's Competitive Forces? **40**

The Competitive Force of Buyer Bargaining Power **41**

The Competitive Force of Substitute Products **43**

The Competitive Force of Supplier Bargaining Power **43**

The Competitive Force of Potential New Entrants **45**

The Competitive Force of Rivalry Among Competing Sellers **47**

The Collective Strengths of the Five Competitive Forces and Industry Profitability **51**

Question 3: What Are the Industry's Driving Forces of Change, and What Impact Will They Have? **51**

The Concept of Industry Driving Forces **52**

Identifying an Industry's Driving Forces **52**

Assessing the Impact of the Industry Driving Forces **54**

Determining Strategy Changes Needed to Prepare for the Impact of Driving Forces **54**

Question 4: How Are Industry Rivals Positioned? **55**

Using Strategic Group Maps to Assess the Positioning of Key Competitors **55**

The Value of Strategic Group Maps **57**

Question 5: What Strategic Moves Are Rivals Likely to Make Next? **58**

Question 6: What Are the Industry Key Success Factors? **59**

Question 7: Does the Industry Offer Good Prospects for Attractive Profits? **61**

Key Points **62**

Assurance of Learning Exercises **63**

Exercises for Simulation Participants **63**

Endnotes **64**

**CONCEPTS & CONNECTIONS 3.1: COMPARATIVE MARKET POSITIONS OF PRODUCERS IN THE U.S. BEER INDUSTRY: A STRATEGIC GROUP MAP EXAMPLE 56**

### **Chapter 4 Evaluating a Company's Resources, Capabilities, and Competitiveness 65**

Question 1: How Well Is the Company's Strategy Working? **66**

Question 2: What Are the Company's Competitively Important Resources and Capabilities? **67**

Identifying Competitively Important Resources and Capabilities	67
Determining the Competitive Power of a Company's Resources and Capabilities	68
The Importance of Dynamic Capabilities in Sustaining Competitive Advantage	70
Is the Company Able to Seize Market Opportunities and Nullify External Threats?	71
Question 3: Are the Company's Cost Structure and Customer Value Proposition Competitive?	73
Company Value Chains	73
Benchmarking: A Tool for Assessing Whether a Company's Value Chain Activities Are Competitive	75
The Value Chain System for an Entire Industry	77
Strategic Options for Remediating a Cost or Value Disadvantage	78
How Value Chain Activities Relate to Resources and Capabilities	80
Question 4: What Is the Company's Competitive Strength Relative to Key Rivals?	80
Interpreting the Competitive Strength Assessments	81
Question 5: What Strategic Issues and Problems Must Be Addressed by Management?	83
Key Points	83
Assurance of Learning Exercises	84
Exercises for Simulation Participants	87
Endnotes	87
<b>CONCEPTS &amp; CONNECTIONS 4.1: AMERICAN GIANT: USING THE VALUE CHAIN TO COMPARE COSTS OF PRODUCING A HOODIE IN THE UNITED STATES AND ASIA</b>	<b>76</b>

---

## Section C: Crafting a Strategy

### Chapter 5 The Five Generic Competitive Strategies 89

The Five Generic Competitive Strategies	90
Low-Cost Provider Strategies	91
The Two Major Avenues for Achieving Low-Cost Leadership	91
When a Low-Cost Provider Strategy Works Best	94
Pitfalls to Avoid in Pursuing a Low-Cost Provider Strategy	95
Broad Differentiation Strategies	96
Approaches to Differentiation	96
Managing the Value Chain in Ways That Enhance Differentiation	97
Delivering Superior Value via a Differentiation Strategy	99
Perceived Value and the Importance of Signaling Value	100
When a Differentiation Strategy Works Best	100
Pitfalls to Avoid in Pursuing a Differentiation Strategy	102
Focused (or Market Niche) Strategies	102
A Focused Low-Cost Strategy	103
A Focused Differentiation Strategy	103
When a Focused Low-Cost or Focused Differentiation Strategy Is Viable	105
The Risks of a Focused Low-Cost or Focused Differentiation Strategy	105
Best-Cost Provider Strategies	106
When a Best-Cost Provider Strategy Works Best	106
The Danger of an Unsound Best-Cost Provider Strategy	106
Successful Competitive Strategies Are Resource Based	108

Key Points **108**Assurance of Learning Exercises **109**Exercises for Simulation Participants **110**Endnotes **110****CONCEPTS & CONNECTIONS 5.1: HOW WALMART MANAGED ITS VALUE CHAIN TO ACHIEVE A LOW-COST ADVANTAGE OVER RIVAL SUPERMARKET CHAINS 95****CONCEPTS & CONNECTIONS 5.2: HOW BMW'S DIFFERENTIATION STRATEGY ALLOWED IT TO BECOME THE NUMBER-ONE LUXURY CAR BRAND 101****CONCEPTS & CONNECTIONS 5.3: ARAVIND EYE CARE SYSTEM'S FOCUSED LOW-COST STRATEGY 104****CONCEPTS & CONNECTIONS 5.4: AMERICAN GIANT'S BEST-COST PROVIDER STRATEGY 107****Chapter 6 Strengthening a Company's Competitive Position: Strategic Moves, Timing, and Scope of Operations 111**Launching Strategic Offensives to Improve a Company's Market Position **112**Choosing the Basis for Competitive Attack **112**Choosing Which Rivals to Attack **114**Blue Ocean Strategy—A Special Kind of Offensive **114**Using Defensive Strategies to Protect a Company's Market Position and Competitive Advantage **115**Blocking the Avenues Open to Challengers **115**Signaling Challengers That Retaliation Is Likely **115**Timing a Company's Offensive and Defensive Strategic Moves **116**The Potential for Late-Mover Advantages or First-Mover Disadvantages **117**Deciding Whether to Be an Early Mover or Late Mover **118**Strengthening a Company's Market Position via Its Scope of Operations **118**Horizontal Merger and Acquisition Strategies **119**Why Mergers and Acquisitions Sometimes Fail to Produce Anticipated Results **120**Vertical Integration Strategies **122**The Advantages of a Vertical Integration Strategy **122**The Disadvantages of a Vertical Integration Strategy **124**Outsourcing Strategies: Narrowing the Scope of Operations **125**Strategic Alliances and Partnerships **126**Failed Strategic Alliances and Cooperative Partnerships **127**The Strategic Dangers of Relying on Alliances for Essential Resources and Capabilities **128**Key Points **128**Assurance of Learning Exercises **129**Exercises for Simulation Participants **130**Endnotes **130****CONCEPTS & CONNECTIONS 6.1: GILT GROUPE'S BLUE OCEAN STRATEGY IN THE U.S. FLASH SALE INDUSTRY 116****CONCEPTS & CONNECTIONS 6.2: AMAZON.COM'S FIRST-MOVER ADVANTAGE IN ONLINE RETAILING 121****CONCEPTS & CONNECTIONS 6.3: KAISER PERMANENTE'S VERTICAL INTEGRATION STRATEGY 124**



