CHAPTER 1

DESIGNING MANAGEMENT STRATEGY

Contents

Scenario #1. You are the CEO of an entrepreneurial start-up company that is being established to capitalize on a technological innovation. Working with the owner, you have assembled an accomplished advisory board, and a high-quality management team as well as some talented engineers and marketing professionals. You have already made initial contacts with some impressive potential clients and begun discussions with technology partners. An investment bank has scheduled meetings with a group of venture capital investors in two weeks. To launch the venture, the advisory board, management group, a representative from the investment bank and other personnel are meeting in a conference room at a downtown hotel. You have distributed a basic business plan to the participants. After introductions have been made around the table and a set of presentations given during the morning meeting, a question arises during the afternoon session: What is our strategy? A heated discussion breaks out and the group turns to you for leadership.

Scenario #2. You have just been made head of a division of a rapidly growing regional business. The company's brands are gaining national recognition and the firm's financial performance to date has been outstanding. The board went to great lengths recruiting you as the leading prospect among over a dozen attractive candidates. Since you are new to the organization, you are being deluged with information about the company as you get up to speed. Although you have always been a quick study, what information should be the focus of your attention? Should you continue the successful policies of your predecessor or chart out a new direction? What is the relationship of the division to the rest of the company? Taking the helm is both a thrill and a challenge, but what do you do now?

Scenario #3. You have just completed business school and joined a consumer products division of a major corporation. Your job description is fairly specific and the immediate tasks that you need to accomplish are spelled out when you join the team. A few weeks after your arrival, the senior manager of your division convenes the division personnel for a briefing. He makes a rather long speech, outlining the company's mission and specific goals. The senior manager provides some details about the company's overall strategy and the challenges that the division faces. The senior manager also points to some changes in the firm's market position and the possible impact on the organization. It all sounds vague and rather distant from your day-to-day activities. You wonder whether the briefing is really necessary and if all the discussion of the company's strategy will affect your job description, not to mention your stock options. How important is the briefing for your assigned tasks?

Scenario #4. You have just joined a top international consulting company. You are sent with a team to meet with an important corporate client in Europe. The client company is under siege, with entrepreneurial European firms introducing low-cost alternatives and international competitors attracting its customers with superior products and services. The client's company is in an industry that, until now, has been sheltered from competition by trade restrictions and other government controls. A combination of technological change and market deregulation have altered the landscape considerably. You wonder whether consumer characteristics and market conditions in Europe should affect your recommendations, or whether you can give management some generic strategic advice. As you meet with senior personnel at the client company, they urgently seek your guidance on a course of action.

These four scenarios are based on actual experience. Whatever your position — CEO, division manager, employee, consultant — similar questions arise. What are you trying to achieve? What information do you need? What actions should you take? How should you deal with competitors? What are your responsibilities and those of other people in the organization?

Strategic analysis provides a method for answering these crucial questions. By the time you have gone through this text, you will know the basic principles of strategic analysis. You will have in mind all the steps needed to create your own strategy. You will know how to start from your position in the company, how to gather the necessary information, and how to design your strategy. You will have a systematic framework to help you decide on a course of action and to get others on board. Understanding the strategy-making process set out in this book will prepare you to become a successful business leader.

Formulating strategy is the primary responsibility of the company's managers. As a manager, you must prepare a strategy, regardless of whether you are leading the whole company or a division of a company. If you are an entrepreneur, you must devise a strategy to prepare a complete business plan and to guide the company. As a consultant, you need to understand the strategy process since you have to assist clients in formulating strategy. Even if you are a company employee who is not a part of the management, it is often necessary to understand the strategy process because your actions must help carry out the company's strategy.

What is the purpose of having a strategy? Simply put: *Management strategy* is a broad *plan of action* to achieve the company's goals. As a manager, you must formulate a strategy to prepare your company for competition. You also need a strategy to lead and coordinate the members of your organization. This chapter outlines the main steps of strategic analysis. After you have completed the chapter, you will know the key concepts which you will need for strategy-making.

Management strategy has five main components which form the outline of the book. (1) The manager begins the strategic analysis by selecting the *goals* of the company. (2) The manager performs a comprehensive *external analysis* of market conditions and a careful *internal analysis* of the characteristics of the company's organization. The manager adjusts the choice of the company's goals taking into account information about both the company's potential markets and its organizational abilities. (3) The manager identifies the critical factors that distinguish the firm from its competitors and allow the firm to attain a *competitive advantage*. (4) The manager formulates a *competitive strategy* that anticipates the strategies of competitors and chooses market actions to outperform competitors. (5) Finally, the manager turns to the design of an *organizational structure* that conforms to the company's overall strategy.

Even though market conditions are changing constantly and business practices are evolving rapidly, managers will always benefit from the guidance provided by the basic principles of management strategy. However, strategy-making is an ongoing process. As market conditions shift and organizations develop, it is often necessary for the manager to start the process again. The basic steps of strategy-making covered in this chapter can be applied repeatedly to respond to changing market conditions.

Chapter 1: Take-Away Points

Managers formulate the company's strategy by following the five steps of strategic analysis — select goals, perform external and internal analyses, identify competitive advantage, devise competitive strategy, and design the organization:

- The manager selects the company's *goals* to make the best match between organizational abilities and market opportunities. Information from the manager's external and internal analyses guides the manager's choice of goals and in turn, the company's goals serve to refine and update the manager's external and internal analyses.
- The manager performs an *external analysis* to examine what types of markets the firm will encounter as the strategy unfolds. The manager performs an *internal analysis* to determine the characteristics of the organization and its potential to realize market opportunities.
- The manager selects activities to obtain a *competitive advantage* by emphasizing factors that lead to superior market performance, including costs, products, and transactions.
- The manager devises a *competitive strategy* by anticipating rival strategies and choosing actions to outperform rival firms, including choosing the types of moves, timing of moves, defensive actions, and methods of market entry.
- Having set the goals of the business and chosen the competitive strategy to achieve them, the manager designs an *organizational structure* that conforms to the company's overall strategy.

1.1 *Strategic Analysis and the Goals of the Firm*

Strategic analysis is a management decision-making process. After applying the five steps of strategy making, the manager is ready to guide the business organization in competition. Accordingly, strategy is forward-looking — the manager asks what the company should do. Moreover, strategy is externally-focused — the manager asks what will succeed in the marketplace. Also, strategy has an internal-perspective — the manager asks how the organization will carry out the company's strategy. There is no universal strategic prescription; strategy depends on context and what works in one type of market may not work in another. However, the method of strategic analysis is sufficiently general that it works in many different market situations. The basic steps of strategic analysis are illustrated in Figure 1.1.

Every journey begins with a single step. But where do we begin? Just as the traveler needs a destination, the company needs a goal. The goal is what the company is trying to achieve. If goals are the company's destination, strategies are the route to the destination — strategies are the means to achieve the company's goals. Goal setting is the crucial first step in strategy-making.

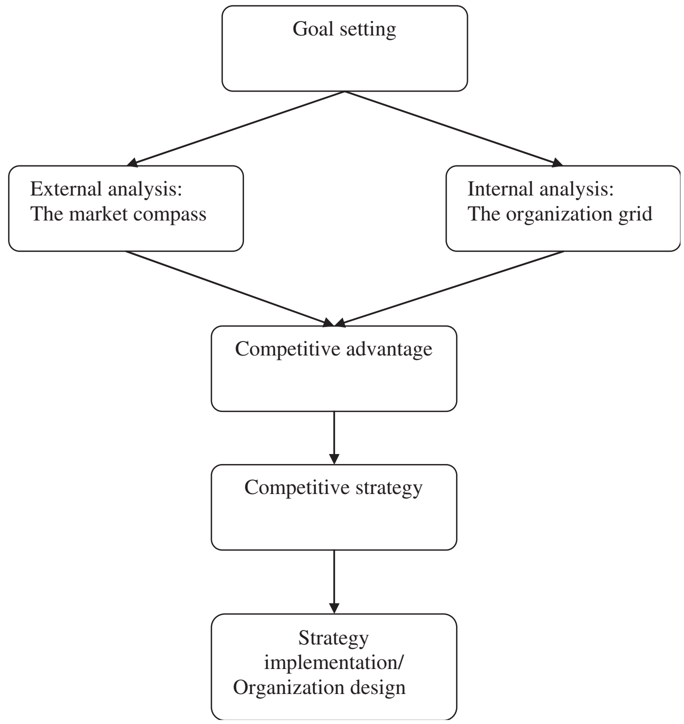

Figure 1.1: The manager's process of strategic analysis.
The process includes feedback between goal setting and the external and internal analyses. Managers apply the process repeatedly to address changes in the company's markets and its organization.

