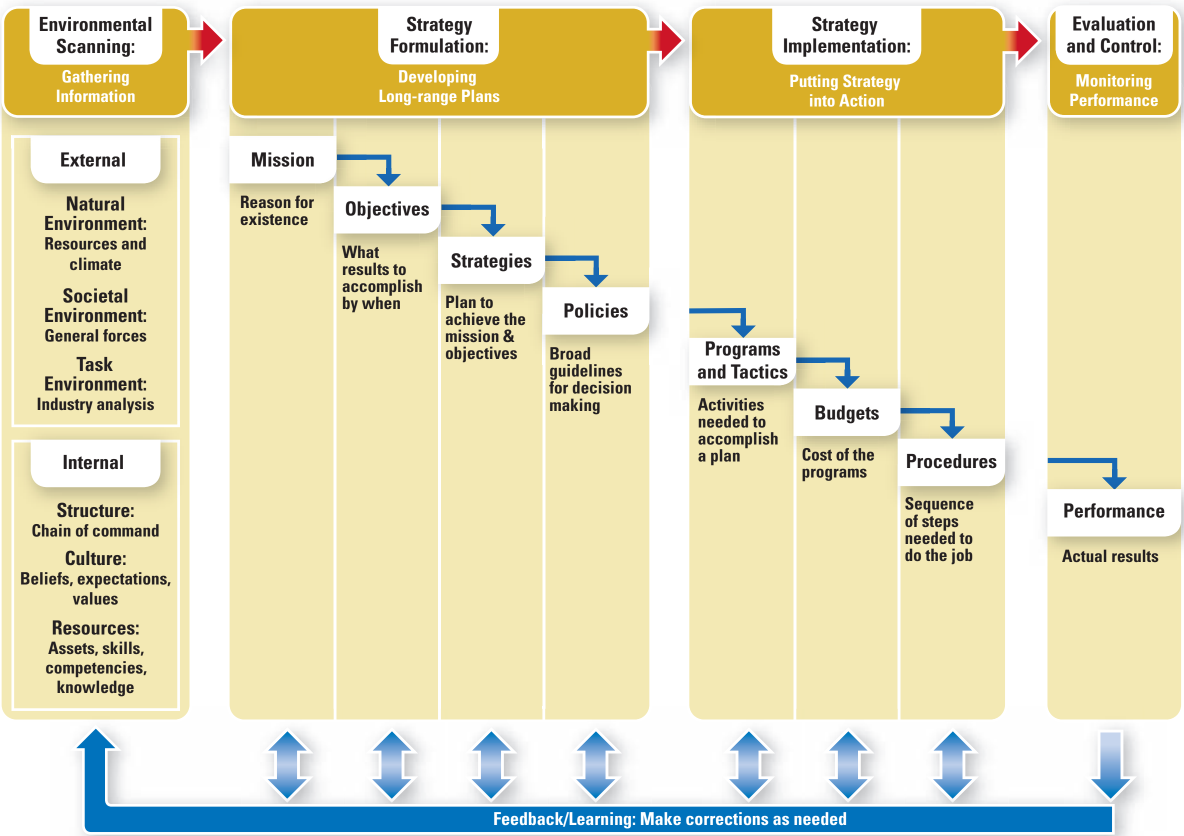
PART 1

Introduction to Strategic Management and Business Policy

CHAPTER 1

Basic Concepts of Strategic Management



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Learning Objectives

After reading this chapter, you should be able to:

1-1. Discuss the benefits of strategic management

1-2. Explain how globalization, innovation, and environmental sustainability influence strategic management

1-3. Discuss the differences between the theories of organizations

1-4. Discuss the Activities where learning organizations excel

1-5. Describe the basic model of strategic management and its components

1-6. Identify some common triggering events that act as stimuli for strategic change

1-7. Explain strategic decision-making modes

1-8. Use the strategic audit as a method of analyzing corporate functions and activities

Toyota Motors Co.

In 1937, Kiichiro Toyoda founded the Toyota Motor Corporation, headquartered in Aichi Prefecture, Japan. The company, now headed by Akio Toyoda, the President and Representative Director, has a capital of around \$179,399 million. Its primary business activities involve automotive manufacturing. As of March 2016, the company employs around 348,977 people.

Sakichi Toyoda, the founder of Toyota Industries, set certain Guiding Principles that reflect Toyota's organizational culture and values, and are the basis for the corporate management philosophy. These were first revised in 1992, and again in 1997, to support its operations in a multicultural environment. They were modified in response to the societal changes and the company's business structure, which support its global vision, strategies, and operations worldwide. An example of its strategy to keep with the changing times is the Toyota Way 2001, which focuses on CSR and customer orientation, innovative management, and the nurturing of its employees' creativity and teamwork, mutual trust, and respect between labor and management. At the heart of the Toyota Way are two pillars—continuous improvement and respect for people. These are supported by five values: challenge, continuous improvement (kaizen), seeing for yourself (genchi genbutsu), respect, and teamwork.

In 1997, Thailand, a regional hub of Toyota's auto manufacturing industry in ASEAN, faced an economic crisis resulting from over-investment in real estate and a liberal financing policy. Toyota Motor Thailand Co., Ltd. (TMT) subsequently encountered huge losses. To overcome the crisis various actions were taken—the TMT first requested and received two capital injections, totaling US\$200 million, from Toyota Motor Corporation in Japan. However, since the automotive market was down by about 75%, the TMT had to use a job-sharing approach to retain its skilled, but redundant, workforce. Together with this measure, the company observed it's "no lay-off" policy by sending about 200 idle associates to Japan for training, while others assisted their local dealers. To avoid further losses, TMT focused on 100% localization of parts and took advantage of export opportunities. Undertaking new business reforms, such as online management of vehicle supply and demand and the formation of project teams in finance and marketing, helped boost new vehicle sales. For dealers and suppliers, TMT granted credit lines and short-term loans.

At the time, the former king of Thailand, Bhumibol Adulyadej, showed concern for the issues of possible unemployment and granted a purchase order to TMT to produce a Toyota Soluna (Vios) and prolong the working period of Thai workers. Instead of selling the vehicle, TMT presented it to the king as a gift; the King, in turn, granted $17,518 (600,000 baht) to TMT to help establish the Rachamongkol Rice Mill, a project spearheaded by Ninnart Chaithirapinyo, the Vice Chairman of TMT. As an ongoing TMT-CSR activity, the mill still helps rice farmers maintain their crop prices and benefits TMT associates and the overall community. In brief, TMT overcame the crisis of 1997 by using Kaizen to strengthen its competitiveness and improving communication among top management and all of its associates.

In its developmental path towards sustainability, Toyota Motors set a Global Vision. The medium- to long-term management plan is prepared and implemented with the controlling measures as a feedback in its management system. In the implementation process, the Toyota Way 2001 and the Toyota Code of Conduct serves as an important global guideline for daily business operations for all employees.

Toyota's divisional organization structure is based on varied business operations, but is linked to the traditional Japanese organizational structures. In 2013, as a response to the safety issues and corresponding product recalls crisis of 2009, the centralized hierarchical structure underwent significant changes to become more decentralized. After the re-organization, Toyota's new organizational structure has the following main characteristics: global hierarchy, geographic divisions, and product-based divisions. The company is now more capable of responding to regional market conditions and is empowered to speedily respond to issues and to provide higher quality products. However, the increased decision-making power of regional heads has reduced headquarters' control over the global organization. Still, this organizational structure facilitates business resilience and continued growth.

A study by Wells and Orsato (2005) suggests that there is currently a shift away from the current all-steel, internal combustion engine car, which requires automakers to fundamentally reform their systems of production. The business challenges and the governmental regulations to preserve the environment means cars of the future have to be eco-friendly. This created a big challenge for auto firms that have sunk investments in the existing traditional car manufacturing technology.

In 2009, as a result of its worldwide recall-crisis and with over 8 million vehicles addressing issues related to 'unintended acceleration,' Toyota had a great lesson in keeping up with its production and leveraging of quality, durability, safety, and reliability issues. The company continued to develop innovative models to overcome environmental regulation challenges and to add a 'humanistic' dimension to consumers' image of auto companies. Its strategic direction is to go beyond zero environmental impact and achieve a net positive impact and sustainability.

SOURCES: Orsato, R. J. and P.Wells (2007a) "The Automobile Industry & Sustainability", *Journal of Cleaner Production* 15 (2007) 989-993; Orsato, R.J. and P. Wells (2007b) "U-Turn: The Rise And Demise Of The Automobile Industry," *Journal of Cleaner Production*, 15 (2007) 994-1006; Wells P, Orsato R. Redesigning the industrial ecology of the automobile; *Journal of Industrial Ecology* 2005;9(3):15e30; Prahalad C, Hamel G. "The core competence of the corporation," *Harvard Business Review*, Vol. 79-91, May and June, 1990; "Top 100 Most Innovative Companies Shift Focus from Quantity To Quality," Clarivate Analytics, http://www.prnewswire.com, accessed January 2017; "The Most Innovative Companies 2016: Getting Past "Not Invented Here"," The Boston Consulting Group, https://media-publications.bcg.com, accessed January, 2017; Guiding Principles at Toyota, http://www.toyota-global.com/company/vision_philosophy/guiding_principles.html; Jon Miller, "Challenging 'Challenge' Within the Toyota Way," *Quality Digest*, November 19, 2012, https://www.qualitydigest.com; Lawrence Gregory, "Toyota's Organizational Structure: An Analysis," *Panmore Institute*, February 1, 2017, http://panmore.com/toyota-organizational-structure-analysis; and http://www.toyota-global.com/sustainability/environment/challenge2050/

The Study of Strategic Management

1-1. Discuss the benefits of strategic management

Strategic management is a set of managerial decisions and actions that help determine the long-term performance of an organization. It includes environmental scanning (both external and internal), strategy formulation (strategic or long-range planning), strategy implementation, and evaluation and control. Originally called *business policy,* strategic management has advanced substantially with the concentrated efforts of researchers and practitioners. Today, we recognize both a science and an art to the application of strategic management techniques.

