

Chapter 1: Introduction to Strategic Management

CHAPTER SUMMARY

This chapter introduces the business challenges of a turbulent and ambiguous competitive landscape that is driven by globalization trends and rapid changes in technology.

The emergence of the field of strategic management is a response to the competitive environment, and it is briefly presented to provide a foundation for the concepts found throughout the text.

In a general sense, the central question of strategic management is why some firms outperform other firms. Comprehensively, a firm can be viewed as a bundle of market activities, a bundle of resources, or a network of relationships. These three perspectives are examined in this chapter as the basis for determining the strategic direction of a firm.

Defining the process and outlining the major portions of the book, strategic management is reviewed to provide a road map for the topics examined throughout the book.

CHAPTER OUTLINE

The Competitive Landscape

- Globalization of Markets and Industries

- Technological Advances

The Emergence of Strategic Management as a Business Discipline

- Early Influences on the Strategy Concept

- Modern Strategic Management

Three Perspectives on Value Creation

- The I/O Model of Above-Average Returns

- The Resource-Based Model of Above-Average Returns

- The Stakeholder Model of Responsible Firm Behavior and Firm Performance

Strategic Thinking and the Strategic Management Process

- Strategic Thinking

- The Strategic Management Process

- Summary

KNOWLEDGE OBJECTIVES

1. Describe the 21st century competitive landscape and explain how globalization and technological changes shape it.
2. Use the industrial organization (I/O) model to explain how firms can earn above-average returns.
3. Use the resource-based model to explain how firms can earn above-average returns.
4. Explain the stakeholder perspective and how effective management of stakeholders can lead to high firm performance and responsible firm behavior.
5. Define strategic thinking and explain how it is used to guide decision making during the strategic management process.
6. Describe the strategic management process.

Chapter 1 - Introduction to Strategic Management

LECTURE NOTES

The Competitive Landscape - This opening section uses a discussion of the automobile industry to illustrate the impact that environmental influences, particularly global forces and rapid changes in technology, have on the success of businesses today.

See slide 1.
See slide 2.

1. What conditions in the automobile industry impacted the success of U.S. automakers in the 1970s?
 - a. Increases in gas prices created demand for smaller, more efficient automobiles in the U.S.
 - b. The quality of Japanese-made vehicles dramatically increased.
2. Why did these trends have such a negative effect on U.S. automakers?
 - a. They were slow to respond to global forces and to adopt a global mindset.
 - b. They were unable to effectively compete against new entrants in the large U.S. market.
 - c. They failed to make the necessary technological changes needed to stay competitive.

Globalization of Markets and Industries - This section discusses the changes in the nature of competition that have resulted from a continued increase in the globalization of world markets and the way that globalization has led to a hypercompetitive environment for businesses today.

See slide 3.

Key Terms

- Globalization - increasing economic interdependence among countries as reflected in the flow of goods and services, financial capital, and knowledge across country borders.
- Hypercompetition - extremely intense rivalry among firms, characterized by escalating and aggressively competitive moves amongst competing firms.

See slides 4-5.

3. How has the global economy significantly expanded and complicated the competitive environment for companies?
 - a. Restraints on business transactions across national boundaries (such as tariffs) have been reduced.
 - b. It is often difficult to recognize or determine the boundaries of an industry (for example, the blur amongst television, telephone, and computer service providers).
 - c. The range of opportunities for acquiring resources (such as equipment, capital, raw material and even employees) and for selling goods and services has been

Chapter 1 - Introduction to Strategic Management

	greatly increased. d. Hyper-competition has resulted from the dynamics of strategic maneuvering among global and innovative competitors. e. Performance standards have increased in many areas, including quality, cost, productivity, product introduction time, and operational efficiency. f. Continuous improvement in all areas is necessary for continued survival.
--	--

