

1 Introducing Strategic Management

In This Chapter We Challenge You To >>>

1. Understand what a *strategy* is and identify the difference between business-level and corporate-level strategy.
2. Understand why we study *strategic management*.
3. Understand the relationship between *strategy formulation* and *implementation*.
4. Describe the determinants of *competitive advantage*.
5. Recognize the difference between the *fundamental* and *dynamic* views of *competitive advantage*.



Click Clack— David Challenging Goliath



welve years ago, Kevin Plank was a walk-on football player for the University of Maryland Terrapins. He hated how his cotton T-shirts became soaking wet with sweat during every practice. The wet T-shirts would cause chaffing, gain several pounds in weight, and generally just feel very uncomfortable. He wondered why, in an era of microfiber fabric with moisture-wicking properties, he and other football players had to put up with uncomfortable cotton T-shirts under their shoulder pads. Runners, bicyclists, and others were already benefiting from clothing made of advanced materials to make their workouts more comfortable. Plank, who grew up always looking for a way to make money, went to a fabric store and bought a bolt of moisture-wicking fabric and paid



a tailor to make several prototype shirts. Plank’s teammates envied his new shirts, so he set out to make more samples. He officially launched his company out of his grandmother’s basement and called his product Under Armour®. As you can see from the snapshot in Exhibit 1.1, sales in 2006 were \$430 million, and the company’s equity was valued at over \$1.8 billion.¹ With such dominant incumbents as Nike and adidas, how did Plank successfully enter and grow his company into one of the best performing companies on Wall Street? Apparently, at least early on, its competitors did not heed Under Armour’s savvy and mega-successful advertising campaign titled “Click-Clack: I think you hear us coming!” Although Under Armour has been successful to date, surely Nike and others did not stand idly by while watching its customers migrate to the new upstart. What can Under Armour do to maintain and grow its position in the industry? Let’s first look at the industry, then we’ll review Under Armour’s strategy for entering and competing in this dynamic industry.

Exhibit 1.1 Under Armour at a Glance

	1996	2006														
Revenues	\$17,000	\$430,000,000														
Net Income	0	57,300,000														
Equity Value	0	1,800,000,000														
		<div><div>Revenue Distribution</div><table><tr><th>Category</th><th>Percentage</th></tr><tr><td>Apparel</td><td>59.4%</td></tr><tr><td>men's</td><td>19.9%</td></tr><tr><td>youth</td><td>7.4%</td></tr><tr><td>footwear</td><td>6.2%</td></tr><tr><td>accessories</td><td>3.5%</td></tr><tr><td>licensing revenues</td><td>3.6%</td></tr></table></div>	Category	Percentage	Apparel	59.4%	men's	19.9%	youth	7.4%	footwear	6.2%	accessories	3.5%	licensing revenues	3.6%
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accessories	3.5%															
licensing revenues	3.6%															
Brands and Trademarks		Under Armour®, HeatGear®, ColdGear®, AllSeasonGear®, LooseGear®, Under Armour design mark, Protect This House™, Duplicity™, I Think You Hear Us Coming™ and Click Clack™														
NYSE Ticker (Went public in August 2005)		UA														
Kevin Plank's Vision		To become the #1 performance athletic brand in the world														

The Performance Apparel Industry Under Armour participates in the sports apparel market, which NPD Group, a leading provider of consumer and retail market research information, estimated was a \$45 billion market in 2006. Approximately 30 percent of the market is synthetic product and purchased for use in active sport or exercise. While one might assume that Nike dominates the market, in fact the active sports apparel market is fragmented—10 brands combine to comprise the top 30 percent of the market.

Historically, exercise clothing consisted of products made with relatively unsophisticated design and generic fabrics. The most common shirt used in exercise was a standard cotton T-shirt, often decorated with logos and company or team names. In segments like running and basketball, there were specialized jerseys made of synthetic fibers and tank top designs that improved performance. Lycra® revolutionized sportswear in the late twentieth century, and the microfibers revolutionized the market later. Fabrics like fleece and Sympatex® were specifically developed for fluctuations in weather conditions. It is unlikely that street fashion would have adopted them so readily if there had not been the status association of sporting prowess. When this was combined with effective functional utility, a fabric fashion was born that encompassed all ages from young skateboarders to mature golfers. Moisture-management fibers were developed to accommodate the desire for more comfortable sportswear. According to Dupont, who invented Coolmax® and Tactel®, function is paramount. These fibers are used commonly today not only in sports apparel, but in other products ranging from socks to lingerie.

The performance apparel segment of the sports apparel market is growing more rapidly than other segments. This growth is fueled by demographic trends and increased consumer awareness and participation in active lifestyles. During the past two decades, consumers have continued to spend heavily in the areas of weight loss and dieting, fitness center memberships, and sports and athletic equipment. And sports enthusiasts tend to spend more for their equipment than casual users, which translates to the possibility for higher price points and greater margins.

As upstarts like Under Armour in sports apparel and Sketchers in specialized footwear have gained strong footholds in emerging segments, industry giants like Nike and adidas have taken notice and responded in kind with their own specialized products. However, while the market is large and growing rapidly, incumbents in traditional segments of the industry have not grown as rapidly.

Under Armour's Entry The original Under Armour shirt that Kevin Plank designed was made as a form-fitting compression using microfiber that would wick perspiration away from the body and dry quickly. The shirts he shared with teammates were a big hit and this led him to believe there was a market for these “performance shirts.” He guessed there would be a big market for his shirts among professional and amateur athletes who, like himself, were irritated by working out in cotton shirts but continued to do so simply because there were few alternatives. Kevin Plank figured he had a winning product that was quite different from current products. His product has three distinct features. First, the fabric wicks moisture and dries quickly (a sweat-soaked cotton T-shirt can weigh two to three pounds). Second, Plank used a compression design—tight, form-fitting cuts that reduced the amount of fabric and improved comfort when worn under a uniform (and equipment like shoulder pads). Third, Under Armour shirts were made with a tagless design; conventional tags on the collar often irritate the neck of athletes. Plank designed a way to heat-seal the tag information directly to the fabric rather than needing to sew on a separate tag.

