Gopinath
Siciliano

Strategize!

FOURTH EDITION

Experiential Exercises in Strategic Management

Strategize! 4e

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Strategize! Experiential Exercises in Strategic Management, Fourth Edition
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Cover Image(s): © Neil Guegan/ Image Source/Corbis

Library of Congress Control Number: 2012954799

ISBN-13: 978-1-133-95337-1

ISBN-10: 1-133-95337-9

South-Western
5191 Natorp Boulevard
Mason, OH 45040
USA

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Printed in the United States of America
1 2 3 4 5 6 7 17 16 15 14 13

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INTRODUCTION

The Strategic Management/Business Policy course is among the most challenging in the business curriculum—and for good reason. It is designed to teach the skills of strategic thinking and analysis and it requires that students integrate information from courses throughout the business curriculum. The goal of the course is equally challenging: to learn strategic management theories and concepts in order to "do" strategy. The relevance and significance of the models and concepts in this field have migrated to other courses such as Marketing Strategy and Introduction to Business/Management.

Cases have been an important and traditional component of the strategic management course. Indeed, cases are excellent devices for compelling students to appreciate the intricacies of making decisions within a context. However, what is often missing in case-driven courses is that critical bridge between understanding strategic models and applying them in ways that ensure active engagement with case material at levels beyond the merely factual. Computer-based strategy simulations, likewise, give students lots of practice in making decisions, but they are also somewhat limiting as students rarely get to experiment with appropriate models or concepts before attempting to apply them to simulation specifics. *Strategize!* bridges this gap by providing a series of "Strategy Sessions," through which students can evaluate theories in incremental and structured ways in advance of applying them to resolve strategic business problems.

These 19 unique action-oriented Strategy Sessions present experiential exercises and projects for use in class and out: as breaks away from straight lectures, as segues to case discussions, as homework, as collaborative assignments, as lecture launchers, as pre-class case preparation, and as similar alternatives. Exercises can be drawn on when theories are first introduced and discussed in class or at other times during the semester to reinforce previously reviewed material.

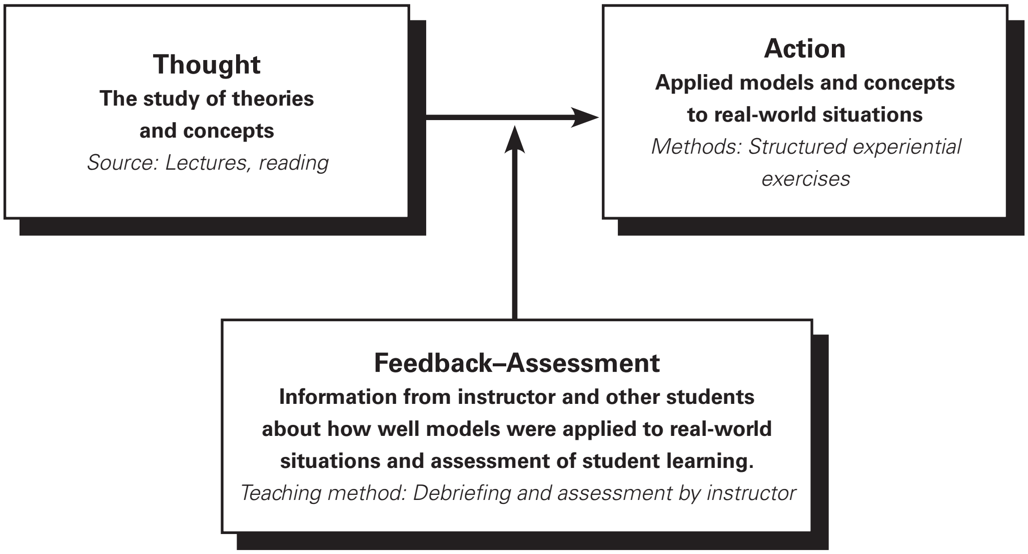
Each Strategy Session makes a complete turn through the active learning cycle of thought, action, feedback, and assessment. In our view, working productively, staying motivated, and actively exploring potentially relevant theories generate a greater probability of successfully achieving the goals of demanding capstone courses, such as strategic management, and so we have incorporated these aims into our exercises. Figure I.1 depicts the experiential learning cycle as we implement it.

Our approach to experiential learning, as Figure I.1 shows, incorporates successive rounds of reflection, experimentation, and assessment. Our exercises focus on building abilities to apply appropriate strategic theories and models to reach meaningful conclusions, along the way strengthening critical thinking skills, analytical skills, and the ability to make defensible decisions and generate persuasive arguments.

Testing the strengths and limitations of theories and getting regular feedback about one's understanding of them form an important complement to the case-study method. The design of each Strategy Session brings together a number of elements that support the thinking/acting/assessing components of the active learning cycle:

1. Brief explanations—or readings—of relevant concepts, wherein the academic purpose of the exercise is made absolutely clear.
2. Structured applications.

FIGURE I.1 EXPERIENTIAL LEARNING CYCLE



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3. Instructor-facilitated debriefings.
4. Assessments of individual participation and accountability.
5. Assessments of overall learning.

Some Strategy Sessions require teams, whereas others may be completed on an individual or team basis, depending on instructor preference. To promote individual accountability, many sessions have assessment forms to document the student's understanding of the work before performing an activity. All sessions have assessments to be administered after each exercise. The forms vary and either gauge how well students fit strategic concepts and tools to given problems or provide feedback to the instructor about the class session in general. (Assessment literature suggests that the formats vary from one session to another.)

As in any course that revolves around experiential methods, the instructor plays a crucial role acting as moderator, questioner, and lecturer, probing for details, for support for arguments, and for alternative courses of action. *Strategize!*, through the simultaneous publication of a resource manual for instructors, can provide useful strategies for managing exercises in the classroom. More information about instructor support materials is available at **http://www.cengage.com/management/Gopinath—**but a quick reference of Figure I.2, the Strategy Session Matrix, shows how each Strategy Session complements chapter discussions in several leading strategic management texts. Detailed guidelines for debriefing, providing feedback, and assessing student learning, are provided in the aforementioned instructor's manual (0324596413).

Organization of the Book

In this fourth edition, we have added two new cases about e-strategy, and the competitive environment in the airline industry, and new companies for the exercises (such as Apple, GM-SAIC alliance in China, Netflix, Life is Good, Subway, and Stonyfield Farm). We have also revised and updated the information in Strategy Sessions and exercises retained from the third edition.

Strategize! is divided into five parts. Parts I, II, and III, on understanding strategic management, designing strategy, and implementing strategy, set up a series of Strategy Sessions designed primarily for in-class use. The sequencing of Strategy Sessions is key because it simulates the steps in the strategic management process common to most textbooks in the field. Strategy Sessions are intended to provide students with an active experience of concepts. Each session opens with a precisely stated learning objective, followed by a short reading that frames the theory or concept that is highlighted in the real drama: the session's featured exercise. As noted earlier, exercises have been developed for students to complete individually or in groups. However, we have also designed them to increase variety and interest in the classroom.

Part IV features a profile of the lodging industry. Industry data is culled from secondary sources readily available to decision makers in the real world. This profile is used principally as background information for certain Strategy Sessions, but it also serves as an example of the industry overview that students should build for assigned cases or projects. A template for students to use in gathering information on an industry, as a precursor for other kinds of in-depth analysis, is also included in this part as is the template for students to use in undertaking analysis of financial statements. Three cases follow describing the rivalry in coffee beverage retailing, E-strategy, and the competitive environment in the airline industry.

Part V consists of two optional, semester-long projects, along with a framework (the MICA method) for in-class discussion of strategic management cases—a format that facilitates full-class participation. The projects require field research and decision making by students in teams. The MICA method is an alternative to the standard Socratic approach to case discussion and is designed to generate maximum participation by students in class using a structured format. It also incorporates a technique for clarifying grading criteria.

Acknowledgments

We would like to record our sincere appreciation to South-Western/Cengage Learning for its continued support of our efforts in propagating experiential learning as a means to understanding strategic management. In particular, our thanks go to Michele Rhoades, Senior Acquisitions Editor, and Ruth Belanger, Senior Editorial Assistant, for their extensive help on this edition.

We wish to thank the following users of the book for their comments and suggestions in the production of this fourth edition:

Bindu Arya
University of Missouri-St. Louis

Tom Aylward
Suffolk University

James Cordeiro
State University of New York, Brockport

Steve Courter
University of Texas at Austin

Sushil Bhatia
Suffolk University

Bella Butler
Curtin University, Australia

Kalyan Chakravarthy
California State University, Northridge

Lawrence Loh
National University of Singapore

Shalei Simms
Rutgers University

We continue to acknowledge our reviewers for the second edition of *Strategize!*:

Macgorine A. Cassell
Fairmont State College

James J. Cordeiro
State University of New York, Brockport

Sr. Mary M. Fanning
College of Notre Dame

Santo D. Marabella
Moravian College

Bernard Skown
Stevens Institute of Technology

Finally, the exercises and projects described here have benefited from the feedback that we have received over several semesters from our students. We are grateful for their guidance in helping us strike the right chords. Nevertheless, there is always room for further improvement. We welcome your comments, as they will most definitely help

us make *Strategize!* even better for you in the future. Please e-mail your experiences or register your comments at **http://www.cengage.com/management/Gopinath.**

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Strategy Session Matrix for Strategic Management Textbooks

The Strategy Sessions are experiential activities designed to give students practice in applying models and concepts from the strategic management course. These exercises can be included when theories are being discussed in class or at other times during the semester to reinforce previously reviewed material. The correlations grid in Figure I.2 on the facing page shows how the Sessions complement chapter discussions in several leading strategic management texts.

FIGURE I.2 STRATEGY SESSION MATRIX FOR SELECTED STRATEGIC MANAGEMENT TEXTS

	Strategy Session	David 14th ed. 2013	Hill & Jones 10th ed. 2013	Hitt, et al 10th ed. 2013	Wheelen & Hunger 13th ed. 2012	Duhaime, et al., 2012	Pearce & Robinson, 2013	Thompson et al., 2012	Grant, 2010	Rotharmael, 2013	Grant & Jordan, 2012
1.	Decision Making at the Strategic and Operational Level	1	1	1	1	1	1	1	1	1	1
2.	Understanding the Concept of Strategy	1	1	Ch. 1	1	1	1	1, 2	1, 2	1	1
3.	Communicating Purpose Through Mission Statements	2	1	1	1, 6	1	2	2	1	2	1
4.	The Board's Role in Corporate Governance	6	11	10	2	1	2	2	17	12	1
5.	Viewing Strategy from the Stakeholder Perspective	2	11	1	3	12	3	1, 9	2	12	5
6.	Forces Affecting Competitive Strategy	3	2	2	4	4	4	3	3, 4	3	2
7.	Generating a Plan of Action: SWOT Analysis	3, 4, 5	1	2, 3	1, 6	4	6	4	1	4	2, 3
8.	Developing Generic Strategy	5	5	4	6	7	7	5	8, 9, 10	6	4
9.	Build Competitive Advantage through Differentiation	5	4, 5	4, 5	6	7, 2	8	5	8, 9, 10	5, 6	4
10.	Corporate Strategy - Corporate Competencies Perspective	5, 6	9, 10	3, 6, 7	7	10	7, 9	8	15, 16	8, 9	7
11.	Global Strategic Alliances	11	8	8, 9	1	10	7	6, 7	15, 16	10	7, 8
12.	Identifying Transnational Strategies	11	8	8	1	10	7	7	15	10	8
13.	Understanding Turnaround Management	5	6	7	7, 9	6	7	4	13	5	3, 4
14.	Scenario Planning	6	1	2	4, 11	3, 12	4	3	11	2	5
15.	Succeeding in Strategy Formulation and Implementation	7, 8	12, 13	11, 12	9, 10	11	10	10, 11, 12	7, 17	11	9
16.	Structuring to Support Strategy	7	12	11	9	11	11	10	7	11	9
17.	Strategy Implementation Using the 7S Model	7, 8, 9	12, 13	11, 12	9, 10, 11	11	11, 12	10, 11, 12	7, 17	11	9
18.	Corporate Sustainability	10	5, 11	3	3, 5	12	3	9	18	12	10
19.	Monitoring Implementation Through the Balanced Scorecard	5, 9	4, 11	12	11	11	7	2	2	5	9

Strategize! 4e

Experiential Exercises in Strategic Management

PART I

Understanding Strategic Management

Strategy Session 1

Decision Making at the Strategic and Operational Level

OBJECTIVE

In this session, we explore the concept of strategy by distinguishing it from operational issues. After finishing this reading and performing the accompanying exercise, you will be able to identify strategic- and operational-level decisions.

> Managers must clearly distinguish operational effectiveness from strategy. Both are essential, but the two agendas are different.
>
> —*Michael E. Porter*

Decisions are constantly made in organizations, and they can broadly be considered to fall in one of two categories. One set of decisions involve the development of strategies for the total organization. These strategic-level decisions include defining the mission and overall corporate goals, determining what businesses to be in, and how to compete in those businesses. The second set of decisions help to make strategic-level decisions work. They keep the business running efficiently by translating strategies into action in the areas of human resources, finance, accounting, marketing, research and development, and manufacturing. When managers of these business functions choose courses of action, they take their cues from the strategies developed for the total organization. Thus, because strategic decisions affect the firm as a whole and involve creating competitive advantage, it is important to have a clear understanding of the distinction between strategic and operational decision making—however, it is a distinction that is not always easy to make.

At the start of this strategic management course, the typical way that many view the issues will be from an operational perspective. This is a familiar perspective for business majors who take courses of study specializing in one function of the business (such as marketing, accounting, or computer information systems). Also, up to this point in most curricula, courses are designed around the business functions and provide theory and training at the operational level. Moreover, individuals with professional experience often make decisions dealing with their particular area of expertise at the operational level. In addition, these individuals have tended to be members of a single department focused on a business function. Although more and more organizations encourage employees at all levels to view their areas from a broader and strategic perspective, many have not had the opportunity or training to practice strategic thinking. Even when the conceptual distinction between strategic- and operational-level decision making becomes clear, in reality the line separating the two types of decisions is not always obvious. For example, on the face of it, buying a small machine should be considered operational, should it not? But if new equipment is purchased in support of a new *strategic* direction for the firm, is the decision to purchase suddenly strategic in scope? What about an aggregated series of operational decisions, such as purchasing several machines in the production area? If equipment purchases can, in fact, give an organization additional competencies and thereby alter the strategy of the firm, then the answer, perhaps, is yes.

To help clarify what should be viewed as strategic decision making, the following points provide a basis for thinking about issues and decisions from a strategic perspective:

1. Is the decision about changing the firm's position within the industry?
2. Will the decision involve a new business area?
3. Does the decision have a significant financial impact on the firm?
4. Would it evoke a significant response in the environment—that is, from competitors or other stakeholders?

The benefit of distinguishing between the two levels of decision making in the strategic management course is that one begins to develop a type of *strategic thought process*. This helps the strategic manager to recommend decisions that affect the firm as a whole and to better understand the importance of competitive advantage. While effectiveness at both the operational and strategic levels is essential to competitiveness, a focus on operational decisions can result in an organization doing things better than its competitors. However, improvements in operational performance are often easily imitated.

The strategic-level decisions that focus on doing things *differently* are what provide a sustained competitive advantage where an organization preserves meaningful differences with rivals. By the time this strategic management course is completed, how these strategic-level decisions differ from those involving operational-level issues will not only be understood, it will be appreciated, too, in a completely new way.

Exercise

Innkeepers of America

INSTRUCTIONS

After reading the following case, read the statements that follow it and put an S next to the decisions that are strategic and an O next to the ones that are operational.

Innkeepers of America, a medium-sized national hotel chain, has operated successfully for many years in the economy segment of the lodging industry. Its chain of hotels provides rooms that are comfortable and roomy. To keep costs low, the company locates its properties near a major restaurant instead of providing that service itself. The rooms and lobby areas are comfortable with normal accommodations, but extra frills are avoided. Although the company has its own staff of security guards, cleaning and landscaping services are contracted out to local companies.

During the past three years, several new competitors have entered the economy segment of the industry using aggressive pricing strategies. To meet the new competitive threat, management responded with a series of steps over the past two years. Management lowered the price of the hotel rooms by 10% last year and again this year with the goal of matching competitor prices and also created a new advertising campaign that targeted budget-conscious customers by giving them discount coupons for weekend stays. This promotion increased occupancy on the weekends, and plans are to continue it this year. Three new positions were created and filled in the customer service department. Employees were given shares of the company stock as part of a bonus plan. A continental breakfast menu was created. Guests could get bread rolls and breakfast drinks in the lobby, or they could get them delivered to their room for an extra fee. Over 50% of the guests used this service. The reservation system was fully computerized, and front-desk employees received four half-day training sessions on the new system. However, despite these changes, the company's overall market share did not increase, and in the last quarter, it dropped slightly. The company's net profit margin also declined from the previous year.

Management was concerned, and a meeting was held to review and recommend courses of action. The head of marketing proposed a new company Web site where customers could book reservations online. The operations vice president noted that with the additional customer service staff and features, such as the continental breakfast, the company's image was beginning to change. She recommended that all of the new hotels planned for construction next year be designed with more features to appeal to an upscale market segment. The marketing vice president agreed and noted that an upscale property would allow management to charge higher prices for the rooms to cover the higher costs associated with the upcoming campaigns. The president shared a letter with the group where a major competitor, Economy Lodge, Inc., wanted to merge with Innkeepers of America. According to the president, "This merger would increase our market share by a sizable amount, and we would be able to compete more strongly in the economy segment of this industry. However, before we decide on this and other actions you've recommended, we should rewrite our mission statement so that we have a sense of our core purpose and which decisions we should make to achieve that purpose."

_______ 1. Innkeepers of America's position in the economy segment of the lodging industry.

_______ 2. Locating properties next to a restaurant rather than having food and beverage in-house.

_______ 3. Price of rooms lowered further to meet competition.

_______ 4. New advertising campaign with discount coupons for weekend stays.

_______ 5. Three new customer service positions.

_______ 6. Shares of company stock issued for employee bonuses.

_______ 7. Providing continental breakfast in the lobby.

_______ 8. Room service (for continental breakfast only).

_______ 9. Computerized reservation system.

_______ 10. Training program for front-desk employees.

_______ 11. Web site where reservations can be booked online.

_______ 12. New hotel properties built with additional features to appeal to an upscale market.

_______ 13. Merger with Economy Lodge, Inc.

_______ 14. Rewrite mission statement.

_______ 15. Contracting cleaning and landscaping services.

Strategy Session 2

Understanding the Concept of Strategy

OBJECTIVE

This session's reading and exercise provide the opportunity to explore strategy from several points of view. Knowing multiple definitions helps in understanding the different facets of the concept.

> The field of strategic management cannot afford to rely on a single definition of strategy, indeed the word has long been used implicitly in different ways even if it has traditionally been defined formally in only one.
>
> —*Henry Mintzberg*

Strategy is a term used in many ways. The exercise in Strategy Session 1 revealed that strategy can be large decisions that managers make. But even smaller, tactical moves can prove to be strategic in certain cases. Early definitions of strategy were the plans that "matched" the organization to its environment, whereas today the formal definitions describe it as a set of decisions and actions that managers take to achieve organizational goals related to achieving strategic competitiveness and earning above-average returns. In addition, the word *strategic* modifies many other words and actions to give them a sense of importance. For example, we read about a "strategic move" or a major "strategic undertaking." Quite often, the debate on what to do and how it is done occurs because of the different meanings attributed to *strategy*. Henry Mintzberg provides five definitions—the "Five P's":

1. **Strategy as a plan.** This is a consciously intended course of action. It could take the form of a set of guidelines or a written report that managers use to guide their decisions. Start-ups usually write a business plan for their future. Some organizations go through a formal planning process and arrive at a document that will guide their actions in the years to come.
2. **Strategy as a pattern.** This is an after-the-fact view of strategy. When we look at organizations over time, as journalists in the business press often do in their reports, we see a "pattern in a stream of actions." We may see a consistency that suggests a direction. When that pattern was not originally intended, then the realized strategy is also called "emergent strategy."
3. **Strategy as a position.** Managers see their firm as occupying a place within an environment. This is its position in the market in relation to its competition and is often defined in terms of market share. Automotive companies see the market as comprised of several segments, such as minivans and trucks, and set targets in terms of a share of the market.
4. **Strategy as a perspective.** This represents how the organization sees itself and expresses its way of doing things. It is the organization's way of perceiving the world. 3M sees itself as providing "innovative technology for a changing world" and sees new technology as a way of exploiting new markets.

5. **Strategy as a ploy.** This is a short-term tactic or a maneuver that is intended to outwit or preempt competitive strategic moves. For example, a firm that anticipates market growth might announce a five- or tenfold increase in production capacity. This extensive capacity discourages potential rivals from trying to set up their own facilities. Another example is a software company announcing a new product that was going to reach the market in a year or so with the result that customers avoid competitive products as they wait for the new software. Another ploy occurs when a company learns about a new innovative product and then slows the introduction by questioning whether the advertising is false or misleading and holding up the introduction process until legal questions are resolved. These examples illustrate how strategic ploys can take the steam out of new offerings.

These different definitions enrich our understanding of how strategies are formed and how the process can be managed. They are also different ways of getting a handle on the term *strategy*. As a plan, strategy provides information about what was intended. As a ploy, the focus is on direct competition and how maneuvers can gain short-term advantage for a firm. As a pattern, strategy looks at actions and behaviors, where intentions give way to decisions taken in the face of a changing environment, revealing the unintended or emergent strategies that often occur. As a position, the focus is on the competitive environment and how organizations struggle for advantage. As a perspective, strategy looks at how a collective group of individuals share values and behave in a cooperative way in the production of specific goods and services.

These definitions enable us not only to view strategy from the important competitive perspective but also to better understand how organizational members help to shape the process. In some ways the definitions may compete by substituting for each other, but they also complement each other. Thus, they are not mutually exclusive. Importantly, as a diagnostic tool, if we find contradictions in the different P's when applied to an organization, it may suggest confusion in the organization's sense of direction and how it is trying to achieve its goals.

Exercise

How Do You Define Strategy?

INSTRUCTIONS

Reconsider the Innkeepers of America case on page x. Read it again if necessary. Do you find evidence of the different forms of strategy in the case? Look for statements/phrases in the case that illustrate the different definitions of strategy.

Form of Strategy	Statements/Phrases in Case
Plan	
Pattern	
Position	

(*Continued on next page*)

Form of Strategy	Statements/Phrases in Case
Perspective	
Ploy	

Strategy Session 3

Communicating Purpose through Mission Statements

OBJECTIVE

This session shows whether organizations define their core purpose by simply describing current product lines and the service they provide—or whether they define their core purpose in terms of the customer-needs being satisfied. After finishing this reading, perform the exercises and team activities that follow.

> Only a clear definition of the mission and purpose of the business makes possible clear and realistic business objectives. It is the foundation for priorities, strategies, plans, and work assignments.
>
> —*Peter F. Drucker*

The first responsibility of management is to provide a clear sense of direction for decision making and to guide strategy development. In strategic management, an organization's general and enduring sense of direction is defined as its *mission*. The most common way that organizations attempt to communicate their sense of purpose or direction is through a mission statement.

Overview of Mission Statement Criteria

Mission statements vary considerably in their design. Two basic criteria, however, define for employees, customers, and all stakeholders the organization's highest and most enduring goals:

1. A statement that defines the organization's core purpose in terms of customer needs.
2. A statement that indicates the key beliefs, values, and priorities that managers are committed to and that influence the decisions they make.

Definition of the Organization's Core Purpose

When an organization defines its core purpose, it should make clear the importance people attach to the organization's work. In other words, the organization must define its reason for being.

The mission statement should clearly answer the questions: "What business are we in?" and "What business should we be in?" It is important that these questions be answered in terms of customer needs and not based on the products or services the company currently offers. Some companies make the mistake of simply describing their current product lines or customer segments as their core purpose, when instead they should focus on the customer needs that the business seeks to satisfy. To get at a customer-oriented definition, one method is to answer the question Why? several times.

A technique for moving from a product or service orientation to a customer-needs definition of an organization's purpose is shown in Table 3.1, with examples using a company that manufacturers cosmetics and a company that provides market research data, respectively.

TABLE 3.1 MISSION STATEMENTS MOVING FROM A PRODUCT/SERVICE DEFINITION TO A CUSTOMER-NEEDS ORIENTATION

Product/Service Definition	**Examples**
Instruction: Start with a descriptive statement: "We make X products or we provide X services."	Company that manufactures and markets face makeup*: We make quality cosmetics.* Company that provides market research to other organizations: *We do research about market characteristics and market demand for companies in a variety of industries.*
Customer-Needs Definition	**Examples**
Instruction: Answer the question *why* as many times as it takes to get to the fundamental purpose of the organization—or the customer-needs definition. That is, why do we make these products or deliver these services? What needs do the products/ services satisfy?	**Face Makeup Company** ("We make quality cosmetics.") Why? – *We enhance beauty and enable our customers to maintain a youthful appearance.* **Market Research Organization** ("We do research about market characteristics . . .") Why? – *To provide the best data available so that the customers will understand their markets better.* Why? – *To contribute to our customers' success by helping them understand their markets.*

For many people in a company, it is difficult to think about the organization's purpose in any way other than the product manufactured or the service provided. After all, it is "what we do." Because it is so obvious, it is easier to identify and buy into the mission. However, this paradigm can be a trap that potentially may keep management focused on outdated products.

Charting a Strategic Course

Today, many products and services race through the business cycle and are obsolete or outmoded faster than products and services were in the past. For example, once there was only one long-distance telephone service. Now there are long distance "packages" for a range of customer types that, in turn, change their pricing, features, and names from month to month. By being very clear about what the organization stands for and why it exists, decision makers enhance their ability to think strategically about what the organization could do, as well as what it should not do.

Compare the stories of Zenith and Motorola. For many years, both companies were known for manufacturing televisions. While Zenith retained its focus on television manufacturing, Motorola changed from televisions to microprocessors—and then on to aggressively pursuing strategies to achieve its core purpose of providing integrated communication solutions and embedded electronic solutions. Motorola could give up what it made years ago when it did not fit the core purpose. Zenith could not.

Making Operational-Level Decisions

Mission statements, when they are written in terms of customer needs, also serve as a decision making and leadership tool for operational-level decisions. An example from the government sector illustrates this process. At first glance, a city fire department might define its mission based on what it does: put out fires. But a fire department's purpose goes beyond this definition. If a car is leaking gasoline, or if a parent calls to say his or her child stopped breathing, the fire department will respond and provide life-saving measures and emergency transportation to a hospital. Thus, a more realistic statement based on why the fire department exists would be to ensure the preparation of officers, men, women, and equipment "so that together we are prepared to provide cost-effective resolutions to emergencies that threaten or will threaten life and property in our community."

Given this new definition—or mission statement—of the city's fire department, suppose the department has limited funds and must choose between purchasing a ladder truck to increase the capabilities of the department and an equipment truck to carry new rescue tools. As part of the decision-making process, the team of firefighters reviews these two options against the statement.

First, the ladder truck: Does it improve the preparedness of the equipment? Yes.

Is it cost effective? Yes, as made evident by a review of the financial data.

Will it help to reduce the threat to lives and property? Yes. It will provide access to those who need rescue from upper floors.

The review continues. Then the equipment truck is compared in terms of its value in supporting the department's purpose. The advantage of this process is that the operational-level decision is based on clear facts and is linked to the organization's mission.

Similarly, at AT&T, the decision to add new products and services is based largely on the company's customer-oriented mission to bring people together and give them easy access to each other. How closely the proposed product or service achieves this mission determines whether it will be introduced or not.

Thus, in for-profit, nonprofit, and government organizations, a clearly defined purpose written from a customer-oriented perspective has two advantages. It provides a framework for charting an organization's strategic course, and it is a guide for operational-level decision making.

Philosophy and Values

Another component that companies include in mission or vision or value statements defines the organization's philosophy—its basic beliefs, values, and priorities. These statements also provide guidelines for those within the company, particularly in terms of their behaviors, their conduct, how they intend to do business, and what kind of organization they want to build. An understanding of the organization's social responsibility is also spelled out.

A company whose values are legendary is Johnson & Johnson. This organization publishes a value statement—a *credo*—that expresses its belief that the company's first responsibility is to the doctors, nurses, and patients who use Johnson & Johnson products. Next are its employees, the communities in which the employees live and work, and finally the stockholders. The credo is displayed in every manager's office, and it guides every important decision making. To view a copy of the Johnson & Johnson credo, go to **http://www.jnj.com/connect/about-jnj/jnj-credo.**

Exercise 1

How Well Do These Organizations Communicate Their Purpose?

INSTRUCTIONS

Review the mission statements of Harley-Davidson, Google, and Southwest in Table 3.2. Each provides a definition of the company's purpose. Circle the letter in questions 1-4 that most closely matches how you think the statements satisfy the criteria for defining the core purpose in terms of customer needs. Then, as a team, perform activities on pages 16–17.

TABLE 3.2 SAMPLE MISSION STATEMENTS

Harley-Davidson	Google
Mission	Mission
We fulfill dreams through the experience of motorcycling, by providing to motorcyclists and to the general public an expanding line of motorcycles and branded products and services in selected market segments.	To organize the world's information and make it universally accessible and useful.
Southwest Airlines	
Mission	
The mission of Southwest Airlines is dedication to the highest quality of Customer Service delivered with a sense of warmth, friendliness, individual pride, and Company Spirit.	

Dell computers

Harley-Davidson

1. How closely does the mission statement define Harley-Davidson's core purpose in terms of customer needs?

A	B	C
No core purpose discussed	Defines core purpose in terms of product/service provided	Defines core purpose very well in terms of customer needs

Google

2. How closely does the mission statement define Google's core purpose in terms of customer needs?

A	B	C
No core purpose discussed	Defines core purpose in terms of product/services provided	Defines core purpose very well in terms of customer needs

Southwest Airlines

3. How closely does the mission statement define Southwest Airline's core purpose in terms of customer needs?

A	B	C
No core purpose discussed	Defines core purpose in terms of product/service provided	Defines core purpose very well in terms of customer needs

Team Activity
Mission Statement Revision

Names: ____

____

1. Transfer each team member's ratings onto the following charts:

	Team Member Ratings		
Team Member Names:	**Harley-Davidson**	**Google**	**Southwest Airlines**

2. Discuss the individual ratings in activity 1. Through consensus, develop a new team rating of an A, B, or C for each of the mission statements.

	Harley-Davidson	Google	Southwest Airlines
Team Rating			

3. Rewrite one of the company statements to incorporate an improved definition of the core purpose according to the customer-needs criteria.

Exercise 2: Video

Create a Mission Statement for the Life Is Good Company

INSTRUCTIONS

View the video titled "Life is Good," which provides an overview of the Life is Good Company. The company is headquartered in Boston, Massachusetts and has 232 employees. Brothers Bert and John Jacobs began selling tee shirts in Boston and along the east coast, and in 1994 formally began the Life is Good Company.

1. Individually or in teams, complete the following chart identifying the product and the customer-need:

Product Definition	Customer-Need Definition
What is made?	What customer-need(s) does the product satisfy?

2. Prepare a mission statement for the company using the customer-need definition.

Exercise 3: Video

Create a Mission Statement for Subway

INSTRUCTIONS

View the video titled "Subway," which provides an overview of the Subway organization. Subway started in 1965 as a means for Fred DeLuca to fulfill his dream of becoming a medical doctor, and the submarine sandwich shop was a way for him to help pay for his education. Today it is the largest submarine sandwich chain in the world with more than 34,000 locations.

3. Individually or in teams, complete the following chart identifying the product and the customer-need:

Product/Service Definition	Customer-Need Definition
What is made/sold?	What customer-need(s) does the product/service satisfy?

4. Prepare a mission statement for the company using the customer-need definition.

Strategy Session 4

The Board's Role in Corporate Governance

OBJECTIVE

This session develops an understanding of the key issues involved in the governance of a corporation. The board of directors has important roles to play, and an understanding of these roles provides a necessary element in understanding the corporation as a whole.

The focus in strategic management is typically on the CEO. This individual is taken to represent the top management team of the enterprise, charged with the formulation and implementation of strategy. However, the CEO is answerable to the owners of the enterprise, namely the shareholders. In a public limited company, the board of directors, headed by a chairman, is elected by the shareholders to oversee the affairs of the corporation. Thus, an examination of the roles of the board and the relationship of the CEO to the board is important for understanding the strategic management of the firm.

> The governing board of directors must be a board that represents no one except the basic long-term interests of the enterprise.
>
> —*Peter F. Drucker*

Board Roles

The board performs three distinct roles in the governance of the firm:

1. **Control.** This role is internally focused and is derived from its position as representatives of the owners. Agency theory suggests that in a principal (shareholders)–agent (management) relationship, the agent's interests may diverge from those of the principal and need to be controlled. For example, management may pursue market share while the shareholders may want higher returns. Thus the board serves as a watchdog over management, a role that includes monitoring managerial competence and overseeing resource allocation.
2. **Service.** This role has an external focus and considers the board as a *boundary spanner*. That is, it serves to connect the organization to its environment by providing information to management on the one hand, and represent the firm to the community on the other. As suggested by stakeholder theory, the board enhances the firm's legitimacy in society.
3. **Strategy.** This role is more recent in origin. Institutional theory suggests that organizations develop an inner logic of their own and seek a position and purpose different from that of those who control them. For example, some influential groups of shareholders may be looking for short-term appreciation of share prices and not for long-term competitive advantage. Thus, this theory argues that the board needs to think in terms of the long-term strategy of an enterprise, even though it may not always serve the purpose of the diverse group of owners, some of whom may seek short-term rewards.

In seeking to perform these three roles, different boards have taken different paths. Some boards are active and others are more passive. During the late 1980s and early 1990s, several large corporations in the United States went through a difficult period of governance that led to disagreements between the board and the CEO. At various times, the CEOs of General Motors, IBM, Kmart, HP, Yahoo!, Abbott Laboratories, and Greyhound Lines, among others, have quit or been fired over differences with their boards on how to run their respective organizations. A study by consulting firm Booz Allen found that 31.6% of CEOs worldwide who stepped down from office did so due to conflicts with their board.

The 1990s also saw scandals in major U.S. corporations such as Enron, WorldCom, and Tyco, which were related to accounting irregularities or financial mismanagement. As a response, the U.S. Congress passed the Sarbanes-Oxley Act in July 2002 that established the Public Accounting Oversight Board. The Oversight Board requires public companies to create and document new internal financial control systems, add independent directors, strengthen the role of audit committees, and make executive officers personally certify the accuracy of financial documents. Stock exchanges around the world have also put down guidelines on corporate governance for their listed companies.

The focus of most regulatory efforts and guidelines on governance is on better control and the expectation that the board would play an effective supervisory role. This has led boards to require a better working relationship with their CEOs and the desire to be kept informed about major plans of the company and variations in performance. The old era of boards rubber-stamping management decisions seems to be changing.

Independent guidelines exist in the United States (www.nacdonline.org) and in Europe (www.ecgi.org) in order to encourage good governance practices. Many large companies have devised their own set of guidelines on governance. These go beyond accounting or financial matters and typically include advice on becoming active participants and decision makers in the boardroom and not merely passive advisers. The guidelines also stress director independence, limiting the number of board memberships, and requiring members to immerse themselves in the company's business and industry.

Exercise

Translating the Board's Role into Guidelines for Practice

INSTRUCTIONS

PART I: BOARD GUIDELINES

The following are a selection from the 38 items in the guidelines that were adopted by the board of directors of General Motors, a U.S.-based global automotive company. These guidelines were first set in 1994 and most recently revised in November 2011. GM was a pioneer in developing such guidelines, a practice now being followed by many leading corporations. For each item, assign one or more of the three roles (control, service, and strategy) that seem to most closely relate to the activity by checking the appropriate box(es).

GM Board Guidelines

"The General Motors Board of Directors represents the owners' interest in perpetuating a successful business, including optimizing long-term financial returns. The Board is responsible for determining that the Corporation is managed in such a way to ensure this result. The business of GM is conducted by management under the oversight of the Board… In performing its general oversight function, the Board reviews and assesses GM's strategic and business planning as well as management's approach to addressing significant tasks and challenges facing the Company … as well as significant issues and risks that may affect GM's business or financial performance. [T]he Board recognizes that stockholders' long-term interests will be advanced by responsibly addressing the concerns of other stakeholders essential to the Company's success, including customers, employees, suppliers, government officials and the public at large."

Selection and Composition of the Board

1. *Board Membership Criteria*

   The Governance Committee is responsible for reviewing with the Board, on an annual basis, the appropriate skills and characteristics required of Board members in the context of the current makeup of the Board. Board candidates are evaluated based upon various criteria, such as their broad-based business, governmental, non-profit or professional skills and experiences, ethical standards, special skills, concern for the stockholders and other stakeholders, and a global business and social perspective, personal integrity, and judgment. In addition, directors must have significant time available to devote to Board activities and to enhance their knowledge of GM and the global automotive industry.

Control	Service	Strategy

2. *Board Membership Selection*

   The Board itself is responsible for selecting its own members. The Board delegates the screening process involved to the Governance Committee with input from the Chairman and the Chief Executive Officer. The Committee is also responsible for evaluating each incumbent director. In determining whether to recommend a director for re-election, the Committee considers relevant factors including the director's participation in and contributions to the activities of the Board, past attendance at meetings, and the result of Board self-evaluations.

Control	Service	Strategy

Board Functioning

3. *Selection of the Chairman of the Board and the Role of Lead Director*

The Board should be free to choose a Chairman of the Board in the way that seems best for the Company at a given time. Therefore, the Board does not have any policy whether or not the role of the Chairman and CEO should be separate or combined and, if it is separate, whether the Chairman should be an employee or a non-employee director. If the Chairman is not an independent director, the independent directors will elect a Lead Director from among the independent directors. The Lead Director will have duties assigned by the Board, which may include calling executive sessions of the non-management and independent directors and leading the annual evaluation of the Chairman and CEO.

Control	Service	Strategy

4. *Mix of Management and Independent Directors*

The Board believes that there should be a substantial majority of independent Directors on the GM Board. Senior executives other than the Chairman and Chief Executive Officer currently attend Board meetings on a regular basis by invitation even though they are not members of the Board.

Control	Service	Strategy

5. *Board Definition of What Constitutes Independence for Directors*

At least two-thirds of the Board is comprised of directors who qualify as independent under the listing standards of the NYSE. An independent director is one who does not have a material relationship to GM, neither he/she nor immediate family members has been employed by GM, its auditors, or significant supplier/customer in the past three years.

Control	Service	Strategy

6. *Former Chief Executive Officer Board Membership*

The Board believes that it is preferable that the CEO and other senior executives of GM not serve on the Board following retirement from GM.

Control	Service	Strategy

7. *Limits on Outside Board Membership*

It is the expectation that every member have sufficient time to commit to preparation for and attendance at meetings. Therefore, non-employee directors should not serve on more than four other boards of publicly traded companies (excluding non-profits and subsidiaries), unless determined otherwise. Management directors may not serve on more than one other public company or for-profit entity.

Control	Service	Strategy

8. *Term Limits and Retirement Age*

Non-employee directors will not stand for re-election after reaching 72. The Board does not believe it should establish term limits. As an alternative to term limits, the Governance Committee formally reviews each Director's continuation on the Board every five years.

