FORMULATION AND IMPLEMENTATION OF COMPETITIVE STRATEGY

PEARCE · ROBINSON

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Preface

Formulation and Implementation of Competitive Strategy is a book which was designed to help you to acquire the critical business skills of planning and managing strategic activities. It incorporates two teaching approaches: text, and cohesion cases.

The *text* portion of this book attempts to provide you with a readable, up-to-date introduction to the management of strategy in the business enterprise. We have tried to integrate the work of strategic management theorists, practitioners, and researchers with a strong emphasis on real-world applications of strategic management concepts. To further this aim, we have included "Strategy in Action" reports in each chapter which give current examples of the application of key concepts by well-known business firms.

The structure of the text material is guided by a comprehensive model of the strategic management process. The model will aid you in acquiring an executive-level perspective on strategy formulation and implementation. It provides a visual display of the major components of the entire process and shows how they are conceptually related and how they are sequenced throughout the process.

The major components of the model are each discussed in depth in separate chapters, thereby enabling you to acquire detailed knowledge and specific skills within a broad framework of strategic management. The use of the model is also extended to the cohesion cases where you will have the opportunity to study disciplined, systematic, and comprehensive solutions of actual strategic dilemmas.

The *cohesion cases* offer a particularly unique feature. We have taken a well-known, multi-industry firm—Holiday Inns, Inc.—and used it as the basis of an in-depth case study to illustrate in detail the application of the text material. To do this, we provide a cohesion case section at the end of each chapter which applies the chapter material to the company. The Holiday Inns, Inc. case offers a clear illustration of the corporate, business, and functional levels of strategy—so important to the understanding of strategic management in today's corporate environment.

The Cohesion case offers several advantages:

It provides a continuous illustration of the interdependence of the various parts of the strategic management process by using the same enterprise throughout the chapters.

It is a useful aid in understanding the text material, when the primary emphasis in the course is to be on case studies or other nontext analysis.

It offers an in-depth basis for discussion of strategic management concepts, application, and ideas.

Finally, to maximize the value of the cohesion case concept, we have included a second cohesion case at the end of the text portion of this book. It applies the strategic management concepts to a single business firm—Congress Motel—in the same chapter-by-chapter format. This alternate cohesion case applies strategic management at the business and functional strategy levels, thus offering a simplified illustration of the formulation and implementation of competitive strategy.

The development of this book was aided by many friends and colleagues. We are grateful to Jack Ruhe of St. Mary's College for his contributions of focus, insight, and examples of strategic behavior to Chapter 5. Larry Cummings of the University of Wisconsin-Madison, Liam Fahey of Northwestern University, Don Hambrick of Columbia, and Kirby Warren of Columbia deserve our special thanks for their helpful and thorough review of each chapter. Cynthia Montgomery of Michigan State University and Bill Warren of the College of William and Mary also provided useful review on selected portions of the book. The valuable recommendations of these outstanding scholars have added quality to our final product.

The stimulating environment at the University of South Carolina has also contributed to the development of this book. Thought-provoking discussions with our business policy colleagues Alan Bauerschmidt, Carl Clamp, Greg Dess, Herb Hand, John Logan, and Bob Rosen provided numerous useful ideas. Likewise, we want to thank James F. Kane, dean of the College of Business Administration, James G. Hilton, associate dean, and Joseph C. Ullman, Program Director of Management for their interest and support.

Finally, we would like to acknowledge the contribution of the business executives who have attended our strategic management seminars. Their penetrating questions, ideas, and insights have provided an ideal "test of consistency" for the material in this book.

In using this book, we hope that you will share our enthusiasm both for the rich subject area of strategic management which we have attempted to portray and for the learning approach which we have taken.

Jack Pearce • Richard Robinson

Contents

part one

Overview of strategic management

THE first two chapters of this book provide a broad introduction to strategic management. We want to help you become acquainted with the nature, need, benefits, and terminology of the processes which produce and implement the major plans that direct business activities. Subsequent chapters then build on a common understanding as a basis for providing greater detail.

In Chapter 1, "The Nature and Value of Strategic Management," we emphasize the practical value of a strategic management approach to a business organization. We review the actual benefits for companies which have instituted strategic management. And we present the critical activities of strategic management in addition to a set of dimensions that can be used to distinguish strategic decisions from other planning tasks of the firm.