The manager's first responsibility in the strategy process is goal selection. The company's *goals* often are framed in terms of *serving specific markets*. The manager poses the key question: "What business should we be in?" Answering this question can require continuing to serve the company's existing markets. The company may need to enter promising new markets and to exit from unfavorable markets. The goal might look like one of the following:

The company will produce sportswear for sale in its own outlets in North America.
The company will operate hair care salons in Japan.
The company will conduct basic research in biotechnology for pharmaceutical companies.
The company will provide a complete line of financial services throughout Europe.
The company will serve the market for electric power generation in Brazil.
The company will create and supply specialized designs of microprocessors.
The company will operate supermarket chains in many countries around the world.

These goals are fairly simple. Generally, defining the goal requires a careful definition of the business and the market that it serves. Often, companies want to be the leading firm in their chosen markets.

How should a manager choose the company's goals? The process cannot be accidental — a dart thrown at a chart on the wall will not do. The goal can change over time, but that does not mean that managers can wing it, hoping that the goal will emerge over time as the company experiments with different activities. The manager needs to follow a systematic procedure so as to take advantage of available information and to increase the chances that the company will be successful.

Understandably, the question of choosing goals is hotly debated in strategy making. Some argue that the company should choose goals based only on the best market opportunities. Market-driven goals are based on discovering original market opportunities that are characterized by growing customer demand and relatively limited competition. However, in some markets, the company may find that competitors are much better at satisfying customer needs. The video game market may look attractive but other companies might be better at designing or marketing games. Then, the company's goals must adapt to the abilities of the organization relative to its competitors.

Others argue that the company should engage in those tasks that reflect the company's unique skills and competencies, particularly those that are hard for others to copy. Organization-driven goals are based on recognizing unique organizational abilities and resources that will help the company prevail over its competitors. However, in some cases, there is little demand for the things the company is best able to do. The company may be very good at designing wooden tennis rackets when the market has switched to composite materials.

This text focuses on *value-driven strategy*. The manager chooses goals and strategies that maximize the total value of the firm. The manager chooses *value-driven goals by making the best match of organizational abilities with market opportunities*. This means that a compromise may be necessary. The company may not necessarily chase the most attractive market opportunity or employ the best skills of its organization. The path to success is choosing the best *combination* of market opportunities and organizational strengths. The company might target an apparently less attractive opportunity that fits its skills or develop some secondary skills to meet an opportunity. This is why the manager must integrate information from both the external analysis and the internal analyses when choosing the company's goals.[1]

The goals of the company are not only to serve particular markets but also to serve them well. Companies strive for winning performance in their markets. Kenichi Ohmae observes that "[i]n the real world of business, 'perfect' strategies are not called for. What counts ... is not performance in absolute terms but performance relative to competitors".[2]

Corporate strategy is the overall strategy of a multi-business company. The corporation's senior management sets its goals by choosing the collection of individual businesses, thus determining the scope of the firm's activities. Each business serves a specific set of markets. Top management chooses a policy of diversification if entering multiple businesses increases the total value of the firm. Companies should operate multiple businesses only if those businesses are worth more when operated together than if they were operated separately. Corporate strategy involves the selection and coordination of the multiple businesses. Thus, the goals of corporate strategy are expressed in terms of the set of businesses the company wishes to operate. For example, Groupe Danone chooses to operate three global businesses: dairy products, biscuits, and beverages.

Business strategy is the overall strategy of a business unit of a large corporation or that of a standalone business. Business strategy refers to the plans of an established firm for serving existing markets or new markets. Business strategy also refers to the plans of an entrepreneur contemplating entry into a market. Many dot-coms failed because they followed a policy of ready-fire-aim. A start-up company certainly needs to have a business plan before it is established. The goals of a business are expressed in terms of the set of markets that the business wishes to serve. For example, one of the goals of Danone's dairy products business is to continue providing the highest-selling brand of yogurt worldwide.

This text uses the general term *management strategy* to include both corporate strategy and business unit strategy. The term *manager* is used generally here to refer to a business leader. Management strategy refers to the manager's decisions and plans that are necessary to guide the company. As already emphasized, management strategy results from the process of selecting goals, performing external and internal analyses, identifying competitive advantage, devising competitive strategy and designing the organization.

Most organizations have well-defined goals. Many types of organizations exist, including profit-maximizing businesses, educational establishments, religious institutions, informal communities, non-profit enterprises, governmental agencies, and the military. Objectives and decision-making procedures vary across organizations, making generalizations difficult. Different types of organizations might have different measures of success. A non-profit organization might have public service goals. A private club is operated for the benefit of its members. A government agency may serve political or social interests. To carefully define the main issues, this text concentrates on *profit-maximizing* businesses, whether privately held or publicly traded.

After the manager completes the strategic analysis, the process of strategy implementation begins. *Implementation* means that the manager must *act through others* to execute the strategy. The manager communicates the strategy to the members to the organization. The manager exercises leadership to guide the company's employees and motivates employees to cooperate with each other and to act in the interests of the company. After monitoring the performance of the organization in executing the strategy, managers make the necessary adjustments both in organizational design and in the strategy itself. Implementation brings a strategy to life, but implementation cannot be effective without a good strategy. Because the focus of this book is on strategy analysis, the important but extensive problem of strategy implementation is beyond the scope of the discussion.

Taking some time to choose goals is worthwhile because a brilliant strategy in pursuit of the wrong objectives can be of limited value. The company's top managers must be involved with defining its goals. Strategy in this text is concerned with *rational actors*, that is, managers seeking to make explicit goals and choosing the best means to achieve these goals. In contrast, some analysts emphasize the importance of evolutionary, non-rational approaches to forming strategy. Henry Mintzberg speaks of managers crafting strategy, which is the outcome of rational deliberations and of responses that emerge as reactions to unforeseen events.[3] Many managers form their ideas based on experience or substantially change their plans over time.

Strategies always involve risk and conjecture. The failure or success of the firm's actions provides valuable feedback. Companies continually encounter technological innovations, changes in customer demand, and creative competitors. Companies and their managers update their goals and strategies as new information becomes available. Strategies are not set in stone, but, instead, anticipate and respond to competition. Accordingly, the strategy process in this text can be applied to develop dynamic strategies that adapt to changing market conditions.

