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LO 1-2 Define competitive advantage, sustainable competitive advantage, competitive disadvantage, and competitive parity.

LO 1-3 Describe the roles of vision, mission, and values in a firm's strategy.

LO 1-4 Evaluate the strategic implications of product-oriented and customer-oriented vision statements.

LO 1-5 Justify why anchoring a firm in ethical core values is essential for long-term success.

LO 1-6 Explain the AFI strategy framework.

CHAPTERCASE 1

Tesla's Secret Strategy

IN 2017, TESLA INC.—an American manufacturer of all-electric cars—boasted a market capitalization[1] of over $60 billion, an appreciation of more than 1,400 percent over its initial public offering price in 2010. How can a California startup achieve a market valuation that exceeds that of GM, the largest car manufacturer in the world, making some 10 million vehicles a year? The answer: Tesla's Secret Strategy. In a blog entry on Tesla's website in the summer of 2006, Elon Musk, Tesla's co-founder and CEO, explained the startup's master plan:[2]

1. Build sports car.
2. Use that money to build an affordable car.
3. Use *that* money to build an even more affordable car.
4. While doing above, also provide zero-emission electric power generation options.
5. Don't tell anyone.

Let's see if Tesla stuck to its strategy. In 2008, Tesla introduced its first car: the Roadster, a $110,000 sports coupe with faster acceleration than a Porsche or a Ferrari. Tesla's first vehicle served as a prototype to demonstrate that electric vehicles can be more than mere golf carts. Tesla thus successfully completed Step 1 of the master plan.

Tesla's Model X with falcon wing doors. ©Bloomberg/Getty Images

In Step 2, after selling some 2,500 Roadsters, Tesla discontinued its production in 2012 to focus on its next car: the Model S, a four-door family sedan, with a base price of $73,500 before tax credits. The line appeals to a somewhat larger market and thus allows for larger production runs to drive down unit costs. The Model S received an outstanding market reception. It was awarded not only the 2013 Motor Trend Car of the Year, but also received the highest score of any car ever tested by Consumer Reports (99/100). Tesla manufactures the Model S in the Fremont, California, factory that it purchased from Toyota. By the end of 2016, it had sold some 125,000 of the Model S worldwide.

Hoping for an even broader customer appeal, Tesla also introduced the Model X, a crossover between an SUV and a family van with futuristic falcon-wing doors for convenient access to second- and third-row seating. The $100,000 starting sticker price of the Model X is quite steep, however; thus limiting mass-market appeal. Technical difficulties with its innovative doors delayed its launch until the fall of 2015.

Tesla has now reached Step 3 of its master plan. In 2017, Tesla delivered the company's newest car: the Model 3, an all-electric compact luxury sedan, with a starting price of $35,000. Tesla received some 375,000 preorders within three months of unveiling its model. Many of the want-to-be Tesla owners stood in line overnight, eagerly awaiting the opening of the Tesla stores to put down a $1,000 deposit to secure a spot on the waiting list for the Model 3, a car they had never even seen, let alone taken for a test drive. By the time Tesla delivered the first 30 cars of its new Model 3 (to Tesla employees for quality testing and appreciation of their hard work), the California car maker had received over 500,000 preorders. This customer enthusiasm amounted to $500 million in interest-free loans for Tesla. The Model 3 was slated for delivery by late 2017. Tesla hoped to sell 500,000 total vehicles by the end of 2018. To accomplish this ambitious goal, Musk also promised that Tesla would increase its annual production from 50,000 in 2015 to 1 million vehicles a year by 2020.

Step 4 of Musk's master plan for Tesla aims to provide zero-emission electric power generation options. To achieve this goal, Tesla acquired SolarCity, a solar energy company, for more than $2 billion in the fall of 2016. This joining creates the world's first fully integrated clean-tech energy company by combining solar power, power storage, and transportation. A successful integration of Tesla and SolarCity, where Musk is also chairman and an early investor, would allow completion of Step 4 of Tesla's master plan.

Step 5: "Don't tell anyone"—thus the ChapterCase title "Tesla's Secret Strategy."[3]

You will learn more about Tesla by reading this chapter; related questions appear in "ChapterCase 1 / Consider This . . . ."

WHY IS TESLA SO SUCCESSFUL? In contrast, the big-three U.S. automakers—Ford, GM, and Chrysler—struggled during the first decade of the 21st century, with both GM and Chrysler filing for bankruptcy protection.

If once-great firms can fail, why is any company successful? What enables some firms to gain and then sustain their competitive advantage over time? How can managers influence firm performance? These are the big questions that define strategic management. Answering these questions requires integrating the knowledge you've obtained in your studies of various business disciplines to understand what leads to superior performance, and how you can help your organization achieve it.

strategic management An integrative management field that combines analysis, formulation, and implementation in the quest for competitive advantage.

Strategic management is the integrative management field that combines *analysis, formulation*, and *implementation* in the quest for competitive advantage. Mastery of strategic management enables you to view an organization such as a firm or a nonprofit outfit in its entirety. It also enables you to think like a general manager to help position your organization for superior performance. The *AFI strategy framework* embodies this view of strategic management. It will guide our exploration of strategic management through the course of your study.

In this chapter, we lay the groundwork for the study of strategic management. We'll introduce foundational ideas about strategy and competitive advantage. We then move from thinking about why strategy is important to considering the role an organization's vision, mission, and values play in its strategy. Next, we take a closer look at the components of the AFI framework and provide an overview of the entire strategic management process. We conclude this introductory chapter, as we do with all others in this text, with a section titled *Implications for Strategic Leaders*. Here we provide practical applications and considerations of the material developed in the chapter. Let's begin the exciting journey to understand strategic management and competitive advantage.

LO 1-1

Explain the role of strategy in a firm's quest for competitive advantage.

1.1 What Strategy Is: Gaining and Sustaining Competitive Advantage

strategy The set of goal-directed actions a firm takes to gain and sustain superior performance relative to competitors.

Strategy is a set of goal-directed actions a firm takes to gain and sustain superior performance *relative* to competitors.[4] To achieve superior performance, companies compete for resources: New ventures compete for financial and human capital, existing companies compete for profitable growth, charities compete for donations, universities compete for the best students and professors, sports teams compete for championships, while celebrities compete for media attention.

As highlighted in the ChapterCase, Tesla, a new entrant in the automotive industry, is competing with established U.S. companies such as GM, Ford, and Chrysler and also with foreign automakers Toyota, Honda, Mercedes, and BMW, among others, for customers. In any competitive situation, a **good strategy** enables a firm to achieve superior performance relative to its competitors. This leads to the question: What is a good strategy?

1. A *diagnosis* of the competitive challenge. This element is accomplished through *analysis* of the firm's external and internal environments (Part 1 of the AFI framework).
2. A *guiding policy* to address the competitive challenge. This element is accomplished through strategy *formulation*, resulting in the firm's corporate, business, and functional strategies (Part 2 of the AFI framework).
3. A *set of coherent actions* to implement the firm's guiding policy. This element is accomplished through strategy *implementation* (Part 3 of the AFI framework).

Good strategy A strategy is good when it enables a firm to achieve superior performance. It consists of three elements: (1) a diagnosis of the competitive challenge; (2) a guiding policy to address the competitive challenge; and (3) a set of coherent actions to implement a firm's guiding policy.

Let's revisit ChapterCase 1 to see whether Tesla, Inc. is pursuing a good strategy. Tesla appears to be performing quite well when considering indicators such as stock appreciation, where it outperforms its competitors by a wide margin. The high appreciation of Tesla stock points to investors' expectations of future growth. By other measures, such as generating profits, Tesla underperforms compared to established car companies. Losses are common for startups early on, especially if the business requires large upfront investments such as building new factories, which Tesla was required to do. What we can say at this point is that Tesla seems to be starting with a promising strategy and is in the process of gaining a competitive advantage. But can Tesla sustain its advantage over time? Let's use the three elements of a good strategy to assess how Tesla CEO Elon Musk could turn an early lead into a sustainable competitive advantage.

THE COMPETITIVE CHALLENGE. A good strategy needs to start with a clear and critical diagnosis of the competitive challenge. Musk, Tesla's co-founder and CEO, describes himself as an "engineer and entrepreneur who builds and operates companies to solve environmental, social, and economic challenges."[5] Tesla was founded with the vision to "accelerate the world's transition to sustainable transport."[6]

To accomplish this mission, Tesla must build zero-emission electric vehicles that are attractive and affordable. Beyond achieving a competitive advantage for Tesla, Musk is working to set a new standard in automotive technology. He hopes that zero-emission electric vehicles will one day replace gasoline-powered cars.

Tesla's competitive challenge is sizable: To succeed it must manufacture attractive and affordable vehicles using its new technology, which will compete with traditional cars running on gasoline. It also needs the required infrastructure for electric vehicles, including a network of charging stations to overcome "range anxiety"[7] by consumers; many mass-market electric vehicles cannot drive as far on one charge as gasoline-powered cars can with a full tank of gas. Gas stations can be found pretty much on any corner in cities and every couple of miles on highways.[8]

A GUIDING POLICY. After the diagnosis of the competitive challenge, the firm needs to formulate an effective guiding policy in response. The formulated strategy needs to be consistent, often backed up with *strategic commitments* such as sizable investments or changes to an organization's incentive and reward system—big changes that cannot be easily reversed. Without consistency in a firm's guiding policy, employees become confused and cannot make effective day-to-day decisions that support the overall strategy. Without consistency in strategy, moreover, other stakeholders, including investors, also become frustrated.