PHASES OF STRATEGIC MANAGEMENT

Many of the concepts and techniques that deal with strategic management have been developed and used successfully by the largest business organizations in the world as well as the newest startups. Over time, business practitioners and academic researchers have expanded and refined these concepts. One of the most critical drivers of business success is a leader's ability to design and implement a strategy for the company. Increasing risks of error, costly mistakes, and even economic ruin are causing today's professional managers in all organizations to take strategic management seriously in order to keep their companies competitive in an increasingly volatile environment.

As managers attempt to better deal with their changing world, a firm generally evolves through the following four **phases of strategic management**:[1]

Phase 1—Basic financial planning: Managers initiate serious planning when they are requested to propose the following year's budget. Projects are proposed on the basis of very little analysis, with most information coming from within the firm. The sales force usually provides the small amount of environmental information used in this effort. Such simplistic operational planning only pretends to be strategic management, yet it is quite time consuming. Normal company activities are often suspended for weeks while managers try to cram ideas into the proposed budget. The time horizon is usually one year.

Phase 2—Forecast-based planning: As annual budgets become less useful at stimulating long-term planning, managers attempt to propose five-year plans. At this point, they consider projects that may take more than one year. In addition to internal information, managers gather any available environmental data—usually on an ad hoc basis—and extrapolate current trends. This phase is also time consuming, often involving a full month or more of managerial activity to make sure all the proposed budgets fit together. The process gets very political as managers compete for larger shares of limited funds. Seemingly endless meetings take place to evaluate proposals and justify assumptions. The time horizon is usually three to five years.

Phase 3—Externally oriented (strategic) planning: Frustrated with highly political yet ineffectual five-year plans, top management takes control of the planning process by initiating a formal strategic planning system. The company seeks to increase its responsiveness to changing markets and competition by thinking and acting strategically. Planning is taken out of the hands of lower-level managers and concentrated in a planning staff whose task is to develop strategic plans for the corporation. Consultants often provide the sophisticated and innovative techniques that the planning staff uses to gather information and forecast future trends. Organizations start competitive intelligence units. Upper-level managers meet once a year at a resort "retreat" led by key members of the planning staff to evaluate and update the current strategic plan. Such top-down planning emphasizes formal strategy formulation and leaves the implementation issues to lower-management levels. Top management typically develops long-term plans with help from consultants but minimal input from lower levels.

Phase 4—Strategic management: Realizing that even the best strategic plans are worthless without the input and commitment of lower-level managers, top management forms planning groups of managers and key employees at many levels, from various departments and workgroups. They develop and integrate a series of plans focused on emphasizing the company's true competitive advantages. Strategic plans at this point detail the implementation, evaluation, and control issues. Rather than attempting to perfectly forecast the future, the plans emphasize probable scenarios and contingency strategies. The sophisticated annual five-year strategic plan is replaced with strategic thinking at all levels of the organization throughout the year. Strategic information, previously available only centrally to top management, is used by people throughout the organization. Instead of a large centralized planning staff, internal and external planning consultants are available to help guide group strategy discussions. Although top management may still initiate the strategic planning process, the resulting strategies may come from anywhere in the organization. Planning is typically interactive across levels and is no longer strictly top down. People at all levels are now involved.

General Electric, one of the pioneers of strategic planning, led the transition from strategic planning to strategic management during the 1980s.[2] By the 1990s, most other corporations around the world had also begun the conversion to strategic management.

BENEFITS OF STRATEGIC MANAGEMENT

Strategic management emphasizes long-term performance. Many companies can manage short-term bursts of high performance, but only a few can sustain it over a longer period of time. Since the release of the original *Fortune 500* companies listing in 1955, more than 1,800 companies have made the list. In 2015, 18 new companies joined the list for the first time meaning that 18 others fell from the list.[3] To be successful in the long-run, companies must not only be able to *execute* current activities to satisfy an existing market, but they must also *adapt* those activities to satisfy new and changing markets.[4]

Research reveals that organizations that engage in strategic management generally outperform those that do not.[5] The attainment of an appropriate match, or "fit," between an organization's environment and its strategy, structure, and processes has positive effects on the organization's performance.[6] Strategic planning becomes increasingly important as the environment becomes more unstable.[7] For example, studies of the impact of deregulation on the U.S. railroad and trucking industries found that companies that changed their strategies and structures as their environment changed outperformed companies that did not change.[8]

A survey of nearly 50 corporations in a variety of countries and industries found the three most highly rated benefits of strategic management to be:

- A clearer sense of strategic vision for the firm.
- A sharper focus on what is strategically important.
- An improved understanding of a rapidly changing environment.[9]

A survey by McKinsey & Company of 800 executives found that formal strategic planning processes improved overall satisfaction with strategy development.[10] To be effective, however, strategic management need not always be a formal process. It can begin with a few simple questions:

- Where is the organization now? (Not where do we hope it is!)
- If no significant changes are made, where will the organization be in one year? Two years? Five years? Ten years? Are the answers acceptable?
- If the answers are not acceptable, what specific actions should management undertake? What are the risks and payoffs involved?

The Bain & Company's *2015 Management Tools and Trends* survey of 1,067 global executives revealed that strategic planning was the number two tool used by decision makers just behind customer relationship management. Other highly ranked strategic management tools were mission and vision statements, change management programs, and balanced scorecards.[11] A study by Joyce, Nohria, and Roberson of 200 firms in 50 subindustries found that devising and maintaining an engaged, focused strategy was the first of four essential management practices that best differentiated between successful and unsuccessful companies.[12] Based on these and other studies, it can be concluded that strategic management is crucial for long-term organizational success.

Research into the planning practices of companies in the oil industry concludes that the real value of modern strategic planning is more in the *strategic thinking* and *organizational learning* that is part of a future-oriented planning process than in any resulting written strategic plan.[13] Small companies, in particular, may plan informally and irregularly. Nevertheless, studies of small- and medium-sized businesses reveal that the greater the level of planning intensity, as measured by the presence of a formal strategic plan, the greater the level of financial performance, especially when measured in terms of sales increases.[14]

Planning the strategy of large, multidivisional corporations can be complex and time consuming. It often takes slightly more than a year for a large company to move from situation assessment to a final decision agreement. For example, strategic plans in the global oil industry tend to cover four to five years. The planning horizon for oil exploration is even longer—up to 15 years.[15] Because of the relatively large number of people affected by a strategic decision in a large firm, a formalized, more sophisticated system is needed to ensure that strategic planning leads to successful performance. Otherwise, top management becomes isolated from developments in the business units, and lower-level managers lose sight of the corporate mission and objectives.

Globalization, Innovation, and Sustainability: Challenges to Strategic Management

1-2. Explain how globalization, innovation, and environmental sustainability influence strategic management

Not too long ago, a business corporation could be successful by focusing only on making and selling goods and services within its national boundaries. International considerations were minimal. Profits earned from exporting products to foreign lands were considered frosting on the cake, but not really essential to corporate success. During the 1960s, most U.S. companies organized themselves around a number of product divisions that made and sold goods only in the United States. All manufacturing and sales outside the United States were typically managed through one international division. An international assignment was usually considered a message that the person was no longer promotable and should be looking for another job.

Similarly, for a very long time, many established companies viewed innovation as the domain of the new entrant. The efficiencies that came with size were considered to be the core competitive advantage of the large organization. That view has proven to be a recipe for failure. The ability to create unique value and grow an organization organically requires innovation skills. A strategic management approach suggests that if an organization stands still, it will be run over by the competition. What was extraordinary last year is the standard expectation of customers this year. We have watched many large corporations succumb to the lack of innovation in their organization. Sears was the dominant retailer in the United States for more than 70 years. Today, it is struggling to find an approach that will give it a competitive advantage. IBM was a company that dominated mainframe computing and was fortunate enough to find a visionary CEO when the mainframe market was crushed by the advent of the PC. That CEO (Louis V. Gerstner, Jr.) transformed the organization with innovation that was cultural, structural, and painful for the company employees. Innovation is rarely easy and it is almost never painless. Nonetheless, it is a core element of successful strategic management.

Lastly, until the later part of the 20th century, a business firm could be very successful without considering sustainable business practices. Companies dumped their waste products in nearby streams or lakes and freely polluted the air with smoke containing noxious gases. Responding to complaints, governments eventually passed laws restricting the freedom to pollute the environment. Lawsuits forced companies to stop old practices. Nevertheless, until the dawn of the 21st century, most executives considered pollution abatement measures to be a cost of business that should be either minimized or avoided. Rather than clean up a polluting manufacturing site, they often closed the plant and moved manufacturing offshore to a developing nation with fewer environmental restrictions. The issues of recycling and refurbishing, as well as a company's responsibility to both the local inhabitants and the environment where it operated, were not considered mainstream business approaches, because it was felt these concerns did not help maximize shareholder value. In those days, the word *sustainability* was used to describe competitive advantage, not the environment.