## Chapter 7 Strategies for Competing in International Markets 132

Why Companies Expand into International Markets	133
Factors That Shape Strategy Choices in International Markets	134
Cross-Country Differences in Demographic, Cultural, and Market Conditions	134
Opportunities for Location-Based Cost Advantages	135
The Risks of Adverse Exchange Rate Shifts	135
The Impact of Government Policies on the Business Climate in Host Countries	136
Strategy Options for Entering Foreign Markets	137
Export Strategies	137
Licensing Strategies	138
Franchising Strategies	138
Foreign Subsidiary Strategies	138
Alliance and Joint Venture Strategies	139
International Strategy: The Three Principal Options	141
Multidomestic Strategy—A Think Local, Act Local Approach to Strategy Making	142
Global Strategy—A Think Global, Act Global Approach to Strategy Making	143
Transnational Strategy—A Think Global, Act Local Approach to Strategy Making	144
Using International Operations to Improve Overall Competitiveness	145
Using Location to Build Competitive Advantage	146
Using Cross-Border Coordination to Build Competitive Advantage	147
Strategies for Competing in the Markets of Developing Countries	147
Strategy Options for Competing in Developing-Country Markets	148
Key Points	149
Assurance of Learning Exercises	150
Exercises for Simulation Participants	151
Endnotes	151

**CONCEPTS & CONNECTIONS 7.1: SOLAZYME'S CROSS-BORDER ALLIANCES WITH UNILEVER, SEPHORA, QANTAS, AND ROQUETTE 141**

**CONCEPTS & CONNECTIONS 7.2: FOUR SEASONS HOTELS: LOCAL CHARACTER, GLOBAL SERVICE 145**

## Chapter 8 Corporate Strategy: Diversification and the Multibusiness Company 153

When Business Diversification Becomes a Consideration	155
Building Shareholder Value: The Ultimate Justification for Business Diversification	155
Approaches to Diversifying the Business Lineup	156
Diversification by Acquisition of an Existing Business	156
Entering a New Line of Business Through Internal Development	156
Using Joint Ventures to Achieve Diversification	156
Choosing the Diversification Path: Related Versus Unrelated Businesses	157
Diversifying into Related Businesses	158
Strategic Fit and Economies of Scope	159
The Ability of Related Diversification to Deliver Competitive Advantage and Gains in Shareholder Value	159
Diversifying into Unrelated Businesses	160
Building Shareholder Value Through Unrelated Diversification	160

The Pitfalls of Unrelated Diversification	<b>160</b>
Misguided Reasons for Pursuing Unrelated Diversification	<b>161</b>
Diversifying into Both Related and Unrelated Businesses	<b>162</b>
Evaluating the Strategy of a Diversified Company	<b>162</b>
Step 1: Evaluating Industry Attractiveness	<b>163</b>
Step 2: Evaluating Business-Unit Competitive Strength	<b>165</b>
Step 3: Determining the Competitive Value of Strategic Fit in Multibusiness Companies	<b>169</b>
Step 4: Evaluating Resource Fit	<b>169</b>
Step 5: Ranking Business Units and Setting a Priority for Resource Allocation	<b>172</b>
Step 6: Crafting New Strategic Moves to Improve the Overall Corporate Performance	<b>173</b>
Key Points	<b>177</b>
Assurance of Learning Exercises	<b>178</b>
Exercises for Simulation Participants	<b>179</b>
Endnotes	<b>180</b>

### **CONCEPTS & CONNECTIONS 8.1: MICROSOFT'S ACQUISITION OF SKYPE: PURSUING THE BENEFITS OF CROSS-BUSINESS STRATEGIC FIT** 175

## **Chapter 9 Ethics, Corporate Social Responsibility, Environmental Sustainability, and Strategy** 181

What Do We Mean by Business Ethics?	<b>182</b>
Drivers of Unethical Strategies and Business Behavior	<b>182</b>
The Business Case for Ethical Strategies	<b>184</b>
Ensuring a Strong Commitment to Business Ethics in Companies with International Operations	<b>185</b>
The School of Ethical Universalism	<b>185</b>
The School of Ethical Relativism	<b>185</b>
Integrative Social Contracts Theory	<b>187</b>
Strategy, Corporate Social Responsibility, and Environmental Sustainability	<b>188</b>
What Do We Mean by Corporate Social Responsibility?	<b>188</b>
What Do We Mean by Sustainability and Sustainable Business Practices?	<b>190</b>
Crafting Social Responsibility and Sustainability Strategies	<b>192</b>
The Business Case for Socially Responsible Behavior	<b>192</b>
Key Points	<b>194</b>
Assurance of Learning Exercises	<b>195</b>
Exercises for Simulation Participants	<b>196</b>
Endnotes	<b>196</b>

