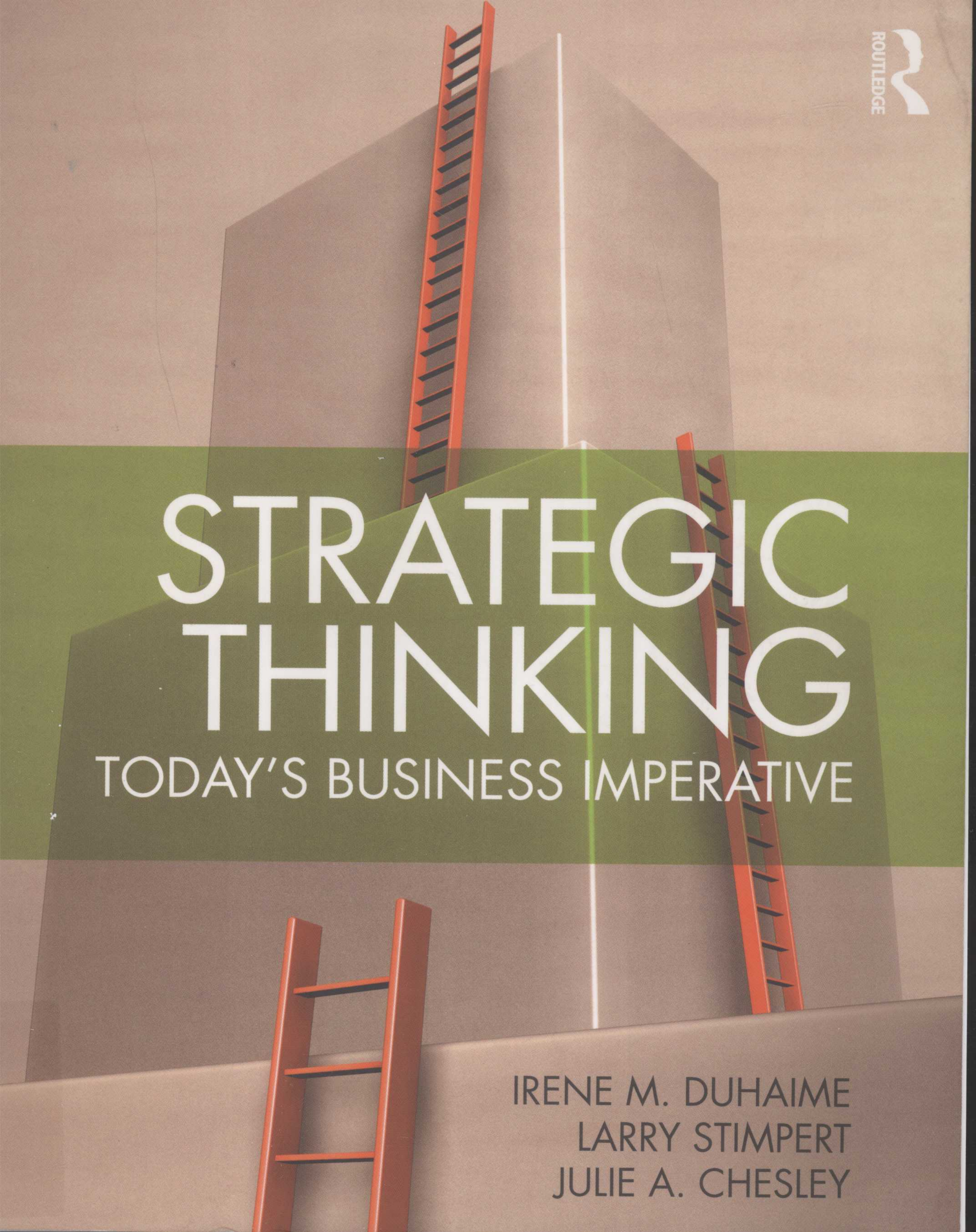

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STRATEGIC THINKING

TODAY'S BUSINESS IMPERATIVE

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Strategic Thinking

Today's Business Imperative

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Strategic Thinking

There are many strategy books available in the marketplace for today's student or business professional; most of them view strategy from the 10,000 foot level, while *Strategic Thinking* looks at this important business topic through a different lens. Written from the perspective of a manager, this book builds on theories of managerial and organizational cognition that have had a powerful influence on many business fields over the last two decades. As other books on business policy and strategy cover a broad range of topics, models, frameworks, and theories, the unique feature of this book is that it covers all this, but also focuses on how managers of business firms understand their business environments, assess and marshal their firms' resources, and strive for advantage in the competitive marketplace. It examines the economic, structural, and managerial explanations for firm performance.