Today, the term used to describe a business's sustainability is the **triple bottom line**. This phrase was first used by John Elkington in 1994 to suggest that companies prepare three different bottom lines in their annual report.[16]

- Traditional Profit/Loss
- People Account—The social responsibility of the organization
- Planet Account—The environmental responsibility of the organization

This triple bottom line has become increasingly important to business today. Companies seek Leadership in Energy and Environmental Design (LEED) certification for their buildings and mold a reputation for being a business that is friendly to the world. LEED certification is available for all structures and includes a number of levels depending upon the efforts made to have a building be self-sustaining or to have as little impact (the smallest footprint) on the environment as possible.[17]

IMPACT OF GLOBALIZATION

Today, everything has changed. **Globalization**, the integrated internationalization of markets and corporations, has changed the way modern corporations do business. As Thomas Friedman points out in *The World Is Flat*, jobs, knowledge, and capital are now able to move across borders with far greater speed and far less friction than was possible only a few years ago.[18]

For example, the interconnected nature of the global financial community meant that the mortgage lending problems of U.S. banks led to a global financial crisis that started in 2008 and impacted economies for years. The worldwide availability of the Internet and supply-chain logistical improvements, such as containerized shipping, mean that companies can now locate anywhere and work with multiple partners to serve any market. For companies seeking a low-cost approach, the internationalization of business has been a new avenue for competitive advantage. Nike and Reebok manufacture their athletic shoes in various countries throughout Asia for sale on every continent. Many other companies in North America and Western Europe are outsourcing their manufacturing, software development, or customer service to companies in China, Eastern Europe, or India. English language proficiency, lower wages in India, and large pools of talented software programmers now enable IBM to employ an estimated 100,000 people in its global delivery centers in Bangalore, Delhi, or Kolkata to serve the needs of clients in Atlanta, Munich, or Melbourne.[19] Instead of using one international division to manage everything outside the home country, large corporations are now using matrix structures in which product units are interwoven with country or regional units. Today, international assignments are considered key for anyone interested in reaching top management.

As more industries become global, strategic management is becoming an increasingly important way to keep track of international developments and position a company for long-term competitive advantage. For example, General Electric moved a major research and development lab for its medical systems division from Japan to China in order to learn more about developing new products for developing economies. Microsoft's largest research center outside Redmond, Washington, is in Beijing.

The formation of regional trade associations and agreements, such as the European Union, NAFTA, Mercosur, Andean Community, CAFTA, and ASEAN, is changing how international business is being conducted. See the **Global Issue** feature to learn how regional trade associations are pushing corporations to establish a manufacturing presence wherever they wish to market goods. These associations have led to the increasing harmonization of standards so that products can more easily be sold and moved across national boundaries. International considerations have led to the strategic alliance between British Airways and American Airlines and to the acquisition of the Anheuser-Busch Companies by the Belgium company InBev, creating AB InBev, among others.

IMPACT OF INNOVATION

Innovation, as the term is used in business, is meant to describe new products, services, methods, and organizational approaches that allow the business to achieve extraordinary returns. Boston Consulting Group (BCG) found that innovation is a top 3 priority for three-quarters of the companies in the 2014 BCG global innovation survey.[20] They also found that:

- 61% were spending more money on innovation in 2014 than in 2013
- 75% of respondents reported that innovation investment was primarily aimed at long-term advantage and current competitive advantage
- The top five most innovative companies were Apple, Google, Samsung, Microsoft, and IBM
- 70% of executives felt their own companies' innovation capabilities were only average and 13% felt they were weak.

GLOBAL issue

ASEAN: REGIONAL TRADE ASSOCIATIONS

The Association of Southeast Asian Nations (ASEAN) was formed in 1967 with 5 founding members: Indonesia, Malaysia, the Philippines, Singapore, and Thailand in an effort to reduce regional hostilities and to fight the potential threat of communist-led insurgencies at the height of the U.S. war in Vietnam. They signed the Treaty of Amity and Cooperation emphasizing ASEAN's promotion of peace, prosperity and stability. Later in 1990s, Brunei (1984), Vietnam (1995), Laos and Myanmar (1997), and Cambodia (1999) joined the ASEAN. Along with the regional security objectives, ASEAN have established its regional economic integration, ASEAN economic community (AEC). The AEC's four pillars include: the creation of a single market with the free flow of goods, services, investment, and skilled labor; fair economic competition; sustainable and equitable economic development; and integrating ASEAN into the global economy. ASEAN have liberalized intra-ASEAN trade over the last 20 years by establishing the ASEAN Free Trade Area (AFTA).

The region accounts for over 600 million people and a combined GDP of about $2.6 trillion in 2014. Historically, ASEAN has been one of the most liberal and attractive investment regimes among developing countries. It has liberalized intra-ASEAN trade over the last 20 years by establishing the ASEAN Free Trade Area (AFTA). During 2001-2013, it was the second fastest growing economy in Asia, i.e., China (575%) and ASEAN (313%), while those in the U.S. and E.U. have slowed down significantly. It is expected to rank as the world's fourth-largest economy by 2050. With the drop in FDI from developed countries, the emergence of FDI from ASEAN, which is rising, could complement the drop. Furthermore, ASEAN countries such as Singapore, Malaysia, and Thailand are also gradually extending their contribution to world FDI.

SOURCES: Lee, C. and y. Fukunaga,"ASEAN Regional Cooperation on Competition Policy", *Journal of Asian Economics,* (2014), 77–91; and Eleanor Albert, "ASEAN: The Association of Southeast Asian Nations," Council on Foreign Relations, (September 1, 2016), www.cfr.org.

Innovation is the machine that generates business opportunities in the market; however, it is the implementation of potential innovations that truly drives businesses to be remarkable. Although there is a value in being a first mover, there is also a tremendous value in being a second or third mover with the right implementation. PC tablets had been developed and sold for more than two decades before the iPad stormed the market. Many people forget that Apple released the Newton tablet back in 1992.[21] Not only was the timing not right, but the product was not promoted in a way that consumers felt a compelling need to buy one. Many elements have to come together for an innovation to bring long-term success to a company.

IMPACT OF SUSTAINABILITY

Sustainability refers to the use of business practices to manage the triple bottom line as was discussed earlier. That triple bottom line involves (1) the management of traditional profit/loss; (2) the management of the company's social responsibility; and (3) the management of its environmental responsibility.

The company has a relatively obvious long-term responsibility to the shareholders of the organization. That means that the company has to be able to thrive despite changes in the industry, society, and the physical environment. This is the focus of much of this textbook and the focus of strategy in business.

The company that pursues a sustainable approach to business has a responsibility to its employees, its customers, and the community in which it operates. Companies that have embraced sustainable practices have seen dramatic increases in risk mitigation and innovation, and an overall feeling of corporate social responsibility. The 2014 Sustainability & Employee Engagement survey managed by GreenBiz in association with the National Environmental Education Foundation found that employees at companies who focused on business sustainability reported 57% applied more effort in their jobs and 87% were less likely to leave the company. In addition, more than 50% of companies place at least some or a great deal of value on a job candidate's sustainability knowledge.[22] In fact, a Gallop research study found that these engaged organizations had 3.9 times the earnings per share (EPS) growth rates when compared to organizations with lower engagement in the same industry.[23]

The company also has a responsibility to treat the environment well. This is usually defined as trying to achieve (or approach) zero impact on the environment. Recycling, increased use of renewable resources, reduction of waste, and refitting buildings to reduce their impact on the environment, among many other techniques, are included in this element of the triple bottom line. The most recognized worldwide standard for environmental efficiency is the ISO 14001 designation. It is not a set of standards, but a framework of activities aimed at effective environmental management.[24]

South American countries are also working to harmonize their trading relationships with each other and to form trade associations. The establishment of the **Mercosur** (**Mercosul** in Portuguese) free-trade area among Argentina, Brazil, Paraguay, Uruguay, and Venezuela brings together a group that includes 295 million people and $3.5 trillion in combined GDP. As of late 2015 Bolivia was in the final stages of accession. The **Andean Community** (Comunidad Andina de Naciones) is a free-trade alliance composed of Columbia, Ecuador, Peru, and Bolivia (until its acceptance into Mercosur). On May 23, 2008, the **Union of South American Nations** was formed to unite the two existing free-trade areas with a secretariat in Ecuador and a parliament in Bolivia. It consists of 12 South American countries.

In 2004, the five Central American countries of El Salvador, Guatemala, Honduras, Nicaragua, and Costa Rica, plus the United States, signed the **Central American Free Trade Agreement (CAFTA)**. The Dominican Republic joined soon thereafter. Previously, Central American textile manufacturers had to pay import duties of 18%–28% to sell their clothes in the United States unless they bought their raw material from U.S. companies. Under CAFTA, members can buy raw material from anywhere, and their exports are duty free. In addition, CAFTA eliminated import duties on 80% of U.S. goods exported to the region, with the remaining tariffs being phased out over 10 years.

The **Association of Southeast Asian Nations (ASEAN)**—composed of Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam—is in the process of linking its members into a borderless economic zone by 2020. Increasingly referred to as ASEAN+3, ASEAN now includes China, Japan, and South Korea in its annual summit meetings. The ASEAN nations negotiated linkage of the ASEAN Free Trade Area (AFTA) with the existing free-trade area of Australia and New Zealand. With the EU extending eastward and NAFTA extending southward to someday connect with CAFTA and the Union of South American Nations, pressure is building on the independent Asian nations to join ASEAN.

Porter and Reinhardt warn that "in addition to understanding its emissions costs, every firm needs to evaluate its vulnerability to climate-related effects such as regional shifts in the availability of energy and water, the reliability of infrastructures and supply chains, and the prevalence of infectious diseases."[25] The National Centers for

Environmental Information has calculated that there were 178 weather and climate disasters where damages exceeded $1 billion between 1980 and 2014. The total cost of these 178 events exceeded $1 trillion.[26]

Theories of Organizational Adaptation

1-3. Discuss the differences between the theories of organizations

Globalization, innovation, and sustainability present real challenges to the strategic management of businesses. How can any one company keep track of all the changing technological, economic, political–legal, and sociocultural trends around the world in order to make the necessary adjustments? This is not an easy task. Various theories have been proposed to account for how organizations obtain fit with their environment and how these approaches have been used to varying degrees by researchers trying to understand firm performance. The theory of **population ecology** suggests that once an organization is successfully established in a particular environmental niche, it is unable to adapt to changing conditions. Inertia prevents the organization from changing in any significant manner. The company is thus replaced (is bought out or goes bankrupt) by other organizations more suited to the new environment. Although it is a popular theory in sociology, research fails to support the arguments of population ecology.[27] **Institution theory**, in contrast, proposes that organizations can and do adapt to changing conditions by imitating other successful organizations. Many examples can be found of companies that have adapted to changing circumstances by imitating an admired firm's strategies and management techniques.[28] The theory does not, however, explain how or by whom successful new strategies are developed in the first place. The **strategic choice perspective** goes a significant step further by proposing that not only do organizations adapt to a changing environment, but they also have the opportunity and power to reshape their environment. This perspective is supported by research indicating that the decisions of a firm's management have at least as great an impact on firm performance as overall industry factors.[29] Because of its emphasis on managers making rational strategic decisions, the strategic choice perspective is the dominant one taken in strategic management. Its argument that adaptation is a dynamic process fits with the view of **organizational learning theory**, which says that an organization adjusts defensively to a changing environment and uses knowledge offensively to improve the fit between itself and its environment. This perspective expands the strategic choice perspective to include people at all levels becoming involved in providing input into strategic decisions.[30]

In agreement with the concepts of organizational learning theory, an increasing number of companies are realizing that they must shift from a vertically organized, top-down type of organization to a more horizontally managed, interactive organization. They are attempting to adapt more quickly to changing conditions by becoming "learning organizations."