### **CONCEPTS & CONNECTIONS 9.1: IKEA'S GLOBAL SUPPLIER STANDARDS: MAINTAINING LOW COSTS WHILE FIGHTING THE ROOT CAUSES OF CHILD LABOR** 186

### **CONCEPTS & CONNECTIONS 9.2: BURT'S BEES: A STRATEGY BASED ON CORPORATE SOCIAL RESPONSIBILITY** 190

---

#### **Section D: Executing the Strategy**

## **Chapter 10 Superior Strategy Execution—Another Path to Competitive Advantage** 198

The Principal Managerial Components of Strategy Execution	<b>199</b>
Building an Organization Capable of Good Strategy Execution: Three Key Actions	<b>200</b>

Staffing the Organization	201
Acquiring, Developing, and Strengthening Key Resources and Capabilities	202
Matching Organizational Structure to the Strategy	205
Allocating Resources to Strategy-Critical Activities	208
Instituting Strategy-Supportive Policies and Procedures	208
Striving for Continuous Improvement in Processes and Activities	209
The Difference Between Business Process Reengineering and Continuous Improvement Programs	211
Installing Information and Operating Systems	212
Using Rewards and Incentives to Promote Better Strategy Execution	213
Motivation and Reward Systems	213
Guidelines for Designing Monetary Incentive Systems	213
Nonmonetary Rewards	214
Instilling a Corporate Culture That Promotes Good Strategy Execution	215
High-Performance Cultures	215
Adaptive Cultures	217
Unhealthy Corporate Cultures	218
Changing a Problem Culture	220
Leading the Strategy Execution Process	222
Staying on Top of How Well Things Are Going	222
Putting Constructive Pressure on Organizational Units to Achieve Good Results and Operating Excellence	223
Initiating Corrective Actions to Improve Both the Company's Strategy and Its Execution	223
Key Points	224
Assurance of Learning Exercises	225
Exercises for Simulation Participants	226
Endnotes	226
Appendix Key Financial Ratios: How to Calculate Them and What They Mean	228
<b>CONCEPTS &amp; CONNECTIONS 10.1: ZARA'S STRATEGY EXECUTION CAPABILITIES</b>	<b>203</b>
<b>CONCEPTS &amp; CONNECTIONS 10.2: WHIRLPOOL'S USE OF SIX SIGMA TO PROMOTE OPERATING EXCELLENCE</b>	<b>211</b>
<b>CONCEPTS &amp; CONNECTIONS 10.3: HOW THE BEST COMPANIES TO WORK FOR MOTIVATE AND REWARD EMPLOYEES</b>	<b>216</b>
<b>CONCEPTS &amp; CONNECTIONS 10.4: THE CULTURE THAT DRIVES INNOVATION AT W. L. GORE &amp; ASSOCIATES</b>	<b>217</b>

## PART TWO **CASES IN CRAFTING AND EXECUTING STRATEGY**

### Cases

- 
- Case 1** **BillCutterz.com: Business Model, Strategy, and the Challenges of Exponential Growth** 231  
*John E. Gamble, Texas A&M University–Corpus Christi*  
*Randall D. Harris, Texas A&M University–Corpus Christi*

- Case 2**    **Whole Foods Market in 2014: Vision, Core Values, and Strategy**    **237**  
*Arthur A. Thompson, The University of Alabama*
- Case 3**    **Apple Inc. in 2015**    **268**  
*John E. Gamble, Texas A&M University–Corpus Christi*  
*John D. Varlaro, Johnson & Wales University*
- Case 4**    **Sirius XM Satellite Radio, Inc in 2014: On Track to Succeed After a Near-Death Experience?**    **279**  
*Arthur A. Thompson, The University of Alabama*
- Case 5**    **Panera Bread Company in 2015—What to Do to Rejuvenate the Company’s Growth?**    **300**  
*Arthur A. Thompson, The University of Alabama*
- Case 6**    **Vera Bradley in 2015: Can Its Turnaround Strategy Reverse Its Continuing Decline?**    **320**  
*David L. Turnipseed, University of South Alabama*  
*John E. Gamble, Texas A&M University–Corpus Christi*
- Case 7**    **Tesla Motors’s Strategy to Revolutionize the Global Automotive Industry**    **333**  
*Arthur A. Thompson, The University of Alabama*
- Case 8**    **Deere & Company in 2015: Striving for Growth in a Weakening Global Agricultural Sector**    **366**  
*Alen Badal, Author and Researcher*  
*John E. Gamble, Texas A&M University–Corpus Christi*  
*David L. Turnipseed, University of South Alabama*
- Case 9**    **PepsiCo’s Diversification Strategy in 2015**    **377**  
*John E. Gamble, Texas A&M University–Corpus Christi*  
*David L. Turnipseed, University of South Alabama*
- Case 10**    **Robin Hood**    **390**  
*Joseph Lampel, Alliance Manchester Business School*
- Case 11**    **Southwest Airlines in 2014: Culture, Values, and Operating Practices**    **392**  
*Arthur A. Thompson, The University of Alabama*  
*John E. Gamble, Texas A&M University–Corpus Christi*
- Case 12**    **TOMS Shoes: A Dedication to Social Responsibility**    **430**  
*Margaret A. Peteraf, Tuck School of Business, Dartmouth College*  
*Sean Zhang, Dartmouth College, Research Assistant*  
*Meghan L. Cooney, Dartmouth College, Research Assistant*
- Glossary**    **439**
- Indexes**
- Organization**    **443**
- Subject**    **448**
- Name**    **459**



# connect<sup>®</sup>

Required=Results

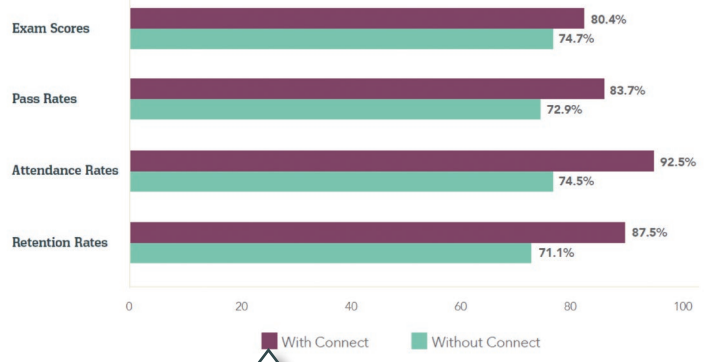


## McGraw-Hill Connect<sup>®</sup> Learn Without Limits

Connect is a teaching and learning platform that is proven to deliver better results for students and instructors.

