

## CHAPTER ONE

### BASIC CONCEPTS OF STRATEGIC MANAGEMENT

#### SUMMARY OF KEY POINTS

- Strategic management starts with three key questions: (1) Where is the organization now? (2) If no changes are made, where will the organization be in a few years? (3) If the answers are not acceptable, what specific actions should management undertake?
- Strategic management is that set of managerial decisions and actions that determines the long-run performance of a corporation. It includes environmental scanning, strategy formulation, strategy implementation, and evaluation and control.
- Strategic management in many organizations tends to evolve in four phases from basic financial planning to forecast-based planning, to what people refer to as strategic planning (strategy formulation only), and finally to full-blown strategic management (including implementation and evaluation and control).
- Research reveals that companies engaging in strategic management tend to outperform those organizations which do not.
- Strategy formulation is typically not a regular, continuous process but is often initiated by triggering events, such as a new CEO or a performance gap.
- The strategic management model proceeds from environmental scanning to strategy formulation (including establishing mission, objectives, strategies, and policies) to strategy implantation (including developing programs, budgets, and procedures) to evaluation and control. This model is made action-oriented through the strategic decision making process depicted in Figure 1.3..
- A large corporation tends to have three levels of strategy (corporate, business, and functional) which form a hierarchy of strategy.
- Strategic decisions are rare, consequential, and directive.
- Top managers tend to use one of three modes of strategy formulation: entrepreneurial, adaptive, planning, or logical incrementalism.

#### SUGGESTED ANSWERS TO DISCUSSION QUESTIONS

**1. Why has strategic management become so important to today's corporations?**

Research indicates that organizations that engage in strategic management generally outperform those that do not. The attainment of an appropriate match or fit between an organization's environment and its strategy, structure, and processes has positive effects on the organization's performance. A firm cannot afford to follow intuitive strategies once it becomes large, has layers of management, or its environment changes substantially. As the world's environment becomes increasingly complex and changing, strategic management is used by today's corporations as one way to make the environment more manageable.

**2. How does strategic management typically evolve in a corporation?**

Strategic management in a corporation appears to evolve through four sequential phases according to Gluck, Kaufman and Walleck. Beginning with basic financial planning, it develops into forecast-based planning, and then into externally-oriented planning, and finally into a full-blown strategic management system. The evolution is most likely caused by increasing change and complexity in the corporation's external environment. The phases are thus likely to be characterized by a change from primarily an inward-looking orientation in the first phase to primarily an outward-looking orientation in the third phase, and to a more integrative orientation in the final strategic management phase with equal emphasis on both the external and internal environments.

**3. What is a learning organization? Is this approach to strategic management better than the more traditional top-down approach in which strategic planning is primarily done by top management?**

Traditional top-down strategic planning assumes that top management has all the information and knowledge needed to properly understand the firm's external and internal environments and to formulate and implement strategic plans. This approach may be appropriate when the organization is in a stable and fairly simple environment, but not when the situation is complex and quickly changing. Increasing environmental uncertainty means that corporations must develop *strategic flexibility*—the ability to shift from one dominant strategy to another. It also demands that the company become a *learning organization*: an organization skilled at creating, acquiring, and transferring knowledge, and at modifying its behavior to reflect new knowledge and insights. Learning organizations avoid stability through continuous self-examination and experimentation. People at all levels, not just top management, are involved in strategic management: scanning the environment for critical information, suggesting changes to strategies and programs to take advantage of environmental shifts, and working with others to continuously improve work methods, procedures, and evaluation techniques.

**4. Why are strategic decisions different from other types of decisions?**

Strategic decisions deal with the long-run future of the entire organization and have three characteristics which differentiate them from other types of decisions: (1) They are rare. Strategic decisions are unusual and typically have no precedent to follow; (2) They are consequential. Strategic decisions commit substantial resources and demand a great deal of commitment; (3) They are directive. Strategic decisions set precedents for lesser decisions and future actions throughout the organization.

**5. When is the planning mode of strategic decision making superior to the entrepreneurial and adaptive modes?**

The planning mode is generally superior to the entrepreneurial and adaptive modes when the organization is fairly large, when knowledge is spread throughout the organization, and when the organization has at least a moderate amount of time to engage in strategic planning. The book proposes that the planning mode is more rational and thus a better way of making most strategic decisions than are the other modes. It may not, however, always be possible. The entrepreneurial mode can be very useful when time is short, one person or group is able to grasp the essentials of the business and its environment, and that person or group is able to influence the rest of the organization to accept the strategic decision. The adaptive mode is generally not considered to be very effective in most situations, but seems to be the fallback mode when entrepreneurial or planning modes can't operate effectively because of political infighting or lethargy. It is a typical mode in not-for-profit organizations.