Creating a Learning Organization

1-4. Discuss the Activities where learning organizations excel

Strategic management has now evolved to the point that its primary value is in helping an organization operate successfully in a dynamic, complex environment. To be competitive in dynamic environments, corporations are becoming less bureaucratic and more flexible. In stable environments such as those that existed in years past, a competitive strategy simply involved defining a competitive position and then defending it.

As it takes less and less time for one product, service, or technology to replace another, companies are finding that there is no such thing as a permanent competitive advantage. Many agree with Richard D'Aveni, who says in his book *Hypercompetition* that any sustainable competitive advantage lies not in doggedly following a centrally managed five-year plan but in stringing together a series of strategic short-term thrusts (as Apple does by cutting into the sales of its own offerings with periodic introductions of new products).[31] This means that corporations must develop *strategic flexibility*—the ability to shift from one dominant strategy to another.[32]

Strategic flexibility demands a long-term commitment to the development and nurturing of critical resources and capabilities. It also demands that the company become a **learning organization**—an organization skilled at creating, acquiring, and transferring knowledge and at modifying its behavior to reflect new knowledge and insights. Organizational learning is a critical component of competitiveness in a dynamic environment. It is particularly important to innovation and new product development.[33] Siemens, a major electronics company, created a global knowledge-sharing network, called ShareNet, in order to quickly spread information technology throughout the firm. Based on its experience with ShareNet, Siemens established PeopleShareNet, a system that serves as a virtual expert marketplace for facilitating the creation of cross-cultural teams composed of members with specific knowledge and competencies.[34]

Learning organizations are skilled at four main activities:

- Solving problems systematically
- Experimenting with new approaches
- Learning from their own experiences and past history as well as from the experiences of others
- Transferring knowledge quickly and efficiently throughout the organization.[35]

Business historian Alfred Chandler proposes that high-technology industries are defined by "paths of learning" in which organizational strengths derive from learned capabilities.[36] According to Chandler, companies spring from an individual entrepreneur's knowledge, which then evolves into organizational knowledge. This organizational knowledge is composed of three basic strengths: technical skills; functional knowledge, such as production and marketing; and managerial expertise. This knowledge leads to new areas in which the company can succeed and creates an entry barrier to new competitors. Chandler believes that once a corporation has built its learning base to the point where it has become a core company in its industry, entrepreneurial startups are rarely able to successfully enter. Thus, organizational knowledge becomes a competitive advantage that is difficult to understand and imitate.

Strategic management is essential for learning organizations to avoid stagnation through continuous self-examination and experimentation. People at all levels, not just top management, participate in strategic management—helping to scan the environment for critical information, suggesting changes to strategies and programs to take advantage of environmental shifts, and working with others to continuously improve work methods, procedures, and evaluation techniques. The Toyota production system is famous for empowering employees to improve. If an employee spots a problem on the line, he/she pulls the cord, which immediately starts a speedy diagnosis. The line continues if the problem can be solved within one minute. If not, the production line is shut down until the problem is solved. At Toyota, they learn from their mistakes as much as they learn from their successes. Improvements are sent to all factories worldwide.[37]

Organizations that are willing to experiment and are able to learn from their experiences are more successful than those that are not.[38] This was seen in a study of U.S. manufacturers of diagnostic imaging equipment, the most successful firms were those that improved products sold in the United States by incorporating some of what they had learned from their manufacturing and sales experiences in other countries. The less successful firms used their foreign operations primarily as sales outlets, not as important sources of technical knowledge.[39] Research also reveals that multidivisional corporations that establish ways to transfer knowledge across divisions are more innovative than other diversified corporations that do not.[40]

Basic Model of Strategic Management

1-5. Describe the basic model of strategic management and its components

Strategic management consists of four basic elements:

- Environmental scanning
- Strategy formulation
- Strategy implementation
- Evaluation and control.

Figure 1–1 illustrates how these four elements interact; **Figure 1–2** expands each of these elements and serves as the model for this book. This model is both rational and prescriptive. It is a planning model that presents what a corporation *should* do in terms of the strategic management process, not what any particular firm may actually do. The rational planning model predicts that as environmental uncertainty increases, corporations that work diligently to analyze and predict more accurately the changing situation in which they operate will outperform those that do not. Empirical research studies support this model.[41] The terms used in **Figure 1–2** are explained in the following pages.

ENVIRONMENTAL SCANNING

Environmental scanning is the monitoring, evaluating, and disseminating of information from the external and internal environments to key people within the corporation. Its purpose is to identify **strategic factors**—those external and internal elements that will assist in the analysis of the strategic decisions of the corporation. The simplest way to represent the outcomes of environmental scanning is through a **SWOT approach**. SWOT is an acronym used to describe the particular **S**trengths, **W**eaknesses, **O**pportunities, and **T**hreats that appear to be strategic factors for a specific company. The **external environment** consists of variables (opportunities and threats) that are outside the organization and not typically within the short-run control of top management. These variables form the context within which the corporation exists.