To address the competitive challenge, Tesla's current guiding policy is to build a cost-competitive mass-market vehicle such as the new Model 3 (this is also Step 3 in Tesla's "Secret Strategy," as discussed in the ChapterCase). Tesla's formulated strategy is consistent with its mission and the competitive challenge identified. It also requires significant strategic commitments such as Tesla's $5 billion investment in a new lithium-ion battery plant in Nevada, the so-called Gigafactory. Batteries are the most critical component for electric vehicles. To accomplish this major undertaking, Tesla has partnered with Panasonic of Japan, a world leader in battery technology.

COHERENT ACTIONS. Finally, a clear guiding policy needs to be implemented with a set of coherent actions. Tesla appears to implement its formulated strategy with actions consistent with its diagnosis of the competitive challenge. To accomplish building a cost-competitive mass-market vehicle, Tesla must benefit from *economies of scale*, which are decreases in cost per vehicle as output increases. To reap these critical cost reductions, Tesla must ramp up its production volume. This is a huge challenge: Tesla aims to increase its production output by some 20 times, from 50,000 cars built in 2015 to 1 million cars per year by 2020. Tesla's retooling of its manufacturing facility in Fremont, California, to rely more heavily on cutting-edge robotics as well as its multibillion-dollar investment to secure an uninterrupted supply of lithium-ion batteries are examples of actions coherent with Tesla's formulated strategy. At the same time, Tesla is further building out its network of charging stations across the United States and globally. To fund this initiative, it announced that using the company's charging network will no longer be free for new Tesla owners.

To accomplish the lofty goal of making zero-emission electric motors the new standard in automotive technology (rather than gas-powered internal combustion engines), Tesla decided to make its proprietary technology available to the public. Musk's hope is that sharing Tesla's patents will expand the overall market size for electric vehicles as other manufacturers, such as BMW with its i3 line of vehicles, can employ Tesla's technology.

In review, to create a good strategy, three steps are crucial. First, a good strategy defines the competitive challenges facing an organization through a critical and honest assessment of the status quo. Second, a good strategy provides an overarching approach on how to deal with the competitive challenges identified. The approach needs to be communicated in policies that provide clear guidance for employees. Last, a good strategy requires effective implementation through a coherent set of actions.

WHAT IS COMPETITIVE ADVANTAGE?

LO 1-2
Define competitive advantage, sustainable competitive advantage, competitive disadvantage, and competitive parity.

Competitive advantage is always *relative*, not absolute. To assess competitive advantage, we compare firm performance to a *benchmark*—that is, either the performance of other firms in the same industry or an industry average. A firm that achieves superior performance relative to other competitors in the same industry or the industry average has a **competitive advantage**.[9] In terms of stock market valuation, Tesla has appreciated much more in recent years than GM, Ford, or Chrysler, and thus appears to have a competitive advantage, at least on this dimension.

A firm that is able to outperform its competitors or the industry average over a prolonged period has a **sustainable competitive advantage**. Apple, for example, has enjoyed a sustainable competitive advantage over Samsung in the smartphone industry for over a decade since its introduction of the iPhone in 2007. Other phone makers such as Microsoft (which purchased Nokia) and BlackBerry have all but exited the smartphone market, while new entrants such as Xiaomi and Huawei of China are trying to gain traction.

If a firm underperforms its rivals or the industry average, it has a **competitive disadvantage**. For example, a 15 percent return on invested capital may sound like

competitive advantage Superior performance relative to other competitors in the same industry or the industry average.

sustainable competitive advantage Outperforming competitors or the industry average over a prolonged period of time.

competitive disadvantage Underperformance relative to other competitors in the same industry or the industry average.

superior firm performance. In the consulting industry, though, where the average return on invested capital is often above 20 percent, such a return puts a firm at a competitive disadvantage. In contrast, if a firm's return on invested capital is 2 percent in a declining industry, like newspaper publishing, where the industry average has been negative (–5 percent) for the past few years, then the firm has a competitive advantage. Should two or more firms perform at the same level, they have **competitive parity**. In Chapter 5, we'll discuss in greater depth how to evaluate and assess competitive advantage and firm performance.

Spanx founder and CEO Sara Blakely, a graduate of Florida State University, is the world's youngest female billionaire.

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competitive parity Performance of two or more firms at the same level.

To gain a competitive advantage, a firm needs to provide either goods or services consumers value more highly than those of its competitors, or goods or services similar to the competitors' at a lower price. The rewards of superior value creation and capture are profitability and market share. Elon Musk is particularly motivated to address global warming, and thus formed Tesla to build electric vehicles with zero emissions. Sara Blakely, the founder and CEO of Spanx, the global leader in the shapewear industry, is motivated to change women's lives. Sam Walton was driven by offering lower prices than his competitors when creating Walmart, the world's largest retailer. For Musk, Blakely, Walton, and numerous other entrepreneurs and businesspeople, creating shareholder value and making money is the *consequence* of filling a need and providing a product, service, or experience consumers wanted, at a price they could afford.

The important point here is that strategy is about creating superior value, while containing the cost to create it, or by offering similar value at lower cost. Managers achieve these combinations of value and cost through *strategic positioning*. That is, they stake out a unique position within an industry that allows the firm to provide value to customers, while controlling costs. The greater the difference between value creation and cost, the greater the firm's *economic contribution* and the more likely it will gain competitive advantage.

Strategic positioning requires *trade-offs*, however. As a low-cost retailer, Walmart has a clear strategic profile and serves a specific market segment. Upscale retailer Nordstrom has also built a clear strategic profile by providing superior customer service to a higher end, luxury market segment. Although these companies are in the same industry, their customer segments overlap very little, and they are not direct competitors. Walmart and Nordstrom have each chosen a distinct but different strategic position. The managers make conscious trade-offs that enable each company to strive for competitive advantage in the retail industry, using different competitive strategies: cost leadership versus differentiation. In regard to the customer service dimension, Walmart provides acceptable service by low-skill employees in a big-box retail outlet offering "everyday low prices," while Nordstrom provides a superior customer experience by professional salespeople in a luxury setting.

A clear strategic profile—in terms of product differentiation, cost, and customer service—allows each retailer to meet specific customer needs. Competition focuses on creating value for customers (through lower prices or better service and selection, in this example) rather than destroying rivals. Even though Walmart and Nordstrom compete in the same industry, both can win if they achieve a clear strategic position through a well-executed competitive strategy. Strategy, therefore, is not a zero-sum game.

The key to successful strategy is to combine a set of activities to stake out a *unique strategic position* within an industry. Competitive advantage has to come from performing different activities or performing the same activities differently than rivals are doing. Ideally, these activities reinforce one another rather than create trade-offs. For instance, Walmart's strategic activities strengthen its position as cost leader: Big retail stores in rural locations, extremely high purchasing power, sophisticated IT systems, regional distribution centers, low corporate overhead, and low base wages and salaries combined with employee profit sharing reinforce each other, to maintain the company's cost leadership.

Since clear strategic positioning requires trade-offs, strategy is as much about deciding what *not* to do, as it is about deciding what to do.[10] Because resources are limited, managers must carefully consider their strategic choices in the quest for competitive advantage. Trying to be everything to everybody will likely result in inferior performance. In addition, operational effectiveness, marketing skills, and other functional expertise all strengthen a unique strategic position. Those capabilities, though, do not substitute for competitive strategy. Competing to be similar but just a bit better than your competitor is likely to be a recipe for cut-throat competition and low profit potential.

Let's take this idea to its extreme in a quick thought experiment: If all firms in the same industry pursued a low-cost position through application of competitive benchmarking, all firms would have identical cost structures. None could gain a competitive advantage. Everyone would be running faster, but nothing would change in terms of relative strategic positions. There would be little if any value creation for customers because companies would have no resources to invest in product and process improvements. Moreover, the least-efficient firms would be driven out, further reducing customer choice.

To gain a deeper understanding of what strategy is, it may be helpful to think about what strategy is *not*.[11] Be on the lookout for the following major hallmarks of what strategy is *not:*

1. *Grandiose statements are not strategy.* You may have heard firms say things like, "Our strategy is to win" or "We will be No. 1." Twitter, for example, declared its "ambition is to have the largest audience in the world."[12] Such statements of desire, on their own, are not strategy. They provide little managerial guidance and often lead to goal conflict and confusion. Moreover, such wishful thinking frequently fails to address economic fundamentals. As we will discuss in the next section, an effective vision and mission *can* lay the foundation upon which to craft a good strategy. This foundation must be backed up, however, by strategic actions that allow the firm to address a competitive challenge with clear consideration of economic fundamentals, in particular, value creation and costs.
2. *A failure to face a competitive challenge is not strategy.* If the firm does not define a clear competitive challenge, employees have no way of assessing whether they are making progress in addressing it. Managers at the now-defunct video rental chain Blockbuster, for example, failed to address the competitive challenges posed by new players Netflix, Redbox, Amazon Prime, and Hulu.
3. *Operational effectiveness, competitive benchmarking, or other tactical tools are not strategy.* People casually refer to a host of different policies and initiatives as some sort of strategy: pricing strategy, internet strategy, alliance strategy, operations strategy, IT strategy, brand strategy, marketing strategy, HR strategy, China strategy, and so on. All these elements may be a *necessary* part of a firm's functional and global initiatives to support its competitive strategy, but these elements are *not sufficient* to achieve competitive advantage. In this text, though, we will reserve the term *strategy* for describing the firm's overall efforts to *gain and sustain competitive advantage.*

1.2 Vision, Mission, and Values

LO 1-3

Describe the roles of vision, mission, and values in a firm's strategy.