Technological Advances - This section discusses three major technological trends that have significantly altered the nature of competition and closes with a discussion of how competitive advantage can no longer be achieved through traditional forms of competition (like economies of scale and advertising).	
See slide 6.	Key Terms ▪ <u>Strategic Flexibility</u> - set of capabilities used to respond to various demands and opportunities existing in a dynamic and uncertain competitive environment. (More detail covered in Chapter 13.)
See slide 7.	4. What types of technological trends have impacted competition in today's business environment? (Try to give examples of each.) a. The increasing rate of technological change and diffusion. The increasing speed at which new technologies become available and are used. (Rapid introduction of Internet access into American homes compared to the time it took to introduce televisions or telephones into the home a few decades ago.) b. The dramatic information technology changes in recent years. The different ways that information is being used. (Personal computers, cell phones, artificial intelligence, virtual reality, and massive databases to name a few.) c. Increasing knowledge intensity. The basis for technology and its application. (Information, intelligence, and expertise are being acknowledged as corporate assets.) (Discussed more fully in Chapter 6.)
See Figure 1.1: Changes in the Competitive Landscape (Slide 8).	5. How have these trends affected today's business environment? a. It is important for firms to quickly gather information about their competitors' research and development and subsequent product decisions.

Chapter 1 - Introduction to Strategic Management

See slide 9.	b. Product life cycles are shorter. c. Products can become somewhat indistinguishable. d. New technologies are rapidly replacing existing technologies. e. Access to significant quantities of relatively inexpensive information is now possible. f. The pervasive influence of electronic-business models is creating a new business culture. g. Continuous learning is necessary to provide businesses with the skills needed to adapt to changes in the environment.
See slide 10.	6. What sources of competitive advantage have resulted from these technological and global trends? a. Speed to market. b. The ability to effectively and efficiently access and use information. c. The ability to capture intelligence, transform it into usable knowledge, and diffuse it rapidly throughout the company. d. Innovation. e. Effective integration of new conditions into the mindset of an organization. f. Meeting and exceeding global standards. g. Strategic flexibility.
See slide 11.	7. Describe the impact of developing “disruptive technologies” on the marketplace. (Can you think of any examples?) a. This type of innovation destroys the value of existing technologies. b. This creative destruction process replaces existing technologies with new ones to create new markets.

The Emergence of Strategic Management as a Business Discipline - This section presents a brief history of the field of strategic management, which will serve as a conceptual foundation for strategic management concepts throughout the text.

Early Influences on the Strategy Concept - This section discusses the work that evolved from the study of business policy, which was an integrated, multifunctional approach to address management challenges emerging from the increasingly complex and turbulent external environment facing businesses. The theoretical foundation for modern strategic management is introduced.

See slide 12.	Key Terms
---------------	------------------

Chapter 1 - Introduction to Strategic Management

	▪ <u>Agency Theory</u> - concept that agency problems exist when managers take actions that are in their own best interests, rather than those of shareholders. ▪ <u>Transactions Costs Economics</u> - examination of the efficiency of economic activity which instructs firms to purchase required resources through a market transaction unless particular conditions exist that make creating them internally more efficient.
See slides 13-14.	8. What are some of the foundational concepts to emerge during this period? a. The need for businesses to establish goals, formulate strategies to achieve them, and implement (resource-allocation) plans to meet stated goals. b. The integration of the external market factors into business planning. c. The wisdom of balancing the conflicting needs of businesses' internal and external stakeholders. d. The importance of an economic approach to identify market opportunities. e. The importance of having or acquiring the resources and capabilities to achieve organizational objectives. f. The idea that political strategies should be used in addition to rational-deductive strategy development to address stakeholder interests and facilitate the achievement of organizational goals. g. The use of organizational learning processes to achieve strategic success. h. The use of Agency Theory to focus on shareholder returns as a primary criterion for firm success. i. The use of Transactions Costs Economics to determine whether to produce or acquire the resources needed by businesses.
Modern Strategic Management - This section discusses the evolution of the strategic management process into a broader, more comprehensive theory which identifies the importance of both adaptation and enactment in strategy formulation.	
See slide 15.	Key Terms ▪ <u>Deterministic Perspective</u> - argument that firms should adapt to their environments (establishing "fit") because the environmental situation determines the most effective strategies for achieving success. ▪ <u>Enactment</u> - principle that recognizes the potential of influencing the environment through human action

Chapter 1 - Introduction to Strategic Management

	(environmental forces do not entirely determine strategic moves to create a competitive advantage).
--	---

Three Perspectives on Value Creation - This section outlines three models for organizing the critical concepts and activities central to the strategic management process.