Connect empowers students by continually adapting to deliver precisely what they need, when they need it, and how they need it, so your class time is more engaging and effective.

Course outcomes improve with Connect.



Using Connect improves passing rates by **10.8%** and retention by **16.4%**.

88% of instructors who use **Connect** require it; instructor satisfaction increases by 38% when **Connect** is required.

## Analytics

### Connect Insight<sup>®</sup>

Connect Insight is Connect's new one-of-a-kind visual analytics dashboard—now available for both instructors and students—that provides at-a-glance information regarding student performance, which is immediately actionable. By presenting assignment, assessment, and topical performance results together with a time metric that is easily visible for aggregate or individual results, Connect Insight gives the user the ability to take a just-in-time approach to teaching and learning, which was never before available. Connect Insight presents data that empowers students and helps instructors improve class performance in a way that is efficient and effective.

Connect helps students achieve better grades

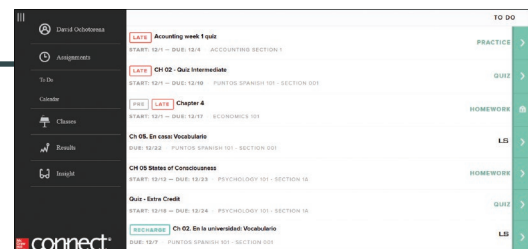


Based on McGraw-Hill Education Connect Effectiveness Study 2013

Students can view their results for any **Connect** course.

## Mobile

Connect's new, intuitive mobile interface gives students and instructors flexible and convenient, anytime-anywhere access to all components of the Connect platform.



# Adaptive



More students earn **A's** and **B's** when they use McGraw-Hill Education **Adaptive** products.

## SmartBook®

Proven to help students improve grades and study more efficiently, SmartBook contains the same content within the print book, but actively tailors that content to the needs of the individual. SmartBook's adaptive technology provides precise, personalized instruction on what the student should do next, guiding the student to master and remember key concepts, targeting gaps in knowledge and offering customized feedback, and driving the student toward comprehension and retention of the subject matter. Available on smartphones and tablets, SmartBook puts learning at the student's fingertips—anywhere, anytime.

Over **4 billion** questions have been answered, making McGraw-Hill Education products more intelligent, reliable, and precise.

THE FIRST AND ONLY  
**ADAPTIVE READING**  
**EXPERIENCE DESIGNED**  
TO TRANSFORM THE  
WAY STUDENTS READ



of students reported **SmartBook** to be a more effective way of reading material



of students want to use the Practice Quiz feature available within **SmartBook** to help them study



of students reported having reliable access to off-campus wifi



of students say they would purchase **SmartBook** over print alone




reported that **SmartBook** would impact their study skills in a positive way




\*Findings based on a 2015 focus group survey at Pellissippi State Community College administered by McGraw-Hill Education

# Course Design and Delivery

## Create

 **create**™ Instructors can now tailor their teaching resources to match the way they teach! With McGraw-Hill Create, [www.mcgrawhillcreate.com](http://www.mcgrawhillcreate.com), instructors can easily rearrange chapters, combine material from other content sources, and quickly upload and integrate their own content, such as course syllabi or teaching notes. Find the right content in Create by searching through thousands of leading McGraw-Hill textbooks. Arrange the material to fit your teaching style. Order a Create book and receive a complimentary print review copy in three to five business days or a complimentary electronic review copy via e-mail within one hour. Go to [www.mcgrawhillcreate.com](http://www.mcgrawhillcreate.com) today and register.

## Tegrity Campus

 **tegrity** Tegrity makes class time available 24/7 by automatically capturing every lecture in a searchable format for students to review when they study and complete assignments. With a simple one-click start-and-stop process, you capture all computer screens and corresponding audio. Students can replay any part of any class with easy-to-use browser-based viewing on a PC or Mac. Educators know that the more students can see, hear, and experience class resources, the better they learn. In fact, studies prove it. With patented Tegrity “search anything” technology, students instantly recall key class moments for replay online or on iPods and mobile devices. Instructors can help turn all their students’ study time into learning moments immediately supported by their lecture. To learn more about Tegrity, watch a two-minute Flash demo at <http://tegritycampus.mhhe.com>.

## Blackboard® Partnership



McGraw-Hill Education and Blackboard have teamed up to simplify your life. Now you and your students can access Connect and Create right from within your Blackboard course—all with one single sign-on. The grade books are seamless, so when a student completes an integrated Connect assignment, the grade for that assignment automatically (and instantly) feeds your Blackboard grade center. Learn more at [www.domorenow.com](http://www.domorenow.com)

## McGraw-Hill Campus™



### Campus

McGraw-Hill Campus is a new one-stop teaching and learning experience available to users of any learning management system. This institutional service allows faculty and students to enjoy single sign-on (SSO) access to all McGraw-Hill Higher Education materials, including the award-winning McGraw-Hill Connect platform, from directly within the institution's website. With McGraw-Hill Campus, faculty receive instant access to teaching materials (e.g., eTextbooks, test banks, PowerPoint slides, animations, learning objectives, etc.), allowing them to browse, search, and use any instructor ancillary content in our vast library at no additional cost to instructor or students. In addition, students enjoy SSO access to a variety of free content (e.g., quizzes, flash cards, narrated presentations, etc.) and subscription-based products (e.g., McGraw-Hill Connect). With McGraw-Hill Campus enabled, faculty and students will never need to create another account to access McGraw-Hill products and services. Learn more at [www.mhcampus.com](http://www.mhcampus.com).