Chapter 1 stresses the key point that strategic management activities are undertaken at three levels in many companies: corporate, business and functional. The distinctive characteristics of strategic decision making at each of these levels are discussed as the basis for observations throughout the book of the differential impact which the activities at different levels have on company operations.

The extent of desirable formality in strategic management is another key point in the chapter as is the alignment of strategy makers with particular activities in the overall process of strategy formulation and implementation. We reach the conclusions that it is possible to assign areas of decision-maker responsibility and to suggest an appropriate degree of formality in strategic activities. The determining factors for these conclusions are discussed in detail.

A final section in Chapter 1 reviews the results of research in business organizations. The studies demonstrate convincingly that companies which undertake strategic management processes often enjoy financial and behavioral benefits that justify the additional costs involved.

Chapter 2 presents a model of the strategic management process. It is representative of the approaches currently used by strategic planners and serves as an outline for the remainder of the book. That is, each subsequent chapter is devoted to an in-depth discussion of one of the major components of the strategic management model. Each of the individual components is carefully defined and explained in Chapter 2. Attention is also given to understanding the integrative process by which each of the components is blended together to produce cohesive and balanced results from the system. The chapter concludes with a discussion of the practical limitations of the model. In this way, you will be alert to the advisability of tailoring the general recommendations suggested in each chapter to the unique situations which you confront in actual business practice.

chapter 1

The nature and value of strategic management

THE practice of strategic management is recognition of the complexity and sophistication demanded by business decision making.

Managing the various and multifaceted internal activities of a company is only part of the modern executive's responsibilities. The firm's immediate external environment poses a second set of challenging factors. It includes competitors whenever profits seem possible, suppliers of ever more scarce resources, government agencies which watch for adherence to an ever increasing number of regulations, and customers whose often inexplicable preferences must be anticipated. Additionally, there is a remote external environment which contributes to a general yet pervasive climate for business. It consists of economic conditions, social change, political priorities, and technological developments. An executive must anticipate, monitor, assess, and incorporate each of these factors in top-level decision making. However, the attention to all of these influences is often subordinated to the fourth major consideration in executive decision making—the multiple and often mutually inconsistent objectives of the stakeholders of the business: its owners, top managers, employees, communities, customers, and country.

To deal effectively with all of the considerations which affect the ability of a company to grow profitably, executive officers design strategic management processes which they feel will facilitate the optimal positioning of the firm within its competitive environment. Such positioning is made possible because of the value of these processes both in more accurately acting in anticipation of environmental changes and in improving preparedness for reacting to unexpected internal or competitive demands.

The sophistication of broad-scope, large-scale management processes has increased dramatically since the end of World War II, principally as a reflection of the increases in the size and number of competing firms; of the heightened intervention of government as a buyer, seller, regulator, and competitor in the free enterprise system; and of the greater involvement of businesses in international trade. Perhaps the most significant improvement came in the decade of the 1970s, as the "long-range planning," "new venture management," "planning, programming, budgeting," and "business policy" approaches blended with a greater-than-ever emphasis on environmental forecasting and the addition of external to internal considerations in the formulation and implementation of plans. This approach is known as "strategic management" or as "strategic planning."[1]

Strategic management is defined as the set of decisions and actions resulting in the formulation and implementation of strategies designed to achieve the objectives of the organization. It involves attention to no less than nine critical areas. (See Figure 1-1.)

1. Determination of the mission of the company, including broad statements about its purpose, philosophy, and goals.
2. Development of a company profile which reflects its internal condition and capability.
3. Assessment of the company's external environment, both in terms of competitive and general contextual factors.
4. Interactive opportunity analysis of possible options uncovered in the matching of the company profile with the external environment.
5. Identification of the desired options uncovered when the set of possibilities is considered in light of the company mission.
6. Strategic choice of a particular set of long-term objectives and grand strategies needed to achieve the desired options.
7. Development of annual objectives and short-term strategies which are compatible with the long-term objectives and grand strategies.
8. Implementation of strategic choice decisions based on budgeted resource allocations and emphasizing the matching of tasks, people, structures, technologies, and reward systems.
9. Review and evaluation of the success of the strategic process to serve as a basis of control and as an input for future decision making.