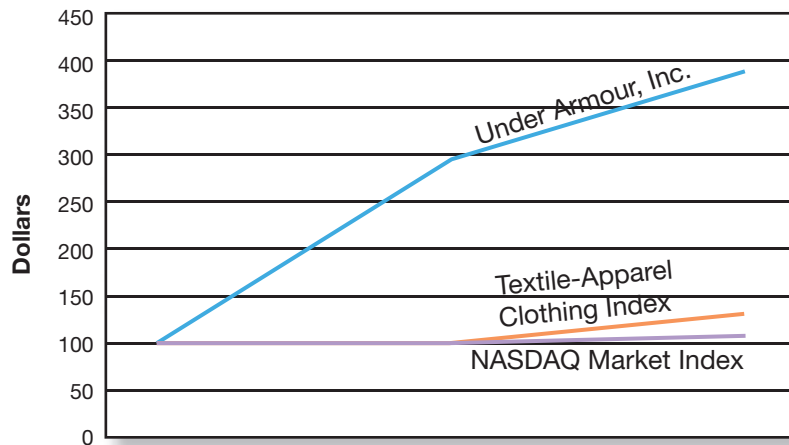
With a superior product designed for a specific market, Plank still faced the issue of how to get his product to market. Like many entrepreneurs, he started with who he

knew—former teammates from college and prep school who were now playing in the NFL. He figured that if he could get some professional athletes to use the product, teammates would hound them for their own shirts, much like his college teammates did at Maryland. While working on getting athletes to demand his product, Plank also went about securing wholesale and retail accounts. Early NFL players who started wearing Under Armour shirts included quarterbacks Jeff George and Frank Wycheck (a former Maryland teammate) and all pro and hall of fame receiver Jerry Rice. In baseball, Roger Clemens got Under Armour rolling by being an early adopter of the new shirts. Today, Under Armour is available via the Internet, catalogs, and 12,000 sporting goods stores worldwide.

With the early success of the basic product, Under Armour set out to find natural product extensions. The first product growth came in expanding from the basic shirt, known as AllSeason Gear®, to HeatGear® and ColdGear®, products designed to be worn in hot climates or cold temperatures while still providing the basic performance technology of the original product. Later, Under Armour looked for additional growth from new geographic areas. The major targets for international expansion today are Europe and Asia. More recently, Under Armour has expanded into new product and sports segments. In 2006, Under Armour launched what has proved to be a highly successful line of footwear. The specific target area? Football and baseball cleats. Why did Under Armour pick this particular segment? Plank says that the Under Armour strategy is not to be a niche player in football (or baseball) cleats. Rather, this segment is designed to be the platform from which to launch into a broader athletic footwear position at a later time. Because so many football and baseball players were already using Under Armour performance shirts, Under Armour felt that they would be a very receptive audience for footwear. The highly successful “Click-Clack” advertising campaign propelled Under Armour to a fabulous first year in footwear; in its first year of marketing cleats, Under Armour captured 20 percent market share overall, and an amazing 40 percent of the market for cleats priced over \$70! In 2007, Under Armour launched lines of performance sunglasses and sports watches, both targeted at the premium price segments.

Under Armour’s targets for growth in the near future focus on three main areas. First, Plank plans to continue to reinvigorate the core products, which are men’s and women’s apparel. And, Under Armour is just beginning to grow in the women’s market. Within the basic product segment, Under Armour sees room to expand into other sports. For instance, within the last year, Under Armour started to notice that their shirts were showing up on golf courses. Golfers who used the products in other activities saw the benefits of the product while spending hours on the golf course. That led Under Armour to start marketing a specific polo-style shirt line through golf stores and later to start a full line of golf apparel. Similarly, Under Armour now targets outdoor adventure seekers (climbers, hikers, skiers), largely because they noticed the product being used in those venues. In addition, Under Armour sees lots of growth opportunity in footwear. Football and baseball cleats are seen as a mechanism to get Under Armour into this vast and potentially lucrative market. Analysts are anxious to know when Under Armour will move into other sports shoes (e.g., running, basketball). Plank simply responds: “When the time is right.” Finally, Under Armour has just begun to get serious about international expansion. Under Armour recently opened a European office to lead negotiations with local athletes and distributors.

In a recent conference call with financial analysts covering Under Armour’s stock, Kevin Plank was asked how Nike and adidas could have been taken by surprise by Under Armour’s entry into the performance apparel segment. Indeed, Under Armour is now credited with creating the sports performance segment because former products are seen

Exhibit 1.2 Under Armour's Cumulative Total Stock Market

	11.18.05		12.31.05		12.31.08
Under Armour, Inc.	100.00		214.89		381.08
Hemscott Group Textile-Apparel Clothing Index	100.00		113.00		131.72
NASDAQ Market Index	100.00		98.78		101.82

as so technologically backwards. Analysts posed the question: “How was the door left so wide open (for your entry)?” Plank’s response was telling: “I don’t know, but our job is to close that door.” He went on to comment that nobody thought consumers would spend \$25 to \$35 for a T-shirt. He concluded by noting that when you give the consumer some tangible benefit, you’re able to reinvent entire product categories. Evidently, as summarized in Exhibit 1.2, in its first year of trading as a public company, Wall Street appeared to like Plank’s plays as much as consumers did.²

Why are some firms incredibly successful while others are not? And why is it that once they’re successful, so few can sustain a high level of success? We are sure that you are familiar with many once successful firms, that today no longer enjoy such success. In this text, we’ll introduce you to the concepts that you’ll need to answer questions about gaining and sustaining success in the world of business competition. <<<

Three Overarching Themes

As you’ve probably gathered from the topic of this book—*strategic management*—a firm’s performance is directly related to the quality of its strategy and its competency in implementing it. You also need to understand that concerns about strategy, sometimes referred to as *business policy*, preoccupy the minds of many top executives. Their responsibility is to see that the firm’s whole is ultimately greater than the sum of its parts—whether these parts are distinct business units, such as Under Armour’s men’s apparel and footwear, or simply the functional areas that contribute to the performance of one particular business, such as Under Armour’s distribution through national sporting goods chains. Good strategies are affected by, and affect all of, the functional areas of the firm, including marketing, finance, accounting, and operations. Thus, we’ll also introduce you to the concepts and tools that you’ll need to analyze the conditions of a firm and its industry, to formulate appropriate strategies, and to determine how to implement a chosen strategy.