Offering professors and business people who are intrigued by the ideas introduced in Peter Senge's books ways to apply those ideas and principles in the classroom and in the companies in which they work, the book puts managers front and center.

Irene M. Duhaime, Senior Associate Dean and Professor at Georgia State University.

Larry Stimpert, Professor of Economics and Business at Colorado College.

Julie A. Chesley, Assistant Professor of Organization Theory and Applied Behavioral Science at the Graziadio School of Business, Pepperdine University.

To Walter, always, for everything—I. M. D.

To my students, past and future—L. S.

To Bruce, Abbey, and Alex for their gracious support and love …
and for keeping me grounded—J. A. C.

Preface

Probably every business manager and professor would agree with the statement that "[t]he critical resource of the modern … firm is general management skill."[1] But, most strategic management textbooks view firms as a "faceless abstraction," giving little attention to the managers and executives who make the decisions that are the building blocks of their firms' strategies.[2] As a result, we are left with a paradox: An implicit acknowledgment of the importance of managers and executives, but business and management texts that give little attention to the roles of managers, how managers make decisions, and the knowledge and learning that are so essential to managers as they must guide their firms successfully through dynamic business environments. This book aims to fill this critical gap.

The field of strategic management is multidisciplinary, and has built upon many other disciplines, including marketing, political science, psychology, and, above all, economics. In fact, some of the most influential and well known contributions, such as Michael Porter's *Competitive Strategy*, have their theoretical grounding in microeconomics and industrial organization economics.[3] According to this perspective, firm performance is largely a function of industry structure and how competitive an industry is. This kind of thinking leads to many commonly accepted expectations, for example that firms operating in less competitive industries will enjoy higher performance than firms operating in highly competitive environments.

This book examines these economic and structural explanations for firm performance, but our underlying thesis is that the task of strategic management is not only structural but also *managerial*. This book does not argue that industry structure is unimportant—in fact, two chapters (Chapters 4 and 5) are devoted to developing ways of thinking about and analyzing industry structure. But, we begin with a premise that *managerial* thinking about such issues and *managerial* decision making are fundamentally important to the success of business organizations.

Another reason why many books on strategy tend to have a structural rather than a managerial perspective is because "the human variable" is elusive and difficult to study. As organizational theorist James Thompson has described:

> The human actor is a multidimensional phenomenon subject to the influences of a great many variables. The range of differences in aptitude is great, and the learned behavior patterns … [are] quite diverse. Neither we nor organizations have the data or the calculus to understand organization members in their full complexity.[4]

More recently, advances in management research, specifically efforts to understand managerial and organizational cognition, have provided us with a vocabulary, key constructs and variables, and methodological tools for understanding how managers and executives process information, make decisions, and learn from the decisions they make. This book incorporates these research advances to place managers and executives front and center in the strategic management process.

At the heart of our emphasis on managerial thinking is the concept of mental models, which Peter Senge has defined as "deeply ingrained assumptions, generalizations, or even pictures or images that influence how we understand the world and how we take action."[5] Managerial thinking—embedded in managers' mental models—influences strategic decision making and the actions firms take. Managers' mental models of the situations they encounter determine whether a particular strategic issue or situation will be noticed, how it will be interpreted and understood, and how they will respond to the situation. The study of managerial thinking thus helps to explain why some managers notice important business issues while other managers do not, why some managers correctly interpret these issues while others do not, and why some managers respond appropriately to these issues while others do not. As a result, the linkages among business environments (including industry structure), managerial thinking, and strategic decision making are keys to understanding performance differences across firms and how competitive advantage is developed.