**ADDITIONAL DISCUSSION QUESTIONS**

**A1. What is meant by the hierarchy of strategy?**

The hierarchy of strategy is a term used to describe the interrelationships among the three levels of strategy (corporate, business, and functional) typically found in large business corporations. Beginning with the corporate level, each level of strategy forms the strategic environment of the next level in the corporation. This means that corporate level objectives, strategies, and policies form a key part of the environment of a division or business unit.

The objectives, strategies, and policies of the division or unit must therefore be formulated so as to help achieve the plans of the corporate level. The same is true of functional departments which must operate within the objectives, strategies, and policies of a division or unit.

**A2. Does every business firm have business strategies?**

Every business firm should have a business strategy for every industry or market segment it serves. A business strategy aims at improving the competitive position of a business firm's products or services in a specific industry or market segment. Firms must therefore have business strategies even if they are not organized on the basis of operating divisions. Nevertheless, it is still possible that some business firms do not have clearly stated business strategies. If they hope to be successful, however, they must have at least some rudimentary (even though unstated) position they take in terms of getting and keeping customers or clients through competitive and/or cooperative strategies.

**A3. What information is needed for the proper formulation of strategy? Why?**

In order to properly formulate strategy, it is essential to have information on the important variables in both the external and internal environments of the corporation. This includes general forces in the natural and societal environment as well as the more easy-to-identify groups, such as customers and competitors in the task environment. A corporation needs to have this information in order to identify a need it can fulfill via its corporate mission. It is also important to have information on the corporation's structure, culture, and resources. A corporation needs to have this information in order to assess its capabilities to satisfy a customer's need by making and/or distributing a product or service. Information on both the internal and external environments can also help a corporation to predict likely opportunities and threats. Long-term strategies can be designed with these in mind.

## **CHAPTER TWO**

### **CORPORATE GOVERNANCE AND SOCIAL RESPONSIBILITY**

#### **SUMMARY OF KEY POINTS**

- Corporate governance is the relationship among the board of directors, top management, and the shareholders in determining the direction and performance of the corporation. The board of directors of the modern corporation is typically responsible for setting corporate direction, hiring and firing top management, monitoring top management and its use of resources, and stockholder interests.
- Boards can be placed on a continuum from passive to active regarding their involvement in the strategic management process through monitoring corporate activities, evaluating and influencing top management, plus initiating and determining a corporation's strategic direction.
- In addition to fulfilling key roles and managing the strategic planning process, top management is responsible for providing executive leadership.
- The concept of social responsibility proposes that a private corporation has responsibilities to society that extend beyond making a profit.
- Even though a business firm has economic and legal responsibilities (in agreement with Friedman's stand), it can be argued (from Carroll) that it also has ethical and discretionary responsibilities.
- Strategists must be aware of the stakeholders within their company's task environment and be prepared to

juggle priorities in order to negotiate through a maze of conflicting demands.

- Ethical problems in organizations may be resolved by considering the utilitarian, individual rights, and justice approaches to ethical behavior.

## SUGGESTED ANSWERS TO DISCUSSION QUESTIONS

### 1. **When does a corporation need a board of directors?**

Given that a number of people do not consider the board of directors to have much of a role in a corporation's strategic management, this is no idle question. A good case can be made that a closely-held corporation has no need of a board. Since the owners are likely to compose both top management and board membership, the board becomes superfluous at best and may even create more problems that it solves by getting in the way of management's quick response to opportunities and threats. Even in a publicly-held corporation, the board may be composed of nothing but a few insiders who occupy key executive positions and few "good old boy" outsiders who go along with the CEO on all major issues. Nevertheless, the rationale for the board of directors seems to be changing from simply one of safeguarding stockholder investments to a broader role of buffering the corporation from its task environment and forcing management to manage strategically. If nothing else, the board can do the corporation a great service by simply offering to top management a different point of view. The board's connections to key stakeholders in the corporation's task environment can also provide invaluable information for strategic decision-making.

