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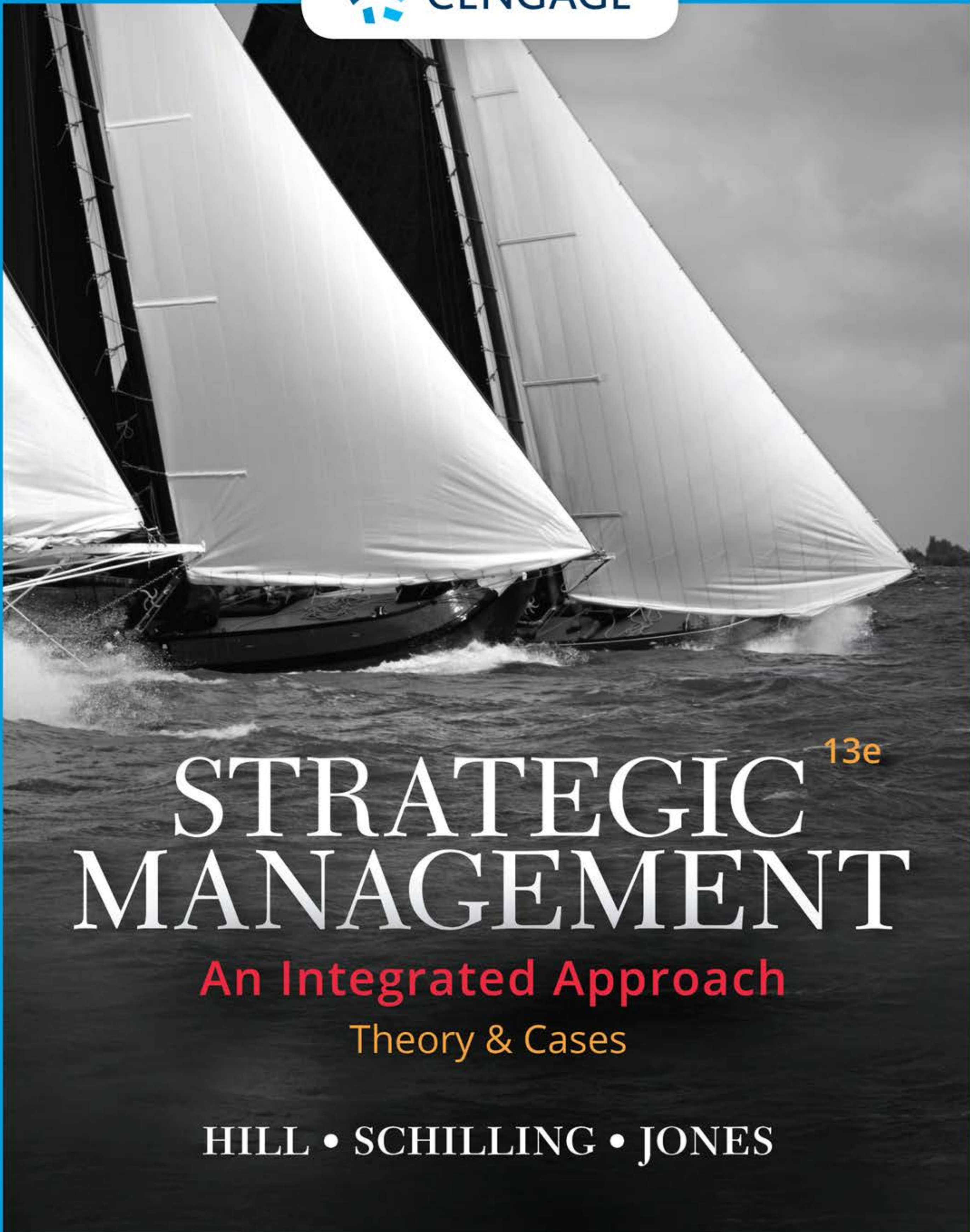

STRATEGIC MANAGEMENT

13e

An Integrated Approach

Theory & Cases

HILL • SCHILLING • JONES

STRATEGIC MANAGEMENT

13e

AN INTEGRATED APPROACH

THEORY & CASES

CHARLES W. L. HILL
University of Washington – Foster School of Business

MELISSA A. SCHILLING
New York University – Stern School of Business

GARETH R. JONES

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***Strategic Management: An Integrated Approach: Theory and Cases,* 13th Edition**

Charles W. L. Hill, Melissa A. Schilling, Gareth R. Jones

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Library of Congress Control Number: 2018959065

Soft Cover Edition ISBN: 9780357033845
Loose-Leaf Edition ISBN: 9781337916721

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Printed in the United States of America
Print Number: 01 Print Year: 2019

ABOUT THE AUTHORS

Charles W. L. Hill

Charles W. L. Hill is the Hughes M and Katherine Blake Professor of Strategy and International Business at the Foster School of Business, University of Washington, Seattle. He received his Ph.D. from the University of Manchester's Institute of Science and Technology (UMIST) in Britain. Before joining the University of Washington in 1988, he served on the faculties of UMIST, Texas A&M University and Michigan State University. Professor Hill has published extensively in top tier peer reviewed academic journals. His work is widely cited. Professor Hill teaches courses on strategic management, microeconomics, and international business. He has received numerous awards for teaching excellence. In addition to his academic work, he has worked on a private basis with many organizations including Alaska Airlines, Boeing, Microsoft, Swedish Health Services, Thompson Financial Services, and Wizards of the Coast.