Exhibit 1.1 Jack Welch at General Electric

Jack Welch, the legendary chairman and CEO of General Electric, spelled out his strategy clearly with his "number one, number two" concept. He pledged to continue to operate or to acquire only those businesses that would be number one or number two in their market. He took over a company in 1981 that had 350 different businesses in its portfolio clustered in 43 Strategic Business Units.[4] Those businesses that did not perform or could not be improved to meet the goal would be divested. The corporate winners would only be those who are the "leanest", the "lowest-cost worldwide producers of quality goods and services or those who have a clear technological edge, a clear advantage in a market niche".[5]

(*Continued*)

Exhibit 1.1 (*Continued*)

Welch put forward a "fix, close, or sell" policy.[6] He drew three circles representing services, high technology and core businesses, and placed the names of 15 businesses inside the circles. The businesses outside the circles would be divested if they could not be improved. Welch stated, "I'm looking at the competitive arena. Where does the business sit? What are its strengths vis-à-vis the competition? And what are its weaknesses? What can the competition do to us despite our hard work that can kill us a year or two years down the road? What can we do to them to change the playing field?" He continued: "If you have a game that's vulnerable, somebody can move fast, get you. And you don't have a checkmate play or another move. You've got to get out of that game".[7]

In addition to the "number one, number two" policy, Jack Welch reoriented the company toward services. When Jack Welch began managing GE, the company was composed of 15 percent services and 85 percent products. As the company began the 21st century, it had a mix of 25 percent products and 75 percent services, including financial services and medical systems.[8]

While focusing on strengths and shifting to services, GE under Welch embraced globalization. Operating in more than 100 countries, the company has about 45 percent of its 293,000 employees outside the United States and earns approximately the same share of revenues outside the country. The company was named the World's Most Admired Company by *Fortune* and the World's Most Respected Company by the *Financial Times*. Welch's choices of what businesses to maintain, improve or to exit; the decision to enter into international markets; and orientation toward services established *goals* for General Electric.

1.2 *External Analysis and Internal Analysis*

The manager's choice of the company's goals and strategy depends critically on information. Managers are responsible for gathering information about the company's markets and the company's organization. The manager's external analysis evaluates market opportunities both to suggest the goals of the firm and to evaluate the potential economic returns after goals are selected. The manager's internal analysis evaluates the organization's abilities both to help in the selection of goals and to determine how the organization should be structured to achieve those goals.

External Analysis

The company's goals are generally framed in terms of the markets that the company intends to serve. Accordingly, the strategy process requires an external analysis of the characteristics of the markets the company proposes to serve. The manager evaluates how the firm's markets are changing and how those markets will look in the future. The manager generally knows well who the firm's customers, suppliers, competitors, and partners are today. Choosing the company's goals requires thinking about how the company's markets will look in the future. Because the external analysis looks at the future of the firm's markets, it is outward-directed and forward-looking. Scanning the company's actual and potential markets is a critical step in the strategy-making process.

Effective strategy requires competing in markets that highlight a company's strengths relative to its potential competitors.[9] Webvan, an Internet-based grocery delivery service, failed in trying to take on the major grocery chains. Despite its large warehouses, Webvan was not able to achieve lower costs than the supermarkets because it did not generate enough orders to benefit from scale, and customers preferred shopping at supermarkets to having their groceries delivered.[10] Toshiba abandoned the manufacture of commodity memory chips, where it did not have an advantage over low-cost producers, choosing instead to focus on custom-designed chips where its technological strength might provide an edge over competitors.[11]

Context matters a great deal when few, if any, universal policy prescriptions are available. The ultimate success or failure of strategic actions depends on the markets in which the company operates. What type of products and services are customers seeking? What type of products and services do suppliers offer? What kind of competitors does the company face? Who are the company's potential partners? Selling computers in China is not the same as selling computers in Europe. The manager must tailor strategy to the market situation, as defined by potential customers, suppliers, competitors, and partners.

Other factors also affect the company's strategy. The geographic scope of the market is significant: Is the market local, national, regional, or global? The pace of technological change and the sources of innovation also have considerable impact: Is the firm operating in an industry with a rapid or slower rate of technological change? The social context affects available strategies by influencing relationships between employers and workers and between firms and customers. The legal and regulatory environment affects strategy by setting constraints on the actions of firms and creating opportunities.

The manager's external analysis looks at how the firm's markets will change as its competitive strategy is implemented. The external

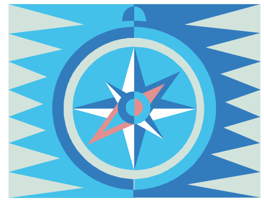

Figure 1.2: The market compass.

analysis entails information gathering, data analysis and informed prediction. Strategy-making guides external analysis since the manager's strategic choices require gathering specific types of information. The information that is obtained leads to refinements in strategy.

The external analysis looks at the firm's markets. I introduce a concept that guides the external analysis called "the market compass". There are four main players: customers, suppliers, competitors and partners. The external analysis seeks to identify the firm's *prospective* customers, suppliers, competitors and partners. What will the company's markets look like at the time that strategies will be implemented? How will the company's strategies change the market conditions that it faces? Figure 1.2 shows the market compass.

Internal Analysis

Managers also perform an internal analysis as part of the strategy process. The purpose of the internal analysis is to support the decision-making process by determining whether the company's goals and strategies are feasible for the organization and whether the design of the organization should be modified to adapt to the company's strategy. Do the company's goals make the best match between the abilities of the organization and market opportunities? Can the organization implement the required strategies to attain the goals?

The internal analysis examines the company's organizational structure, performance, abilities, and resources. The company's *organizational structure* refers to its boundaries, divisions, lines of authority, management practices, and incentives. The company's *performance* is evaluated in terms of the total value of the firm, which depends on the present discounted value of the company's economic profit over the long term. The company's *abilities* include the capabilities and competencies of the company's employees as they work together to achieve the company's goals. Finally, the company's *resources* encompass tangible assets such as plant and equipment, inventories, and accounts receivable as well as less tangible assets

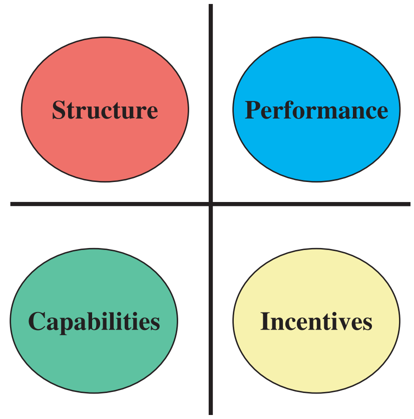

Figure 1.3: The organizational grid.

such as intellectual property, technological knowledge, product brands, and goodwill.

As part of the strategy-making process the manager evaluates how the company's organization should change as a result of the company's strategy. The market opportunities identified through the process of setting goals and examining market dynamics can suggest the need for changing the company's organizational structure.

I introduce a concept that guides the internal analysis called "the organizational grid." This concept refers to the organization's structure, performance, abilities, and resources. In computer science, virtual organizations draw upon a "grid" to bring together resources.[12]

A manager can use the concept of the organizational grid to identify the organization's abilities and resources, as well as its structure and performance. Then, the organization's abilities and resources can be organized to implement to manager's strategy. Figure 1.3 shows the organizational grid.

1.3 *Competitive Advantage and Competitive Strategy*

To succeed in attaining its goals, the firm must perform better than its competitors. This means that the company must identify a *competitive advantage* that distinguishes the business from its competitors. A company with a competitive advantage is able to create greater economic value for its shareholders, customers, and suppliers than its competitors. The company attempts to sustain its competitive advantage by engaging in continual innovation in production processes, product features, and transaction methods.

A competitive advantage is not in itself a guarantee of success. The company must put its competitive advantage into practice by devising and executing a *competitive strategy*. The company takes actions in the marketplace that anticipate the strategies of established competitors and potential entrants. The company exits some of its existing markets and enters new markets. The company further extends its advantage by creating and operating markets. In addition, the company pursues non-market strategies to address law, regulation, and public policy.

Creating Value and Competitive Advantage

Competition is the fundamental challenge of business strategy. Good products and an efficient organization are rarely enough. To survive and succeed, the company must outperform competitors in many different ways. Its products and services must offer customers greater value through higher quality and convenience or lower prices than rivals offer. The company must be more attractive to critical suppliers and distributors. It also must compete for the attention of investors. The company's cost efficiencies must exceed market benchmarks. Capturing market share can boost profits if the company takes advantage of its sales to achieve recognition, market power and cost economies.