The first step to gain and sustain a competitive advantage is to define an organization's vision, mission, and values. Managers must ask the following questions:

- **Vision.** What do we want to accomplish ultimately?
- **Mission.** How do we accomplish our goals?
- **Values.** What commitments do we make, and what guardrails do we put in place, to act both legally and ethically as we pursue our vision and mission?

The vision is the first principle that needs to be defined because it succinctly identifies the primary long-term objective of the organization. Strategic leaders need to begin with the end in mind.[13] In fact, early on strategic success is created *twice*. Leaders create the vision in the abstract by formulating strategies that enhance the chances of gaining and sustaining competitive advantage, before any actions of strategy implementation are taken in a second round of strategy creation. This process is similar to building a house. The future owner must communicate her vision to the architect, who draws up a blueprint of the home for her review. The process is iterated a couple of times until all the homeowner's ideas have been translated into the blueprint. Only then does the building of the house begin. The same holds for strategic success; it is first created through strategy formulation based on careful analysis before any actions are taken. Let's look at this process in more detail.

VISION

A **vision** captures an organization's aspiration and spells out what it ultimately wants to accomplish. An effective vision pervades the organization with a sense of winning and motivates employees at all levels to aim for the same target, while leaving room for individual and team contributions.

vision A statement about what an organization ultimately wants to accomplish; it captures the company's aspiration.

Tesla's vision is *to accelerate the world's transition to sustainable transport.* The goal is to provide affordable zero-emission mass-market cars that are the best in class. SpaceX is a spacecraft manufacturer and space transport services company, also founded by Elon Musk, whose inspirational vision is *to make human life multi planetary.* To achieve this goal, SpaceX aims to make human travel to Mars not only possible but also affordable. Moreover, SpaceX also sees a role in helping establish a self-sustainable human colony on Mars.[14]

Employees in visionary companies tend to feel part of something bigger than themselves. An inspiring vision helps employees find meaning in their work. Beyond monetary rewards, it allows employees to experience a greater sense of purpose. People have an intrinsic motivation to make the world a better place through their work activities.[15] This greater individual purpose in turn can lead to higher organizational performance.[16] Basing actions on its vision, a firm will build the necessary resources and capabilities through continuous organizational learning, including learning from failure, to translate into reality what begins as a stretch goal or **strategic intent.**[17]

strategic intent A stretch goal that pervades the organization with a sense of winning, which it aims to achieve by building the necessary resources and capabilities through continuous learning.

To provide meaning for employees in pursuit of the organization's ultimate goals, vision statements should be forward-looking and inspiring. Strategy Highlight 1.1 shows how Wendy Kopp, the founder of Teach for America, uses an inspiring vision to effectively and clearly communicate what TFA ultimately wants to accomplish, while providing a stretch goal.

It's not surprising that vision statements can be inspiring and motivating in the nonprofit sector. Many people would find meaning in wanting to help children attain an excellent education (TFA) or wanting *to be always there*, touching the lives of people in need, the vision of the American Red Cross. But what about for-profit firms?

Strategy Highlight 1.1

Teach for America: How Wendy Kopp Inspires Future Leaders

Wendy Kopp, Teach for America founder.
©Bloomberg/Getty Images

Teach for America (TFA) is a cadre of future leaders who work to ensure that underprivileged youth get an excellent education. The nonprofit organization recruits both graduates and professionals to teach for two years in economically disadvantaged communities in the United States. TFA's vision is: *One day, all children in this nation will have the opportunity to attain an excellent education.*

The idea behind TFA was developed by then-21-year-old Wendy Kopp as her college senior thesis (in 1989). Kopp was convinced that young people generally search for meaning in their lives by making a positive contribution to society. The genius of Kopp's idea was to turn on its head the social perception of teaching—to make what could appear to be an unattractive, low-status job into a high-prestige professional opportunity. Kopp works to eliminate educational inequality by enlisting the nation's most promising future leaders in the effort. Thus to be chosen for TFA is a badge of honor.

In the first four months after creating TFA, Kopp received more than 2,500 applicants. Her marketing consisted of flyers in dorm rooms. During its first academic year (1990–91), TFA was able to serve five states and reached some 36,000 students. After 25 years, during the 2015–16 academic year, some 20,000 TFA corps members were teaching in 36 states (and Washington, D.C.) and more than 1,000 schools. To date, TFA has reached over 10 million students.

To see how all three components—vision, mission, and values—work together, see Exhibit 1.1, which provides a snapshot of aspirations at Teach for America.

While initially targeted at college seniors, today, one-third of all TFA corps members applied as graduate students or professionals. In 2015, TFA added 4,100 new teachers to its corps from over 27,300 applications, representing more than 800 colleges and universities throughout the United States. This equates to about 15 percent acceptance, roughly equivalent to the admission rate of highly selective universities such as Northwestern, Cornell, or University of California, Berkeley. TFA's teaching cohort is also much more diverse than the national average: While some 20 percent of teachers nationwide are people of color, about 50 percent of TFA corps members are. TFA corps members receive the same pay as other first-year teachers in the local school district.

Most importantly, TFA makes a significant positive impact on students. Some 95 percent of all school principals working with TFA members say these teachers make a positive difference. A study commissioned by the U.S. Department of Education found that students being taught by TFA corps members showed significantly higher achievement, especially in math and science.

In 2016, after celebrating its 25th anniversary, TFA CEO Elisa Villanueva Beard recalls that she was inspired to sign up for TFA (when a freshman in high school) by Wendy Kopp's "audacity to believe young people could make a profound difference in the face of intractable problems standing between the ideals of a nation I loved and a starkly disappointing reality; who were bound by a fierce belief that all children, from American Indian reservations in South Dakota to Oakland to the Rio Grande Valley to the Bronx, should have the opportunity to write their own stories and fulfill their true potential."[18]

EXHIBIT 1.1 / Teach for America: Vision, Mission, and Values

VISION	One day, all children in this nation will have the opportunity to attain an excellent education.
MISSION	Our mission is to enlist, develop, and mobilize as many as possible of our nation's most promising future leaders to grow and strengthen the movement for educational equity and excellence.
VALUES	**Transformational Change:** We seek to expand educational opportunity in ways that are life-changing for children and transforming for our country. Given our deep belief in children and communities, the magnitude of educational inequity and its consequences, and our optimism about the solvability of the problem, we act with high standards, urgency, and a long-term view.
	Leadership: We strive to develop and become the leaders necessary to realize educational excellence and equity. We establish bold visions and invest others in working towards them. We work in purposeful, strategic, and resourceful ways, define broadly what is within our control to solve, and learn and improve constantly. We operate with a sense of possibility, persevere in the face of challenges, ensure alignment between our actions and beliefs, and assume personal responsibility for results.
	Team: We value and care about each other, operate with a generosity of spirit, and have fun in the process of working together. To maximize our collective impact, we inspire, challenge, and support each other to be our best and sustain our effort.
	Diversity: We act on our belief that the movement to ensure educational equity will succeed only if it is diverse in every respect. In particular, we value the perspective and credibility that individuals who share the racial and economic backgrounds of the students with whom we work can bring to our organization, classrooms, and the long-term effort for change.
	Respect & Humility: We value the strengths, experiences, and perspectives of others, and we recognize our own limitations. We are committed to partnering effectively with families, schools, and communities to ensure that our work advances the broader good for all children.

SOURCE: www.teachforamerica.org.

Visionary companies, such as 3M, General Electric, Procter & Gamble (P&G), and Walmart, provide more aspirational ideas that are not exclusively financial. The upscale retailer Nordstrom's vision, for example, is *to provide outstanding service every day, one customer at a time*. Visionary companies often outperform their competitors over the long run. Tracking the stock market performance of companies over several decades, strategy scholars found that visionary companies outperformed their peers by a wide margin.[19] A truly meaningful and inspiring vision makes employees feel they are part of something bigger. This is highly motivating and, in turn, can improve firm financial performance.

MISSION

Building on the vision, organizations establish a **mission**, which describes what an organization actually does—that is, the products and services it plans to provide, and the markets in which it will compete. People sometimes use the terms *vision* and *mission* interchangeably, but in the strategy process they differ.

Mission Description of what an organization actually does—the products and services it plans to provide, and the markets in which it will compete.

- A vision defines what an organization wants to accomplish ultimately, and thus the goal can be described by the infinitive form of the verb starting with *to*. As discussed in Strategy Highlight 1.1, TFA's vision is *to attain an excellent education for all children*.
- A mission describes what an organization does; it defines *how* the vision is accomplished and is often introduced with the preposition *by*. Accordingly, we can recast

TFA's mission that it will achieve its vision *by enlisting, developing, and mobilizing as many as possible of our nation's most promising future leaders to grow and strengthen the movement for educational equity and excellence*. (See Exhibit 1.1).