Melissa A. Schilling

Melissa A. Schilling is the John Herzog Chair Professor of Management at New York University Stern School of Business. She received her Ph.D. in strategic management from the University of Washington. Her research focuses on innovation and strategy in high technology industries such as smartphones, videogames, pharmaceuticals, biotechnology, electric vehicles, and renewable energies. Her research has earned her awards such as the National Science Foundation's CAREER Award, and the Best Paper in *Management Science* and *Organization Science* for 2007 Award. Professor Schilling teaches courses in technology and innovation management, strategic management, corporate strategy, and strategy for social-mission-based organizations. She has also taught workshops or consulted with organizations such as Bloomberg Corporation, IBM, Siemens, Standard & Poor's, Warner Chilcott, White & Case, PayPal, Facebook, Skullcandy, Behr Paints, The Kauffman Foundation, National Academy of Sciences, the American Antitrust Institute, and others. She has been quoted in or interviewed for articles in *Fortune, Forbes, Inc., Thomson Reuters*, *CNBC, CNN Money, Bloomberg Business Week*, *NPR's Marketplace, NPR's Tech Nation, Machine Design*, *The Brian Lehrer Show*, *The Huffington Post*, *Scientific American*, and more.

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PREFACE

Consistent with our mission to provide students with the most current and up-to-date account of the changes taking place in the world of strategy and management, there have been significant changes in the 13th edition of *Strategic Management: An Integrated Approach*.

After making major contributions to the last two editions, Melissa Schilling has fully replaced Gareth Jones as a contributor in this edition. Melissa is a Professor of Management and Organization at the Leonard Stern School of Business at New York University, where she teaches courses on strategic management, corporate strategy, and technology and innovation management. She has published extensively in top-tier academic journals and is recognized as one of the leading experts on innovation and strategy in high-technology industries.

Second, continuing the trend of the last two editions, there have been significant revisions to the text in this edition. In the 11th edition, Chapter 5, “Business-Level Strategy,” was rewritten from scratch. In addition to the standard material on Porter’s generic strategies, this chapter now includes discussion of *value innovation* and *blue ocean strategy* following the work of W. C. Kim and R. Mauborgne. Chapter 6, “Business-Level Strategy and the Industry Environment,” was also extensively rewritten and updated to clarify concepts and bring it into the 21st century. For the 12th edition, we significantly revised and updated Chapter 3, building discussion of resources and competitive advantage around Jay Barney’s popular VRIO model. We also combined Chapters 12 and 13 into a single chapter on implementing strategy through organization. We think this more streamlined approach greatly strengthened the book and enhanced readability, particularly for students.

For the 13th edition, further changes were made in content. For example, Chapter 7 contains a more in-depth discussion of direct and indirect network effects and switching costs. In Chapter 8, we discuss how the rapidly changing international trade environment as exemplified by Brexit, the renegotiation of the North American Free Trade Agreement (NAFTA), and ongoing trade disputes between the United States and China, might impact enterprise strategy. In Chapter 9, we added an extensive section on the multiple benefits of horizontal integration, and added a section on modularity and platform competition. Chapter 10 was strengthened by the addition of a section on how agency problems can lead to acquisitions that do not create value.

Third, the examples and cases contained in each chapter have been revised. Every chapter has a new Opening Case and a new Closing Case. There are also many new Strategy in Action features. In addition, we have significantly updated the examples used in the text to make them both more modern and more globally representative. In making these changes, our goal has been to make the book relevant for students reading it in the second decade of the 21st century.

Fourth, we have a substantially revised selection of cases for this edition. All cases are either new to this edition or are updates of cases that adopters have indicated they like to see in the book. As with the last edition, we made the decision to use only our own cases. Over the years, it has been increasingly difficult to find high-quality, third-party cases, while we have received consistently positive feedback about the quality of cases that we have written; so, we decided that from this point forward we would only use our own cases. We have also received feedback that many professors like to use shorter cases, instead of or in addition to the longer cases normally included in our book. Consequently, in this edition of the book we have included 32 cases, 20 of which are the traditional long-form cases, and 12 of which are shorter cases. All of the cases are current. We have made an effort to include cases that have high name recognition with students, and that they will enjoy reading and working on. These include long-form cases on Trader Joe's, Coca Cola, Wal-Mart, Uber, SpaceX, Alibaba, Dell, Apple, IKEA, Tesla, 3M, and General Electric.