To win markets, companies seek competitive advantage, an edge that will differentiate the company and allow it to outperform other companies. The purpose of strategy is to enhance the firm's competitive chances in the market by choosing actions that yield the greatest expected value for the company. The manager's external analysis identifies attractive businesses. The manager's internal analysis identifies effective organizational activities, resources, and competencies. To distinguish itself from its competitors, the company creates innovative matches between organizational abilities and market opportunities.

A company must create greater value than its competitors to continue attracting customers, suppliers and investors. Companies create value for customers by offering them better product features, lower prices, or both. Companies create value for suppliers by lowering their costs through cooperation, giving them a greater share of earnings, or both. Companies create value for shareholders by capturing a greater share of total value created, resulting in a higher net present value of earnings over time.

Thus, to create greater value for customers, suppliers and shareholders, the company's *total* value created must be greater than that of its competitors. *Competitive advantage* is defined as the difference between the value created by the company and the value created by competitors. There are three main sources of competitive advantage. First, the firm has a *cost advantage* if it operates at lower cost than competitors. Second, the firm has a *differentiation advantage* if the firm's product creates greater customer benefits than those of its competitors. Third, the firm has a *transaction advantage* if the company has lower transaction costs or creates innovative combinations of buyers and sellers in comparison with competitors, thus generating greater value than competitors.

A number of strategic actions can achieve a transaction advantage. As intermediaries, companies bring buyers and sellers together, acting as agents for their customers and suppliers, monitoring the performance of contractual partners, brokering transactions, and communicating market information to customers and suppliers. Intermediaries earn rent by improving transactional convenience for their suppliers and customers. Acting as entrepreneurs, companies create new combinations of buyers and sellers through new types of transactions, novel goods and services, and involvement of new customers and suppliers.

As *market makers*, companies manage market transactions and create the institutions of exchange. Markets are mechanisms or institutions that bring buyers and sellers together. The firm's four primary market-making actions include price setting, market clearing, coordinating buyers and suppliers, and allocating goods and services. By creating markets, companies not only gain a home-court advantage, they become the focal point of their industry. Companies make markets work by forming relationships with suppliers and customers. Through information gathering, communication, and price-setting activities, firms provide competitive outlets for suppliers and competitive sources of products for their customers, discerning new opportunities for purchasing and selling goods and services. By coordinating their selling and buying activities companies create markets. Managers that are market-focused are better prepared to observe and respond to changes in customer needs and supplier abilities.

The market-making firm stands between its suppliers and customers, creating innovative transactions that coordinate their economic activities. By creating and operating markets, companies remain at the center of economic activity even as the characteristics of products and the way they are produced continue to change. Advantages from creating markets can be more durable than those founded on specific product designs or production processes.

Strategic analysis helps managers identify sources of competitive advantage. The relentless give-and-take of competition suggests that it is difficult to find sources of competitive advantage. The great complexity of business decision-making implies that opportunities are hard to find and still harder to exploit. Turbulent markets create risk and uncertainty for decision makers. Yet it is precisely these difficulties that make strategic analysis a necessity. Because of complexity and uncertainty, decision makers are unlikely to choose the same strategies. Managers must sort through many strategic alternatives and work with diverse sources of information. Strategic analysis is valuable because it helps managers process and organize information, pose the necessary questions, and sort through solutions, effectively.

Is Competitive Advantage Sustainable?

Although competitive advantage is attainable through business strategy, can success be sustained? A theme of this text is that *no specific competitive advantage can be sustained indefinitely*. Continual innovation surpasses existing products, processes, and transaction methods. Once a competitive advantage is attained through innovative processes, products, or transactions, market forces are likely to erode the returns. Strategy-making is not a one-shot deal — companies cannot hope that successful actions will remain so indefinitely. Maximizing the present value of profit requires long-term strategies, not short-term fixes. Strategy-making is an inherently *dynamic* process, requiring continual updating of company goals and the plans to achieve them.

Creating greater value than competitors requires innovation. Three main types of innovation correspond to the three main types of competitive advantage. *Process innovation* is the employment of new methods of producing and delivering goods and services. Process innovations include such significant changes as the assembly line, industrial robots, and computer-aided design and manufacturing, as well as specific management changes that consistently yield operating efficiencies. *Product innovation* refers to the introduction of new goods and services. Product innovations involve both major changes such as the creation of the automobile and enhancements such as closed auto bodies, steel frames, and anti-lock brakes. *Transaction innovation* is the use of new methods of buying, selling and contracting for goods and services. Transaction innovations include credit cards, bar-coding merchandise, Internet commerce, and other specific changes that enhance customer convenience. Finally, entrepreneurial companies engage in transaction innovation by introducing new combinations of products, processes and transactions into the marketplace.

The key to contemporary strategy is *technological change*. Because technological change is not particular to any specific industry or sector of the economy, it is fundamental to strategic analysis. The accelerating pace of technological change calls for more strategic analysis — to process information effectively, to adjust goals frequently, to recognize market opportunities, to act decisively and to organize with greater flexibility.

Management experts emphasize the concept of change in many colorful ways. Joseph A. Schumpeter described competition as gales of creative destruction. More recently, Peter Drucker speaks of managing in a time of great change. Richard D'Aveni refers to escalating market challenges as hypercompetition. Tom Peters tells managers to thrive on chaos. Charles Fine speaks of managing at clockspeed in an environment of temporary advantage. Philip Evans and Thomas S. Wurster suggest that some existing business approaches will be blown to bits by e-commerce.[13]

Tremendous technological change sweeps through the economy leaving no industry or business intact. Advances in computers and communications affect the production processes of practically every company, whether manufacturer, service provider, wholesaler, or retailer. The Internet changes the shape of retailing and reconfigures business-to-business transactions. Progress in science and engineering, including biology, chemistry, physics, electronics and materials sciences, impacts specific industries.

Technological change creates winners and losers. Occupations that existed at the start of the 20th century are rare at the start of the 21st century. There were over 100,000 carriage and harness-maker workers in 1900 and over 238,000 blacksmiths in 1910, whereas there are only a few thousand of each today. Railroad employees have fallen from 2 million in 1920 to about 230,000, and farm workers have declined from 11.5 million in 1910 to about 850,000 today. In contrast, there are well over 1.38 million medical technicians; 1.3 million computer programmers and operators, 864,000 auto mechanics; 3.3 million truck, bus and taxi drivers; and 200,000 airline pilots — professions that did not exist at the start of the 20th century.[14]

In addition, individual firms come and go. In the industries shown in Table 1.1, the number of establishments has fallen considerably, giving an indication of the attrition of individual firms. A pattern of growth, shakeout, and leveling off has been observed in many industries including compressors, electrocardiographs, gyroscopes, jet-propelled engines, lasers, outboard motors, nylon, paints, ballpoint pens, photocopy machines, radar, heat pumps, nuclear reactors, transistors, and zippers.[15] Shakeouts in wholesaling occurred in over a dozen industries including flowers, woodworking machinery, locksmith, specialty tools and fasteners, sporting goods, wholesale grocers, air conditioning and refrigeration, electronic components, wine and spirits, waste equipment, and periodicals.[16]

Enhanced computer power and improvements in communication have increased the information available to managers and changed their focus from data processing to strategic decision-making. These developments continue to reshape organizations, flattening corporate hierarchies and increasing outsourcing.

Technological change is the greatest force changing the market landscape but markets change in many other ways. Customer preferences for goods and services are likely to fluctuate. The characteristics of suppliers and the goods they offer vary over time. The actions of competitors are likely to change significantly as they pursue innovative strategies and discover new market opportunities. The company's actual and prospective partners change their objectives and seek new alliances.

Technological change has far-reaching social effects that translate into further market change. The transformations set in motion by the

Table 1.1: Selected shrinking and expanding industries.