# Strategy, Business Models, and Competitive Advantage

chapter

1

## LEARNING OBJECTIVES

- LO1** Understand why every company needs a distinctive strategy to compete successfully, manage its business operations, and strengthen its prospects for long-term success.
- LO2** Learn why it is important for a company to have a viable business model that outlines the company's customer value proposition and its profit formula.
- LO3** Develop an awareness of the five most dependable strategic approaches for setting a company apart from rivals and winning a sustainable competitive advantage.
- LO4** Understand that a company's strategy tends to evolve over time because of changing circumstances and ongoing management efforts to improve the company's strategy.
- LO5** Learn the three tests of a winning strategy.

In thinking strategically about a company, *managers of all types of businesses must develop a clear understanding of what moves and approaches will be employed to gain advantage in the marketplace.* Advantage over rivals and market-leading performance rarely occur due to happenstance or by merely following routines. Top-performing companies deliberately develop and carry out plans to offer customers value in ways that competitors cannot match. Long-term success in the marketplace is dependent on an action plan for making a company's products or services unique and important in the minds of customers.

### CORE CONCEPT

A company's **strategy** explains why the company matters in the marketplace by specifying an approach to creating superior value for customers and determining how capabilities and resources will be utilized to deliver the desired value to customers.

A company's **strategy** spells out why the company matters in the marketplace by defining its approach to creating superior value for customers and how capabilities and resources will be employed to deliver the desired value to customers. In effect, the crafting of a strategy represents a managerial commitment to pursuing an array of choices about how to compete. These include choices about:

- *How* to create products or services that attract and please customers.
- *How* to position the company in the industry.
- *How* to develop and deploy resources to build valuable competitive capabilities.
- *How* each functional piece of the business (R&D, supply chain activities, production, sales and marketing, distribution, finance, and human resources) will be operated.
- *How* to achieve the company's performance targets.

In most industries, companies have considerable freedom in choosing the *hows* of strategy. Thus some rivals strive to create superior value for customers by achieving lower costs than rivals, while others pursue product superiority or personalized customer service or the development of capabilities that rivals cannot match. Some competitors position themselves in only one part of the industry's chain of production/distribution activities, while others are partially or fully integrated, with operations ranging from components production to manufacturing and assembly to wholesale distribution or retailing. Some competitors deliberately confine their operations to local or regional markets; others opt to compete nationally, internationally (several countries), or globally. Some companies decide to operate in only one industry, while others diversify broadly or narrowly, into related or unrelated industries.

The role of this chapter is to define the concepts of strategy and competitive advantage, the relationship between a company's strategy and its business model, why strategies are partly proactive and partly reactive, and why company strategies evolve over time. Particular attention will be paid to what sets a winning strategy apart from a ho-hum or flawed strategy and why the caliber of a company's strategy determines whether it will enjoy a competitive advantage or be burdened by competitive disadvantage. By the end of this chapter, you will have a clear idea of why the tasks of crafting and executing strategy are core management functions and why excellent execution of an excellent strategy is the most reliable recipe for turning a company into a standout performer.

## The Importance of a Distinctive Strategy and Competitive Approach

For a company to matter in the minds of customers, its strategy needs a distinctive element that sets it apart from rivals and produces a competitive edge. A strategy must tightly fit a company's own particular situation, but there is no shortage of opportunity to fashion a strategy that is discernibly different from the strategies of rivals. In fact, competitive success requires a company's managers to make strategic choices about the key building blocks of its strategy that differ from the choices made by competitors—not 100 percent different but at least different in several important respects. A strategy stands a chance of succeeding only when it is predicated on actions, business approaches, and competitive moves aimed at appealing to buyers *in ways that set a company apart from rivals*. Simply trying to mimic the strategies of the industry's successful companies never works. Rather, every company's strategy needs to have some distinctive element that draws in customers and produces a competitive edge. Strategy, at its essence, is about competing differently—doing what rival firms *don't* do or, better yet, what rival firms *can't* do.<sup>1</sup>

**LO1** Understand why every company needs a distinctive strategy to compete successfully, manage its business operations, and strengthen its prospects for long-term success.

Mimicking the strategies of successful industry rivals—with either copycat product offerings or efforts to stake out the same market position—rarely works. A creative, distinctive strategy that sets a company apart from rivals and yields a competitive advantage is a company's most reliable ticket for earning above-average profits.

## The Relationship Between a Company's Strategy and Business Model

Closely related to the concept of strategy is the concept of a company's **business model**. While the company's strategy sets forth an approach to offering superior value, a company's business model is management's blueprint for delivering a valuable product or service to customers in a manner that will yield an attractive profit.<sup>2</sup> The two elements of a company's business model are (1) its *customer value proposition* and (2) its *profit formula*. The customer value proposition is established by the company's overall strategy and lays out the company's approach to satisfying buyer wants and needs at a price customers will consider a good value. The greater the value provided and the lower the price, the more attractive the value proposition is to customers. The profit formula describes the company's approach to determining a cost structure that will allow for acceptable profits given the pricing tied to its customer value proposition. The lower the costs given the customer value proposition, the greater the ability of the business model to be a moneymaker. The nitty-gritty issue surrounding a company's business model is whether it can execute its customer value proposition profitably. Just because company managers have crafted a strategy for competing and running the business does not automatically mean the strategy will lead to profitability—it may or it may not.<sup>3</sup>

**LO2** Learn why it is important for a company to have a viable business model that outlines the company's customer value proposition and its profit formula.