Practicing Strategic Management: An Interactive Approach

We have received a lot of positive feedback about the usefulness of the end-of-chapter exercises and assignments in the Practicing Strategic Management sections of our book. They offer a wide range of hands-on and digital learning experiences for students. We are thrilled to announce that we have moved some of these elements into the MindTap digital learning solution to provide a seamless learning experience for students and instructors. We have enhanced these features to give students engaging, multimedia learning experiences that teach them the case analysis framework and provide them multiple opportunities to step into the shoes of a manager and solve real-world strategic challenges. For instructors, MindTap offers a fully customizable, all-in-one learning suite including a digital gradebook, real-time data analytics, and full integration into your LMS. Select from assignments including:

- **Cornerstone to Capstone Diagnostic** assesses students' functional area knowledge and provides feedback and remediation so that students are up to speed and prepared for the strategic management course material.
- **Multimedia Quizzes** assess students' basic comprehension of the reading material to help you gauge their level of engagement and understanding of the content.
- **Guided Cases** engage students by presenting businesses facing strategic challenges, placing concepts in real-world context, and making for great points of discussion. As they complete these activities, students receive instruction and feedback that teaches them the case analysis methodology and helps them build critical thinking and problem-solving skills.
- **Experiential Exercises** are based on the "Practicing Strategic Management" assignments in the end-of-chapter materials in previous editions. They have been updated for the MindTap and challenge students to work in teams using the YouSeeU app in our one-of-a-kind collaborative environment to solve real-world managerial problems and begin to experience firsthand what it's like to work in management.
- **Branching Activities** present challenging problems that cannot be solved with one specific, correct answer. Students are presented with a series of decisions to be made based upon information they are given about a company, and are scored according to the quality of their decisions.
- **Case Analysis Projects** are delivered in our online collaborative environment via the YouSeeU app so that students can work together synchronously to complete their comprehensive case analysis projects, papers, and presentations. Offered in conjunction with robust cases written exclusively by Charles Hill and Melissa Schilling, these activities challenge students to think and act like tomorrow's strategic leaders. Use our default activity, written by seasoned strategic management instructors, or customize the project to suit your class.

It is not our intention to suggest that *all* exercises should be used for *every* chapter. Strategic management is taught at both undergraduate and graduate levels, and therefore we offer a variety of pedagogically designed activities with numerous challenge levels so that instructors can customize MindTap to best suit their teaching style and the objectives of the course.

We have found that our interactive approach to teaching strategic management appeals to students. It also greatly improves the quality of their learning experience. Our approach is more fully discussed in the *Instructor's Resource Manual*.

Strategic Management Cases

The 32 cases that we have selected for this edition will appeal, we are certain, to students and professors alike, both because these cases are intrinsically interesting and because of the number of strategic management issues they illuminate. The organizations discussed in the cases range from large, well-known companies, for which students can do research to update the information, to small, entrepreneurial businesses that illustrate the uncertainty and challenge of the strategic management process. In addition, the selections include many international cases, and most of the other cases contain some element of global strategy. Refer to the Contents for a complete listing of the cases.

To help students learn how to effectively analyze and write a case study, we continue to include a special section on this subject. It has a checklist and an explanation of areas to consider, suggested research tools, and tips on financial analysis. Additionally, the MindTap learning activities include Directed Cases that ask students to complete the steps and offer in-depth explanations to guide them through the process, as well as case-based Branching Activities that place students in the shoes of a manager and require them to move through strategic decisions; students are assessed on the quality of their analysis in making their choices, and the activity concludes with a discussion question for you to implement in class.

We feel that our entire selection of cases is unrivaled in breadth and depth.

Teaching and Learning Aids

Taken together, the teaching and learning features of *Strategic Management* provide a package that is unsurpassed in its coverage and that supports the integrated approach that we have taken throughout the book.

- **MindTap.** MindTap is the digital learning solution that helps instructors engage students and help them become tomorrow's strategic leaders. All activities are designed to teach students to problem-solve and think like management leaders. Through these activities and real-time course analytics, and an accessible reader, MindTap helps you turn cookie cutter into cutting edge, apathy into engagement, and memorizers into higher-level thinkers.

  Customized to the specific needs of this course, activities are built to facilitate mastery of chapter content. We have addressed case analysis from cornerstone to capstone with a functional area diagnostic of prior knowledge, guided cases, branching activities, multimedia presentations of real-world companies facing strategic decisions, and a collaborative environment in which students can complete group case analysis projects together synchronously.
- **Instructor Website.** Access important teaching resources on this companion website. For your convenience, you can download electronic versions of the instructor supplements from the password-protected section of the site, including Instructor's Resource Manual, Comprehensive Case Notes, Cognero Testing, and PowerPoint® slides. To access these additional course materials and companion resources, please visit www.cengage.com.