Control	Service	Strategy

9. *Assessing the Board's Performance*

   The Board conducts a self-evaluation on an annual basis. The Governance Committee oversees this process and reports an assessment annually to the Board. The assessment will focus on the Board's contribution to the Company and specifically focus on areas in which the Board or any of its committees could improve. In addition, the Governance Committee determines if individuals sitting on the Board bring the skills and expertise appropriate for the Company and how they work as a group.

Control	Service	Strategy

10. *Ethics and Conflicts of Interest*

    The Board expects all Directors, as well as officers and employees, to act ethically at all times and to adhere to GM's policies. The Board will not permit any waiver of any ethics policy for any Director or executive officer.

Control	Service	Strategy

Board Relationship to Senior Management

11. *Board Access to Senior Management*

    Board members have complete access to GM's Management. It is assumed that Board members will use judgment to be sure that this contact is not distracting to the business operation of the Company and that such contact, if in writing, be copied to the Chairman or CEO, as appropriate.

Control	Service	Strategy

Meeting Procedures

12. *Selection of Agenda Items for Board Meetings*

    The Chairman establishes the agenda for each Board meeting (in consultation with the CEO, if the Chairman is not also the CEO). Each Board member may suggest the inclusion of item(s) on the agenda.

Control	Service	Strategy

Committee Matters

13. *Board Committees*

    Membership on the Audit, Governance, and Executive Compensation Committees consists only of independent directors. All Committee charters are available on the Corporation's Web site.

Control	Service	Strategy

Leadership Development

14. *Formal Evaluation of the Chief Executive Officer*

    The non-management directors, meeting separately in executive session, annually conduct a formal evaluation of the CEO which is communicated to the CEO by the Chairman or, if the Chairman is not independent, the Lead Director. The evaluation is based on both qualitative and quantitative factors, including but not limited to the company's financial performance, accomplishment of long-term strategic objectives, and development of the top management team. The evaluation is used by the Executive Compensation Committee.

Control	Service	Strategy

Questions

1. Which role has the maximum and which has the minimum coverage in the guidelines? Why is this so?

2. Do any of the items infringe on what you would consider top management's prerogative in running the company?

3. Are there any areas of governance of a corporation not considered in these guidelines? Write a statement that can be added to the guidelines.

PART II: GM'S BOARD

GM was in deep financial difficulty in December 2008 and filed for bankruptcy protection in June 2009. In addition to the financial crisis of 2008 and the slowing down of the economy having affected GM's performance, its board was criticized for being supportive of underperforming executives, and not insisting on accountability. The U.S. Department of Treasury, as part of providing a bailout loan to the company (in return for 60% of the equity), ousted GM's chairman and CEO, Rick Wagoner. About six directors left the board with him. A director, Kent Kresa, temporarily held the post of chairman from March 2009, and then the government appointed Edward Whitacre Jr., former AT&T Corporation chairman, as GM's chairman in June 2009. Whitacre had no prior experience in the auto industry. Seven of the board members were also asked to leave, and the government appointed five new directors with experience in the telecom and private equity industries. Reports suggest that the government wanted the directors to keep a close watch over management and performance, something the previous board was not believed to have done. Frederick Henderson, a longtime GM executive, was appointed CEO. Although Henderson had been successful in turning around GM's European operation in the past, he quit GM in December 2009 after disagreements with the board. Whitacre became chairman and CEO. Whitacre stepped down in September 2010 and Dan Akerson took his place.

GM's postbankruptcy board, which included government representatives, attracted the criticism of some corporate governance experts who believed that it brought government influence on corporate decisions and might distort governance practices. When the company emerged from bankruptcy in July 2009, ownership was approximately distributed as follows: U.S. government, 60.8%, naming four members; Canadian government, 11.7%, naming one director; United Auto Workers (the labor union), 17.5% naming one director; bondholders, 10.0%.

4. Review GM's board (as of May 2012, given in Table 4.1) and evaluate its effectiveness from the perspective of corporate governance in general, and GM's guidelines in particular.

TABLE 4.1 BOARD MEMBERS OF GM

Name (year appointed)	Title and Committee Membership	Other Information
Daniel F. Akerson (2009)	Chairman & CEO	Prior to joining GM, Akerson was a managing director and head of global buyout of the Carlyle Group, a private equity firm in Washington, DC. Before that, he had been CEO or president of several telecom and technology companies including MCI, Nextel, and General Instruments. He has a background in engineering and economics.
Stephen J. Girsky (2009)	Vice Chairman, Corporate Strategy, Business Development, Global Product Planning & Global Purchasing and Supply Chain (since 03/10)	Represented the UAW's voluntary employee beneficial association (VEBA, health care trust), which owns 17.5%. Credited with over 25 years experience in the automotive industry including serving as an analyst with, and advisor to, GM; with Morgan Stanley; and with an investment fund.

(*Continued*)

Name (year appointed)	Title and Committee Membership	Other Information
Philip A. Laskawy (2003)	Independent Director	Retired chairman and CEO, Ernst & Young LLP. Also, nonexecutive chairman, Federal National Mortgage Association; director of Henry Schein, Inc., Lazard Ltd., and Loews Corporation.
Thomas M. Schoewe (2011)	Independent Director	Former executive vice president and CFO, Wal-Mart Stores, Inc. Currently director, KKR Management LLC; Northrop Grumman Corporation; and PulteGroup, Inc.
David Bonderman (2009)	Director	Co-founding partner and managing general partner, TPG, a private investment firm. Prior to that, he was COO of Robert M Bass Group. He is also currently chairman of Ryanair, a European airline; and director of Armstrong Worldwide Industries; CoStar Group, Caesars Entertainment, and Energy Future Holdings.
E. Neville Isdell (2008)	Independent Director	Retired chairman and CEO, The Coca-Cola Company.
Kathryn V. Marinello (2007)	Independent Director.	Chairman and CEO, Stream Global Services, Inc., a business process services firm.
Carol Stephenson (2009)	Independent Director	Dean, Richard Ivey School of Business, University of Western Ontario, Canada. Previously, CEO of Lucent Technologies, Canada. Currently, also director of Intact Financial Services Corporation and Manitoba Telecom Services. Formerly, a member of the Advisory Board of GM, Canada. Represents the Canadian government's 8% stake.
Erroll B. Davis, Jr. (2009)	Independent Director	Superintendent for Atlanta Public Schools. Formerly chancellor, University System of Georgia; Chairman of Alliant Energy Corporation. Currently director, Union Pacific Corporation.
Robert D. Krebs (2009)	Independent Director	Retired chairman and CEO, Burlington Northern Santa Fe Corporation.
Patricia F. Russo (2009)	Independent Director; Lead Director since March 2010.	Former CEO, Alcatel Lucent Inc., a telecommunications company. Also, a director, Alcoa Inc., Hewlett- Packard Coy., KKR Management LLC, and Merck & Co.
Dr. Cynthia A. Telles (2010)	Independent Director	Associate clinical professor, UCLA School of Medicine. Member of the Board of Kaiser Foundation Health Plan and Hospitals. Formerly on the board of Burlington Northern Santa Fe Corporation.

Source: Compiled by the authors from GM's annual report and publicly available information.

Strategy Session 5

Viewing Strategy from the Stakeholder Perspective

OBJECTIVE

This session illustrates the influence and claims of various stakeholder groups. In the exercises that follow the introductory reading, identify the stakeholders—and demonstrate how stakeholder interests and power are part of the strategy process.

> The stakeholder approach is about groups and individuals who can affect the organization, and is about managerial behavior taken in response to those groups and individuals.
>
> —*R. E. Freeman*

Stakeholders are the individuals and groups who have the potential to influence the performance of an organization and who are impacted by the firm's strategies. The traditional concept of business gives supreme importance to the role and interests of the investors or stockholders. However, the concept of *stakeholders* provides a useful alternative formulation for understanding how numerous organizations, groups, and individuals affect and are affected by a company's strategies and its performance. Examples of stakeholders in a company include customers and, of course, stockholders. However, employees, creditors, suppliers, governments—and the local community—are stakeholders in the company as well. Starbucks, the coffee store chain based in Seattle, is a good example of a company that identifies stakeholders beyond the organization. Its "Starbucks Gives Back" policy states that people "at all levels of the company support Starbucks' guiding principle to contribute positively to our communities and our environment."

The relationship of an organization with its stakeholders can be viewed as one of mutual interdependence. Customers provide the organizations with revenue in exchange for products and services. Stockholders buy shares and thus provide capital in exchange for a return on their investment. Employees provide the skills and labor and get income, good working conditions, and job satisfaction. Creditors provide loans and in exchange receive interest payments. Suppliers provide the inputs and receive payment for the inputs. Governments set rules and regulations that maintain fair competition and in exchange expect companies to adhere to the rules. The local community provides an infrastructure and expects the organization to be a socially responsible citizen.

Although managers must view the impact of these relationships when developing strategy, an organization cannot always satisfy the claims of all of its stakeholders. This is particularly the case when the goals of different groups conflict. For example, the local community may ask for a percentage of profits to be donated to local causes. However, stockholders might expect dividends to be paid from extra profits. Alternatively, employees may demand higher wages, while customers look for lower prices.

Because of these potential conflicts, managers are compelled to identify and prioritize stakeholders. The ultimate goal is to develop strategies that assure the achievement of organizational goals while maintaining positive stakeholder relations.

Exercise 1

The E-Cigarettes Case

INSTRUCTIONS

Read this case about e-cigarettes, a product that simulates tobacco smoking. Then complete the following form to develop a preassessment of the e-cigarette case and perform the team exercise that follows.

As smoking cigarettes becomes less acceptable and not permitted in more and more establishments and areas, a product that was invented in 1963 and further developed in 2003 is gaining in popularity. Electronic cigarettes (e-cigarettes or e-cigs as they are known) were first invented by Herbert Gilbert in 1963 and patented in 1965. However, during that period, the tobacco cigarette was not considered harmful, so there was little perceived need for electronic cigarettes that delivered nicotine without the noxious substances found in cigarette smoke. Four decades later, Hon Lik, a Chinese pharmacist, further developed the battery-operated electronic nicotine delivery system and formed a company in China named Ruyan, which means "like smoke." He first patented the product in China in 2003, and he received an international patent for the e-cigarettes product he developed in 2007. E-cigarettes have a cartridge that contains a moisture producing carrier, such as propylene glycol, that often has nicotine in the solution but no tobacco. When the cartridge is inserted into a tube through which the user inhales, the battery-powered heating element causes the cartridge to form a mist. The user puffs or "vapes" on the vapor, gets the sensation of bringing a cigarette to the mouth and, depending on the brand, gets various levels of nicotine. Considered a drug with benefits, similar to claims about caffeine benefits, nicotine has been linked by researchers and smokers to the reduction of anxiety and stress, faster reaction time, and improved concentration. Also e-cigarettes have no smell, no tar, and no secondhand smoke issues.

According to the Centers for Disease Control and Prevention, the number of Americans trying e-cigarettes from 2009 to 2010 quadrupled. Annual sales for the product that arrived from China five years ago grew between $250 million and $500 million. Although sales have increased, they are still only a fraction of the $100 billion U.S. tobacco market. There are now hundreds of companies selling e-cigarettes, with parts for the product coming from just four factories in China. One of the largest companies manufacturing e-cigarettes is Blu Cigs, which was founded in 2008. It reported sales of $12.5 million in 2010 and more than $30 million in 2011. Also, V2 Cigs, which sold its product at a holiday pop-up store in New York, reported that gross revenue grew 20% each month during 2011.

Many brands are sold over the Internet, although increasingly more can be found at retailers such as 7-Eleven, Walgreens, and Walmart. The cost of e-cigarettes is half of traditional cigarettes, since they are not taxed like traditional cigarettes.

Health Effects

For the most part, the health effects of e-cigarettes are unknown to date. As long ago as 2008, the World Health Organization (WHO) reported there were no rigorous, peer-reviewed studies that had been conducted that showed the product was safe and an effective form of nicotine replacement therapy. Until such studies were performed, the WHO advised that it did not consider the product to be an appropriate nicotine replacement therapy.

In 2009, the U.S. Food and Drug Administration (FDA), Division of Pharmaceutical Analysis, tested 19 varieties of electronic cigarette cartridges produced by two companies (NJoy and Smoking Everywhere). Diethylene glycol, which is poisonous, was detected in one of Smoking Everywhere's cartridges; and traces of tobacco-specific nitrosamines (known cancer-causing agents) were found in all of the cartridges from one brand and two of the cartridges from the other brand. In July 2009, the FDA issued a press release discouraging people from using e-cigarettes. However, the Electronic Cigarette Association said the FDA testing was too narrow to reach valid and reliable conclusions. Additionally, the FDA methods were criticized and reported in the *Harm Reduction Journal* and the *Journal of Public Health*. Research experts pointed out that the levels of toxicity detected by the FDA were highly unlikely to have any possible significance to the users because the potentially harmful chemicals were measured at a concentration level one million times lower than are related to human health.

The American Association of Public Health Physicians, as of April 2010, supported e-cigarette sales to adults, since there is the possibility of saving the lives of four to eight million current American smokers who will otherwise die of tobacco-related illnesses over the next 20 years. Additionally, a Boston University School of Public Health study in 2010 found that e-cigarettes were much safer than tobacco cigarettes and equally as unhealthy as conventional nicotine replacements, such as nicotine gum and patches. Although the researchers said more studies were needed, few, if any, chemicals detected in the e-cigarettes raised serious health concerns, and carcinogens were up to 1,000 times lower than regular cigarettes.

Classification of E-Cigarettes

The FDA classified e-cigarettes as drug delivery devices and argued that they are subject to regulation under the Federal Food, Drug, and Cosmetic Act (FDCA) prior to importation to and sale in the United States. That is, with this classification, the FDA would stop the sale of the product until its safety could be demonstrated in clinical trials. This classification was challenged and overruled in January 2010 by Federal District Court Judge Leon. Although the FDA appealed the ruling and argued that e-cigarettes are not tobacco products and should be under regulation as a drug, device, or combination product (which puts regulation under the FDCA), the appeals court unanimously ruled that the FDA can only regulate e-cigarettes as tobacco products. The judges ruled that such devices would fall under drug legislation if they were marketed for therapeutic use. E-cigarette manufacturers successfully proved their products were marketed to smokers and not to those seeking to quit. In January 2011, the District of Columbia Circuit Court of Appeals declined to review the decision, and the products are not classified or regulated as medical devices.

Attracting Minors

Antismoking groups argue for tight regulation of e-cigarettes not only due to the potential harmful health effects but also because these products are more likely to attract youth, particularly since manufacturers incorporate a wide range of ingredients for different flavors. For example, some companies produce the option of flavors, such as peppermint, chocolate, cherry, and piña colada, to name a few. These flavors, argue antismoking groups, would encourage underage youth to try the product and become addicted to nicotine. Manufacturers to date show support for groups and states that argue for age restrictions and ban of the product's sale to minors.

For Now

Various stakeholders agree that e-cigarettes should be studied more thoroughly, subject to tighter regulation and quality control standards, and banned from sales to minors. However, for as many groups that want to ban altogether the sales of e-cigarettes, there are those who see advantages to the nicotine delivery system.

E-Cigarette Case: Preassessment

Identify the stakeholders in the e-cigarette case. List them according to the level of influence they exert, showing the stakeholder group with the highest level of influence first, then the stakeholder with the next highest level of influence, and so on. The last stakeholder should be the one with the lowest level of influence. Next to each, briefly discuss the reasons behind your ranking.

Stakeholder Listing	Brief Discussion of Stakeholder Influence/Power

Team Activity

Names:

Suppose you are a company that manufactures e-cigarettes. Identify a strategy to deal with each stakeholder group noted earlier.

Stakeholder Group	Your Strategy

Exercise 2

Role Playing Global Chemical Stakeholders' Interests and Power

INSTRUCTIONS
Read this case about Global Chemical Corporation, a fictitious company facing a situation that is a composite of many real-life scenarios. Then complete the following form to develop a preassessment of the Global Chemical case and perform the team exercise that follows.

Global Chemical Corporation

Several years ago, a citizen environmental group from Kentucky began complaining about the health hazards it claimed were being carried downstream from the processing facility of Global Chemical across the state border in Ashton, West Virginia. Several small towns along the river in Kentucky had been affected by the pollution. The environmental group brought in health specialists to support its claims that pollutants from the river were causing serious health problems in these towns.

An independent study conducted by the state of West Virginia concluded that while the residents of these towns did experience higher-than-normal levels of a number of types of cancer, "there is no proven link between these diseases and the chemicals from Global."

Now, despite this lack of proof, it appears that Global Chemical's board of directors will consider the charges against the facility at its next meeting.

As part of the materials to be sent to board members, the CEO would like to include recommendations about what action to take on this problem. The filtering system is too old to be upgraded, and to put in a new system would cost millions and would close the plant for months. Some board members think it would make more sense to build a new plant somewhere else (maybe overseas, where environmental laws are not as strict) rather than put an entirely new filtering system in such an old facility.

Further complicating the situation is the fact that almost half of the workers in this community work at Global. Closing the plant for even a few months not only would cause extreme financial hardship but also would threaten the existence of many local businesses. Understandably, the unions at the company are totally opposed to any actions that might hurt their members, especially since none of the pollution charges have been proven.

The citizens' environmental group from Kentucky is threatening to cooperate with a *60 Minutes*–type program that is going to develop an expose of the situation on national television. If it gets to that point, it might not matter that there is no proof that the chemicals from Global cause the diseases found in the Kentucky towns.

Global Chemical Case: Preassessment

1. After reading the Global Chemical case, what strategy should Global Chemical pursue at this time and why?

2. Identify the stakeholders of Global Chemical. List them according to the level of influence they exert over the company, showing the stakeholder with the highest level of influence first, then the stakeholder with the next highest level of influence, and so on. The last stakeholder on the list should be the one with the lowest level of influence. Next to each, briefly discuss the reasons behind your ranking.
3.

Stakeholder Listing	Brief Discussion of Stakeholder Influence/Power

Team Activity
Stakeholder Group

Names:____

____

You will be assigned to a stakeholder group. Each group develops a specific position on what Global Chemical's strategy should be while management formulates its strategic plan.

1. Each stakeholder group should select one person to act as spokesperson while the management team should divide responsibilities among its various members (30 to 40 minutes for this activity).
2. The entire class reconvenes with each stakeholder group staying intact. The Global Chemical management team presents its plan and answers any questions of clarification. Then the stakeholder groups huddle individually for 5 minutes to review their positions in light of the Global Chemical presentation. A spokesperson from each group gives a brief response to the strategic plan. The management in turn is allowed to respond in a very brief manner. The board of directors should have the final say in its role as the group to which management is primarily accountable. Once all of the stakeholder groups have presented, a question and answer period directed to the management team is in order (40 to 45 minutes).
3. A second brief round of meetings takes place. Global Chemical's management team should reassess its strategic plan in light of the critiques by various groups. Each stakeholder group should discuss its position in relationship to the corporation as well as other stakeholder groups (10 minutes).
4. The entire class reconvenes. Global Chemical management presents any changes in its strategic plan. Each stakeholder is given an opportunity to make a brief statement. The board of directors should have the final say (10 to 15 minutes).

PART II

Designing Strategy

Strategy Session 6

Forces Affecting Competitive Strategy

OBJECTIVE

This session will help identify the forces of competition and determine what effects these forces have on a competitor's ability to earn high profits. The exercise features a profile of the casino gambling industry that lets you assess these forces.

> Most of us never recognize opportunity until it goes to work in our competitor's business.
>
> —*P. L. Andarr*

An *industry* is defined as the group of competitors that produce similar products or services that satisfy the same basic consumer need. For example, the lodging industry consists of hotels and motels that compete with one another to provide accommodation for travelers away from home. The automobile industry consists of competitors that manufacture and market cars, trucks, and other kinds of vehicles to transport people, property, and services.

Managers must understand the nature of competition within their industry so that they can identify opportunities and threats facing the company. From this analysis, they judge the potential in the industry for above-normal profitability and ultimately determine the best strategy for the firm to pursue to either offset or influence competitive forces. The model for analyzing an industry consists of five forces of competition developed by Michael Porter:

1. **Industry Competition—Rivalry among Existing Firms.** When companies in the same industry compete, they often use tactics such as price competition, new product introduction, and advertising slogans and campaigns. The intensity of the competition depends on factors such as the number of competitors, rate of industry growth, amount of fixed costs, product or service characteristics, exit barriers, capacity levels, and the diversity of rivals.
2. **Threat of New Entrants.** New entrants or companies that are not currently part of the competitive group may be looking for an opportunity to enter the industry. How much of a threat they pose depends on the existing barriers to entry and the reaction from existing competitors. Barriers to entry include economies of scale, product differentiation, capital requirements, cost disadvantages independent of size, access to distribution channels, and government policy.
3. **Bargaining Power of Suppliers.** Suppliers to an industry are those who supply materials and services required by firms in the industry. Suppliers can affect the profitability of an industry if they are able to raise prices or reduce the quality of purchased goods or services. Forces affecting supplier bargaining power include the number of available suppliers, the uniqueness of a supplier's product or service, whether the industry competitor has the potential of integrating backward to produce

the supplier's product, the cost to change suppliers, and whether the industry is an important customer of the supplier.

4. **Bargaining Power of Buyers.** Buyers are usually consumers of the product or service, but they can also include wholesalers and retailers who bring the product to the consumer. Buyers affect an industry by being able to force down prices, bargain for more services, or play competitors against each other. Typically, industrial or commercial buyers have bargaining power when they purchase in large volume or when the costs of switching from one industry player to another are low. Consumer buyers tend to be more price-sensitive when they purchase undifferentiated products or when the products are expensive relative to their income.
5. **Threat of Substitute Products and Services.** Substitute products are those provided by competitors in a different industry but come close to satisfying the same consumer need. For example, renting DVDs or ordering movies through companies such as Netflix or the Internet is a substitute for going to the movies, wine is a substitute for beer, and so on. The threat of substitutes exists because their existence places a ceiling on prices the industry can charge. When prices get too high, consumers will switch to the substitute, unless the industry upgrades or differentiates its product, thus making the substitute less appealing.

Other scholars have suggested the following two additional forces for inclusion in an industry analysis.

1. **Relative Power of Other Stakeholders.** Other stakeholders, such as local communities, creditors, trade associations, governments, special-interest groups, and stockholders, can exert powerful influence on the industry and affect the nature of competition.
2. **Power of Complementors.** A *complementor* is defined as an industry whose product works with the product of the industry being analyzed and without which the industry's product would lose much of its value. An example can be found in the microprocessor industry, in which companies in the software industry are seen as complementors.

In scanning the industry, management assesses each force as high, medium, or low in terms of its strength and judges the potential for above-normal profitability in the industry. While a high force is a threat because it is likely to reduce profits, a low force is an opportunity because it may allow the company to raise prices and earn higher profits. Thus, studying each force points management to actions that it can take to influence the effect of the industry's forces on the company.

Exercise

Intensity of Competition in the Casino Industry

INSTRUCTIONS

Read the following description of the casino gambling industry. Respond to the questions that follow in order to evaluate the intensity of the forces and their impact on the profitability that can be attained in the industry.

The Casino Gambling Industry in the United States: Expansion and Competition

The overall gaming industry consists of casinos, pari-mutuel wagering (horse racing, dog racing, and jai-alai), tribal gaming operations, and lotteries. Casino gaming is the largest part of the overall gaming industry, and the most recognizable form of the casino segment is the Las Vegas–style properties. Also included in the segment are riverboats, card rooms, and racetrack casinos (known as racinos).

Although the economic recession over the past few years resulted in less casino revenues for the industry, 2011 showed a slow but steady recovery. In 2011, gross gaming revenues (amount of money wagered less the winnings paid to players) totaled $35.64 billion—an increase of 3% compared to 2010.

Table 6.1 shows a breakdown of casino gambling revenue.

TABLE 6.1 CASINO GAMING REVENUE TREND (BILLIONS)

2002	$28.07
2003	$28.72
2004	$31.17
2005	$32.77
2006	$35.27
2007	$37.52
2008	$36.22
2009	$34.28
2010	$34.60
2011	$35.64

The casino gambling industry is highly regulated and is one of the most taxed industries in the United States. State governments are the primary regulators, and taxes vary by state. The money collected through state and local taxes funds programs such as education, infrastructure projects, youth and senior services, and public safety. At the federal level, casinos are required to comply with regulations associated with financial institutions (banks and money-lending organizations) due to the large amount of money that is transferred on the casino floor. The 1985 Bank Secrecy Act amendment added casinos to the financial institution list to prevent money laundering. The act requires that casinos report every deposit, withdrawal, exchange of currency, or any other transfer of more than $10,000.

Of the 22 states that have approved commercial casino gambling through 2011, 15 had increases in gross gaming revenues in 2011, and 13 had increases in gaming tax contributions.

Entertainment Complexes

Commercial casinos in Las Vegas and other centers have added nongaming entertainment components, such as spas, retail shopping, restaurants, golf courses, and theater-style shows. These nongaming components provided a way for properties to differentiate from the competition and to boost the bottom line.

Native American Casinos

The Indian Gaming Regulatory Act of 1988 gave Native American tribes the right to negotiate for the development of a gaming facility. Based on data from the federal regulatory agency known as the National Indian Gaming Commission, more than 200 of approximately 550 Native American tribes in the United States own and/or operate casinos in the nation. The highest volume projects are on Mohegan and Mashantucket Pequot land in Connecticut.

The growth of Native American–owned gaming creates opportunities for other casino companies to provide management services. Although outsiders cannot own Native American gambling facilities, they are allowed to manage properties under contract. It is expected that the Indian Gaming Regulatory Act will be extended to cover Internet gambling.

Industry Structure

The U.S. casino gambling industry has become more consolidated over time due to acquisitions and internal growth. The largest company, ranked by casino winnings, is Caesars Entertainment Corp. This company was taken private in 2007.

Internationally, the industry is growing through expansion of U.S. casino companies. Asian markets have experienced very large growth. Macau, which is the only place in China with legalized casino betting, had gambling revenue of $34 billion in 2011, a 42% increase from the year before. Because of the less favorable global economic conditions, growth is forecasted to cool down to 18% in 2012. Other markets such as Taiwan and Korea are reviewing casino gaming, and properties in Singapore should expand the Asian gaming industry. Development plans for the Primorye Gambling Zone in Russia, near the eastern port of Vladivostok, also have potential for expanding Asian gaming industry.

Suppliers

Gaming equipment manufacturers supply electronic gaming devices, systems, table games, key components, and support products and services to the casino gaming industry. These suppliers are part of a global industry, and they design, manufacture, and market computerized gaming equipment, systems, and services. Although a larger number of manufacturers have entered the gaming equipment industry, International Game Technology (IGT) is the nation's largest slot machine maker and is one of the leading suppliers of gaming products to the world. With a strong presence in the United States and operations and sales offices in the Asia Pacific region, the company posted revenues of approximately $2 billion in 2011. It has a strong focus on research and development, with 1,500 employees dedicated to R&D efforts involving engineering, hardware, electrical systems, and software. As a result of the economic downturn, the company reduced its global workforce through restructuring efforts and closed its operations in Japan. The CEO of IGT (Patti Hart) identified a new strategy to transform the company through cloud technology to deliver casino games remotely. In January 2012, the company bought

Double Down Interactive, which runs a Facebook poker game. The application mimics casino games but is legal because there is no prize money. Users pay to buy virtual chips, producing revenue. So while Internet gambling is still mostly illegal in the United States, most gambling companies and suppliers to the industry are preparing for states or the federal government to change regulations. The other four other major gaming equipment manufacturers are Novomatic AG in Austria; Intralot S.A. in Athens, Greece; Universal Entertainment Corporation in Tokyo; and Scientific Games Corporation in New York.

Internet Gambling

In December 2011, the U.S. Department of Justice issued an opinion that provided states and lotteries with the opportunity to begin legalizing online gambling for casino games. Proponents argue that online gambling will be a source of tax revenue. Delaware lawmakers passed a law in June 2012 that would make Delaware the first state to legalize online gambling, including Internet blackjack, poker, and slot games. The Delaware law requires the lottery to verify that residents are within Delaware and to exclude minors. Opponents of online gambling include convenience stores that sell lottery tickets, Native American Indian tribes, local casino companies, and activists concerned about gambling addiction.

Globally, the online gambling market experienced strong growth in 2011 with wins of \$33.6 billion. Europe's portion of the total was \$16 billion and Asia Pacific markets totaled \$8.9 billion. The sports betting segment equaled 48.9% and the casino segment totaled 25.5% of the market's overall value. The market is fragmented with some nations totally prohibiting online gambling and others having specific restrictions. In 2010, 70 jurisdictions worldwide allowed online gambling operations. Government regulation is strict; however, due to the nature of the Internet, policing of various laws is not easily done.

Social Gaming

A new business model for gaming equipment manufacturers involves the creation of social networking sites. In addition to IGT's acquisition of Double Down Interactive, described earlier, WMS Industries, the nation's second-largest slot machine manufacturer, created the site called Player's Life. It is more than just a place for site members to chat and share videos; the site is connected to a server linked to the company's more advanced slot games. Members play casual online games and then get the opportunity to play bonus rounds when they return to the property-based casinos. Casino owners are not aggressively pursuing WMS machines because they are based on a revenue-sharing model. Besides not wanting to share revenue, the casino owners are concerned that if online gambling becomes legal in the United States, companies such as WMS will be have advanced positioning in the online gambling business.

Transportation

For many of the larger gambling properties, customers arrive by airline, especially business and vacation travelers. Although fares for air travel rose substantially in recent years, airlines have offered fare sales. Automobiles are the primary means by which customers travel to casinos. The smaller, regional, and Native American gambling markets are negatively affected by the gasoline prices.

Activists

Although many residents of communities where commercial casinos are located support casino gambling, many other groups do not. Various churches, ad hoc citizens' groups, and national organizations such as the National Coalition Against Legalized Gambling protest legalized gambling because it comes with a high social cost in the form of addiction. Protesters argue that youth are drawn into compulsive gambling habits at double the rate of adults, and that gambling has hidden negative economic impacts, such as diverting revenue that would be spent at local businesses. This, in turn, results in increased costs to the state from bankruptcies, addiction treatment centers, and the penal system. These organizations also point to the fact that when state governments depend on casinos for tax revenue, it puts the government in a compromised position. Government now has a vested interest in encouraging its citizens to lose money.

Casinos have attempted to address these concerns much like the alcohol companies that encourage responsible drinking. Most casinos post phone numbers for Gamblers Anonymous at their cashier windows and provide literature with information on problem gambling. Underage gambling is not allowed, and many casinos will not even permit minors in the gambling areas.

Complete the following and identify the intensity of each of the forces of competition:

1. Rivalry among Existing Firms **High** **Medium** **Low**

   a) Define the casino gambling industry.

   ____

   ____

   ____

   b) What is its level of concentration?

   ____

   ____

   ____

2. Threat of New Entrants **High** **Medium** **Low**

   a) What are the barriers to entry into this industry?

   ____

   ____

   ____

3. Bargaining Power of Suppliers **High** **Medium** **Low**

   a) Who are the suppliers?

   ____

   ____

   ____

   b) Discuss supplier bargaining power.

   ____

   ____

   ____

4. Bargaining Power of Buyers **High** **Medium** **Low**

   a) Who are the buyers?

   ____

   ____

   ____

   b) Discuss whether the buyers have bargaining power.

   ____

   ____

   ____

5. Threat of Substitutes **High Medium Low**

   a) What other substitutes limit the sales and profits for firms in this industry?

6. Relative Power of Other Stakeholders **High Medium Low**

   a) Who are other major stakeholders?

7. Relative Power of Complementors **High Medium Low**

   a) Who are the complementors?

8. Now that you have analyzed each of the forces of competition, discuss the implications of the above-mentioned levels of intensity.

   a) Which forces of competition are most threatening now? Which do you expect will change over the next, say, five years?

b) What are the implications in terms of profit margins in this industry today? Over the next five years?

c) As the CEO of a firm in this industry, what actions does this analysis suggest you implement in order to strengthen your competitive strategy?

d) As an advisor to a potential entrant, would you recommend entry? What steps would you advise new entrants to take?

Strategy Session 7

Generating a Plan of Action: TOWS (SWOT) Analysis

OBJECTIVE
The SWOT model provides a comprehensive view of the firm in relation to its environment. Taking this further, you will learn to build a plan of action using the TOWS matrix.

> The strategic alternative, which results from matching opportunity and corporate capability at an acceptable level of risk, is what we may call an economic strategy.
>
> —*Kenneth R. Andrews, The Concept of Corporate Strategy*

The term SWOT is widely used and well known in the field of strategic management. It is an acronym for Strengths, Weaknesses, Opportunities, and Threats, and represents a helpful tool for generating a summary of a strategic situation. Strengths and weaknesses capture the internal environment of the firm and may include skills, expertise, organizational resources, competitive capabilities, positional advantages or disadvantages, weak finances, market share, brand recognition, or distribution capabilities, to name a few. Opportunities and threats stem from a company's external competitive environment. It represents trends in the environment that may be favorable or unfavorable to the firm. A merger of two rivals may, for example, be a threat. Or, increasing concern in society about convenience may be a favorable trend for a company whose products and services are designed for busy consumers. New regulations or the emergence of lower-cost technologies, on the other hand, may pose threats. The purpose of this classification was to ensure a good fit between the firm's material, technical, financial, and managerial resources to ensure full exploitation of opportunities while minimizing risks facing the firm.

By putting the four categories in a matrix format, Prof. H. Weihrich provided a useful tool to generate alternatives in a systematic manner. In this format, the analysis is referred to as the *TOWS matrix* (Figure 7.1, shown in the following exercise). This enables one to match the elements of strengths and weaknesses with the opportunities and threats to generate action steps. When S and O are matched in the SO box, they represent possible ways in which the organization can use its strengths to take advantage of opportunities and favorable trends in the environment. Similarly, the ST box represents ways in which strengths could be used to protect the organization from threats. The WO suggests areas internally that need to be tackled to take advantage of the opportunities, and WT shows how the weaknesses make the organization most vulnerable against threats and thereby point to defensive tactics.

Take care in entering items in the S, W, O, and T boxes, for they determine the quality of action steps you will generate. Try to be as specific as you can. For instance, rather than saying "Good marketing skills," it is better to specify what aspect of marketing a company can do well. Or, instead of listing "International expansion" as an opportunity, try to spell out what market characteristic, internationally, represents the opportunity. When you match the items to generate action steps, state it as actions the organization can undertake, rather than as an analysis of the situation. Matching the strengths and opportunities directs the growth and expansion of firms. However, equally important is the intersection of weaknesses and threats. They represent areas where the organization is particularly vulnerable, especially in a very competitive environment. Steps the organization could take to mitigate potential threats and strengthen its position are important components of an action plan.

Complementary action steps, from the various boxes, can be combined to form a cohesive "alternative." When at least two such alternative groups of action steps are formed, they present alternative plans of action for the future. Then, depending on goals, resource availability, short vs. long-term time frame, etc., the organization can make a choice.

Exercise 1

An Action Plan for Robin Hood[1]

INSTRUCTIONS

Read the "Robin Hood" case below. Look at Robin Hood and his band of Merry Men as an organization. Think of their activities and the issues that they face using management and business terms such as leadership, recruitment, revenue generation, expansion, diversification, competition, and the like.

1. Identify elements of their organizational strengths and weaknesses. Examine the external environment and identify trends that represent opportunities and threats. Enter the items identified in the appropriate places in the TOWS matrix in Figure 7.1 that follows the case.
2. Then match, one by one, the elements from the "Internal" axis (S or W) with ones from the "External" axis (O or T) and write them as action step (that is, actions the organization can undertake) at the intersections in the boxes labeled SO, WO, ST, and WT. Track the source of the ideas for the match within parenthesis. A brief example is given in the chart in Figure 7.1. Then answer questions 1 and 2 that follow.

Robin Hood

It was in the spring of the second year of his insurrection against the High Sheriff of Nottingham that Robin Hood took a walk in Sherwood Forest. As he walked, he pondered the progress of the campaign, the disposition of his forces, the Sheriff's recent moves, and the options that confronted him.

The revolt against the Sheriff had begun as a personal crusade. It erupted out of Robin's conflict with the Sheriff and his administration. However, alone Robin Hood could do little. He therefore sought allies, men with grievances and a deep sense of justice. Later he welcomed all who came, asking few questions and demanding only a willingness to serve. Strength, he believed, lay in numbers.

He spent the first year forging the group into a disciplined band, united in enmity against the Sheriff and willing to live outside the law. The band's organization was simple. Robin ruled supreme, making all important decisions. He delegated specific tasks to his lieutenants. Will Scarlett was in charge of intelligence and scouting. His main job was to shadow the Sheriff and his men, always alert to their next move. He also collected information on the travel plans of rich merchants and tax collectors. Little John kept discipline among the men, and saw to it that their archery was at the high peak that their profession demanded. Scarlock took care of the finances, converting loot to cash, paying shares of the take, and finding suitable hiding places for the surplus. Finally, Much, the Miller's son, had the difficult task of provisioning the ever increasing band of Merry Men.

[1]Copyright 1991 by Joseph Lampel, University of Nottingham, England. Reprinted with permission.

The increasing size of the band was a source of satisfaction for Robin, but also a source of concern. The fame of his Merry Men was spreading, and new recruits poured in from every corner of England. As the band grew larger, their small bivouac became a major encampment. Between raids the men milled about, talking and playing games. Vigilance declined, and discipline was becoming harder to enforce. "Why," Robin reflected, "I don't know half the men I run into these days."

The growing band was also beginning to exceed the food capacity of the forest. Game was becoming scarce, and supplies had to be obtained from outlying villages. The cost of buying food was beginning to drain the band's financial reserves at the very moment when revenues were in decline. Travelers, especially those with the most to lose, were now giving the forest a wide berth. This was costly and inconvenient to them, but it was preferable to having all their goods confiscated.

Robin believed that the time had come for the Merry Men to change their policy of outright confiscation of goods to one of a fixed transit tax. His lieutenants strongly resisted this idea. They were proud of the Merry Men's famous motto "Rob from the rich and give to the poor." "The farmers and the townspeople," they argued, "are our most important allies. How can we tax them, and still hope for their help in our fight against the Sheriff?"

Robin wondered how long the Merry Men could keep to the ways and methods of their early days. The Sheriff was growing stronger and becoming better organized. He now had the money and the men and was beginning to harass the band, probing for its weaknesses. The tide of events was beginning to turn against the Merry Men. Robin felt that the campaign must be decisively concluded before the Sheriff had a chance to deliver a mortal blow. "But how," he wondered, "could this be done?"

Robin had often entertained the possibility of killing the Sheriff, but the chances for this seemed increasingly remote. Besides, killing the Sheriff might satisfy his personal thirst for revenge, but it would not improve the situation. Robin had hoped that the perpetual state of unrest, and the Sheriff's failure to collect taxes, would lead to his removal from office. Instead, the Sheriff used his political connections to obtain reinforcement. He had powerful friends at court and was well regarded by the regent, Prince John.