To be effective, firms need to back up their visions and missions with *strategic commitments*, in which the enterprise undertakes credible actions. Such commitments are costly, long-term oriented, and difficult to reverse.[20] However noble the mission statement, to achieve competitive advantage companies need to make strategic commitments informed by economic fundamentals of value creation.

As mentioned in the ChapterCase, Tesla is investing billions of dollars to equip its car factory in California with cutting-edge robotics and to build the Gigafactory producing lithium-ion batteries in Nevada. These investments by Tesla are examples of strategic commitments because they are costly, long-term, and difficult to reverse. They are clearly supporting Tesla's vision *to accelerate the world's transition to sustainable transport*. Tesla hopes to translate this vision into reality *by providing affordable zero-emission mass-market cars that are the best in class*, which captures Tesla's mission.

LO 1-4

Evaluate the strategic implications of product-oriented and customer-oriented vision statements.

VISION STATEMENTS AND COMPETITIVE ADVANTAGE. Do vision statements help firms gain and sustain competitive advantage? It depends. The effectiveness of vision statements differs by type. *Customer-oriented* vision statements allow companies to adapt to changing environments. *Product-oriented* vision statements often constrain this ability. This is because customer-oriented vision statements focus employees to think about how best to solve a problem for a consumer.[21]

Clayton Christensen shares how a customer focus let him help a fast food chain increase sales of milk shakes. The company approached Christensen after it had made several changes to its milk-shake offering based on extensive customer feedback but sales failed to improve. Rather than asking customers what kind of milk shake they wanted, he thought of the problem in a different way. He observed customer behavior and then asked customers, "What job were you trying to do that caused you to hire that milk shake?"[22] He wanted to know what problem the customers were trying to solve. Surprisingly he found that roughly half of the milk shakes were purchased in the mornings, because customers wanted an easy breakfast to eat in the car and a diversion on long commutes. Based on the insights gained from this problem-solving perspective, the company expanded its milk-shake offerings to include healthier options with fruit chunks and provided a prepaid dispensing machine to speed up the drive-through, and thus improve customers' morning commute. A customer focus made finding a solution much easier.

You could say that the restaurant company had a product orientation that prevented its executives from seeing unmet customer needs. Product-oriented vision statements focus employees on improving existing products and services without consideration of underlying customer problems to be solved. Our environments are ever-changing and sometimes seem chaotic. The increased strategic flexibility afforded by customer-oriented vision statements can provide companies with a competitive advantage.[23] Let's look at both types of vision statements in more detail.

PRODUCT-ORIENTED VISION STATEMENTS. A product-oriented vision defines a business in terms of a good or service provided. Product-oriented visions tend to force managers to take a more myopic view of the competitive landscape. Consider the strategic decisions of U.S. railroad companies. Railroads are in the business of moving goods and people from point A to point B by rail. When they started in the 1850s, their short-distance competition was the horse or horse-drawn carriage. There was little long-distance competition (e.g., ship canals or good roads) to cover the United States from coast to coast. Because of their monopoly, especially in long-distance travel, these companies were initially extremely profitable. Not surprisingly, the early U.S. railroad companies saw their vision as being in the railroad business, clearly a product-based definition.

However, the railroad companies' monopoly did not last. Technological innovations changed the transportation industry dramatically. After the introduction of the automobile in the early 1900s and the commercial jet in the 1950s, consumers had a wider range of choices to meet their long-distance transportation needs. Rail companies were slow to respond; they failed to redefine their business in terms of services provided to the consumer. Had they envisioned themselves as serving the full range of transportation and logistics needs of people and businesses across America (a customer-oriented vision), they might have become successful forerunners of modern logistics companies such as FedEx or UPS.

Recently, the railroad companies seem to be learning some lessons: CSX Railroad is now redefining itself as a green-transportation alternative. It claims it can move one ton of freight 423 miles on one gallon of fuel. However, its vision remains product-oriented: *to be the safest, most progressive North American railroad.*

CUSTOMER-ORIENTED VISION STATEMENTS. A *customer-oriented vision* defines a business in terms of providing solutions to customer needs. For example, "We provide solutions to professional communication needs." Companies with customer-oriented visions can more easily adapt to changing environments. Exhibit 1.2 provides additional examples of companies with customer-oriented vision statements. In contrast, companies that define themselves based on product-oriented statements (e.g., "We are in the typewriter business") tend to be less flexible and thus more likely to fail. The lack of an inspiring needs-based vision can cause the long-range problem of failing to adapt to a changing environment.

Customer-oriented visions identify a critical need but leave open the means of how to meet that need. Customer needs may change, and the *means* of meeting those needs may change with it. The future is unknowable, and innovation is likely to provide new ways to meet needs that we cannot fathom today.[24] For example, consider the need to transmit information over long distances. Communication needs have persisted throughout the millennia, but the technology to solve this problem has changed drastically over time.[25] During the reign of Julius Caesar, moving information over long distances required papyrus, ink, a chariot, a horse, and a driver. During Abraham Lincoln's time, railroads handled this task, while an airplane was used when Franklin Delano Roosevelt was president. Today,

EXHIBIT 1.2 Companies with Customer-Oriented Vision Statements

Alibaba: To make it easy to do business anywhere.
Amazon: To be Earth's most customer-centric company, where customers can find and discover anything they might want to buy online.
Better World Books: To harness the power of capitalism to bring literacy and opportunity to people around the world.
Facebook: To make the world more open and connected.
GE: To move, cure, build, and power the world.
Google: To organize the world's information and make it universally accessible and useful.
Nike: To bring inspiration and innovation to every athlete in the world.
SpaceX: To make human life multi planetary.
Tesla: To accelerate the world's transition to sustainable energy.
Walmart: To be the best retailer in the hearts and minds of consumers and employees.

we use connected mobile devices to move information over long distances at the speed of light. The problem to be solved—moving information over long distance—has remained the same, but the technology employed to do this job has changed quite drastically. Christensen recommends that strategic leaders think hard about how the means of getting a job done have changed over time and ask themselves, "Is there an even better way to get this job done?"

It is critical that an organization's vision should be flexible to allow for change and adaptation. Consider how Ford Motor Co. has addressed the problem of personal mobility over the past 100 years. Before Ford entered the market in the early 1900s, people traveled long distances by horse-drawn buggy, horseback, boat, or train. But Henry Ford had a different idea. In fact, he famously said, "If I had listened to my customers, I would have built a better horse and buggy."[26] Instead, Henry Ford's original vision was *to make the automobile accessible to every American*. He succeeded, and the automobile dramatically changed how mobility was achieved.

Fast-forward to today: Ford Motor Co.'s vision is *to provide personal mobility for people around the world*. Note that it does not even mention the automobile. By focusing on the consumer need for personal mobility, Ford is leaving the door open for exactly how it will fulfill that need. Today, it's mostly with traditional cars and trucks propelled by gas-powered internal combustion engines, with some hybrid electric vehicles in its lineup. In the near future, Ford is likely to provide vehicles powered by alternative energy sources such as electric power or hydrogen. In the far-reaching future, perhaps Ford will get into the business of individual flying devices. Throughout all of this, its vision would still be relevant and compel its managers to engage in future markets. In contrast, a product-oriented vision would have greatly constrained Ford's degree of strategic flexibility.

MOVING FROM PRODUCT-ORIENTED TO CUSTOMER-ORIENTED VISION STATEMENTS. In some cases, product-oriented vision statements do not interfere with the firm's success in achieving superior performance and competitive advantage. Consider Intel Corp., one of the world's leading silicon innovators. Intel's early vision was *to be the preeminent building-block supplier of the PC industry*. Intel designed the first commercial microprocessor chip in 1971 and set the standard for microprocessors in 1978. During the personal computer (PC) revolution in the 1980s, microprocessors became Intel's main line of business. Intel's customers were original equipment manufacturers that produced consumer end-products, such as computer manufacturers HP, IBM, Dell, and Compaq.

In the internet age, though, the standalone PC as the end-product has become less important. Customers want to stream video and share selfies and other pictures online. These activities consume a tremendous amount of computing power. To reflect this shift, Intel in 1999 changed its vision to focus on being *the preeminent building-block supplier to the internet economy*. Although its product-oriented vision statements did not impede performance or competitive advantage, in 2008 Intel fully made the shift to a customer-oriented vision: *to delight our customers, employees, and shareholders by relentlessly delivering the platform and technology advancements that become essential to the way we work and live*. Part of this shift was reflected by the hugely successful "Intel Inside" advertising campaign in the 1990s that made Intel a household name worldwide.

Intel accomplished superior firm performance over decades through continuous adaptations to changing market realities. Its formal vision statement lagged behind the firm's strategic transformations. Intel regularly changed its vision statement *after* it had accomplished each successful transformation.[27] In such a case, vision statements and firm performance are clearly not related to one another.

It is also interesting to note that customer-oriented visions also frequently change over time. When Telsa was founded in 2003, its mission was *to accelerate the world's* *transition to sustainable transport*. Over the last decade or so, Tesla completed several steps of its initial master plan (as detailed in the opening case), including providing zero-emission electric power generation options (Step 4), through the acquisition of the SolarCity. Tesla, therefore, no longer views itself as a car company but as a fully integrated clean-tech company. To capture this ambition more accurately Tesla changed its vision *to accelerate the world's transition to sustainable energy*. To reposition Tesla as an integrated clean-tech energy company, in 2017, Tesla changed its official name from Tesla Motors to Tesla, Inc.