Dimensions of strategic decisions

What decisions facing a business are strategic and therefore deserve strategic management attention? Typically, strategic issues have six identifiable dimensions.

1. Strategic issues require top management decisions. Strategic decisions overarch several areas of a firm's operations. Therefore, top management involvement in decision making is imperative since only they have the perspective to understand and anticipate broad implications and ramifications, and only they have the power to authorize necessary resource allocations needed for implementation.

[1] In this text the term *strategic management* is used when referring to the broad overall process, since to some scholars and practitioners the term *strategic planning* connotes only the formulation phase of total management activities.

figure 1-1
Strategic management responsibilities

What would a practicing executive say are the responsibilities of management in the strategy process? One answer comes from Marvin Bower, the long-time managing director of McKinsey and Company, one of the world's largest and most respected management consulting firms. Bower lists 14 processes for which management at some level in the organization must claim responsibility.

1. Setting the mission. Deciding on the business or businesses in which the company or division should engage and on other fundamentals that shall guide and characterize the business, such as continuous growth. A mission is typically enduring and timeless.

2. Developing a company philosophy. Establishing the beliefs, values, attitudes, and unwritten guidelines that add up to "the way we do things around here."

3. Establishing objectives. Deciding on achievement targets with a defined time range or narrower in scope than the mission, designed to aid in making operational plans for carrying out strategy.

4. Planning strategy. Developing concepts, ideas, and plans for achieving objectives successfully, and for meeting and beating competition. Strategic planning is part of the total planning process that includes management and operational planning.

5. Establishing policies. Deciding on plans of action to guide the performance of all major activities in carrying out strategy in accordance with company philosophy.

6. Planning the organization structure. Developing the plan of organization—the harness that helps people pull together in performing activities in accordance with strategy, philosophy, and policies.

7. Providing personnel. Recruiting, selecting, and developing people—including an adequate proportion of high-caliber talent—to fill the positions provided for in the organization plan.

8. Establishing procedures. Determining and prescribing how all important and recurrent activities shall be carried out.

9. Providing facilities. Providing the plant, equipment, and other physical facilities required to carry on the business.

10. Providing capital. Making sure the business has the money and credit needed for physical facilities and working capital.

11. Setting standards. Establishing measures of performance that will best enable the business to achieve its long-term objectives successfully.

12. Establishing management programs and operational plans. Developing programs and plans governing activities and the use of resources which—when carried out in accordance with established strategy, policies, procedures, and standards—will enable people to achieve particular objectives. These are phases of the total planning process that includes strategic planning.

13. Providing control information. Supplying facts and figures to help people follow the strategy, policies, procedures, and programs; to keep alert to forces at work inside and outside the business; and to measure their own performance against established plans and standards.

14. Activating people. Commanding and motivating people up and down the line to act in accordance with philosophy, policies, procedures, and standards in carrying out the plans of the company.

Source: Adapted with some modification to ensure consistency in terminology from Marvin Bower, *The Will to Manage: Corporate Success through Programmed Management* (New York: McGraw-Hill, 1966), pp. 17–18.

2. Strategic issues involve the allocation of large amounts of company resources. Strategic decisions characteristically involve substantial resource deployment. These people, physical assets, or monies must be either redirected from internal sources or secured from outside the firm. In either case, strategic decisions commit a firm to a stream of actions over an extended period of time thus involving substantial resource support.

3. Strategic issues are likely to have a significant impact on the long-term prosperity of the firm. Strategic decisions ostensibly commit the firm for a period of approximately five years; however, the time frame of impact is often much longer. Once a firm has committed itself in a major way to a particular strategic option, its competitive image and advantages are usually tied to that strategy. Firms become known in certain markets, for certain products, with certain characteristics. To shift from these markets, products, or technologies through the adoption of a radically different strategy would jeopardize the progress which they had previously made. Thus, strategic decisions have enduring impacts on the firm—for better or worse.

4. Strategic issues are future oriented. A major distinguishing feature of strategic decisions is they are made based upon what managers anticipate or forecast rather than know. Emphasis is placed on the development of projections which will enable the firm to select the most promising strategic options. In the turbulent and competitive free enterprise environment, a successful firm must take a proactive stance toward change.