- **The Instructor's Resource Manual.** For each chapter, we provide a clearly focused synopsis, a list of teaching objectives, a comprehensive lecture outline, teaching notes for the Ethical Dilemma feature, suggested answers to discussion questions, and comments on the end-of-chapter activities. Each Opening Case, Strategy in Action boxed feature, and Closing Case has a synopsis and a corresponding teaching note to help guide class discussion.
- **Case Teaching Notes.** These include a complete list of case discussion questions, as well as comprehensive teaching notes for each case, which give a complete analysis of case issues.
- **Cognero Test Bank.** A completely online test bank allows the instructor the ability to create comprehensive, true/false, multiple-choice, and essay questions for each chapter in the book. The mix of questions has been adjusted to provide fewer fact-based or simple memorization items and to provide more items that rely on synthesis or application.
- **PowerPoint Presentation Slides.** Each chapter comes complete with a robust PowerPoint presentation to aid with class lectures. These slides can be downloaded from the text website.

ACKNOWLEDGMENTS

This book is the product of far more than three authors. We are grateful to our Senior Product Manager, Mike Giffen; our Content Manager, Amanda White; and our Marketing Manager, Audrey Wyrick, for their help in developing and promoting the book and for providing us with timely feedback and information from professors and reviewers, which allowed us to shape the book to meet the needs of its intended market. We also want to thank the departments of management at the University of Washington and New York University for providing the setting and atmosphere in which the book could be written, and the students of these universities who react to and provide input for many of our ideas. In addition, the following reviewers of this and earlier editions gave us valuable suggestions for improving the manuscript from its original version to its current form:

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Ken Armstrong, *Anderson University*
Richard Babcock, *University of San Francisco*
Kunal Banerji, *West Virginia University*
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Charles W. L. Hill
Melissa A. Schilling
Gareth R. Jones

DEDICATION

To my daughters Elizabeth, Charlotte, and Michelle

— Charles W. L. Hill

For my children, Julia and Conor

— Melissa A. Schilling

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1

INTRODUCTION TO STRATEGIC MANAGEMENT

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CHAPTER 1

STRATEGIC LEADERSHIP: MANAGING THE STRATEGY-MAKING PROCESS FOR COMPETITIVE ADVANTAGE

LEARNING OBJECTIVES

1.1 Explain what is meant by "competitive advantage"

1.2 Discuss the strategic role of managers at different levels within an organization

1.3 Identify the primary steps in a strategic planning process

1.4 Discuss the common pitfalls of planning, and how those pitfalls can be avoided

1.5 Outline the cognitive biases that might lead to poor strategic decisions, and explain how these biases can be overcome

1.6 Discuss the role strategic leaders play in the strategy-making process

OPENING CASE

T-Mobile's Uncarrier Strategy

When John Legere joined T-Mobile as CEO in September 2012, the number four US wireless service provider was in trouble. The company would lose $7.2 billion in 2012. The market was saturated, and growth was slow. Verizon and AT&T dominated the business with almost 80% of the market between them. T-Mobile had just 10% Verizon and AT&T enjoyed cost advantages that came from significant economies of scale. Both companies had better network coverage and fewer dropped calls than T-Mobile. Moreover, unlike its larger rivals, T-Mobile did not offer the best-selling iPhone to its customers. To compound matters, AT&T had tried to acquire T-Mobile, but the deal fell apart after opposition from the

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Justice Department who thought that merger would reduce competition in the industry. Employee moral had taken a hit during the merger talks and had yet to recover.

Legere saw things differently. Although employee morale was beaten down, he thought that the overall culture was intact and had the potential to be a powerful driver of growth. The average age of field employees was just 27. They were looking for somebody to energize them, and Legere meant to deliver. He did so by providing a clear strategic direction, eliminating bureaucratic rules and procedures that stifled motivation and initiative taking, and creating a sense of excitement. Legere also realized that customers hated industry practices. They hated being locked into contracts. They hated being gouged by extra fees they couldn't understand or couldn't fully control, such as data and roaming charges. They also thought wireless phones were cheap, whereas the wireless carriers were in fact subsidizing the phone manufacturers and recouping the cost of selling cheap handsets by charging high service fees. To Legere's way of thinking, customer dissatisfaction with industry practices created an opportunity for T-Mobile. He believed that the best way to succeed in the industry was to do things differently from existing carriers – to do the complete opposite – and so was born T-Mobile's strategy of being the "Un-carrier."

First though, Legere had to fix some obvious problems. T-Mobile wasn't selling the iPhone, so he went to Apple and made a deal. T-Mobile's network coverage had been terrible, so the company began buying up all of the wireless spectrum they could and investing heavily in upgrading their network to improve both the coverage and speed of service. Next, Legere and his team started to make dramatic changes to the company's offering aimed at making the experience better for customers. T-Mobile eliminated long-term contracts and replaced them with a transparent pricing model. They made it easier to upgrade to a new smartphone, and stopped charging for global roaming. They offered to pay the early termination fees for customers who wanted to switch from other carriers to T-Mobile. The company was also the first to offer unlimited data plans. In 2017, it upped the ante by offering free Netflix streaming to customers with two or more lines. Legere backed up all of this with flashy marketing, including creative use of his twitter account to promote T-Mobile and lambast industry rivals (Legere has an impressive 5.3 million followers on Twitter).