Three themes that run throughout this book are critical to developing competency in the field of strategic management:

1. **Firms and industries are *dynamic in nature*.** In recent years, theories and research have emerged on issues regarding dynamic markets and the importance of developing dynamic capabilities to create value. Our first theme, then, is the dynamic nature of both firms and their competitive environments. It's easy, for instance, to look at a financial snapshot of Under Armour and understand the competitive position that it commands in its industry. But we need to see Under Armour not as a snapshot at one particular moment in time but as an ongoing movie. Under Armour's current position isn't the result of a single strategic decision but rather the product of many decisions made over time. Under Armour's current stock of resources and capabilities weren't always available to the firm; they had to be developed dynamically. For instance, entering segments dominated by companies such as Nike and adidas required it to develop exceptional capabilities in design and marketing. And as tempting as it is to use hindsight to see some of Under Armour's competitors as inept, they didn't sit idly by while Under Armour ascended, created new market segments, and stole market share in existing segments. Indeed, Nike now has its own line of compression performance sports apparel. For pedagogical simplicity, we first introduce some fundamental concepts in strategic management and then move on to discuss the concepts and tools that managers use to think of strategy in dynamic terms.
2. **To succeed, the *formulation of a good strategy and its implementation* should be *inextricably connected*.** Unfortunately, many managers tend to focus on formulating a plan of attack and give too little thought to implementing it until it's too late. Likewise, they may similarly give short shrift to the importance of strategic leadership in effectively bridging strategy formulation and implementation. In fact, research suggests that, on average, managers are better at formulating strategies than they are at implementing them. This problem has been described as a "knowing–doing gap."³ Effective managers realize that successfully implementing a good idea is at least as important as generating one. To implement strategies, the organization's leaders have numerous levers at their disposal. Levers such as organization structure, systems and processes, and people and rewards are tools that help strategists achieve alignment—that is, the need for all of the firm's activities to complement each other and support the strategy.
3. **Strategic leadership is essential if a firm is to both formulate and implement strategies that create value.** Strategic leaders are those responsible for formulating firms' strategies, such as Kevin Plank at Under Armour. They have this responsibility as a consequence of their hierarchical status in management. In addition, strategic leadership plays two critical roles in successful strategy implementation, and it's important to highlight them here so that you can incorporate them into your own assessment of a strategy's feasibility as well as ensure that you include these roles in your implementation plans. Specifically, strategic leadership is responsible for (1) making substantive implementation-lever and resource-allocation decisions and (2) developing support for the strategy from key stakeholders.

What Is Strategic Management?

Strategic management is the process by which a firm manages the formulation and implementation of its strategy. But we still need to ask ourselves: What is the *goal* of strategic management? What does "having a *strategy*" mean? Even if we're pretty sure that we have a strategy and a goal for it, how do we know whether we have a good strategy or a bad one?

strategic management

Process by which a firm manages the formulation and implementation of a strategy.

THE STRATEGIC LEADER'S PERSPECTIVE

The word *strategy* is derived from the Greek *strategos*. Roughly translated, it means “the general’s view,” and thinking about military ranks and responsibilities is one way to focus on the difference between the general’s view (and the CEO’s view) and that of some lower-level officer (like line or middle managers). The primary responsibility of a lower-level officer might be supply logistics, infantry, or heavy armored vehicles. Thus, lower-level officers may not be too concerned with the overall plan because of their attention to detail in specific areas of responsibility. The general, however, must not only understand how *all* of the constituent parts interrelate, but must use that understanding to draw up a plan that will lead to victory—a strategy. In the business context, the idea of strategy, therefore, suggests a big-picture perspective on the firm and its context. We call this holistic view of the organization the *strategic leader’s perspective*.

The success of a military strategy depends not only on the quality of the general’s planning and the vision behind it, but also on the execution of the strategy by the forces under the general’s command. In business settings, likewise, a strategy is of little use if it is not well-executed by line managers. In addition, the quality of a strategy is often dependent on the leader’s soliciting and utilizing the advice of other senior and midlevel leaders. In other words, a good leader can’t afford to devise a strategy in isolation from the lower-level leaders who are responsible for executing it.

The ideas of strategy need not focus exclusively on military analogies just because the root of the word is from this context. You can see ideas analogous to the difference between the general’s view and the lower-level officer’s view in sports, education, personal life, and business. The important thing about the Greek derivation of the word *strategy* is that the big-picture perspective is fundamentally different from the detail of operational tactics.

In business, strategy requires a big-picture perspective. Up to this point, most of your business courses have probably focused on important but limited aspects of business. Indeed, most business-education classes are devoted to specialized areas of study on specific functional areas, such as finance or marketing. In strategic management, however, we’re concerned with an overall, holistic view of the firm and its environment and the ways in which such a view determines the competitive decisions that businesspeople have to make. For this reason, when studying strategic management we generally take the perspective of the strategic leader. Recognize, however, that strategies often emerge from bottom-up processes and from fortuitous circumstances that the leader could not have anticipated. The strategic leader’s perspective does not mean to suggest that plans are formulated in some linear fashion by a single leader. Rather, the strategic leader’s perspective is the holistic consideration of the business and its environment rather than the myopic focus on a single functional area.

WHY STUDY STRATEGY?

You may wonder why it is important to study strategy when your career is unlikely to begin at the level of strategic leadership. From a practical standpoint, employers expect you to be functionally fluent in accounting, marketing, or some other specialization. They also expect that you will understand the “big picture”—strategic management gives you the tools to understand and describe the big picture. If strategy is the means by which an organization goes about pursuing its overarching objectives, then studying and gaining an understanding of the principles, theories, and tools of strategic management will be an important aid for you even early in your career. This course will help you in several areas critical to your career: you will be in a better position to understand your firm’s objectives (or what they should be), you will be equipped to analyze and understand how competition will interfere with attaining your objectives and what can be done to minimize these threats, you will comprehend how effective strategy formulation and implementation requires complementary

organizational resources and capabilities, and you will be able to identify which of these key factors may be missing in your organization. In addition, while the ultimate responsibility for strategy lies with senior management, the process of strategic management is one that requires the coordinated cooperation of employees at all levels of the organization. Top executives are not lone wolves when it comes to devising and implementing strategy. They rely on lower-level managers to collect and analyze data regarding competition and commercial opportunities. Consequently, the better employees understand the firm's strategy, the better they'll be able to make choices that are consistent with it. It's critical, therefore, that managers at every level understand the firm's strategy and work toward implementing its strategic initiatives.