Prince John was vicious and volatile. He was consumed by his unpopularity among the people, who wanted the imprisoned King Richard back. He also lived in constant fear of the barons, who had first given him the regency, but were now beginning to dispute his claim to the throne. Several of these barons had set out to collect the ransom that would release King Richard the Lionheart from his jail in Austria. Robin was invited to join the conspiracy in return for future amnesty. It was a dangerous proposition. Provincial banditry was one thing, court intrigue another. Prince John had spies everywhere, and he was known for his vindictiveness. If the conspirators' plan failed, the pursuit would be relentless, and retributions swift.

The sound of the supper horn startled Robin from his thoughts. There was the smell of roasting venison in the air. Nothing was resolved or settled. Robin headed for camp promising himself that he would give these problems his utmost attention after tomorrow's raid.

FIGURE 7.1 TOWS MATRIX FOR "ROBIN HOOD"

EXTERNAL / INTERNAL	**Strengths (S)** Size: more fighting men	**Weaknesses (W)**
Opportunities (O) *Favorable Trends* 1. Other forests available	**SO** 1. Expand operations to other forests (S1,O1)	**WO**
Threats (T) *Unfavorable Trends* 1. Game (food) becoming scarce	**ST** 1. Create separate group with a different mission—to hunt for food and not involved in robbing. (S1,T1)	**WT**

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1. The boxes SO, WO, ST, and WT contain individual action steps. Combine them into at least two categories that represent alternative courses of action. List the two alternatives and their constituent action steps.

2. What criteria will you use to choose between the alternatives listed in Figure 7.1?

Exercise: Video

Life is Good, Inc.—Future Strategy

INSTRUCTIONS

View the video titled "Life is Good," which describes how two brothers invested $200 to make T-shirts and turned the project into a $100 million business. Their products are sold by 5000 retailers, 100 of which are dedicated Life is Good, Inc., stores.

1. Identify the Life is Good company's internal strengths and weaknesses, as well as opportunities and threats from the external environment. Enter the items identified in the appropriate places in Figure 7.2, the blank TOWS matrix on the next page.
2. Next, one by one, match the elements from the "Internal" axis (S or W) with ones from the "External" axis (O or T) and write them as action steps (that is, actions the organization can undertake) in the inside boxes labeled SO, WO, ST, and WT. Then answer questions provided by your instructor.

FIGURE 7.2 TOWS MATRIX FOR LIFE IS GOOD, INC.

INTERNAL

EXTERNAL

	Strengths (S)	**Weaknesses (W)**
Opportunities (O) *Favorable Trends*	**SO**	**WO**
Threats (T) *Unfavorable Trends*	**ST**	**WT**

Strategy Session 8

Developing Generic Strategy

OBJECTIVE

In this session, consider the advantages of generic strategy and then compare organizations in the exercise—ones that pursue each of the four kinds of generic strategies—and a firm that is stuck in the middle.

> A manufacturer should and must excel all competition in some way . . . the product can be more efficiently made and be cheaper in price . . . or designed for different uses. Or it may be applied to the customer's needs in a way that will make it more useful because of the application.
>
> —*James F. Lincoln*

Organizations develop a business-level strategy by using company resources and distinctive competencies to gain a competitive advantage over rivals in an industry. Michael Porter, who developed the framework for business-level strategy, labeled it *generic strategy* because in principle the choices of strategy can be applied to any business and any industry.

Generic strategy choices involve two dimensions: Competitive advantage and competitive scope. In seeking competitive advantage, a company might choose a low-cost strategy when trying to outperform other firms in a particular industry. This strategy is the ability of a company to design, produce, and market a product more efficiently and at a lower cost than its competitors. Alternatively, a company might choose a differentiation strategy as a means of gaining competitive advantage. Differentiation is the ability to provide products or services that are perceived to be unique by customers and for which they are willing to pay more. For example, Maytag produces washers and other household appliances that consumers pay more for because they are perceived to be of better quality and rarely need service.

Besides competitive advantage, a firm must choose its competitive scope, either targeting a broad market or a narrow—or niche—market. A broad market scope implies that the firm targets the mass market or many market segments, whereas the narrow market scope focuses on one particular buyer group.

Combining the two types of competitive advantage with the two types of target markets results in four potential variations of generic strategy options. When the lower cost and differentiation strategies of a broad mass-market target are pursued, they are referred to as *cost leadership* and *differentiation*. When they are targeting only one buyer group, they are called *focus cost leadership* and *focus differentiation*.

According to Porter, the greatest danger in pursuing a generic strategy is the possibility of being stuck in the middle. From a competitive advantage standpoint, this occurs when a firm is unwilling to commit marketing and research-and-development resources needed to create a product or service that is perceived to be unique, or when a firm tries to keep costs low but does not aggressively pursue strategies that have the lowest cost in the industry. Regarding competitive scope, a firm that is pursuing a focus strategy can be stuck in the middle when it becomes overconfident and starts to go after many market segments or expand into the mass market without committing the necessary resources to successfully reach the larger market.

Although Porter argues that achieving both a low-cost and a high-differentiation position is often temporary and cannot be sustained over the long term, some strategy scholars suggest that a “best cost” position is, in fact, achievable. The objective of the best-cost position is to deliver superior value to buyers by meeting expectations on key quality, service, or other features and having low enough costs to price the product lower than competitors. To become a best-cost provider, a company must have the resources and capabilities to achieve differentiation at a lower cost than rivals. For example, investments in technology allow firms to lower their costs while also improving performance in areas that differentiate the products or services. Wal-Mart’s costs are the lowest in the industry, due to its technologically advanced distribution system that ensures efficient delivery of products and, at the same time, differentiates the company’s services in the eyes of the consumers by having complete product assortment and availability.

While the best-cost position is an option for any firm, this strategy has risks for a company with a focus-market scope because it is hard to achieve both low-cost and meaningful differentiation when volume levels are low. Also, as Porter cautioned, any firm pursuing the best-cost position may get squeezed between the strategy of low-cost leaders, who are able to siphon customers away with the appeal of a lower cost, and high-end differentiators, who appeal to consumers with better product characteristics, service, or quality.

Exercise 1

Choosing How to Compete in the Lodging Industry

INSTRUCTIONS

Read the lodging industry profile in Part IV (pp. 143–148). On an individual basis, identify features and descriptive characteristics for five hypothetical companies in Table 8.1 on the following page. The information from the lodging industry profile provides background information about the industry and environmental trends.

TABLE 8.1 IDENTIFYING THE CHARACTERISTICS OF THE FOUR KINDS OF GENERIC STRATEGY

Strategy	Company Features and Description	Target Market	Environmental Trends That Support Strategy	Environmental Trends That Threaten Strategy
Stuck in the middle or best cost: Company E				
Focus differentiator: Company D				
Focus cost leadership: Company C				
Differentiator: Company B				
Cost leadership: Company A				

Based on Journal of Management Education 23(4): 428–437.

Team Activity

Top Management Team

INSTRUCTIONS

You are the top management team who is proposing a new hotel entering the lodging industry. You will be assigned Company A, B, C, D, or E by your instructor. Prepare a poster depicting the type of hotel you will build using the following guidelines and be sure to follow the strategy that has been assigned to your company. The poster will be used to sell the idea of the hotel and the organization to potential investors who might want to fund the company as it attempts to capture its target market. When you are finished, put your poster on the wall and choose one member of your group to “sell” your hotel and your organization. You have 45 minutes to complete this exercise. Be prepared to discuss how your strategy will take advantage of environmental trends.

Guidelines for Preparing the Team Poster and Presentation

1. What kind of hotel would you build? What would it be called? Describe its five main features.
2. How would you market your hotel? To whom?
3. Describe three specific skills or resources you would use. How would you use them?
4. Describe two features of the organization (structure, incentive systems, etc.).

Exercise 2: Video

The Generic Strategy of JetBlue Airways Corporation

INSTRUCTIONS

View the video about JetBlue Airways. As of December 31, 2011, the company has been in operation for 11 years. It operates 169 aircraft including 120 Airbus A320 jets and 49 EMBRAER 190 aircraft. The Company serves 70 destinations in 22 states, Mexico, and 12 countries in the Caribbean and Latin America. Identify JetBlue's strategy, complete the chart, and then briefly discuss the generic strategy that the company follows.

1. List company features that support differentiation:	2. List company features that support cost leadership:
Who is the target market? ______________________________	

1. Based on the information about JetBlue, what is the company's generic strategy? Briefly discuss.

____

____

Strategy Session 9

Build Your Competitive Advantage

OBJECTIVE

In this session, you will learn to build competitive advantage through differentiation strategies.

> We need to stand out from the crowd. Ads showing beautiful people dancing on beaches tell you nothing about the product or the brand.
>
> —*Andrew Morley, VP, Motorola*

To build competitive advantage, a firm begins by clarifying the marketplace in which it competes. This requires defining the customer need, who will be served, and how the need will be satisfied. When these questions are answered, the firm can then begin to seek to differentiate itself from its competitors.

To be successful in the marketplace, management identifies a generic strategy, which would dictate a set of consistent actions that the firm can undertake to build advantage over its rivals. As we outlined in Strategy Session 8, one viewpoint suggests that there are two broad categories of generic strategies: cost leadership and differentiation.

However, a different framework was developed by Henry Mintzberg, a strategy scholar. He argued that cost leadership, as a generic strategy, does not directly lead to competitive advantage unless it is used to underprice rivals and thereby attract customers. A firm would not pursue a cost leadership strategy only to charge the same price as its rivals; with a lower price, the firm is really differentiating on the basis of price. Thus, Mintzberg claimed that cost leadership was just another form of differentiation.

Broadening this view and introducing more fine-grained choices, Mintzberg argued that a firm, in pursuit of competitive advantage, will seek to differentiate its products (and services) in six major ways. These are:

Differentiation by Price: In pursuing a lower price, the firm may be driven to follow a functional strategy that brings down costs, lowers quality, provides less service, offers fewer options, and so on. Everything else remaining the same, customers always prefer a lower price.

Differentiation by Image: To create an image is to create a psychological distinction where it does not otherwise exist, through careful marketing. In a sense, this is an artificial form of differentiation, since it is achieved by creating a different perception. For instance, since blind taste tests sometimes show that customers cannot distinguish between different brands of beer, manufacturers work hard to build an image for their brand.

Differentiation by Support: Support refers to related products or services that go with the primary product. It may be included with the product or sold separately. Thus, it is a peripheral form of differentiation, such as the local pharmacy offering a 24-hour delivery service, or Mercedes-Benz offering free oil changes for the car for the first five years.

Differentiation by Quality: The effort here is to make the product itself better and not just different. Thus, the product does everything that competing products do; however, it does these things better through improved performance, or through its durability or reliability. Toyota's automobiles, for instance, have a reputation for fewer defects.

Differentiation by Design: The focus here is to offer something that is very different and to provide unique features. Apple's iPhone and iPad take the lead over all its rivals with special features. Sometimes, the uniqueness may be less ambitious, such as a fashion-conscious individual being attracted to a pair of "designer" jeans.

Undifferentiation: When the firm has no clear basis for differentiation, except perhaps through scope, it is following a policy of undifferentiation. The corner grocery store, in many cities, survives primarily based on its location, not because the owners offer anything special compared to the store a few blocks down the street. Firms that merely try to copy the actions of a main rival are also following undifferentiation.

These forms of differentiation need not be mutually exclusive. Some firms may try to combine different forms of differentiation to stand out in the marketplace. For example, IKEA, the furniture chain store, uses unique designs with a policy of the customer assembling the product so as to offer a lower price.

A firm has to carefully choose the functional strategies it would follow to achieve the desired differentiation. When a cost-reduction strategy is followed all along the value chain, including sourcing cheaper components, the firm can support a price differentiation strategy. Highly skilled advertising and promotion, within the function of marketing, perhaps with higher pricing, would be required to follow an image differentiation strategy. Competence in the areas of product development and care in manufacturing would be required to deliver on a quality differentiation strategy.

When the market space is sliced based on factors such as geography (mass market versus local market), how the customer buys (in the store or through the Internet), and so on, there are many segments to manage. When such segmentation is combined with the forms of differentiation described earlier, several possibilities exist to generate competitive advantage.

Exercise

Build Your Intended Strategy

INSTRUCTIONS

Read the case "Caffeine Satisfaction: Rivalry among the Coffee Shops" (pp. 175–184) before you come to class. Think about the industry, and study the different strategies followed by the companies described in the case.

In class, as a team, you will assume the role of the top management of a particular coffee shop/chain. You now have the opportunity to set the strategy for the future. Your task is to discuss and formulate the intended strategy of your firm for the next five years based on your analysis of the competitive conditions in the market and your understanding of the firm and its capabilities.

Your team has 100 points. You may choose to acquire specific competencies listed in Table 9.1 that will form the basis of your strategy. Each method has a point allocation, and the total may not exceed 100. Write a paragraph describing your strategy by explaining how the competencies you have acquired will be used. Make a brief presentation to the class. Then await further instructions.

TABLE 9.1 COMPETITIVE METHODS

No.	Competitive Method	Points
1	Broad product range	25
2	Building brand identification	20
3	Capability to manufacture specialty products	20
4	Competitive pricing	25
5	Continuing overriding concern for cost reduction	15
6	Efficient logistics	15
7	Efforts to build reputation	15
8	Efforts to enhance quality of advertising	20
9	Efforts to insure availability of raw materials	25
10	Enforcing strict product quality control procedures	25
11	Extensive customer service capabilities	25
12	Forecasting market growth	15
13	Increased speed to market	15
14	Influencing channels of distribution	20
15	Information management	15

(*Continued*)

TABLE 9.1 COMPETITIVE METHODS (continued)

No.	Competitive Method	Points
16	Innovation in manufacturing process	20
17	Innovations in marketing techniques and methods	25
18	Integrate vertically (backward/forward)	15
19	Maintaining low inventory levels	15
20	Maximize capacity utilization	15
21	New product development/innovation	25
22	Operating efficiency of business unit	20
23	Premium pricing	15
24	Products in high-price segments	20
25	Promotion and advertising above industry average	25
26	Protect technology through patents	15
27	Prudent management of receivables	15
28	Pursue scale economies	15
29	Quality of product	25
30	Reducing variety of products and channels	15
31	Refining existing products	15
32	Serving discriminating customers	15
33	Serving special geographic segments	20
34	Specific attempts to insure a pool of highly trained experienced personnel	20
35	Use of alliances	15

Strategy Session 10

Viewing Corporate Strategy from the Core Competencies Perspective

OBJECTIVE

In this session, practice designing corporate strategy for a diversified company from a core competencies perspective.

> Core competencies are different for every organization; they are, so to speak, part of an organization's personality.
>
> *—Peter Drucker*

Corporate strategy deals with making choices about the direction for a firm as a whole and about the areas in which a company should compete. In choosing business areas, management decides whether to concentrate resources and create competitive advantage in one line of business or in one industry, such as McDonald's in the fast-food industry and Southwest Airlines in the airline industry, or to select and manage a mix of businesses competing in several industries, such as General Electric and Johnson & Johnson. Either way, issues of growth or downsizing become part of what is considered corporate-level strategic decision making.

An earlier approach to corporate strategies of growth was by expanding product offerings and diversifying into different business areas. To help executives make decisions about how to divide organizational resources and where to invest new capital, several portfolio models were created. Among the most well known were the BCG growth/share matrix, the GE/McKinsey industry attractiveness and business strength model, and the Arthur D. Little matrix that incorporated life-cycle stages into the analysis. These techniques provided a convenient means for management to review the competitive position of diversified business units against one another all on one chart.

While these models simplified large amounts of information about a multidivisional firm's many holdings, the "portfolio of businesses" approach had limitations. It focused on viewing businesses in the portfolio as freestanding units, an approach that could fragment and misguide resource allocation. For example, pulling resources from a strong business unit that operated in a low-growth mature industry to fund an up-and-coming unit in a high-growth industry could actually result in the premature decline of the strong unit. Also, this approach gave little guidance to management in terms of what new businesses should be added to the company's holdings and how to increase overall revenues.

To promote a wider view of the firm beyond a collection of individual business units, Hamel and Prahalad created a framework that considers the firm as a portfolio of core competencies. The idea of core competencies in business comes from the resource-based view of strategic thinking. This view holds that strategy should be developed based on a company's unique resources and capabilities. Resources include capital equipment, the skills of employees, patents, finance, and talented managers. Capabilities are the skills needed to take full advantage of a firm's assets. Competitive advantage occurs when resources and capabilities are

- Valuable to a company's chosen direction
- Rare
- Costly to imitate
- Cannot easily be substituted

FIGURE 10.1 CORE COMPETENCIES

When these four criteria are met, resources and capabilities become core competencies (see Figure 10.1).

By viewing the firm as a portfolio of core competencies rather than as a collection of individual business units, management is in a better position to identify acquisition and deployment goals. That is, it focuses attention on how a company can create value by building new competencies or by recombining existing competencies to enter new business areas.

To actively manage core competencies, managers must share a view of what those core competencies are. While many managers can articulate what is done well in the organization, it may be more difficult for them to separate competencies from the products or services offered. For example, at Canon, the core competencies are not its color copiers or bubble jet printers, but rather its capability for precision mechanics, fine optics, and electronic imaging that result in the end products. Therefore, the first step in creating this type of portfolio is to identify an inventory of competencies separate from the inventory of products or services.

The matrix in Figure 10.2 shows these two dimensions (core competencies and products) at two time frames: Existing and new. The inventory of existing competencies and existing products falls in the lower left quadrant of the matrix. Once the inventory is prepared, management is ready to move to the next step of considering strategic options. Are there opportunities to strengthen the company's position in a particular product area by importing competencies that may exist elsewhere in the company? This was a strategy adopted by General Electric when it transferred competencies between its power generator business and its jet engine business, both of which rely on advanced materials and engineering skills to produce large turbines.

Other strategic options involve considering new core competencies and new products (see Figure 10.2). The advantage of this framework is that it seeks to identify and exploit the interlinkages across units. Whether management chooses to diversify into related or unrelated industries or whether the company remains in one industry and competencies are shared across product lines, this technique keeps management focused on adding value to the corporate whole from a resource-based, core competencies perspective.

FIGURE 10.2 NEW CORE COMPETENCIES AND NEW PRODUCTS

Core Competencies	**New**	**What new core competencies are needed to protect and extend existing markets?**	**What new core competencies would we need to participate in new markets?**
	Existing	**This is the existing portfolio or inventory of competencies and products. What is the opportunity to improve the company's position in existing markets through existing core competencies?**	**What new products or services could be created through recombining current core competencies?**
		Existing	**New**
		Products	

Exercise
Corporate Strategy at Honda

INSTRUCTIONS
Read and use the Honda profile in the following section to complete Table 10.2 as part of a team activity. The table appears at the end of the exercise.

Honda Motor Company Limited

In 1946, Honda Technical Research Institute, a manufacturer of motors for motorized bicycles, became the Honda Motor Company. By the 1950s, the newly formed Honda Motor Company became one of the leading motorcycle manufacturers in the world, and in 1963 the firm launched its first sports car in Japan. By 1967 the company was producing automobiles in its Suzuka factory, and it established a manufacturing plant in the United States in 1980. Its expertise in small engines and power trains led to other products such as power units, generators, lawn mowers, tillers, snow throwers, water pumps, marine engines, and electric wheelchairs.

The research and development (R&D) center of Honda was set up as an independent subsidiary in 1960 and is considered one of the secrets to the company's success. Unlike Toyota, which is considered to be more structured and bureaucratic, Honda is entrepreneurial. Employee satisfaction and loyalty are strong in the R&D center due to the high value placed on creativity and independence. Located in Saitama, west of Tokyo, the engineers in this subsidiary create every product that the company makes and pursues new projects on the side. Although the subsidiary reports to Honda Motor Company, it is recognized throughout the company as a very influential and powerful group. In fact, every CEO has come from the R&D Center. The current CEO, Takanobu Ito, who took over as CEO in 2009, was president and director of Honda R&D Co., Ltd., since 2003.

In 1986 one team in the R&D group began research into aviation. Although Honda decided to move the team to another project, the group persisted in working on the aviation project on the side. This tinkering continued, and in 1997 a new design for a plane with the engines mounted above the wings was presented to management. The roomier cabin and greater fuel economy which resulted from the new configuration won over management, and the project was at the forefront again. Honda set up a wholly owned subsidiary, Honda Aircraft Company, which is responsible for further development, sales promotion, and production of the HondaJet. Based in Greensboro, North Carolina, near the Piedmont Triad International Airport, the very light passenger jet innovations include optimal over-the-wing engine mount configuration to reduce drag, natural-laminar flow (NLF) technology, and an advanced composite fuselage. The company partnered with GE in its engine design. The first flight of the HondaJet was December 21, 2010, with a commercial debut date scheduled for the third quarter of 2012. However, due to engine damage from ice, a redesign will postpone the debut until mid 2013. The aircraft is priced at $4.5 million.

Another innovation from the R&D group is a humanoid robot called ASIMO (advanced step in innovative mobility). The goal was to design a robot that can duplicate human motion and genuinely help people. It speaks, balances on one foot (34 small electric motors are required to accomplish this movement), is able to kick a soccer ball, recognize faces, and distinguishes sounds. First displayed at Expo 2005 in Japan, the robot resembles a small astronaut wearing a backpack and is able to walk similarly to humans at a speed of 3.7 mph. It is the world's only humanoid that can go up and down stairs independently, and it can walk hand-in-hand with a person. In August 2012 ASIMO traveled to Germany to attend a major event (IdeenPark), which is designed to inspire young people to study science, technology, and engineering.

In the automobile division, the company has focused its R&D resources on developing new hybrid technology. The latest innovation is a two-motor plug-in hybrid technology that is due to be introduced in the United States. as a fully remodeled Accord. The company also developed a highly efficient, high output "Sport Hybrid Super Handling All-Wheel Drive" system. In January 2012, three new hybrid technology offerings were unveiled at the North American International Auto Show in Detroit : NSX Concept sports car, the ILX compact sports sedan, and a prototype of the second generation RDX crossover sport utility vehicle.

Net sales and other operating revenue for the company's four business segments (automobile, motorcycle, financial services, and power products/other business) totaled 7,948.0 billion yen in 2012 as compared to 8,936.9 billion yen in 2011. Net income declined to 211.4 billion yen in 2012 from 534.1 billion yen in 2011. Unit sales for the company's manufactured-product business segments are shown in Table 10.1.

TABLE 10.1 UNITS SOLD (THOUSANDS) BY THE COMPANY'S MANUFACTURED PRODUCT BUSINESS SEGMENTS*

Business Segment	2010	2011	2012
Automobile business	3,392	3,512	3,137
Motorcycle business	9,639	11,445	12,559
Power product business	4,744	5,509	5,819
Total	17,775	20,466	21,515

*Figures are for Financial Year ending 31 March.

Rating the Honda Company

Name(s): ____

____

1. Complete the information for Honda in the boxes in Table 10.2. Next to each product, give a rating that identifies whether the product is linked to the core competencies (5 = closely linked; 3 = somewhat linked; 1 = very limited linkage).
2. Once you have completed Table 10.2, using the scale given, rate how well you think the company overall has linked its core competencies to its products:

   Rating = ________

   5 = Linkage is the strongest that it has been in the company's history.

   4 = Linkage is improving as a result of new products.

   3 = Linkage is the same now as it was when the company started.

   2 = Link is getting weaker as a result of new products.

   1 = No linkage between core competencies and products exists.
3. Briefly note opportunities that may exist for the company to further leverage its core competencies and what issues may be of concern for this diversified firm.

TABLE 10.2

Core Competencies	Products

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Strategy Session 11

Global Strategic Alliances

OBJECTIVE

In this session, the goal is to understand the objectives and nature of cooperation between companies in a strategic alliance, and the decisions required to make an alliance work. Following this introductory reading, review and reconsider the GM–SAIC strategic alliance.

> In the fluid global marketplace, it is no longer possible or desirable for single organizations to be entirely self-sufficient. Collaboration is the value of the future. Alliances are the structure of the future.
>
> —*Joel Bleeke and David Ernst*

A strategic alliance may be defined very broadly as any arrangement or agreement under which two or more firms cooperate to achieve certain commercial objectives. Given this definition, the term covers a wide range of options, from simple agreements to buy and sell each other's goods, to creating separate and legally distinct ventures. Although the objectives of an alliance can vary widely, if properly dealt with, an alliance can be a relatively inexpensive way of achieving targeted objectives.

Cooperation is practiced in the business world in several ways. It may occur within the framework of a contract, or not. In Strategy Session 6, we came across the role of the complementor, another industry whose products or services cause a customer to value your product more. In the personal computer industry, for example, Hewlett-Packard and Dell are competitors, but they are complementors to Intel, the maker of computer processor chips, and Microsoft, the maker of computer operating system software. Cooperation between Microsoft and Intel and Hewlett-Packard benefits technological improvements and overall growth of the market.

Game theory and transaction cost analysis are two ways of explaining why firms might consider creating a strategic alliance within a contractual framework. Game theory suggests that firms cooperate rather than compete when benefits are maximized—so the alliance can be seen as an example of how cooperation can maximize benefits for the two partners. However, the nature of an alliance, especially when it involves two players in the same or related industry, suffers from some inherent contradictions. The contradictions occur because there are positive and defensive objectives associated with the alliance, even though the two partners will not enter into an alliance unless they hope to gain more from cooperating than being on their own.

On the positive side, the objectives for each partner are to add value to the activity on which they are cooperating and to enhance their competencies through learning from the partner. Possession or control of key resources by each partner can create the conditions for dependency. On the defensive side, the objective is to avoid becoming too dependent on the partner (which can reduce the firm's flexibility in strategic decision making), and to avoid its core competencies being absorbed and learned by the partner. The latter situation, in particular, may make that firm less attractive and reduce its competitive edge.

These conflicting objectives can cause tension and lead to failure. Thus, there is a need for careful structuring of the alliance. The parties must be clear about their objectives, bring complementary strengths to the alliance, and ensure the benefits to cooperation are maximized. Sometimes entering into long-term commitments can help achieve these benefits.

Transaction cost analysis theory explains that ownership of resources is more efficient than contracting for goods and services when the transaction cost of buying goods on the open market becomes too great. Thus, an alliance should deliver greater benefits to the two parties than what might be achieved from a purely market-based transaction between them or with others for similar goods and services. That is, if the two parties can achieve their objectives through outsourcing their needs, or outright purchase of components, there is no need to enter into an alliance. As a result, this approach calls for detailed contractual agreements between the parties that clearly cover the cost-benefit issues; and as trust develops, the costs can be reduced with less supervision and better interaction between the partners.

A changing environment and the partners' experience with each other can lead to renegotiating the alliance. Alternatively, ongoing problems or achieving the objectives of the alliance can lead to its termination.

Whether an alliance is created because cooperation offers greater benefits or because transaction costs can be reduced, parties go through three important stages. These are (1) the careful selection of a partner, (2) negotiation and structuring of the agreement, and (3) the postagreement management of the alliance. Other factors that contribute to a successful alliance are as follows:

1. The partnership should preferably be between "equals." When partners bring complementary skills and keep their objectives clear, there is less room for confusion.
2. An ownership interest and clearly stated contractual rights and obligations help cement and deepen commitment to the alliance.
3. Partners should recognize differences in management styles and cultures and work toward dealing with these issues openly and in a sensitive manner.
4. Regular review of progress in the alliance keeps a focus on objectives and prevents problems from getting too large before they are sorted out.

Exercise

Shanghai General Motors: Renewing the GM–SAIC Alliance

INSTRUCTIONS

Read the following Shanghai General Motors case and complete the form that follows, before class. Then, in class, the instructor will form teams and provide you with additional information and instructions for the next step of this exercise.

Shanghai General Motors (SGM)

Shanghai General Motors Co. Ltd (SGM), a joint-venture between General Motors (GM) and Shanghai Automotive Industry Corporation Group (SAIC), was established on June 12, 1997, in Shanghai, China. It started as a 50:50 partnership with each partner contributing $350 million toward equity; SAIC acquired an additional 1% stake of the venture in 2010. Governance of the partnership was split evenly with each partner having five board seats on a ten-member board and each appointing two executives on a four-person executive committee.

Apart from the financial contributions, the agreement listed specific obligations for the two sides. SAIC was to assist in obtaining all necessary approvals, permits, and licenses required for manufacture and distribution of the products; procuring import and export licenses; obtaining land use rights for the manufacturing facility; obtaining electricity; visas, and work permits for directors and foreign personnel; recruitment of employees from SAIC and others; obtaining tax and customs reductions or exemptions; assist in relations with local governments; obtain adequate raw materials and transport facilities; and assist in obtaining loans from Chinese financial institutions. GM was obligated to assist in procuring equipment and supplies from overseas; recruit management and technical support; and enter into trademark and import supply contract, services contract; and technology license contract with SGM. SGM can be dissolved, among other reasons, if either party does not meet its obligations; if there is expropriation of the assets, employees, or property of SGM; or by mutual agreement.

SGM built a most advanced car factory in Pudong. Production began in 1999 with the Buick Century, a medium luxury sedan based on GM's Buick Regal. It was targeted at the upper-middle segment, including government officials and wealthy businessmen. The Buick was redesigned to suit the Chinese market, with raised back seats, more leg room, sturdier suspension, and a smaller engine. The SGM product portfolio grew to include three major brands (Buick, Cadillac, and Chevrolet). The company created a large nationwide dealer network, serving all three model lines.

GM senior executives were regularly rotated through the SGM venture. GM and SAIC built their cooperation and communication about their values and priorities by setting up joint task forces, and by collaborating on specific business procedures in vehicle development.

From the start, SGM took a total solution approach by paying attention to all aspects of its value chain—Chinese suppliers were expected to meet U.S. quality standards, and assistance and training was provided; sales and service personnel were trained as well. SGM sold both locally manufactured as well as imported vehicles.

In 2011, SGM led the market with total sales of 1.23 million vehicles, a record for the company attaining 18.5% growth over the previous year.

Shanghai Automotive Industry Corporation (SAIC)

Established in 1955, SAIC, the largest domestic automaker, was wholly owned by the Shanghai Municipal Government. The company played a major role in the development of the country's automotive industry. In the early years, it manufactured cars, motorcycles, and heavy trucks but transitioned, in the 1980s, to becoming a component supplier and joint venture (JV) partner. The company entered into a JV with Volkswagen (VW) of Germany called the Shanghai Volkswagen (SVW) and started producing the "VW Santana" in 1985. VW was looking to access the Chinese market and also to open channels to other East Asian markets.

In 1985, the Chinese government nominated the automobile industry to be a pillar industry for growth and assistance. It was the government's explicit goal to create a market dominated by a few internationally competitive JV assemblers, who would be supplied by local parts manufacturers and produce to world standards. China's rapidly growing auto industry was an attraction for global automotive majors, and in 1997, the Chinese government eased the entry of foreign manufacturers but required them to undertake JVs with local partners.

SAIC's JV with GM in 1997 allowed the company to reduce dependence on VW, and the competition between SVW and SGM benefited SAIC in the areas of acquiring technology and developing strong manufacturing competencies. SAIC was involved in other JVs including those with Iveco and Volvo. SAIC's practice of moving managers from one JV to another created strong information flows between the ventures, although it created distrust between the JV partners.

SAIC and its JVs faced problems with regard to intellectual property. In one case, the joint venture SAIC–Chery Automobile Company integrated components of SVW's German–Chinese suppliers, which had been developed for VW in Germany. VW Germany regarded the parts and components as its intellectual property and the suppliers' headquarters in Germany were asked to stop deliveries to SAIC–Chery, failing which their relationships with VW would suffer. Although the Shanghai suppliers disagreed, they acquiesced to VW's decisions to avoid further problems. In another case, SAIC–Chery's model, the Chery QQ, was considered identical to GM's Chevrolet Spark. It was believed that SAIC had passed on trade secrets to Chery. When the State Intellectual Property Office ruled in 2004 that there was no infringement, GM filed a lawsuit, which was settled out of court. SAIC sold its 20% stake in Chery in 2003.

In 2007, SAIC launched its first independently developed model, the Roewe 750, termed a Chinese national brand. British employees of the defunct MG Rover Group Ltd., United Kingdom, and Chinese engineers who had trained at GM were recruited to develop the model. Hu Maoyuan, chairman of SAIC, said he wanted to "build a global Chinese brand" and acknowledged that "there may be some conflict" with partners like GM. When questioned, GM's chairman dismissed the threat and said he always knew SAIC wanted its own brands. The Roewe competes with Buicks domestically, especially on price.

SAIC, as part of its global ambitions, set up a 50:50 venture with GM for manufacturing cars in India. It already exports the Chevy SAIL compacts made in China to Chile and Peru and is exploring more new models to be sold globally. Michael Robinet, a U.S.-based senior analyst observed that SAIC is "very well situated to meet western car companies head on" in global markets.

General Motors

General Motors Company (GM) was a global automotive company, established in 1908 and headquartered in Detroit, Michigan (United States). The company developed, produced, and marketed automobiles and parts throughout the world. It was the world's largest automaker in terms of unit sales in 2011.

GM first entered the Chinese market in the 1920s, selling Chevrolets, and exited China in 1949 (at the time of the communist revolution). Looking for growth opportunities, GM, in 1992, partnered with state-owned First Auto Works (FAW) Jinbei to produce light commercial vehicles.

GM's CEO Jack Smith promised in 1994 that GM would bring its best technologies to China and help build the country's automobile market. When GM finalized its JV with SAIC, it was criticized for giving up too much, but the company argued that its venture in China was for the long term. GM made efforts in the training and development of local managers and at all levels of operations.

GM initially adapted its popular models from the United States for the Chinese market, to meet local regulations and Chinese consumer needs, and gradually gained insight regarding Chinese consumer preferences.

GM built its legitimacy in China by working with local suppliers to help them improve their quality and production processes. This also built goodwill with government officials. SAIC being government owned and well connected with other officials helped GM navigate the local and central government bureaucracies and also helped GM avoid interference by various parties.

Happy with the SGM venture, GM extended its market presence with other three-way Chinese (SAIC)–Chinese (SGM)–GM ventures to make minivans, minitrucks, and the Chevrolet Spark minicar. GMs component subsidiary, Delphi Automotive Systems, had over 21 JV plants in China.

Following the 2008 financial crisis and recession, GM saw falling sales and, with high legacy costs, suffered losses. In 2009, the company filed for bankruptcy reorganization and the U.S. and Canadian governments, as part of a bailout plan, provided financial support apart from acquiring shares in the company. At that time, GM also sold 1% of its stake in SGM to SAIC, as noted earlier.

GM and SAIC signed agreements to pursue the development and commercialization of hybrid and fuel cell vehicles, and to develop and build electric cars in China, to be sold worldwide. The new vehicle, to be engineered at SAIC and GM's Pan Asia Technical Automotive Center in Shanghai, would qualify for government assistance that could help reduce retail price by about 30%.

GM totally had 11 JVs and two wholly owned foreign enterprises as well as more than 35,000 employees in China. It also operated more than 2,700 dealers. GM, through its various JVs, sold more autos in China in 2010 than it did in the United States. In 2011, GM sold a record 2.55 million vehicles, compared to 2.26 million sold by VW (and its JVs), which began a decade earlier in China.

China's Automotive Industry Conditions

The Chinese government's plan for the auto industry was to gradually upgrade the state-owned manufacturers with JVs so they would learn advanced manufacturing and design technologies and be able to produce high quality cars for export. Foreign auto companies were not allowed wholly owned operations and were invited on a case-by-case basis to have JVs. All JVs were required to localize their parts and components. The policy also encouraged knowledge transfer to the local firms, and the foreign companies had to establish technical centers for training Chinese workers. Since China's entry into the World Trading Organization (WTO) in December 2001, tariffs on car imports dropped from over 200% to about 25%. In 2006, import quotas were scrapped, and local content requirement eliminated. Firms were also allowed to own their own vehicle wholesale and retail organizations, which were previously limited to JVs.

The Chinese government's plan was to build three to five Chinese companies into globally competitive makers of all-electric cars or plug-in hybrids and two to three global suppliers of key components, such as advanced battery and electric-motor technologies, by 2020.

Various foreign manufacturers competed for sales in the Chinese market. Apart from SVW and SGM, other foreign manufacturers included Daihatsu, Peugot, Citroen, and Ford in various segments. VW, which through its two JVs controlled about 60% of the market in 1999, has gradually had to cede market shares to others. Imported autos account for about 3% of the market.

In China's regulated market, car buyers go through administrative procedures and various types of licenses in order to own a car. For example, in Shanghai, a buyer has to apply to 13 government units to obtain 9 official permissions before being allowed on to the road. In Beijing, potential car buyers have to first obtain a license plate. In January 2012, Beijing announced that 240,000 license plates will be issued during the year (700,000 cars were sold in Beijing in the previous year).

About 4%–5% of the people own cars in China (compared to about 80%–90% in the United States). The Chinese automotive industry grew rapidly from 1991 to 1993 at an average of 37% per year. It slowed down drastically to a rate of about 5% between 1994 and 1998, and grew at about 4% during 1999–2000.

Both GM and SAIC felt they had benefited from the JV. GM had obtained access to a growing market and had succeeded in establishing its brands with growing market shares. SAIC had obtained advanced technologies and had developed manufacturing competencies, and knowledge about building a successful distribution channel and sales skills.

Based on your reading of the case, what are the strengths and capabilities of SGM? Do these suggest potential areas of cooperation and conflict between the partners into the future? Complete Tables 11.1 and 11.2.

TABLE 11.1. ALLIANCE CONTRIBUTIONS

Capability or success factor for SGM	Contributed by (specify GM or SAIC)	Future role of partner on this issue

TABLE 11.2 AREAS OF COOPERATION AND CONFLICT

	Cooperation	Conflict
Strategic		
Operational		

Team Activity

Negotiations

After negotiation of the SGM alliance in class, answer the following questions. Check your team's role as appropriate (to be completed one per team).

☐ SAIC ☐ GM

1. What objectives did you have in mind for the negotiation?

2. What elements in the new agreement help in maximizing the benefit for your company?

3. What elements in the agreement have minimized the potential for future conflicts?

4. How would you judge whether SGM was a success or not?

Strategy Session 12

Identifying Transnational Strategies

OBJECTIVE

This session develops an understanding of global, multidomestic, and transnational strategies. The exercise leads you through the decisions that would be taken in two global footwear companies, Bata Shoes and Nike, in order to understand their strategies.

