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STRATEGIC MANAGEMENT

AND

BUSINESS POLICY

13th Edition

**CHAPTER NOTES**

**CHAPTER ONE**

**BASIC CONCEPTS OF STRATEGIC MANAGEMENT**

This chapter sets the stage for the study of strategic management and business policy. It summarizes research supporting the conclusion that those corporations that are able to learn from their experiences and manage strategically perform at a higher level than corporations which do not. It describes a number of triggering events which act to initiate strategic change in most organizations. A normative model of strategic management is presented as the basic structure underlying the book. Key concepts are defined and explained as part of the discussion of the model. The chapter also introduces the strategic audit as a method of operationalizing strategic decision making.

**TOPICS COVERED**

• Phases of strategic management.

• Benefits of strategic management.

• Globalization and environmental sustainability as challenges to strategic management.

• Theories of organizational adaptation

• The learning organization.

• Basic model of strategic management.

• Triggering events initiating strategy.

• Mintzberg's modes of strategic decision making.

• Strategic decision making process.

* The strategic audit.

**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. The three most highly-rated benefits of strategic management are a clearer sense of a firm’s strategic vision, a sharper focus on what is strategically important, and an improved understanding of a rapidly changing environment. 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?**

Simply put, a learning organization is one which is able to learn from its experiences. In reality, it is much more complicated. The text points out that learning organizations are skilled at four main activities: (1) systematic problem solving, (2) experimenting with new approaches, (3) learning from their own experience and past history as well as from the experiences of others, and (4) transferring knowledge quickly and efficiently throughout the organization. This means that people at all levels, not just top management, need to be involved in strategic management - by helping to scan 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. Research indicates that those organizations that are willing to experiment and able to learn from their experiences are more successful than are those which do not.

Top-down strategic management assumes that only top management is in a position to contribute to strategic planning. This approach can work reasonably well in bureaucratic organization with very little horizontal communication. Top-down strategic planning forces all units to get involved in the planning process and makes sure that all units fit into the overall corporate mission, objectives, strategies, and policies. A limitation of the top-down approach is that all motivation comes from the top and lower units may simply go through the motions in order to please the boss. The likelihood of fresh, new strategic concepts at lower levels of the organization becomes less, the more the stimulus for strategic planning comes from above.

**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. See *Top Decisions: Strategic Decision-Making in Organizations* by Hickson, Butler, Cray, Mallory, and Wilson for further discussion.

**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. 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 its 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.

**ADDITIONAL DISCUSSION QUESTIONS**

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

A 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.

**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 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.

**A4. Reconcile the strategic decision-making process depicted in Fig. 1.5 with the strategic management model depicted in Fig. 1.2.**

The strategic management model depicts the key input variables (internal and external environments) and the key output factors (mission, objectives, strategy, and policies). It shows how strategy formulation, implementation, and evaluation and control are related and how a change in any one factor (e.g., corporate objectives) affects other factors (e.g., strategies, policies, programs, budgets, procedures, evaluation and control techniques). This model, however, does not depict how these output factors are generated. In contrast, the strategic decision-making model depicts how the process of strategic management happens in the form of strategic decisions. It is a series of interrelated activities depicted as eight distinct steps. These two models therefore complement one another and are very useful in increasing one's understanding of strategic management.

**SUGGESTIONS FOR STRATEGIC PRACTICE EXERCISE**

This end of chapter exercise is a good way to motivate students to apply some of the concepts in the chapter, particularly those from the strategic management model. There are a lot of bad mission statements being written. The most blatant are the ones that simply say "Our mission is to build shareholder value."

The text states that a good mission statement should define 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 offered and markets served. It may also include the firm's philosophy about how it does business and treats its employees. It puts into words not only what the company is now, but what it wants to become - management's strategic vision of the firm's future. Simply put, a good mission statement tells who we are, what we do, and what we'd like to become.

Andrew Campbell proposes ten questions for evaluating a mission statement. Both exercises request the reader to use Campbell’s questions as a starting point to develop suitable criteria for evaluating any mission statement.