Taken together, empirical research shows that sometimes vision statements and firm performance are *associated* with one another. A positive relationship between vision statements and firm performance is more likely to exist under certain circumstances:

- The visions are customer-oriented.
- Internal stakeholders are invested in defining the vision.
- Organizational structures such as compensation systems align with the firm's vision statement.[28]

The upshot is that an effective vision statement can lay the foundation upon which to craft a strategy that creates competitive advantage.

VALUES

LO 1-5 Justify why anchoring a firm in ethical core values is imperative for long-term success.

While many companies have powerful vision and mission statements, they are not enough. An organization's values also need to be clearly articulated in the strategy process. A **core values statement** matters because it provides touchstones for the employees to understand the company culture. It offers bedrock principles that employees at all levels can use to deal with complexity and to resolve conflict. Such statements can help provide the organization's employees with a moral compass.

core values statement Statement of principles to guide an organization as it works to achieve its vision and fulfill its mission, for both internal conduct and external interactions; it often includes explicit ethical considerations.

Consider that much of unethical behavior, while repugnant, may not be illegal. Often we read the defensive comment from a company under investigation or fighting a civil suit that "we have broken no laws." However, any firm that fails to establish extra-legal, ethical standards will be more prone to behaviors that can threaten its very existence. A company whose culture is silent on moral lapses breeds further moral lapses. Over time such a culture could result in a preponderance of behaviors that cause the company to ruin its reputation, at the least, or slide into outright legal violations with resultant penalties and punishment, at the worst.

Organizational core values are the ethical standards and norms that govern the behavior of individuals within a firm or organization. Strong ethical values have two important functions. First, ethical standards and norms underlay the vision statement and provide stability to the strategy, thus laying the groundwork for long-term success. Second, once the company is pursuing its vision and mission in its quest for competitive advantage, they serve as guardrails to keep the company on track.

Organizational core values Ethical standards and norms that govern the behavior of individuals within a firm or organization.

The values espoused by a company provide answers to the question, *how do we accomplish our goals?* They help individuals make choices that are both ethical and effective in advancing the company's goals. Strategy Highlight 1.2, featuring the pharmaceutical company Merck, provides an example of how values can drive strategic decision making, and what can happen if a company deviates from its core values.

One last point about organizational values: Without commitment and involvement from top managers, any statement of values remains merely a public relations exercise. Employees tend to follow values practiced by strategic leaders. They observe the day-to-day decisions of top managers and quickly decide whether managers are merely paying lip service to the company's stated values. Organizational core values must be lived with integrity,

Strategy Highlight 1.2

Merck: Reconfirming Its Core Values

Merck's vision is to *preserve and improve human life*. The words of founder George W. Merck still form the basis of the company's values today: *We try to never forget that medicine is for the people. It is not for profits. The profits follow, and if we have remembered that, they have never failed to appear.*[29]

ENDING RIVER BLINDNESS In 1987, Ray Vagelos, a former Merck scientist turned CEO, announced the company would donate its recently discovered drug Mectizan, without charge, to treat river blindness. For centuries, river blindness—a parasitic disease that leads to loss of eyesight—plagued remote communities in Africa and other parts of the world. Merck's executives formed a novel private-public partnership, the Mectizan Donation Program (MDP), to distribute the drug in remote areas, where health services are often not available.

After more than 25 years, more than 1 billion treatments, and some 120,000 communities served, the disease had effectively been eradicated. Merck's current CEO, Kenneth Frazier, announced himself "humbled" by the result of the company's value-driven actions.[30]

WITHDRAWING VIOXX In the case of another drug, though, Merck's values were brought into question. Vioxx was a painkiller developed to produce fewer gastrointestinal side effects than aspirin or ibuprofen. Once the Food and Drug Administration (FDA) approved the new drug in 1999, Merck engaged in typical big pharma promotional practices:

- Heavy direct-to-consumer advertising via TV and other media.
- Luxury doctor inducements, including consulting contracts and free retreats at exotic resorts.

Merck's new drug was a blockbuster, generating revenues of $2.5 billion a year by 2002 and growing fast.

Allegations began to appear, however, that Vioxx caused heart attacks and strokes. Critics alleged that Merck had suppressed evidence about Vioxx's dangerous side effects from early clinical trials. In 2004, Merck voluntarily recalled the drug. Merck's CEO at the time, Raymond Gilmartin, framed the situation in terms of knowledge learned *after* the initial release. He said he received a phone call from the head of research. "He told me that our long-term safety study of Vioxx was showing an increased risk of cardiovascular events compared to placebo, and the trial was being discontinued. . . . After analyzing the data further and consulting with outside experts, the Merck scientists recommended that we voluntarily withdraw the drug."[31]

Kenneth Frazier, CEO of Merck.
©Bloomberg/Getty Images

Regardless of what Merck knew when, the voluntary withdrawal reconfirmed in a costly way its core value that patients come before profits. Merck's reputation damaged, its stock fell almost 30 percent, eradicating $27 billion in market value almost overnight—an amount much greater than the estimated net present value of the profits that Merck would have obtained from continued sales of Vioxx. Merck has been hit by lawsuits ever since; legal liabilities have cost the company up to $30 billion thus far.

Some corporate social responsibility experts argue that Merck should have never put Vioxx on the market in the first place, or that it should have at least provided up front, clear assessments of the risks associated with Vioxx.[32]

especially by the top management team. Unethical behavior by top managers is like a virus that spreads quickly throughout an entire organization. It is imperative that strategic leaders set an example of ethical behavior by living the core values. Strategic leaders have a strong influence in setting an organization's vision, mission, and values. This is the first step in the entire strategic management process, which is captured in the AFI strategy framework to which we turn next.

1.3 The AFI Strategy Framework

LO 1-6
Explain the AFI strategy framework.

How do organizations craft and execute a strategy that enhances their chances of achieving superior performance? A successful strategy details a set of actions that managers take to gain and sustain competitive advantage. Effectively managing the strategy process is the result of three broad tasks:

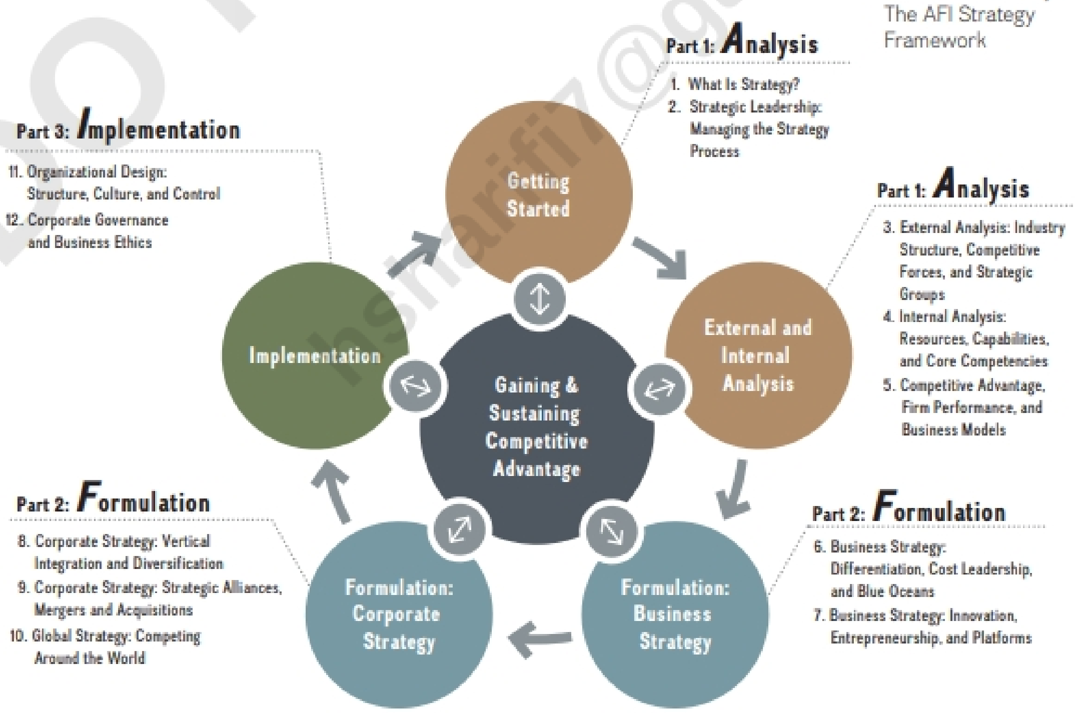
1. Analyze (A)
2. Formulate (F)
3. Implement (I)

The tasks of analyze, formulate, and implement are the pillars of research and knowledge about strategic management. Although we will study each of these tasks one at a time, they are highly interdependent and frequently happen simultaneously. Effective managers do not formulate strategy without thinking about how to implement it, for instance. Likewise, while implementing strategy, managers are analyzing the need to adjust to changing circumstances.

We've captured these interdependent relationships in the **AFI strategy framework** shown in Exhibit 1.3. This framework (1) explains and predicts differences in firm performance, and (2) helps managers formulate and implement a strategy that can result in superior performance. In each of the three broad strategy tasks, managers focus on specific *questions*, listed below. We address these questions in specific chapters, as indicated.