The strategy has produced some noticeable results. The total number of subscribers at T-Mobile increased from 33 million in late 2012 to 70 million by late 2017, making the company number one in terms of customer growth. Market share expanded from 10% to 17% over the same period. Monthly churn rates, a key metric of customer satisfaction, fell from 2.7% in 2011 to 1.3% in 2017, close to the 1% achieved by industry leader Verizon. That being said, T-Mobile still faces big challenges. It continues to lack the economies of scale and coverage of its larger rivals. T-Mobile also has poor retail distribution in one-third of the United States, a deficiency it is now trying to fix by rapidly expanding its retail presence. It added more than 3,000 retail stores in 2017 alone. If it gains enough new customers, it may be able to attain scale economies, lower its costs per customer and become more profitable.

Sources: John Legere, "T-Mobile's CEO on winning market share by trash talking rivals," *Harvard Business Review,* January-February 2017. Brandt Ranj, "How the unlimited data plans from AT&T, Verizon, T-Mobile and Sprint all stack up," *Business Insider,* June 29, 2017. Ina Fried, "T-Mobile COO explains why the "uncarrier" strategy is working," Axios, September 11, 2017.

1-1 OVERVIEW

Why do some companies succeed, whereas others fail? In the airline industry, how has Southwest Airlines managed to keep increasing its revenues and profits through both good times and bad, whereas rivals such as United Airlines have had to seek bankruptcy protection? What explains the persistent growth and profitability of Nucor Steel, now the largest steelmaker in the United States, during a period when many of its once-larger rivals disappeared into bankruptcy? And with reference to the Opening Case, why has T-Mobile recently been able to grow faster than its rivals?

In this book, we explain how the strategies that a company's managers pursue have a major impact on the company's performance relative to that of its competitors. A **strategy** is a set of related actions that managers take to attain a goal or goals. For most, if not all, companies, achieving superior financial performance relative to rivals is the ultimate goal. If a company's strategies result in superior performance, it is said to have a competitive advantage.

strategy
A set of related actions that managers take to increase their company's performance.

For T-Mobile, the search for competitive advantage is still a work in progress. When John Legere joined T-Mobile as CEO in 2012, his primary goal was to increase the market share of the company in order to better attain economies of scale and increase profitability (see the Opening Case). He pursued a number of actions that were consistent with this goal, which collectively are referred to at T-Mobile as the "un-carrier" strategy. So far, the strategy has been successful at increasing market share. By 2018, T-Mobile had twice as many subscribers as it did when Legere became CEO. However, the company still lags its larger rivals on common measures of financial performance such as return on invested capital (a popular measured of profitability). T-Mobile will need to continue to build on its current success if it is going to establish a sustainable competitive advantage and reap the gains in terms of superior financial performance.

This book identifies and describes the strategies that managers can pursue to achieve superior performance and provide their companies with a competitive advantage. One of its central aims is to give you a thorough understanding of the analytical techniques and skills necessary to formulate and implement strategies successfully. The first step toward achieving this objective is to describe in more detail what superior performance and competitive advantage mean, and to explain the pivotal role that managers play in leading the strategy-making process.

Strategic leadership is about how to most effectively manage a company's strategy-making process to create competitive advantage. Strategy-making is the process by which managers select and then implement a set of strategies that aim to achieve a competitive advantage. **Strategy formulation** is the task of selecting strategies. **Strategy implementation** is the task of putting strategies into action, which includes designing, delivering, and supporting products; improving the efficiency and effectiveness of operations; and designing a company's organizational structure, control systems, and culture. T-Mobile has been successful so far under Legere's leadership not just because he and his team formulated a viable strategy, but because that strategy has been well implemented.

strategic leadership
Creating competitive advantage through effective management of the strategy-making process.

strategy formulation
Selecting strategies based on analysis of an organization's external and internal environment.

strategy implementation
Putting strategies into action.

By the end of this chapter, you will understand how strategic leaders can manage the strategy-making process by formulating and implementing strategies that enable a company to achieve a competitive advantage and superior performance. Moreover, you will learn how the strategy-making process can sometimes go wrong, and what managers can do to make this process more effective.

1-2 STRATEGIC LEADERSHIP, COMPETITIVE ADVANTAGE, AND SUPERIOR PERFORMANCE

Strategic leadership is concerned with managing the strategy-making process to increase the performance of a company, thereby increasing the value of the enterprise to its owners, its shareholders. As shown in Figure 1.1, to increase shareholder value, managers must pursue strategies that increase the *profitability* of the company and ensure that *profits grow* (for more details, see the Appendix to this chapter). To do this, a company must be able to outperform its rivals; it must have a competitive advantage.