Features of This Book

In addition to giving managers and managerial thinking prominent roles in the strategic management process, this book also highlights two other themes: the dynamic and ever-changing nature of business environments and the value of organizational knowledge and learning. We focus on the dynamic nature of business environments because change is a fact of life in the business world and much organizational success rests on the ability of managers to anticipate and respond to industry change. Furthermore, it has now become imperative for business organizations to learn and acquire new knowledge, but they must also have structures that effectively move knowledge and information from those who have it to those who need it. At the end of every chapter, we describe how that chapter's material is related to these themes.

Throughout the chapters, we not only introduce concepts and ideas, but we also provide many illustrations of these concepts in order to show how these ideas can be applied to actual business situations and to reinforce understanding and learning. While we provide many contemporary examples, we also include some historic examples because we believe they offer timeless truths that are just as relevant today. Finally, the end of every chapter also includes a "key questions for managers" section in which we ask readers to take the most important ideas presented in the chapter and apply them to actual company situations. Students who have worked in companies can apply these questions to the firms where they have worked, or students might select a company and address these questions in a short research project. Current managers can, of course, apply these questions to their own firms and businesses.

Acknowledgments

A project of this scale and scope is only possible with help, and we are grateful to all who helped us at every step. John Szilagyi approached us with the idea for this book, and we are grateful for his encouragement. We hope that the final project warrants his initial confidence

About the Authors

Irene M. Duhaime has taught at the University of Pittsburgh, the University of Illinois at Urbana-Champaign, the University of Memphis, and Georgia State University where she now serves as Senior Associate Dean and Professor of Strategic Management.

Professor Duhaime received her Ph.D. from the University of Pittsburgh. Her dissertation on corporate divestment won the General Electric Award for Outstanding Research in Strategic Management. Before entering the doctoral program, she was responsible for cash management and short-term investments at New England Mutual Life Insurance Company and was an investment officer at Pittsburgh National Bank.

Her research on diversification, acquisition, divestment, and turnaround has been published in the leading management journals including the *Academy of Management Journal*, the *Academy of Management Review*, and the *Strategic Management Journal*. Her research and teaching interests have spanned the range from large, diversified corporations to small entrepreneurial firms and family businesses.

Professor Duhaime has served in a variety of leadership roles in the Academy of Management (including Book Review Editor of the *Academy of Management Review* and chair of the Business Policy and Strategy Division) and in the Strategic Management Society (including two terms on the Board of Directors). She is a Fellow of the Strategic Management Society. She lives with her husband Walter in Atlanta and enjoys music, reading, discovering new restaurants, and weekend exploration of the South Carolina beach.

Larry Stimpert is Professor of Economics and Business at Colorado College, and he has also taught as a Visiting Professor at the Korea University Business School and the United States Air Force Academy. He received his B.A. from Illinois Wesleyan University and his M.B.A. from the Columbia University Business School. Prior to entering the academic field, he worked in the railroad industry and served in various marketing, forecasting, and economic analysis positions at the Southern Railway Company and the Norfolk Southern Corporation. Later, he worked as manager of marketing and pricing for the Chicago and North Western Transportation Company.

Professor Stimpert received his Ph.D. in Business Administration from the University of Illinois where he was recognized for the quality of his teaching while still a graduate student. Professor Stimpert's research interests focus on top managers and their influence on strategic decision making and firm strategies. He has written on many strategy issues, including managerial responses to environmental change and organizational decline, business definition and organizational identity, the management of corporate strategy and diversification, company strategies following deregulation, and corporate governance. His articles have appeared in the *Academy of Management Journal*, the *Academy of Management Review*, the *Journal of Management*, the *Journal of Management Studies*, and the *Strategic Management Journal*, and he has also authored chapters that have appeared in several edited books. He has also served as Essay Editor for the *Journal of Management Inquiry*. He is a member of the Academy of Management, the Southern Academy of Management, and the Strategic Management Society.

Dr. Julie A. Chesley is an Assistant Professor of Organization Theory and Applied Behavioral Science at the Graziadio School of Business, Pepperdine University. Julie holds a B.S. in Management from the United States Air Force Academy, an M.B.A from the University of Colorado, Leeds School of Business at Boulder, Colorado, and a Ph.D. in Organization Theory and Management from the Leeds School of Business at the University of Colorado. Julie has also taught undergraduate management courses at the United States Air Force Academy and at Colorado College.