5. Strategic issues usually result in major multifunctional or multibusiness consequences. A strategic decision is a coordinative one. Decisions about such factors as customer mix, competitive emphasis, or organizational structure necessarily involve a number of a firm's strategic business units (SBUs), functions, divisions, or program units. Each of these areas will be affected by the allocation or reallocation of responsibilities and resources related to the decision.

6. Strategic issues necessitate consideration of factors in the firm's external environment. All business firms exist within an open system. They impact and are impacted by conditions external to the firm and largely beyond their control. Therefore, if a firm is to be successful in optimally positioning itself in future competitive situations, its strategic managers need to look beyond the limits of the firm's own operations. They must consider what relevant others are likely to do, e.g., competitors, customers, suppliers, creditors, government, and labor.

Three levels of strategy

Business firms typically exhibit three levels in their decision-making hierarchy. At the top is the corporate level, composed principally of members of the board of directors and the chief executive and administrative officers. They bear the responsibility for the financial performance of the corporation as a whole and for achieving the nonfinancial goals of the firm, e.g., corporate image and social responsibility. To a large extent, their orientations reflect the concerns of stockholders and of the society at large. Particularly in multibusiness firms, it is their duty to determine in what businesses the company should be involved. Further, they set objectives and formulate strategies which overarch the activities of individual businesses in the corporation and of their respective functional areas. By adopting a portfolio approach to strategic management, corporate level strategic managers attempt to exploit their distinctive competencies within their industries while typically planning with a five-year time horizon.

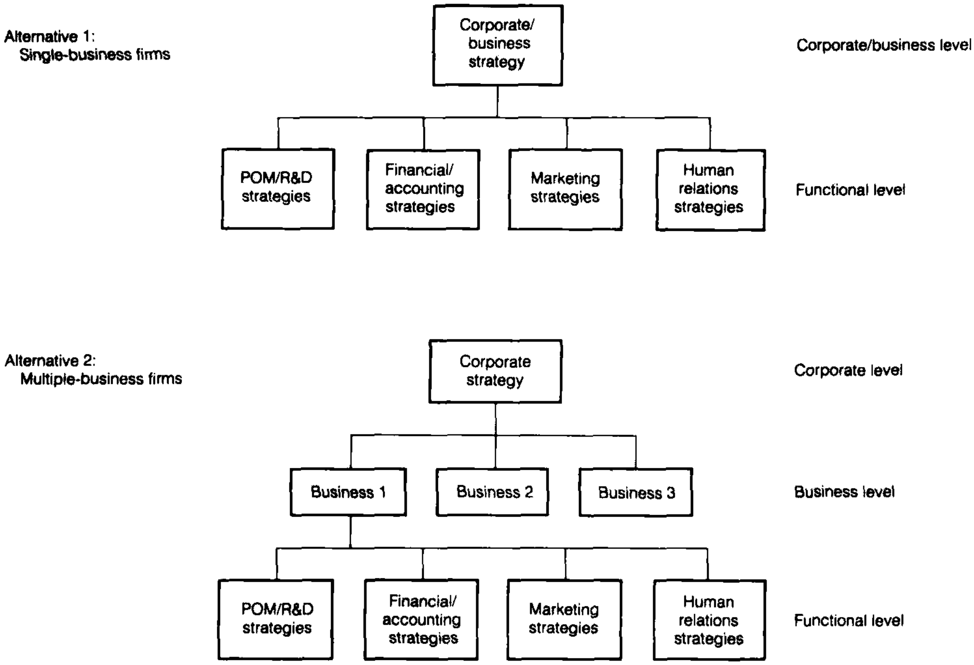
The second rung of the decision-making hierarchy is the business level, which is composed principally of business and corporate managers. They must translate the general statements of direction and intent which were generated at the corporate level into more concrete and operational objectives and strategies for their individual business divisions or SBUs. In essence, business level strategic managers must determine on what basis the company can compete in the selected product-market area. While so doing, they strive to identify and secure the most profitable and promising market segment. This market segment is the fairly unique piece of the total market which the business can claim and defend because of its competitive advantages. Every corporation, even the largest multinational, depends on the strength of their market segments as the basis of its continuing viability.