WHAT IS STRATEGY?

The idea of "strategy" means different things to different people (and a lot of these ideas aren't particularly accurate).⁴ In fact, experts in the field have formulated various definitions of *strategy*. We've adopted the simple and direct definition; **strategy** is the coordinated means by which an organization pursues its goals and objectives.⁵ A strategy thus encompasses the pattern of actions that have been taken and those that are planned to be taken by an organization in pursuing its objectives.⁶

strategy The coordinated means by which an organization pursues its goals and objectives.

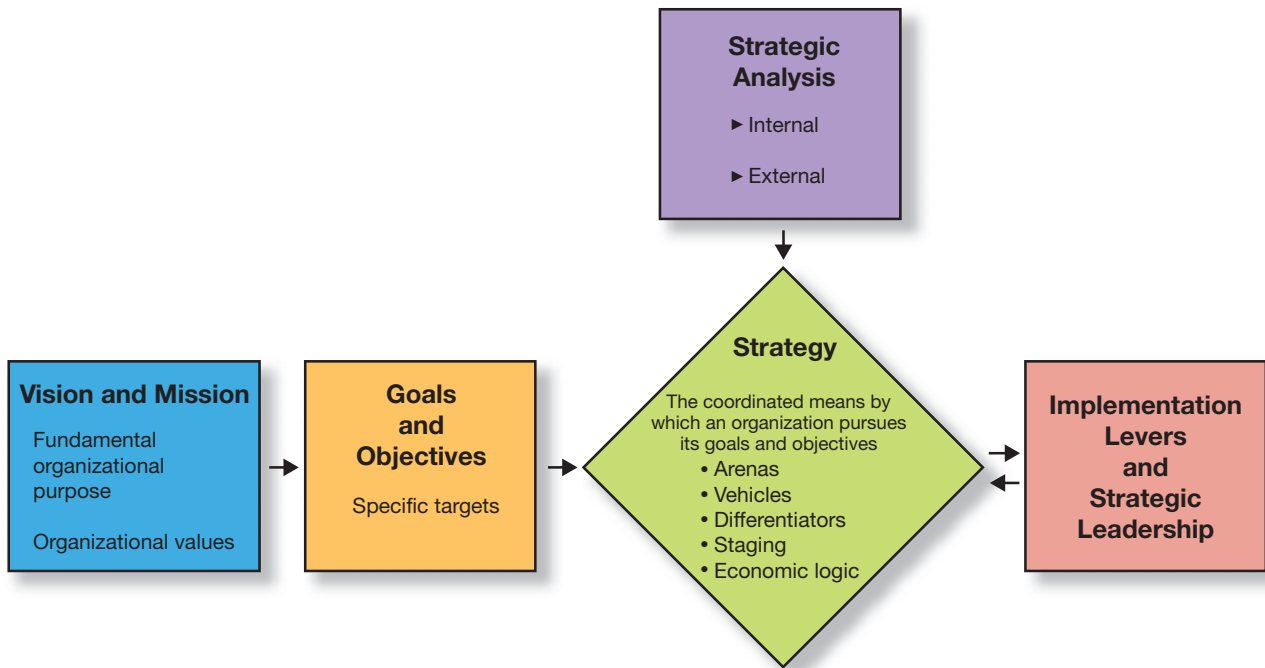
Because firms are attempting to sell products or services to potential customers, an implication of strategy in this context is that the firm is attempting to gain an advantage over other potential providers of those products and services. Virtually all firms face some level of competition. A strategy helps a firm accomplish its objectives in the face of competition. Strategy is not, however, necessarily a zero-sum game in which one firm wins and one loses. In many instances, firms cooperate in some aspects of business and compete in others.

Exhibit 1.3 outlines the strategic management process that you will be exploring and applying throughout this textbook.⁷ From the exhibit, you can see how vision, goals and objectives, internal and external analysis, and implementation levers can be used to help formulate and implement strategy. Strategy outlines the means by which a firm intends to create unique value for customers and other important stakeholders.⁸ This definition of strategy is important because, as you will see later, it forces managers to think holistically and dynamically about what the firm does and why those activities consistently lead customers to prefer the firm's products and services over those of its competitors.

BUSINESS STRATEGY VERSUS CORPORATE STRATEGY

In studying strategy, you'll find it useful to distinguish between strategic issues at the *business level* and those at the *corporate level*. Some firms are focused sharply on their *business* strategy: They compete in only one or very few industries. Other firms compete in many industries. The opening vignette on Under Armour paints a picture of a firm that has a very specific core business (athletic apparel). Some firms, such as General Electric (GE) or United Technologies, are called *conglomerates* because they're so diversified that it's difficult to pigeonhole them into any specific industry.

Consider the two largest competitors in the aircraft-engine industry. The largest is General Electric (GE), with \$11 billion in aircraft-engine sales; the second largest is Rolls-Royce PLC, with approximately \$8.4 billion in total sales. Rolls-Royce gets most of its revenue—approximately 74 percent—from this industry. (The firm no longer makes luxury cars; the operation was parceled off to BMW and Volkswagen in 1998.) In contrast, GE is involved in hundreds of businesses, including such diverse enterprises as manufacturing light bulbs, medical devices, and commercial jet engines; providing home mortgages; broadcasting (it

Exhibit 1.3 The Strategic Management Process

owns NBC); and operating self-storage facilities. It derives less than 10 percent of its revenue from aircraft engines. Within this industry, of course, both GE and Rolls-Royce face the same competitive pressures, such as determining how to compete against each other and such rivals as Pratt & Whitney (the third-largest firm in the industry). In managing its portfolio of businesses, GE faces strategic issues that are less relevant to Rolls-Royce.

Business Strategy What sort of issues are these? **Business strategy** refers to the ways a firm goes about achieving its objectives within *a particular industry or industry segment*. In other words, one of GE's business strategies would be how it pursues its objectives within the jet engine business. This strategy may encompass such things as how it competes against Rolls-Royce for contracts from Boeing and Airbus, how it cooperates with other suppliers of technology it uses in designing its engines, and the decision to ramp up scale in an effort to reduce its costs. When Under Armour managers decide how to compete with Nike for consumer dollars, they, too, are engaged in business strategy. Business strategy, therefore, focuses on *achieving a firm's objectives within a particular business line*.