FIGURE 1–1 Basic Elements of the Strategic Management Process

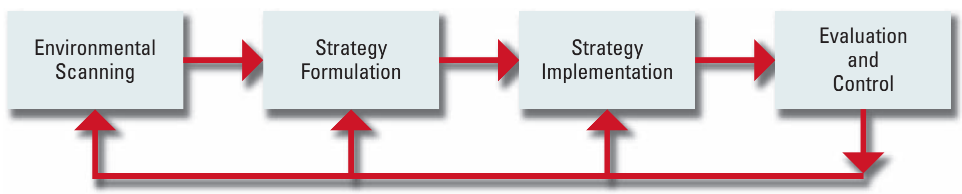

FIGURE 1–2 Strategic Management Model

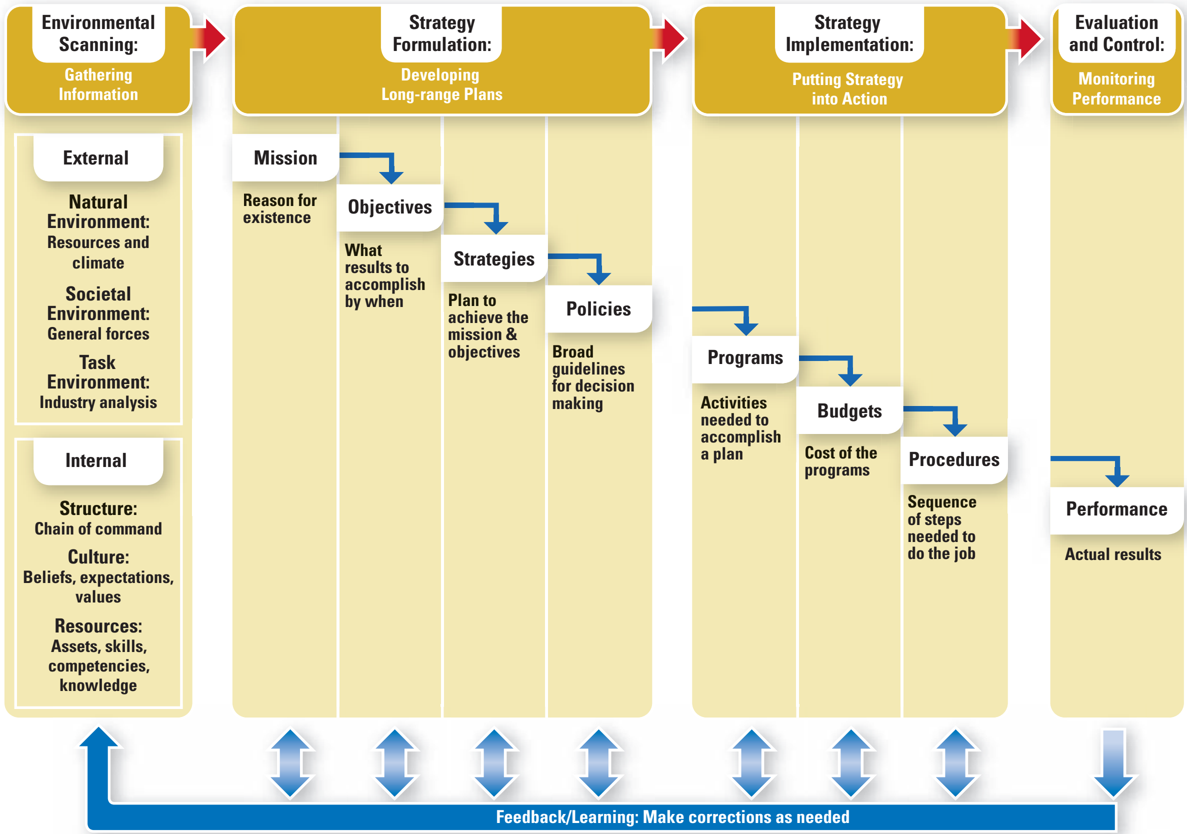

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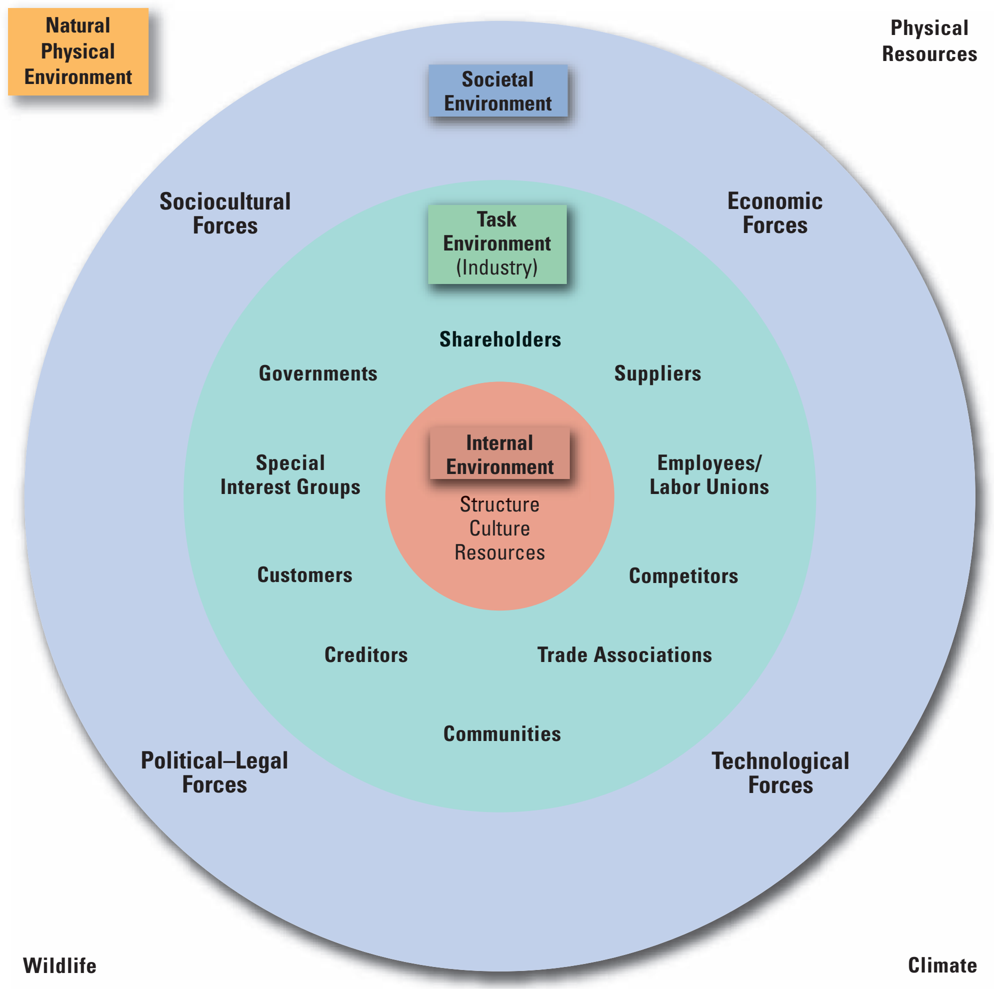
Figure 1–3 depicts key environmental variables. They may be general forces and trends within the natural or societal environments or specific factors that operate within an organization's specific task environment—often called its *industry*. The analysis techniques available for the examination of these environmental variables are the focus of **Chapter 4**.

The **internal environment** of a corporation consists of variables (strengths and weaknesses) that are within the organization itself and are within the short-run control of top management. These variables form the context in which work is done. They include the corporation's structure, culture, capabilities, and resources. Key strengths form a set of core competencies that the corporation can use to gain competitive advantage. Although strategic management is fundamentally concerned with what constitutes an organization's strengths, weaknesses, opportunities, and threats, the methods to analyze each has developed substantially in the past two decades. No longer do we simply list the SWOT variables and have employees try to populate the quadrants. Each of the four is rich with processes and techniques that will allow for a robust and sophisticated understanding of the company. This will be examined in detail beginning with **Chapter 5** of the text.

FIGURE 1–3 Environmental Variables



STRATEGY FORMULATION

Strategy formulation is the process of investigation, analysis, and decision making that provides the company with the criteria for attaining a competitive advantage. It includes defining the competitive advantages of the business, identifying weaknesses that are impacting the company's ability to grow, crafting the corporate mission, specifying achievable objectives, and setting policy guidelines.

Mission: Stating Purpose

An organization's **mission** is the purpose or reason for the organization's existence. It announces what the company is providing to society—either a service such as consulting, a set of products such as automobile tires, or a combination of the two such as tablets and their associated Apps. A well-conceived mission statement defines the fundamental, unique purpose that sets a company apart from other firms of its type. Research reveals that firms with mission statements containing explicit descriptions of their competitive advantages have significantly higher growth than firms without such statements.[42] A mission statement may also include the firm's values and philosophy about how it does business and treats its employees; however, that is usually better kept as a separate document. A well-crafted mission statement describes what the company is now and what it wants to become—management's strategic vision of the firm's future. The mission statement promotes a sense of shared expectations in employees and communicates a public image to important stakeholder groups in the company's task environment. Some people like to consider vision and mission as two different concepts: Mission describes what the organization is now; **vision** describes what the organization would like to become. We prefer to combine these ideas into a single mission statement.[43]

A classic example is that etched in bronze at Newport News Shipbuilding, unchanged since its founding in 1886:

> *We shall build good ships here—at a profit if we can—at a loss if we must—but always good ships.*[44]

A mission may be defined narrowly or broadly in scope. An example of a *broad* mission statement is that used by many corporations: "Serve the best interests of shareowners, customers, and employees." A broadly defined mission statement such as this keeps the company from restricting itself to one field or product line, but it fails to clearly identify either what it makes or which products/markets it plans to emphasize. Broad statements are relatively useless while narrow statements provide direction and value to the organization.

Objectives: Listing Expected Results

Objectives are the end results of planned activity. They should be stated as *action verbs* and tell employees what is to be accomplished and when, with appropriate metrics. The achievement of corporate objectives should result in the fulfillment of a corporation's mission. In effect, this is what society gives back to the corporation when the corporation does a good job of fulfilling its mission. Coca-Cola has set the standard of a focused, international company. In their Vision 2020 plan, they have laid out specific objectives including reducing the overall carbon footprint of their business operations by 15% by 2020, as compared to the 2007 baseline, and reducing the impact of their packaging by maximizing their use of renewable, reusable, and recyclable resources to recover the equivalent of 100% of their packaging. This type of focus has made Coca-Cola a perennial member of the Fortune 500, one of the Fortune 50 Most Admired Companies, one of Barron's Most Respected Companies in the World, and a Diversity, Inc. Top 50 company. Over the past 10 years, they have raised their dividend an average of 9.8% per year and the company's earnings per share have jumped 11.3% per year over the past five years.[45]

The term *goal* is often used interchangeably with the term objective. In this book, we prefer to differentiate the two terms. In contrast to an objective, we consider a *goal* as an open-ended statement of what one wants to accomplish, with no quantification of what is to be achieved and no time criteria for completion. For example, a simple statement of "increased profitability" is thus a goal, not an objective, because it does not state how much profit the firm wants to make the next year. A good objective should be action-oriented and begin with the word *to*. An example of an objective is "to increase the firm's profitability in 2017 by 10% over 2016."

Some of the areas in which a corporation might establish its goals and objectives are:

- Profitability (net profits)
- Efficiency (low costs, etc.)
- Growth (increase in total assets, sales, etc.)
- Shareholder wealth (dividends plus stock price appreciation)
- Utilization of resources (Return on Equity (ROE) or Return on Investment (ROI))

- Reputation (being considered a "top" firm)
- Contributions to employees (employment security, wages, diversity)
- Contributions to society (taxes paid, participation in charities, providing a needed product or service)
- Market leadership (market share)
- Technological leadership (innovations, creativity)
- Survival (avoiding bankruptcy)
- Personal needs of top management (using the firm for personal purposes, such as providing jobs for relatives)

Strategy: Defining the Competitive Advantages

An organization must examine the external environment in order to determine who constitutes the perfect customer for the business as it exists today, who the most direct competitors are for that customer, what the company does that is necessary to compete, and what the company does that truly sets it apart from its competitors. These elements can be rephrased into the strengths of the business, the understanding of its weaknesses relative to its competitors, what opportunities would be most prudent, and what threats might affect the business's primary competitive advantages.

A **strategy** of a business forms a comprehensive master approach that states how the business will achieve its mission and objectives. It maximizes competitive advantage and minimizes competitive disadvantage. Pfizer, the giant drug company has embraced the need for this type of approach. Faced with the rapid fall-off of its biggest blockbuster drugs (patents expiring), Pfizer was faced with the question of how to generate the R&D to create new drugs. Historically, the company had relied upon its cadre of scientists, but this changed in the past few years. Pfizer moved aggressively to acquire drug makers in the emerging biosimiliar market (small molecule biologics made from living cells). Pfizer's late-stage biosimiliar drugs have a very good chance of allowing the company to capture a significant part of what is expected to be a US$20 billion market by 2020. This is the crucial new ground from which they hope to replace such blockbusters as Lipitor, which saw its sales drop from US$12 billion in 2012 to just over US$2 billion in 2015 after the patent expired.[46]

The typical larger business addresses three types of strategy: corporate, business, and functional.