	Number of Establishments	
	1970	1996
Selected Shrinking Industries		
Fur goods	980	133
Barber shops	24,577	4,499
Asbestos products	133	30
Drive-in theaters	1,567	408
Leather and leather products	3,430	1,938
General merchandise stores	25,032	14,797
Glass containers	128	78
Brooms and brushes	449	278
Trailer parks and campsites	6,419	3,984
Bowling centers	9,215	5,735
Concrete block and brick	1,332	901
Manufactured ice	800	578
Variety stores	14,439	10,848
Radio and television repair	7,953	6,212
Labor organizations	20,376	19,536
Selected Expanding Industries		
Videotape rental	0	20,816
Computer and data processing services	6,517 (1975)	88,911
Carpet and upholstery cleaning	816	8,879
Prepackaged software	1,522 (1975)	9,084
Vocational schools	1,188	6,816
Movie production and services	2,922	14,680
Semiconductors and related devices	291	1,052
Amusement parks	362	1,174
Chocolate and cocoa products	51 (1975)	165
Car washes	4,624	13,334
Political organizations	928	2,579
Office and computing equipment	923	2,112
Eating and drinking places	233,048	466,386
Colleges and universities	1,855	3,663
Florists	13,865	26,728
Tour operators	2,464 (1988)	4,725
Dental offices	63,817	113,054
Internal combustion engines	162	277
Passenger car rental	2,556	4,231
Pharmaceuticals	1,041	1,637
Aircraft	163	255
Plastic bottles	280 (1988)	437
Aircraft engines and parts	247	355
Physical fitness facilities	7,723 (1990)	10,720

(*Continued*)

Table 1.1: (*Continued*)

	Number of Establishments	
	1970	**1996**
Hotels and motels	34,674	45,252
Travel agencies	22,609 (1988)	28,735
Space vehicle equipment	39 (1975)	45
Beauty shops	70,967	81,872

Source: W. Michael Cox and Richard Alm, "The Churn Among Firms," *Southwest Economy*, Federal Reserve Bank of Dallas, January/February 1999, pp. 6–9, based on data from U.S. Bureau of the Census County Business Patterns, various years. Establishments are classified based on their major activity.

automobile and air travel are well recognized. In turn, political and social changes impact markets. Regulatory and legal changes also have far-reaching effects. Deregulation of transportation, energy, telecommunications, and financial transactions has had significant effects in many countries. Lowering or raising barriers to trade alters the volume and direction of world trade.

Accordingly, attaining and sustaining competitive advantage demand continual creativity. No matter how innovative they are, the firm's strategies are eventually subject to imitation or counteraction by competitors. Indeed, the more successful the strategy, the greater the returns to competitors seeking to emulate or surpass it. With the increasing pace of technological change, companies can no longer rely on building castle walls for long-term protection.

The notion that all advantages are temporary is both good news for entrants and bad news for established companies. On the other hand, others argue that technological change enhances first-mover advantages, thus harming entrants and helping established companies. Which view is correct? Does the entrant always win and the incumbent always lose, or vice versa? As one might expect, the outcome of competition is not so predictable. Advantages may be temporary, and companies can only develop or sustain a winning performance by finding new sources of competitive advantage.

Competitive Strategy and Anticipating Rival Strategies

Competitive strategy refers to the actions of the firm that are best responses to the observed or anticipated actions of competitors. Competitive strategy is a critical component of the company's overall strategy because it specifies the company's market moves. The manager's competitive strategy spells out the types of moves and their timing. Should the firm try to move before or after competitors? Should the firm emphasize prices or distinctive product features? How should the firm carry out market entry? What market segments should be targeted? Managers must understand that competitive strategy is difficult because they are playing a game against clever opponents.

Strategic analysis by managers must be suited to the market context. Accordingly, the choice of strategic moves depends on industry conditions such as the number of competing firms and their market power, the extent of product differentiation and the rate of technological change. Moreover, companies must anticipate the potential for entry of new competitors. The manager chooses competitive strategy by building on market information from the external analysis.

Competitive strategy can depend strongly on the number of competitors the firm faces. There are two important competitive situations: competition *in the market* and competition *for the market*. Companies competing *in* the market face a known set of rivals. The outcome of the competition is defined in terms of strategic moves. Companies pay close attention to the number and size of competitors. The number and size of firms in the market are referred to as *market structure*.

In contrast, when companies compete *for* the market, the number of competitors changes. New competitors may choose to enter the industry or established companies may choose to exit the industry. Established companies plan for the entry or exit of competitors or the possibility that they may be forced from the industry. Moreover, potential entrants make plans to establish their companies in anticipation of the reaction of incumbent firms.

Competitive strategy requires anticipating the future actions of competitors and preparing the best response. Companies need to develop market intelligence regarding their competitors so as to respond effectively to their strategies. The manager chooses prices, production, and products that are best responses to expected strategies of competitors. The company competes to win markets by delivering superior performance. Entrepreneurial companies devise entry strategies to attempt to win new markets. There are no guarantees of success in a competitive environment. However, it is useful to understand the strategy-making process.

Managers seek to understand factors that affect rivals' profits. For example, by understanding how competitor revenues and costs vary with sales, it is possible to make some predictions about future pricing and other strategic behavior. Companies try to identify the types of strategies available to their rivals. Are competitors most likely to vary their prices, productive capacity, or product features? The choice of strategic instruments can change the outcome of the game significantly.

In addition to the number of competitors, their payoffs, and the types of strategic moves that are available, *timing* of moves is fundamental to interaction with competitors. When should a new venture be launched?

When should new products be announced and when should they be introduced? When should a price change be put in place? When should a promotion begin? Should the company respond immediately to a competitor's price cuts or a targeted marketing campaign? Should the company introduce products to the market before their rivals or try to leapfrog over competitors' products after they are introduced? Competitive strategy takes account of the trade-offs between first-mover advantages and second-mover technological improvements.

Companies tend to be better informed than their competitors about their own costs, revenues, and strategic options. Competitive strategy operates in a world with information asymmetries. The manager must make predictions on the basis of limited knowledge of the motivations and competencies of competitors. Competitive analysis can be useful in narrowing the possible outcomes and pointing out effective moves.

Competitive strategy requires choosing key market segments to be contested and other segments to be conceded to competitors. An attempt to dominate all segments of the market can strain the company's limited resources and increase costs, putting the company at a disadvantage resulting in losing the overall strategic objective. Competitive strategy spells out the specifics of pricing, products and technology needed to surpass competitors. Companies choose their battles carefully, entering market segments that promise the highest return first, and avoiding battles in other segments that do not contribute directly to the company's overall strategy.[17] The reason for this is that any company, whether long established or a start-up, has limited resources. It faces constraints on productive capacity, technical capability, market knowledge, or availability of managers and employees. Thus, the need to attack from strength can require focusing attention on a few market segments.

Competitive strategies must be flexible and are subject to far less planning than the company's overall strategy. Some competitive decisions must be delegated to personnel with the best information on the actions and strategic intent of competitors, but they require constant monitoring to determine their effectiveness. Competitive strategies directly involve many functional areas of the company, particularly marketing and sales personnel who are in the trenches and can closely track the actions of rivals and customer responses. Pre-emptive actions or competitive reactions such as product promotions are designed to address the actions of close rivals. Competitive strategy must adapt rapidly to market change.

Competing for the Market and Entry Strategies

Market structure is far from stable. Although the number of competitors may seem fixed in the short run, companies enter and exit industries all the time. Innovative entrants seek advantage over incumbents. Companies with weaker sales and profitability exit the business. Competitive strategy takes place in the context of ever-changing rivalries. Companies compete with established firms and entrants to be the market leader.

Competition is a dynamic process in which companies seek to win their markets. Being the leading firm confers additional advantages such as customer recognition and cost economies. Companies that become complacent, however, are often displaced by energetic rivals. Entrants attack incumbent firms where the entrants' strength is greatest in relation to established firms. Entrants offer customers better value through lower prices or higher quality, and they can be expected to go all out in terms of marketing, sales efforts, management attention, customer service and innovation.