### CORE CONCEPT

A company's **business model** sets forth how its strategy and operating approaches will create value for customers, while at the same time generating ample revenues to cover costs and realizing a profit. The two elements of a company's business model are its (1) customer value proposition and (2) its profit formula.

Cable television providers utilize a business model, keyed to delivering news and entertainment that viewers will find valuable, to secure sufficient revenues from

# Concepts Connections 1.1

## PANDORA, SIRIUS XM, AND OVER-THE-AIR BROADCAST RADIO: THREE CONTRASTING BUSINESS MODELS

	Pandora	Sirius XM	Over-the-Air Radio Broadcasters
Customer value proposition	<ul style="list-style-type: none"> <li>Through free-of-charge Internet radio service, allowed PC, tablet computer, and smartphone users to create up to 100 personalized music and comedy stations</li> <li>Utilized algorithms to generate playlists based on users' predicted music preferences</li> <li>Offered programming interrupted by brief, occasional ads; eliminated advertising for Pandora One subscribers</li> </ul>	<ul style="list-style-type: none"> <li>For a monthly subscription fee, provided satellite-based music, news, sports, national and regional weather, traffic reports in limited areas, and talk radio programming</li> <li>Also offered subscribers streaming Internet channels and the ability to create personalized, commercial-free stations for online and mobile listening</li> <li>Offered programming interrupted only by brief, occasional ads</li> </ul>	<ul style="list-style-type: none"> <li>Provided free-of-charge music, national and local news, local traffic reports, national and local weather, and talk radio programming</li> <li>Included frequent programming interruption for ads</li> </ul>
Profit Formula	<p>Revenue generation: Display, audio, and video ads targeted to different audiences and sold to local and national buyers; subscription revenues generated from an advertising-free option called Pandora One</p> <p>Cost structure: Fixed costs associated with developing software for computers, tablets, and smartphones</p> <p>Fixed and variable costs related to operating data centers to support streaming network content royalties, marketing, and support activities</p> <p>Profit margin: Profitability dependent on generating sufficient advertising revenues and subscription revenues to cover costs and provide attractive profits</p>	<p>Revenue generation: Monthly subscription fees, sales of satellite radio equipment, and advertising revenues</p> <p>Cost structure: Fixed costs associated with operating a satellite-based music delivery service and streaming Internet service</p> <p>Fixed and variable costs related to programming and content royalties, marketing, and support activities</p> <p>Profit margin: Profitability dependent on attracting a sufficiently large number of subscribers to cover costs and provide attractive profits</p>	<p>Revenue generation: Advertising sales to national and local businesses</p> <p>Cost structure: Fixed costs associated with terrestrial broadcasting operations</p> <p>Fixed and variable costs related to local news reporting, advertising sales operations, network affiliate fees, programming and content royalties, commercial production activities, and support activities</p> <p>Profit margin: Profitability dependent on generating sufficient advertising revenues to cover costs and provide attractive profits</p>

**Sources:** Company documents, 10-Ks, and information posted on their websites.

subscriptions and advertising to cover operating expenses and allow for profits. Aircraft engine manufacturer Rolls Royce employs a “power-by-the-hour” business model that charges airlines leasing fees for engine use, maintenance, and repairs based upon actual hours flown. The company retains ownership of the engines and is able to minimize engine maintenance costs through the use of sophisticated sensors that optimize maintenance and repair schedules. Gillette’s business model in razor blades involves achieving economies of scale in the production of its shaving products, selling razors at an attractively low price, and then making money on repeat purchases of razor blades. Concepts & Connections 1.1 discusses three contrasting business models in radio broadcasting.

## Strategy and the Quest for Competitive Advantage

The heart and soul of any strategy is the actions and moves in the marketplace that managers are taking to gain a competitive edge over rivals.<sup>4</sup> Five of the most frequently used and dependable strategic approaches to setting a company apart from rivals and winning a sustainable competitive advantage are:

**LO3** Develop an awareness of the five most dependable strategic approaches for setting a company apart from rivals and winning a sustainable competitive advantage.

1. **A *low-cost provider strategy***—achieving a cost-based advantage over rivals. Walmart and Southwest Airlines have earned strong market positions because of the low-cost advantages they have achieved over their rivals. Low-cost provider strategies can produce a durable competitive edge when rivals find it hard to match the low-cost leader’s approach to driving costs out of the business.
2. **A *broad differentiation strategy***—seeking to differentiate the company’s product or service from rivals’ in ways that will appeal to a broad spectrum of buyers. Successful adopters of broad differentiation strategies include Johnson & Johnson in baby products (product reliability) and Apple (innovative products). Differentiation strategies can be powerful so long as a company is sufficiently innovative to thwart rivals’ attempts to copy or closely imitate its product offering.
3. **A *focused low-cost strategy***—concentrating on a narrow buyer segment (or market niche) and outcompeting rivals by having lower costs than rivals and thus being able to serve niche members at a lower price. Private-label manufacturers of food, health and beauty products, and nutritional supplements use their low-cost advantage to offer supermarket buyers lower prices than those demanded by producers of branded products.
4. **A *focused differentiation strategy***—concentrating on a narrow buyer segment (or market niche) and outcompeting rivals by offering niche members customized attributes that meet their tastes and requirements better than rivals’ products. Louis Vuitton and Rolex have sustained their advantage in the luxury goods industry through a focus on affluent consumers demanding luxury and prestige.
5. **A *best-cost provider strategy***—giving customers more value for the money by satisfying buyers’ expectations on key quality/features/performance/service attributes, while beating their price expectations. This approach is a hybrid strategy that blends elements of low-cost provider and differentiation strategies; the aim