The third rung of the strategic decision-making hierarchy is the functional level, which is composed principally of activity managers of product, geographic, and function areas. It is their responsibility to develop annual objectives and short-term strategies for such areas as production, operations management, and research and development; financial and accounting; marketing; and human relations. However, their greatest responsibilities are in the implementation or execution of the company's strategic plans. While corporate and business-level managers center their planning concerns on "do the right things," functional-level managers must stress "doing things right." Thus, they directly address such issues as the efficiency and effectiveness of production and marketing systems, the quality and extent of customer service, and the success of particular products and services in increasing their market shares.

Figure 1–2 depicts the three levels of strategic management as they are actually structured in practice. In alternative 1, where the company is engaged in only one business, the corporate and business-level responsibilities are concentrated in a single group of directors, officers, and managers. This particular strategic management structure is nearly synonymous with the organizational formats of small businesses, which constitute approximately 95 percent of all business organizations in the United States.

Alternative 2 displays a classical corporate structure which is comprised of three fully operative levels. Providing the suprastructure is the corporate level, with the superstructure coming from the business level to provide direction and support for functional level activities.

figure 1-2
Alternative strategic management structures



The approach taken throughout this book is best depicted by alternative 2. Thus, whenever appropriate, the topics covered in the text will be addressed from the perspective of all three levels of strategic management. By so doing, you will be exposed to one of the most comprehensive and up-to-date discussions of the strategic management process.

Characteristics of strategic management decisions

The characteristics of strategic management decisions vary with the level of strategic activity being considered. As shown in Figure 1-3, corporate level decisions tend to be more value oriented, conceptually based, and less concrete than are those pertaining to business or functional level strategy formulation and implementation. Corporate level decisions are also characterized by greater magnitudes in risk, cost, and profit potential, as well as by longer time horizons and greater needs for flexibility and for external infusions of resources. These characteristics are logical consequences of the more far-reaching, futuristic, innovative, and pervasive nature of corporate level strategic activity. Examples of corporate level decisions include the choice of business in which to engage, dividend policies, sources of long-term financing, and priorities for the growth.

figure 1-3
Characteristics of strategic management decisions at alternative levels

	Level of strategy		
Characteristic	*Corporate*	*Business*	*Functional*
Type	Conceptual	Mixed	Operational
Definitions	Intangible	Mixed	Concrete
Measurability	Value judgments dominant	Semiquantifiable	Usually quantifiable
Frequency	Periodic or sporatic	Periodic or sporadic	Periodic
Adaptability	Low	Medium	High
Relation to present activities	Innovative	Mixed	Supplementary
Risk	Wide range	Moderate	Low
Profit potential	Large	Medium	Small
Cost	Major	Medium	Modest
Time horizon	Long range	Medium range	Short range
Flexibility	High	Medium	Low
Availability of resources	Partially available	Partially available	Usually available
Cooperation required	Considerable	Moderate	Little

At the other end of the continuum, functional level decisions principally address action-oriented or operational issues. Made periodically, they lead directly to the implementation of some part of the overall general strategy for the firm formulated at corporate and business levels. Therefore functional level decisions are relatively short range in their time horizon, involving low risk and modest costs because of substantial reliance on available resources. They usually determine actions requiring minimal company-wide cooperation which are supplemental to the functional area's present activities and which are highly adaptable to ongoing activities so that minimal cooperation is needed for their successful implementation. Because of their relatively concrete and quantifiable nature, functional level decisions receive critical attention and analysis despite their independently low comparative profit potential.

Some commonly encountered functional level decisions might include generic versus brand name labeling, basic versus applied R&D, high versus low inventory levels, general versus specific purpose production equipment, and close versus loose supervision.

Bridging corporate and functional level decisions are those made at the business level. As Figure 1-3 indicates, business level strategic decisions exhibit characteristics whose descriptors fall between the other two levels. For example, business level decisions are less costly, risky, and potentially profitable than corporate level decisions but more costly, risky, and potentially profitable than functional level decisions. Some frequently required business level decisions involve plant location, marketing segmentation and geographic coverage, and distribution channels.