*• Exercise 1: Evaluate the mission statement of Celestial Seasonings.*

This is a good example of a mission statement. Even if someone had never heard of Celestial Seasonings, the mission statement tells clearly that this is a company which makes specialty teas. Its scope of operations is natural hot and iced teas. Its domain is the U.S. specialty tea market. Its strategic vision is to grow and dominate this market by satisfying the customer more than does the competition. It indicates a strong quality orientation and a focus on continuous improvement. This mission statement does a good job of establishing a solid foundation upon which can be built objectives, strategies, and policies as part of strategy formulation. Depending upon one’s answers to Campbell’s ten questions, the Celestial Seasonings mission statement could earn a total score of around 12. (1=Y; 2=S; 3=S; 4=Y; 5=S; 6=S; 7=S; 8=N; 9=S; 10=Y for a total of 11.) Ask the class if they agree that all of Campbell’s ten questions are equally important. Should some be dropped and others added? Why?

*• Exercise 2: Using the Internet, find the mission statements of three different organizations and tell which is best. Why?*

This is a good exercise to encourage students to begin Internet research. This exercise serves two purposes. It gets everyone up to speed in terms of doing Internet research. It also forces them to re-read chapter one to get a solid understanding of what differentiates a good from a poor mission statement. Encourage them to use Campbell’s ten questions to develop criteria. You can give them this assignment on the first day of class and then use the second day to discuss chapter one and the various mission statements people have found. This is a good way to encourage student participation in the class.

**CHAPTER TWO**

**CORPORATE GOVERNANCE**

This chapter describes the basic governance mechanisms of the corporation: the board of directors and top management. These are the people who are primarily tasked with the strategic management process if the corporation is to have long-term success in accomplishing its mission. The responsibilities of both are described and explained. It proposes a board of directors’ continuum on which boards can be placed in terms of their involvement in strategic management. Agency theory is contrasted with stewardship theory. The chapter explains how the composition of the board can affect both its performance and that of the corporation. It also describes the impact of the Sarbanes-Oxley Act on corporate governance in the U.S. and trends in corporate governance around the world. Top management is discussed in terms of executive leadership, strategic vision, and managing the strategic planning process.

**TOPICS COVERED**

• Responsibilities of the board of directors and its role in strategic management.

• Board of directors’ continuum

• Composition of the board of directors.

• Agency theory versus stewardship theory.

• Codetermination and interlocking directorates.

• Impact of the Sarbanes-Oxley Act on U.S. corporate governance.

• Trends in corporate governance.

• Responsibilities of top management in strategic management.

• Executive leadership and the importance of strategic vision.

**SUGGESTED ANSWERS TO DISCUSSION QUESTIONS**

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

A board of directors is needed to protect the interests of the corporation’s owners, its shareholders. By law, when a company incorporates, it must have a board of directors - even if the stock is only held by the founder and his/her spouse. A good case can be made that a small, closely-help 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. The board meets only to satisfy legal requirements. Even when stock is more widely owned in a publicly-held corporation, the board may be composed of nothing but a few insiders who occupy key executive positions and few friendly 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 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. This is the main reason why advisory boards are often used by companies that are not incorporated and thus have no shareholders.

**2. Who should and should not serve on a 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. This is the point of view taken in the U.S. by the Sarbanes-Oxley Act. A good argument can be started by suggesting that a representative from labor be a director. This is done in Germany. If this makes some sense, who should it be – a union member that is 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. Environmentalists could provide excellent information to top management, but could be a problem if they argue only for environmental considerations without regard to the corporation’s other stakeholders.

This question provides the instructor with the opportunity to get the class involved in a discussion of agency and stewardship theories. *Agency theory* suggests that insiders should be kept to a minimum and that the board be heavily composed of objective outsiders who own large blocks of stock. Because of their stake in corporate decisions, affiliated directors would not be considered for board membership. This would ensure that the board would primarily represent shareholder interests and objectively monitor the “hired hands” serving as top management. This is the point of view taken by the Sarbanes-Oxley Act in the U.S. In contrast, stewardship theory views top management as concerned “stewards” of the corporation – people who may have a greater concern for the corporation as a whole and its survival than do the shareholders, who may only be interested in earnings per share and little else. *Stewardship theory* suggests that the board should be composed of people who can provide important information from the task environment and valuable insight to top management. It would work to consider interests beyond shareholder value.

**3. Should a CEO be allowed to serve on another company’s board of directors?**

The majority of outside directors are active or retired CEOs of other corporations. The chapter states that the average board member of a U.S. Fortune 500 firm serves on three boards and that only 40% of U.S. boards limit the number of directorships a board member many hold in other corporations. CEOs from other firms are highly valued because they can provide excellent advice to the CEO. Having a CEO from another firm serve on a corporation’s board of directors results in an interlocking directorate between the two corporations. The text points out that this is a good way to obtain inside information about an uncertain environment and objective expertise about potential strategies and tactics. For these and other reasons, well-interlocked firms are better able to survive in a highly competitive environment. This is a good reason for allowing a firm’s CEO to serve on the boards of other companies. The CEO is likely to bring back information and contacts that are be very useful to the corporation.