Increasingly, business strategy also takes into account the changing competitive landscape in which a firm is located. Two critical questions that business strategy must address are (1) how the firm will achieve its objectives *today*, when other companies may be competing to satisfy the same customers' needs, and (2) how the firm plans to compete *in the future*. In later chapters, we'll focus specifically on issues related to business strategy.

Corporate Strategy Many firms are involved in more than one line of business. Large corporations like 3M and GE can be involved in dozens or hundreds of separate business activities. Under Armour started with a focus on men's performance apparel, but has expanded into other apparel like footwear. **Corporate strategy** addresses issues related to

business strategy Strategy for competing against rivals within a particular industry or industry segment.

corporate strategy Strategy for guiding a firm's entry and exit from different businesses, for determining how a parent company adds value to and manages its portfolio of businesses, and for creating value through diversification.

three fundamental questions associated with managing a company that operates in more than one business:

1. **In what businesses will we compete?** In the 1970s and 1980s, for instance, Sears chose to branch out of retailing into credit cards, stock brokerage, and real estate. Later, it decided that many of these moves were ill-advised and it divested most of these new businesses. GE managers address corporate-strategy questions when deciding whether the firm should enter a new business. All of the decisions about what businesses to compete in (including decisions to exit businesses) are issues of corporate strategy.
2. **How can we, as a corporate parent, add value to our various lines of business?** At GE, for instance, senior management might be able to orchestrate synergies and learning across its commercial- and consumer-finance groups, which are two separate business units. Under Armour sees an opportunity to create synergies by operating in the related businesses of performance apparel and athletic footwear. These synergies, if they are to materialize, will require the corporate office to help the business units to work in a co-operative manner. Sears once thought that it could provide one-stop shopping at retail outlets for everything from tools to life insurance. Thus, corporate strategy also deals with *finding ways to create value by having two or more owned businesses cooperate and share resources*.
3. **How will diversification or our entry into a new industry help us to compete in our other industries?** Under Armour thinks that by entering athletic footwear they may be better positioned to sell more performance apparel. In addition, because Nike operates in both markets, it puts them in a better competitive position in both industries relative to this large incumbent. Wal-Mart has found that diversification into the grocery business segment of retailing has increased retail foot traffic and boosted sales of non-grocery retail products.

Strategy Formulation and Implementation

Earlier we defined *strategy* as the means by which an organization pursues its goals and objectives. **Strategy formulation** is the process of *deciding what to do*; **strategy implementation** is the process of performing all the activities necessary *to do what has been planned*.⁹ Because neither can succeed without the other, the two processes are iterative and interdependent from the standpoint that implementation should provide information that is used to periodically modify business and corporate strategy. Our opening vignette focused mostly on Under Armour's strategy. However, as the company has grown, it found that in order to implement this strategy, it had to invest heavily in organizational structure, systems, and processes.

The Under Armour example also shows how good strategies represent solutions to complex problems. They help to solve problems *external* to the firm by enabling the production of goods or services that both beat the competition and have a ready market. They solve problems *internal* to the firm by providing all employees, including top executives, with clear guidelines as to what the firm should and should not be doing.

STRATEGY FORMULATION

So now we know that strategy formulation means deciding what to do. Some strategies result from rational and methodical planning processes based on analyses of both internal resources and capabilities and the external environment. Others emerge over time and are

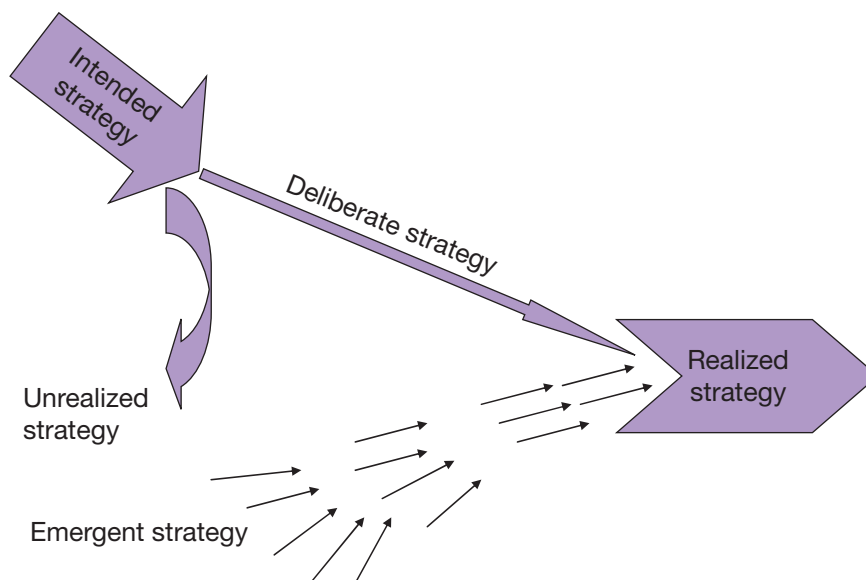
strategy formulation Process of developing a strategy.

strategy implementation Process of executing a strategy.

adopted only after an unplanned pattern of decisions or actions suggests that an unfolding idea may unexpectedly lead to an effective strategy. Sometimes the recognition of a strategically good idea is accidental or “lucky,” but corporate innovation and renewal are increasingly the products of controlled experiments and the opportunistic exploitation of surprise.¹⁰ As you can see in Exhibit 1.4, these different aspects of strategy are referred to as intended, deliberate, realized, emergent, and unrealized.¹¹ You can think of intended strategy as the initial plan, whereas the realized strategy is what actually is put in place and succeeds. Thus, parts of the realized strategy can be credited to deliberate choices and actions (i.e., intended strategies that are realized), and parts are due to unplanned ones (i.e., realized strategies that were not deliberate but nevertheless emerged). Finally, some aspect of the initial strategic plan is not realized at all, and drops by the wayside.