> Pernod's strategy is to be present in every single wine and spirits market through its local roots, global reach strategy.
>
> *—Pierre Pringuet, MD, Pernod Ricard SA*

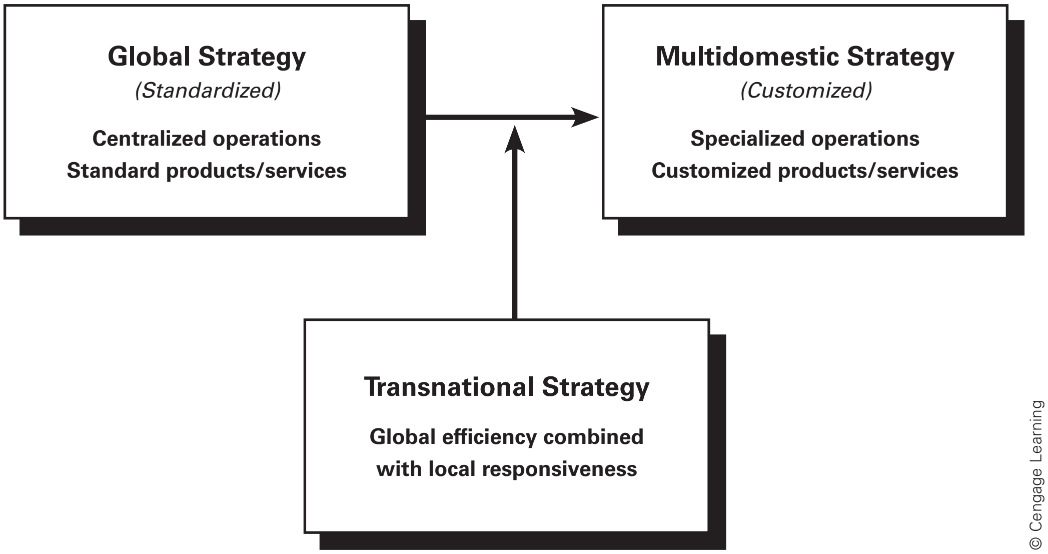
The falling economic barriers between nations cause more and more organizations to pursue business opportunities worldwide. As companies ponder the actions they should take in different markets, they are faced with the fundamental choice of following a common strategy across all nations or designing a unique one for each country. How should operations be integrated, can products be standardized, and what must be adapted to the needs and variations of each country? These decisions contribute to, and are derived from, a choice between global and multidomestic strategy.

A company following a *global strategy* tends to take a centralized and coordinated view of its strategy across the globe since it believes that the similarities of markets allow for exploiting a common strategy. This company is highly focused on global profitability and would therefore coordinate activities across the world to maximize the benefits derived from each location and operation. The marketing, R&D, production, and other operational activities of this company may be distributed across the globe or concentrated in one place depending on scale/scope economies and how it fits a global plan. This company tends to have rather standardized products and thus cater to a customer segment that has generic attributes across countries and is not seeking local responsiveness. This approach is on the rise, as products with worldwide acceptance continue to emerge and as less-expensive transportation and communication networks make globalization efficient and effective. One disadvantage of this strategy is that companies may not be able to market to segments that may be looking for something different.

A company that follows a *multidomestic strategy* tends to look upon its strategy in each country as being independent of another, since it believes that national markets differ significantly in their structure and key success factors. This strategy gives a high preference to location and national considerations. In each individual country, operations would tend to be involved in as many value creation activities as possible, including marketing, production, financing, R&D, and other operational activities. Three social forces encourage customized operations and products. First, cultural differences continue to exist among countries, and different tactics are necessary to target these differences. Second, governments often require that organizations follow legal mandates of the host nation. Third, as competition increases, local firms become aggressive niche players that closely tailor their products and services to consumer needs. One disadvantage of a multidomestic strategy is that multinational organizations may not get the benefits of the experience curve of the company as a whole as country operations run independent of each other.

A company that follows a *transnational strategy* seeks to achieve both global efficiency and local responsiveness. This is difficult to implement since it requires close global coordination and flexibility at the national level. Firms need to build sophisticated networks for integration across some business functions (say, sourcing materials using global supply chains), while at the same time delegating authority to local managers for other functions (say, marketing). A transnational strategy can be seen as falling in between global and multidomestic strategies. When effectively implemented, a transnational strategy can deliver higher performance than purely global or multidomestic strategies. Figure 12.1 illustrates these choices on a continuum from standardized to customized strategy.

FIGURE 12.1 THE CONTINUUM BETWEEN GLOBAL AND MULTIDOMESTIC STRATEGIES



Exercise

Global Operations of Bata Shoe and Nike

INSTRUCTIONS

Read the company profiles of Bata and Nike. In questions 1–8 that follow, circle the appropriate response in the scale below each statement. Then write a brief response to question 9.

Bata Shoe Organization[1]

The Bata Shoe Organization (BSO) runs the global operations of Bata Ltd. Based in Lausanne, Switzerland, it is credited with being the world's largest manufacturer and retailer of footwear, selling about 300 million pairs a year. BSO has a reputation for manufacturing sturdy yet stylish mass-merchandized shoes—both formal and casual—for men, women, and children. (Being privately owned, financial performance figures are not released, but recent annual sales revenues are estimated at $3 billion.) It retails in over 70 countries, employing about 40,000 people. It owns 5,000 stores, apart from distributing through several thousand franchisees worldwide. Its 33 operating units in 22 countries include shoe manufacturing, mold making, quality control laboratories, hosiery units, and tanneries. The operating companies are grouped into three regional business units that, according to BSO, are based on similarities in markets and business issues. Each unit benefits from synergies in product development, sourcing, and market appeal. The business units are Bata Emerging Markets, based in Singapore; Bata Branded Business, based in Best, Netherlands, and Bata Europe, based in Lausanne, Switzerland.

The Batas, a family of shoemakers, began operations in 1894 in Czechoslovakia, and had built a shoe network in 28 countries by the 1930s. The founder's son, Thomas J. Bata, migrated to Canada at the time of the Nazi invasion of his country and was largely responsible for building the company to its present status. In 2001, his son, Thomas G. Bata, was appointed chairman. Eighty-five percent of BSO's subsidiaries are wholly owned; although in some countries, due to local regulations (e.g., Zimbabwe), Bata has only a minority ownership. Where it has no equity, it provides licensing, consulting, and technical assistance. Bata likes to be seen as a local company in every country it serves, and as a policy, its three business units each have "the flexibility and independence to produce footwear that responds to the unique needs of its region."

Factories and stores are built to standard specifications around the world. Bata focuses on low-cost manufacturing and builds a local network of retailers and suppliers around it. It takes advantage of local materials in the countries where its plants are based. It prefers to produce in a given market nearly everything it sells there. While the Bata brand is common across the group, it does not use the Bata label in the United States where it makes industrial and protective footwear.

[1] For more information about Bata, visit its corporate Web site at http://www.bata.com.

Bata India Ltd., the largest subsidiary in the Emerging Markets Group with 50 million pairs sold in 2011, is 51% owned by the group and had sales revenues of about $330 million in 2011, and exported about 1% of its production. The company saw its business as offering footwear and accessories for the whole family. It distributed its products through company-owned stores and private retailers, and sold other brands too, such as Scholl, Hush Puppies, and Reebok, in its outlets. In addition to its own factories, production was outsourced to local manufacturers. Regional cooperation between companies is common. Problems in Uganda led to closing operations there, with the market to be served from Bata's production center in neighboring Kenya. The company operates in several developing countries and is conscious of its role as a provider of jobs in the economy. While top management may be composed of expatriates, local personnel are inducted, trained, and given increasing responsibilities. Senior executives are rotated around business units across the world; in the 1990s, when the Indian unit was in trouble, an expatriate team came in to organize a turnaround. Regular training programs are conducted at headquarters for senior worldwide employees. Country-based training programs work toward solutions to local problems that are culturally sensitive to their area.

BSO deals with a variety of political environments and has units in democratic and totalitarian regimes. In some countries, its operations have been nationalized and then denationalized. It sponsors local sporting events and engages with the local communities, such as supporting Junior Achievement (an organization that promotes entrepreneurship) and AIDS education. Many of the company's factories are located away from urban centers. In some countries, Bata provides housing, schools, and other amenities for its workers and extends its employee facilities such as health clinics to poor neighborhoods nearby.

The arrival of manufacturers such as Nike and Adidas on a global scale caused consumer preferences to change dramatically. Innovation and brand image in the footwear industry in the early 1990s forced the industry to be more market driven rather than manufacturing driven. Bata closed about 20% of its outlets—as many of them had begun to lose money—and the company restructured its operations in Europe. Bata's strategy is to provide trendy footwear at affordable prices to the largest possible segment of the population. In some African markets, it began to face competition from Chinese imports and secondhand goods. It also opened its own procurement center in China to supply its worldwide markets. More recently, it has begun to renovate its stores and revitalize its image in various markets from traditional and conservative to modern and upmarket, and work toward a regionally integrated marketing. It has also started offering online purchases in markets such as India and Malaysia, and is targeting the Asia Pacific region for its future growth.

Nike Inc.[2]

Nike Inc., based in Beaverton, Oregon (United States), is the largest seller of a wide variety of high-quality athletic footwear, apparel, equipment, and accessories in the world, with 55% of sales coming from footwear, and 60% of sales coming from international markets. The company was cofounded in 1964 by Phil Knight, a long-distance runner, who remains chairman. The company catalog lists over 800 models for use in about 25 different sports and leisure activities. It uses its brand "Nike" and logo "swoosh" consistently in all its products. In 2006, the company organized in six divisions along categories of sports, with each division combining shoes and apparel: running, soccer, basketball, men's training, women's fitness, and sports culture (products for casual wear). Since 2009, it organized itself around six geographies: North America, Western Europe, Japan, Greater China, Central and Eastern Europe, and Emerging Markets. In 2011, Nike posted revenues of $20.6 billion. It plans to reach global sales of $27 billion by

[2] For more information about Nike, visit its corporate Web site at http://www.nike.com.

2015 by focusing on fast growing regions such as China, India, Russia, and Brazil. The company often has to deal with national authorities that levy licensing requirements or antidumping duties on imports of its products into their country.

The focus of the company is sports and fitness, and it creates and markets its shoes, accessories, and related products to males and females between 18 and 34 years. Its success began with manufacturing running shoes for jogging, a popular activity in the United States. As it expanded, it successfully faced the challenge of bringing into its product line shoes popular in other regions, such as European-style soccer shoes, cricket shoes, and shoes for skateboarding. In each sports line, it targets its premium sports footwear at the high-performance athlete while other models are designed and priced for the general consumer.

More recently, it has begun targeting action sports such as snowboarding, skateboarding, and surfing.

Nike's strategy is built around individual sports and star players. The company has used famous sports personalities such as Michael Jordan (basketball), Roger Federer (tennis), David Beckham (soccer), and Tiger Woods (golf) as celebrity spokespersons offering them lucrative endorsement contracts on the belief that consumers will purchase Nike shoes and remain loyal to a brand name that is so closely identified with successful athletes. It views Adidas as its global rival. Advertising, although centrally developed, is adapted to local cultures.

Nike sells its products through its retail partners, such as footwear chain stores (e.g., Foot Locker), department stores, and franchises in 170 countries, apart from its own retail (and online) stores. It very closely monitors its international marketing and consolidated distribution operations in 24 centers across the world for better control over marketing. The company's R&D centers in the United States, Taiwan, and South Korea work on new technologies and advanced materials with which to update shoe models at least every six months. Its competencies include design and development, incorporating customer insight, and so on, and outsources manufacturing and logistics.

The company has contracted with manufacturers of footwear and apparel in 33 mostly low-wage countries including China, Thailand, Vietnam, Indonesia, Turkey, El Salvador, and India to produce its products. A major logistic center is located in China. Company technicians work closely with these contract factories. The company's production system is closely tied to its order-booking program, in which retailers order up to six months in advance of delivery and receive discount rates. Quick delivery is also ensured, where necessary, through bypassing its distribution centers, and moving directly to retail.

In the early 1990s, Nike faced unwanted publicity in the United States about sweatshop conditions in some of its contract factories, and has since worked to resolve the issues through better supervision and setting a code of conduct. Nike's growth has also come from acquisitions of companies such as Converse (sports footwear), Umbro (soccer shoes and apparel), Cole Haan (casual luxury footwear), and Hurley International (sports and youth lifestyle), and it maintains those brands.

1. Each company perceives its target consumers as having similar needs across the globe.

Bata:	To a lesser extent	1	2	3	4	5	To a greater extent
Nike:	To a lesser extent	1	2	3	4	5	To a greater extent

2. The Chinese factory's union has raised a dispute about poor working conditions. This matter is to be reported to headquarters.

Bata:	To a lesser extent	1	2	3	4	5	To a greater extent
Nike:	To a lesser extent	1	2	3	4	5	To a greater extent

3. The marketing coordinator for Emerging Markets wishes to launch a new promotional campaign. This is a matter to be discussed and approved at a senior level in the headquarters.

Bata:	Less likely	1	2	3	4	5	More likely
Nike:	Less likely	1	2	3	4	5	More likely

4. The Indonesian plant manager wishes to hire more workers to meet production needs. She would need to obtain prior approval from the headquarters.

Bata:	Less likely	1	2	3	4	5	More likely
Nike:	Less likely	1	2	3	4	5	More likely

5. In this company, the production schedule for each plant would need to be closely coordinated with the sales plan on a global basis.

Bata:	To a lesser extent	1	2	3	4	5	To a greater extent
Nike:	To a lesser extent	1	2	3	4	5	To a greater extent

6. This company sees a need for better coordination among its offices for strategy and operational efficiencies. What would be the appropriate basis on which to undertake the restructuring?

   Bata: Geographic/By product lines

   Nike: Geographic/By product lines

7. A country manager on a field visit has spotted an opportunity for a new line of footwear for use in schools in their physical education classes. Would prior permission be needed from headquarters in order to proceed?

   Bata: Prior permission needed/Not needed

   Nike: Prior permission needed/Not needed

8. In light of the responses to questions 1–7, what strategy would you say the company is following globally?

Bata:	Global strategy	1	2	3	4	5	Multidomestic strategy
Nike:	Global strategy	1	2	3	4	5	Multidomestic strategy

9. Speculate on trends in the industry over the next 10 years with respect to (a) consumer preferences for footwear, (b) national investment policies, and (c) any other. What changes would you recommend the company initiate in its strategy/operations to best face these trends, and why?

Bata:

Nike:

Strategy Session 13

Understanding Turnaround Management

OBJECTIVE

The purpose of this session is to help develop an understanding of the critical issues surrounding organizational decline and the nature of turnaround management. An understanding of these issues enables managers to better understand the consequences of inaction and assist in developing a viable turnaround strategy. The exercise provides an opportunity to use analytical skills to assess decline and turnaround.

How few there are who have courage enough to own their faults, or resolution enough to mend them!

—Benjamin Franklin, Poor Richard's Almanack

Most management theories are built on the assumption of a firm seeking growth and profitability. Thus, when an organization is undergoing decline in its performance with the prospect of eventual failure, it faces an experience for which it has limited preparation. An understanding of the processes of decline and the principles of effective turnaround management are skills that prospective managers need to have to develop viable turnaround strategies.

Decline in performance is common in the workplace. Most organizations face occasional decline that is quickly reversed. The causes that lead to these drops in performance are external and internal to the organization. External causes include general economic recession, regulatory actions, changes in consumer buying practices, and competitive actions. Internal causes deal with poor management and include a wide range of issues such as over expansion, an improper fit between the company and its environment, poor marketing or product problems, and lack of effective controls. When the managers take timely action in dealing with the causes and reverse the trend, it is a part of the normal management function. However, research has shown that this does not always happen. In the early stages of decline, managers may deny the severity of the problems, or not identify the causes of the problem correctly, and the decline continues.

As the firm continues to decline, the severity of the problems worsens and the organization starts incurring cash losses. Other signs may include the exit of valuable personnel. The firm now enters a critical phase, and it usually takes some kind of a crisis to shake the organization into realizing the severity of its problems. It could be union action, vendors withholding supplies until payment, or a bank refusing further credit terms to the organization. When this happens, the firm realizes the need for drastic actions to stem the decline. These actions would be targeted toward cutting costs by improving efficiencies and reducing wasteful expenditures. Employees may be laid off and activities shrunk. The organization may also have to resort to selling assets to raise necessary funds. Quite often at this stage, several members of the top management team may be replaced, including the CEO, in order to bring in new skills for the turnaround.

When the decline has been stabilized (that is, when the cash loss has been stemmed), then revenue-generating measures may be instituted, such as increasing sales and new product development. The firm is now on a turnaround path that should be directed toward building its competencies back.

The key principles of turnaround management are precise identification from a strategic perspective of the causes of the organization's decline and turnaround strategies that incorporate key stakeholders.

1. It is important to take care in *identifying the causes of the problems*. Since actions need to be taken to deal with the causes, the more precise the firm is in identifying the problems, the higher the probability of the turnaround effort succeeding. Turnaround management consists of careful review of the causes before actions to correct the problems are defined. Causes of the problems should be grouped as strategic and operating. Strategic causes will include: What businesses the firm is in, whether it has the skills to be in those businesses, and how it competes in those businesses. Operational causes will deal with functional areas and include problems in marketing (advertising and promotional issues), human resources (pay, training, etc.), production (plant size, equipment, etc.), and so on.
2. The key point is that management must deal with the strategic causes. If the firm does not have the skills to be successful in the business and is experiencing a poor fit with its environment, then it needs to change its direction, reexamine its niche, and perhaps alter the strategy it is following to compete in this business. No amount of operational efficiencies will help if it has not fixed its strategic problems.
3. To achieve a turnaround, the firm needs the *help and support of various stakeholders* such as vendors, distribution channels, customers, bankers, and the like. Part of the skill of implementing the turnaround lies in stakeholder management and the firm's ability to extract concessions from them in the short run. The right leadership is also a crucial factor in successful turnarounds.

Bankruptcy, as an option, is resorted to usually only under extreme circumstances. Under the U.S. Bankruptcy Code, firms usually choose one of two options. Under Chapter 7, the firm may opt for liquidation. Under Chapter 11, the firm may seek the protection from creditors while it implements a turnaround plan with the approval of the court. Firms resort to Chapter 11 filing only when they have exhausted all other options and need the protection that the court can give.

Exercise

The Decline–Turnaround Sequence

INSTRUCTIONS

Find an article from a recent issue of a business magazine or newspaper that describes a company in decline. As you read the article, keep in mind the key principles of turnaround management from the reading. Complete the following information individually or in teams.

1. Define and review the extent of the decline:

2. What is the crisis? How was the decline recognized?

3. Complete the following table:

Cause of Decline: *External*	**Turnaround Actions:** *Strategic*
Internal	*Operational*
Stakeholders Involved:	**Their Role:**

4. Changes in the top management team (TMT):

5. Results: Has the decline been stemmed/turnaround achieved?

6. What actions do you recommend and why?

Strategy Session 14

Scenario Planning: Innovative Approaches for the Future

OBJECTIVE
Learn the process of constructing innovative scenarios as a means to aid strategic decision making while dealing with an uncertain future environment.

> Scenarios are stories about the way the world might turn out tomorrow, stories that can help us recognize and adapt to changing aspects of our environment.
>
> —*Peter Schwartz, The Art of the Long View*

Strategic decision making involves managers making decisions in the present to strengthen the position of the firm in the future. Under reasonably stable environments, it may be possible to forecast the future by extrapolating the conditions of the past. However, in dynamic environments, where there are several variables at play, the past is not likely to repeat itself. Customer needs change, regulatory conditions vary, availability of inputs is constrained, and competitors may be sharpening their plans. Building scenarios is a way of dealing with an unknowable—that is, an uncertain—future in a systematic manner. It helps in several ways:

- Scenario planning leads to innovative thinking about the future because managers "stretch their minds" to reflect, brainstorm, and consider a wide range of possibilities.
- Scenario planning helps prepare firms for the unexpected by educating managers about uncertainty. It teaches them to understand and challenge their own assumptions.
- Scenarios can be the starting point for developing a strategy for the organization.
- Scenarios serve as a testing ground for ongoing strategies.

Scenarios, however, are not predictions. They are a way for managers to visualize different futures based on the probability of occurrence of events and trends.

The technique of scenario planning has been practiced since the 1960s. The company most closely associated with the method is the oil multinational Royal Dutch/Shell Group, which credited scenario planning for its quick and effective response to the oil crisis of 1973.* Another adherent is Duke Energy Corporation in the United States, which developed three scenarios to gauge the impact of events such as varying rates of economic growth, the role of the Internet, and the extent of deregulation of the energy industry to obtain what it calls euphemistically a "wind tunnel" for testing strategy.

Scenarios are short narratives describing a future state of affairs. The future state is based on observable trends, the present knowledge of experts and built on causal relationships. Different probabilities are assigned to the different ways in which events can develop in the future. This makes it possible to construct different scenarios of future states with the same set of events and trends. As time progresses, reality is constantly matched against the scenarios leading to their evaluation and refinement. Scenario planning is credited with helping AutoNation, the U.S. auto retailer, to chart out strategies

* For more information about Royal Dutch/Shell's strategic use of scenarios, visit **http://www.shell.com / scenarios.**

to deal with the auto buying environment and the competitive activity. The scenarios also become a framework against which the strategy can be evaluated and, if necessary, the direction altered.

Scenario descriptions are drawn focused on a single issue of critical importance to the company and are developed with internal consistency. This focal issue is the starting point for the development of scenarios. For Royal Dutch/Shell, one example would be scenarios that seek to answer the question: "Is there life for our company after the world runs out of oil?" Another example, say for a manufacturer of formal attire, are scenarios that address the issue: "Should we launch a line of fashion clothing for teenagers?" In both examples, the collection of quantitative and qualitative (such as expert opinions) data and the identification of social, cultural, technological, economic, and other kinds of environmental trends would be determined by the focal issue.

The writing of the scenario is a critical and innovative part of the process. This is the stage where facts, opinions, and expectations are woven into a narrative and form a plausible story. Yet the story needs to be analytical and not merely descriptive; namely, the logical development of events in the story should be clearly linked through cause-and-effect relationships. Given the interactions among the key driving forces in any situation, it is possible for several scenarios to be written. However, experts argue for a limited number—three or four—because too many scenarios may compromise the focus managers need for decision making.

Creation and use of scenarios, the two phases of the scenario planning process, are closely intertwined. Some scholars recommend that a best, worst, and most probable scenario be developed. The problem with this approach is that managers quickly commit to the middle path—and this builds rigidities in their response. A more sophisticated approach is to write the scenarios in a manner such that no one scenario becomes clearly preferable and all are equally plausible. This better achieves the purpose of getting managers to break from "mindsets" and to think innovatively of different possibilities, that is, "outside of the box." It is not necessary to commit to a particular scenario and when the existence of the scenarios is known widely among the key decision makers, managers can compare the unfolding reality with these scenarios and judge how further events may turn out.

Exercise

Develop Some Scenarios

INSTRUCTIONS

This exercise will take you through the steps of writing scenarios. To prepare, refresh your reading of the Innkeepers of America case in Strategy Session 1 (p. 5–6) and the Lodging Industry Profile (pp. 143–148) before coming to class. Then await instructions.

Step 1. Focal Issue Identification

Identify one strategic issue for the future of Innkeepers of America that will set a direction for the company and involve major resource allocation. (As an example, for a U.S. microprocessor manufacturer, the issue could be, "Shall we set up the R&D center for new chip design in India?"). State the focal issue in the form of a question on the following line:

Focal Issue: ____

Step 2. Key Factors in the Industry and General Environment

In Table 14.1, list the key factors (i.e., events or trends) that would influence the success or failure of the focal issue under different categories into the future. First, look for factors dealing with the industry environment (see Strategy Session 6 on p. 39) that *have a bearing on the focal issue*. Then, look for factors in the general environment. These deal with the macroeconomic, social, political/governmental, and technological forces. What events (i.e., single observable incidents) or trends (i.e., forces that bring about change) can affect the decision in these areas? Some may be predetermined, such as demographics, and others may be highly variable and subjective, such as issues of style or preferences.

Approach this step as a brainstorming exercise. First, let each member of the team take turns suggesting a factor under one of the listed categories. Do not evaluate but merely note it down in the first column of the table under Factors. Identify two or three in each category.

Step 3. Identify Importance and Assign Probabilities

Revisit each factor, and in column 2, on a five-point scale, assign numbers from 1 (unimportant) to 5 (very important) to reflect the importance of the factor identified for the success of the focal issue. Then, in column 3, assign a probability ranging from 0 (will not happen) to 1 (certain to happen) to reflect the certainty that you would attach to its occurrence.

Step 4. Building the Scenarios

Once a set of the critical uncertainties have been identified in the table, the scenario writing can begin. The scenarios will differ due to factors you have identified that are high

TABLE 14.1 FACTORS AFFECTING THE FUTURE

Factors	Importance Scale 1 (unimportant) to 5 (very important)	Probability of Occurrence Scale 0 (will not happen) to 1 (will happen)
Customers		
(e.g., PC manufacturers are demanding lower cost chips)	5	1
Suppliers		
Competitors		
Complementors		
Macroeconomic		
Social		
Political/Governmental		
(e.g., U.S. government may levy tariffs on imports)	3	0.2
Technological		

in importance and are uncertain (i.e., probability ~.5). Each scenario may be a couple of paragraphs long. This is a creative process similar to story writing. Each scenario follows a "logic" or plot that ties the various elements together. Three typical themes are as follows:

- **Winners and losers.** In this logic, resources are scarce, trade-offs are frequent, and there is usually one dominant player in the market.
- **Challenge and responses.** This scenario exhibits a kind of cyclical nature to events in which challenges arise and are met; there is a spirit of cooperation and accommodation.
- **Evolution.** In this scenario, changes take place slowly, organizations adapt to the changes while learning and adjustment take place.

Step 5. Scenario Elaboration

Although the most important forces identified in Step 3 determine the logic of the scenario, every key factor needs to have a place in it. At this stage, the scenarios are checked to see if they are consistent internally, and distinct from each other. Identify data points—or signposts—for each scenario that can be tracked to judge which particular scenario is unfolding.

Step 6. Implications

Examine the focal issue in relation to each scenario. Respond to the following questions:

1. Do one or more scenarios support the decision posed in the focal issue?

2. Can the decision be altered so it is supported by more than one scenario?

PART III

Implementing Strategy

Strategy Session 15

Succeeding in Strategy Formulation and Implementation

OBJECTIVE

To achieve its objectives, an organization must both formulate and implement its strategies. If either of these tasks is done poorly, the result is the likely failure of the overall strategy. This session provides an understanding of both formulation and implementation.

> I have thought too much to stoop to action.
>
> —*Philipe Auguste Villiers de L'Isle-Adam*

Early writers in the field of strategic management developed rational planning models that distinguished between strategy formulation and strategy implementation. According to the traditional or rational planning framework, strategy formulation was the role of corporate level managers such as the CEO and other senior executives, and it involved developing a strategy that achieved a fit between the external environment (opportunities and threats) and an organization's internal capabilities and resources (strengths and weaknesses). Once a strategy was formulated or developed, its implementation involved a series of subactivities. These included creating an organizational structure to support the company's chosen strategy and designing performance measurement, compensation, incentives, and controls to achieve the kind of management and employee behavior required for successfully executing the strategy.

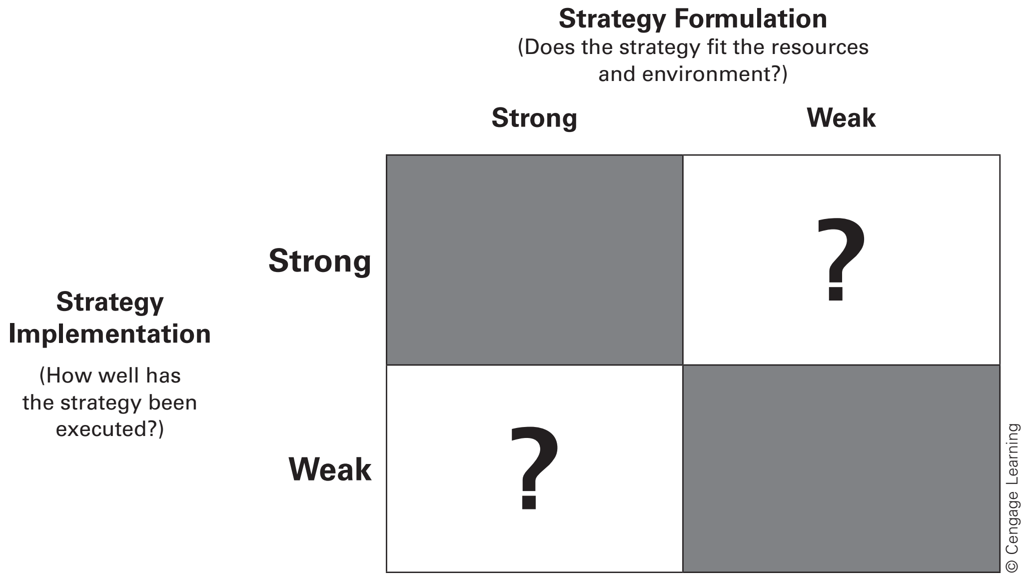
A revision of the rational planning framework suggests that strategy can emerge in response to unforeseen circumstances. Unplanned responses occur to take advantage of or react to changes in the environment. As a result, the strategies that are implemented look different from what was intended. These effective, but often unintended, strategies have been labeled *emergent strategies*.

In practice, organizational strategies are probably a combination of the planned and the emergent and often are partially formulated, implemented, and then reformulated to capitalize on strategic opportunities. While it may seem difficult to separate strategy formulation and implementation, since they are closely linked, the two concepts are fundamentally different. In fact, analyzing issues associated with each can provide a useful technique for diagnosing strategic problems.

Framework for Diagnosing Problems. Stated simply, strategy formulation is what you are going to do; strategy implementation is doing it. When an organization chooses to change to a cost leadership strategy (formulation), the execution of that strategy may involve such changes as developing new pricing policies, establishing cost-control procedures, building new facilities, and modifying employee hiring practices and benefits (implementation). If these changes are not carried out successfully, it is impossible to assess the soundness and quality of a given strategy.

The chart in Figure 15.1 shows a way to distinguish between the two concepts in the assessment of strategic performance. The shaded boxes represent the extremes that managers rarely face. In the upper-left box, there is outstanding success when the strategy is appropriate and its implementation is sound. All that can be done has been done, and performance indicators are usually strong. The lower-right box is exactly the opposite, and performance indicators reveal revenue declines and profit losses. If management tries to improve the strategy, the programs fail because they cannot be executed. If implementation problems are fixed, it results in the execution of a strategy that is not sustainable.

FIGURE 15.1 DISTINGUISHING STRATEGY FORMULATION AND IMPLEMENTATION



The two question-mark boxes are the ones that practicing managers typically face. The lower-left cell involves a situation where the company has chosen a strong strategy that matches organizational resources and capabilities with competitive forces. However, weak implementation will often disguise the appropriateness of the strategy. Because managers are more accustomed to focusing on strategy formulation, the real problem with the strategy (faulty implementation) is often not diagnosed. When performance is low, managers are likely to develop a new strategy rather than question whether the implementation was effective. The new, and perhaps even less appropriate, strategy is then reimplemented and continues to fail.

The upper-right box represents situations where an inappropriate strategy is implemented well. The strong execution may overcome the unsound strategy—or at least give management an early warning of impeding problems and the need for a change in strategy. Alternatively, the same strong execution can hasten the failure of the weak strategy. For example, although efficient production and cost-cutting measures may bring an organization to a cost leadership position, this strategy choice may be inappropriate for the target market.

The important point is that diagnosing problems in an organization requires analysis of strategy implementation as well as strategy formulation. It is critical to incorporate both, since strategic soundness cannot be assessed without reviewing issues involving implementation.

Exercise

Diagnosing the Netflix Problem

INSTRUCTIONS

Read this short case and then diagnose the problems that occurred at Hewlett-Packard in the questions that follow.

Netflix

Reed Hastings cofounded Netflix in 1997 and became CEO two years later. Under his guidance and visionary thinking, the company created a user-friendly Web site that delivered DVDs directly to customers through the mail. There were no late fees, and customers returned the DVDs by mail. Netflix and at-home delivery of DVDs ended up being the demise of traditional video stores such as Blockbuster.

While the DVD rental business was profitable, in 2007 Hastings realized that the company's direction needed to move to streaming video through the Internet. The company began to build its streaming video distribution platform that was compatible with Web-connected devices. In order to be ahead of the curve in terms of streaming, Netflix set up the business model where customers could get a subscription that offered access to DVD rentals as well as unlimited on-demand streaming video for $10 per month. By 2010, the popularity of streaming increased, and Netflix was positioned perfectly as it transitioned into an online-video company. The customer base increased to 20 million subscribers. Rivals such as Amazon, Hulu, and Google were behind in streaming, since they did not work as quickly to arrange the agreements for acquiring rights to content from companies such as CBS, Walt Disney, and Comcast Corp's NBC Universal.

Two Subscriptions and a Price Increase

Given Netflix's ongoing success, Hastings gained the reputation for being a technology and media visionary. By 2011, he became thoroughly convinced that DVDs were becoming a technology of the past, and he argued that companies that succeeded at one business stayed too long with what made them successful. Although the management team agreed with this assessment, none were aware of how quickly Hastings wanted Netflix to shift completely to streaming. Without discussion, at a meeting held in the spring of 2011 with his management team, Hastings outlined his strategy to separate the DVD and streaming operations, with the goal to phase out DVD rentals. To implement the spin-off of DVD rentals, customers would no longer be able to get one subscription covering both options of DVDs and on-demand streaming video. Instead, each would be a separate subscription costing $7.99 a month or $15.98 for both, which represented a 60% price hike. There would be no debate about the strategy or its implementation, since Hastings had already appointed Andy Rendich (Netflix's long-time chief service and operations officer) as CEO for the new "DVD Co.," as it was referred to internally.

Employees were surprised at how quickly and unemotionally the backbone of Netflix—the DVD operations—was split off from the company. DVD Co. was moved out of Netflix offices to facilities several blocks away, and the executives who moved out reportedly were not invited to Netflix management meetings. These executives included Netflix's vice president of human resources, the vice president of financial planning, and the vice president of DVD product development. Netflix management stopped discussing DVDs and managers were not asked to weigh in on the new strategy or its implementation.

Up to 2010, the Netflix management team had been experienced and aggressive, and would challenge Hastings' ideas. The old guard began to change in December of 2010 when CFO Barry McCarthy after 12 years at Netflix left the company after a conflict about his role and compensation. Two months later, Ken Ross, head of worldwide communications, also resigned.

The new dual subscription model and the price hike were announced on July 12, 2011. Critics and customers immediately focused on the 60% price increase. Subscribers blasted Hastings on Facebook, Twitter, and in the company's own blog. Indicative of the outrage felt by customers, the CEO was nicknamed "Greed" Hastings.

Netflix's cavalier response was to downplay the price increase as being equivalent to a couple of Starbucks lattes. Two weeks later in a letter to investors, Hastings optimistically said the company was sorry it had upset subscribers, that most would not cancel, and the increase in revenue would get Netflix to reach the $1 billion mark in quarterly revenue.

However, Hollywood film studios that were never fans of Netflix began raising fees to license movies for streaming. Also, Netflix was not able to acquire certain titles because the rights were already locked up. Then Netflix lost its contract with Starz, a premium pay TV service that owned the rights of 2500 Disney and Sony Pictures movies. On September 1, 2011, Starz announced it would not renew its agreement with Netflix, thus removing movies from the Netflix library effective February 2012. For Starz, the timing was right, since customers did not blame Starz for being a greedy old-media company that provided movie content but rather blamed Netflix and its relationship with customers and movie content partners.

Qwikster

By September 15, 2011, at the close of trading, Netflix shares were down $40 or 19%, closing at $169.25 and far from the company's high of $304 in July 2011. Hastings decided to unveil Qwikster (formerly named DVD Co.) a month earlier than planned. The announcement was made in a hastily shot YouTube video. It is reported that the management team tried to discourage Hastings from announcing a major change at the company this way but without success. From the customers' point of view, Netflix now required them to create a new account, to order from a new company (Qwikster) as well as to receive an additional bill, if they wanted both DVD rental and streaming.

After three weeks, Hastings reversed the new strategy move and closed down Qwikster. On October 24, 2011, Netflix reported a loss of 800,000 subscribers. The stock shares were trading at $77; and since the price increase, Netflix had lost three-quarters of its value. Most of the 150 employees hired for this operation were let go. Those who had moved to Qwikster from Netflix had no jobs to return to, since theirs had been filled. Included in this list was Andy Rendich, the 12-year Netflix employee, who had been given the CEO position at Qwikster.

International Operations

With an eye toward growth, Hastings argued that particularly when access to high-speed Internet is available internationally, the new market will be a boost to streaming video demand. In 2010, the company set up a streaming service in Canada and in Latin American and the Caribbean in 2011. The third phase of the international expansion involved launching a streaming service in the United Kingdom and Ireland in 2012. The latter involves a different situation since Amazon's LoveFilm has a presence in both countries, particularly since LoveFilm also distributes DVDs. Some analysts question Hastings grow-at-all-costs business model, particularly when expansion is at the expense of the company's bottom line.

1. Describe the strategy developed for Netflix by Hastings in 2011. Was it a strong or weak strategy? (To determine if the strategy was strong or weak, review whether it dealt with environmental trends and whether it would offset company weaknesses or capitalize upon company strengths.)

2. Identify ways the strategy was implemented. Was it executed well? Discuss.

3. What additional information would you like to be able to judge formulation and implementation better?

4. In the following chart, place an "X" in the cell that best depicts the Netflix situation in 2011.

		Strategy Formulation	
		Strong	**Weak**
Strategy Implementation	**Strong**		
	Weak		

Session 16

Structuring to Support Strategy

OBJECTIVE

Changes in corporate strategy often require changes in the way an organization is structured. In this strategy session, practice designing new structures and systems for a business as its strategy evolves.

> Form follows function.
>
> —*Louis H. Sullivan, founder of the Chicago School of Architecture, in 1896*

An organization's structure is the formal definition of working relationships between people and departments in an organization. Companies often create organizational charts to show who reports to whom and how tasks are divided up. Different structures are required to implement different strategies, and typically structures are changed when they no longer provide the coordination and control necessary to implement strategies successfully.

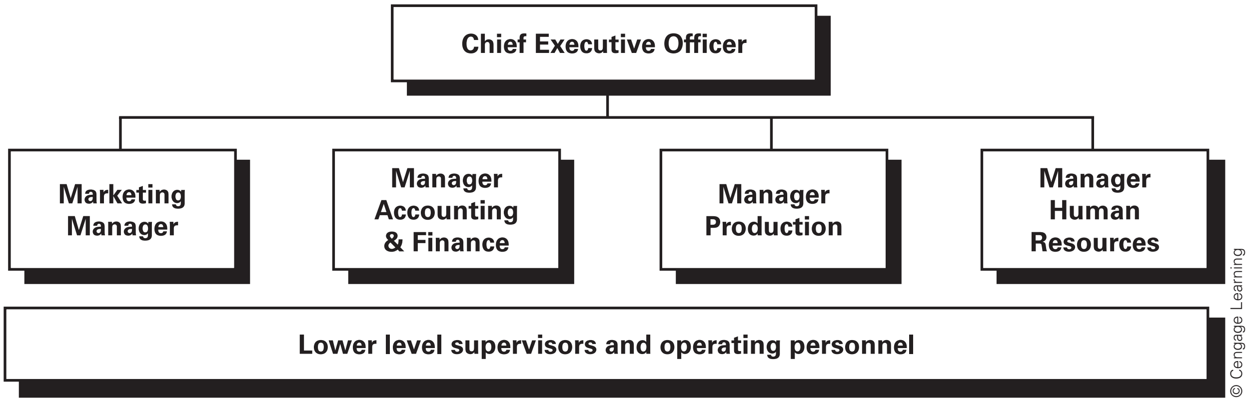
Management historian Alfred Chandler conducted one of the classic studies dealing with the strategy and organizational structure relationship. After studying U.S. corporations, such as Sears, General Motors, DuPont, and others, Chandler found evidence that when companies changed their strategies, they changed their structures. That is, management set up departments and divisions within the organization to pursue specific strategies, and Chandler labeled this process "structure follows strategy."