Dr. Chesley has over 26 years' experience implementing, teaching and researching organization management. She has led critical strategy implementation and change efforts and has been responsible for several national security space staff functions in her 20-year Air Force career.

Dr. Chesley's teaching, research, training, and consulting focus primarily on organization change, team development, leadership development and strategy implementation. She has numerous publications and presentations including articles in *California Management Review*, *Journal of Leadership and Organizational Studies*, *Journal of Business Research*, and the *Journal of Leadership Studies*, as well as the text, *Applied Project Management for Space Systems*.

Brief Contents

Full Contents

Chapter 1

Managerial Decision Making and Strategic Management

***Strategic management** is the process by which managers formulate and implement strategies to generate high performance and to create sustained competitive advantage. Our focus will be on the decisions made by CEOs, presidents, and general managers, as well as mid- and lower-level managers of firms and business units and how, over time, those decisions become the strategies that influence firm performance. The main objectives of this book are: 1) to develop your understanding of the strategic management process and 2) to understand how and why some firms enjoy sustained high performance and why many other firms do not.*

This first chapter introduces the field of strategic management and provides an overview of the book. It begins by describing the tasks of general managers and the dynamic and challenging environments that managers face as they develop and implement strategies. We then define strategy, elaborate on the strategic management process, and describe how managerial thinking—the assumptions, beliefs, and understandings contained in managers' mental models—is the source of, and a key to understanding, strategic decision making and firm performance.

Chapter Objectives

The specific objectives of this chapter are to:

- Describe how the study of strategic management is uniquely different from other fields of management study.
- Describe the tasks of general managers and the dynamic characteristics of the business environments in which managers must formulate and implement strategies.
- Define strategy and the concepts of managerial thinking and mental models, and illustrate how managers' mental models influence decision making.
- Show how specific decisions become the building blocks of strategies that ultimately determine firm performance outcomes.
- Provide a model of strategic management that will serve as an organizing framework for this book.

Strategy's Unique Focus on the Management of Firms and Businesses

This book aims to develop your understanding of how managers formulate and implement strategies that lead to sustained **competitive advantage**—the reason some firms enjoy higher levels of performance than their rivals. Our aim is to go well beyond asking whether a firm does or doesn't enjoy high performance; we seek to provide you with the skills and tools to ask how and why some firms do or don't develop a competitive advantage and enjoy high performance. For many, the terms strategy and strategic management are synonymous with an undergraduate or M.B.A. capstone course. Many business education programs expect that the strategy course will provide students with an overview or "big picture" of how other courses in accounting, finance, organizational behavior, marketing, and operations tie together.

But beyond offering you an integrative experience, the field of strategic management should introduce you to concepts, ideas, and theories that will stimulate your thinking about the important roles of general managers, those who have broad responsibilities for the strategic management of entire firms or of the business units of multibusiness firms.

One of the most distinguishing features of strategic management is its unique focus or level of analysis. As illustrated in Exhibit 1.1, the study of economics focuses on more "macro" level—or outside the company—issues. For example, the field of macroeconomics examines employment, price levels, and the growth of the national and international economies, while the field of microeconomics focuses on industries and the nature of competition in various industry environments.

On the other hand, most business fields examine more "micro"—or inside the firm—levels of analysis. For example, the focus of finance is on firms' investment projects and how those projects will be financed. The aim of marketing is to understand the promotion of individual products or services. Similarly, the focus of organizational behavior is on the motivation and job performance of individuals. In fact, motivating colleagues and co-workers is probably one of the most important day-to-day leadership tasks facing any manager!

But the unique focus of strategic management is on the management of *firms and businesses*. Strategists cannot make decisions about firms and businesses in isolation, but must necessarily

Exhibit 1.1 Strategy's Level of Analysis Is Unique

Field of Study	Level of Analysis
Macroeconomics	The economy
Microeconomics	Industries and markets
Strategy	*Firms and businesses*
Finance	Investment projects
Marketing	Products and services
Organizational behavior	Individuals
Operations management	Manufacturing plants

integrate information from across the broader economy, industry, and market levels of analysis while also considering the important roles played by functional departments and individuals within their own firms and businesses. As a result, the tasks of general managers are not only important and demanding, but they are also highly knowledge-intensive because managers use information and knowledge gleaned from experience and a wide range of other sources to make key—strategic—decisions.