You can see these various aspects of intended and realized strategy through the experience of Intel. During its early years, for instance, the chipmaker Intel was consciously focused on the design and manufacture of dynamic, random-access memory chips (DRAMs), and through the 1970s and early 1980s virtually all of the firm’s revenue came from DRAMs. Intel’s participation in the DRAM market was intentional and planned virtually from the moment of its founding. By 1984, however, 95 percent of the company’s revenue came from the microprocessor segment of the industry. Ironically, Intel’s participation in this segment of the industry was not planned by senior management. Rather, it evolved from an experimental venture to make processors for Busicom, a Japanese maker of calculators.¹² Unbeknownst and unforeseen by top management was the fact that market demand was shifting dramatically from DRAMs to microprocessors. Only through the Busicom experiment—and Intel’s willingness to follow the signals this experiment sent them in terms of market-demand shifts—was the firm able to dramatically change its business strategy. To this day, Intel officials give credit for the firm’s dominance in the microprocessor market to a strategy that emerged originally from a lower-level management initiative—one that, at the time, wasn’t greeted with unanimous enthusiasm by senior management.¹³

Exhibit 1.4 Intended and Realized Strategies



You might be more familiar with Rolls-Royce's automobiles than its jet engines. The fact is, however, that Rolls-Royce PLC no longer even makes luxury automobiles. The company's core business is now jet engines. Jet engines generate 72 percent of its revenues.



Since their lucky foray into the microprocessor market, Intel managers have obviously focused on effective strategies for maintaining the firm's advantages in the segment while at the same time promoting experiments and exploiting surprises like Busicom to keep abreast of significant underlying market-demand shifts.

The Strategy Diamond and the Five Elements of Strategy Good strategy formulation means refining the elements of the strategy.¹⁴ Remember, first of all, not to confuse *part* of a strategy—for example, being a low-cost provider or first mover in an industry—for strategy itself. Being a low-cost provider or first mover may be part of a strategy, but it's not a complete strategy.

As we noted earlier, a strategy is the means by which a firm will achieve its goals and objectives. This is, of course, the *intended strategy* (referring back to Exhibit 1.4); although through this process managers have a good chance of shaping the *realized strategy* as well. In a for-profit firm, a business strategy will generally address how it will compete against its rivals and make a profit. For instance, if a firm has an objective to be one of the top two firms in a particular industry, this is a complex objective. As result, a strategy designed to pursue this objective will consist of an *integrated set of choices*. These choices can be categorized as five related elements of strategy based on decisions that managers make regarding *arenas*, *vehicles*, *differentiators*, *staging*, and *economic logic*. We refer to this constellation of elements, which are central to the strategic management process outlined in Exhibit 1.3, as the *strategy diamond*. Unfortunately, many naïve managers only focus on one or two such elements, often leaving large gaps in the overall strategy. Or, they may have all five pieces, but not understand how they need to fit together. Only when you have answers to your questions about *each of these five elements* can you determine whether your strategy is an integrated whole; you'll also have a better idea of the areas in which your strategy needs to be revised or overhauled. As Exhibit 1.5 shows, a good strategy diamond provides answers to all five questions:¹⁵

1. **Arenas.** Where will we be active?
2. **Vehicles.** How will we get there?

3. **Differentiators.** How will we win in the marketplace?
4. **Staging.** What will be our speed and sequence of moves?
5. **Economic logic.** How will we obtain our returns?

Let's take a closer look at each of these elements.

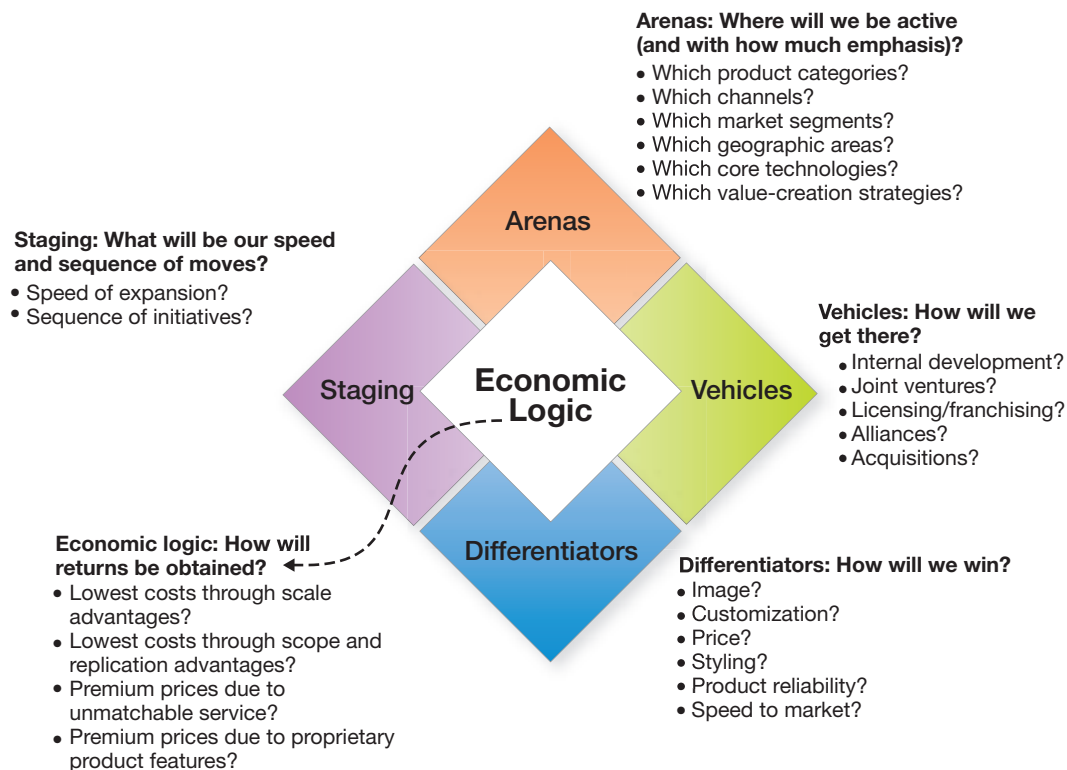
Arenas By **arenas**, we mean areas in which a firm will be active. Decisions about a firm's arenas may encompass its products, services, distribution channels, market segments, geographic areas, technologies, and even stages of the value-creation process. Unlike vision statements, which tend to be fairly general, the identification of arenas must be very specific: It will clearly tell managers what the firm should and should not do. In addition, because firms can contract with outside parties for everything from employees to manufacturing services, the choice of arenas can be fairly narrowly defined for some firms.