- **Corporate strategy** describes a company's overall direction in terms of growth and the management of its various businesses. Corporate strategies generally fit within the three main categories of stability, growth, and retrenchment.
- **Business strategy** usually occurs at the business unit or product level, and it emphasizes improvement of the competitive position of a corporation's products or services in the specific industry or market segment served by that business unit. Business strategies may fit within the two overall categories: *competitive* and *cooperative* strategies. For example, Staples, the U.S. office supply store chain, has used a competitive strategy to differentiate its retail stores from its competitors by adding services to its stores, such as copying, UPS shipping, and hiring mobile technicians who can fix computers and install networks. British Airways has followed a cooperative strategy by forming an alliance with American Airlines in order to provide global service. Cooperative strategy may be used to provide a competitive advantage in situations where the cooperating entities are not in direct competition for customers. Intel, a manufacturer of computer microprocessors, uses its alliance (cooperative strategy) with Microsoft to differentiate itself (competitive strategy) from AMD, its primary competitor.

- **Functional strategy** is the approach taken by a functional area to achieve corporate and business unit objectives and strategies by maximizing resource productivity. It is concerned with developing and nurturing a distinctive competence to provide a company or business unit with a competitive advantage. Examples of research and development (R&D) functional strategies are technological followership (imitation of the products of other companies) and technological leadership (pioneering an innovation). For years, Magic Chef had been a successful appliance maker by spending little on R&D but by quickly imitating the innovations of other competitors. This helped the company keep its costs lower than those of its competitors and consequently to compete with lower prices. In terms of marketing functional strategies, Procter & Gamble (P&G) is a master of marketing "pull"—the process of spending huge amounts on advertising in order to create customer demand. This supports P&G's competitive strategy of differentiating its products from those of its competitors.

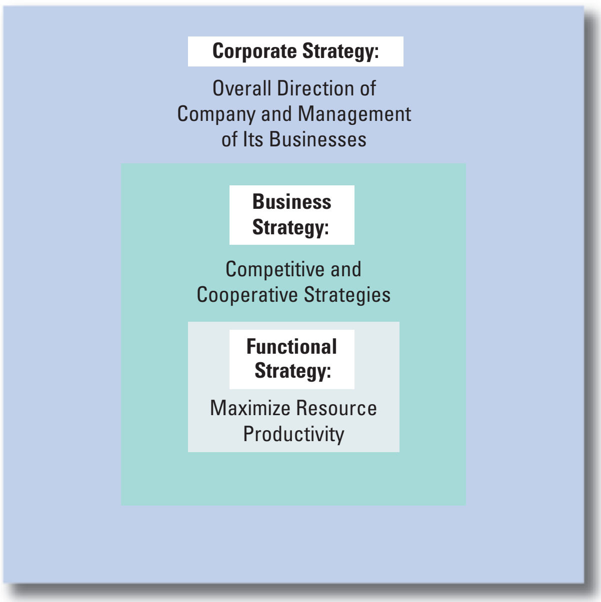
Business firms use all three types of strategy simultaneously. A **hierarchy of strategy** is a grouping of strategy types by level in the organization. Hierarchy of strategy is a nesting of one strategy within another so that they complement and support one another. (See **Figure 1–4**.) Functional strategies support business strategies, which, in turn, support the corporate strategy(ies).

Policies: Setting Guidelines

A **policy** is a broad guideline for decision making that links the formulation of a strategy with its implementation. Companies use policies to make sure that employees throughout the firm make decisions and take actions that support the corporation's mission, objectives, and strategies. For example, when Cisco decided on a strategy of growth through acquisitions, it established a policy to consider only companies with no more than 75 employees, 75% of whom were engineers.[47] Consider the following company policies:

- **3M:** 3M says researchers should spend 15% of their time working on something other than their primary project. (This supports 3M's strong product development strategy.)

FIGURE 1–4 Hierarchy of Strategy



- **Google:** Google's health care plan includes their onsite medical staff. Any employee who feels ill at work can make an appointment with the doctor at the Googleplex. This supports the Google HRM functional strategy to support its employees.
- **General Electric:** GE must be number one or two wherever it competes. (This supports GE's objective to be number one in market capitalization.)
- **Starbucks:** All Starbucks employees are offered a Total Pay Package that includes a 401(k) savings plan, stock options, and an employee stock purchase plan. This goes a long way toward their goal of having every employee feel like a partner in the business.
- **Ryanair:** Ryanair charges for everything a passenger might want or need on a flight. The only thing you get with your ticket is the right to a seat on the plane (and that seat depends upon how fast you can run across the tarmac to the plane).

Policies such as these provide clear guidance to managers throughout the organization. (Strategy formulation is discussed in greater detail in **Chapter 6, 7,** and **8**.)

STRATEGY IMPLEMENTATION

Strategy implementation is a process by which strategies and policies are put into action through the development of programs, budgets, and procedures. This process might involve changes within the overall culture, structure, and/or management system of the entire organization. Except when such drastic corporatewide changes are needed, however, the implementation of strategy is typically conducted by middle- and lower-level managers, with review by top management. Sometimes referred to as *operational planning*, strategy implementation often involves day-to-day decisions in resource allocation.

Programs and Tactics: Defining Actions

A **program** or a **tactic** is a statement of the activities or steps needed to support a strategy. The terms are interchangeable. In practice, a program is a collection of tactics where a tactic is the individual action taken by the organization as an element of the effort to accomplish a plan. A program or tactic makes a strategy action-oriented. It may involve restructuring the corporation, changing the company's internal culture, or beginning a new research effort. For example, Boeing's strategy to regain industry leadership with its 787 Dreamliner meant that the company had to increase its manufacturing efficiency in order to keep the price low. To significantly cut costs, management decided to implement a series of tactics:

- Outsource approximately 70% of manufacturing.
- Reduce final assembly time to three days (compared to 20 for its 737 plane) by having suppliers build completed plane sections.
- Use new, lightweight composite materials in place of aluminum to reduce inspection time.
- Resolve poor relations with labor unions caused by downsizing and outsourcing.

Another example is a set of programs or tactics used by automaker BMW to achieve its objective of increasing production efficiency by 5% each year: (a) shorten new model development time from 60 to 30 months, (b) reduce preproduction time from a year to no more than five months, and (c) build at least two vehicles in each plant so that production can shift among models depending upon demand.

Budgets: Costing Programs

A **budget** is a statement of a corporation's programs in terms of dollars. Used in planning and control, a budget lists the detailed cost of each program. Many corporations demand a certain percentage return on investment, often called a "hurdle rate," before management will approve a new program. This is done so that the new program has the potential to significantly add to the corporation's profit performance and thus build shareholder value. The budget not only serves as a detailed plan of the new strategy in action, it also specifies through proforma financial statements the expected impact on the firm's financial future.

A company that has really invested in the future is Nordstrom. The company plans to spend upwards of US$4.3 billion over the next few years to dramatically grow their online and store presence. The company has a goal of reaching US$20 billion in sales by 2020 (up from roughly US$13 billion in 2015). The CEO is aiming to integrate their ecommerce platform and store operations, both in their luxury stores as well as their rack outlets.[48]

Procedures: Detailing Activities

Procedures, sometimes termed Standard Operating Procedures (SOP), are a system of sequential steps or techniques that describe in detail how a particular task or job is to be done. They typically detail the various activities that must be carried out in order to complete the corporation's program. For example, when the home improvement retailer Home Depot noted that sales were lagging because its stores were full of clogged aisles and had long checkout times and too few salespeople, management changed its procedures for restocking shelves and pricing the products. Instead of requiring its employees to do these activities at the same time they were working with customers, management moved these activities to when the stores were closed at night. Employees were then able to focus on increasing customer sales during the day. Both UPS and FedEx put such an emphasis on consistent, quality service that both companies have strict rules for employee behavior, ranging from how a driver dresses to how keys are held when approaching a customer's door. (Strategy implementation is discussed in more detail in **Chapter 9** and **10**.)

EVALUATION AND CONTROL

Evaluation and control is a process in which corporate activities and performance results are monitored so that actual performance can be compared with desired performance. Managers at all levels use the resulting information to take corrective action and resolve problems. Although evaluation and control is the final major element of strategic management, it can also pinpoint weaknesses in previously implemented strategic plans and thus stimulates the entire process to begin again.

Performance is the end result of activities.[49] It includes the actual outcomes of the strategic management process. The practice of strategic management is justified in terms of its ability to improve an organization's performance, typically measured in terms of profits and return on investment. For evaluation and control to be effective, managers must obtain clear, prompt, and unbiased information from the people below them in the corporation's hierarchy. Using this information, managers compare what is actually happening with what was originally planned in the formulation stage.

Starbucks had created a mystique around the enjoyment of coffee. Carefully designed stores and an experience that encouraged people to stay and chat had built Starbucks into a powerhouse. Howard Schultz (founder and CEO) stepped down from active management of the business and Jim Donald took over as CEO and drove the company toward efficiency, pricing growth, and diversification. The company went from an American success story to one with a 97% drop in net income and same store sales in negative territory. Despite a well-known e-mail from Schultz to Donald in 2007 encouraging him to return to core elements of the business, things did not improve, and in January 2008 Schultz replaced Donald as CEO. In February 2008, all 7,100+ Starbucks in North America shut their doors for a three-hour video conference with Schultz so they could reset the Starbucks experience. He shut down almost 1,000 outlets and instituted a series of moves aimed at returning the company to its preeminent position. The turnaround at Starbucks has been a remarkable story of regaining the cache they almost lost.[50]

The evaluation and control of performance completes the strategic management model. Based on performance results, management may need to make adjustments in its strategy formulation, in implementation, or in both. (Evaluation and control is discussed in more detail in **Chapter 12**.)

FEEDBACK/LEARNING PROCESS

Note that the strategic management model depicted in **Figure 1–2** includes a feedback/learning process. Arrows are drawn coming out of each part of the model and taking information to each of the previous parts of the model. As a firm or business unit develops strategies, programs, and the like, it often must go back to revise or correct decisions made earlier in the process. For example, poor performance (as measured in evaluation and control) usually indicates that something has gone wrong with either strategy formulation or implementation. It could also mean that a key variable, such as a new competitor, a change in the environment, or a significant regulatory change has occurred. Just after Shultz took back the reigns at Starbucks, the recession hit and the mantra in the country became, "save money, don't buy Starbucks." The business was built on an image as the comfortable place away from home, but had trended toward a fast-food operation. Schultz eliminated hot sandwiches which were filling the place with the smell of burnt cheese instead of coffee, refocused on the services provided by the baristas, started grinding coffee on-site to add the smells so loved at a Starbucks, and put in new coffee machines that allowed baristas to talk with customers. Starbucks reassessed the environment and found a better way to profitably apply its core competencies.

