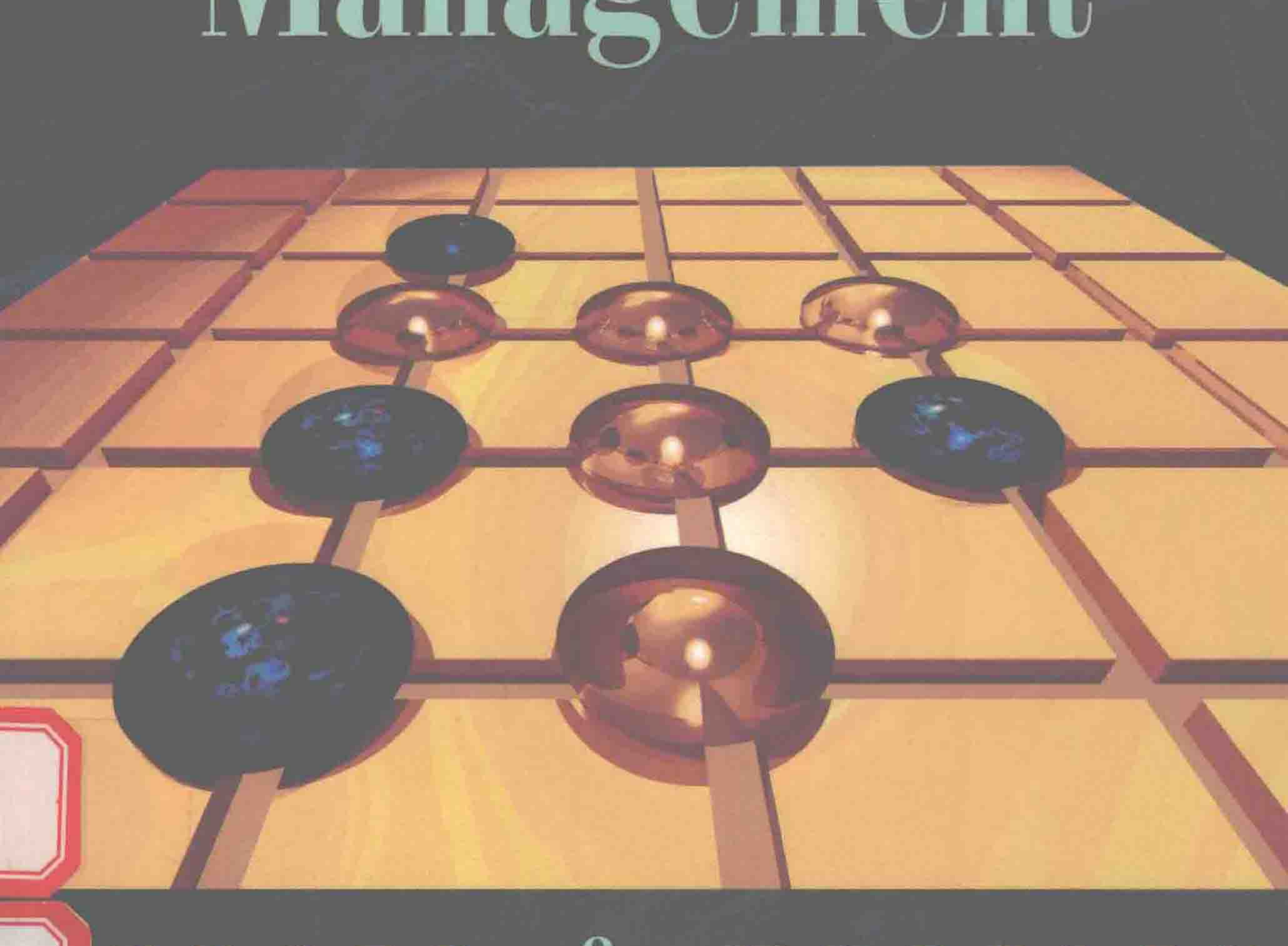
Essentials of Strategic Management



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Essentials of Strategic Management

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DEDICATED TO

Kathy, Richard, Tom

Betty, Kari, Suzi, Lori, Merry, and Smokey

People are asking us, "Why are textbooks so large and expensive?" Too many of today's textbooks are like 1950s-style automobiles: overweight and loaded down with bells, whistles, and tailfins. Students have complained that the books are now so bulky that they can't easily carry them to classes—so they leave them at home. The costs of the books have been escalating to the point that even used books are now being priced out of many students' reach—so they share them with others or don't even buy them at all!