There is a down side, however, to allowing a CEO to sit on the boards of other firms. For one thing, serving on another company’s board requires time and energy being devoted to something other than the job he/she is paid to fulfill. Given the increasing pressure being placed on board members, such service is becoming increasingly onerous. Because of this, the typical CEO now sits on only one board in addition to his/her own – down from two additional boards in the 1990s. Consequently, a board should work closely with its CEO to decide which other board(s) are most useful to the company for the CEO to join.

**4. What would be the result if the only insider on a corporation’s board were the CEO?**

One result would be a board composed primarily of outsiders who would be objective, but also dependent upon the CEO for information about the company and its activities. Thanks to Sarbanes-Oxley and other actions by the New York Stock Exchange, this appears to be a trend in most U.S. Fortune 500 companies. As of 2007, the typical U.S. Fortune 500 board had an average of ten directors, only two of whom being insiders. The number of insiders tends to be higher for boards in other countries. Even when a CEO might be the sole insider on the board, he/she still has a great deal of influence because the CEO usually also serves as the Chairman of the Board. Nevertheless, an increasing number of boards are selecting a “lead director” to oversee the evaluation of top management, so this can counter the dual CEO/Chair’s power. A positive result of the CEO being the only insider on a board is that the board would be more likely to be objective and serious about its responsibility to oversee the corporation’s management. A negative result would be the lessened opportunity to view potential successors in action or to obtain alternate points of view to management decisions.

**5. Should all CEOs be transformation leaders? Would you like to work for a transformational leader?**

According to the text, top management must successfully handle two responsibilities that are crucial to the effective strategic management of the corporation: (1) provide executive leadership and a strategic vision and (2) manage the strategic planning process. The text further argues that successful CEOs often provide this executive leadership by taking on many of the characteristics of the transformation leader by communicating a clear strategic vision, demonstrating a strong passion for the company, and communicating clear directions to others. Such transformational leaders, like Bill Gates at Microsoft, Steve Jobs at Apple, and Anita Roddick at The Body Shop, have been able to command respect and energize their employees. They not only articulated a strategic vision, but they also presented a role for others in the company to identify with and to follow. Their communication of high performance standards coupled with their confidence in their fellow employees often raised performance to a high level. Nevertheless, such transformation leaders can be very difficult to work for and their overconfidence may even get the firm in trouble. Their forcefulness may drive other competent people away when they fail to allow for differences of opinion. Hint to the instructor: Once the class has discussed the pros and cons of transformation leaders, ask them how many would like to work for such an executive? Use Donald Trump as an example. (“You’re fired!” You may be surprised by the number of people who would not like to work for such a CEO.

**ADDITIONAL DISCUSSION QUESTIONS**

**A1. What recommendations would you make to improve the effectiveness of today's boards of directors?**

Among the many suggestions often made 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 less than 50% 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. If can't separate Chair from CEO, select a Lead Director from among the outside directors.

• 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 people to the board 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. Make sure that they are diverse in terms of background and experience.

• 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.

• Allow shareholders to nominate people for election to director.

**A2. Is there a conflict between Agency Theory and the concept of organizational stakeholders?**

*Agency theory* is concerned with problems that occur in relationships between principals (owners) and their agents (top management). Because agents are, in effect, "hired hands," their interests are not usually aligned with those of the owner (stockholders) of a corporation. Consequently, agency theory is primarily interested in ways to better align these two sets of interests, such as management owning significant shares of stock or having a strong financial stake in the long-term performance of the corporation via long-term incentive plans. This helps to ensure that management looks beyond selfish short-term benefits of a decision to the more strategic issues that concern stockholders. The *concept of organizational stakeholders*, in contrast, looks at more than just owners and managers. It argues that groups other than stockholders and top management have a significant stake in the actions of the corporation and need to be considered in strategic decisions. What might benefit owners and management might hurt employees, the local community, or the environment. The concept of stakeholders thus proposes that the suggestions of agency theory are incomplete and insufficient to ensure that top management deals fairly not only with stockholders, but also with the needs of all concerned stakeholder groups. As it is currently defined, agency theory is more in agreement with Milton Friedman's narrow view of the responsibilities of a corporation than with the stakeholder view more common to concerns of social responsibility. (See Chapter Three for Friedman’s view of corporate responsibility.) This could change if society begins to consider top management not only as direct agents for stockholders, but also as indirect agents for other groups with a stake in the corporation's activities. Agency theory could thus be expanded to include the concerns of other interested groups and thus incorporate the stakeholder approach.