## Concepts & Connections 1.2

### STARBUCKS' STRATEGY IN THE SPECIALTY COFFEE MARKET

Since its founding in 1985 as a modest nine-store operation in Seattle, Washington, Starbucks had become the premier roaster and retailer of specialty coffees in the world, with nearly 22,000 store locations in more than 65 countries as of April 2015 and annual sales that were expected to exceed \$19 billion in fiscal 2015. The key elements of Starbucks' strategy in specialty coffees included:

- **Train “baristas” to serve a wide variety of specialty coffee drinks that allow customers to satisfy their individual preferences in a customized way.** Starbucks essentially brought specialty coffees, such as cappuccinos, lattes, and macchiatos, to the mass market in the United States, encouraging customers to personalize their coffee drinking habits. Requests for such items as an “Iced Grande Hazelnut Macchiato with Soy Milk and NO Hazelnut Drizzle” could be served up quickly with consistent quality.
- **Emphasis on store ambience and elevating the customer experience at Starbucks stores.** Starbucks management viewed each store as a billboard for the company and as a contributor to building the company's brand and image. Each detail was scrutinized to enhance the mood and ambience of the store to make sure everything signaled “best-of-class” and reflected the personality of the community and the neighborhood. The thesis was “everything mattered.” The company went to great lengths to make sure the store fixtures, the merchandise displays, the colors, the artwork, the banners, the music, and the aromas all blended to create a consistent, inviting, stimulating environment that evoked the romance of coffee, that signaled the company's passion for coffee, and that rewarded customers with ceremony, stories, and surprise.
- **Purchase and roast only top-quality coffee beans.** The company purchased only the highest quality arabica beans and carefully roasted coffee to exacting standards of quality

and flavor. Starbucks did not use chemicals or artificial flavors when preparing its roasted coffees.

- **Commitment to corporate responsibility.** Starbucks was protective of the environment and contributed positively to the communities where Starbucks stores were located. In addition, Starbucks promoted fair trade practices and paid above-market prices for coffee beans to provide its growers/suppliers with sufficient funding to sustain their operations and provide for their families.
- **Expansion of the number of Starbucks stores domestically and internationally.** Starbucks operated stores in high-traffic, high-visibility locations in the United States and abroad. The company's ability to vary store size and format made it possible to locate stores in settings such as downtown and suburban shopping areas, office buildings, and university campuses. Starbucks added 317 new company-owned locations in the United States and another 253 company-owned stores internationally in fiscal 2014. Starbucks also added 101 licensed store locations in the United States and 648 licensed stores internationally in 2014. The company planned to open 1,650 new stores globally in fiscal 2015, with 1,000 new units being opened in international markets.
- **Broaden and periodically refresh in-store product offerings.** Noncoffee products offered by Starbucks included teas, fresh pastries and other food items, candy, juice drinks, music CDs, and coffee mugs and coffee accessories.
- **Fully exploit the growing power of the Starbucks name and brand image with out-of-store sales.** Starbucks consumer packaged goods division included domestic and international sales of Frappuccino, coffee ice creams, and Starbucks coffees.

Sources: Company documents, 10-Ks, and information posted on Starbucks' website.

is to have the lowest (best) costs and prices among sellers offering products with comparable differentiating attributes. Target's best-cost advantage allows it to give discount store shoppers more value for the money by offering an attractive product lineup and an appealing shopping ambience at low prices.

In Concepts & Connections 1.2, it's evident that Starbucks has gained a competitive advantage over rivals through its efforts to offer the highest quality coffee-based beverages, create an emotional attachment with customers, expand its global presence, expand the product line, and ensure consistency in store operations. A creative,

distinctive strategy such as that used by Starbucks is a company's most reliable ticket for developing a sustainable competitive advantage and earning above-average profits. A **sustainable competitive advantage** allows a company to attract sufficiently large numbers of buyers who have a lasting preference for its products or services over those offered by rivals, despite the efforts of competitors to offset that appeal and overcome the company's advantage. The bigger and more durable the competitive advantage, the better a company's prospects for winning in the marketplace and earning superior long-term profits relative to rivals.

### CORE CONCEPT

A company achieves **sustainable competitive advantage** when an attractively large number of buyers develop a durable preference for its products or services over the offerings of competitors, despite the efforts of competitors to overcome or erode its advantage.

## The Importance of Capabilities in Building and Sustaining Competitive Advantage

Winning a *sustainable* competitive edge over rivals with any of the above five strategies generally hinges as much on building competitively valuable capabilities that rivals cannot readily match as it does on having a distinctive product offering. Clever rivals can nearly always copy the attributes of a popular product or service, but it is substantially more difficult for rivals to match the know-how and specialized capabilities a company has developed and perfected over a long period. FedEx, for example, has superior capabilities in next-day delivery of small packages. And Hyundai has become the world's fastest-growing automaker as a result of its advanced manufacturing processes and unparalleled quality control system. The capabilities of both of these companies have proven difficult for competitors to imitate or best and have allowed each to build and sustain competitive advantage.

## Why a Company's Strategy Evolves over Time

The appeal of a strategy that yields a sustainable competitive advantage is that it offers the potential for an enduring edge over rivals. However, managers of every company must be willing and ready to modify the strategy in response to the unexpected moves of competitors, shifting buyer needs and preferences, emerging market opportunities, new ideas for improving the strategy, and mounting evidence that the strategy is not working well. Most of the time, a company's strategy evolves incrementally as management fine-tunes various pieces of the strategy and adjusts the strategy to respond to unfolding events. However, on occasion, major strategy shifts are called for, such as when the strategy is clearly failing or when industry conditions change in dramatic ways.