We wrote this book to provide you with a short, concise explanation of the most important concepts and techniques in strategic management. There is no fluff in this book. *Essentials of Strategic Management* is significantly shorter than our other books, but we have not "dumbed it down" or made it "cutesy." It is a rigorous explanation of many topics and concerns in strategic management. We condensed the content of the field into ten carefully crafted chapters. The key concepts and techniques are here. We cite only enough examples to help you understand the material and we restrict our use of boxed examples to one per chapter. Although the content is based on rigorous research studies, we don't report every study and we don't provide endless footnotes. For those who want more research detail and illustrative examples, please see our other textbook, *Strategic Management*, 5th edition. For a combination of text *and* cases, please see our *Strategic Management and Business Policy*, 5th edition. If you would like to use cases to accompany this *Essentials of Strategic Management*, please consider our *Cases in Strategic Management*, 4th edition.

Features

Essentials of Strategic Management contains the following features:

- *A strategic decision-making model* based on the underlying processes of environmental scanning, strategy formulation, strategy implementation, and evaluation and control is presented in **Chapter 1** and provides an integrating framework for the book.
- Michael Porter's approach to *industry analysis* and *competitive strategy* (plus competitive tactics!) is highlighted in **Chapters 3 and 6.**
- The *resource-based view of the firm* serves in **Chapter 4** as a foundation for organizational analysis.
- *Functional analysis* and *functional strategies* receive major attention in **Chapters 4 and 6.** Sections on research and development and R&D strategies emphasize the importance of technology to strategy and product-market decisions.
- *Strategy implementation* deals not only with organization design and structure, but also with *executive leadership* and succession, *reengineering*, *total quality management*, *MBO*, and *action planning* in **Chapters 7 and 8.**
- **Chapter 9** on *evaluation and control* explains the importance of measurement and incentives to organizational performance. *Benchmarking* and *economic value-added measures* are highlighted.

- *International* considerations are included in all chapters and are highlighted in special sections in Chapters **3, 5, 7, and 8.**
- *Environmental scanning and forecasting* is given emphasis equal to industry analysis in **Chapter 3.**
- Suggested *EFAS, IFAS, and SFAS matrixes* in **Chapters 3, 4, and 5** enable the reader to better identify and evaluate strategic factors.
- *Top management* and the *board of directors* are examined in detail in their roles as strategic managers in **Chapter 2.**
- *Social responsibility* is discussed in **Chapter 2** in terms of its importance to strategic decision making.
- Suggestions for in-depth *case analysis* provide a complete listing of financial ratios, recommendations for oral and written analysis, and ideas for further research in **Chapter 10.** The *strategic audit* is proposed as an aid to case analysis. This chapter is most useful for those who wish to supplement this book with cases.
- A boxed *Spotlight on Maytag Corporation* in **every chapter** illustrates chapter concepts and integrates the material.
- **Each chapter** begins and ends with a *brief situation vignette* of an actual company that helps illustrate the material.
- **Each chapter** ends with a list of *key terms* (which are also boldfaced within the text) and a set of discussion questions.

Instructors Manual

An instructors manual has been carefully constructed to accompany this book. It includes a series of multiple choice questions and answers to discussion questions plus a set of additional discussion/essay questions to use in exams.

Acknowledgments

We are grateful to the people who reviewed this book for their constructive criticism and suggestions. Their thought and effort have resulted in a book that is superior to the original manuscript. Our thanks go to Mary Clare McEwing and Michael Payne of Addison-Wesley Publishing Company for their help in the development of this book. Without their support and encouragement, this book would never have been written. We are very grateful to Nancy Benjamin for her patience, expertise, and even disposition during the copyediting and production process. We also thank Mei Xue and Lori Hunger for their help in preparing the index.