For example, Under Armour made the choice to compete in performance apparel for men, women, and children. Historically, their target market has been in the U.S., but they recently expanded into Europe. More recently, they also targeted users in new market segments and moved into athletic footwear. They sell their products primarily through sporting goods stores. In addition to these arena choices, Under Armour has entirely outsourced the production of its products to outside textile firms, mostly in Asia.

Vehicles Vehicles are the means for participating in targeted arenas. For instance, a firm that wants to go international can achieve that objective in different ways. Under Armour sent their own personnel to Europe to open those operations. Wal-Mart, in recent moves to

arena Area (product, service, distribution channels, geographic markets, technology, etc.) in which a firm participates.

Exhibit 1.5 The Business Strategy Diamond



enter certain international markets (such as Argentina and China), has both acquired local retail chains and opened new stores on its own in order to gain more immediate presence. Likewise, a firm that requires a new technology could develop it through investments in R&D. Or, it could opt to form an alliance with a competitor or supplier who already possesses the technology, thereby accelerating the integration of the missing piece into its set of resources and capabilities. Finally, it could simply buy another firm that owns the technology. In this case, then, the possible vehicles for entering a new arena include acquisitions, alliances, and organic investment and growth.

differentiator Feature or attribute of a company's product or service (e.g., image, customization, technical superiority, price, quality, and reliability) that helps it beat its competitors in the marketplace.

Differentiators A firm that understands why its customers regularly choose its products or services over those of competitors has identified its **differentiators**. The output of differentiators can be seen in the features and attributes of a company's products or services that help it win sales. Firms can be successful in the marketplace along a number of common dimensions, including *image*, *customization*, *technical superiority*, *price*, and *quality and reliability*. Under Armour gains sales in the marketplace through both image and technical superiority. Toyota and Honda have done very well by providing effective combinations of differentiators. They sell both inexpensive cars and cars with high-end, high-quality features, and many consumers find the value that they provide hard to match. As you will learn later in this course, while effective strategies often combine differentiators, it is important to make very specific choices about what your product or service is and what it is not. It is impossible to be all things to all consumers. It's difficult to imagine, for instance, a single product that boasts both state-of-the-art technology and the lowest price on the market. Part of the problem is perceptual—consumers often associate low quality with low price. Part of it is practical—leading-edge technologies cost money to develop and command higher prices because of their uniqueness or quality.

There are two critical factors in selecting differentiators:

- **These decisions must be made early.** Key differentiators rarely materialize without significant up-front decisions, and without valuable differentiators, firms tend to lose marketplace battles.
- **Identifying and executing successful differentiators means making tough choices—tradeoffs.** Managers who can't make tough decisions about tradeoffs often end up trying to satisfy too broad a spectrum of customer needs; as a result, they make too many strategic compromises and execute poorly on most dimensions.

Audi provides an example of a company that has aligned these two factors successfully. In the early 1990s, Audi management realized that its cars were perceived as low-quality, high-priced German automobiles—obviously a poor position from which to compete. The firm decided that it had to move one way or another—up market or down market. It had to do one of two things: (1) lower its costs so that its pricing was consistent with customers' perceptions of product quality or (2) improve quality sufficiently to justify premium pricing. Given limited resources, the firm could not go in both directions—that is, produce cars in both the low-price and high-quality strata. Audi made a decision to invest heavily in quality and image; it invested significantly in quality programs and in refining its marketing efforts. Ten years later, the quality of Audi cars has increased significantly, and customer perception has moved them much closer to the level of BMW and Mercedes. Audi has reaped the benefits of premium pricing and improved profitability, but the decisions behind the strategic up-market move entailed significant tradeoffs.¹⁶

Differentiators are what drive potential customers to choose one firm's offerings over those of competitors. The earlier and more consistent the firm is at defining and driving these differentiators, the greater the likelihood that customers will recognize them.

Staging Staging refers to the timing and pace of strategic moves. Staging choices typically reflect available resources, including cash, human capital, and knowledge. At what point, for example, should Under Armour enter specific international markets? Perhaps if the company pursues global opportunities too early, it may redirect resources that are needed to exploit its existing opportunities in the U.S. And, when it is time to expand internationally, it is critical to decide which countries they will enter first and which will come later. Furthermore, as product lines are expanded, it is critical to decide which products make the most sense to enter next, and which should be saved for a later time. For instance, there are many possible expansion moves for Under Armour in sporting goods. They have sacrificed some of these possible opportunities for the time being (e.g., running shoes) in order to focus on other activities first (e.g., football cleats). Wal-Mart explicitly decided to delay its international moves so that it could focus first on dominating the U.S. market, which is, after all, the largest retail market in the world. Despite mixed results overseas, Wal-Mart is the undisputed leader in global retailing and has recently increased its emphasis on international markets as the basis for future growth.¹⁷

Staging decisions should be driven by several factors: resources, urgency, credibility, and the need for early wins. Because few firms have the resources to do everything they'd like to do immediately, they usually have to match opportunities with available resources. In addition, not all opportunities to enter new arenas are permanent; some have only brief windows. In such cases, early wins and the credibility of certain key stakeholders may be necessary to implement a strategy.

Economic Logic Most of the firms you will study in this course are likely to be for-profit firms. As such, a key objective of these firms is to earn an economic profit. The previous four elements of strategy just reviewed (arenas, vehicles, differentiators, and staging) will only make sense for a for-profit firm to the extent that they combine to earn a profit. **Economic logic** is the fifth element of strategy and it refers to *how* the firm will earn a profit—that is, how the firm will generate positive returns over and above its cost of capital. Economic logic is the “fulcrum” for profit creation. Earning normal profits, of course, requires a firm to meet all of its fixed, variable, and financing costs, and achieving desired returns over the firm's cost of capital is a tall order for any organization. In analyzing a firm's economic logic, think of both costs and revenues. Sometimes economic logic resides primarily on the *cost* side of the equation. Southwest Airlines, for example, can fly passengers for significantly lower costs per passenger mile than any major competitor. At other times, economic logic may rest on the firm's ability to increase the customer's willingness to pay premium prices for products (in other words, prices that significantly exceed the costs of providing enhanced products).

When the five elements of strategy are aligned and mutually reinforcing, the firm is generally in a position to perform well. The discussion in the box entitled “How Would You Do That? 1.1” demonstrates how you would apply the strategy diamond to JetBlue airlines. High performance levels, however, ultimately mean that a strategy is also being executed well, and we now turn to strategy implementation. It is important to note that you can apply the strategy diamond at multiple levels—at a product level (product strategy), business level (business strategy), corporate level (corporate strategy), and global level (international strategy). The strategy diamond will become a powerful and flexible tool in your strategic management and business policy toolkit.

staging Timing and pace of strategic moves.

economic logic Means by which a firm will earn a profit by implementing a strategy.