1-2a Superior Performance

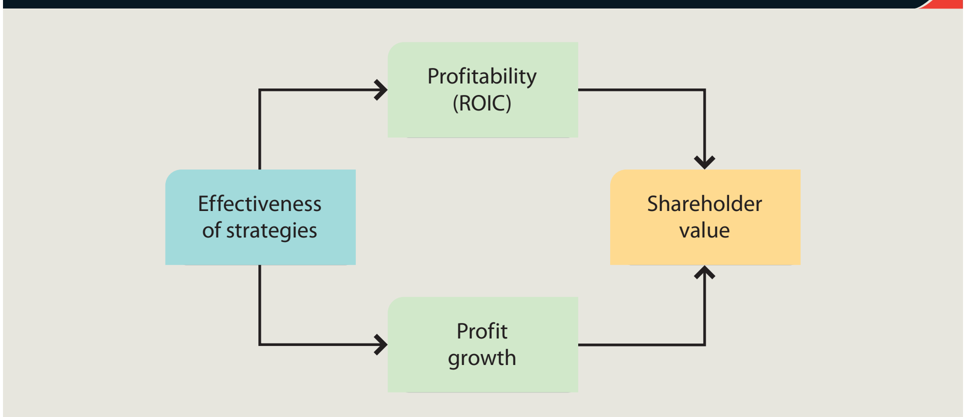
Shareholder value refers to the returns that shareholders earn from purchasing shares in a company. These returns come from two sources: (a) capital appreciation in the value of a company's shares, and (b) dividend payments. For example, during 2017, a share of Microsoft increased in price from $62.84 to $85.95. Each share of Microsoft also paid a dividend of $1.56 to its owners during 2017. Thus, in 2017, shareholders in Microsoft earned a return of 39.3%, 36.8% of which came from capital appreciation in the value of the share, and 2.5% of which came in the form of a dividend payout.

Maximizing shareholder value is the ultimate goal of profit-making companies, for two reasons. First, shareholders provide a company with the risk capital that enables managers to buy the resources needed to produce and sell goods and services. **Risk capital** is capital that cannot be recovered if a company fails and goes bankrupt.

shareholder value
Returns that shareholders earn from purchasing shares in a company.

risk capital
Equity capital invested with no guarantee that stockholders will recoup their cash or earn a decent return.

Figure 1.1 Determinants of Shareholder Value



Shareholders will not provide risk capital unless they believe that managers are committed to pursuing strategies that provide a good return on their capital investment. Second, shareholders are the legal owners of a corporation, and their shares therefore represent a claim on the profits generated by a company. Thus, managers have an obligation to invest those profits in ways that maximize shareholder value.

profitability
The return a company makes on the capital invested in the enterprise.

As noted in Figure 1.1, increasing shareholder value requires strategies that boost the profitability of the enterprise, and enable it to attain greater profit growth. One way to measure the **profitability** of a company is by its return on the capital invested in the enterprise.[1] The return on invested capital (ROIC) that a company earns is defined as its net profit over the capital invested in the firm (profit/capital invested). By net profit, we mean net income after tax. By capital, we mean the sum of money invested in the company: that is, stockholders' equity plus debt owed to creditors. So defined, *profitability is the result of how efficiently and effectively managers use the capital at their disposal to produce goods and services that satisfy customer needs.* A company that uses its capital efficiently and effectively makes a positive return on invested capital. On this measure, T-Mobile still has some way to go. Although the company has been profitable since 2012, T-Mobile's **return on invested capital** (ROIC) remains mired in the low to mid-single digits. In 2017, for example, it was 6.7% compared to 14% at Verizon. In the long run, Legere will have to increase ROIC if his tenure is to be judged a complete success.

return on invested capital
Return on invested capital is equal to net profit divided by capital invested in the company.

profit growth
The increase in net profit over time.

A company's **profit growth** can be measured by the increase in net profit over time. A company can grow its profits if it sells products in rapidly growing markets, gains market share from rivals, increases sales to existing customers, expands overseas, or diversifies profitably into new lines of business. For example, between 2013 and 2017, T-Mobile increased its net profits from $35 million to $2.2 billion, gaining market share and doubling its subscriber base thanks to its successful "un-carrier" strategy. Due to its profit growth, T-Mobile's earnings per share increased from $0.05 to $2.55 over this period, resulting in appreciation in the value of each share in T-Mobile.

Together, profitability and profit growth are the principal drivers of shareholder value (see the Appendix to this chapter for details). *To both boost profitability and grow profits over time, managers must formulate and implement strategies that give their company a competitive advantage over rivals*. Under the leadership of Legere, T-Mobile has been doing this. Between the start of 2013 and the end of 2017, the company's share price rose from $18 to almost $64, as investors came to realize that Legere's strategy was starting to work. If T-Mobile can continue to improve its market share, higher profitability will follow and shareholders will be rewarded for their decision to invest in the company.