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Finally, to the many strategy/policy instructors and students who have moaned to us about the increasing size and cost of textbooks: We have tried to respond to your concerns as best we could by providing a comprehensive yet usable text that is half the size and cost of other books on the market. Instead of the usual five-course meal (complete with heartburn), we are offering you "lean cuisine." This book should taste good with fewer empty calories. Enjoy!

J.D.H.	Ames, Iowa
T.L.W.	Tampa, Florida

CONTENTS

1

Basic Concepts of Strategic Management

During the 1950s and 1960s, no bicycle manufacturer was as successful in the United States as Schwinn Bicycle Company. Schwinn bikes dominated the world of paper routes and after-school street races. "We used to ride Schwinns anywhere and everywhere," remembered one ex-rider wistfully. "We rode them with kids from the neighborhood to school and to baseball practice, and when they got old, we'd repaint them."

Founded in 1895 by the German immigrant Ignaz Schwinn, the firm led the U.S. bicycle market for many years. In the 1960s, one out of every four bikes sold in the United States was a Schwinn. Toward the end of the 1980s, however, everything seemed to fall apart. Sales dropped from 1 million bikes in 1987 to 500,000 in 1991. Market share declined from 10% in 1983 to less than 4% in 1992. "Schwinn used to be the only bike I'd look at," offered one biking enthusiast. "[Now] I don't even know where a Schwinn bike store is."

Between 1989 and 1992, the company lost around $50 million. Top management looked for an outside partner to save the company, but President Edward Schwinn, great-grandson of the founder, was reluctant to give up control. By 1992, the Schwinn Bicycle Company filed for Chapter 11 bankruptcy. The end was in sight for one of the most renowned brand names in the United States.

What went wrong? How could such a successful company fall on such hard times? "Schwinn never spent the money on research and development or planned for the long-term. . . . And they never took their competition seriously," explained one custom bicycle dealer. "Except for their name, they really have nothing to sell."[1] Once, when asked about the company's competition, Schwinn's management was reported to have responded, "We don't have competition. We're Schwinn."[2]

These comments suggest why the managers of today's business corporations must manage firms strategically. They cannot make decisions based on long-standing rules, historical policies, or simple extrapolations of current trends. Instead, they must look to the future as they plan organizationwide objectives, initiate strategy, and set policies. They must rise above their training and experience in such functional and operational areas as accounting, marketing, production, or finance, and grasp the overall picture. They must be willing to ask **three key strategic questions:**

1. *Where is the organization now?* (*Not where do we hope it is!*)
2. *If no changes are made, where will the organization be in one year? two years? five years? ten years? Are the answers acceptable?*
3. *If the answers are not acceptable, what specific actions should management undertake? What risks and payoffs are involved?*

In the 1960s and 1970s, Schwinn sold quality bicycles to a market composed mostly of school-age children. Preferring to sell its products through dealers, the company allowed Huffy and Murray to take over the low-end, mass-merchandise market (in which over 70% of today's bikes are now sold). Management seemed unaware of changing consumer tastes and did not take aggressive new rivals seriously. Newcomers Trek USA and Specialized Bicycle Components attracted biking enthusiasts with lighter, sleeker models in the early 1980s. Considering mountain bikes to be just a temporary fad, management continued to crank out Schwinn's durable, but bulky, standbys. Trying to reduce costs, Schwinn began making its bikes overseas using cheaper foreign labor. This shift led to quality problems that began to erode the brand's image. By the end of the 1980s, management's inability to manage the company strategically resulted in a crisis. Schwinn's management had failed to realize that environmental changes had altered the rules for success. A poor job of environmental scanning had resulted in poor strategic planning; poor strategic planning had led to ineffective strategic management.