See slide 16.	9. What are the three strategic management models for creating value, or above-average returns, for the firm? a. Industrial/Organization (I/O) Economic Model b. Resource-Based View c. Stakeholder Approach
---------------	---

The Industrial/Organization (I/O) Model of Above-Average Returns - This section presents the model for strategy development that predicts value creation when strategy selection is dictated by the characteristics of the general, industry, and competitive environments. Four underlying assumptions to the model are identified and the Porter's Five-Forces Model is introduced.

See slide 17.	10. Describe the basic premise of the I/O Model. a. The model explains the dominant influence of the external environment on a firm's strategic actions and performance. (Industry characteristics further developed in Chapter 3.)
See slides 18-19.	11. What are the four underlying assumptions to the model? a. The external environment is assumed to impose pressures and constraints that determine the strategies that would result in above-average returns. b. Most firms competing within a particular industry or industry segment are assumed to control similar strategically relevant resources and to pursue similar strategies in light of those resources. c. Resources used to implement strategies are assumed to be highly mobile across firms. Because of resource mobility, any resource differences that might develop between firms will be short lived. d. Organizational decision makers are assumed to be rational and committed to acting in the firm's best interests, as shown by their profit-maximizing behaviors.
See Figure 1.2: The I/O Model of Above-Average Returns (See slide 20).	
See slide 21.	12. What contribution to strategic management does Michael Porter's Five-Forces Model make? a. It reinforces the importance of economic theory. b. It offers an analytical approach that was previously lacking in the field of strategy.

Chapter 1 - Introduction to Strategic Management

See slide 22. See Additional Notes below.	c. It describes the forces that determine the nature/level of competition and profit potential in an industry. d. It suggests how an organization can use the analysis to establish a competitive advantage. 13. What are the limitations of the model? a. At its basic level, the model only suggests two strategies for establishing a defensibly competitive position (cost-leadership and differentiation). b. The model does not address the need to develop or acquire unique internal resources and capabilities to aid in success. Research shows that both the environment and internal conditions play a role in determining a firm's profitability.
See slides 18-19.	Additional Discussion Notes for the I/O Model - These notes include additional materials that cover the assumptions underlying the model. Two examples of the McDonald's and Starbucks organizations and their strategies are provided to illustrate the model. Four Assumptions of the I/O Model Both Crock and Schultz identified the strategy that allowed their companies to achieve high profits: McDonald's through the "assembly line" of their burgers, and Starbucks with product marketing that created ambiance and consistency; a value perception that allowed them to charge a high premium for their coffee. Both McDonald's and Starbucks then spent time and capital to acquire and develop the skills needed to implement the business strategy. Crock became a business partner of the McDonald brothers and sold franchise agreements for them. Schultz took a position in the marketing department of Starbucks. Each later purchased the firm and used what they had learned to rapidly expand the company. Crock was able to use McDonald's quality, consistency, rapid assembly system, and drive-thru concepts to continue to realize high profits. Schultz was able to use the Starbucks image, ambiance concept, and marketing strengths to rapidly expand. One interesting note: Initially, Schultz started a Seattle coffee-house chain (Il Giorande) that competed with Starbucks. His marketing manager was so adamant that Starbucks was a better concept capable of "going global" that Schultz sold his original coffeehouse chain and purchased Starbucks. I/O Model: McDonald's and Starbucks Respectively, in both cases the CEOs Ray Crock and Howard Schultz were examining the industry in which they worked. Crock was a sales rep for a firm that built malted milkshake machines. Schultz was a sales rep for a company that made home espresso machine accessories. Both

Chapter 1 - Introduction to Strategic Management

	noticed that there was a customer purchasing a large volume of these machines. They made trips to the locations of these stores and noticed that each was in an emerging industry that had high-growth potential and higher-than-average profit margins. McDonald's is in fast-food and drive-thru restaurants, and Starbucks is in specialty coffee retail.
--	--