Established companies must be constantly prepared to defend market segments against the entry of competitors, but it may not be possible to defend all market segments simultaneously. The incumbent needs a game plan to discern which segments will draw the attention of entrants.

There are many asymmetries between incumbent companies and entrants. Incumbents operate at a greater scale than entrants by virtue of being established in the market. Most significantly, incumbent firms have already made irreversible investments in plant and equipment, marketing, and research and development (R&D), while entrants have yet to make commitments to the market. Incumbents often have established brands and customers may be accustomed to using their products and services. In contrast, entrants often introduce new brands and products with unfamiliar features. Incumbents may have greater knowledge of customer preferences and production technology than start-ups.

These and other differences between incumbents and entrants have been termed *barriers to entry*. Entrants perceive that there are barriers to entry if incumbents have a competitive advantage over entrants. Incumbents may have cost advantages, differentiation advantages or transaction advantages over entrants. Such advantages can give market power and economic rents to incumbents as long as they are sustainable.

In a static environment, barriers to entry would appear to be important competitive weapons. However, in a dynamic environment, such advantages are likely to be temporary. Technological change erodes potential differences between entrants and incumbents. Entrants can outperform incumbents by adopting efficient production processes, introducing innovative products, or employing new transaction techniques. Changes in consumer preferences also create opportunities for entrants to provide new products and services. Changes in international trade restrictions and other government regulations further open markets to new competitors.

Entrants can overcome incumbent advantages in a variety of ways. For example, if an incumbent has a cost advantage, entrants can counter with a differentiation or transaction advantage. Entrants can address the costs of building production facilities by joining with others in joint venture agreements, sharing risks by contracting with customers, or outsourcing to suppliers. Entrants can build distribution networks, partner with established distributors, or sell through independent wholesale and retail companies. By varying their mode of entry, entrants reduce the costs and risks of market commitment. Companies that identify significant weaknesses relative to their competitors pursue *indirect strategies*, serving niches or entering markets overlooked by incumbent firms.

Exhibit 1.2 Fox Television and Entry Strategies

Fox Television, a subsidiary of Rupert Murdoch's News Corporation, became the fourth broadcast television network in the 1990s. Its battles with the big three traditional networks, NBC, CBS and ABC, illustrate successful use of strategic maneuvers. Rather than attempting to conquer every segment of the TV market, Fox has avoided some battles and joined others with its full strength. For example, it outbid other networks for rights to broadcast National Football League games and even hired CBS announcers John Madden and Pat Summerall. A key area of focus for Fox was the children's television segment.

Children's television was a fast-growing and important segment of the television marketplace. For a time, that segment had been conquered by Fox's superheroes, the Mighty Morphin Power Rangers. Six happy, well-adjusted teenagers "morph" or transform into a team of superheroes. A marketer's dream, their outfits came in a rainbow of colors: white, red, blue, black, yellow, and pink. While they preferred karate chops, each hero had a different weapon that fit together with the others to form a superweapon, all sold separately along with action figures. Every ranger had a mechanical dinosaur ally, called a "dinozord", that he or she summons whenever they needed assistance. These friendly machines also fit together to form the ultimate weapon, the "megazord". Each weekday, the rangers fought and defeated a new extraterrestrial monster to the tune of "go, go, Power Rangers".

While saving the universe from evil, the Power Rangers won another battle — they topped all other children's TV shows. Moreover, they led the Fox Children's Television Network to the lead position in children's TV by its fifth season. Of the top 10 children's

(*Continued*)

Exhibit 1.2 (*Continued*)

TV shows, Fox had the top four (Power Rangers, Animaniacs, Batman, and Tiny Toons) and the number 10 show (X-Men). Fox led not only in ratings but in advertising revenue as well, with $200 million out of a market segment total of $700 million in that year.[18] The Fox Children's Television Network, along with the cable channel Nickelodeon, initially dominated the segment while ABC and CBS curtailed their offerings and NBC ceded the segment altogether.[19]

In the children's television market, individual shows and their assignment to time slots were of less importance than broader maneuvers. Chase Carey, chairman of Fox Television, cautioned that the comprehensiveness of Fox president Margaret Loesch's strategy was more important than the network's ratings. Carey noted that in a very short period of time Loesch "pulled together the support of the children's creative community, of the affiliates, of the advertisers — really all the aspects of the business you'd want in place — she was able to win over".[20]

The start-up network also was strong in the youth market with a variety of innovative shows. The tension showed at the other networks. Howard Stringer, president of the CBS broadcast group, groused "sometimes I think that youth is wasted on Fox".[21] Fox had successfully entered the market by concentrating its efforts on a market segment where it was relatively stronger than incumbent firms — the youth market.

1.4 *Strategy and Organizational Structure*

Having established the company's goals and strategies to achieve the goals, the manager next makes sure that the organizational structure conforms to the company's strategy. The reason that the company's organizational structure must follow its strategy is that the organization is responsible for putting strategy into practice. After senior managers have completed the strategy process, including redesign of the organization, they assign tasks to the members of the organization. For the company's strategy to be carried out effectively, the organizational design must facilitate the assignment and completion of the necessary tasks by managers and employees.

Organizational structure has two main aspects: horizontal and vertical. A company's *horizontal structure* refers to the scope of the company's product and service offerings and the divisions of the organization. For example, Pepsico has three principal divisions: Frito-Lay Company, the largest manufacturer and distributor of snack chips; Pepsi-Cola Company, the second largest soft drink business; and

Tropicana Products, the largest marketer and producer of branded juice.[22]

A company's *vertical structure* refers to the types of functional activities the organization performs and the degree of vertical integration between them. For example, Nike focuses its attention on product design, product development, marketing and distribution. The company forms Category Product Teams, consisting of its own designers, developers and marketing specialists, to develop an athletic shoe as well as a marketing plan, a process that the company says takes up to a year and a half. The company then puts together a technical package consisting of designs, patterns, lasted uppers, and model shoes. The company does not produce a shoe but instead ships the technical package to manufacturing subcontractors that operate factories in Europe and Asia. Then, after the shoes are produced, they are shipped to Nike distribution centers and finally to independent retailers. Thus, Nike is involved in design, development, contracting, marketing and distribution, but is not vertically integrated significantly into manufacturing or retailing.[23]

The Horizontal Structure of the Firm

The manager's choice of goals specifies the company's target markets. As a result, the goals of the company determine what businesses the company wants to begin operating, continue operating, and cease operating. The organization must conform to these objectives. If the company plans to enter a new market, it should establish a corresponding business unit, adapt an existing business unit, or acquire an existing business. If the company plans to exit from a market, it must close the corresponding business unit, adapt the business unit to focus on other activities, or divest the unit.

The manager's choice of goals thus helps to specify the scope of the firm. As already stated, the company's strategy specifies the plan of action to achieve the goals, whether the firm will emphasize a cost advantage, a differentiation advantage, or a transaction advantage. In addition, the firm will choose market actions that anticipate the strategies of competitors. To implement the company's strategy, the organization must have sufficient personnel to perform the necessary tasks. Moreover, the strategic tasks should somehow be divided among the members of the organization. Deciding how to allocate strategic tasks across the organization guides the process of organizational design.

The manager should choose the organizational form that best implements the company's strategy. Companies operate in the realm of the possible. Therefore, management cannot choose the organizational form arbitrarily because the company is limited by many constraints, including the availability of qualified personnel, the costs of travel, telecommunications and information systems, and legal and regulatory restrictions. If the company is already established, the manager may not be able to redesign the organization from scratch because of the significant costs of adjustment. These costs of adjustment are a source of inertia and explain why some organizations are slow to adapt to market change. The manager must compare the costs of organizational change with the benefits of improved strategy implementation.

A business organization can be structured in many different ways. One way to structure an organization is along *functional* lines, by dividing the organization into units responsible for R&D, finance, human resources, purchasing, marketing, sales, operations, and information systems. Such an organization is often appropriate for a company operating a single business or a closely related collection of businesses. A functional structure tends to favor central control of the organization's activities by its managers.