One key challenge managers face is how best to simultaneously generate high profitability and increase profits. Companies that have high profitability but no profit growth will often be less valued by shareholders than companies that have both high profitability and rapid profit growth (see the Appendix for details). At the same time, managers need to be aware that if they grow profits but profitability declines, that too will be less highly valued by shareholders. What shareholders want to see, and what managers must try to deliver through strategic leadership, is *profitable growth*: that is, high profitability and sustainable profit growth. This is not easy, but some of the most successful enterprises of our era have achieved it—companies such as Apple, Google, and Microsoft.

It is important to remember that while maximizing shareholder value is the primary goal of for profit enterprises, as explained later in this book, managers must behave in a legal, ethical, and socially responsible manner while working towards this goal. Moreover, as we shall see, there is good evidence that the best way to maximize the *long-run* return to shareholders is to focus on customers and employees. Satisfying customer needs, and making sure that employees are fairly treated and work productively, typically translates into better financial performance and superior long-run returns for shareholders. Alternatively, ignoring customer needs, and treating employees unfairly, may boost short-run profits and returns to shareholders, but it will also damage the long-run viability of the enterprise and ultimately depress shareholder value. This is why many successful managers argue that if a company focuses on its customers, and creates incentives for its employees to work productivity, shareholder returns will take care of themselves. Interestingly, at T-Mobile a major part of Legere's strategy has been to focus on treating customers well and empowering employees.

1-2b Competitive Advantage and a Company's Business Model

Managers do not make strategic decisions in a competitive vacuum. Their company is competing against other companies for customers. T-Mobile competes against Verizon, AT&T, and Sprint. Competition is a rough-and-tumble process in which only the most efficient, effective companies win out. It is a race without end. To maximize long-run shareholder value, managers must formulate and implement strategies that enable their company to outperform rivals—that give it a competitive advantage. A company is said to have a **competitive advantage** over its rivals when its profitability and profit growth are greater than the average of other companies competing for the same set of customers. The higher its profitability and profit growth relative to rivals, the greater its competitive advantage will be. A company has a **sustained competitive advantage** when its strategies enable it to maintain above-average profitability and profit growth for a number of years. T-Mobile isn't there yet, but it is moving in the right direction.

The key to understanding competitive advantage is appreciating how the different strategies managers pursue over time can create activities that fit together to make a company unique and able to consistently outperform them. A **business model** is managers' conception of how the set of strategies their company pursues work together as a congruent whole, enabling the company to gain a competitive advantage and achieve superior profitability and profit growth. In essence, a business model is a kind of mental model, or gestalt, of how the various strategies and capital investments a company makes fit together to generate above-average performance. A business model encompasses the totality of how a company will:

- Select its customers.
- Define and differentiate its product offerings.
- Create value for its customers.
- Acquire and keep customers.
- Produce goods or services.
- Increase productivity and lower costs.
- Deliver goods and services to the market.
- Organize activities within the company.
- Configure its resources.
- Achieve and sustain a high level of profitability.
- Grow the business over time.

competitive advantage
The achieved advantage over rivals when a company's profitability is greater than the average profitability of firms in its industry.

sustained competitive advantage
A company's strategies enable it to maintain above-average profitability for a number of years.

business model
The conception of how strategies should work together as a whole to enable the company to achieve competitive advantage.

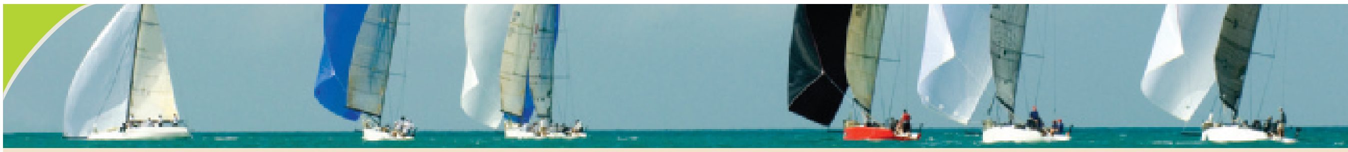
The business model at discount stores such as Wal-Mart, for example, is based on the idea that costs can be lowered by replacing a full-service retail format with a self-service format and a wider selection of products sold in a large-footprint store that contains minimal fixtures and fittings. These savings are passed on to consumers in the form of lower prices, which in turn grow revenues and help the company achieve further cost reductions from economies of scale. Over time, this business model has proved superior to the business models adopted by smaller, full-service, "mom-and-pop" stores, and by traditional, high-service department stores such as Sears. The business model—known as the self-service supermarket business model—was first developed by grocery retailers in the 1950s and later refined and improved on by general merchandisers such as Wal-Mart in the 1960s and 1970s. Subsequently, the same basic business model was applied to toys (Toys "R" Us), office supplies (Staples, Office Depot), and home-improvement supplies (Home Depot and Lowes).