The Resource-Based Model of Above-Average Returns - This section presents the model for strategy development that predicts value creation when strategy selection is dictated by the firm's unique collection of resources and capabilities, rather than the structural characteristics of the industry in which it competes.	
See slides 23-24.	Key Terms ▪ <u>Distinctive Competencies</u> - firm attributes that allow it to pursue a strategy better than other firms. ▪ <u>Resources</u> - inputs into a firm's production process, such as capital equipment, employee skills, patents, high-quality managers, financial condition, etc. (More detail in Chapter 4.) ▪ <u>Capability</u> - capacity for a set of resources to perform a task or activity in an integrative manner. ▪ <u>Core Competencies</u> - resources and capabilities that serve as a source of competitive advantage for a firm over its rivals. ▪ <u>Competitive Advantage</u> - created by the successful formulation and execution of strategies that are different from and which produce more value than the strategies of competitors. ▪ <u>Sustainable Competitive Advantage</u> - referred to as "Competitive Advantage" for the purposes of this text - competitive advantage that is possible only after competitors' efforts to duplicate the value-creating strategy have ceased or failed.
See slide 25.	14. Describe the basic premise of the Resource-Based Model.
See slide 26.	a. The model proposes that a firm's unique resources and capabilities should define its strategic actions and be used effectively to exploit opportunities in the external environment to ensure successful performance.
See slide 27.	15. Name three categories of resources. a. Physical b. Human c. Organizational capital
	16. Not all of a firm's resources and capabilities have the potential to be a competitive advantage. What types of resources and capabilities can realize this potential? a. Valuable b. Rare

See slide 28. See Figure 1.3: The Resource-Based Model of Above-Average Returns (See slide 29). See Additional Notes below.	c. Costly to imitate d. Nonsubstitutable 17. Discuss two types of core competencies (cite examples of each). a. Managerial competencies (Xerox). b. Product-related competencies (Apple).
See slide 29.	Additional Discussion Notes for the Resource-Based Model - These notes include additional material that discusses two axiomatic assumptions. First, resources are distributed heterogeneously across firms, and second, these resources cannot be transferred between firms without cost. Research references are included and extensive discussion here may help you present this concept. There is also discussion regarding “inventions” as an example of a resource that is valuable, rare, hard to imitate and not substitutable. The notes are spread over several lecture notes pages, beginning where the model is first presented. Resource-based model: Patents and Inventions Resource-based view (RBV) of the firm is hedged on two axiomatic assumptions. First, resources are distributed heterogeneously across firms, and second, these resources cannot be transferred between firms without cost. These axioms lend themselves to two additional tenets (cf., Barney, 1991): (a) Resources that simultaneously enhance a firm’s market effectiveness (valuable) and are not widely dispersed (rare) can produce competitive advantage; and (b) when such resources are concurrently expensive to imitate (inimitable) and costly to substitute (non-substitutable), the competitive advantage is sustainable. Thus, value and rarity are each necessary before inimitability and nonsubstitutability might yield a sustainable competitive advantage (Priem & Butler, 2001). Despite its face validity and rapid diffusion throughout the management literature, there have only been limited empirical tests of RBV’s tenets (cf., Priem & Butler, 2001). To echo Miller and Shamsie (1996, p. 519), “the concept of resources remains an amorphous one that is rarely operationally defined or tested for its performance implications in different competitive environments.” Many managers use RBV’s terms with little specificity or attention to causal relationships. Researchers have identified several types of valuable and rare resources that could generate rents. Some examples include information technology (Powell, 1997), strategic planning (Powell, 1992), organizational alignment (Powell, 1992a), human resources management (Lado & Wilson, 1994;

Wright & McMahan, 1992), trust (Barney & Hansen, 1994), organizational culture (Oliver, 1997), administrative skills (Powell, 1993), expertise of top management (Castanias & Helfat, 1991), and even Guanxi □ complex networks (Tsang, 1998).

The degree to which RBV is likely to help managers depends on the extent to which it can be used to achieve competitive advantage. Hence, recently, Markman and his colleagues have attempted to clarify three basic questions: (1) Can a single resource be simultaneously valuable, rare, inimitable, and non-substitutable? (2) Can an inimitable and nonsubstitutable resource be measured? and (3) To what extent is an inimitable and nonsubstitutable resource associated with competitive advantage?

Using five-year data from 85 large, publicly traded pharmaceutical companies, Markman and his colleagues advance the view that a single resource-patented invention □ could qualify as simultaneously valuable, rare, hard to imitate, and difficult to substitute. In other words, the answer to the first question is yes; some patents are valuable, rare, inimitable, and nonsubstitutable resources. The answers to the second and third questions are “yes” as well. That is, controlling for assets, sales, and investment in R&D, they found that a patent’s quality and scope are significantly related to competitive advantage as captured by new products and, to some extent, to profitability.