For a company operating multiple businesses, another way to structure the organization is to divide it into individual *business units*. The company can further create strategic business units that combine multiple related lines of business. The company's divisions then contain groupings of lines of business based on related products and services or based on the provision of products and services to particular target customers. An organizational structure based on business units tends to make the company more responsive to market forces. In choosing the design of the organization, managers consider the trade-offs between central control of organizational activities and overall market responsiveness.

Organizational design matches organization to the company's strategy. The critical design issue is defining the company's markets and then forming an organizational structure that helps the company serve those markets most effectively. Managers creating organizations dedicated to retail, wholesale, manufacturing, or R&D will select distinct structural forms. Managers operating closely related business lines or significantly diversified business lines will configure the organization's divisions differently. A manager pursuing a cost advantage, differentiation advantage or transaction advantage will adjust the organization appropriately.

Exhibit 1.3 Microsoft Reorganizations

Prior to 1999, Microsoft had been organized in three technology-oriented divisions: operating systems for personal computers, applications such as word processing and spreadsheet programs, and Internet-related businesses. Then, in March of that year, Microsoft reorganized the company into five units to better reflect its five core businesses.

(*Continued*)

Exhibit 1.3 (*Continued*)

Microsoft identified the company's five core businesses as the Windows operating system for consumers, applications for small business and home office knowledge workers, software for information technology use by large organizations, tools for software developers, and e-commerce applications including Internet portals and access service.[24] The goals of the company were to maintain or achieve a winning position in each of these businesses. In particular, the company sought to maintain the position of Windows as the leading operating system for personal computers in the world. After the company's reorganization, the five main divisions of the reorganized company mirrored its five core businesses.[25] They included

1. The Consumer Windows Division, which provided Windows software.
2. The Business Productivity Division, which offered business applications such as Microsoft Office; server applications including BackOffice, Small Business Server, and Exchange; and software for appliances (Windows CE).
3. The Business and Enterprise Division, which dealt with the information technology needs of large organizations and development of the Windows product line.
4. The Developer Group, which offered products for software developers that included SQL Server, COM+, Visual Basic, and Visual C++.
5. The Consumer and Commerce Group, which offered Commerce Server and WebTV products and operated the Microsoft network.[26]

The Microsoft reorganization in 1999 showed how a company's vision of its core businesses are reflected in its organizational divisions.

With the development of the Internet, Microsoft's vision changed again, going beyond its Windows-based approach. The emphasis on software for use within business enterprises led to the formation of the company's ".Net" strategy. The company's increased focus on the Internet and on software for use within business enterprises was then reflected in a new configuration of Microsoft's businesses. The company's three main product segments were as follows: (1) Desktop and Enterprise Software and Services, (2) Consumer Software, Services, and Devices, and (3) Consumer Commerce Investments.

(*Continued*)

Exhibit 1.3 (*Continued*)

According to Microsoft, its business groups and its product segments were once again closely aligned:

1. Desktop and Enterprise Software and Services. Associated with this product segment were two divisions: the Platforms Group and the Productivity and Business Services Group. The Platforms Group focused on the Windows platform and software for enterprise servers. According to the company, the Productivity and Business Services Group "drives Microsoft's broad vision for productivity and business process applications and services," including Microsoft Office and other business applications.
2. Consumer Software, Services, and Devices. Associated with this product segment were three divisions of the company: The MSN Business Group developed television network programming. The Personal Services Group provided platforms and software for consumers using the Internet and mobile devices, and extended the company's ".Net" strategy to consumer devices. The Home and Retail Division was responsible for learning and entertainment software, and the Xbox game player.
3. Consumer Commerce Investments. Finally, according to the company, associated with this product segment are various products and services including Expedia Inc., the HomeAdvisor online real estate service, and the MSN CarPoint online automotive service.[27]

As Microsoft's activities and market vision changed, its organizational structure followed. The company's corporate strategies were reflected in the configuration of business groups it operated. The company's businesses strategies were reflected in the activities of the business units within each business group.

The Vertical Structure of the Firm

The boundaries of the firm are defined both by the company's product and service offerings and its functional activities. The manager considers the company's target markets and its product and service offerings in creating the divisions of the firm. The manager next considers what functional tasks are required to execute the company's strategy and chooses which of those tasks the organization will perform and which of those tasks the company's suppliers will perform. The choice of what tasks the organization will perform is a crucial determinant of the vertical structure of the organization.

Practically any of the company's functional tasks — R&D, finance, human resources, purchasing, marketing, sales, operations, and information systems — can be outsourced. Transaction costs are an important component of the manager's decision. The manager examines not only the direct costs of procuring a good or service from the company's suppliers, but also the indirect costs of creating market transactions. The manager then examines the costs of producing that good or service within the organization, taking into account not only the direct costs but also the indirect costs of expanding management responsibilities. The activities of the organization must be selected to minimize the combined costs of managing the organization and conducting market transactions.

The manager must then allocate functional tasks between the company's central office and its divisions. Tasks such as marketing, sales and operations can be centralized or decentralized, that is, split up between divisions. These decisions depend on the trade-off between the benefits of scale and coordination when functions are centralized and the benefits of market responsiveness when functions are decentralized. Finally, the organization must delegate authority to its employees and provide them with incentives to implement the strategy.

Having chosen the firm's market boundaries, management assigns tasks to members of the organization. Senior managers often retain a major share of strategy-making functions. They devise the company's strategy, design the organization, and define projects for employees. Managers monitor the performance of employees to make sure that the organization is executing the company's strategy and achieving its goals. For employees to carry out their tasks, management must delegate authority to employees and specify responsibility for satisfactory performance.

1.5 *Overview*

Business strategy continues to be increasingly sophisticated and the speed of competition continues to accelerate. Managers face challenges from technological developments such as electronic commerce and market developments such as the growth of global competition. Managers and entrepreneurs cannot expect to succeed with enthusiasm and guesswork. Effective management depends on knowing how to perform a strategic analysis, and then applying the strategy to face market competition and to lead the company's organization. The five basic steps of strategic analysis set out in this chapter are the main topics of the textbook.

Designing strategy requires formulating goals that specify what markets the company should serve. Thus, goals are forward-looking and outward-oriented. Part I of this text shows how to start the process of strategic analysis. This chapter introduces goal setting and the basic outline of the book. Chapter 2 explains value-driven strategy and examines how managers should choose goals.

Managers examine the company's actual and potential markets and the existing and desired characteristics of the organization. Part II introduces the concept of the market compass and considers the manager's external analysis. Chapters 3 and 4 provide basic tools for conducting the external analysis of the firm's actual and potential markets, including customers, suppliers, competitors, and partners.

Part III of the book introduces the concept of the organizational grid and examines the manager's internal analysis. Chapters 5 and 6 present concepts used in conducting the internal analysis of the organization, including structure, performance, abilities, and resources.

Part IV considers the company's sources of its competitive advantage. The manager considers what the company needs to do to win its markets or, if the company is already successful, continue to maintain its leadership position. Chapter 7 introduces the pivotal concept of creating value and obtaining competitive advantage. Chapter 8 considers the value chain and applies transaction cost analysis to the choice of the vertical boundaries of the firm.

Part V turns to the manager's formulation of the firm's competitive strategy. The manager formulates competitive strategies that are targeted to market segments and anticipate competitor actions. Chapter 9 looks at the firm's price leadership strategy when the firm builds on a cost advantage. Chapter 10 sets out the firm's product differentiation strategy when the firm builds on a differentiation advantage by creating and operating markets. Chapter 11 introduces the transaction coordination strategy when the firm builds on a transaction advantage. Chapter 12 examines entry strategies and their relationship to barriers to entry and mobility.