Organizational Structures. Although there are many structural forms, there are common types in modern organizations. The first is a simple structure where the owner-manager makes all major decisions directly and coordinates all activities. This structure is appropriate for a small entrepreneurial firm with one or two product lines following a focused cost leadership or a focused differentiation strategy. Employees tend to be generalists.

As companies grow and add several product lines in one industry, the range of tasks that must be performed expands and no one person can successfully perform more than one organizational task without becoming overloaded. The owner-manager, for example, can no longer make and sell the expanded product lines. Employees tend to be specialists in the business functions and are grouped into departments, such as marketing, production, accounting and finance, and human resources, as shown in the simplified organizational chart shown in Figure 16.1. The task of the CEO is to ensure that communication and coordination exists among the departments and that the actions of the departments benefit the entire organization.

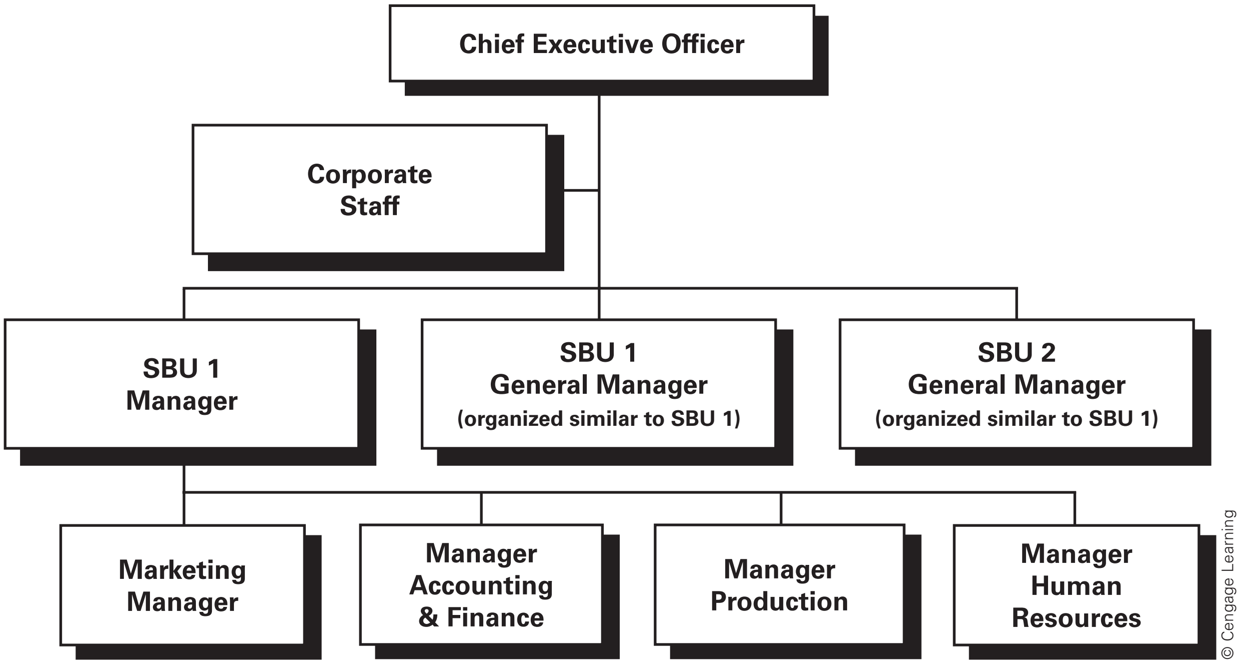
Once a corporation diversifies into more than one industry, the multidivisional structure is used. It better equips the organization to handle corporate strategies, which deal with the question of what businesses to be in. As a company expands and diversifies, it becomes more difficult for the CEO to process increasing quantities of strategic information. Therefore, responsibilities for day-to-day operations are delegated to division managers. Employees tend to be functional specialists grouped according to product and market distinctions. How autonomous the divisions are varies from company to company.

FIGURE 16.1 FUNCTIONAL STRUCTURE



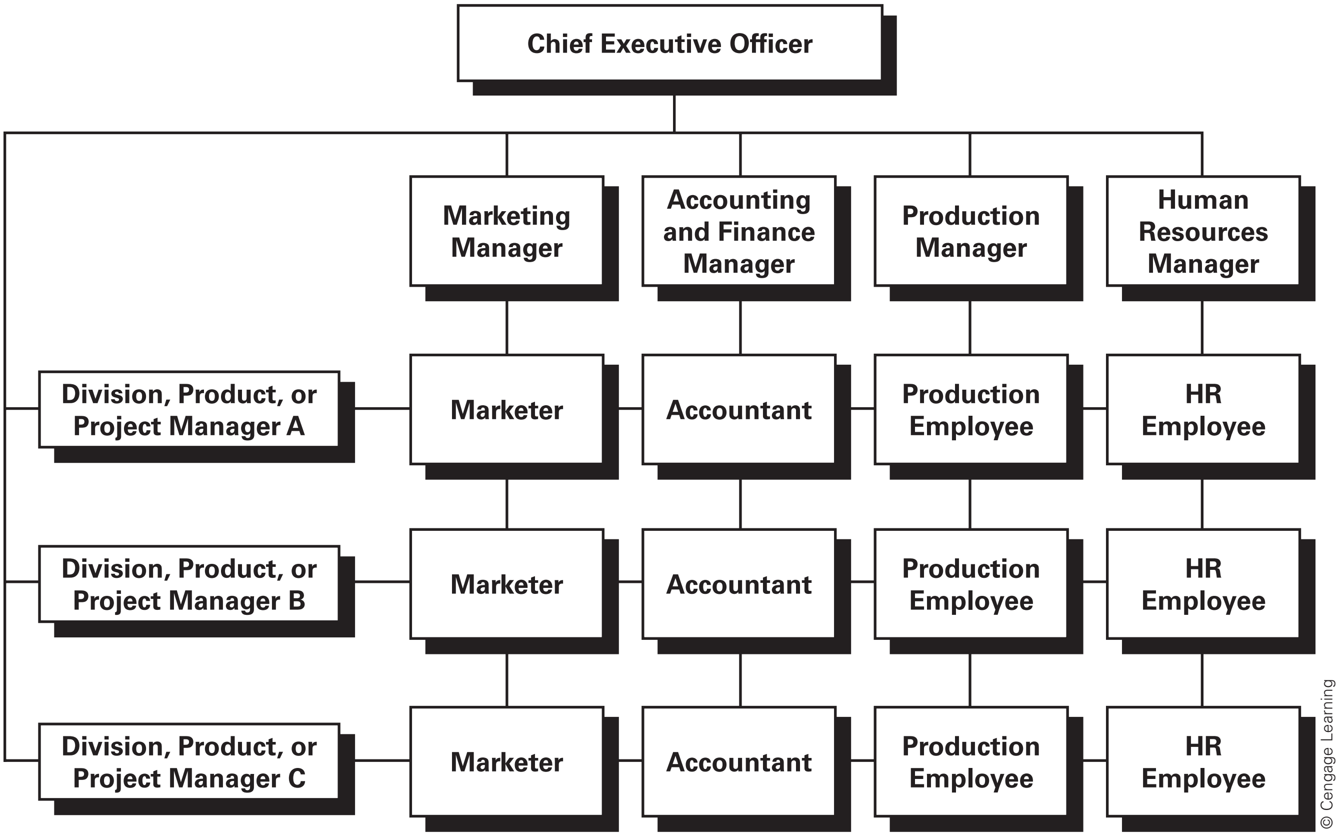
When organizations expand into many areas of business with dozens of different products and markets, the diversity and number of divisions can cause the CEO problems in strategic planning and control as well as overseeing operations. The span of control becomes too large. The solution is to combine several divisions into product groups or strategic business units (SBUs), each under one executive, such as a group vice president. The CEO then can manage the divisions through this level of vice presidents. An example of a strategic business unit organizational chart is shown in Figure 16.2.

FIGURE 16.2 SBU STRUCTURE



As strategies change, other structures have emerged to serve specific organizational needs. Organizations that manage several projects often use a complex matrix design, which is a hybrid of the functional and the divisional structures as shown in Figure 16.3. Employees literally work in two departments and have two supervisors. For example, an employee in the marketing department reports to the head of marketing but also reports to a product or project manager. Another unique structure is a network-type form, often termed a "nonstructure." In a network, or "virtual organization" as it is also called, companies outsource many activities traditionally handled by employees of the organization and thus eliminate in-house business departments.

FIGURE 16.3 MATRIX DESIGN STRUCTURE



Exercise

Designing Organizational Structures for Club Ed

INSTRUCTIONS
Break up into small groups and discuss the strategy and structure for your new resort business as it evolves over the periods described in the following paragraphs—and then create an organizational structure for each period.

Team Activity

Period I

Determined never to shovel snow again, you are establishing a new resort business on a small Caribbean island. Construction is under way, and the resort is scheduled to open a year from now. You decide it is time to draw up an organizational chart for this new venture, Club Ed. Your initial workforce consists of 15 employees.

1. Develop your generic strategy. Who is the target market? What will be your competitive advantage (cost leadership or differentiation)?
2. What jobs do you need to have covered? What tasks need to be done? What services will you provide?

Work in your group to draw your organizational chart and be prepared to discuss your generic strategy and the components and rationale for your company structure.

Your instructor will select one or two groups to present their designs and lead the class discussion.

Cheryl Harvey and Kim Morouney, Organizational Structure and Design: The Club Ed Exercise. Journal of Management Education 22(3): 425–430, © 1998. Reprinted by Permission of SAGE Publications.

Team Activity
Period II

You are into your tenth year of operation; Club Ed is wildly successful and you would not recognize a snow shovel if you saw one! You and your partners own 30 Club Eds in a variety of locations in South America, Central America, North America, the Caribbean, and the South Pacific, and the total number of employees is over 400. What are the biggest problems to date? Have you dealt with them in your structure? How have your human resource, control, and information systems developed? Draw an up-to-date organizational chart and prepare to explain your rationale to your classmates.

Your instructor will select one or two groups to present their designs and lead the class discussion.

Team Activity
Period III

Ten more years pass. The Club is now in 50 locations and operates three cruise ships. The fleet of "Love Boats" offers seven-day cruises to the Caribbean, Alaska, and the Far East. Ships include casinos, live music, dancing, nightclubs, and a selection of movies. Food is available around the clock in the main dining rooms. A recent customer profile shows that almost 50% of customers are repeat business and are 40 years and older. The three "Ss" (sun, sand or snow, and sex) marketing theme no longer appeals to this population in a world where AIDS and fears of skin cancer are all too real. Reservations have been down over the past several seasons as economic conditions fluctuate. How does Club Ed restructure to adapt?

Your instructor will select one or two groups to present their designs and lead the class discussion.

Discussion Questions

1. What is the relationship between strategy and structure?
2. How can Club Ed structure itself as an adaptive organization? Does it always have to react to environmental changes or are there some ways it can be proactive?

Notes

Strategy Session 17

Strategy Implementation Using the 7-S Model

OBJECTIVE

This session will help you recognize the actions that are needed in different areas of the organization to implement strategy. The 7-S Model provides the framework for examining the actions and appreciating the interrelationships between them.

> The value of a strategy depends not only on the elegance of its conception but fully as much on whether the company proposing the strategy can really execute it.
>
> —*Robert H. Waterman, Jr.*

Effective strategic management requires that an organization have a good strategy, and that its members make it work as well. Implementing strategy involves coordinating a broad range of actions that interrelate and focused on the strategy. Making limited changes seldom brings any significant overall organizational result. To redirect organizations, managers must deal with several overlapping and related issues.

When the various parts and processes of an organization are all in complete alignment, it is reflected in the organization's performance. A powerful way of visualizing these various components and their alignment is through the "7-S Model." The model was originally developed by McKinsey & Company, a consulting firm, as a framework for thinking about effective management and for bringing about change in an organization. By presenting an integrated view of an organization, the 7-S Model is a useful tool to see the interplay between the various elements in the process of implementation enabling better decision making. The 7-S framework consists of the following:

1. **Strategy.** How the organization seeks to gain competitive advantage, and achieve desired long-term performance.
2. **Structure.** The organization chart and other means by which an organization divides the tasks to be performed, and simultaneously ensures its coordination.
3. **Systems.** The procedures (both formal and informal) through which the organization functions on a daily basis. These include budgeting systems, information systems, quality control systems, production scheduling, and so on.
4. **Style.** The culture, or values and beliefs, of the organization as revealed in the way its members behave.
5. **Staff.** The human resource practices of the organization, including those that deal with recruitment, training, compensation, morale, and so on.
6. **Superordinate goals (or shared values).** Abstract guiding concepts of an organization, shared by most employees. These are sometimes captured in its mission statement, but may go beyond formally stated objectives.
7. **Skills.** The capabilities of the organization that collectively contribute to its competencies.

The basic message of the model is as follows: (1) Many factors exist that determine an organization's success; (2) all of them must complement each other; and (3) they are all equally important. Thus, it is an iterative process and there is no start or finish to the model. To use the model to examine implementation, we can start by first identifying the strategy and then assess whether the other elements are consistent with it, and if not, what changes need to be made. For instance, if an organization's strategy calls for differentiation based on design and superior product features, then actions in the "staff" area should ensure that people with the right skills are hired and rewarded. The "systems" should ensure that the monitoring measures track product development. The "structure" must allow the product development department to access the information it needs and have the authority to make the decisions it needs to make. The "style" should encourage innovation through more risk taking.

Poor implementation can make the best designed strategies fail. Hence, the formulation and implementation of strategy can rarely be separated and together is referred to as the "formation" of strategy. Poor implementation has also been identified as a major cause for failure of mergers and acquisitions. While the strategy may call for two organizations to be joined to achieve certain goals, lack of consideration of how the two cultures will fit, whether the systems can be integrated, and so on could easily result in the M&A unraveling.

Exercise

Transition at Apple Inc.

INSTRUCTIONS

Read the following Apple case. As you read, identify data that represents each S in the 7-S Model. Then respond to the question that follows.

Apple Inc. designed, manufactured, and marketed a variety of devices including mobile communication and media devices, personal computers, portable digital music players, and also a variety of related software, services, and peripherals. In fiscal 2011, the company's net income of about $26 billion was on sales revenues of $108 billion. The company's reach was global and the segments accounting for its 2011 sales were: North and South America (35%), Europe as well as Middle East and Africa (26%), Japan (5%), Asia Pacific (21%) (Australia and Asian countries other than Japan), and retail 13% (Apple retail stores worldwide).

The company had pioneered the personal computer revolution with the Apple II in 1977. In 2011, its three main products included the iPhone (44% of 2011 sales), which combined a mobile phone with a Web-browsing device, listening to music, and camera; Mac Hardware products (20%), which were personal computing products for the desktop and portable, as well as peripherals; and the iPad (19%), which was a multipurpose tablet device for browsing the Web, sending email, viewing photos, videos, and so on.

Other company products included the iPod (a portable digital music and video player); the iTunes, which was an application that allowed customers to buy or rent digital content, and included the App store, the iBookstore; and the iCloud, which was a cloud service to store music, photos, applications, documents, and so on, accessible through multiple devices. In addition, the company sold application software, which were various integrated productivity tools, as well as Apple TV, a set-top box for viewing live television and other content.

The company had a manufacturing facility in Ireland but a substantial part of its hardware was manufactured by outsourcing partners primarily located in Asia to keep costs low. A big contractor was Hon Hai (Foxconn), a Taiwanese firm with manufacturing operations in the People's Republic of China. A high rate of suicides at this contractor's plants, said to have been driven by working conditions, had brought attention to Apple, which then promised stricter oversight of the contractor's compliance.

Jobs' Personality Imprint

Apple, for many years, was closely identified with its iconic / cofounder, Steve Jobs, who passed away in October 2011. Jobs was an intense person whose passion to create new products brought an entrepreneurial energy to the firm. Rather than have a thousand ideas bloom, Jobs insisted that the company focus on just two or three priorities at any time. He also had the ability to identify the winners from all the ideas that bubbled up in the company.

Jobs' biographer, Isaacson, wrote: "At Apple, managers were often excitable and exhausted, Jobs tended to be volatile, and people felt nervous about where they stood with him." Some of his product developers would not show him an idea they were working on in its early stages for fear that he may not like it and snuff the idea. He had a binary way of classifying people or things as stupid or brilliant; partly a personality trait, and partly a desire for perfection. He encouraged people to challenge him and would also take contrary positions to generate more discussion.

Jobs was detail oriented and involved himself in everything that dealt with the customer experience. Rather than "give the customers what they want," Jobs felt his job was to figure out what customers wanted before they did. His personal philosophy and style impacted the company from its early days. Minimalism (often attributed to his interest in Zen Buddhism) exemplified his style, and extended from product design and functionality to store design.

Apple was not organized into semi-autonomous divisions, believing it inhibited collaboration and there was one profit and loss statement for the whole company. Teams would be created from within for a new project; for example, the team that worked on the iPhone involved about 1,000 people. To achieve the integration of the whole product, from design to hardware, software, content, all departments needed to collaborate simultaneously. Moreover, regular meetings were held involving marketing strategy, product review, and so on.

When hiring, a new candidate did not just interview with the department he/she was being hired into but with all the top leaders, who then got together to decide about whether the person would fit in. The company believed in excellence and it searched for the best person it could get to do something and actively recruited him/her, even if that person was an independent consultant or working for another company.

Selected valuable employees were taken on an annual retreat. Executive team meetings were held on Monday mornings for about three hours and always focused on the future. It was a way to enforce a sense of shared mission and centralized control. Apple University was an in-house training center and cases would be compiled, studying important decisions the company had made. Top executives were involved in teaching the cases to new employees so the Apple style of decision making would be embedded in the culture.

A company characteristic was the extreme secrecy that was used while teams developed products. For example, those working in the teams involved in the development of the iPhone and the iPad could not even talk to others in the company about their projects. The areas where they worked had special access codes that prevented other employees from entering.

Jobs felt it was better to cannibalize yourself otherwise someone else will. In 2005, the iPod accounted for 45% of company revenues and Jobs realized that if the cell phone makers included a music player (it already had a camera, etc.), it would undercut iPod sales. So Apple first worked with Motorola to include a music player with Motorola's phone, but Apple was not happy with the product and then started designing its own phone. In 2011, iPod was down to about 7% of sales.

Customer and Technology Driven

A guiding principle for the company was that its products provide the customer superior ease-of-use, which drove its pursuit of seamless integration between software and hardware, and innovative design. For example, with the iPad 2, even the cover was designed by the company because it believed that the commercial covers available were too bulky and hid the shape and features of the iPad. Products also built a kind of companywide synergy: The iTunes was necessary to back the popularity of iPod, which drove Mac sales.

The company invested a lot in its R&D; it developed proprietary software, and held patents and copyrights. It grew on sustained innovation, and connecting creativity with technology. The company carefully built its technical skill, mostly by hiring people with the required skills but also occasionally through acquisition such as when it acquired a small company that had developed tablets with multitouch sensing technology, thereby getting access to its patents and the services of its founders. When the Mac computer shifted from the Motorola-IBM Power PC chip to Intel for its core microprocessor, most observers were amazed at how smoothly the transition took place, considered an almost impossible event in this industry.

Apple had difficulties in collaborating with others since its style was to do everything itself. However, when necessary, it struck good deals with network carriers who also sold the Apple phone and supported it. The company took 18 months negotiating with music companies to make iTunes, a product that depended critically on the collaboration of others, into a powerful store for selling music belonging to several labels. The Apple TV, a set-top box, also required collaborating with content providers.

Such collaborations did not prevent Apple from aggressively competing. Google's CEO, Eric Schmidt, had been on Apple's board while the iPhone and iPad were being developed and Jobs felt betrayed when Google produced the rival Android OS, complaining that Apple had stayed out of search and Google should have stayed out of phone. Apple, which for years offered Google Maps on its phones then built its own map capabilities through acquisitions. When Google introduced the multitouch features on a htc phone, Apple sued for patent infringement. The company also won a case in the United States against Samsung, one of its major suppliers of memory chips and display screens, on charges of having violated Apple's patents in the look and feel of some of Samsung phones. Although Amazon was a major retailer of Apple products, Apple got into a pricing fight with Amazon over the cost of books it would offer on the iPad.

The ability to integrate hardware, software, and content into one unified system enabled end-to-end control of every product. Even apps for the phone and tablet were tested by the company and sold only through the iTunes store. An early choice that the company made was not to have an "open" architecture, unlike the Microsoft/ Intel platform, and refused to license its hardware or software to third parties. Bill Gates, cofounder of Microsoft, is quoted by Isaacson as saying, "The integrated approach works well when Steve is at the helm." Google was also following an "open" structure with regard to its Android OS, allowing others to use it since its revenues were coming from search. Phones with Android software were said to be about 51% of the market in 2011, compared to Apple's share of 23%. Although the open system resulted in a low market share (about 5% for Macs at the best of time), it allowed for large operating margins.

Moving Forward under Cook

Tim Cook was appointed CEO after Jobs. Unlike Jobs, Cook liked to avoid the limelight. A workaholic and a detail-oriented person, he was considered calm and decisive. He was first tasked (he joined in 1998 and became COO in 2005) with setting right manufacturing, distribution, and supplier relations. He shut many factories and moved to contract manufacturing, and trained vendors on Apple's demanding requirements. Jobs (according to Isaaccson) had observed that Cook was not a product person, per se, a view held by some observers who wondered if he had the ability to keep the stream of new and innovative products that was the hallmark of the company.

Apple had considered itself a mobile device company, and Jobs' vision was for the computer to be the hub for a variety of lifestyle devices including music players, video recorders, phones, tablets, cameras, and so on. Apple visualized a future where everyone's content including documents, pictures, and medical data would be held in remote servers as a digital hub, and serviced by Apple's iCloud.This would help Apple's desire to "lock in" the customer within its own family of devices. Although Microsoft, Google, and Amazon had announced cloud services earlier, Apple was banking on its strength of seamless integration across all devices.

Apple made several mistakes along the way but always bounced back with an improved product. The MacMini, an entry level desktop did not do well; the Apple Newton, a personal digital assistant PDA, similarly did not take off. Its computer, Lisa, targeted at the high-end market was a failure. When Apple's early cloud service called MobileMe did not work very well as the devices did not sync well and email got lost, Jobs had berated about the product in front of the whole team and replaced the team's leader since accountability in the company was strictly enforced.

Apple's expanding desire to use technology to bring lifestyle products had challenged firms in several businesses: personal computers, tablet computing, mobile phones, music distribution, and retailing. The company had other ideas for the future: make all textbooks available on iPad and disrupt the textbook industry; make better quality photos with the iPhone; develop an integrated and interactive TV set that would be easy to use, without separate remotes for DVD players, streaming, and cable. Cook had continued the classical Apple secrecy on forthcoming products or services.

Environmental changes would continue to challenge Apple's lead, making it hard to stay ahead. Microsoft's Windows 8 OS was going to make user interface easier and had an alliance with Nokia; Google's acquisition of Motorola Mobility brought it 17,000 patents and sharpened the competition in mobile devices. Amazon was launching a phone and upgrading its book reader as a tablet.

Cook initially announced to all employees that Apple was not going to change and that he cherished Apple's unique principles and values. However, some small changes had begun. He was said to be more open and accessible to employees. He had given the educational division of the company its own sales and marketing arm. About half of the accumulated cash of about $65 billion in May 2011 was used to pay dividends and buy back stock, and analysts wondered if the balance will be used to make acquisitions. And, in about 10 months under Cook, the company on August 20, 2012, became the most valuable company in the United States, based on market capitalization.

Name: ______________________________

Directions: Reflect on the case, and respond, under "Actions I," how, as an observer, you see Apple under Tim Cook's leadership. Then await further instruction.

Strategy: (Actions planned in response to or in anticipation of changes in the external environment—customers and competition.)

Actions I:

Actions II:

Superordinate Goals: (Guiding concepts, a set of values and aspirations, often unwritten, that may go beyond formally stated objectives. They are succinct, abstract, and mean a lot to insiders.)

Actions I:

Actions II:

Structure: (The division of tasks and its coordination within the company.)

Actions I:

Actions II:

Systems: (All the procedures, formal and informal, that make the organization work: budgeting systems, training systems, accounting systems, etc.)

Actions I:

Actions II:

Style: (A representation of the organization's culture, it reflects the values and beliefs as demonstrated in symbolic behavior.)
Actions I:
Actions II:

Staff: (People issues, both hard—pay scales, training programs, etc.—and soft—morale, attitude, motivation, etc.)
Actions I:
Actions II:

Skills: (Crucial attributes of the company, its strengths, and its competencies.)
Actions I:
Actions II:

Strategy Session 18

Corporate Sustainability

OBJECTIVE

Understand corporate sustainability and its connection to corporate social responsibility.

> How to balance the common good and the special purpose of the institution is the question we must answer.
>
> —*Peter F. Drucker*

From the 1970s and through the 1980s, questions arose about the obligation of organizations toward society. Company mission statements began to incorporate commitments to some level of social responsibility, and annual reports often included discussions of what was done during the year to demonstrate the company's attention to the ideal of social performance in addition to economic performance.

During that timeframe, the idea of corporate social responsibility became part of management study. Two viewpoints guided the level and type of involvement management undertook in terms of activities to benefit society.

The Classical Economic Approach. This approach argued for a low level of involvement in social activities, unless there was a direct benefit to the bottom line. It called for the role of management to focus on activities that improved the economic performance of the firm and that resulted in profits for the owners (stockholders). According to the economist Milton Friedman, a strong proponent of this view, a potential conflict of interest existed when society held managers responsible to owners for meeting profit goals, yet at the same time held them responsible to society to enhance the social welfare. Every dollar spent on social problems or donated to a charity was one fewer dollar distributed to the owners in the form of dividends and one fewer dollar for the kind of investment needed to build a firm's competitive position. In summary, management's sole responsibility should be to follow legal and ethical rules of society while maximizing profitability.

The Activist Approach. This approach argued for a high level of involvement in social activities because business is a part of society and therefore has an obligation to deal with social issues. This framework sees business as a corporate citizen with the technical, financial, and managerial resources to help solve society's difficult problems. Managers have an obligation to respond to the needs of all stakeholders while pursuing a profit. This framework calls for business to advance both societal and economic objectives.

Until the 1990s, corporate social responsibility remained a mixture of both approaches. Some firms, such as Ben & Jerry's, had strong preferences toward the activist approach. However, in most organizations the costs of pursuing a socially responsible activity versus the consequences of not doing so were taken into account, along with the personality and preferences of the top management team. As a result, the involvement in social responsibility activities varied widely among corporations.

Corporate Sustainability and the Environment

A major shift in corporate responsibility to sustainability began in the 1990s, with increased emphasis throughout the 2000s. The concept began to take hold as a result of the 1987 publication of the World Commission on Environment and Development report entitled *Our Common Future*. In this report, sustainability was defined as development that meets the needs of the present without compromising the ability of future generations to meet their own needs. The report noted that corporations have been the engines for economic development, and it was critical for management to be more proactive in balancing the drive for profit with social equity and environmental protection, partly because corporations have caused some of the unsustainable conditions and also because they have the access to resources needed to address the problems. In the report, both public and private organizations were charged with becoming better stewards of the environment and with promoting positive economic growth and social objectives. The old concept of corporate social responsibility, which blended both economic and social components, was replaced by corporate sustainability that included a third element—the environment.

By 2012, the concepts of "going green" and "green initiatives" were part of management's vocabulary and were familiar to virtually every employee and consumer.

Strategic Management and Sustainability

From a strategy perspective, corporate sustainability is in line with strategic management and the stakeholder approach in particular. First developed by R. Edward Freeman, the basic premise of stakeholder theory is that strong relationships with external groups make it easier to meet corporate objectives and to achieve a competitive advantage when those relationships are built on trust, respect, and cooperation. Many stakeholder groups can be identified, although the most frequently discussed are stockholders and investors, employees, customers, and suppliers. The goals of economic stability, environmental protection, and social justice are common across these groups, and stakeholder theory suggests it is in the company's best economic interest to develop strategies that meet stakeholder goals.

Today, most business writers and scholars agree that sustainability is more than "another thing to do." The principles of sustainability can stimulate technological innovation, advance competitiveness, and improve the quality of life. The extent to which a company incorporates sustainability has strategic management implications.

Ad-hoc Level. For many firms, a more informal or ad-hoc approach to incorporating sustainability is taken as a starting point. For example, this level might include one or two stand-alone sustainability initiatives that are not connected to strategic objectives of the company. The reason for these initiatives can be to improve the company's profit through increased efficiencies or as a means of demonstrating leadership and improving the company's image and reputation. Without a more formalized approach to ensure long-standing commitment, however, these initiatives can fade as attention is focused on other issues.

Part of the Strategic Management Process. A formalized approach includes statements by the company as to its understanding of corporate sustainability and the level to which it commits. Frequently sustainability objectives are outlined in formal reports, as in the case of Hewlett-Packard. In its Global Citizenship Report 2010—and prominently displayed on its corporate website—HP reports its annual scorecard on its values. These include sustainability, social innovation, employment practices and ethics and compliance. The Global Citizenship Report identifies specific goals and shows performance toward these goals. This latter piece (showing performance toward goals) is a key component of strategy implementation. Performance metrics demonstrate what a company has done versus its intentions.

Another example is PepsiCo's Sustainability Report, which includes goals and progress reporting in the areas of (a) performance—superior, sustainable financial performance, (b) human sustainability—addressing global and complex nutrition needs, (c) environmental sustainability—being a good steward of the planet's natural resources, and (d) talent sustainability—creating employment opportunities and developing associates while fostering a diverse and inclusive workplace.

UN Global Compact. Companies such as HP produce sustainability reports because they are members of the UN Global Compact. The United Nations has taken the lead in this area by identifying ten universally accepted principles dealing with areas such as human rights, labor standards, the environment, and anti-corruption. Once a company decides to adopt the compact, it requires endorsement by its board of directors, and the principles are expected to become a part of the strategy and operations of the company. The company is also required to publish an annual report on progress made. Information about the UN Global Compact can be found at http://www.unglobalcompact.org/.

Exercise: Video

Stonyfield Farm: Corporate Sustainability

INSTRUCTIONS

View the video about Stonyfield Farm, which provides an example of a company's sustainability efforts, and respond to the following questions.

1. Write a mission statement for Stonyfield Farm that reflects the company's core purpose and its understanding of its corporate sustainability.

____

____

____

____

____

2. At what level of corporate sustainability is Stonyfield Farm? Briefly describe.

____

____

____

____

____

3. Describe whether Stonyfield Farm is meeting the economic, social, and environmental goals typically associated with corporate sustainability.

Strategy Session 19

Monitoring Strategy Implementation Through the Balanced Scorecard

OBJECTIVE
This session illustrates how a balanced scorecard links the organization's mission and strategy to performance measures.

> If you can measure that of which you speak and express it in numbers, you know something about your subject; but if you cannot measure it, your knowledge is of a very meager and unsatisfactory kind.
>
> —*Lord Kelvin*

It is not unusual for planning teams to spend months crafting a mission statement, analyzing environments, and developing strategic initiatives only to find that few strategic changes occur as expected. Although external factors, such as economic downturns or competitive actions may affect the execution of intended strategies, the majority of strategic plans break down because of ineffective implementation. Typically, this is due to no measurable definitions for success from an operational standpoint.

The balanced scorecard, developed by Kaplan and Norton, is a performance measurement and strategic management system that looks at more than just financial measures to evaluate an organization's progress toward achieving its mission. As one executive noted, "When I receive financial reports, I am either happy or upset, but rarely am I smarter." By incorporating other operational perspectives in the scoring system, the balanced scorecard reflects continuous improvement in management thought and learning about how to better strategically manage organizations.

The balanced scorecard suggests that implementation of the organization's mission and strategies be viewed from four perspectives and that metrics be developed in each of the following areas.

Customers. Customer measures focus on how an organization is viewed by its customers. While most companies recognize the importance of customer perception, the balanced scorecard forces managers to turn general goals, such as increasing customer satisfaction, into specific, measurable characteristics. A manufacturing organization's scorecard might include customer measures such as delivery time, defect rates, number of returns, warranty claims, or customer satisfaction ratings. These measures help managers to evaluate their performance through the customers' eyes, while also benchmarking their performance against industry leaders and standards.

Business Processes. Business processes deal with existing operations to determine where the organization must excel to become successful. It helps find the processes that are critical for satisfying customer needs. Typically, business processes include:

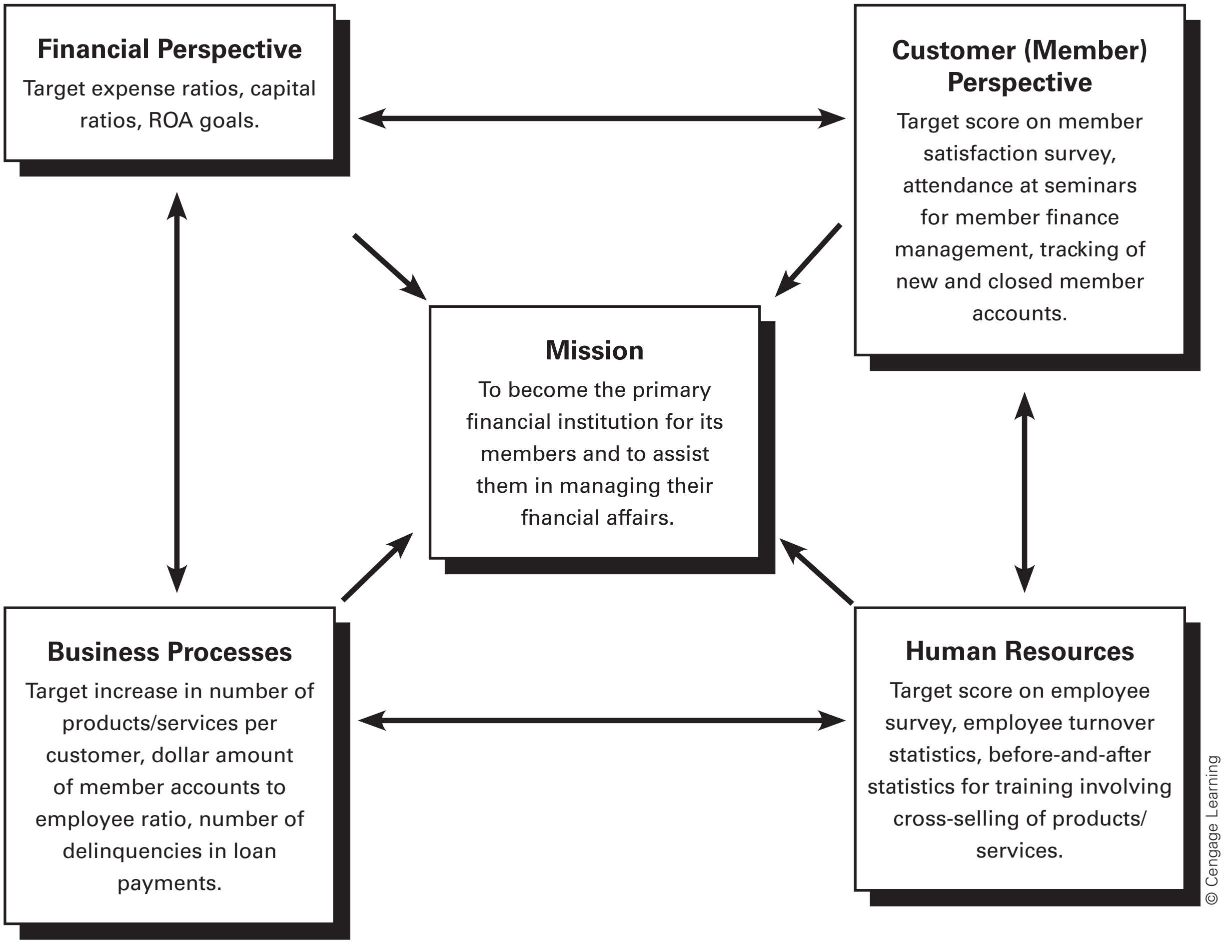
- Building the company by spurring innovation to develop new products and services and to penetrate new markets and customer segments.
- Achieving operational excellence by improving supply chain management and other internal processes to improve costs and quality of the operation.
- Increasing customer value by expanding relationships with existing customers

Human Resources. These measures evaluate the return on intellectual assets, education and training, innovation, morale, and other human-resource-related factors to evaluate how well the organization is implementing its strategies. Typical metrics might include measures of employee satisfaction, employee turnover, absenteeism, and the percentage of employee suggestions implemented.

Financial Perspective. The financial perspective traditionally has been the focus of performance measurement systems. For organizations adopting the balanced scorecard approach, financial performance measures are used in tandem with the customer, business processes, and human resource measures. Typical indicators include cash flow, return on equity, sales, and income growth.

The balanced scorecard in diagram form in Figure 19.1 shows the mission at the heart of the scoring system. Surrounding the mission are specific measurements grouped according to the perspectives described earlier. All of the boxes are connected by arrows to illustrate the integration of these areas. Achieving one perspective's targets should lead to desired improvements in the next perspective, and so on. The example of a financial institution such as a credit union, which serves the financial needs of its members, illustrates the scorecard approach.

FIGURE 19.1 BALANCED SCORECARD



Exercise

Everyone Knows the Score When a Major League Baseball Team Ties Performance to Its Mission

INSTRUCTIONS

Review the mission statement developed by the Colorado Rockies Major League Baseball team and identify specific performance measures as they relate to the mission.

Colorado Rockies Mission Statement

The Colorado Rockies is a sports business with a team value of $464 million as of March 2012. The team generated revenues of $193 million and income of $14.4 million. Its mission statement is

To provide the highest level of baseball entertainment in an excellent stadium environment at prices affordable for families, and to support the development of youth baseball throughout the Rocky Mountain region.

The statement clearly identifies the fans' needs. First and foremost, it is baseball entertainment. By being very clear about the team's mission, the statement provides a foundation for strategies and new activities. If management is looking for ways to increase attendance, its focus is on enhancing the baseball entertainment experience of fans. For example, new activities could be added to the program, such as fireworks after home runs or the creation of "grandstand manager nights" when fans in the stands—not the Rockies' manager—decide whether the players on the field would bunt (purposely tap the ball only a few yards using the barrel of the bat), steal a base by running to the next base when the pitcher is delivering a pitch, or what pitches would be thrown (fastball, slider, change-up, and the like.). However, activities are not performance measures, and specific targets are needed to ensure that the energies, abilities, and specific knowledge of people throughout the sports organization are linked to its mission.

Complete the table in Figure 19.2. Identify at least three specific measures in each of the areas shown. The mission components have been separated and labeled (a), (b), (c), or (d):

a. Highest level of baseball entertainment
b. Excellent stadium environment
c. Prices affordable to families
d. Support of youth baseball

For each measure, identify which element(s) of the mission relate to the measure. An example is given in each section.

FIGURE 19.2 MISSION MEASURES AND ELEMENTS

Measures	Mission Elements
Financial perspective	1. Revenue target (a, c) 2. 3. 4.
Customers	1. Number of fans' visits per season (a) 2. 3. 4.
Business processes	1. Stadium sound levels (b) 2. 3. 4.
Human resources	1. Employee turnover rates (a, b) 2. 3. 4.