Initiation of Strategy: Triggering Events

1-6. Identify some common triggering events that act as stimuli for strategic change

After much research, Henry Mintzberg concluded that strategy formulation is not a regular, continuous process: "It is most often an irregular, discontinuous process, proceeding in fits and starts. There are periods of stability in strategy development, but also there are periods of flux, of groping, of piecemeal change, and of global change."[51] This view of strategy formulation as an irregular process can be explained by the very human tendency to continue on a particular course of action until something goes wrong or a person is forced to question his or her actions. This period of strategic drift may result from inertia on the part of the organization, or it may reflect management's belief that the current strategy is still appropriate and needs only some fine-tuning.

Most large organizations tend to follow a particular strategic orientation for a period of years before making a significant change in direction.[52] This phenomenon, called *punctuated equilibrium*, describes corporations as evolving through relatively long periods of stability (equilibrium periods) punctuated by relatively short bursts of fundamental change (revolutionary periods).[53] After this rather long period of fine-tuning an existing strategy, some sort of shock to the system is needed to motivate management to seriously reassess the corporation's situation.

A **triggering event** is something that acts as a stimulus for a change in strategy. Some possible triggering events are:[54]

- **New CEO:** By asking a series of embarrassing questions, a new CEO cuts through the veil of complacency and forces people to question the very reason for the corporation's existence.

- **External intervention:** A firm's bank suddenly refuses to approve a new loan or suddenly demands payment in full on an old one. A key customer complains about a serious product defect.
- **Threat of a change in ownership:** Another firm may initiate a takeover by buying a company's common stock.
- **Performance gap:** A *performance gap* exists when performance does not meet expectations. Sales and profits either are no longer increasing or may even be falling.
- **Strategic inflection point:** Coined by Andy Grove, past-CEO of Intel Corporation, a *strategic inflection point* is what happens to a business when a major change takes place due to the introduction of new technologies, a different regulatory environment, a change in customers' values, or a change in what customers prefer.[55]

Strategic Decision Making

1-7. Explain strategic decision-making modes

A distinguishing characteristic of strategic management is its emphasis on strategic decision making. As organizations grow larger and more complex, with more uncertain environments, decisions become increasingly complicated and difficult to make. In agreement with the strategic choice perspective mentioned earlier, this book proposes a strategic decision-making framework that can help people make these decisions regardless of their level and function in the corporation.

WHAT MAKES A DECISION STRATEGIC?

Unlike many other decisions, **strategic decisions** deal with the long-term future of an entire organization and have three characteristics:

- **Rare:** Strategic decisions are unusual and typically have no precedent to follow.
- **Consequential:** Strategic decisions commit substantial resources and demand a great deal of commitment from people at all levels.
- **Directive:** Strategic decisions set precedents for lesser decisions and future actions throughout an organization.[56]

One example of a strategic decision with all of these characteristics was that made by Genentech, a biotechnology company that had been founded in 1976 to produce protein-based drugs from cloned genes. After building sales to US$9 billion and profits to US$2 billion in 2006, the company's sales growth slowed and its stock price dropped in 2007. The company's products were reaching maturity with few new ones in the pipeline. To regain revenue growth, management decided to target autoimmune diseases, such as multiple sclerosis, rheumatoid arthritis, lupus, and 80 other ailments for which there was no known lasting treatment. This was an enormous opportunity, but also a very large risk for the company. Existing drugs in this area either were not effective for many patients or caused side effects that were worse than the disease. Competition from companies like Amgen and Novartis were already vying for leadership in this area. A number of Genentech's first attempts in the area had failed to do well against the competition.

The strategic decision to commit resources to this new area was based on a report from a British physician that Genentech's cancer drug Rituxan eased the agony of rheumatoid arthritis in five of his patients. CEO Arthur Levinson was so impressed with this report that he immediately informed Genentech's board of directors. He urged them to support a full research program for Rituxan in autoimmune disease. With the board's blessing, Levinson launched a program to study the drug as a treatment for rheumatoid arthritis, MS, and lupus. The company deployed a third of its 1,000 researchers to pursue new drugs to fight autoimmune diseases. In 2006, Rituxan was approved to treat rheumatoid arthritis and captured 10% of the market. By 2014, Rituxan had sales of more than US$7 billion. The research mandate was to consider ideas others might overlook. This has led to a series of FDA-approved drugs for breast cancer and vision loss. “There’s this tremendous herd instinct out there,” said Levinson. “That’s a great opportunity, because often the crowd is wrong.”[57]

MINTZBERG’S MODES OF STRATEGIC DECISION MAKING

Some strategic decisions are made in a flash by one person (often an entrepreneur or a powerful chief executive officer) who has a brilliant insight and is quickly able to convince others to adopt his or her idea. Other strategic decisions seem to develop out of a series of small incremental choices that over time push an organization more in one direction than another. According to Henry Mintzberg, the three most typical approaches, or modes, of strategic decision making are entrepreneurial, adaptive, and planning (a fourth mode, logical incrementalism, was added later by Quinn):[58]

- **Entrepreneurial mode:** Strategy is made by one powerful individual. The focus is on opportunities; problems are secondary. Strategy is guided by the founder’s own vision of direction and is exemplified by large, bold decisions. The dominant goal is growth of the corporation. Amazon.com, founded by Jeff Bezos, is an example of this mode of strategic decision making. The company reflects Bezos’ vision of using the Internet to market everything that can be bought.
- **Adaptive mode:** Sometimes referred to as “muddling through,” this decision-making mode is characterized by reactive solutions to existing problems, rather than a proactive search for new opportunities. Much bargaining goes on concerning the priority of objectives. Strategy is fragmented and is developed to move a corporation forward incrementally. This mode is typical of most universities, many large hospitals, a large number of governmental agencies, and a surprising number of large corporations. Encyclopedia Britannica Inc. operated successfully for many years in this mode, but it continued to rely on the door-to-door selling of its prestigious books long after dual-career couples made that marketing approach obsolete. Only after it was acquired in 1996 did the company change its door-to-door sales to television advertising and Internet marketing. The company now charges libraries and individual subscribers for complete access via its Web site and has apps for the iPad and iPhone that cost users US$50. In May 2012, the company stopped producing the bound set of encyclopedias that had been in print for over 244 years.[59]
- **Planning mode:** This decision-making mode involves the systematic gathering of appropriate information for situation analysis, the generation of feasible alternative strategies, and the rational selection of the most appropriate strategy. It includes both the proactive search for new opportunities and the reactive solution of existing problems. IBM under CEO Louis Gerstner is a great example of the planning mode. When Gerstner accepted the position of CEO in 1993, he realized that IBM was in serious difficulty. Mainframe computers, the company’s primary product line, were suffering a rapid decline both in sales and market share. One of Gerstner’s first actions was to convene a two-day meeting on corporate strategy with senior executives. An in-depth analysis of IBM’s product lines revealed that the only part of the company that was growing was services, but it was a relatively small segment and not very profitable. Rather than focusing on making and selling its own computer hardware, IBM made the strategic decision to invest in services that integrated

information technology. IBM thus decided to provide a complete set of services from building systems to defining architecture to actually running and managing the computers for the customer—regardless of who made the products. Because it was no longer important that the company be completely vertically integrated, it sold off its DRAM, disk-drive, and laptop computer businesses and exited software application development. Since making this strategic decision in 1993, 80% of IBM's revenue growth has come from services. Most of this is chronicled in an outstanding business practices book written by Gerstner himself entitled *Who Says Elephants Can't Dance?* It should be one of the top reads for anyone really interested in this topic.[60]

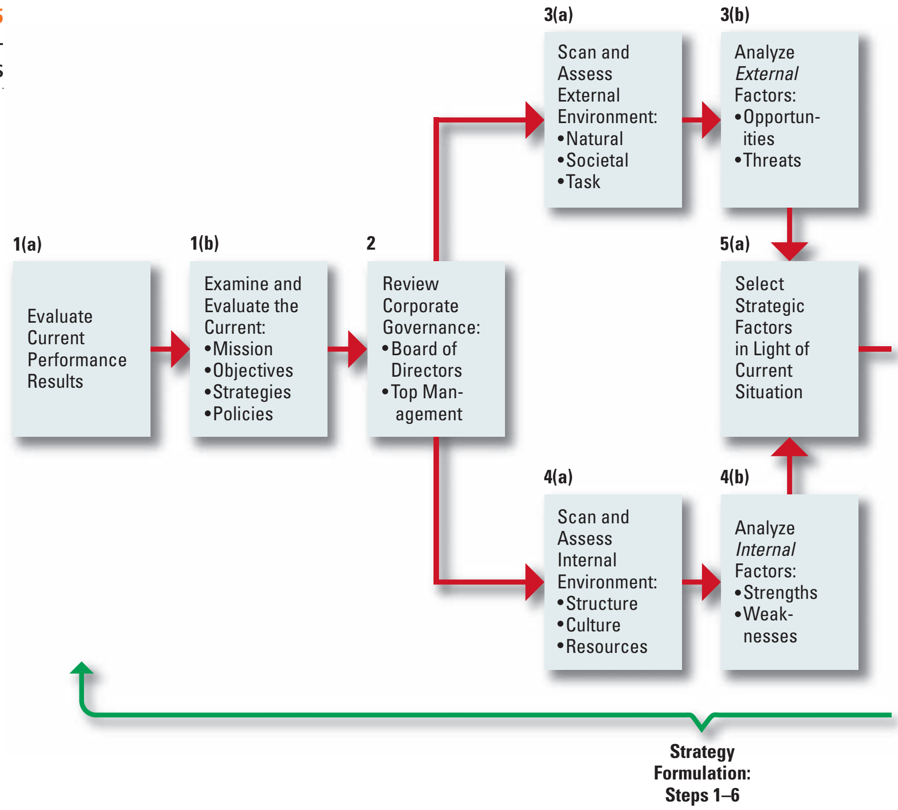
- **Logical incrementalism:** A fourth decision-making mode can be viewed as a synthesis of the planning, adaptive, and, to a lesser extent, the entrepreneurial modes. In this mode, top management has a reasonably clear idea of the corporation's mission and objectives, but, in its development of strategies, it chooses to use "an interactive process in which the organization probes the future, experiments, and learns from a series of partial (incremental) commitments rather than through global formulations of total strategies."[61] Thus, although the mission and objectives are set, the strategy is allowed to emerge out of debate, discussion, and experimentation. This approach appears to be useful when the environment is changing rapidly and when it is important to build consensus and develop needed resources before committing an entire corporation to a specific strategy. In his analysis of the petroleum industry, Grant described strategic planning in this industry as "planned emergence." Corporate headquarters established the mission and objectives but allowed the business units to propose strategies to achieve them.[62]