### 2. **Who should or should not serve on a corporation's board of directors? What about environmentalists or union leaders?**

This is a wide-open question with no simple answer. Some may argue that representatives from each stakeholder group in the corporation's task environment should be included so as to keep top management aware of key environmental considerations. Others may argue that only outsiders with no personal stake in the corporation (i.e., not a member of a local bank or a key supplier, etc.) would be best able to bring the amount of objectivity needed to help make strategic decisions. A good argument can be started by suggesting that a representative from labor be a director. If this makes some sense, who should it be -- an employee of the corporation or an employee of another corporation? If the firm is not unionized, what then? Further discussion can be generated by suggesting that the composition of the board reflect the key demographics of the corporation's workforce in terms of race, sex, and age. Agency theory, in contrast, would suggest that these social considerations should not be reflected in board membership. Since, according to agency theory, the board exists to protect the interests of the stockholders, other constituencies (such as employees) should not be represented on the board.

### 3. **What recommendations would you make to improve corporate governance?**

The answer to this question is not provided in the text. Some likely suggestions are the following:

- Add more outsiders (people not affiliated with the corporation) to the board of directors. Keep the percentage of insiders (typically top management) to about 25% or less of board membership.
- Separate the positions of CEO and Chairman so that top management cannot unduly influence the board's meetings and agenda. This should improve the board's ability to properly evaluate top management.
- Use a committee composed of outsiders to nominate potential new directors. This will help to ensure that potential members are not friends of top management who may owe more allegiance to the CEO than to the shareholders.

- Nominate to the board those who have knowledge valuable to the board and who have expertise of value to top management. These should be people who will have the respect of top management and who can both advise and criticize top management as needed.
- Require board members to own substantial amounts of stock in the corporation to ensure that they have a personal as well as professional stake in the welfare of the corporation.

**4. Do you agree with the economist Milton Friedman that social responsibility is a "fundamentally subversive doctrine" that will only hurt a business corporation's long-term efficiency?**

Using Carroll's categories, Friedman could be said to argue that the only responsibilities of a business firm are economic and legal. (Friedman does say that business should stay "within the rules of the game." This can be interpreted as meaning legal responsibilities.) If a purely economic justification is used, it may be difficult but still possible to justify ethical and discretionary responsibilities. Carroll points out that a refusal to consider ethical responsibilities is likely to lead to an increase in a firm's legal responsibilities - which considering the usual inefficiencies of government will lead to higher costs and lower long-run business efficiency. If this appeal to financial considerations is not enough to justify socially responsible actions, an appeal to morality may be enough to swing the class toward a justification of ethical and even discretionary responsibilities. Nevertheless, this question should engender a lot of discussion on the topic.

**5. Is there a relationship between corporate governance and social responsibility?**

Since it is the job of the board to oversee the decisions and actions of top management, the board is the last opportunity of the company to ensure that the firm's actions do not hurt the environment of which the company is a part. It can be argued that one way to increase a corporation's social responsibility is to increase the presence and power of outside directors. The board can then be held more accountable for corporate actions. This has been the approach taken in the U.S. through the Sarbanes-Oxley Act to formalize greater board independence and oversight by demanding greater involvement in board decisions by outside directors. There appears to be increasing pressure on boards to balance the economic goal of profitability with the social needs of society.

**ADDITIONAL DISCUSSION QUESTIONS**

**A1. How appropriate is the theory of laissez-faire in today's world?**

Milton Friedman contends that it is very appropriate. The quote from his classic article, "The Social Responsibility of Business Is to Increase its Profits" does suggest a certain modification, however, to pure laissez faire. He states that business should work to increase its profits "so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud." These "rules of the game" form the crux of the argument. What should these rules be and who should communicate and enforce them? This leads directly into Archie Carroll's contention that there are four responsibilities of business corporations: economic, legal, ethical, and discretionary. Pure laissez faire argues for economic responsibilities only. Friedman modifies laissez faire by presumably adding legal responsibilities. One could make the point that the "rules of the game" should include ethical responsibilities as well. The problem, of course, is what happens to the concept of laissez faire when one adds all these responsibilities to it and then expects business people at all levels to accept them without outside force? Does laissez faire as proposed by Adam Smith and argued by others include only economic responsibilities? If legal and ethical responsibilities are also expected by society of business corporations, is it still "free enterprise" laissez faire or some other kind of system?

**A2. How does a strategic vision differ from a corporation's mission?**

As stated in Chapter One, a corporation's *mission* is its purpose, or the reason for its existence. It provides the fundamental, unique purpose that sets the company apart from other firms of its type and identifies the scope of the company's operations in terms of products/services offered and markets served. It tells who the company is and what it currently does. A corporation's *vision*, in contrast, is a description of what the company is capable of becoming. It tells not what the company is now (as does the mission), but what it is striving to become. Whereas the mission is present-oriented, the vision is future-oriented. A corporation's *mission statement* typically includes both the corporation's mission and vision by stating what the company is now and what it wants to become.