1. Briefly explain how measurement in the customers area may affect business processes or human resources.

2. How easy or difficult is it to identify measures for the four quadrants?

3. How important is technology and information systems for the success of the balanced scorecard system?

PART IV

Industry Analysis

Lodging

Industry Profile

The lodging industry is mature and very competitive, and occupancy levels are an important barometer of not only a hotel's success but also of the industry's performance. Occupancy levels in the U.S. lodging industry dropped to the 50% range from 2008 through 2010 as a result of the uncertain economic environment. In 2011, rates improved to 60.1% as a result of an ongoing recovery of business travel in addition to the booking of more corporate events and other group business. With cautious optimism, analysts expect lodging demand to increase. With the growth of properties at a low of 0.5%, occupancy levels are forecasted to reach 60.9% by year-end 2012. Increased confidence from improved occupancy levels is expected to allow hotel management to increase room rates, which will result in average daily rate (ADR) gains of over 5% in 2012. Globally, the compound annual growth rate for the industry was 3.6% between 2006 and 2010. North and South America account for 39.1% of industry properties, and Europe makes up 31% of the global industry. In the United States and globally, the leisure segment represents approximately three quarters of the industry's total revenue; the remaining one quarter is from business customers.

Industry Overview

The lodging industry provides accommodations for travelers while they are away from home. The business travelers needs include basic room essentials, meal services, and Internet access. In addition, meeting rooms, duplicating services, and recreational and entertainment options are frequently desired. Increasingly, lobbies are viewed as social environments where people sit and work on their laptops, so Wi-Fi is an important amenity.

Nonbusiness travelers look for the basic accommodations of bed, bath, telephone, and sometimes meal services. If the location is a destination resort, travelers expect extensive leisure and recreational facilities. Increases in fuel prices, however, can negatively impact consumer travel behavior. Drivers must pay higher gas prices and airlines must add fuel surcharges, and car rental agencies must increase rates to cover the added fuel costs. Price fluctuations and the state of the economy quickly affect the amount of personal travel, whereas business travel follows turns in the economy by three to six months.

As Table A.1 shows, the 2011 U. S. lodging industry average room rate, occupancy rate, and revenue per available room showed improvement over 2010 and 2009. Modest increases in room rates for business travel are expected for 2012, particularly with corporate profits improving in 2011.

Industry Competitors

Although the lodging industry consists of establishments that range from luxurious five-star hotels to youth hostels and Recreational Vehicle (RV) parks, hotels and motels are the major components. In general, these properties are classified as full service or limited service. Full-service establishments offer a variety of services, and most include at least

TABLE A.1 AVERAGE ROOM RATES AND REVENUE PER AVAILABLE ROOM

Year	Average room rate ($)	Occupancy rate (%)	Revenue per available room ($)
2011	101.64	60.1	61.06
2010	98.06	57.5	56.43
2009	98.17	54.5	53.50
2008	106.96	60.3	64.49
2007	103.64	63.2	65.50
2006	97.89	63.3	61.96
2005	90.91	63.1	57.37
2004	86.23	61.3	52.88
2003	83.12	59.2	49.18
2002	83.01	58.9	48.91

Source: Extracted from S&P Net Advantage: Industry Surveys, May 2012.

one or more restaurant and beverage service options. These options may range from coffee bars to full restaurants. They also provide room service. A number of full-service hotels have features such as laundry and valet services, fitness centers, and swimming pools. Some luxury hotel chains also manage condominium units in combination with the nightly rate rooms, giving both hotel guests and condominium owners access to their services and amenities.

Limited-service hotels do not have on-site restaurants or most other amenities offered by the full-service establishments. They usually offer continental breakfasts, vending machines, Internet access, and unattended pools or game rooms.

In 2011, of the hotels in the United States, 31% were independent hotels not affiliated with a chain. The chains are multiproperty hotel operators, such as Wyndham Worldwide, Marriott, Hilton, and Starwood. Most of these operate several different brands. Additionally, these large operators have diversified through ownership of casinos, restaurants, and shops. Table A.2 provides an overview of the large hotel establishments.

Market Segments

Market segmentation is dividing a larger market into segments based upon different consumer needs or product preferences, and hotel companies have used segmentation as a way to increase revenues. In the lodging industry, segmentation involves developing

TABLE A.2 OVERVIEW OF LARGE HOTEL COMPANIES

Company	Business Segments	Brands	Properties	Rooms
Wyndham Worldwide	Vacation ownership, vacation exchange and rentals, lodging	Wyndham Hotels and Resorts, Ramada, Days Inn, Super 8	7,150	605,700
Marriott International	North American full-service lodging, North American limited-service lodging, international lodging, luxury lodging, timeshare segment	Marriott Hotels and Resorts, Ritz-Carlton, Renaissance Hotels, Courtyard Residence Inn, Fairfield Inn, SpringHill Suites, Residence Inn	3,545	618,104
Hilton Hotels	Vacation ownership, club membership programs, leisure travel and reservation services	Hilton (U.S.), Waldorf Astoria, Conrad, Hilton Garden, Hampton Inns, Doubletree, Embassy Suites, Homewood Suites	3,400	523,000
Starwood	Luxury and upscale, vacation ownership resorts, branded condominiums and residences	St. Regis, The Luxury Collection, W Hotels, Westin, Le Meridien, Sheraton, Four Points, Aloft	1,027	302,000

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different properties to appeal to different types of guests. To attract business, hotels offer packages that include free breakfast and free night stays once a customer reaches a certain number of visits. Recently, hotels are also targeting the conscientious traveler who is looking for eco-friendly practices and a commitment to social responsibility.

Within the chain hotels, there are five broad segment types: luxury, upper, midprice, upscale, midscale, economy, and budget. Table A.3 shows the improvement. Forecasts suggest that demand will increase in all segments except the midscale group. Upper is expected to increase the most from 2011 to 2012 by 4.9%. Table A.3 shows the comparison of occupancy levels by segment and location. As can be seen, for all segments and locations, occupancy percentages and room rates increased from 2010 to 2011.

Marketing and Technology

E-commerce and the use of the Internet to contact properties directly are technological developments that will continue to help smooth sales and the delivery of lodging services.

TABLE A.3 LODGING SEGMENT DATA

	Occupancy (%)		Room rate ($)	
SEGMENT	**2010**	**2011**	**2010**	**2011**
Industry, total	57.5	60.1	98.06	101.64
By price				
Luxury	65.3	68.1	146.02	151.37
Upscale	58.9	61.4	106.31	109.52
Midprice	53.8	56.3	78.40	81.00
Economy	51.4	53.7	58.43	59.99
Budget	53.9	56.1	47.16	48.63
By location				
Urban	65.6	67.7	139.90	146.83
Suburban	57.2	60.2	83.58	86.14
Airport	63.6	66.2	88.40	90.99
Highway	51.4	53.5	69.97	71.79
Resort	59.4	62.2	128.70	135.08
Small metro/town	51.7	53.8	81.59	83.36

Internet addresses and home pages for hotel chains and for individual properties provide direct access to information about facilities that customers can use to perform their own research in making lodging choices when they or their employees travel. In addition, the use of the Internet for booking reservations will continue to grow.

Technology is also enhancing the marketing efforts of hotel firms. Business analytics provide information about how many times a guest stayed at the hotel and what services were used to differentiate the levels and types of services provided. Hotel companies are also creating marketing affiliations to boost sales. For example, cross-marketing arrangements with airlines provide consumers with frequent flyer miles for staying at certain hotels.

Employment

The lodging industry is labor intensive. Work in hotels ranges from demanding and hectic at peak times to slow and tiresome during off-season and overnight periods. The type of jobs include management positions, accountants, chefs, waiters and waitresses, janitors, maids and housekeeping cleaners, landscaping and groundskeeping workers, baggage porters and bellhops, among others. Costs are significant, since quality of service plays a key role in a hotel's success. According to U.S. Bureau of Labor Statistics, employment in 2011 in the lodging industry is below 2009 levels and much lower than levels prior to the recession.

Industry Outlook

It is expected that as the economy slowly recovers, the industry will see increased business travel and moderate travel spending from the leisure segment. Managers pay close attention to occupancy levels, which can provide opportunities for yield management through pricing. As in the airline industry, stronger pricing during peak periods and the replacement of lower mid-week leisure travel with higher-rated business bookings will boost the ADR measure, which will affect positively the revenue per available room. So while the number of new properties is expected to remain fairly stable, the focus for management when looking for revenue growth will be in the area of improved pricing tactics.

Template

For Industry Survey

An industry survey provides important information to understand the environment within which firms compete and follow the strategies they do. It also provides management with needed data in formulating competitive strategies. This template will help you gather the information in a systematic manner to create an industry profile. Once all of the information is gathered, the template provides the framework for further analysis of industry trends and competitive strategies.

Industry Overview

1. **Identification/definition of the industry**
   Brief description of the products or services produced by competitors in the industry, major players, the North American Industry Classification System (NAICS) code.
2. **Origin of industry**
   Historical description including events that affected the firms' profitability, major inventions/innovations that affected the industry.
3. **Location of industry**
   Initial location of the industry, whether geographical clusters exist, importance of being close to markets or inputs.
4. **Globalization trends**
   World Trade Organization requirements and national considerations, intergovernmental agreements, preferential trading arrangements.
5. **Regulatory factors**
   Agencies (national/international) involved in regulating the industry, rules and procedures, compliance requirements.

Players in the Industry

1. **Size of firms in the industry**
   Sales, capacity, and asset base of firms; existence of a minimum efficient size of plant; trends in concentration.
2. **Organizational structures**
   Nature of organizational forms in the industry, private versus public ownership.
3. **Industry restructuring**
   Trends in restructuring of firms in the industry, tendency to diversify, backward/forward integrate, and reasons for the same.
4. **Interfirm arrangements**
   Extent of cooperation within the industry, alliances, joint R&D projects, activities of the trade association, lobbying efforts and relations with the government.

5. **Substitute industry (or industries)**
   Are there substitute products or services from another industry that appear to be different but can satisfy the same need (e.g., bottled water as a substitute for cola, fax as a substitute for shipping via UPS, and wine as a substitute for beer)?
6. **Complementors**
   Are there industries whose products or services work with the industry in focus, and add to the value of the industry?

Other Industry Characteristics

1. **Value creation methods and costs**
   Description of production/value creation process, inventory standards, global supply chain considerations/outsourcing, factors influencing growth of the industry.
2. **Inputs/suppliers**
   Availability of suppliers, supplier concentration trends, nature of competition in the input or supplier industries, price trends, level of technology, and important trends.
3. **Markets**
   Volume of sales in units and value in the industry, distribution channels, selling methods, consumer profile, nature of use of the products of the industry, trends in consumption. What are the products and services that meet the basic need?
4. **Human resources**
   Extent of unionization in the industry, union–management relations, availability of different classes of personnel, training practices, need for special skills/certification.
5. **R&D and innovation**
   Nature of R&D in the industry, R&D's importance, distribution of patents, rate of innovation, and productivity.
6. **Finance**
   Sources of financing in the industry, difficulty in attracting capital.

Future Industry Trends

Limits on future growth of the industry, domestic and international competition, regulation.

Sources of Information

An increasing amount of information is available online. These include: industry/environment information (World Bank, IMF, WTO, Europa World, Source OECD, STAT-USA, S&P NetAdvantage, ABI Inform, etc.) and company data (D&B Key Business Ratios, Hoover's Online, Value Line, Mergent Online, EDGAR Search, Gale Virtual Reference Library, etc.).

Other sources include:

Forbes (mid-January issue)

Industry Norms and Key Business Ratios (by NAICS codes)

Manufacturing USA: Industry Analyses, Statistics, and Leading Companies

Moody's Investors Fact Sheets: Industry Review

Predicasts F&S Indexes

Specific industry trade publications (e.g., *Beverage Industry, Computerworld, American Banker*)

Standard Industrial Classification Manual, Washington, DC.

Ward's Business Directory of U.S. Private and Public Companies

Global Market Information Database (GMID)

Assessing Strategic Performance Through Financial Analysis

VIDEO OPTION
View the video in which Craig Miller, CFO of Pizzeria Uno, outlines how the company's financial oversight guides the company's actions.

Managers must be comfortable with financial ratio analysis and what this information reveals, since ratios indicate the company's strength within its industry and the success of its strategic initiatives. In addition, investors look at company ratios in making decisions about whether to buy or sell stock and creditors use ratios to decide whether or not to lend money to a firm.

Although financial ratios are used frequently as a measure of performance, some weaknesses with this method exist. The information provided is based on past data. While trends can be spotted, the information cannot be automatically applied to the future. In addition, the accuracy of the data assumes sound accounting procedures.

The four groups of financial/accounting ratios are profitability, leverage, liquidity, and activity.

Profitability

Profit ratios show how well the firm is being managed. Three ratios are particularly applicable to top management, and the larger the percentage, the better. The gross profit margin is useful in understanding the direct costs of the firm and how much is left to cover other expenses per dollar of sales.

Return on sales = Net profit/Total sales

Return on assets = Net profit/Total assets

Return on stockholders' equity = Net profit/Total stockholders' equity

Gross profit margin = Net sales − Cost of goods sold/Net sales

Leverage

Leverage ratios identify the source of a firm's capital. The sources are from owners (stockholders) or from external sources (outside creditors). As a general rule of thumb, lower debt ratios are preferred; however, the use of debt or the issuance of stock is typical in growth phases.

Debt ratio = Total debt/Total assets

Debt to equity ratio = Long-term debt/Total stockholders' equity

Activity

Activity ratios show how effectively a firm is using its resources. From a strategy perspective, asset turnover provides information as to how effectively a firm is generating sales from its asset base, and greater sales in relation to a firm's asset base is preferred (i.e., larger ratio).

Asset turnover = Total sales/Total assets

Liquidity

Liquidity ratios indicate whether a firm can meet its short-term obligations. Since slow-moving or obsolescent inventories can overstate the firm's ability to meet short-term obligations, the quick ratio removes these from the equation.

Current ratio = Current assets/Current liabilities

Quick ratio = Current assets − Inventories/Current liabilities

Assessing Strategic Performance Through Financial Analysis

Ratio Calculations Form

	Year T1	Year T2	Year T3
Net profit margin (return on sales) *Analysis:*	______	______	______
Return on assets *Analysis:*	______	______	______
Return on stockholders' equity *Analysis:*	______	______	______
Gross profit margin *Analysis:*	______	______	______
Asset turnover *Analysis:*	______	______	______
Debt to assets *Analysis:*	______	______	______
Debt to equity *Analysis:*	______	______	______
Current ratio *Analysis:*	______	______	______

Analysis: Briefly state what each ratio means using the numbers calculated. Complete the sentence, "For every $1.00 of (   ), there is $ _____ of (   )."

Case Study 1
Parthasarathy Airline

THE Competitive Environment of the US Domestic Airline Industry in 2010

In 2009, U.S. airlines carried 618 million passengers in domestic flights, 5 percent less than the previous year but 9 percent less when compared with the all-time high of 679 million carried in 2007. The 2007–2009 recession, described as the longest in history, had taken a heavy toll on the airline industry. While the industry had grown enormously in size ever since it was deregulated in 1978, fluctuating revenues and uncontrollable costs due to extreme environmental uncertainties had kept airline-finances in constant disarray. As of 2009, the industry had a cumulative loss of nearly $60 billion, far outpacing its combined positive earnings of prior years. Between 2002 and 2005 alone, almost every major carrier was under bankruptcy protection and some had sought it twice. Many had terminated their pension plans, costing the federal government insurer of pensions, the Pension Benefit Guaranty Corporation, $10 billion and beneficiaries more than $5 billion. While analysts predicted a turnaround by 2010 due to an improving economy and the industry's own restructuring efforts, many doubted a stellar recovery since the industry fundamentals were still described as weak. Mounting debt, rising input costs, fluctuating demand, and fierce fare wars due to excess seat capacity had left the industry in a financial quandary, the worst in its history. Fully thirty-two years after the industry had been deregulated, the major airlines were still searching for a competitive position that would defend them against threats and deliver sustained profitability.

Industry History – From Regulation to Deregulation

Regulation

The U.S. airline industry began in the 1920s primarily for carrying mail, but by the 1930s passengers were its prime customers. At first, safety concerns made people reluctant to fly, but demand picked up as aviation and navigational technologies improved. Rapid rise in demand for air travel and resulting need to ensure the orderly growth of the industry led Congress in 1938 to establish a supervisory body, the Civil Aeronautics Board (CAB). The CAB regulated industry competition by awarding routes, setting fares, and deciding on new entry and mergers. The rationale behind regulations was the assumption that air travel is a public utility whose service had to be guaranteed and made available to all – by regulating fares and routes, and competition within routes to protect airlines from going out of business through destructive competition. Consequently, routes were awarded based on the need to connect far-flung areas with mainstream America and fares were set with a concern for public's affordability and airlines' profitability. To ensure that the airlines serviced remote and uneconomical routes and still remained profitable, the CAB set fares on busy routes using a "cost plus markup" formula that allowed airlines to offset losses from weaker routes. In addition, the CAB prevented entry and limited competition within busy routes to ensure that the airlines realized a steady stream of positive cash to stay in business. In sum, government control of fares, routes, and competition characterized the U.S. airline industry for almost the first six decades of its history. Public policy, not market forces, guided the industry's operations and future direction.

Deregulation

While government's aim in regulating the industry was to systematically develop it, what resulted over time was an inefficient system. The airlines had emerged as near monopolies, resisting service improvements and passing increased costs on to customers. New entry that could have benefited the public through healthy competition never occurred. By early 1970s, public dissatisfaction with the airline industry was running high. A non-market-oriented route system and ever-rising fares drew public clamor for reforms. At the same time, political trends were emerging that favored less governmental oversight of business and greater reliance on market forces to do the job. The culmination of these events was the passing of the Airline Deregulation Act in 1978, which abolished the CAB and, along with it, all restrictions over routes, fares, and new entry. The airline industry was now open for unfettered competition – airlines could freely enter or exit routes, set fares, make acquisitions, or enter into inter-firm agreements, all guided solely by the airlines' perceived market opportunities and self interest, not public interest. An era of free market competition had begun for the airlines.

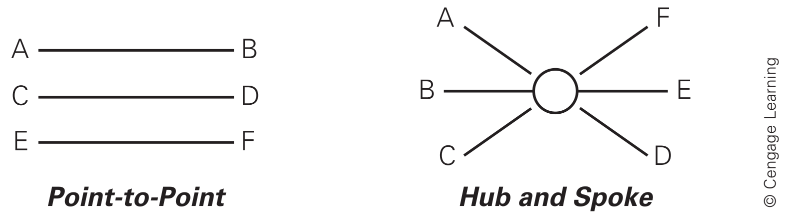
Deregulation eliminated controls over routes, fares, and market entry only, but not safety and operating standards. Safety issues such as aircraft certification, maintenance, operating procedures, pilot qualifications and training, and air traffic control stayed under strict federal government supervision. In addition, airlines were required to obtain boarding-gates from local governments that controlled airports and landing permits (or "slots") – the right to land a plane at a particular time of day - from local governments/ Federal Aviation Administration.

Industry After Deregulation

Emergence of Alternative Route Systems

The airline industry changed dramatically after deregulation. Initial changes resulted from the strategies incumbent airlines employed in response to the new situation. Strategies focused on size and efficient routing to gain competitive advantage. Many acquired small regional carriers and developed "hubs" in major metropolitan cities that would allow them to compete nationally from a position of regional dominance. The ***hub-and-spoke*** or the network system, as it was known, differed from the ***point-to-point*** or direct flight system of the regulation era (Figure 1). In the new system, passengers were flown in

FIGURE 1 POINT-TO-POINT VERSUS HUB-AND-SPOKE SYSTEM



small planes from several lightly traveled cities (*spokes*) into a *hub* airport and redirected on larger planes to their final destination. Several strategic advantages emerged from it: 1) it prevented entry into the hub region as gates and landing slots were already held under lease by the hub carrier; 2) it permitted the hub carrier to offer a seamless service and thus provide connectivity to passengers flying to far-off locations; and, 3) it allowed a high capacity utilization, referred to as the *load factor,* on both the hub and the spoke flights. Load factor is measured using the ratio: "*number of seats occupied by paying passengers divided by total seats flown by an aircraft*". A high load factor, while increasing revenue, reduced the cost per seat mile flown, and thus was critical for airline profitability.

Capacity utilization and connectivity were the hallmarks of the hub system but it had disadvantages as well. Hubs required large investments in real estate, increasing the fixed costs of airlines. It also raised operational costs due to complexities in scheduling, use of different types of aircrafts, and the idling of planes in hubs awaiting feeder flights. Importantly, it increased travel time for passengers. These disadvantages led new entrants to arrive by adopting the point-to-point system and thus differentiate themselves from incumbents. This alternative system yielded certain strategic advantages: a) it eliminated the need for costly hubs, b) it reduced the flight turnaround time by increasing flight frequency between points, and c) it allowed the use of a single standard aircraft that minimized costs on pilot training and aircraft maintenance. These advantages allowed point-to-point carriers to offer deeply discounted fares and speedy travel. And, by offering an array of popular city-pair combinations and flying into secondary airports (less congested) that speeded-up travel time, point-to-point carriers emerged as an attractive alternative to the hub carriers.

Mergers and Acquisitions

Deregulation eliminated entry barriers and soon several new carriers began arriving in waves. By 1983, some 25 had entered; several more entered in the following years. Though many did not survive for long, the threats they posed to incumbents' market share led the latter to seek market power through capacity expansion. New entries and retaliatory expansion by incumbents, in turn, created chronic industry overcapacity, a situation that would plague the industry for most of the deregulation era. Overcapacity led to incessant price wars in which those that could not withstand cost competition exited the industry or died. Surviving airlines sought to soften competition through mergers and alliances. The industry went through several periods of consolidation in which major airlines merged and re-merged. Some strengthened their position by acquiring weaker airlines, restructuring, or seeking bankruptcy protection to gain a temporary breather. While entry subsided after 2005, consolidation and restructuring efforts continued.

Firm Strategy and Strategic Groups

In the regulation era, price competition was non-existent since the CAB determined fares. Airlines competed on the basis of customer service and in-flight amenities such as food, entertainment, and comfort. Deregulation introduced price as a factor in competition and the new comers to the industry quickly positioned themselves as low fare carriers. The incumbents continued to pursue connectivity and in-flight service, and thus set themselves apart from fare-based competitors. As a result, two distinct strategic groups emerged after deregulation: 1) low cost carriers offering point-to-point service and competing on fares, and 2) differentiators offering a network service and competing on connectivity, comfort, and customer service. However, several events occurring in the industry, over time, were rapidly blurring the distinction between these two, thus pitting them as direct competitors.

Industry in 2010

Industry Structure

Figure 2 shows industry participants at the beginning of 2010. Three broad categories of firms provided airline services: 1) legacy (leftover from regulation era) airlines, offering *high connectivity* through a hub-and-spoke system, referred to as the network carriers, 2) new entrants, offering *low fares* via a point-to-point system, known as the low cost carriers; and 3) regional airlines that catered to the *unique needs* of people in their region, e.g., connection to a hub airport, or business commuting. The regionals were mostly contracted or owned by the networks to provide connection to remote cities and hence acted as a vertical extension to the networks' service. In effect, at a national level, there were just two groups of firms competing as airline service providers: networks and low costs.

In early 2010, there were six *networks* (American, Alaska, Continental, Delta, United, and US Airways) and seven *low-cost* carriers (Air Tran, Allegiant, Frontier, Jet Blue, Southwest, Spirit, and Virgin America) competing for customers across national routes. Figure 3 shows the market share of these airlines (not shown are regional carriers, four low cost airlines - Allegiant, Frontier, Spirit, and Virgin America - each with a 1.0% or less market share).

Analysts believed the industry structure in 2010 to be somewhat stable, resulting from the shake-outs and mergers of earlier years. More mergers had occurred just prior to 2010, between

US Air and America West and Delta and Northwest, all hub carriers, and had further stabilized the industry. Nonetheless, many viewed the industry as still fragmented; to some, the industry could support only 3 carriers. Many also described the industry as suffering from excess capacity, due to the left-over effects of new entries and retaliatory expansion by incumbents. Hence, further consolidation was viewed as vital and a strong possibility Sure enough, early in 2010, United and Continental, both network carriers, announced plans to merge.

FIGURE 2 AIRLINE INDUSTRY PARTICIPANTS

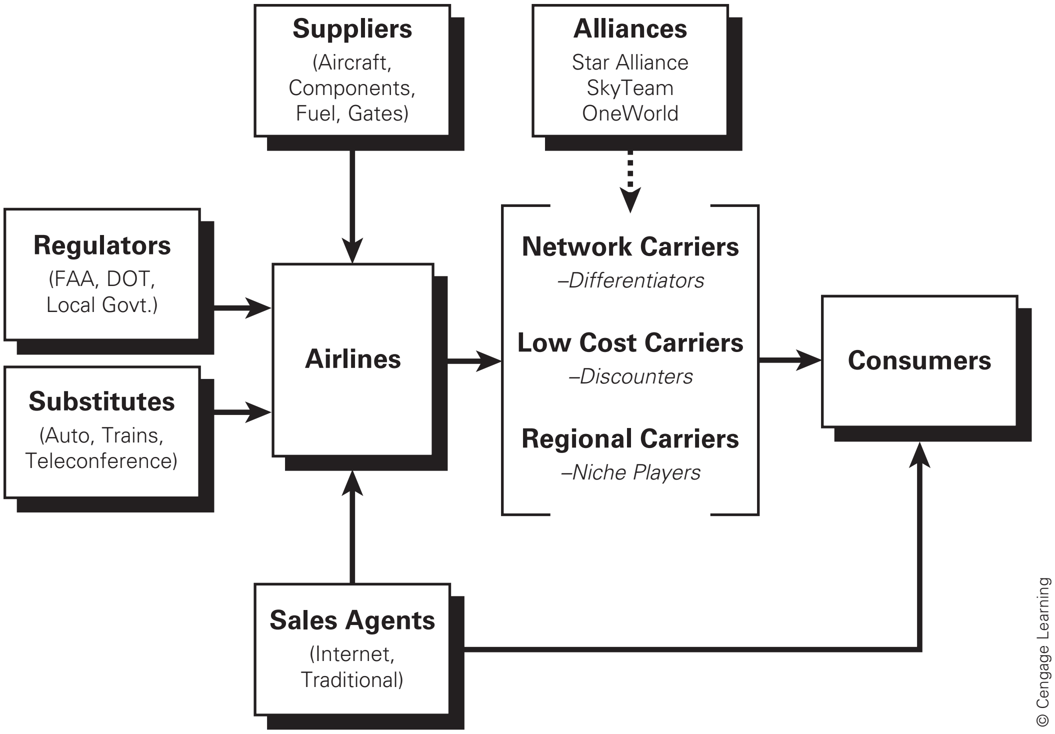
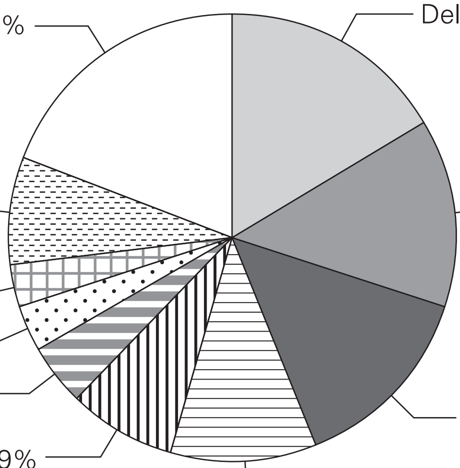


FIGURE 3 MARKET SHARE OF U.S. NATIONAL CARRIERS EARLY IN 2010



Source: Bureau of Transportation Statistics, Department of Transportation, U.S. Government

Passenger Traffic and Demand

Passenger traffic in the U.S., measured by passenger enplanements (number of revenue passengers boarding aircrafts), had grown exponentially since the Second War. In 1950, airlines enplaned 16 million passengers in domestic travel; by 2009 that number had swelled to 618 million. A phenomenal growth in the U.S. population (from 152 million in 1950 to 307 million in 2009) was a major factor contributing to this steep increase. However, two other factors had a more compelling influence: deregulation and the economy. Deregulation ushered in an era of price-based competition and rock-bottom fares, making air travel affordable to many who would otherwise travel by bus or train only. The economy on its part produced a similar and a more striking impact. An unprecedented economic growth (the U.S. GDP, in current dollars, grew from $500 b in 1950 to $14.7 trillion in 2010), absence of meaningful inflation, and resulting rise in disposable income made air travel virtually accessible to the masses, increasing both the potential market and actual demand for air travel significantly.

In 2010, airlines were the predominant mode of long distance travel in the U.S. Cars, buses, and trains acted as close substitutes but for short travel only. Analysts perceived no immediate threat to airlines' hegemony on the long distance segment, emerging either from high-speed trains or other forms of transportation. As regards demand for air travel, forecasts varied. The U.S. Federal Aviation Administration predicted demand to grow steadily and reach the 1 billion passenger mark by 2023 but analysts were not as sanguine. To them, domestic traffic had peaked and was likely to grow at a nominal rate of just 2 to 3 percent a year. More importantly, analysts cautioned that any growth forecast must take into account the susceptibility of the industry to economic downturns and environmental shocks. Historical data indicated that recessions and calamitous events dramatically impacted airline traffic and return to normalcy generally took a long-time. By all accounts, the U.S. economy of 2010 was anemic due to the 2007-2009 recession and full recovery was not expected any time soon

Industry Performance

Seat capacity and miles flown carrying paying passengers are crucial measures of airline performance. A seat mile is one seat flown one mile and a revenue passenger mile is onepaying passenger flown one mile. Airline seats times miles flown by airlines, referred to as a*vailable seat miles* (ASM's), indicates industry capacity during a period. Number of paying passengers times miles flown by them, referred to as *revenue passenger miles* (RPM's), indicates traffic volume or industry output during a period. The percentage of RPM to ASM, known as the *load factor,* indicates capacity utilization by the industry.

Seats available for travel and revenue passenger traffic had both grown steeply ever since 1950, especially after deregulation (Table 1). More seats, flown more often with revenue paying passengers, affect total income positively. Consequently, revenue through passenger seat-sales grew along with seat addition and utilization - revenue grew impressively, from $2 billion in 1960 to over $100 billion in 2009. However, despite this huge top-line growth, the profit record of the industry had stayed dismal. As of the end of 2009, the industry had lost more money than it ever earned in its lifetime - accumulated losses stood at over $60 billion, twice as much as the industry had earned ever since inception. In 2008 and 2009 alone, the industry suffered a combined loss of about $26 billion. Remarkably, the 2009 balance sheet of the industry showed retained losses rather than retained earnings! And, between 1980 and 2009, much of the industry had not earned the cost of capital even during its best performing years!

TABLE 1 PASSENGER TRAFFIC, AVAILABLE SEAT CAPACITY, AND CAPACITY UTILIZATION

	1950	1970	1978	1985	1990	2001	2002	2003	2004	2005	2006	2007	2008	2009
Passengers (mm)	16	122	196	380	423	570	560	593	640	670	671	679	651	618
RPM (billion)[1]	30	105	190	275	350	468	476	497	546	572	577	592	570	540
ASM (billion)[2]	50	200	300	425	575	677	676	684	733	742	730	741	715	667
Load Factor (%)[3]	60	53	63	65	61	69	70	73	74	77	79	80	79	81

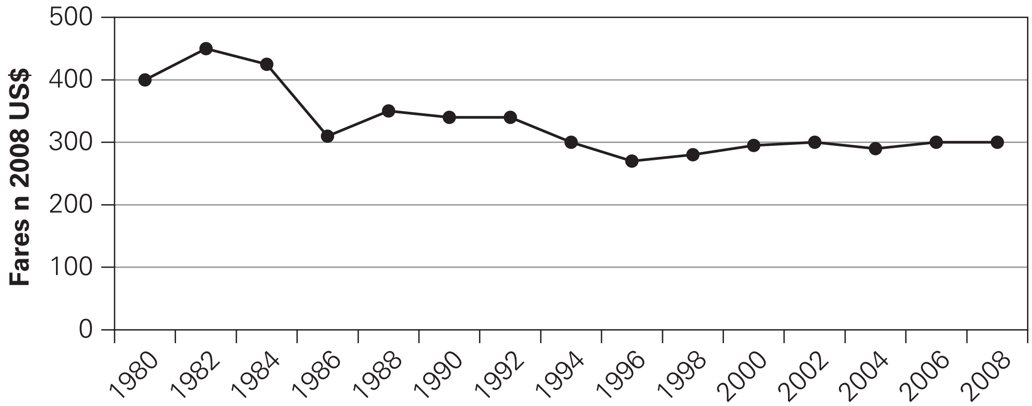
[1] Revenue Passenger Miles = Number of paying passengers x Miles flown. Indicates traffic volume
[2] Available Seat Miles = Total seats available x Number of miles flown. Indicates industry capacity
[3] Factor = RPM/ASM. Indicates capacity utilization
Source: Bureau of Transportation Statistics, Department of Transportation, U.S. Government.

Several exogenous factors impacted airlines' financial performance - *the economy, wars andcalamities, fuel prices, and competition.* While a vibrant U.S. economy had undoubtedly propelled industry revenues, intense competition following deregulation had led to an era of steadily falling airfares and deflated profits. Since 1980, airfares and per passenger yield in real terms had steadily fallen (Figures 4 & 5), leaving little or no profit for airlines. The cost of fuel for its part had steeply risen ever since 9/11, further cutting inroads into airlines' profits. Importantly, the environmental setbacks of 2000-2009 (wars, terrorist strikes, and recession) had created a climate of perennially fluctuating demand and excess seat supply in which sustained profitability required unique cost advantages. Most network airlines, lacking such an advantage due to a burdensome fixed cost structure, lost money year after year (see Table 2).

Performance of Airline Groups

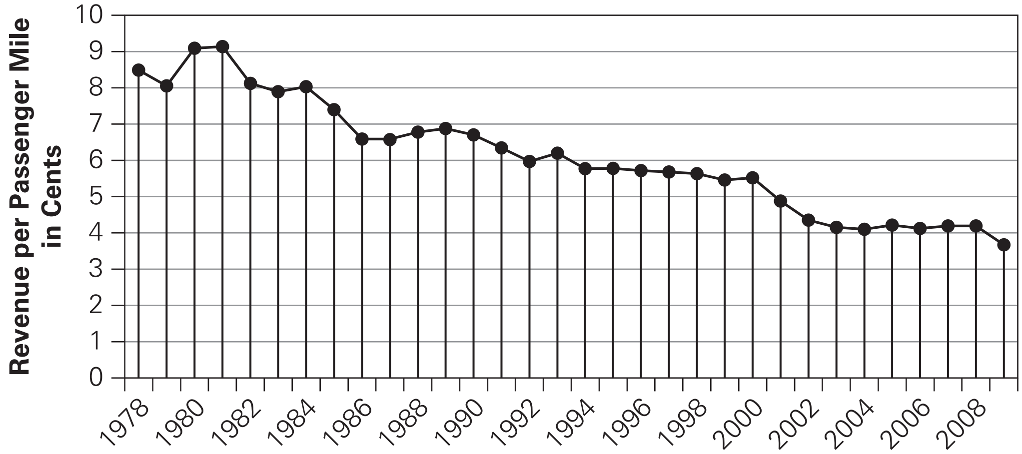
Among airline groups, the networks had been consistent poor performers, post-deregulation. Between 2000 and 2009, the market share of the networks decreased from about 70 percent to 60 percent while the share of the low-costs for the same period rose from about 18 percent to 30 percent (Figure 6). During the same period, the networks collectively lost over $86 billion while the low-costs together earned about $5 billion. Analysts attributed networks' poor performance to excess seat capacity and inefficiencies associated with the hub system. Seat capacity among networks had been steadily growing ever since the low-costs arrived on the scene. Expansionary moves the networks employed to squeeze the new entrants out were rapidly adding to

FIGURE 4 MEDIAN ROUND-TRIP FARE, 1980–2008



Source: Constructed by the authors using data from the Bureau of Transportation Statistics, U.S. Government.

FIGURE 5 DOMESTIC AIRLINE YIELD ADJUSTED FOR INFLATION (1978 US$)



Source: Air Transport Association www.airlines.org/eco/data "Yield" denotes price in cents a passenger pays to fly one mile.

TABLE 2 OPERATING REVENUES AND NET INCOME OF SELECT AIRLINES, 2000–2009 *($ MILLION)*

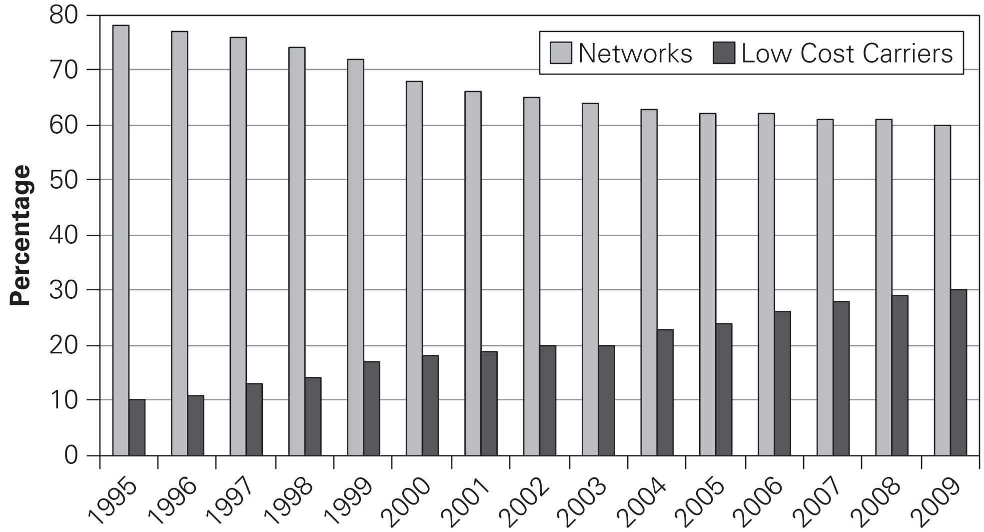
Network Airlines	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Alaska	1760	1763	1832	2019	2241	2416	2692	3076	3221	3006
	(10)	(64)	(75)	(2)	(14)	(2)	(56)	139	95	109
American	18117	15639	15870	17403	18607	20657	22493	22832	23696	19898
	778	(1317)	(3495)	(1318)	(821)	(892)	164	355	(2530)	(1475)
Continental	9449	8199	7352	7333	9124	11108	13010	14105	15032	12361
	308	(97)	(451)	382	(363)	(66)	343	460	(585)	(282)
Delta	15320	13211	12410	14203	15154	16112	17339	19238	20972	18046
	686	(1107)	(1295)	(8960)	(3362)	(3798)	(5995)	1794	(8433)	(999)
Northwest	10956	9591	9151	9183	11265	12315	12555	12734	14095	10863
	270	(418)	(766)	478	(757)	(2310)	(2798)	2591	(5987)	(296)
United	19331	16087	13915	13398	15701	17304	19334	20049	20237	16359
	52	(2110)	(3325)	(3086)	(2002)	(21036)	450	348	(3827)	(628)
US Air	9181	8253	6914	6761	7073	7212	10960	12055	12459	10780
	(**255**)	(1989)	(1659)	(421)	(578)	(2130)	350	350	(2148)	(140)

TABLE 2 OPERATING REVENUES AND NET INCOME OF SELECT AIRLINES, 2000–2009 *($ MILLION) (continued)*

Network Airlines	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Total revenue	***84114***	***72743***	***67444***	***70300***	***79165***	***87124***	***98383***	***104089***	***109712***	***91313***
Total Net Income	***1829***	***(7102)***	***(11066)***	***(4863)***	***(7897)***	***(28317)***	***(7542)***	***6037***	***(23415)***	***(3711)***
Low Cost Airlines										
AirTran	624	665	733	918	1041	1450	1893	2308	2552	2341
	47	(3)	11	101	12	2	15	52	274	135
Jet Blue	105	320	635	965	1266	1709	2363	2843	3330	3287
	(21)	39	55	103	47	(21)	(1)	18	(76)	59
Southwest	5649	5555	5521	5937	6530	7584	9086	7861	11023	10350
	603	571	241	442	313	548	499	645	178	99
Total Revenue	***6378***	***6540***	***6889***	***7820***	***8837***	***10743***	***13342***	***13012***	***16905***	***15978***
Total Net Income	***629***	***607***	***307***	***646***	***372***	***529***	***513***	***715***	***376***	***293***

For all airlines: Line 1 = Operating revenues, Line 2 = Net Income
* Delta integrated Northwest's operations only in 2010.
Source: U.S. Department of Transportation, Office of Aviation Analysis, Competition and Policy Analysis Division.