1.1 The Study of Strategic Management

Strategic management is that set of managerial decisions and actions that determines the long-run performance of a corporation. It includes environmental scanning (both external and internal), strategy formulation (strategic or long-range planning), strategy implementation, and evaluation and control. The study of strategic management therefore emphasizes the monitoring and evaluating of external opportunities and threats in light of a corporation's strengths and weaknesses. Originally called business policy, strategic management incorporates such topics as long-range planning and strategy. **Business policy**, in contrast, has a general management orientation and tends primarily to look inward with its concern for properly integrating the corporation's many functional activities. *Strategic management, as a field of study, incorporates the integrative concerns of business policy with a heavier environmental and strategic emphasis.* Therefore, *strategic* *management* has tended to replace *business policy* as the preferred name of the field of study.

How Has Strategic Management Evolved?

Many of the concepts and techniques dealing with long-range (now called strategic) planning and strategic management have been developed and used successfully by business corporations such as General Electric and the Boston Consulting Group. Nevertheless, not all organizations use these tools or even attempt to manage strategically. Many are able to succeed for a while with unstated objectives and intuitive strategies. American Hospital Supply Corporation (AHS) was one such organization until Karl Bays became chief executive and introduced strategic planning to a sales-dominated management. Previously, the company's idea of long-range planning was "Maybe in December we should look at next year's budget," recalled a former AHS executive.[3]

From his extensive work in this field, Bruce Henderson of the Boston Consulting Group concluded that intuitive strategies cannot be continued successfully if (1) the corporation becomes large, (2) the layers of management increase, or (3) the environment changes substantially. The increasing risks of error, costly mistakes, and even economic ruin are causing today's professional managers to take strategic management seriously in order to keep their company competitive in an increasingly volatile environment. As top managers attempt to better deal with their changing world, strategic management within a firm generally evolves through four sequential phases:

Phase 1. Basic financial planning: Seeking better operational control by trying to meet budgets.

Phase 2. Forecast-based planning: Seeking more effective planning for growth by trying to predict the future beyond the next year.

Phase 3. Externally oriented planning (strategic planning): Seeking increased responsiveness to markets and competition by trying to think strategically.

Phase 4. Strategic management: Seeking a competitive advantage and a successful future by managing all resources.[4]

Phase 4 in the evolution of strategic management includes a consideration of strategy implementation and evaluation and control, in addition to Phase 3's emphasis on strategic planning.

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

What Is the Impact of Strategic Management on Performance?

Research has revealed that organizations that engage in strategic management generally outperform those that do not. The attainment of an appropriate match or "fit" between an organization's environment and its strategy, structure, and processes has positive effects on the organization's performance. For example, a study of the impact of deregulation on U.S. railroads found that railroads that changed their strategy as their environment changed outperformed those that did not change their strategies.[5]

Nevertheless, to be effective, strategic management need not always be a formal process. Studies of the planning practices of actual organizations suggest that the real value of strategic planning may be more in the future orientation of the planning process itself than in any resulting written strategic plan. Small companies, in particular, may plan informally and irregularly. The president and a handful of top managers might get together casually to resolve strategic issues and plan their next steps.

In large, multidivisional corporations, however, strategic planning can become complex and time consuming. It often takes slightly more than 12 months for a large company to move from situation assessment to a final decision agreement. Because a strategic decision affects a relatively large number of people, a large firm needs a formalized, more sophisticated system to ensure that strategic planning leads to successful performance. Otherwise, top management becomes isolated from developments in the divisions and lower level managers lose sight of the corporate mission.

1.2 Initiation of Strategy: Triggering Events

After much research, Henry Mintzberg discovered that strategy formulation is typically not a regular, continuous process: "It is most often an irregular, discontinuous process, proceeding in fits and starts. There are periods of stability in strategy development, but also there are periods of flux, of groping, of piecemeal change, and of global change."[6] This view of strategy formulation as an irregular process reflects the human tendency to continue on a particular course of action until something goes wrong or a person is forced to question his or her actions. This period of "strategic drift" may simply be a result of the organization's inertia, or it may reflect management's belief that the current strategy is still appropriate and needs only some fine-tuning. Most large organizations tend to follow a particular strategic orientation for about 15 to 20 years before they make a significant change in direction. After this rather long period of fine-tuning an existing strategy, some sort of shock to the system is needed to motivate management to seriously reassess the corporation's situation.