AFI strategy framework A model that links three interdependent strategic management tasks—analyze, formulate, and implement—that, together, help managers plan and implement a strategy that can improve performance and result in competitive advantage.

EXHIBIT 1.3 / The AFI Strategy Framework



Strategy Analysis (A) Topics and Questions

- Strategic leadership and the strategy process: *What roles do strategic leaders play? What is the firm's process for creating strategy and how does strategy come about? What is the relationship between stakeholder strategy and competitive advantage?* (Chapter 2)
- External analysis: *What effects do forces in the external environment have on the firm's potential to gain and sustain a competitive advantage? How should the firm deal with them?* (Chapter 3)
- Internal analysis: *What effects do internal resources, capabilities, and core competencies have on the firm's potential to gain and sustain a competitive advantage? How should the firm leverage them for competitive advantage?* (Chapter 4)
- Competitive advantage, firm performance, and business models: *How does the firm make money? How can one assess and measure competitive advantage? What is the relationship between competitive advantage and firm performance?* (Chapter 5)

Strategy Formulation (F) Topics and Questions

- Business strategy: *How should the firm compete: cost leadership, differentiation, or value innovation?* (Chapters 6 and 7)
- Corporate strategy: *Where should the firm compete: industry, markets, and geography?* (Chapters 8 and 9)
- Global strategy: *How and where should the firm compete: local, regional, national, or international?* (Chapter 10)

Strategy Implementation (I) Topics and Questions

- Organizational design: *How should the firm organize to turn the formulated strategy into action?* (Chapter 11)
- Corporate governance and business ethics: *What type of corporate governance is most effective? How does the firm anchor strategic decisions in business ethics?* (Chapter 12)

The AFI strategy framework shown in Exhibit 1.3 is repeated at the beginning of each part of this text to help contextualize where we are in our study of the firm's quest to gain and sustain competitive advantage. In addition, the *strategy process map,* presented at the end of Chapter 1, illustrates the steps in the AFI framework in more detail. The different background shades correspond to each step in the AFI framework. This strategy process map highlights the key strategy concepts and frameworks we'll cover in each chapter. It also serves as a checklist when you conduct a strategic management analysis.

We next turn to the *Implications for Strategic Leaders* section to provide practical applications and considerations of the material discussed in this chapter.

1.4 Implications for Strategic Leaders

Strategy is the art and science of success and failure. The difference between success and failure lies in an organization's strategy. A good strategy defines the competitive challenge, provides a guiding policy, and is implemented by coherent actions. Superior performance is the consequence of a good strategy. Moreover, strategic leaders appreciate the fact that competition is *everywhere;* this awareness infuses the other elements of strategy. You need a good strategy to deal with competition.

To create a powerful foundation upon which to formulate and implement a good strategy, strategic leaders need to articulate an inspiring vision and mission backed up by ethical core values. Customer-oriented or problem-defining vision statements are often correlated with firm success over long periods of time. This is because they allow firms strategic flexibility to change in order to meet changing customer needs and exploit external opportunities. Another important implication of our discussion is that all employees should feel invested in and inspired by the firm's vision and mission. Different companies use different tactics to achieve such commitment; some firms annually invite all employees to review and revise the statement of firm values; others ask employees to rank themselves, their departments, and management on success relative to the vision and mission. Belief in a company's vision and mission motivates its employees.

The strategic leader also realizes that the principles of strategic management can be applied universally to all organizations. Strategy determines performance whether in organizations large or small, multinational Fortune 100 companies, for-profit or nonprofit organizations, in the private or the public sector, and in developed as well as emerging economies. A good strategy is more likely when strategic leaders apply the three-step AFI strategy framework:

1. Analyze the external and internal environments.
2. Formulate an appropriate business and corporate strategy.
3. Implement the formulated strategy through structure, culture, and controls.

Keep in mind that strategic leaders are making decisions under conditions of uncertainty and complexity. They must carefully monitor and evaluate the progress toward key strategic objectives and make adjustments by fine-tuning any strategy as necessary. We discuss how this is done in the next chapter where we focus on *strategic leaders* and *the strategic management process*.

This content is also relevant directly for you beyond the classroom: Applying the tools and frameworks developed in this text allows you to help your organization be more successful. You can also apply the strategic management toolkit to your own career to pursue your professional and other goals (see the *my*Strategy modules at the end of each chapter).

CHAPTER**CASE 1** / Consider This . . .

In 2016, 10 years after Tesla's initial "secret strategy," Elon Musk unveiled the second part of his master plan for the company ("Master Plan, Part Deux") to continue the pursuit of its vision "to accelerate the advent of sustainable energy." Again, CEO Musk detailed a set of stretch goals:[33]

1. Create stunning solar roofs with seamlessly integrated battery storage.
2. Expand the electric vehicle product line to address all major segments.
3. Develop a self-driving capability that is 10 times safer than manual via massive fleet learning.
4. Enable your car to make money for you when you aren't using it.

In the updated strategy, Step 1 leverages the integration of SolarCity. The new Tesla company is now a fully integrated sustainable energy company, combining energy generation with energy storage from SolarCity. It provides energy generation via beautiful new solar roofs that look like regular shingles, but cost less, all things considered, and last longer. Tesla also offers its Powerwall to residential consumers, which allows customers to store the solar energy captured on their roofs for later use. Energy generation, therefore, becomes decentralized. This implies that consumers are able to generate and use energy without being dependent on any utility, and are able to sell back excess energy to utilities. Indeed, consumers will generate not only energy for the use of their Tesla cars but also enough to cover the energy needs of the entire house.

Tesla's new solar roof, with a Tesla car and Powerwall in the garage.
©Tesla/Newscom

In Step 2, Tesla is planning to expand the lineup of its electric vehicles to address all major segments, including pickup trucks, buses, and heavy-duty semis.

In Step 3, Tesla is aiming to further develop the self-driving capabilities of its vehicles. The goal is to make self-driving vehicles 10 times safer than manual driving, and thus being able to offer fully autonomous vehicles.

Fully autonomous driving capabilities are required for Tesla to fulfill Step 4 of the new master plan: Turn your car into an income-generating asset. The idea is to offer an Uber-like service made up of Tesla vehicles, but without any drivers. On average, cars are used less than three hours during a day. The idea is that your autonomous-driving Tesla will be part of a shared vehicle fleet when you are not using your car. This will drastically reduce the total cost of ownership of a Tesla vehicle, and it will also allow pretty much anyone to ride in a Tesla as a result of the sharing economy.[34]

Questions

1. Do you agree with the assessment that Elon Musk and Tesla successfully fulfilled their first master plan published in 2006? Why or why not? Buttress your arguments.
2. As of today, does Tesla have a *good strategy?* Why or why not? How do you know?
3. Describe the rationale behind Tesla's new master plan. How does this new strategy help Tesla fulfill its vision? "Master Plan, Part Deux" in its entirety is on Tesla's blog: https://www.tesla.com/blog/master-plan-part-deux
4. Apply the three-step process for crafting a *good strategy* outlined in the chapter (*diagnose the competitive challenge, derive a guiding policy,* and *implement a set of coherent actions)* to each element of the new master plan. On which steps of the new master plan has Tesla made the most progress? Explain. Also, which recommendations would you have for Elon Musk? Support your arguments with examples and observations.

TAKE-AWAY CONCEPTS

This chapter detailed what strategy and competitive advantage is. It described the roles of vision, mission, and values in a firm's strategy. It also set the stage for further study of strategic management by introducing the AFI strategy framework, as summarized by the following learning objectives and related take-away concepts.

LO 1-1 / Explain the role of strategy in a firm's quest for competitive advantage.

- Strategy is the set of goal-directed actions a firm takes to gain and sustain superior performance relative to competitors.
- A good strategy enables a firm to achieve superior performance. It consists of three elements:
  1. A diagnosis of the competitive challenge.
  2. A guiding policy to address the competitive challenge.
  3. A set of coherent actions to implement the firm's guiding policy.
- A successful strategy requires three integrative management tasks—analysis, formulation, and implementation.

LO 1-2 / Define competitive advantage, sustainable competitive advantage, competitive disadvantage, and competitive parity.

- Competitive advantage is always judged relative to other competitors or the industry average.
- To obtain a competitive advantage, a firm must either create more value for customers while keeping its cost comparable to competitors, or it must provide the value equivalent to competitors but at a lower cost.
- A firm able to outperform competitors for prolonged periods of time has a sustained competitive advantage.
- A firm that continuously underperforms its rivals or the industry average has a competitive disadvantage.
- Two or more firms that perform at the same level have competitive parity.
- An effective strategy requires that strategic trade-offs be recognized and addressed—for example, between value creation and the costs to create the value.

LO 1-3 / Describe the roles of vision, mission, and values in a firm's strategy.

- A vision captures an organization's aspirations. An effective vision inspires and motivates members of the organization.
- A mission statement describes what an organization actually does—what its business is—and why and how it does it.
- Core values define the ethical standards and norms that should govern the behavior of individuals within the firm.

LO 1-4 / Evaluate the strategic implications of product-oriented and customer-oriented vision statements.

- Product-oriented vision statements define a business in terms of a good or service provided.
- Customer-oriented vision statements define business in terms of providing solutions to customer needs.
- Customer-oriented vision statements provide managers with more strategic flexibility than product-oriented missions.
- To be effective, visions and missions need to be backed up by hard-to-reverse strategic commitments and tied to economic fundamentals.