FIGURE 6 MARKET SHARE TRENDS – NETWORK AND LOW COST CARRIERS



Source: Bureau of Transportation Statistics, Department of Transportation, U.S. Government

their capacity. But extreme demand fluctuations, unique to this industry due to innumerable environmental uncertainties, had invariably prevented the networks from profitably utilizing their full capacity. What emerged as a denouement were long drawn out fare wars in which the networks filled seats, often at below cost, resulting in successive periods of massive financial losses. In response, many sought to avert further damage by dramatically reducing capacity through mergers (or, shifting aircrafts to international routes, discontinuing uneconomical routes, and discarding old aircrafts) and also by reducing the workforce. In fact, between 2003 and 2009, American, Delta, United, and US Airways collectively shed over 80 billion seat miles but analysts believed the cuts to be insufficient and that more was needed before the majors would see respectable profits.

Airline Competition

The airline industry of 2010 was hyper-competitive, with airlines mostly waging price-based battles. While several factors contributed to price wars, excess seat capacity was predominant among them. Seat capacity had been building up in the industry due to new entries and expansions by the incumbents. However, excess capacity was also because of another reason. Airlines made fleet expansion decisions during economic booms but it took years to acquire and commission new aircraft. Unanticipated events occurring in the interim such as a recession or a tragic environmental event reduced passenger demand, creating excess capacity. In such situations, contestable market theory would predict unprofitable firms to exit the industry, reducing excess capacity. But, the easy access granted to airlines by Chapter 11 bankruptcy courts and a climate of financial generosity created for them by the government following the 9/11 tragedy had allowed inefficient firms to stay-in and intensify competition.

The cost structure of the airline business itself induced price wars. To elaborate, size mattered in the airline business. Large fleet, frequently flown between popular destinations, generated sales volume and economies associated with it. Airlines thus had a high *fixed cost* due to large fleet ownership. In addition, there were upfront costs that had to be incurred before an airline took-off: costs of fuel, aircraft insurance, landing and gate fees, food, and crew compensation. By comparison, *non-operational costs* of the business were relatively low. As a result, airline seats were sunk costs, and empty seats were revenue lost forever. Consequently, pressure to sell seats was high, especially during sluggish demand periods. In 2010, with demand extremely weak due to a deep-seated recession and operational costs mounting due to skyrocketing fuel prices, fight for filling seats and flying with a full aircraft was intense.

Airlines competed within routes. Over the years, demand for air travel had got concentrated in select routes. As of 2010, almost 90 percent of the total domestic travel occurred between ten top U.S. cities (e.g., New York-Los Angeles, New York-Chicago). Consequently, airline competition was intense within these high-volume city-pair routes. Airlines relied on designing and offering an optimal set of attractive “schedule-fare” combinations as a way to achieve differentiation and win customers. However, there were also attempts to soften competition through alliances and cooperative arrangements or outright mergers. Between 2007 and 2009 alone, six airlines merged as mentioned earlier and, according to antitrust watchdog groups, many of them were competing in the same route markets. As for alliances, three industry-wide alliances - Star Alliance, Sky Team, and One World – were in existence in 2010 that included both U.S. and foreign carriers as partners. Of these, Star Alliance was the largest, with 27 alliance partners and a traffic load of nearly 650 million passengers annually. The larger the alliance, the higher was the potential for partners to fill seats and, additionally, enjoy certain cost economies not available to others – e.g., sharing facilities and joint-marketing.

Airlines’ Customers

Airlines’ customers comprised business and leisure travelers. The latter also included those who traveled for personal reasons – meeting family and friends. Historically, business travel comprised about 40 of the total air travel, the rest representing leisure travel. Of the two, leisure travelers were more sensitive to price, postponing travel when fares went up. Business travelers had less flexibility in their travel plans and hence were less price sensitive. Most airlines aimed to capture a larger share of the business travel market by adding value to in-flight services (upper class comforts, food) and charged a premium price for such services. Airlines viewed the business travel market as more valuable due to a higher profit margin emerging from upper class tickets. As a result, seat capacity was allocated between economy and upper classes based on growth predictions for business travel. In 2010, with demand for business travel shrinking due to recession, airlines (especially networks) made significant adjustments to seat capacity allocation – many reduced business class seats and introduced a new class, between coach and business, to accommodate cost conscious business travelers

A trend that worried airlines was that most travelers were becoming indifferent to airlines' offerings, instead making choices about airlines based on fare alone. Absence of switching costs and availability of cheaper substitutes such as cars or trains at least for short distances made matters worse. Most airlines offered some form of frequent traveler rewards to prevent switching and promote loyalty. Many airlines extended these loyalty programs to include credit card purchases and hotel-stays. But surveys indicated that such loyalties broke-down when attractive low fares were available. Even among business travelers, loyalty dwindled during recessionary periods and many opted for cheaper substitutes, e.g., coach class, train (for short distances), or videoconferencing technologies.

Yet another concern for airlines was the rapid diffusion of the Internet and the power it gave to buyers. Indeed, the Internet had helped airlines to directly sell tickets, eliminating dependence on the traditional travel agents for ticket sales. However, the Internet also led to the emergence of e-tailers such as Expedia, Travelocity, and Priceline whose volume sales gave them significant bargaining power. The Internet also made it easier for travelers to shop for low fares, find alternative airlines, or become better informed about travel options and costs. In essence, by making the fare structures of airlines transparent, the Internet endowed the air travelers too with significant bargaining strengths.

Key Inputs and Costs

Aircraft: Aircrafts and jet fuel were critical inputs to the airlines but airport gates, landing slots, and technical personnel were also key inputs. The aircraft supplier segment had been consolidating for long and in 2010, there were just two aircraft makers competing in the large airliner segment - Boeing and Airbus. Two others, Bombardier and Embraer, competed in the market for small airliners (50-75 seating capacity). Aircrafts were expensive items with a price tag of about $150 million for a large airliner - hence airlines were slow to make large-scale purchase decisions. Also, because of their long operational life, airlines had no need to replenish their fleet every so often. As a result, pressure among aircraft suppliers to win and retain customers was high since a customer lost to competition was almost lost for decades. Aircraft suppliers vigorously competed for airlines' orders by offering custom product features, liberal financing and attractive training schemes. Also, both Boeing and Airbus historically competed by building larger aircrafts and providing attractive financing. However, by early 2000, their plans diverged: Airbus speculated the hub-and-spoke system as the airline industry's future and began building super-jumbo aircrafts whereas Boeing believed point-to-point as the future and began offering smaller and more efficient aircrafts. These divergent product offerings provided airlines with more choices and, as a result, more negotiating power.

Fuel: Airlines replaced old aircrafts with newer ones for two important reasons: a) to meet FAA regulations on safety, and b) to realize the fuel efficiency that newer aircrafts offered. An airline with a relatively young fleet enjoyed critical cost advantages, especially when fuel prices were climbing exponentially. In 2008, fuel costs were about one-third of the total airline operational costs. Between 2005 and 2009 alone, oil prices had tripled due to a combination of uncontrollable global events: an unprecedented surge in demand, especially due to the growth needs of developing economies, OPEC reluctance to increase supply, and inadequate refinery capacity and supply channel disruptions arising from Middle-East conflicts. Industry analysts predicted these causal factors to stay intense and probably get worse, making fuel the single most critical item in airline profitability for years to come. Consequently, besides fleet replenishment, a host of other ways for achieving fuel efficiency had emerged: price hedging, retrofitting aircraft wings to improve aerodynamics, remodeling interiors to reduce weight, lowering cruising speed, and smart scheduling to minimize idle time. Of these, the last two areas offered significant potential for cost savings – by developing and installing proprietary IT software technologies, an airline could aim to achieve unique cost advantages over rivals

Labor: After fuel, labor costs (wages, pension) were a large component of an airline's total costs. Most airline-jobs required specialized skills and government certification. As such, substitutes were not easily available on short notice. Hence, labor costs stayed the same for airlines even during periods of weak demand when one would expect cost reductions through layoffs. The industry was highly unionized and the unions were able to negotiate attractive long-term contracts during peak demand periods. Changes in compensation packages typically lagged airline's earnings changes. Union-Management relationship had historically been surrounded by animus and the unions often refused wage cut requests unless forced through bankruptcy proceedings. Shared governance, transparent management, and positive workplace culture were appropriate mechanisms according to some for dramatically altering the situation.

Airport Facilities: The number of FAA certified civilian airports in the U.S. had been steadily declining during the past three decades. In 1980, there were 730 certified airports in operation; in 2009, there were just 559 in service. This significant drop had not been due to decline in demand for air travel but due to concentration of traffic occurring in a few routes and discontinuance of uneconomical routes and airports. In high traffic volume airports, gates and landing slots were mostly in short supply. In the top ten "slot restricted" airports – e.g., New York, Chicago, Atlanta - that collectively handled over 80 percent of the total traffic, slots were unavailable. For an airline contemplating expansion into these high volume routes, the only avenues were buying (or renting) gates and slots from those who had them or acquiring those airlines both of which were expensive. Table 3 provides a summary of airline costs and how they had been escalating ever since 2000.

TABLE 3 PASSENGER AIRLINE COSTS IN 2009

	Index (2000 = 100)	% of Operating Expenses
Fuel	274.5	26.5
Labor	135.2	23.4
Aircraft (rent/ownership)	99.8	11.3
Professional Services	111.0	8.3
Food & Beverage	57.0	1.5
Landing Fees	171.0	2.3
Maintenance	81.0	1.7
Aircraft Insurance	163.0	0.1
Non-aircraft Insurance	193.0	0.4
Passenger Commission	26.0	1.1
Communication	72.0	1.0
Advertising	53.6	0.7
Other	-	7.8

Source: Air Transport Association of America

The Future

Events of the post-deregulation era had turned out to be treacherous for airline competition. Extreme demand-volatility, chronic over-supply conditions, and ever-escalating operating costs had prevented airlines from realizing scale and cost economies, fundamental for success in this industry. At the beginning of 2010, fully thirty-two years after deregulation, the industry's participants were still searching for enduring strategies that would defend them against these threats and engender sustained profitability. The industry had witnessed substantial losses totaling $26 billion in just the two preceding years and the overarching question in 2010 was what airlines should do to turn things around. The economy was recovering, but at a snail's pace, and demand was forecasted to stay flat in 2010 and grow only nominally in the following year. The U.S. dollar was relatively weak and expected to stay that way for a long time, threatening a rise in fuel prices back to the 2008-levels. With the rest of the environment equally turbulent, the strategic options available to airlines were few: alter the industry's competitive structure favorably, devise new ways to increase revenues and cut costs, or do both.

Alter the Industry's Competitive Structure: Existence of several carriers of almost equal size and a chronic overcapacity condition, especially among networks, had created an unfavorable climate for airline profitability. The wave of mergers that took place in the network segment between 2007 and 2009 had greatly reduced the number of competitors, seat capacity, and flight frequency in certain route-markets, giving the merged airlines some pricing power. Many analysts, however, believed that the networks needed to cut capacity and flight frequency more especially in high volume markets to enjoy sustained pricing power and profits. Some suggested a merger between American Airlines, the last freestanding carrier from the legacy era, and US Airways or Alaska Airlines. The stated benefits were: it would eliminate overlapping flights, reduce network capacity further, and foreclose fully the possibility of entry by low-costs into the former's business traveler market. However, American was reported to be averse to the idea as its previous merger with TWA had proved to be costly, instead choosing strategic alliances as its best bet. Additionally, there was the uncertainty of regulatory approval for additional airline mergers – a strong case had to be made for consolidation as the best strategy for the long-term survival and success of the industry. Some analysts were skeptical that such a case could be made convincingly.

Thoughts of networks entering the relatively more attractive low-cost segment by acquiring a low-cost carrier and operating it as an autonomous business unit were also gaining currency in the industry. Some networks had earlier experimented with a low cost service by operating it as a closely-held subsidiary but soon discontinued it as cultural conflicts arose. Continental's Lite (1993–95), Delta's Song, (2003–2006), and United's Ted (2004–2009) were some of them. Embedding a low-cost culture within a network environment could obviously have caused internal tensions, leading to failure, but running a low cost airline as a totally independent business unit was argued as feasible and making much economic sense.

Mergers and acquisitions are costly and risky options. Other less risky options were available to networks that could produce similar results, though to a lesser degree: 1) diverting domestic capacity to international routes, where demand was steady and clear alternatives to air travel did not exist; 2) allying with low-cost carriers, sharing passengers and facilities, and 3) partnering with high-speed trains that would extend airlines' reach and widen the market for customers.

In the low-cost carrier segment, analysts suggested similar approaches for favorably altering industry conditions. While overcapacity was not an issue for the low-costs, analysts still proposed mergers as it would give them size-related advantages to effectively compete with the networks. But others were less enthusiastic about mergers due to the limited financial strengths of the low costs and the financial risks that mergers posed. Instead, they recommended alliances that offered somewhat similar benefits but without concomitant risks. Alliance with a strong network carrier was favored as it offered both revenue enhancement and cost saving opportunities owing to the network's strong market-base and asset-base. For example, in March 2010, Jet Blue Airlines and American Airlines entered into a cooperative agreement that would allow each to share passengers, facilities, landing slots, and gates.

A notable development for the low cost carriers was the opportunity emerging in the business travel market. Cuts in corporate travel budget due to a recessionary economy were making low costs attractive to businesses. To effectively exploit this opportunity, Jet Blue and Southwest began offering choices and amenities appealing to business travelers – refundable/unrestricted fares, corporate volume discount, and upfront and comfortable seats. To be successful, however, a low cost carrier had to have a presence in the high volume business markets (e.g., New York- Los Angeles) and additionally offered frequent flights at convenient times.

Devise New Ways to Increase Revenue and Cut Costs: Opportunities to generate additional income through merchandising were rapidly emerging for airlines. Referred to as ancillary revenues, they are income derived from non-ticket sources, such as baggage and seat-selection fees, food and beverage sales, in-flight communication and entertainment services, and sale of consumer products and services to passengers. Over the years, airlines had been cultivating partnership with hotels, rental car companies, trip insurance providers, tour operators, and credit card issuers. With millions of business and leisure travelers flying each year, the potential to generate additional income by selling partners' products and services to passengers was reported to be immense and growing. In 2009, the top three U.S. airlines collectively earned $5 billion through ancillary sources; in 2010, that amount was $11 billion (United-Continental, $5.2 billion, Delta, $3.7 billion, and American, $2 billion). Forecasts indicated ancillary revenues for the industry to soon double from the 2009 levels and form a significant portion of an airline's total revenues. In 2009, they represented on average around 10% of an airline's revenues. A problem with ancillary fees, especially baggage fees, is their potential to adversely affect leisure travel demand since they made air travel costlier.

In regards to costs, airlines faced challenges since a majority of costs were fixed and also outside airlines' control – e.g., fuel costs, landing and gate fees. Notwithstanding, opportunities existed in operational areas where airlines could gain a sustainable cost advantage. Through investments in information technology and appropriate capabilities to manage it in unique ways, an airline could gain an industry-wide cost advantage in fuel procurement, flight scheduling, route selection, and flight operations. And, apart from internal sources, airlines external connections too offered cost minimization opportunities such as through joint procurement of aircraft and fuel, joint maintenance, and marketing.

Case Study 2

Caffeine Satisfaction: Rivalry Among the Coffee Shops

Coffee was one of the oldest products known to mankind and was consumed around the world as a stimulant. It was second only to oil (petroleum) in traded commodities. The consumer often develops a personal relationship with this product and has strong preferences in taste and brewing methods. Yet, retailing standardized cups of coffee was big business that led to strong rivalry. This case provides an overview of the industry and describes the efforts of Dunkin' Donuts and Starbucks, two companies that followed their separate paths toward satisfying consumer needs.

The Industry

Coffee consumption can be traced back to before 1000 C.E. in Ethiopia when Arab traders were credited with bringing the *Coffea arabica* plant to the Middle East for cultivation. Coffee consumption reached Europe in the 1600s and an early coffee house, where merchants gathered, existed in London in 1668. This shop eventually became Lloyd's, the insurance headquarters. An alternative to Arabica was Robusta (C*offea canephora*), a hardy strain of coffee that yielded double the beans per acre. It produced a harsh and bitter taste when brewed and large manufacturers often blended the Arabica with Robusta beans to produce lower-cost blends. Currently, about 75% of coffee production in the world is Arabica, with the rest being Robusta and other minor strains. Sometimes, especially in preparation of instant coffee, chicory, a plant with a deep taproot, was added as a flavor and to reduce cost.

Some 70 countries produce coffee, and in 2011, Brazil, Vietnam, and Colombia topped the list as producers and exporters. Brazil had for long been the major source of premium Arabica beans. Central America and Vietnam were also mass suppliers of coffee, and the latter was prominent mainly in the last 10 years as a supplier of lower-quality beans. The nature of the coffee market and its distribution resulted in the cost of coffee beans making up only about 10% of the end-user price in the United States. No matter how coffee demand grew, the farmer appeared to get little of the benefits.

The International Coffee Organization (ICO) (**www.ico.org**) was founded in 1963 under the auspices of the United Nations because of the great economic importance of coffee. It aimed to bring together producing and consuming countries to deal with the challenges facing the world coffee sector through international cooperation. Its members included coffee exporting and importing countries and it administered agreements that attempted to produce fair trade. Coffee-exporting members of ICO accounted for over 97% of world coffee production. The consumer concern about poor working conditions, use of child labor, and subsistence wages paid to farmers who grew the coffee led to movements in the developed countries to promote "ethical" or fair-trade coffee. Various labeling/certifying organizations such as Fairtrade International and UTZ Certified deal with cooperatives of small farmers who were guaranteed a contract price, and ensure that farms adhere to a code that includes fair wages, healthcare for workers, and curbed waste and pollution.

Global coffee demand has maintained a slow growth of about 2.5% annually in recent years. Producer countries account for about 30% of the consumption and importers about 70%. The market among importers, mostly developed countries, has tended toward saturation with slow or negative growth. Consumption among the producer countries has grown faster, due to both population and economic growth. Most consumption (about 58%) took place in mature markets of the European Union, the United States, and Japan. However, the fastest growth in consumption has been in the Asia-Pacific region and in Central and Eastern Europe.

Coffee prices over the recent past reversed their previous falling trend. Composite prices (i.e., over different varieties), from a high of $6 per pound in 1977, fell to about $1.71 in 1986, and averaged 48 cents in 2001. The price since recovered to $1.97 in 2011, the highest since 1995–1996. These prices were still low considering cost of production, leading to economic and other problems in the farming sector of various producer countries.

Americans used to be known for their heavy consumption of coffee. For long, coffee was the number one beverage in the United States after tap water. However, average consumption per head, which was at a peak of 3.1 cups per day in 1963, was less than 2 cups by late 1980s and continued to fall. Tea drinking had increased over the years, both hot tea and iced tea. Among alternative beverages, bottled water maintained steady growth (see Table 1).

TABLE 1 U.S. BEVERAGE CONSUMPTION (GALLONS PER CAPITA)

	2005	2010	% change
Coffee	24.3	23.3*	(4)
Tea	8.0	9.0*	13
Bottled water	25.4	28.3	11
Milk	21.2	20.4	(4)
Fruit beverages	13.9	11.5	(17)
Sports beverages	4.1	4.0	(2)
Value-added water	1.1	1.5	36
Energy drinks	0.5	1.2	140
Carbonated soft drinks	51.5	11.4	(78)
Beer	21.4	20.8	(3)
Wine	2.2	2.3	5
Distilled spirits	1.4	1.5	7

Source: Adapted from Advertising Age, 2011, Vol. 82 Issue 26, pp. 4–5. Coffee and tea data alone are from U.S. Department of Agriculture Tables.
* Figures are for 2009.

The way people drank coffee also changed over the years. A kind of generic coffee was typically available in all convenience stores, gas stations, restaurants, and the like. However, more and more consumers became conscious of what beans were used and how much "delicacy" was put into brewing their cup of coffee. They were also willing to pay more money to get a premium coffee latte or mocha. Within coffee consumption, premium coffee (i.e., 25% above value brands) was grabbing an increasing share of consumption, and specialty coffees were estimated to be about one-third of the market and growing at a rate four times that of regular coffee.

Coffee shops that also sell snacks and bakery products competed with doughnut shops, bakeries, supermarket bakeries, gourmet cookie shops, restaurants, convenience stores, and even ice cream franchises such as Dairy Queen. Although fast-food restaurants were not direct competitors, chains such as McDonald's saw the potential in this market and have entered it. Doughnuts were a major sales item in supermarket bakeries too. Convenience stores also moved into food service at a rapid rate. They served coffee, sold packaged doughnuts, were open long hours, and were in premium locations.

Various trends, apart from changes in consumer tastes, impacted coffee consumption. Public libraries in the United States were increasingly allowing their patrons to bring drinks to the premises in response to the competition they faced from bookstores that had coffee bars. Medical research was equivocal and revealed positive and negative effects from drinking coffee. For example, research showed a link between high coffee consumption (seven cups a day) and a lower risk of developing type-2 diabetes, and also association (but no causation) between coffee drinking and long life span. In doses of 200 milligrams or less, the caffeine, a mild central nervous system stimulant, produced feelings of alertness and sociability. However, other studies found that it could raise blood pressure, and some doctors recommended against coffee for pregnant women, or those with insomnia or heartburn. There was also concern that high doses of caffeine may result in a physical dependency and produce withdrawal symptoms such as headaches and poor concentration.

Globally, coffee consumption is expected to enjoy modest growth. Although per capita consumption is the highest in the United States followed by Western Europe, increased consumption is expected in countries such as Russia and China.

Under tough economic conditions in the United States, consumers usually placed a lot of importance on price and perceived value. Among beverages, although carbonated soft drinks showed sluggish growth, noncarbonated drinks showed an ability to attract customers. Most U.S. producers of food, beverages, and related products were small and the industry was fragmented although a few major companies were dominant and operated worldwide. As the dollar weakened against the euro and other currencies, it had a positive effect on companies with significant sales overseas while it made imports of commodities, such as coffee, more expensive.

Dunkin' Donuts

Dunkin' Donuts shops sold coffee beverages—as well as well-known bakery products such as doughnuts, muffins, cookies, bagels, and also sandwiches. They had a reputation for freshness and consistency of their products, apart from convenient locations. The stores were designed for easy access and quick service, while some had televisions tuned to news channels, and also a drive-through window.

The chain was founded by Bill Rosenberg, who opened his first doughnut shop in 1948 in Quincy, Massachusetts, and named it Open Kettle. Two years later the company became Dunkin' Donuts. Presently, it has overseas locations in 32 countries, which include significant presence in the Philippines, Indonesia, South Korea, and Japan.

Dunkin' Donuts primarily served customers on the go. Some stores provided a few tables for those customers who liked to enjoy their breakfast or lunch on the premises, but this was not universal, especially in small and crowded downtown shops.

Dunkin' Donuts' main expansion strategy was through franchising, which it began to do in 1955 when the concept of franchising was itself in its early stages. In 2010, a new restaurant site required about $474,000 in investment. Dunkin' Donuts required potential franchisees to have a proven track record in successfully managing a small- to medium-sized business; experience in hiring, training, and motivating employees; sound understanding of business finance principles; and strong personal commitment to managing franchised stores on a daily basis. Franchisees paid about 5.9% of total sales (rather than income) as royalty fees and could expect a 20% to 25% return on investment.

The franchising system followed different approaches. In some cases the franchisee owned the site, and in other cases, the company acquired appropriate sites and leased it to the franchisee. The company's rental income from company-owned sites was a significant revenue stream even when compared to franchisee royalty payments. Franchise agreements initially granted the franchisee the right to operate at a specified location without territorial exclusivity. Since 1990, the company gave territorial rights, too. The company carefully screened potential new locations to ensure optimal penetration. The company allows a franchisee to operate either a single- or multi-branded point, as also the right to open at a single or multiple locations. The company helps the franchisee to select sites, and develop restaurants. The franchisee payment covers the concept, strategy, marketing, operating system, training, and brand recognition. Overseas expansion is largely through a master franchisee for the country, who is allowed to subfranchise territory.

Dunkin' Donuts also entered into alliances with grocery retail chains such as Stop & Shop Supermarkets and Shaw's, in which selected supermarkets feature a Dunkin' Donuts store on the premises. Nevertheless, Dunkin' Donuts was slow in achieving a nationwide presence in the United States, partly due to an inability to find appropriate franchisees. About two-thirds of its stores were located in the northeast and mid-Atlantic states. Sales pattern varied between regions. Northeastern outlets were primarily coffee shops as against the rest of the country where doughnuts were the profit generator.

A Dunkin' Donuts outlet initially manufactured the products it sold. Franchisees received extensive training at Dunkin' Donuts University, and were prepared to manage the front office retail and the back office production. The company's centralized production centers for donuts and other baked items are also franchised. Franchisees were required to buy delivery trucks and collect the baked goods three times a day. This enabled franchisees to save on real estate costs because stores would require about 2,000 sq. ft. less space without the need for baking equipment on premises. Some restaurants, known as full producers, produce their requirements on site, as well as supply other local restaurants that do not have access to centralized production centers.

Since many shops operated on a 24-hour basis, finding reliable employees for managing the production and sales was often a problem. A significant number of franchisees were immigrants from countries such as Pakistan, Morocco, Portugal, and India who were prepared to work long hours. They also often employed relatives to ease the supervisory or operational problems. The company designed programs to help franchisees improve operations. To improve speed of service and maintain quality, the operating system was made team based. Rather than each person doing different duties, from taking the order, filling it, and ringing up the bill, the new system changed to be team based with individuals doing a particular job. Contests were also initiated between shops with winning teams given cash awards. Franchisees bought their supplies through a cooperative formed by them for the purpose of better bargaining power. There were five such co-ops in the United States.

The company purchased its coffee beans from three countries in Central and South America. Suppliers had to adhere to stringent bean-growing guidelines. The company also sampled and blended its coffee much as a vintner cultivates wine to achieve the Dunkin' Donuts coffee taste.

Franchisees contributed 5% of gross sales to an advertising and promotion fund. Due to an uneven distribution of stores around the United States, the company used regional instead of national television and radio advertising. Costs of new promotions were borne entirely by the franchisees and they could choose to participate or not.

New product innovation, critical for the company, is based at its labs in the head office at Canton, Massachusetts. The company also successfully imitated the new products of others. After Starbucks launched its Frappuccino, Dunkin' Donuts came out with its successful Coolatta. When bagels became popular in the country, the company responded to an initiative by a franchisee to include fresh bagels in their product mix, which became a big selling item. Its introduction of espresso and latte was an attempt to provide pricier drinks for the mainstream customer. It even promised to serve the cappuccino in less than a minute. Ken Kimmel, a vice president of the chain's marketing arm, said, "We watch trends and then Dunkinize them."

While trained baristas at Starbucks took about a minute and a half to prepare a cappuccino for sale at about $3.55, a customer would get it for about $2.79 at half the time in a Dunkin' Donuts (see Table 2 for a price comparison). To achieve that, the company bought automated pushbutton machines that ground the beans, added the right amount of hot water and, using a sensor, steamed the milk to the right temperature. A separate machine dispensed the right amount of milk. The coffee and the milk were then manually combined for some visual effect.

TABLE 2 COMPARISON OF PRICES (US$ PER CUP)—DUNKIN' DONUTS AND STARBUCKS

	Dunkin' Donuts			Starbucks		
	Small	Medium	Large	Small	Medium	Large
Regular	1.59	1.89	2.09	1.65	1.95	2.25
Lattes/Cappuccinos	2.29	2.79	3.29	2.85	3.55	3.97
Flavored/Specialty drinks	2.79	3.79	4.49	3.25	3.95	4.45

Note: Prices are indicative and may vary between regions.

The company has gone through several ownership changes. In 1989, it was acquired by Allied Domecq, the British beverage giant, and then sold to the French beverage company Pernod-Ricard in 2005. In 2006, Dunkin' Donuts, and Baskin Robbins were acquired by Bain Capital, a private investor group in the United States, who took the company, called Dunkin Brands, public in 2011 (although more than 50% of voting stock was still closely held). Coffee was the major product for Dunkin' Donuts, and along with other beverages, accounted for about 60% of a store's sales; doughnuts contributed about 20% and the remaining came from breakfast foods such as muffins, bagels, and sandwiches. Dunkin' Donuts contributed 75% of company revenues in 2011 (the remaining from Baskins Robbins). (See Table 4 for sales and earnings information.)

The company also planned to expand more aggressively in the southern and western regions of the United States, while deepening penetration in its traditional northeast U.S. markets. Newer products such as hot sandwiches were being aimed at reducing dependence on doughnuts, offering a healthier fare, and spreading demand more evenly through the day.

The company saw itself as operating in the "quick service restaurant" industry, which is characterized by counter or drive-through ordering and limited or no-table service. It satisfied a customer need of quality and convenient food at economical prices, offering a quick dining experience through innovative products, served fresh, and meeting the needs of busy people. The growth rate of visits to this segment has been relatively flat over the previous five years. Dunkin' Donuts planned to grow the brands nationally to about 15,000 stores over the next 20 years, and internationally. (See Table 3 for stores distribution.) The company identifies its competitors as including 7-Eleven, McDonalds, Starbucks, Tim Hortons, and Subway.

The company added yogurt drinks and iced tea to its portfolio of beverages and saw these as growth items. The company, which established itself as serving simple fare to working-class customers, had to walk a fine line between adding style and not appearing pretentious, something its loyal customers disliked. Its hot sandwiches were referred to as breakfast sandwiches, as customers felt that the original name "panini" was too fancy. The company introduced music in some stores, but when it tried to paint the stores in coffee-colored hues, customers made the stores go back to the bright pink they always used. The company conducted psychographic studies to gauge people's values and attitudes to determine new locations as it executed its expansion plans. In 2012, its coffee was named # 1 in coffee customer loyalty for the sixth consecutive year by the Brand Keys Customer Loyalty Index.

Dunkin' Donuts also expanded into nontraditional venues such as kiosks in colleges, hospitals, and stadiums. The company entered into an arrangement with Proctor & Gamble to distribute its packaged coffee to grocery stores, club stores, and other retail outlets. It also entered into arrangements with Sara Lee, the food products company, to sell coffee in office buildings and private cafeterias, and with Hess gas stations to dispense it through drink kiosks. In 2008, franchisees in the northeast United States protested these aggressive growth moves saying they cut into franchisee sales and profits. Since 2011, the company began offering its coffee in Keurig K-Cup format that customers could use at home. System-wide sales growth was 4.7% and 9.4% in 2010 and 2011, respectively, in the United States, and 15.0 and 9.1% in international operations. However, comparable store sales growth in the United States in 2011 was only about 5.1%, showing that almost half the growth came from expansion.

Starbucks

Starbucks (**www.starbucks.com**) was founded in Seattle, Washington, in 1971 by three coffee aficionados. In 1982, the company, which had grown to five stores, hired Howard Schultz to manage its retail sales and marketing. On a trip to Italy, Schultz was captivated by the culture of coffee and the romance of the coffee bars in Milan. With the owners reluctant to go in that direction, he left the company and started his own coffee bar in Chicago selling a coffee brand called Starbucks. In 1987, he bought the Starbucks stores from the owners and combined them with his own to form the Starbucks Corporation with 11 stores. (The company went public in 1992.) Starbucks was on its way to becoming a major retailer of coffee beverages. In 1988, it introduced a mail-order catalog and by the end of the year was serving customers in every state. The catalog helped build awareness as well as point the company to potential locations for its cafes. For many years, the company spent little on advertising, relying instead on word of mouth to build a reputation.

Starbucks subsequently grew into a premium coffee empire that featured a coffee shop where you not only drank the best coffee in town, but also relaxed and socialized. The company built consumer loyalty through its superior dark roast coffee, customized espresso drinks, responsive customer service, and an appealing store experience. Stores featured comfortable seating and soft music. The company realized the importance of educating the consumers in order to build a market for specialty coffee. This involved employees communicating their knowledge of, and enthusiasm for, coffee. Starbucks specialty coffee shops served a variety of coffees and coffee drinks. In addition, they also sold teas, pastries and other food items, espresso machines, coffee brewers, and assorted items such as thermal coffee cups with the Starbucks logo.

The company appealed to a target audience of 25 to 45 years of age and generated about 50% of its revenue between 7:00 A.M. and 10:00 A.M. Some of its growth resulted from extending beyond the traditional coffee drink. In 1999, the company experimented with prepackaged sandwiches (to appeal to lunchtime customers), but found people preferred pastries instead. Creative extensions of coffee with different flavors resulted in the chain selling more than 30 distinct drinks.

Schultz said he subscribed to a philosophy of "hire people smarter than you are and get out of their way." From the beginning, he recruited experts in the areas of finance, human resources, marketing, and mail order in his senior management. In the middle ranks, experienced managers were hired from Taco Bell, Wendy's, and Blockbuster. The company installed an expensive computer network and designed a point-of sale system, via PCs, for managers to use. The sales information from every store was passed on to the headquarters every night, allowing analysis to identify regional buying trends quickly.

The company adopted creditable policies for treating the employees well. In 1991, it became the first privately owned company to offer an employee stock ownership program that included part-time employees. Health and dental benefits were also offered to both full- and part-timers. These innovations helped achieve a low rate of turnover. Employee training included 25 hours of coursework about the history of coffee, drink preparation, and how to brew a perfect cup. The company believed that committed and enthusiastic employees were more likely to deliver good service and provide an inviting environment for customers.

In the late 1980s and early 1990s, the company invested substantial time and efforts into building accounting, planning, and logistics systems in preparation for rapid growth—and did not make profits between 1987 and 1989. However, venture capitalists, attracted by the 20% growth of the specialty coffee market, came forward with funds.

Rather than buy from wholesalers, the company bought its coffee beans directly from producing countries, and executives traveled around the world to meet with farmers and get acquainted with all aspects of the commodity business. The beans were then roasted and blended by trained personnel before being shipped to the outlets. As a measure of quality control, once a bag was opened, the beans had to be used within seven days or donated to charity. Roasters were trained extensively. Facing allegations from a human rights group that the company was buying beans from wholesalers who were paying poverty wages, Starbucks began to buy more coffee certified as fair trade.

The company operated its own stores and had an in-house team of architects, real estate personnel, and construction managers to find the right locations and create the right structure. In congested downtown districts, kiosks were opened. The company first opened in a major market that served as a logistical and managerial base or hub to enable further expansion in that region. An important part of its store expansion strategy was "store clustering," when Starbucks opened several stores close to each other to attract consumer attention, gain market share, and prevent other coffee retailers from entering the area.

The company experienced rapid growth in sales in the early years. For instance, sales growth was 65% per year from 1990 to 1993. By 1997, it had reached 1,412 stores and sales reached $1 billion. The rapid growth of the company and intensive geographic coverage even resulted in protests in cities such as Toronto, San Francisco, and Portland, with local citizens supporting local businesses and wanting to keep the chain out of their neighborhood. The company also made horizontal acquisitions to strengthen market position. It purchased Coffee Connection, a 23-store rival based in Boston, for $23 million in 1994, making it a wholly owned subsidiary.

The first overseas venture came in 1996, in Japan, through a joint venture with a prominent local retailer, Sazaby, Inc. Similar ventures with local partners were entered into in Hawaii, Singapore, and the Philippines. In foreign countries, the company conducted focus groups, and sent its foreign managers back to Seattle for 13 weeks of training. It employed a high degree of cultural sensitivity in setting up its new foreign operations.

When Starbucks expanded into the United Kingdom in 1998, it acquired Seattle Coffee Company, a specialty coffee firm and converted its units to the Starbucks name. The company's overseas expansion into 30 countries beyond the United States and Canada, while aggressive, did not meet the same success as in North America. In June 2003, 1,532 stores overseas accounted for 23% of the total number of stores, but only 9% of the sales revenues. The company lost money in Japan and Britain, restructured operations, and closed stores in Europe and the Middle East. In some countries, it acquired licensed operations or increased its equity position over time. The problems in overseas operations arose from high start-up costs, local competition on price, and the different expectations of store experience.

Some ventures took the company into different business areas. The company opened a full-service casual restaurant called Cafe Starbucks and, in 1999, acquired the Pasqua Coffee Co., which owned a chain of coffee and sandwich shops in New York and California. Although Starbucks had developed its own in-house tea brand Infusia, it also acquired Tazo Tea Company in 1999.

The company entered the music business indirectly when it began selling CDs in its stores in the mid-1980s. Schultz saw music and entertainment as helping to draw customers. It acquired a five-store Hear Music Chain in San Francisco in 1999. It helped produce CDs and even offered some exclusive music in its stores, and media bars allowed customers to burn their own CDs. Analysts did not believe that music would account for more than 2% of retail store sales.

The company started a series of partnerships with different businesses such as United Airlines, Host Marriott, Nordstrom's, and Barnes & Noble to open kiosks or facilitate bulk sales of its beverage. It also acquired different players, especially in the international arena. The company entered into a joint venture with PepsiCo to bottle Frappuccino beverages for sale through supermarkets and convenience stores. A joint venture with Dreyer's Grand Ice Cream involved the development and sales of Starbucks Ice Cream. Within a year, Starbucks Ice Cream became the number one coffee ice cream in the United States. Starbucks also signed a long-term licensing arrangement with Kraft Foods for the marketing and distribution of Starbucks whole bean and ground coffee in grocery, warehouse club, and mass-merchandise stores. These partnerships and the wholesale business further helped build brand awareness. The company also sold wholesale its coffee to restaurants, businesses, educational institutions, hospitals, hotels, and airlines.

Starbucks launched a Web site with an online store in 1998, and Schultz reportedly wanted Starbucks to ultimately sell everything from gourmet foods to furniture, although some of these plans were subsequently scaled back. The company also attempted a failed acquisition of Williams Sonoma, Inc., a retailer of high-end kitchenware. Some analysts questioned the wisdom of a company that was moving so far from its core business. In mid-1999, the stock fell 28% following announcement of a shortfall in earnings, making the company pull back from its Internet-sales plans. Nevertheless, the company provided high-speed Internet connections in its stores to encourage people to stay and to compete against Internet and cybercafes. In 2000, Schultz stepped down from the CEO position and became the company's chief global strategist.