A **triggering event** is something that stimulates a change in strategy. Some of the possible triggering events are:

- **New CEO.** By asking a series of embarrassing questions, the new CEO cuts through the veil of complacency and forces people to question the very reason for the corporation's existence.
- **Intervention by an external institution.** The firm's bank suddenly refuses to agree to a new loan or suddenly calls for payment in full on an old one.

- **Threat of a change in ownership.** Another firm may initiate a takeover by buying the company's common stock.
- **Management's recognition of a performance gap.** A performance gap exists when performance does not meet expectations. Sales and profits either are no longer increasing or may even be falling.

Maytag Corporation is an example of one company in which a triggering event forced management to radically rethink what it was doing. See the ***Company Spotlight on Maytag Corporation*** feature to see how specific questions from the CEO stimulated a change in strategy.

COMPANY SPOTLIGHT
MAYTAG
Corporation

Strategic Management Process

Maytag Corporation is a successful full-line manufacturer of major home appliances. Beginning with its very successful high-quality washers and dryers, it branched out through acquisitions into cooking appliances (Magic Chef, Hardwick, and Jenn-Air), refrigerators (Admiral), and vacuum cleaners (Hoover). Until 1978, however, the corporation (then known simply as Maytag Company) was strictly a laundry appliances manufacturer. Its only experience with any sort of strategic planning was in preparing the next year's budget!

In 1978, Daniel Krumm, Maytag's CEO, asked Leonard Hadley (at that time the company's Assistant Controller in charge of preparing the annual budget) and two other managers (from manufacturing and marketing) to serve as a strategic planning task force. Krumm posed to these three people the question: "*If we keep doing what we're now doing, what will the Maytag Company look like in five years?*" The question was a challenge to answer, especially considering that the company had never done financial modeling and none of the three knew much about strategic planning. Hadley worked with a programmer in his MIS section to develop "what if" scenarios. The task force presented its conclusion to the board of directors: A large part of Maytag's profits (the company at that time had the best profit margin in the industry) was coming from products and services with no future: repair parts, portable washers and dryers, and wringer washing machines.

This report triggered Maytag's interest in strategic change. After engaging in a series of acquisitions to broaden its product line, the corporation was poised to become a global power in the major home appliance industry. Its 1988 purchase of Hoover gave Maytag not only a firm with worldwide strength in floor-care appliances, but also Hoover's strong laundry, cooking, and refrigeration appliance business in the United Kingdom and Australia. The trend toward the unification of Europe and rapid economic development of the Far East meant that Maytag could no longer survive simply as a specialty appliance manufacturer serving only North America.

1.3 Basic Model of Strategic Management

Strategic management consists of four basic elements: (1) **environmental scanning**, (2) **strategy formulation**, (3) **strategy implementation**, and (4) **evaluation and control**. Figure 1.1 shows how these four elements interact. Management scans both the external environment for opportunities and threats and the internal environment for strengths and weaknesses. The factors that are most important to the corporation's future are called **strategic factors** and are summarized by the acronym **SWOT**, or Strengths, Weaknesses, Opportunities, and Threats.

What Is Environmental Scanning?

Environmental scanning is the monitoring, evaluating, and disseminating of information from the external and internal environments to key people within the corporation. The **external environment** consists of variables (Opportunities and Threats) that are outside the organization and not typically within the short-run control of top management. These variables form the context within which the corporation exists. They may be general forces and trends within the overall *societal* environment or specific factors that operate within an organization's specific *task* environment—often called its *industry*. (***These external variables are defined and discussed in more detail in Chapter 3.***)

The **internal environment** of a corporation consists of variables (Strengths and Weaknesses) that are within the organization itself and are not usually within the short-run control of top management. These variables form the context in which work is done. They include the corporation's *structure, culture, and resources*. (***These internal variables are defined and discussed in more detail in Chapter 4.***)

What Is Strategy Formulation?

Strategy formulation is the development of long-range plans for the effective management of environmental opportunities and threats, in light of corporate strengths and weaknesses. It includes defining the corporate *mission*, specifying achievable *objectives*, developing *strategies*, and setting *policy* guidelines.

FIGURE 1.1 **Basic Elements of the Strategic Management Process**