Four Attributes of Resources and Capabilities (Competitive Advantage)

Despite these findings and the intuitive appeal of RBV, challenges remain. Priem and Butler (2001) noted that a resource that is valuable, rare, hard to imitate, and not substitutable is also difficult to assess, manipulate, or deploy, and therefore difficult to exploit. Their analytical assessment spurred an important debate regarding RBV’s practical utility. For example, tacit knowledge, organizational learning, workflow, time, inter-organizational ties, communications, and human interactions might be seen as hard to imitate and nonsubstitutable resources, but such resources are neither necessarily rare, nor inevitably valuable. Thus, while many “things” might be classified as resources, intangibles are less amenable to managerial manipulation, rendering their associations with competitive advantage tenuous. For example, tacit knowledge is frequently conceptualized as a source of competitive advantage, yet we don’t know how (and at what rate) managers create and use that which is inherently unknowable. Personnel, machinery, land, technical procedures, and financial capital are relatively easy to quantify resources. Brand names, however, and organizational knowledge, learning, and culture are extremely difficult to craft, use, measure, and manage. In sum, the practical utility of RBV to managers remains weak as long as we fail to explicitly parameterize and measure the extent to which certain resources are valuable, rare, inimitable, and nonsubstitutable.

The Stakeholder Model of Responsible Firm Behavior and Firm Performance - This section presents a framework, based on both moral and economic foundations, for understanding how firms can simultaneously manage relationships with internal and external stakeholders to create and sustain competitive advantage.	
See slide 30.	Key Terms ▪ <u>Stakeholders</u> - individuals and groups who can affect, and are affected by, the strategic outcomes a firm achieves and who have enforceable claims on a firm's performance. ▪ <u>Strategic Intelligence</u> - information firms collect from their network of stakeholders and use to help a firm deal with diverse and cognitively complex competitive situations.
See slide 31. See Figure 1.4: The Three Stakeholder Groups (see slide 32). See slide 33. See Figure 1.5: The Stakeholder Model of Responsible Firm Behavior and Firm Performance (see slide 34). See slides 35-36.	18. Describe the basic premise of the Stakeholder Model of Responsible Firm Behavior and Firm Performance. a. The model proposes that a firm can effectively manage stakeholder relationships to create a competitive advantage and outperform its competitors. 19. Name three stakeholder groups of primary interest to a firm. a. Capital market stakeholders b. Product market stakeholders c. Organizational stakeholders 20. What are some types of secondary stakeholders who should not be ignored? a. Government entities and administrators b. Activists and advocacy groups c. Religious organizations d. Other non-governmental organizations 21. In what ways do stakeholder relationships based on trust and mutual satisfaction of goals contribute to building a competitive advantage and improved business performance? a. Timely and high-quality strategic intelligence can be gathered to improve a firm's strategic decisions. b. A trustworthy reputation draws valuable customers, suppliers, and business partners to acquire or develop competitive resources. c. A trustworthy reputation attracts investors to offer financial resources. d. Good human resources are attracted to firm with fair and respectful treatment of employee relationships. e. Transactions costs associated with making and enforcing agreements can be reduced. f. Implementation of strategies can be enhanced by

Chapter 1 - Introduction to Strategic Management

	improving commitment from stakeholders who are involved with strategic decisions. g. Responsible behavior can protect a firm from the expense and risk associated with negative actions (such as adverse regulations, legal suits and penalties, consumer dissatisfaction, employee work outages, and bad press.)
--	---

Strategic Thinking and the Strategic Management Process - This section introduces the creative aspects of strategic management that result in innovative strategies and organizational changes to enhance competitiveness. These concepts will serve as a foundation to build upon throughout the text.

See slide 37.	Key Terms ▪ <u>Strategic Management Process</u> - full set of commitments, decisions, and actions required for a firm to create value and earn returns that are higher than those of competitors.
---------------	---

Strategic Thinking - This section introduces a method of viewing a firm and its environment. It defines an intent-focused, comprehensive, opportunistic, long-term, hypothesis-driven medium through which the firm uses the strategic management process to pursue value creation and high financial returns.