The new CEO introduced several changes in its format. The company began selling hot sandwiches, added drive-through windows, and switched to automatic espresso machines to improve on speed of service and efficiency. In pursuit of growth, the company opened 3,000 new stores in just the two years between 2005 and 2007. Table 3 gives the distribution of the company's stores. Although Starbucks had a preference for company-owned stores, which generated 85% of 2007 sales, licensing and franchise allowed it to expand to 35 countries.

TABLE 3 DUNKIN' DONUTS AND STARBUCKS STORES

	Dunkin' Donuts			Starbucks		
	Own/Joint venture	Franchisee	Total	Own	Franchisee	Total
United States	25	6,990	7,015	6,705	4,082	10,787
International	857	2,211	3,068	2,326	3,890	6,216
Total	882	9,201	10.083	9,031	7,972	17,003

Source: Company annual reports.

The company's 2007 revenues of $9.4 billion was almost three times the figure of 2002 ($3.3 billion) and a compound annual growth rate of 23% over five years. The sales mix by product type was 75% beverages, 17% food items, 3% whole bean coffees, and 5% coffee-related hardware items. Yet, the company began to face a slowdown, with some store sales rising just 1% by early 2008. The stock price fell by nearly 50% in 2007; analysts believed that the firm's troubles arose from both overexpansion and the rising commodity prices that had driven two price increases in the chain. In early 2007, Chairman Howard Schultz wondered, in a memo to all employees, if the company was becoming more like a fast-food chain and losing the "romance and theater" of its stores.

In response, Schultz again assumed the CEO position in early 2008. The company scaled down its expansion plans of eventually having 40,000 stores, and said it planned 2,000 new stores in 2008. Among some new steps initiated was the decision to stop selling hot sandwiches (that was tried for two years), because it felt that the food smell interfered with the aroma of coffee and made the store look like a fast-food chain. The company also began experimenting with a $1 coffee. Table 4 summarizes Starbucks's five-year performance.

TABLE 4 COMPANYWIDE SALES AND INCOME (IN U.S. DOLLARS)

	Dunkin Brands		Starbucks	
	Sales ($ millions)	Net Income ($ millions)	Sales ($ millions)	Net Income ($ millions)
2007	516.9	34.7	9,411.5	672.6
2008	544.9	(269.9)	10,383.0	315.5
2009	538.1	35.1	9,774.6	390.8
2010	577.1	26.9	10,707.4	945.6
2011	628.2	34.4	11,700.4	1,245.7

Source: Company annual reports

Other Players

The coffee retailing industry covered a range from mom-and-pop stores to national chains. Various players devised their own unique strategies to compete in the market.

A few years ago, Krispy Kreme Doughnuts, Inc., a North Carolina–based company, seemed to be a potential challenger in this market. It sold mainly doughnuts, based on a secret recipe, and coffee. Its famous hot glazed doughnuts attracted a loyal following and helped build the company's reputation. Its full-sized outlets were like factories, with costly doughnut-making machinery that customers could see behind a glass, churning out more than the store could sell, which were sold through area grocery stores. Krispy Kreme expanded through its own stores and gave rights to franchisees to develop major markets. However, accounting irregularities and conflicts of interests issues led to losses in 2006 and slowed down its growth. It had over 300 stores in the Unied States.

McDonald's Corp., which saw rivals draw away its customers by offering sandwiches, also decided to enter the specialty coffee segment. McCafe began in Australia in 1993 and was slowly expanded as the company saw it as a point of leverage and growth. By end 2008, it opened coffee bars selling McCafe drinks (lattes and cappuccinos, apart from regular drip coffee) inside its stores in the United States and priced these drinks to be less expensive than those of Dunkin' Donuts and Starbucks. Coffee became an important part of McDonald's business and between 2004 and 2009 increased from 2% to over 6% of McDonald's U.S. sales. Coffee alone was a $2 billion business in 2010. McDonald's was the largest coffee seller in the United Kingdom. In Australia, the McCafe menu was broader and included snacks, apart from frappes and smoothies. In Paris, McDonald's began spinning of the McCafe as a stand-alone business.

Peet's Coffee & Tea Inc., a specialty-coffee company that mainly sold coffee beans through grocery stores, had about 168 stores and planned to open more, especially in major East Coast markets. Tim Hortons, a Canadian doughnuts and coffee retailer with a franchise model that claimed to sell 8 out of 10 cups of coffee out of its 3,295 outlets in 2011 in Canada, was looking to increase its stores in U.S. markets. It had 714 outlets and was focusing on the Northeast and Midwest regions.

Conclusion

The coffee retailing industry in the United States was going through a period of transition. Observers wondered if it had reached saturation and whether the coffee category was commoditizing. At the same time, while Starbucks and Dunkin' Donuts battled for a share of the consumers' caffeine intake, some wondered if these companies were really rivals. Morningstar analyst Carl Sibiski observed, "There's a lot of professionals running around here in downtown Chicago who pass up Starbucks and go to Dunkin' Donuts. They really have two different brands and their brands mean different things." When Howard Schultz was asked (in 2004) what the difference was between Dunkin' and Starbucks, he responded, "We are in the business of creating an experience in our stores that goes beyond the product. The product is not just the coffee, it's the relationship we have with our customers, the environment, the music, the entire setting." Yet, along with continued growth, the focus of these companies was on how to innovate and respond to consumer's coffee needs, even as they faced constant challenge from newcomers.

The E-Strategy Case

Closing the Gap between Strategy Formulation and Strategy Implementation[1]

Introduction

Nearly two years ago, Suburban Bank completed a very productive strategic planning process. The process was one in which there had been broad participation from employees at all levels, and the result of the process was a document that was widely viewed as providing an energizing vision for the company. Now, over a year later, despite the changes pointed to by the strategic plan, almost no progress has been made toward achieving the plan's new strategic direction.

The New Banking Relationship

In the strategy formulation phase of the planning process, Suburban Bank concluded that in a very short time, the concept of a "primary banking" relationship between the institution and its customers will be outdated. The idea of a primary banking relationship is one where customers handle all of their banking needs at one institution. For this business model, some products are sold at low or negative margins in order to acquire and build relationships. Other products are then cross-sold at high margins to extract value from relationships that have been established.

This relationship will change as a result of a key technological environmental trend, which is the widespread use of the Internet for transactions among buyers and sellers. For the banking industry, this means more than simply setting up a Web site that gives basic information about products and points of contact. It will require the development of specialized software to support home banking by customers and free electronic transactions. In fact, companies such as Microsoft (Money) and Intuit (Quicken) already offer personal financial software that enables consumers to manage their checkbooks and integrate their personal financial affairs at home.

Also, it is expected that as software is developed to draw information from the Web about products and services offered at banks across the country, the Internet will be transformed into a giant primary banking institution (Evans and Wurster, 2000). More and more—the presentation of bills, brokerage transactions, and the soliciting and comparison of bids for credit cards and loans and other financial services—will take place online. When that happens, customers will be able to contact any financial institution for any kind of service or information (McAdam, 2005). They will be able to compare alternative product offerings from as many banks as they want, move funds automatically between accounts at different institutions, and post their requirements for a loan, for example, and accept and compare bids from banks that respond to the inquiry.

In the world of Internet banking, the old competitive value of one-stop shopping and established relationships that banks enjoyed will decline. The winner in any contest

[1] The E-Strategy case, written by Julie Siciliano and Peter Hess of Western New England University, was published in the *Journal of Business Cases and Applications*, Winter 2009: pp. 46–53.

for a consumer's business is less likely to be the primary bank and more likely to be the organization that provides the best offer for that particular product or service.

The E-Strategy

Through its strategic planning process, Suburban Bank concluded that banks will not become obsolete, but their current business definitions will. The smartest institutions will transform themselves into navigators or facilitating agents. The business of banking will be the business of helping customers to navigate the Internet to get the best deal possible on products and services to meet their financial needs.

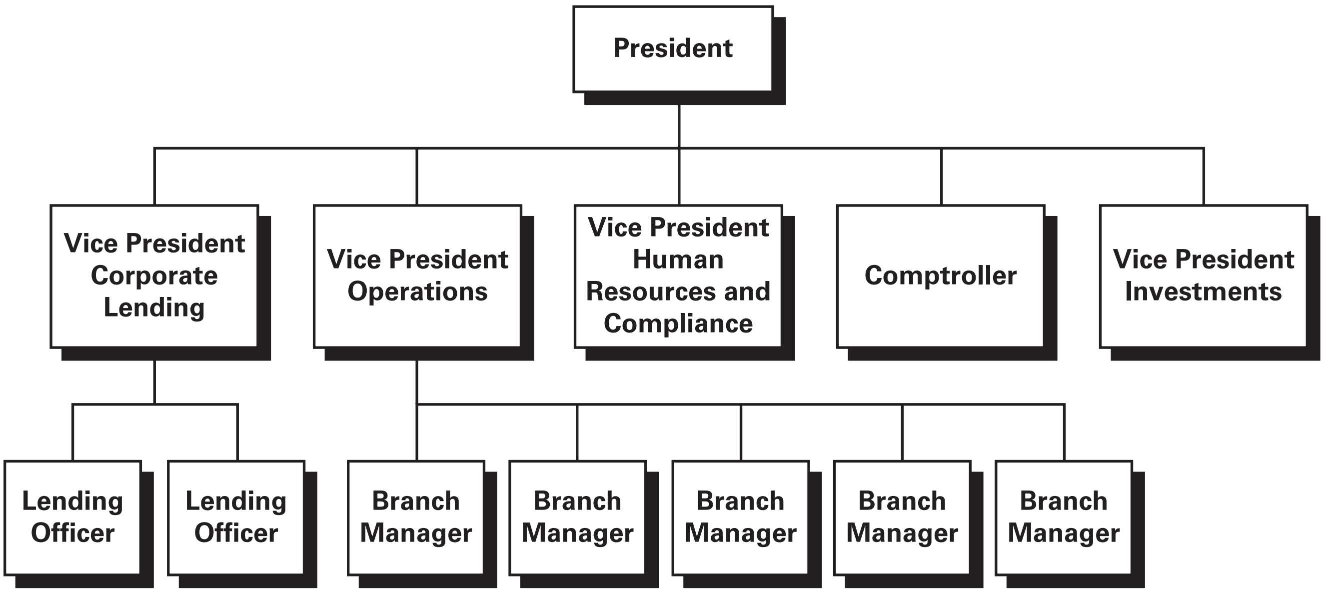
It was this analysis that persuaded Suburban Bank planners that a new strategic direction was necessary to ensure long-term growth and profitability for Suburban Bank. The new direction was labeled the E-Strategy, and it symbolized a change from the type of growth that the bank achieved through building and acquiring branches to one where new business would come from the bank's role as an Internet financial navigator. Since this involved completely new thinking, the planning group recommended that responsibility for the new direction be placed with an E-Strategy committee made up of managers and staff from all areas of the organization.

The Implementation Committee

The E-Strategy committee was formed with a lot of fanfare, and the president of Suburban Bank hosted an all-employee reception to show his support for the bank's new direction. An employee representative from each department, as shown in the bank's current organizational chart in Figure 1, joined the newly formed committee; and the group began its job of e-strategy implementation with great enthusiasm.

Committee meetings were scheduled every Friday at noon. Employees brought their lunches and discussed how to implement the new strategy. The committee began its work by first trying to decide the particular approach the bank should take in becoming an Internet navigator bank or a facilitating agent. From the beginning, many of the members of the committee had great difficulty understanding how a bank might operate without its bricks-and-mortar—the branches. "People come to us because of where we're located," was a typical comment. "A lot of our older customers don't even have computers."

FIGURE 1 SUBURBAN BANK ORGANIZATIONAL STRUCTURE



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There were also members of the committee who seemed unwilling to accept any suggestion that might require substantial changes in how their particular department or area might be required to operate. These individuals were careful, however, not to position themselves as opposing the new direction. Thus, comments like "I think we have to move in the new direction; I just think we have to be careful not to change the things that don't need changing" were not uncommon. Other members of the committee disagreed with this view, a few becoming frustrated with what they saw as foot dragging by those who seemed afraid to move the bank into the 21st century. For these few, the new e-strategy was exactly the right direction, but they were in the minority.

Some members commented privately that they thought the committee had the wrong people on it. One observed, "The president wants every area and branch represented, but that means putting all of in the hands of the ones with the most to lose with the kind of change this will take." Another member commented, "We need everyone's buy-in and ideas, but we're supposed to design a whole new way of doing business, and we're expecting the people who are good at the old way—and who like things the way they are—to be the designers. Does that really make sense?"

To make matters worse, attendance at the committee meetings was often a problem. More than a few of the committee members reported having difficulty leaving their regular work to attend the meetings. "It's not like somebody else is doing the work on my desk while I come to these meetings." To which another member responded, "At least you're the manager in your area. I get a dirty look from my boss every time I leave to come down here. And I'm using my own lunch hour, which I don't think any of us should have to do." On that point, everyone in the group was in agreement.

Finally, more than a few committee members were clearly not convinced that the president was serious about this new direction. "Wait and see," seemed to be their attitude. "There's no reason to put too much effort into this. This plan will end up on the shelf similar to every other plan that's been rolled out around here for the past twenty years."

For all of these reasons, several months' discussion resulted in virtually no progress relative to deciding what Internet navigator might mean for Suburban Bank. Hoping to re-establish at least some momentum, the committee decided to place that discussion on hold, and shift its attention to preparing a job description for the new Webmaster.

As a consequence of having put on hold the decision regarding the approach Suburban would take to become an Internet financial navigator, the committee could only come up with a fairly general job description for the Webmaster's position. Basically, it indicated that the new position would be responsible for revising the bank's current static home page to one that included links to a wide range of data bases and search engines. These links would provide access to information on the Internet about banking products and services. The person filling the position would also be responsible for creating the bank's proprietary software that customers would be given to allow them to conduct all of their banking-related transactions over the Internet. Based on this admittedly very general description, the position was filled. However, in less than three months, the new Webmaster resigned. While the public explanation was that the individual had decided to pursue an exceptional opportunity outside the area, it was fairly common knowledge that this individual had become increasingly frustrated with the fact that no one at the bank—president, senior executives, and committee members—seemed to be able to agree on just what the bank meant by Internet financial navigator.

So now, nearly a year after its creation, the e-strategy committee had nothing to show for its efforts. There was still no agreement on what the bank's specific approach would be to becoming an Internet financial navigator for its customers, and the Webmaster position was again vacant. The process that had begun with such great energy and promise was quietly slowing to a halt.

The Gap Between Formulation and Implementation

Despite these problems, the president was more intent than ever on pursuing the new direction described in the strategic plan. He reassured the board of directors at their annual meeting that initial progress was always slow for changes as major as this, and at the all-employee holiday party, he reaffirmed his commitment to e-strategy. "Our vision is clear, we've done some work, but there's a lot of work still to be done. We will do this together, but I will not impose my ideas, my solutions on you. These must come from you. My job is to support and enable all of you as you give meaning and definition to the exciting new directions pointed to in our strategic plan. My job is to remove whatever barriers might prevent you from seizing this opportunity to put your mark on the future of this bank."

That was the president's public message to the board and to the employees. Privately, however, he was worried that bank employees may not respond to the challenge he had placed before them. He knew the old "bank with branches" model was already becoming less profitable as more and more people were moving to Internet banking, and that the competition was already moving toward greater emphasis on Internet banking. And he knew the board of directors would not be patient much longer with such slow progress in implementing e-strategy. He was also convinced, however, that the bank already had the talent necessary to make the strategy work, and costs for the necessary technology could be covered. He realized now that what was missing was an implementation plan. He knew the bank's strategic plan was solid; what was needed was a plan to ensure that the e-strategy did, in fact, move from the realm of ideas in the strategic plan to the realm of action and reality. And he knew that time was running out.

Discussion Questions

Appendix A outlines an optional strategy implementation guide and Appendix B contains worksheet charts for students to complete the discussion questions.

1. What are the forces working in favor of effective implementation of the e-strategy and those working against effective implementation?
2. What goals should be set for the bank in terms of e-strategy implementation?
3. How should the bank restructure to help implement the new strategy?
4. What leadership style is the most appropriate in this situation? Indicate and explain the rationale for any changes in policy and incentives that would facilitate the implementation process.

Appendix A: Optional Strategy Implementation Guide

Following is a two-part process for developing an implementation plan. The first part focuses on identifying the forces working toward and against implementation of the new strategy. The second part involves the integration of three key dimensions that must be considered in developing a successful implementation plan. These three components are goals, organizational structure, and leadership.

Part I. Identification of Forces Affecting Strategy Implementation

The purpose of outlining these forces is to fully recognize the broad range of factors and forces operating in a change situation. This enables the organization to make effective use of the positive forces affecting the change associated with strategy implementation,

FIGURE 2 FORCES WORKING TOWARD AND AGAINST STRATEGY IMPLEMENTATION

Positive Forces	Negative Forces
These include factors that work toward implementation of the strategy, such as the following: • Environmental changes that represent an opportunity for the organization • Key individuals and groups within the organization who are in favor of and support the change • The availability of training, technology, and other resources necessary for implementation to be effective • Information or experiences that make clear what will happen if the organization does not implement the strategy	These include factors that work against implementation of the strategy, such as the following: • Opposition from key individuals and groups • Lack of available training and resources needed to implement the new strategy • Negative information or experiences relative to the new strategy

while at the same time seeking to eliminate or minimize the negative forces (Lewin, 1951). Figure 2 shows examples of forces typically included in this analysis.

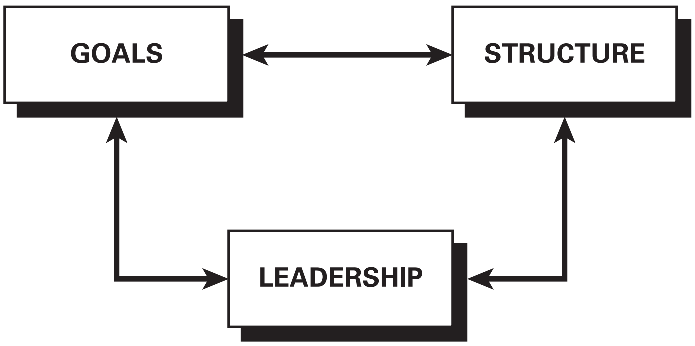
Part II. Integration of Key Elements for Strategy Implementation

The fields of organizational behavior and organization theory include a wide range of elements that affect any organizational change process. Figure 3 is a simplified model that includes some of the most frequently cited variables important to the strategy implementation process.

Goals. The definition of a goal is a statement that sets forth a specific, desired performance result or outcome with a time frame. Goals should reflect key dimensions of performance for which specific measures can be developed. Often, these measures fall into the categories of *customers, internal operations, human resources, and finance* (Kaplan and Norton, 1996). *Customer* measures may consist of customer satisfaction levels, customer retention statistics, market share of customer segments, and the number of new customers. *Internal operation* measures are concerned with technology usage, rates of improvement in terms of processing customer accounts, and the efficiency of business processes,. *Human resources* assess the employee dimension. Measures consist of goals related to employee skills, education and training, morale, and turnover statistics, to name a few. Finally, *financial* measures deal with revenue, profit, and other financial goals.

To be effective in terms of providing direction and serving as a benchmark against which to evaluate the implementation of an organization's intended strategy, goals must be stated in specific and measurable terms. Generalities, such as "improve communication" or "adequate performance," should be avoided, since it is difficult to measure progress and take corrective action when goals are stated in such nonspecific terms.

FIGURE 3 KEY ELEMENTS FOR STRATEGY IMPLEMENTATION



Organizational Structure. Companies often create organizational charts to show who reports to whom and how tasks are divided. How departments are set up is the organization's structure, and different structures are required to implement different strategies. For example, a company that chooses a diversification strategy would most likely change its structure to divisions, rather than be set up solely in departments by functions, such as marketing, finance, operations, and human resources. Or, if emphasis is placed on customer service, a new department may be set up to drive the organization's efforts in that area.

Leadership. Top management leadership styles play a critical role in determining the success or failure of strategic implementation. Bourgeois and Brodwin (1984) described five fundamental approaches to implementing strategies that range from telling employees to implement the strategy to empowering employees who will develop and implement strategies on their own. In each approach the leader plays a somewhat different role and uses different methods of management, as noted in Figure 4.

In addition to the approach taken, leadership also attempts to support and encourage change through modifications to policies and various incentives. Incentives may include nonfinancial elements, such as recognition programs and team celebrations, or compensation-based programs such as bonuses, profit-sharing, or other financial incentives.

FIGURE 4 LEADERSHIP STYLES

Commander approach—The leader provides detailed, centralized direction to guide the implementation of the organization's strategy.

Change approach—The leader focuses on changing the structure, incentive compensation, and control systems of the organization to facilitate implementation of the new strategy.

Collaborative approach—The leader uses group decision making and negotiated outcomes to implement the new strategy.

Cultural approach—The leader focuses on infusing employees throughout the organization with a strong set of collective values, which allow broad-based participation in strategic implementation.

Crescive approach—The leader makes middle managers responsible for developing, championing, and implementing the new strategy. This approach, more than any of the others, shifts decision making and implementation authority to lower levels.

Appendix B: Student Worksheet

Steps:

1. Prepare the chart of forces working toward and against the implementation.
2. Identify four goals that are specific and include numeric measurement targets.
3. Outline a different organizational structure with new divisions or departments that will facilitate the new strategic direction.
4. Complete the table by recommending leadership style, policy changes, and incentives.

FIGURE 5 CHART OF IMPLEMENTATION FORCES

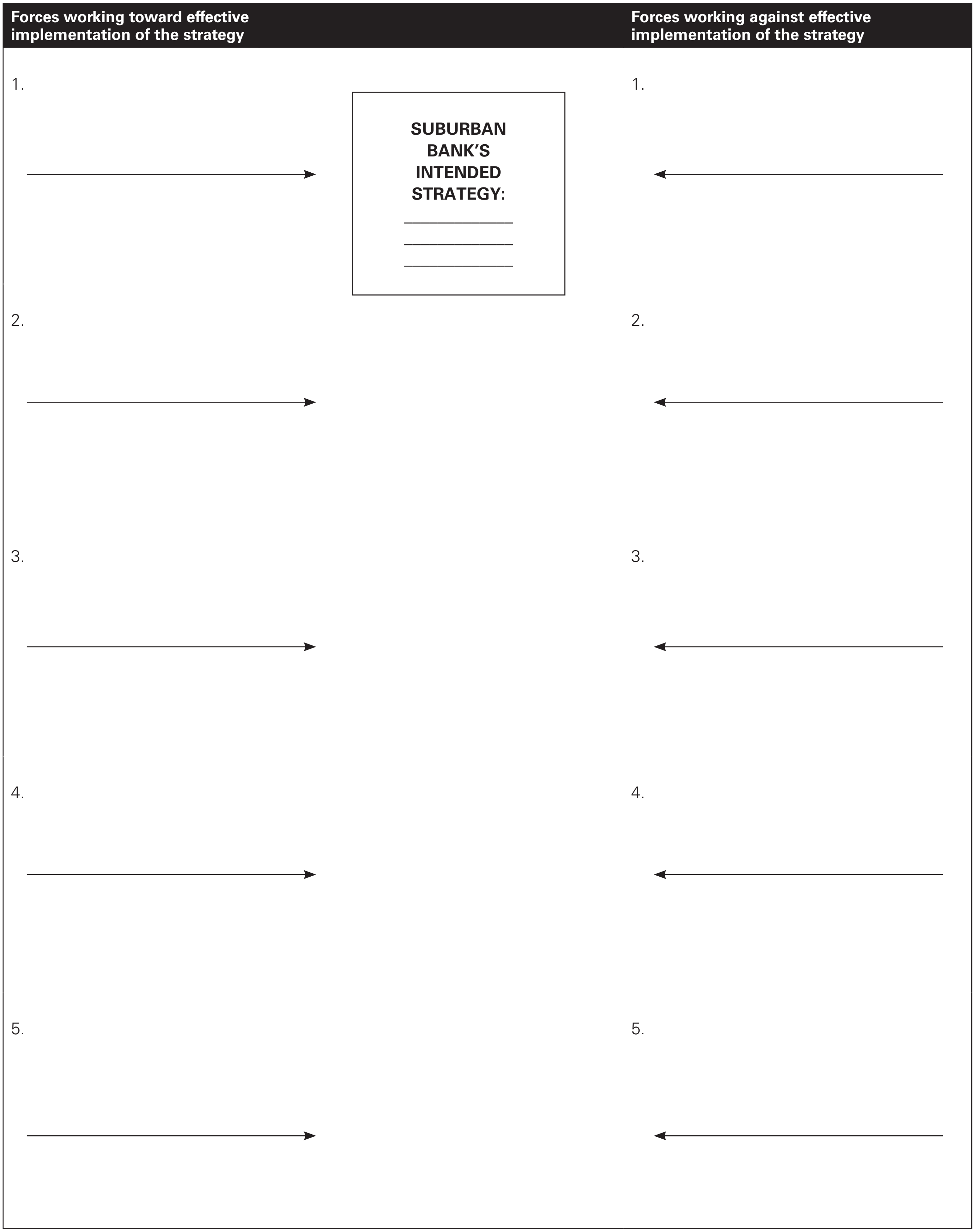


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FIGURE 6 CHART OF GOALS

Goal (specific and measurable)	Time frame	Responsibility
1.		
2.		
3.		
4.		

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FIGURE 7 ORGANIZATIONAL STRUCTURE CHART

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FIGURE 8 CHART OF LEADERSHIP STYLE AND POLICIES

Leadership style to enact strategy	Policy changes	Incentives

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PART V

Semester Projects

Team Projects

MICA

Team Projects

Project A: Comparing Two Organizations in the Same Industry

Project B: Identifying Strategic Issues at Local Business Organizations

OBJECTIVES

These guidelines for two team projects help prepare you and your team for studying strategic issues that organizations face in the context of their environment.

A model of strategic management stipulates that there be a fit between the firm and its environment in order for the firm to achieve its long-term goals. Both of the projects described here provide a framework for analyzing the strategy of a firm in relation to its environment. Teams that work on Project A will compare and contrast the strategic issues faced by two competitors in the same industry. If access to a local organization is possible, Project B is another option that gives teams an opportunity to analyze the strategic management process and its various components at a nearby firm.

Teams should comprise three to five learners. Each project is divided into phases as described in the left column of its respective table. In the right column, relevant Strategy Sessions or industry profiles have been suggested for the teams to review, which provide examples of how to apply analytical models to company situations.

Project A: Comparing Two Organizations in the Same Industry

Phase I Industry Analysis	Strategy Sessions/Industry Profile
1. Choose an industry.	See Part IV—Lodging Industry Profile and the Template for Industry Survey
2. Gather information on the industry.	
3. Analyze the industry. What can you conclude about the attractiveness of the industry over the next three years?	Strategy Session 6—Forces Affecting Competitive Strategy
Phase II Two Competitors in Industry	
Identify two publicly held companies that are operating in the industry you have studied. Preferably, choose two that have had very different performances in the recent past. Divide the team into two subunits, and each unit will focus on one company.	
1. Each team subunit should identify the current strategy of the firm and appraise its internal resources and capabilities. How is the current strategy incorporating these competencies and helping the firm compete within the industry?	Strategy Session 7—Generating a Plan of Action: TOWS Analysis Strategy Session 8—Developing Generic Strategy Strategy Session 9—Build Your Competitive Advantage Strategy Session 10—Viewing Corporate Strategy from the Core Competencies Perspective Session 17—Strategy Implementation Using the 7-S Model

2. Evaluate the current performance of the firm. How successful has the strategy been in generating an above-average financial performance of the firm over time and in relation to the industry and competitors?	Template for Assessing Company Financial Performance
Phase III Final Analysis	
Re-unite both subunits of the team and conduct the final analysis.	
1. Compare the two firms. Faced with the same industry environment, examine how and why the firms pursued the strategies they did.	
2. What are your recommendations for each of them? How would you change their strategies? What recommendations do you have for implementation?	

Project B: Identifying Strategic Issues at Local Business Organizations

Phase I Company Selection	
Identify an organization in your local community. This must be a firm that you have access to both in terms of (1) being able to visit the offices and plants and (2) being able to interview at least one senior company official. The company may be small or large and can operate either in the profit or nonprofit sector. If it is a large organization with divisions in several industries, such as General Electric, choose one of the divisions for this study.	
Phase II Overview	**Strategy Sessions/Industry Profile**
Identify the industry in which the organization (or division) competes.	See Part IV—Lodging Industry Profile and the Template for Industry Survey
1. Gather information on the industry.	
2. Analyze the industry. What can you conclude about the attractiveness of the industry over the next three years?	Strategy Session 6—Forces Affecting Competitive Strategy
Phase III Strategic Issues Identification	**Strategy Sessions**
1. Identify one or two major strategic issues the company faces. State them in a question form. To develop the issues, do *either* of the following:	
a. Develop a table of the definitions of strategy applied to the company. Analyze results from an intended versus emerged strategy perspective, which the definitions help to clarify.	Strategy Session 2—Understanding the Concept of Strategy
b. Based on your reading of the firm and its environment, identify issues that you feel the company must tackle now in order to place it in a better position into the future.	Strategy Session 1—Decision Making at the Strategic and Operational Level
2. After undertaking your analysis (including financial performance) based on publicly available information, meet with company officials and discuss your findings. Use their input to further refine your analysis. Bring your analysis to a conclusion with recommendations.	Strategy Session 7—Generating a Plan of Action: TOWS Analysis OR Strategy Session 17—Strategy Implementation Using the 7-S Model

Report Format

Present your project work in the form of a written report and an oral presentation to the class. In the case of Project B, you may consider giving a copy of your report to the organization, or inviting the company official who was your contact to the class presentation. Your written report should:

1. be no more than about 6,000 words (12 pages). Place all tables and charts in appendixes in the end.
2. be organized in such a way that the report follows the phases of the project.
3. include a complete list of references at the end of all published information, Web sites, and interviews that were sources of information.

Your presentation should last about 20 minutes. Do not repeat all the information in the report, but plan your presentation around the key points you wish to convey to the audience.

MICA

Method of Case Analysis and Discussion

The analysis of case studies is one of the most popular techniques for applying strategic management theory to real-life situations. Typically, you read a factual account of a problem or issue faced by an organization and then come to class prepared to discuss the situation and make recommendations.

The MICA method is an approach to case discussion that is designed to increase student preparation and bring about full-class participation. Its focus is on discussion of the case versus a formal presentation of the case by a team of students. There are four main components to the MICA process:

1. Students submit before class a proposed strategic-level and an operational-level action step (a recommended course of action that the company or individual in the company should take).
2. During the class, a student team administers the case discussion.
3. Class members discuss the action steps proposed by the class and vote on the most acceptable course of action.
4. The instructor evaluates the students based on "what they say at the time they say it" using established MICA scoring criteria.

For each case that is assigned, a team of students administers the case discussion. The remaining students submit action steps to this administrative team before the entire class meets to discuss the case.

Action Steps

Action steps are suggestions to improve the situation described in the case. Each student submits one proposed course of action that is strategic in nature and another that is operational or functional in scope (see Strategy Session 1). For example, a strategic action step might be to sell off one of the company's divisions or to change the company's generic strategy from differentiation to cost leadership. An operational or functional action step might be to develop a new advertising campaign or hire more people in the accounts payable department. The action steps do not include any justification for the proposed action; the students provide justification later during the class discussion.

Administrative Team

The administrative team collects action steps, compiles them, types a listing, and distributes the list to the class either just before or during class. The action steps are grouped into two main categories: strategic and operational. The author's last name is shown at the end of each action step in parentheses. Because it is common for two or more students to submit similar action steps, there may be multiple authors for an action step. The team may list authors in the order in which the steps are received, determine the order of authors according to the completeness of the action step submitted, or list authors on a random basis.

The administrative team does not present or discuss the case but rather is responsible for *administering* class discussion. The team's roles include a chairperson, a counter, and as many recorders as needed. In small classes, teams may consist of as few as two persons (chairperson-recorder roles being combined and a counter) to as many as six (three students handle compiling and typing the action steps; the other three students conduct the case discussion as chairperson, counter, and recorder).

The counter keeps track of how many times each class member has been called on and assists the chairperson in selecting speakers. This process is designed to provide an equal-discussion opportunity for those who wish to participate. The recorder puts on the board any action steps that were modified at the start of class. He or she lists all action steps being discussed and records the outcome of each action step.

Process

1. Introduction

The administrative team arrives early to class. Action steps are distributed to the other members of the class as they arrive. The team signals the start of class by introducing all members of the team, identifying the company to be discussed, and the time frame on which the discussion should center.

2. Modifications of Action Steps

To begin the case discussion, the chairperson asks if the team has compiled any modifications or amendments to the action steps. For example, a member of the class might suggest that step 5, which is to sell the clothing division of the company, is similar to step 12, which is to divest an operation. The administrative team consults with the authors of both steps and decides whether the steps should be combined.

3. Discussion of Strategic-Level Action Step

Once the proposed action steps have been modified or clarified, the team begins discussion of strategic-level action steps by selecting the first action step from the list. Those from the class who authored the action step are called on first to provide their rationale for the proposed course of action. (Because the authors of a particular action step are called on first, they have the opportunity to present the strongest arguments, which is the basis for the scoring system.) Once the authors have completed their discussion, any class member who wishes to support or argue against the step raises his or her hand and is called on by the team chairperson. The administrative team is responsible for cutting off "long-winded" discussions and terminating discussions of a particular course of action when arguments become redundant.

After an action step has been thoroughly discussed, the administrative team conducts a vote of the class whether to accept or reject the action step. If accepted, it becomes a fact of the case. At this point, the administrative team randomly chooses three or four strategic-level action steps (usually from an envelope containing the numbers for each action step). Then the class votes on what step to discuss next. Class members may vote for more than one step; and the chairperson breaks any ties. This process continues until all strategic steps are discussed or until the administrative team feels it is time to move on to operational-level steps.

4. Discussion of Operational-Level Action Steps

The administrative team guides the discussion of operational-level courses of action in the same way that the strategic steps were handled. This continues until approximately 10 to 15 minutes before the class period ends. Typically, the majority of strategic-level action steps are discussed and three or four operational-level steps are covered.

5. Closing the Case Discussion

The administrative team ends the discussion of action steps 10 to 15 minutes before the class period ends. (Typically, there are operational-level action steps that are not discussed. However, students are reminded that the major emphasis of the course is on strategic decision making.) Then the chairperson asks the class if anyone prepared research that was not used during the class discussion ("unspent research"). One article per class member is allowed, and students receive additional credit based on their oral summary of the article's content as it applies to a particular action step. These summaries should be brief and take 1 to 2 minutes at most.

The administrative team delivers a brief summary of the decisions made by the class and asks its members to spend a few minutes thinking about their class discussion. Have they helped the company with their strategic decisions? Did they notice any pattern in the steps chosen or in the class's discussion? For example, during one session, every action step got a "no" vote. Several class members noted this was because the company had been losing money, and people were reluctant to make any major changes.

Scoring

The instructor, seated at the back of the room, assigns points to class members based on the content and frequency of their arguments. Each time a student speaks, he or she may earn from 0 to 4 points, plus bonus points judged by the instructor. Authors of action steps speak first and have the greatest opportunity to back up their argument with facts not yet given. This means, of course, that authors tend to accumulate points quickly. In addition, the first time any class member speaks, he or she is awarded one bonus point regardless of content to encourage participation and give evidence of attendance.

For each case, a student may earn a minimum of 0 and a maximum of 25 points. Students receive points only if their comment is relevant to the action step being discussed, if it contains a supportive argument, and if it is not a repeat of what was said by another student earlier in the discussion. The score for each member of the administrative team equals the highest points allocated to any student for that day; thus the team has an incentive to keep the discussion moving along so that fellow class members will score points.

When the last action step has been discussed and the vote recorded, the instructor asks if any class member feels that he or she was discriminated against (e.g., consistently had a hand up but was not called on). If a student indicates that this occurred, the instructor asks the administrative team's counter (a) how many times the class member was called on in a nonauthor priority call; and (b) excluding author calls, what was the average number of times students were called on that day. The administrative team comments on the alleged discrimination, and the instructor considers his or her own observations and the statements of the student and the administrative team. If it is judged that discrimination occurred, the student is given one to three first discussion opportunities (after the authors) during the next case. In addition, 3 to 10 points may be deducted from the case grade of each member of the administrative team for that case. Under these circumstances, bona fide cases of discrimination rarely occur.

Scores are posted on a spreadsheet at the end of class, using student identification numbers for confidentiality.

Instructor's Roles

The instructor's roles include coaching, scoring, altering the course of debate during the case discussion as required, enforcing MICA rules as needed, and providing a wrap-up at the end of the period. The instructor may intervene at any time during the class for the purpose of guiding discussion or coaching students.

For example, the instructor may accept or reject an action step without allowing discussion if it is deemed a standard business practice or if it is too trivial to be discussed given the context of the case. Suppose the class voted to discussion an action step such as "the company needs a mission statement." The instructor should stop the process, remind the class that this action step as it stands is a normally expected business practice, and indicate that it would be difficult to develop arguments against this step. The author should develop a proposed mission statement and submit it as an action step, which can then be debated.

Coaching is a way of showing students how to score points. It is used extensively in the first few cases or in a trial case. An example of coaching would be an intervention by the instructor after a student comment. The instructor would note that the student did not score points because someone else had already made the comment or that no points were scored because the research presented did not apply to the action step being discussed.

If necessary, altering the course of debate is important, particularly during the early cases. If the class discussion moves away from the specifics of the action step being discussed and if the administrative team does not quickly refocus the discussion, the instructor must interrupt immediately and note what has happened, reminding the class that no points are awarded for these digressions.

At the end of the period, the instructor asks the class members if, in their opinion, they have helped the company. Students comment on their perceptions, and as the semester progresses, they usually become more aware of the quality of their decisions. For example, one group discussed a company that had been a takeover target and had high levels of debt. Yet in the wrap-up session, the group noted that, although they considered the debt when discussing courses of action (difficult to get loans for expansion and the like), the final strategies they recommended did not help the company become more solvent. Several students noted that the class lost sight of the company's difficult debt situation and relied entirely on management's bright forecast for future sales and earnings.

The instructor can also use the end-of-session comments for a review of the case, update the case information, or highlight important issues that the students did not cover in their action steps. A few minutes spent highlighting the key points of the discussion gives students a sense of satisfaction that they hit the important issues, or insight into how a key learning of the case got missed in the discussion.

Summary

Student preparation for class discussion of cases is extensive. Since points are awarded based on information to support or rebut an action step, students read the cases very thoroughly. For example, it is not atypical for students to cite phrases from the case text, as well as information from tables and footnotes. Discussion is also lively. Since points are based primarily on how often students speak and what they say, class participation is very strong.

In addition, some preliminary evidence suggests that students using the MICA method reported better preparation and participation benefits as compared to students using other methods of case discussion. Also, students using the MICA method were better able to identify the main focus of the cases discussed, showing a better recall of content issues involved in case discussions.

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