Questions for Discussion

1. Select a company and examine its annual report or visit its corporate website. Does the company specify goals or objectives? Does the company describe its target markets? Does the company provide a mission statement? Does the company's management articulate a vision of the industry?
2. What is the difference between a company's goal and its overall strategy?
3. How does the manager's choice of company goals affect the external and internal analyses? How would information from the

manager's external and internal analysis affect the manager's choice of a goal? How is the process of selecting goals connected with the external and internal analyses?
4. Which is more important for the manager's decision-making process, the external analysis or the internal analysis, or are both equally important?
5. Why does the strategy process consider the sources of competitive advantage? Should managers be concerned about the differences or similarities between the company and its competitors? Would it be sufficient to focus only on customers?
6. How are competitive advantages different from competitive strategies?
7. Why does the manager's strategy process take into account the design of the organization?
8. Select a specific company and list the businesses that the company is involved in. Consider the organizational structure of the company and list its divisions. Compare the two lists.
9. Consider the first two scenarios given at the beginning of the chapter, the entrepreneurial start-up and the growing regional business. How will the strategy process change in each case? Will you as a manager be choosing different types of goals for the company? Will your process of external analysis and internal analysis be similar or different? How might your analysis of competitive advantage and competitive strategy be similar or different in the two companies? Would you expect the two types of companies to have similar or different organizational structures?
10. Consider the fourth scenario at the beginning of the chapter. Suppose that you are not familiar with the countries that the client firm operates in. How might that affect your strategic analysis? What types of information would you want to obtain about the client firm and its markets?

Endnotes

1. This key insight originates with Kenneth R. Andrews, *The Concept of Corporate Strategy* (Homewood, IL: Irwin, 1971).
2. Keniche Ohmae, *The Mind of the Strategist: The Art of Japanese Business* (New York: McGraw-Hill, 1982). Ohmae emphasizes the distinction between strategy, which involves competitive actions that improve the firm's position relative to other companies, and management actions that improve profitability, streamline the organization, or increase the effectiveness of management.
3. Henry Mintzberg and J. A. Waters, "Of Strategies, Deliberate and Emergent," *Strategic Management Journal* 6 (1985), pp. 257–272, and

Henry Mintzberg, "Crafting Strategy," *Harvard Business Review* 65 (July–August 1987), pp. 66–75.

4. Robert Slater, *The New GE: How Jack Welch Revived an American Institution* (Homewood, IL: Irwin Business One, 1993), p. 80.
5. Ibid., p. 78.
6. Ibid., p. 84.
7. Ibid., pp. 84–85.
8. General Electric Annual Report, 1998.
9. Similar issues arise in military strategy where the terrain — landscape, forest, rivers, plains, and mountains — can have profound effects on the outcome of conflict. The relative strengths of fighting forces will differ as physical conditions vary; tanks may have an edge over infantry in flat plains, whereas infantry with anti-tank weapons has the advantage in the woods or hilly terrain. Strategy, maneuvers and tactics must be appropriate to the terrain. As the military strategist Liddell Hart observed, the essence of military strategy is concentration of strength against the opponent's weakness.
10. See Miguel Helft, "What a Long, Strange Trip It's Been for Webvan," *The Industry Standard*, July 23, 2001, and Saul Hansell, "Webvan Hits Technological Barriers and Ingrained Habits of Consumers," *New York Times*, February 19, 2001, p. C1.
11. See Ken Belson and Don Kirk, "Toshiba Will Abandon Commodity Chip Business," *New York Times*, December 19, 2001, p. W1, and "Toshiba to Drop Low-End Chips, Sell U.S. Plant to Micron," *The Wall Street Journal*, December 19, 2001, p. B6.
12. See Ian Foster and Carl Kesselman, *The Grid: Blueprint for a New Computing Infrastructure* (Morgan Kaufmann Publishers, 1999), and Pawel Plaszczak and Rich Wellner, *Grid computing*, (San Francisco: Elsevier/Morgan Kaufmann, 2005).
13. Josef A. Schumpeter, *History of Economic Analysis: Capitalism, Socialism and Democracy* (New York: Harper, 1942); Peter F. Drucker, *Managing in a Time of Great Change* (New York: Truman Talley Books/Dutton, 1995); Richard A. D'Aveni with Robert Gunther, 1994, *Hypercompetition: Managing the Dynamics of Strategic Maneuvering* (New York: Free Press, 1994); Thomas J. Peters, *Thriving on Chaos: Handbook for a Management Revolution* (New York: Knopf, 1987); Charles H. Fine, *Clockspeed: Winning Industry Control in the Age of Temporary Advantage* (Reading, MA: Perseus Books, 1998); Philip Evans and Thomas S. Wurster, *Blown to Bits: How the New Economics of Information Transforms Strategy* (Cambridge MA: Harvard Business School Publishing, 1999).
14. Michael W. Cox and Richard Alm, *Myths of Rich and Poor* (New York: Basic Books, 1999).
15. See Michael Gort and Steven Klepper, "Time Paths in the Diffusion of Product Innovations," *Economic Journal* 92 (September 1982), pp. 630–653; and Steven Klepper and Elizabeth Graddy, "The Evolution of New

Industries and the Determinants of Market Structure," *Rand Journal of Economics* 21 (Spring 1990), pp. 27–44.

16. See Adam J. Fein, "Understanding Evolutionary Processes in Non-Manufacturing Industries: Empirical Insights from the Shakeout in Pharmaceutical Wholesaling," *Evolutionary Economics* 8 (1998), pp. 231–270.
17. Competitive strategy has similarities to maneuver in military strategy. *Maneuver* is an important planning level between so-called grand strategy and tactics. According to Robert R. Leonhard, strategy is the plan of the war and tactics are chosen to win individual battles, but maneuvers use battles as building blocks to carry out strategy, see Robert R. Leonhard, *The Art of Maneuver* (Novato, CA: Presidio Press, 1991). Leonhard observes that "the greater part of maneuver warfare takes place at the operational level". In military strategy, "operations" is the corresponding intermediate level of planning between strategy and tactics. Strategy forms the plan of the war and tactics are the individual battles and engagements. Operations constructs campaigns, which use battles as building blocks. Leonhard points to the Battle of Bull Run (or Manassas Junction) as an example of a battle that should never have been fought, as part of a misdirected campaign to capture Richmond. The North's strategy was the Anaconda plan to close off Southern ports and isolate the Confederacy by interdicting the Mississippi and other routes of transportation and communication. The Anaconda plan was the strategy that eventually would win the war for the Union. The problem was not simply that the North lost the Battle of Bull Run; the fault was that the battle and the campaign for Richmond were not in the service of the overall strategy. Maneuvers are designed to carefully select the battles to be won and those to be avoided: "history abounds with examples of battles that should not have been fought, that were irrelevant to the outcome of the campaign" (ibid.).
18. Lawrie Mifflin, "Fox Powers Way to Top of Children's TV," *New York Times*, July 3, 1995, p. C1.
19. Ibid.
20. Ibid.
21. Bill Carter, "CBS-Fox War of Words Extends to the Top Ranks," *New York Times*, July 25, 1994, p. C1.
22. See http://www.pepsico.com/.
23. See http://www.nikebiz.com/story/pr_make.shtml.
24. John Markoff, "Microsoft Will Reorganize Into 5 Units," *New York Times*, March 30, 1999, p. C2.
25. Microsoft also had a Streaming Media Division to develop and market Windows Media Technologies. In addition, the company had three centralized functional units: research, worldwide sales and support (including its enterprise, education and organization customer units and a Home and Retail Products Group that offered games, input devices and

reference products such as the Encarta Encyclopedia), and operations (which includes finance, administration, human resources, and information technology).

26. John Markoff, "Microsoft Will Reorganize Into 5 Units," *New York Times*, March 30, 1999, p. C2, and www.microsoft.com/presspass/cpOrg.htm.
27. The discussion of the 2001 organization is based on company statements in its 2001 Annual Report, microsoft.com.