See slide 38.	Key Terms ▪ <u>Strategic Intent</u> - organizational term used for a vision that challenges and energizes a company. The leveraging of a firm's resources, capabilities, and core competencies to accomplish a firm's goals in its competitive environment. ▪ <u>Resources</u> - inputs into a firm's production process; such as capital equipment, employee skills, patents, high-quality managers, financial condition, etc. (Described more fully in Chapter 4.) ▪ <u>Capability</u> - capacity for a set of resources to perform a task or activity in an integrative manner. ▪ <u>Core Competencies</u> - resources and capabilities that serve as a source of competitive advantage for a firm over its rivals.
See slide 39.	22. When is strategic intent being effectively formed within an organization? a. When all levels of a firm are committed to the pursuit of specific, significant performance criterion. b. When employees believe fervently in their company's product.

Chapter 1 - Introduction to Strategic Management

See slide 40.	c. When employees are entirely focused on the firm's ability to outperform its competitors.
See slide 41.	23. Discuss additional elements of strategic thinking. a. Opportunistically takes advantage of unanticipated opportunities as they arise. b. Recognizes all time frames, learning from past experiences, determining how to exploit current competitive advantages, and considering the long-term implications of decisions and actions. c. Is a sequential process of hypothesis testing, evaluating creative ideas from their generation to trial market assessment to full blown market implementation. 24. How can firms encourage strategic thinking? a. Employ top managers who are champions of change. b. Put in place systems and processes to find innovative ideas in operating ("frontline") areas of an organization. c. Train managers and employees in strategic thinking methods and processes. d. Provide flexibility in strategic management processes to allow incorporation of new ideas with potential.

The Strategic Management Process - This section simultaneously presents a logical approach for responding to 21st century competitive challenges while outlining the content of the textbook by each chapter.

See Figure 1.6: The Strategic Management Process (see slide 42).	25. Discuss Chapter 2, Strategic Leadership. a. Strategic leaders are the engines driving the development and use of the strategic management process. b. Strategic direction is reflected in the firm's vision, mission, purpose, and long-term goals. 26. Discuss Part II, Strategic Analysis. a. The two key sources of information-based inputs to the strategic management process are derived from an analysis of the firm's external environment (Ch. 3) and its internal organization (Ch. 4). b. This analysis identifies opportunities, threats, resources, capabilities, and core competencies that are used collectively to establish strategic direction and strategies to create a competitive advantage. 27. Discuss Part III, Creating Competitive Advantage. a. An examination of business-level strategies (Ch. 5) illustrates how firms determine the competitive advantages they will use to effectively compete in
--	--

Chapter 1 - Introduction to Strategic Management

	specific product markets. b. Competitive rivalry and dynamics, the interactive play between rivals in the marketplace, is taken into consideration when firms select and use strategies (Ch. 6). c. The trend toward cooperation reflects the increasing importance of forming partnerships between firms to share and develop competitive resources (Ch. 7). d. Corporate-level strategies are employed by diversified organizations to determine the businesses in which they plan to compete and how they will allocate resources (Ch. 8). e. Merger and acquisition strategies are the primary means diversified firms use to create corporate-level competitive advantages (Ch. 9). f. International strategies can be used to create value and above-average returns for an organization (Ch. 10). g. Each type of strategy commands the type of organizational structure that an organization should use to effectively support its strategic efforts.
28.	Discuss Part IV, Monitoring and Creating Entrepreneurial Opportunities. a. Corporate governance serves to monitor organizational actions, assess their success, make sure they reflect the firm's values, and ensure that they are aligned with stakeholder interests (Ch. 11). b. To compete in today's competitive environment, firms must continuously seek entrepreneurial opportunities (Ch. 12). c. Real options analysis is a tool that is useful for evaluating new ventures and increasing strategic flexibility (Ch. 13).

Ethical Questions - Recognizing the need for firms to effectively interact with stakeholders during the strategic management process, all strategic management topics have an ethical dimension. A list of ethical questions appears after the Summary section of each chapter in the textbook. The topic of ethics is best covered throughout the course to emphasize its prevalence and importance. We recommend posing at least one of these questions during your class time to stimulate discussion of ethical issues relevant to the chapter material that you are covering. (See slides 43-48.)

Chapter 1 - Introduction to Strategic Management