STRATEGIC DECISION-MAKING PROCESS: AID TO BETTER DECISIONS

Good arguments can be made for using the entrepreneurial, adaptive modes, or logical incrementalism approaches in certain specific situations.[63] This book proposes, however, that in most situations the planning mode, which includes the basic elements of the strategic management process, is a more rational, better tested, and more complete method for making strategic decisions. Research indicates that the planning mode is not only more analytical and less political than are the other modes, but it is also more appropriate for dealing with complex, changing environments.[64] We therefore propose the following eight-step **strategic decision-making process** to improve the making of strategic decisions (see **Figure 1–5**):

- **Evaluate current performance results** in terms of (a) return on investment, profitability, and so forth, and (b) the current mission, objectives, strategies, and policies.
- **Review corporate governance**—that is, the performance of the firm's board of directors and top management.
- **Scan and assess the external environment** to determine the strategic factors that pose opportunities and threats.
- **Scan and assess the internal corporate environment** to determine the strategic factors that are strengths (especially core competencies) and weaknesses.
- **Analyze strategic factors** to (a) pinpoint problem areas and (b) review and revise the corporate mission and objectives, as necessary.
- **Generate, evaluate, and select the best alternative strategies** in light of the analysis conducted in the previous step.
- **Implement selected strategies** via programs, budgets, and procedures.
- **Evaluate implemented strategies** via feedback systems, and the control of activities to ensure their minimum deviation from plans.

FIGURE 1–5
Strategic Decision-Making Process



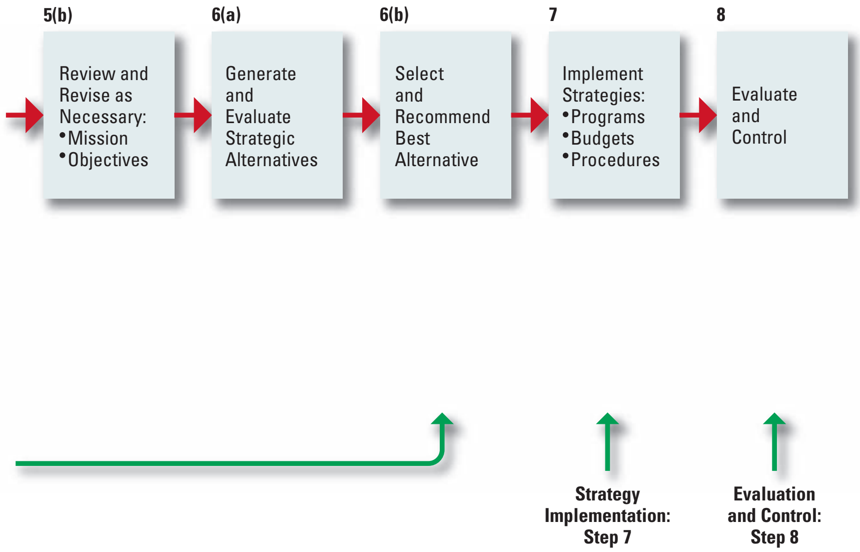
SOURCE: T. L. Wheelen and J. D. Hunger, "Strategic Decision-Making Process." Copyright © 1994 and 1977 by Wheelen and Hunger Associates. Reprinted by permission.

The Strategic Audit: Aid to Strategic Decision Making

1-8. Use the strategic audit as a method of analyzing corporate functions and activities

One effective means of putting the strategic decision-making process into action is through a technique known as the strategic audit. A **strategic audit** provides a checklist of questions, by area or issue, that enables a systematic analysis to be made of various corporate functions and activities. (See **Appendix 1.A** at the end of this chapter.) Note that the numbered primary headings in the audit are the same as the numbered blocks in the strategic decision-making process in **Figure 1–5**. Beginning with an evaluation of current performance, the audit continues with environmental scanning, strategy formulation, and strategy implementation, and it concludes with evaluation and control. A strategic audit is a type of management audit and is extremely useful as a diagnostic tool for pinpointing corporatewide problem areas and to highlight organizational strengths and weaknesses.[65] A strategic audit can help determine why a certain area is creating problems for a corporation and help generate solutions to the problem.

A strategic audit is not all-inclusive, but it asks many of the critical questions needed for a detailed strategic analysis of any business. Some questions, or even some areas, might be inappropriate for a particular company; in other cases, the questions may be insufficient for a complete analysis. However, each question in a particular area of a strategic audit can be broken down into an additional series of sub questions. An analyst can develop responses to these sub questions when they are needed for a complete strategic analysis of a company.



End of Chapter SUMMARY

Strategy scholars Donald Hambrick and James Fredrickson propose that a good strategy has five elements, providing answers to five questions:

- Arenas: Where will we be active?
- Vehicles: How will we get there?
- Differentiators: How will we win in the marketplace?
- Staging: What will be our speed and sequence of moves?
- Economic logic: How will we obtain our returns?[66]

This chapter introduces you to a well-accepted model of strategic management (**Figure 1–2**) in which environmental scanning leads to strategy formulation, strategy implementation, and evaluation and control. It further shows how that model can be put into action through the strategic decision-making process (**Figure 1–5**) and a strategic audit (**Appendix 1.A**). As pointed out by Hambrick and Fredrickson, "strategy consists of an integrated set of choices."[67] The questions "Where will we be active?" and "How will we get there?" are dealt with by a company's mission, objectives, and corporate strategy. The question "How will we win in the marketplace?" is the concern of business strategy. The question "What will be our speed and sequence of moves?" is answered not only by business strategy and tactics but also by functional strategy and by implemented programs, budgets, and procedures. The question "How will we obtain our returns?" is the primary emphasis of the evaluation and control element of the strategic management model. Each of these questions and topics will be dealt with in greater detail in the chapters to come. Welcome to the study of strategic management!

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KEY TERMS

Andean Community (p. 43)
Association of Southeast Asian Nations (ASEAN) (p. 43)
budget (p. 52)
business strategy (p. 50)
Central American Free Trade Agreement (CAFTA) (p. 43)
corporate strategy (p. 50)
environmental scanning (p. 46)
European Union (EU) (p. 42)
evaluation and control (p. 53)
external environment (p. 46)
functional strategy (p. 51)
globalization (p. 40)
hierarchy of strategy (p. 51)
innovation (p. 41)
institution theory (p. 44)
internal environment (p. 47)
learning organization (p. 45)
Mercosur/Mercosul (p. 43)
mission (p. 48)
North American Free Trade Agreement (NAFTA) (p. 42)
objectives (p. 49)
organizational learning theory (p. 44)
performance (p. 53)
phases of strategic management (p. 37)
policy (p. 51)
population ecology (p. 44)
procedures (p. 53)
program (p. 52)
strategic audit (p. 58)
strategic choice perspective (p. 44)
strategic decision-making process (p. 57)
strategic decisions (p. 55)
strategic factors (p. 46)
strategic management (p. 37)
strategy (p. 50)
strategy formulation (p. 48)
strategy implementation (p. 52)
sustainability (p. 42)
SWOT approach (p. 46)
tactic (p. 52)
triggering event (p. 54)
triple bottom line (p. 40)
Union of South American Nations (p. 43)
vision (p. 49)

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✪**1-1.** How do the three elements of globalization, innovation, and sustainability impact your understanding of strategy?

✪**1-2.** Organizational strategy can be divided roughly into two categories: (a) formulation and (b) implementation. Although there is legitimate crossover between the two, how would you characterize the issues involved in each effort?

DISCUSSION QUESTIONS

✪**1-3.** Why is strategic management considered important for global market competition?

1-4. What is the impact of sustainability on business practice?

✪**1-5.** Define strategic flexibility and explain its implications. Why is organizational learning important to the long-term development of strategic flexibility of organizations that intend to enter overseas markets?

1-6. What is a triggering event? List a few triggering events that stimulate strategic changes.

✪**1-7.** What is the most preferred planning mode of strategic decision-making for organizations competing internationally?

STRATEGIC PRACTICE EXERCISES

Advanced economies are emerging from the worst financial recessions in modern times. Many developed nations have implemented austerity measures to adjust the deficit caused by massive spending during the years of cheap and available credit facilities. New industrial policies are also implemented at national and regional levels to police banks and financial institutions as measures of avoiding further economic problems in the future. The austerity measures and policy changes have forced industries and business practices to change. How do you think these act as strategic change stimuli?

1-8. What changes do you think this might cause in the immediate task environment for a business operating within the financial service industry? Look at the *Financial Times* online for information.

1-9. How do these changes impact on corporate, business, and functional level strategies of financial service businesses? Are these changes going to affect you as customers?

1-10. How do you think a learning organization would act in this dynamic environment? What survival chances do the stagnant organizations have?

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