LO 1-5 / Justify why anchoring a firm in ethical core values is essential for long-term success.

- Ethical core values underlay the vision statement to ensure the stability of the strategy, and thus lay the groundwork for long-term success.
- Ethical core values are the guardrails that help keep the company on track when pursuing its mission and its quest for competitive advantage.

LO 1-6 / Explain the AFI strategy framework.

- The AFI strategy framework (1) explains and predicts differences in firm performance, and (2) helps managers formulate and implement a strategy that can result in superior performance.
- Effectively managing the strategy process is the result of three broad tasks:
  1. Analyze (A)
  2. Formulate (F)
  3. Implement (I)

KEY TERMS

AFI strategy framework *(p. 19)*
Competitive advantage *(p. 8)*
Competitive disadvantage *(p. 8)*
Competitive parity *(p. 9)*
Core values statement *(p. 17)*
Good strategy *(p. 7)*
Mission *(p. 13)*
Organizational core values *(p. 17)*
Strategic intentS *(p. 11)*
Strategic management *(p. 6)*
Strategy *(p. 6)*
Sustainable competitive advantage *(p. 8)*
Vision *(p. 11)*

DISCUSSION QUESTIONS

1. The text discusses strategic trade-offs that are different between Walmart and Nordstrom even though they are in the same industry. Think of another industry that you know fairly well and select two firms there that also have made very different choices for these trade-offs. Describe some of the differences between these firms. What type of trade-off decisions have these firms made?
2. What characteristics does an effective mission statement have?

3. The "job to do" approach discussed with the Clayton Christensen milk-shake example can be useful in a variety of settings. Even when we are the customers ourselves sometimes we don't look for better solutions because we get into routines and habits. Think about a situation you sometimes find frustrating in your own life or one you hear others complaining about frequently. Instead of focusing on the annoyance, can you take a step back and look for the real job that needed doing when the frustration occurred? What other options can be developed to "do the job" that may lead to less irritation in these situations?

ETHICAL/SOCIAL ISSUES

1. In the discussion about Merck (Strategy Highlight 1.2) it is clear the firm has followed a socially responsible path by donating more than 1 billion drug treatments to remedy river blindness in remote African communities. Yet Merck must also meet shareholder responsibilities and make profits on drugs in use in more affluent societies. How should a responsible firm make these trade-offs? What steps can strategic leaders take to guide organizations on these challenging issues?
2. The list below shows a sample of various vision/mission statements. Match the company with its corresponding statement. Also identify whether the statements are principally customer-oriented or product-oriented.

Vision/Mission Statement	Type of Statement	Matched Company	Company
To be our customers' favorite place and way to eat and drink.			1. Alibaba
To supply the consumer and our customers with the finest, high-quality products.			2. AutoNation
To help women feel great about themselves and their potential.			3. Barnes & Noble
To provide a global trading platform where practically anyone can trade practically anything.			4. CarMax
To operate the best omni-channel specialty retail business in America.			5. Darden Restaurants
To provide our customers great quality cars at great prices with exceptional customer service.			6. Dole Foods
To be financially successful through great people consistently delivering outstanding food, drinks and service in an inviting atmosphere.			7. eBay
To be America's best run, most profitable automotive retailer.			8. Estée Lauder
Bringing the best to everyone we touch and being the best in everything we do.			9. Facebook
To develop the social infrastructure to give people the power to build a global community that works for all of us.			10. KFC
To give everyone the power to create and share ideas and information instantly, without barriers.			11. Manpower
To be the best worldwide provider of higher-value staffing services and the center for quality employment opportunities.			12. McDonald's
To sell food in a fast, friendly environment that appeals to pride-conscious, health-minded consumers.			13. Spanx
To build the future infrastructure of commerce.			14. Twitter

SMALL GROUP EXERCISES

//// Small Group Exercise 1

The chapter applies the three elements of a good strategy to Tesla for insights into the company's possible competitive advantage. As a group, choose a different firm that is well known to the students. Assign the competitive challenges and company guiding policies and search the internet for information about the firm's actions. As a group discuss key actions the firm has taken and decide if they seem to be coherent. Does the firm demonstrate measures of a competitive advantage? If yes, does it look to be sustainable?

//// Small Group Exercise 2

Strategy Highlight 1.1 discusses the importance of the inspiring vision developed at Teach for America. In your group search the internet for other nonprofit organizations (Red Cross, Habitat for Humanity, etc.). Which of them has vision or mission statements that are appealing to donors, employees, and clients? Do these statements seem relevant in today's environment or are they outdated? What improvements can you create for these organizational statements?

*my*STRATEGY

How Much Are Your Values Worth to You?

How much are you willing to pay for the job you want? This may sound like a strange question, since your employer will pay you to work, but think again. Consider how much you value a specific type of work, or how much you would want to work for a specific organization because of its values.

A study shows scientists who want to continue engaging in research will accept some $14,000 less in annual salary to work at an organization that permits them to publish their findings in academic journals, implying that some scientists will "pay to be scientists." This finding appears to hold in the general business world too. In a survey, 97 percent of Stanford MBA students indicated they would forgo some 14 percent of their expected salary, or about $11,480 a year, to work for a company that matches their own values with concern for stakeholders and sustainability. According to Monster.com, an online career service, about 92 percent of all undergraduates want to work for a "green" company. These diverse examples demonstrate that people put a real dollar amount on pursuing careers in sync with their values.

On the other hand, certain high-powered jobs such as management consulting or investment banking pay very well, but their high salaries come with strings attached. Professionals in these jobs work very long hours, including weekends, and often take little or no vacation time. These workers "pay for pay" in that they are often unable to form stable relationships, have little or no leisure time, and sometimes even sacrifice their health. People "pay for"—make certain sacrifices for—what they value, because strategic decisions require important trade-offs.[35]

1. Identify your personal values. How do you expect these values to affect your work life or your career choice?
2. How much less salary would (did) you accept to find employment with a company that is aligned with your values?
3. How much are you willing to "pay for pay" if your dream job is in management consulting or investment banking?

ENDNOTES

1. Market capitalization = Share price x Number of shares outstanding.

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8. The discussion of Tesla throughout this chapter is based on Rothaermel, F.T., and D. King (2015), Tesla Motors, Inc., *McGraw-Hill Education Case Study MHE-FTR-032,* and Hoang, H., and F. T. Rothaermel (2016), "How to manage alliances strategically," *MIT Sloan Management Review,* Fall, 58(1): 69–76; Ramsey, M. (2016, Mar. 30), "A lot riding on Tesla's Model 3 unveiling," *The Wall Street Journal*; Ramsey, M., and C. Sweet (2016, Aug. 1), "Tesla and SolarCity agree to $2.6 billion deal," *The Wall Street Journal*; Pulliam, S., M. Ramsey, and I. J. Dugan (2016, Aug. 15), "Elon Musk sets ambitious goals at Tesla—and often falls short," *The Wall Street Journal*; and Ramsey, M. (2014, Jun. 12), "Tesla Motors offers open licenses to its patents," *The Wall Street Journal.*

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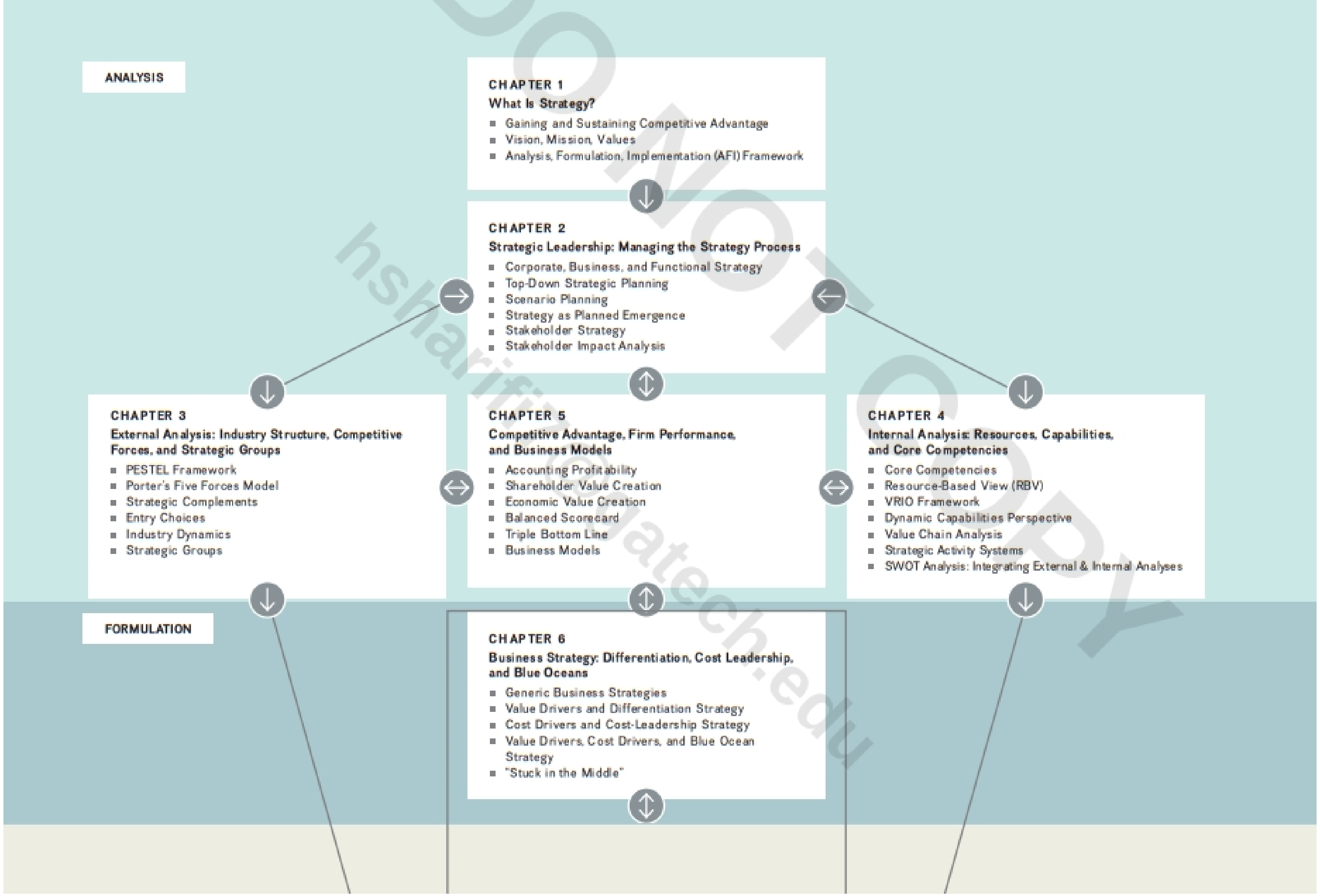
The Strategic Management Process Map