1-2c Industry Differences in Performance

It is important to recognize that in addition to its business model and associated strategies, a company's performance is also determined by the characteristics of the industry in which it competes. Different industries are characterized by different competitive conditions. In some industries, demand is growing rapidly; in others it is contracting. Some industries might be beset by excess capacity and persistent price wars; others by strong demand and rising prices. In some, technological change might be revolutionizing competition; others may be characterized by stable technology. In some industries, high profitability among incumbent companies might induce new companies to enter the industry, and these new entrants might subsequently depress prices and profits in the industry. In other industries, new entry might be difficult, and periods of high profitability might persist for a considerable time. Thus, the different competitive conditions prevailing in different industries may lead to differences in profitability and profit growth. For example, average profitability might be higher in some industries and lower in other industries because competitive conditions vary from industry to industry. Exactly how industries differ is discussed in detail in Chapter 2. For now, it is important to remember that the profitability and profit growth of a company are determined by two main factors: *its relative success in its industry and the overall performance of its industry relative to other industries*.[2]

1-2d Performance in Nonprofit Enterprises

A final point concerns the concept of superior performance in the nonprofit sector. By definition, nonprofit enterprises such as government agencies, universities, and charities are not in "business" to make profits. Nevertheless, they are expected to use their resources efficiently and operate effectively, and their managers set goals to measure their performance. One performance goal for a business school might be to get its programs ranked among the best in the nation. A performance goal for a charity such as the Gates Foundation might be to eradicate malaria (see Strategy in Action 1.1 for details). A performance goal for a government agency might be to improve its services while reducing its need for taxpayer funds. The managers of nonprofits need to map out strategies to attain these goals. They also need to understand that nonprofits compete with each other for scarce resources, just as businesses do. For example, charities



1.1 STRATEGY IN ACTION

The Gates Foundation—Eradicating Malaria

In 2007, the Bill & Melinda Gates Foundation, the philanthropic foundation established by Microsoft founder Bill Gates and his wife Melinda, announced an ambitious, long-term goal: to eradicate malaria worldwide, rather than just keeping it under control, as had been the prevailing policy for decades. Many thought the goal was overly ambitious. An earlier attempt to eradicate the disease in the late 1950s had failed. The call came at a challenging time. Malaria was killing more than 1 million people a year, most of them children. Deaths from malaria in sub-Saharan Africa had doubled over the prior 20 years as the malaria parasite grew resistant to existing drugs, and as the mosquitos that carry the disease grew resistant to insecticides. The Gates Foundation backed up its call to arms with a commitment to invest $860 million to malaria programs, and another $650 million to support the Global Fund to Fight AIDS, Tuberculosis and Malaria.

With a clear, long-term goal in place, the Gates Foundation needed to develop a set of strategies to attain this goal. The Foundation knew only too well that simply throwing money at the problem would not lead to a solution. Besides, even an organization like the Gates Foundation, which is the world's largest private charity, has limited resources and many different requests for funding. The foundation needed to make very clear choices about how it allocated its limited resources in order to have maximum effect and help win the war against malaria. To aid in this process, it hired scientists and public health experts to help evaluate requests for funding.

As it developed over the next few years, the foundation's strategy had several elements. First, it committed funds to promising efforts to develop a vaccine for malaria. Second, realizing that many malaria carriers are asymptomatic, the foundation backed efforts to developing better diagnostic tests that could be used quickly and efficiently in poor regions so that carriers in a population could be identified and treated. Third, it funded efforts to develop new drugs to treat those with malaria. These drugs represented an effort to respond to the rise of drug resistant malaria parasites. Fourth, it sought to fund the development of more effective transmission control tools such as insecticide treated bed nets and indoor spraying of walls and other surfaces with an insecticide. Finally, realizing that it could do far more with the support and cooperation of national governments and multinational institutions, the foundation used its resources to advocate for better funding and more effective policies, and it partnered proactively with national government in affected areas to help them develop more effective policies.

How much progress has the foundation made? In 2016, malaria claimed 429,000 lives. While that figure is still way too high, it represented a 50% reduction overall from the diseases peak in the early 2000s. The Gates Foundation's malaria strategy is evolving. Bill Gates is the first to admit that some of its goals were too ambitious. Early on, he thought we would have a malaria vaccine by now. While that hasn't happened, a promising vaccine is now in development. Equally notable, some low technology and inexpensive strategies have proved to be very successful, such as giving away insecticide treated bed nets and placing mosquito traps in ventilation airways between the walls and rooks of buildings.

Sources: D.G. Blankinship, "Gates Foundation looks to fight Malaria," *Associated Press*, October 17, 2007. Bill Gates, "Mosquito Wars," *gatesnotes*, August 15, 2017. Bill & Melinda Gates Foundation, "Malaria: Strategy Overview," April 2011. N. Kirsch, "Philanthropy King: Bill Gates gives away $4.6 billion, unveils new campaign to combat malaria," *Forbes*, August 15, 2017.