**A3. Tobacco companies are increasing their marketing efforts in Third World countries. Faced with a decline in tobacco usage in the developed countries, these corporations are using their advertising expertise and political connections to open new markets in Japan, Taiwan, Thailand, and South Korea, as well as in eastern Europe. In light of the accumulating evidence regarding the link between tobacco use and cancer, should the strategic managers in these tobacco companies be criticized for taking socially irresponsible actions? Should the government declare the making and selling of tobacco products illegal?**

This question should stir up the class as non-smokers debate against smokers (or chewers)! It may also serve to bring up the issue of self-interest. Why do non-smokers brand tobacco companies irresponsible while smokers do not? Is the concern for social responsibility partly an issue of who gets hurt? Insofar as the non-smokers are concerned, ask them to deal with the question of freedom of choice versus personal health (similar to laws regarding auto seat belts and motorcycle helmets). Is any company making a product (such as guns or knives), which can hurt people, socially irresponsible? Insofar as smokers are concerned, is their personal desire to smoke coloring their view of the tobacco companies' social responsibilities? Although it can be argued that the rights of current users of tobacco should be respected, is it appropriate that firms should try to attract new users who may not be aware of the risks of tobacco? Use the question of outlawing tobacco as a way of getting at the role of government in the relationship of business and society. Do otherwise laissez-faire, free enterprise-oriented students (who happen to be non-smokers) call for government intervention on this issue? Try to get the students to assess the impact of their personal values and opinions on their social responsibility judgments.

**A4. Using Carroll's list of four responsibilities, should a company be concerned about discretionary responsibilities? Why or why not?**

Except for a few die-hard followers of Milton Friedman's philosophy, few people would agree that a business firm should fulfill only its economic and legal responsibilities and completely ignore ethical ones. The same is not true of discretionary responsibilities, however. Since discretionary responsibilities are defined by Carroll as purely voluntary, there is no pressure by anyone for a business firm to fulfill them. One can argue, nevertheless, that there are three good reasons to undertake these kinds of responsibilities. The first reason is the *morality rationale* - it may be the right thing to do, even though the company may not benefit and may even be hurt in the short run. The second reason is *enlightened self-interest*. If a firm undertakes a discretionary activity, it may gain short-run advantages in the market place (e.g., a company offering free day care to its employees may attract more potential workers at lower wages). It may also serve as a role model for government to legislate if and when that responsibility moves from discretionary to ethical and finally to legal (and thus the firm is able to do things its way instead of the government's way). The third reason is also one of enlightened self-interest. If a company develops a reputation for voluntarily doing socially useful activities even though it gains little economically in return, it may collect valuable public relations credit in people's minds. This may translate sometime into better sales or a willingness on the part of some government agency to overlook a questionable activity the company might unthinkingly engage in.

**A5. Should a company be concerned if some of its suppliers in developing countries are abusing their workers, employing child labor, and paying near starvation wages?**

Does a company's responsibilities end at its boundary or does its responsibilities extend to its suppliers and distributors as well? For example, if a firm purchases its raw materials from a company which is a known polluter, is this being socially irresponsible? Should a company sell its goods to a person or another company which misuses its product in a socially irresponsible manner? This very thorny question is a major point of contention in the area of social responsibility. The question includes a basic question in organization theory: What is the boundary of an organization? Certainly, one could argue that a company is composed of its employees and all of its assets, such as land, buildings, and equipment. These can thus define a company's boundary. Given this view, everything else may be called a company's "environment" and therefore outside of a company's control or responsibility. One could thus argue that a purchasing company cannot be held responsible for the actions of a separate and independent supplier company. The very popularity of outsourcing as a substitute for vertical integration means that more firms are contracting with other firms to fulfill functions a company no longer wishes to do on its own. If the contract is long term in nature or if the purchasing company owns a substantial amount of stock in the supplying company, then the hands-length nature of transactions is compromised and it becomes difficult to discern where one firm's boundary begins and another firm's leaves off. Such a relationship suggests that one company does have some influence over another company's actions by nature of the other company's dependency on the first company. One could thus argue that a company's social responsibilities extend beyond what is normally thought of as its boundary to the extent that it has some control and influence over the other company's actions. For example, if one company has an important and long-term relationship with a contracting company that is behaving in a socially irresponsible manner, the first company has an obligation to attempt to change the contractor's behavior. It could certainly be argued that a company should not support a socially irresponsible contractor by continuing the relationship if other more socially responsible contractors are available.