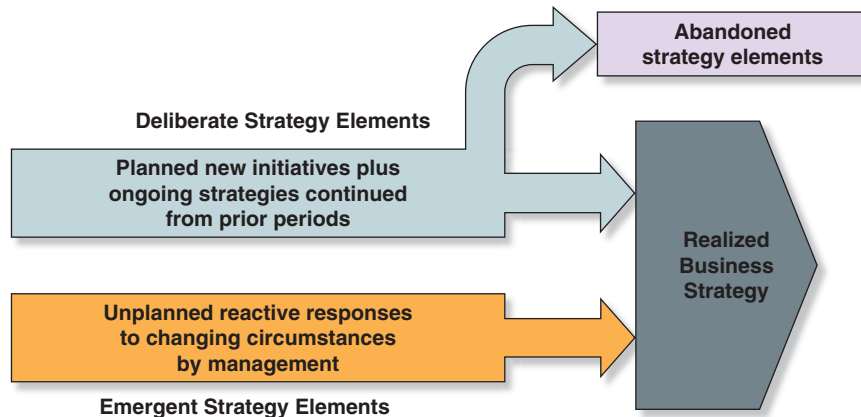
Regardless of whether a company's strategy changes gradually or swiftly, the important point is that the task of crafting strategy is not a onetime event but is always a work in progress.<sup>5</sup> The evolving nature of a company's strategy means the typical company strategy is a blend of (1) *proactive* moves to improve the company's financial performance and secure a competitive edge and (2) *adaptive* reactions to unanticipated developments and

**LO4** Understand that a company's strategy tends to evolve over time because of changing circumstances and ongoing management efforts to improve the company's strategy.

Changing circumstances and ongoing management efforts to improve the strategy cause a company's strategy to evolve over time—a condition that makes the task of crafting a strategy a work in progress, not a onetime event.



**FIGURE 1.1** A Company's Strategy Is a Blend of Planned Initiatives and Unplanned Reactive Adjustments



fresh market conditions—see Figure 1.1.<sup>6</sup> The biggest portion of a company's current strategy flows from ongoing actions that have proven themselves in the marketplace and newly launched initiatives aimed at building a larger lead over rivals and further boosting financial performance. This part of management's action plan for running the company is its proactive, **deliberate strategy**.

At times, certain components of a company's deliberate strategy will fail in the marketplace and become **abandoned strategy elements**. Also, managers must always be willing to supplement or modify planned, deliberate strategy elements with as-needed reactions to unanticipated developments. Inevitably, there will be occasions when market and competitive conditions take unexpected turns that call for some kind of strategic reaction. Novel strategic moves on the part of rival firms, unexpected

shifts in customer preferences, fast-changing technological developments, and new market opportunities call for unplanned, reactive adjustments that form the company's **emergent strategy**. As shown in Figure 1.1, a company's **realized strategy** tends to be a *combination* of deliberate planned elements and unplanned, emergent elements.

### CORE CONCEPT

A company's **realized strategy** is a combination of *deliberate planned elements* and *unplanned emergent elements*. Some components of a company's deliberate strategy will fail in the marketplace and become *abandoned strategy elements*.

**L05** Learn the three tests of a winning strategy.

## The Three Tests of a Winning Strategy

Three questions can be used to distinguish a winning strategy from a so-so or flawed strategy:

1. **How well does the strategy fit the company's situation?** To qualify as a winner, a strategy has to be well matched to the company's external and internal situations. The strategy must fit competitive conditions in the industry and other aspects of the enterprise's external environment. At the same time, it should be tailored to the company's collection of competitively important resources and

A winning strategy must fit the company's external and internal situation, build sustainable competitive advantage, and improve company performance.

capabilities. It's unwise to build a strategy upon the company's weaknesses or pursue a strategic approach that requires resources that are deficient in the company. Unless a strategy exhibits a tight fit with both the external and internal aspects of a company's overall situation, it is unlikely to produce respectable, first-rate business results.

- 2. *Is the strategy helping the company achieve a sustainable competitive advantage?*** Strategies that fail to achieve a durable competitive advantage over rivals are unlikely to produce superior performance for more than a brief period of time. Winning strategies enable a company to achieve a competitive advantage over key rivals that is long lasting. The bigger and more durable the competitive edge that the strategy helps build, the more powerful it is.
- 3. *Is the strategy producing good company performance?*** The mark of a winning strategy is strong company performance. Two kinds of performance improvements tell the most about the caliber of a company's strategy: (1) gains in profitability and financial strength and (2) advances in the company's competitive strength and market standing.

Strategies that come up short on one or more of the above tests are plainly less appealing than strategies passing all three tests with flying colors. Managers should use the same questions when evaluating either proposed or existing strategies. New initiatives that don't seem to match the company's internal and external situation should be scrapped before they come to fruition, while existing strategies must be scrutinized on a regular basis to ensure they have a good fit, offer a competitive advantage, and have contributed to above-average performance or performance improvements.

## Why Crafting and Executing Strategy Are Important Tasks

High-achieving enterprises are nearly always the product of astute, creative, and proactive strategy making. Companies don't get to the top of the industry rankings or stay there with illogical strategies, copycat strategies, or timid attempts to try to do better. Among all the things managers do, nothing affects a company's ultimate success or failure more fundamentally than how well its management team charts the company's direction, develops competitively effective strategic moves and business approaches, and pursues what needs to be done internally to produce good day-in, day-out strategy execution and operating excellence. Indeed, *good strategy and good strategy execution are the most telling signs of good management*. The rationale for using the twin standards of good strategy making and good strategy execution to determine whether a company is well managed is therefore compelling: *The better conceived a company's strategy and the more competently it is executed, the more likely that the company will be a standout performer in the marketplace*. In stark contrast, a company that lacks clear-cut direction, has a flawed strategy, or can't execute its strategy competently is a company whose financial performance is probably suffering, whose business is at long-term risk, and whose management is sorely lacking.

How well a company performs is directly attributable to the caliber of its strategy and the proficiency with which the strategy is executed.