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CHAPTER 3

External Analysis: Industry Structure, Competitive Forces, and Strategic Groups

Chapter Outline

Learning Objectives

LO 3-1 Generate a PESTEL analysis to evaluate the impact of external factors on the firm.

LO 3-2 Differentiate the roles of firm effects and industry effects in determining firm performance.

LO 3-3 Apply Porter's five competitive forces to explain the profit potential of different industries.

LO 3-4 Examine how competitive industry structure shapes rivalry among competitors.

LO 3-5 Describe the strategic role of complements in creating positive-sum co-opetition.

LO 3-6 Explain the five choices required for market entry.

LO 3-7 Appraise the role of industry dynamics and industry convergence in shaping the firm's external environment.

LO 3-8 Generate a strategic group model to reveal performance differences between clusters of firms in the same industry.

CHAPTERCASE 3

Airbnb: Disrupting the Hotel Industry

"Brian Chesky, Joe Gebbia, and Nathan Blecharczyk founded Airbnb on a shoestring budget in 2008. Today, Airbnb is the largest hospitality platform globally."

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IN 2007, BRIAN CHESKY and Joe Gebbia were roommates in San Francisco. Both were industrial designers, people who shape the form and function of everything from coffee cups to office furniture to airplane interiors. But since work gigs were hit-and-miss for the aspiring industrial designers, they could not afford their rent payments. On a whim, they decided to send out an e-mail on the distribution list for an upcoming industrial design conference in their hometown: "If you're heading out to the [industrial design conference] in San Francisco next week and have yet to make accommodations, well, consider networking in your jam-jams. That's right. For an affordable alternative to hotels in the city, imagine yourself in a fellow design industry person's home, fresh awake from a snooze on the ol' air mattress, chatting about the day's upcoming events over Pop Tarts and OJ."

Three people took up the offer, and the two roommates made some money to subsidize their rent payments. But more importantly, Chesky and Gebbia felt that they had stumbled upon a new business idea: Help people rent out their spare rooms. They then brought on computer scientist Nathan Blecharczyk, one of Gebbia's former roommates, to create a website where hosts and guests could meet and transact, naming their site AirBedandBreakfast.com (later shortened to Airbnb). The three entrepreneurs tested their new site at the 2008 South by Southwest (SXSW), an annual music, film, and interactive media conference. SXSW also serves as an informal launch pad for new ventures; for example, Twitter, the social networking and news site, was unveiled at SXSW just a year earlier to great fanfare. Airbnb's launch at SXSW flopped, however, because the conference organizers had exclusive contracts with local hotels (a fact the Airbnb founders only learned after the event), and so conference organizers didn't drive any traffic to Airbnb's site.

Not to be discouraged, Airbnb decided to take advantage of the anticipated shortage of hotel rooms in Denver, Colorado, the site of the Democratic National Convention (DNC) in the summer of 2008. After all hotels were booked, the founders prepared media releases with titles such as "Grassroots Housing for Grassroots Campaign," which Obama supporters loved. As luck would have it, Airbnb was covered in both *The New York Times* and *The Wall Street Journal*. And the newly designed Airbnb site worked! It facilitated about 100 rentals during the DNC. Soon after the event, however, website traffic to Airbnb's site fell back to zero. To keep going, Chesky and Gebbia decided to become cereal entrepreneurs, creating "Obama-O's: The breakfast of change" and "Cap'n McCains: A maverick in every bite," with illustrated images of the 2008 presidential candidates on 1,000 cereal boxes. After sending samples to their press contacts and subsequent coverage in the media, the limited edition cereal sold out quickly, providing enough cash to keep going with Airbnb a bit longer.

The fledgling venture's breakthrough came in 2009 when it was accepted into a program run by Y Combinator, a start-up incubator that has spawned famous tech companies such as Dropbox, Stripe, and Twitch.tv. In exchange for equity in the new venture, these start-up accelerators provide office space, mentoring, and networking opportunities, including with venture capitalists looking to fund the next "big thing." In 2010, Airbnb received funding from Sequoia Capital, one of the most prestigious venture capital firms in Silicon Valley, having provided early-stage capital to companies such as Apple, Google, Oracle, PayPal, YouTube, and WhatsApp. Although not a first mover in the peer-to-peer rental space, Airbnb, while at Y Combinator, was the first one to figure out that a sleek website with professional photos of available rentals made all the difference. In addition, Airbnb developed a seamless transaction experience between hosts and guests, allowing it to make a bit over 10 percent on each transaction conducted on its rental site. Timing was now much more fortuitous, with the global financial crisis in full swing, people were looking for low-cost accommodations while hosts were trying to pay rent or mortgages to keep their homes.

In 2017, a mere 10 years after the two roommates had sent out the fateful e-mail inviting complete strangers to share their apartment with them, Airbnb was valued at a whopping $31 billion! This makes Airbnb the fourth most valuable private company on the planet, just after Uber ($68 billion); Didi Chuxing, basically China's version of Uber ($50 billion); and Xiaomi, a Chinese smartphone maker (46 billion). Even more stunning, Airbnb's $31 billion valuation exceeds that of Marriott, the world's largest hotel chain. And just like global hotel chains, Airbnb uses sophisticated pricing and reservation systems for guests to find, reserve, and pay for rooms to meet their various travel needs. In this sense, Airbnb is a new entrant that competes in the global hotel industry. Indeed, with more than 3 million listings in over 65,000 cities basically anywhere in the world (except North Korea), Airbnb offers more accommodations than the three biggest hotel chains combined: Marriott, Hilton, and Intercontinental.[1]

You will learn more about Airbnb by reading this chapter; related questions appear in "ChapterCase3 / Consider This. . . ."

HOW CAN AN INTERNET startup based on the idea of home sharing disrupt the global hotel industry, long dominated by corporate giants such as Marriott, Hilton, or Intercontinental? One reason is that Airbnb, now the world's largest accommodation provider, owns no real estate. Instead, Airbnb uses a business model innovation to circumvent traditional entry barriers into the hotel industry. Just like Uber, Facebook, or Amazon, Airbnb provides an online platform for sellers (hosts) and buyers (renters) to connect and transact (we'll take a closer look at "Platform Strategy" in Chapter 7). While traditional hotel chains need years and millions of dollars in real estate investments to add additional capacity (finding properties, building hotels, staffing and running them, etc.), Airbnb's inventory is basically unlimited as long as it can sign up users with spare rooms to rent. Even more importantly, Airbnb does not need to deploy millions of dollars in capital to acquire and manage physical assets or manage a large cadre of employees. For example, Marriott has almost 250,000 employees, while Airbnb's headcount is some 2,500 employees (only 1 percent of Marriott's). Thus, Airbnb can grow much faster and respond much more quickly to local circumstances affecting the demand and supply of accommodations. The competitive intensity in the hotel industry is likely to increase especially in high-traffic metropolitan cities such as New York, Paris, Dubai, and Seoul.

In this chapter, we present a set of frameworks to analyze the firm's *external environment*—that is, the industry in which the firm operates, and the competitive forces that surround the firm from the outside. We move from a more macro perspective to a more micro understanding of how the external environment affects a firm's quest for competitive advantage. We begin with the PESTEL framework, which allows us to scan, monitor, and evaluate changes and trends in the firm's macroenvironment. Next, we study Porter's five forces model of competition, which helps us to determine an industry's profit potential. Depending on the firm's strategic position, these forces can affect its performance for good or ill. We also take a closer look at the choices firms must make when considering entry in an industry. We then move from a static analysis of a firm's industry environment to a dynamic understanding of how industries and competition change over time. We also discuss how to think through entry choices once an attractive industry has been identified. Next we introduce the strategic group model for understanding performance differences among clusters of firms in the same industry. Finally, we offer practical *Implications for Strategic Leaders*.