**SUGGESTIONS FOR STRATEGIC PRACTICE EXERCISE**

The end of chapter exercise asks the student to evaluate the “best” and the “worst” manager for whom the student has worked. The questionnaire is based on the concept of French and Raven’s “bases of power.” This concept is usually discussed in Introduction to Management as well as in Organizational Behavior textbooks as a part of their discussion of leadership. You may need to briefly explain what each base means as part of your discussion of their scores. Briefly, reward power is based on someone’s ability to give another something that is valued for doing what the other person wants. Coercive power is based on someone’s ability to give someone something that is disliked if the other person does not do what is desired. Legitimate power is like authority in that it is based on one person’s belief that another person has the right to ask him/her to do something. Referent power is like charisma in that it is one person’s ability to get others to identify with him/her and to want to be like that person. Expert power is based on a person’s knowledge or abilities in an area that is important for job performance and that the person is willing to share with someone else.

List the five bases of power on the board. Ask around five members of the class to provide you with their scores for their “best manager” on each of bases. Write their totals under each of the five bases on the board and then calculate the average for each base. Do the same thing for the same five students for their “worst boss.” In most instances, the average “best boss” will score higher than the average “worst boss” on referent, expert, and reward power and lower on coercive and legitimate power. Since the “best manager” tends to have many of the characteristics of the transformational leader, this questionnaire provides some interesting information to use in answering the fifth discussion question: *Would you like to work for a transformational leader?*

**ADDITIONAL TEACHING MODULE**

CORPORATE GOVERNANCE STYLES

Just as boards of directors vary widely on a continuum of involvement in the strategic management process, so do top management teams. For example, a top management team with a low involvement in strategic management will tend to be functionally oriented and will focus its energies on day-to-day operational problems; this type of team is likely either to be disorganized or to have a dominant CEO who continues to identify with his or her old division. In contrast, a top management team with high involvement will be active in strategic planning. It will try to get division managers involved in planning so that top management will have more time to scan the environment for challenges and opportunities.

Both the board of directors and top management can be placed on a matrix that reflects four basic styles of corporate governance.

**Styles of Corporate Governance**

|  |  |  |  |
| --- | --- | --- | --- |
| **Degree of Involvement**  **by**  **Top Management** | High | Entrepreneurship  Management | Partnership  Management |
| Low | Chaos  Management | Marionette  Management |
|  | Low High | |

Degree of Involvement by Board of Directors

Chaos Management

When both the board of directors and top management have little involvement in the strategic management process, their style is referred to as chaos management. The board waits for top management to bring it proposals. Top management is operationally oriented and continues to carry out strategies, policies, and programs specified by the founding entrepreneur who died years ago. The basic strategic philosophy seems to be, "If it was good enough for old J.B., it's good enough for us." There is no strategic management being done here.

Entrepreneurship Management

A corporation with an uninvolved board of directors but a highly involved top management has entrepreneurship management. The board is willing to be used as a rubber stamp for top management's decisions. The CEO, operating alone or with a team, dominates the corporation and its strategic decisions. An example is Control Data Corporation under the leadership of its founder William C. Norris. For twenty-nine years, Norris dominated both the company's top management and its board of directors. Insisting that the company could profit by addressing "society's unmet needs." Norris directed corporate investments into the rejuvenation of ghettos and support of wind-powered generators and tundra farming, among other projects. Although these investments tended to result in losses, few people were willing to challenge his strategic decisions. Some employees even referred to him as "the Pope." A former Control Data executive noted, "More often than not, he's proven his critics wrong, so now his visions aren't challenged."

Marionette Management

Probably the rarest form of strategic management style, marionette management occurs when the board of directors is deeply involved in strategic decision making, but top management is primarily concerned with operations. Such a style evolves when a board is composed of key stockholders who refuse to delegate strategic decision making to the president. The president is forced into a COO role and can do only what the board allows him/her to do. This style also occurs when a board fires a CEO but is slow to find a replacement. The COO or executive vice-president stays on as "acting" president or CEO until the selection process is complete. In the meantime, strategic management is firmly in the hands of the board of directors.

Marionette Management occurred at Winnebago Industries when the company's Board of Directors, chaired by its