The Tasks of General Managers

The Challenge

General managers—presidents, CEOs, and heads of business units—have responsibility for the overall performance of their firms and businesses. Their tasks are multifaceted and challenging. They must analyze their firm's competitive landscape, position their firm or business within its industry, identify and select the most successful ways of competing in that industry, and secure the necessary resources to implement their strategies. And, much is riding on how well they do their jobs. Shareholders expect and demand a return on their investment. Employees, too, are counting on wise decision making to provide them with a secure livelihood. And, the communities in which companies have offices, production plants, and other facilities also depend on companies to pay taxes and help to provide their citizens with a high quality of life.

The tasks of general managers are made even more complicated because the industry environments in which firms and businesses compete do not remain constant. Thus, strategic management is a highly dynamic process, and the strategies that worked well during one time period are unlikely to remain effective indefinitely. Many changes occur in industry environments, but we will focus on three types of changes that confront all firms and businesses:

Demographic Change

First, customers change. If nothing else, customers get older. But any type of demographic change poses both opportunities and challenges for firms and their managers. For example, if products become identified with an older demographic, it can be difficult to attract younger buyers. The average buyer of Lincoln automobiles is now over 60, and Ford wants and needs its Lincoln line to appeal to a younger demographic or else it risks having the Lincoln brand serve an increasingly smaller group of customers.[1] But if Ford changes its Lincoln car line too much, it may run the risk of alienating its loyal, older buyers before it can successfully transition to a strategy that attracts a new following of younger buyers.

Nearly all developed economies are now aging and growing more diverse, trends that offer opportunities for entrepreneurial businesses to provide new products and services to meet an aging and more diverse population. Health care will remain a high-growth industry in the United States as aging Baby Boomers seek to maintain active lifestyles even as they grow older. And, many companies see the benefits of reaching out to and tailoring products to meet the tastes and preferences of ethnic groups that are often among the fastest growing consumer groups in many developed countries.

Throughout this book, we will offer many other examples of how changing demographics provide both challenges and opportunities. But, the key point we want to underscore here is that managers cannot escape from the challenges associated with changing customer demographics.

Technological Change

It's a given that technologies are rapidly changing all of the time. While we are all aware of the ways technology has enhanced a wide array of consumer products from computers and cell phones to consumer electronics and automobiles, technology affects all industries. Technological change not only alters the array of products and services that can be offered to customers, but it also profoundly affects the way products and services are produced and provided. And, it has also fundamentally changed the nature of work, so that the vast majority of workers now make a living not by physical labor, but by communicating and sharing knowledge.

New Products and Services

Shifting demographics create demands for new products and services, and technological change allows entrepreneurs and entrepreneurial firms to develop new products and services that consumers cannot even imagine they might want or need (but can soon become life's necessities). Companies can either be responsible for developing these new products and services, or they can quickly respond to the firms that do, or they can run the risk of falling behind more nimble and opportunistic competitors.

The problem with all three types of change is that they rarely come in steady, predictable increments. As Henry Mintzberg has noted, an industry may be relatively stable for years or even decades, only to be jolted unexpectedly by dramatic change in one or all three of the dimensions described above.[2] Thus, lulled by complacency and a reliance on a "we've always done it this way" mentality, managers can be caught completely off guard by changes. Sometimes their firms are so profoundly impacted by these changes that they cannot adapt and begin to decline. Some firms never recover.

In such a competitive landscape, firms like Apple Computer, founded by two entrepreneurs working in a garage, can so successfully exploit new technologies to develop products that meet previously unknown consumer needs that the firms they start can become some of the largest companies in the world in a very short period of time. Apple, which so fundamentally changed the computer industry, was later eclipsed by the technological and other industry developments that Apple itself set in motion. In the last decade, however, remarkably innovative and elegantly designed products such as the iPod, iPhone, and iPad, and aggressive marketing and advertising campaigns for those products, have restored Apple to its original place as a technology leader. But whether Apple can continue to maintain market relevance in the years ahead will depend on the ability of its managers to formulate and implement successful new strategies, as no company can thrive or ultimately survive if it grows complacent.[3]