STRATEGY IMPLEMENTATION LEVERS

Whatever the origin of a strategic idea, whether it was carefully planned from the outset or evolved over time by means of luck or experimentation, successful strategies are dependent on effective implementation. As discussed earlier in the chapter, *strategy implementation* is the process of executing the strategy—of taking the actions that put the strategy into effect and ensure that organizational decisions are consistent with it.¹⁸ The

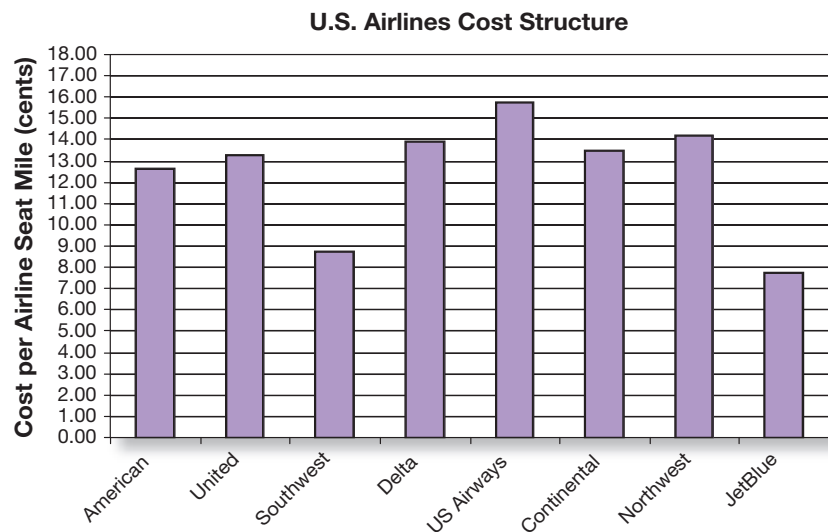
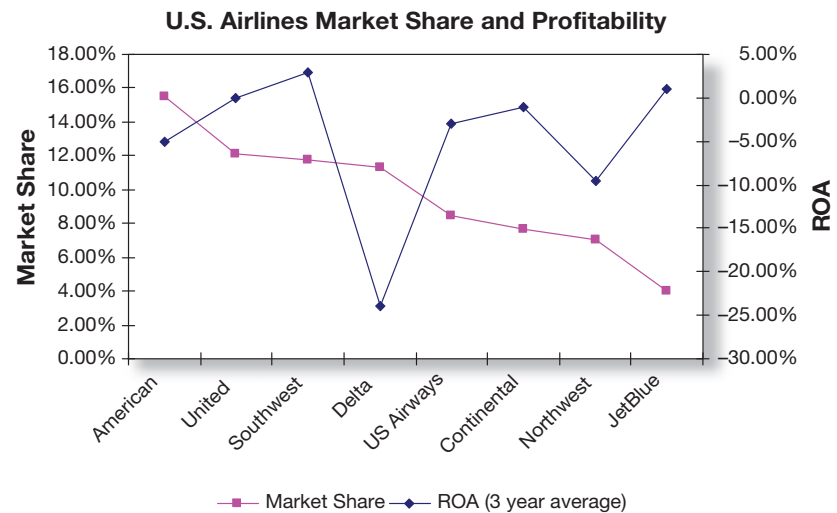


How Would YOU DO THAT? 1.1

The Five Elements of Strategy at JetBlue

To experience how you might apply the strategy diamond, let's consider a recent entrepreneurial success story. The major U.S. airlines lost over \$7 billion between 1998 and 2002. David Neeleman, however, confounded the experts when he decided that despite the industry's horrendous performance, the time was right to step down from his executive position at Southwest Airlines to launch a new airline. JetBlue took off on February 11, 2000, with an inaugural flight between New York City's John F. Kennedy International Airport and Fort Lauderdale, Florida. Today, the airline serves more than 50 cities around the country and in the Caribbean and intends to expand further. If you follow the financial fortunes of commercial airlines you will know that JetBlue has obviously done something right. As shown in Exhibit 1.6, even after suffering some recent setbacks that have severely affected profitability, it is second only to Southwest Airlines in profitability over the past three years.¹⁹ To begin applying the strategy diamond to JetBlue, let's quickly review JetBlue's vision, which is to "bring humanity back to air travel" through product innovation and excellent service. It intends to be a low-fare, low-cost passenger airline that provides high-quality customer service. Using the strategy diamond, and public documents posted at www.jetblue.com, we can determine what strategy JetBlue has pursued in order to meet its stated objective.

Exhibit 1.6 Performance of JetBlue



- **In what arenas does JetBlue compete?** Management states that the company competes as a low-fare commercial air carrier, and caters to underserved but overpriced U.S. cities. Its main base of operations is John F. Kennedy airport in New York City, which serves the largest travel market in the country.
- **What vehicles does JetBlue use to enter the arenas in which it competes?** JetBlue started from scratch and has achieved all of its growth in flights per day through internal growth. The firm could have grown by purchasing regional airlines, but chose not to.
- **What are its differentiators?** Price is a big part of JetBlue's strategy for winning new customers, but it also wants to develop the image that it is a low-fare airline with high-quality service. Although it offers only one class of service, the level of service is rather high for a low-fare airline. For instance, it offers leather seating and individual in-seat live satellite TV. Thus, JetBlue states that it aims to create a new segment in airline travel based on value, service, and style.
- **How does JetBlue's staging—the speed of its expansion and the sequence of its growth initiatives—reflect its timetable for achieving its objectives?** JetBlue has grown from 1 route between 2 cities to routes that serve more than 50 cities in just 7 years. At first, it limited itself to the East Coast (between its JFK home base and destinations in Florida and upstate New York), but it soon proceeded westward, establishing locations in the west. Expansion in the east has filled in many more cities, and destinations in the Caribbean were also added. JetBlue has targeted more cities for future expansion.
- **What's the economic logic of JetBlue's strategy?** JetBlue's income statements show that its



When former Southwest Airlines employee and JetBlue founder David Neeleman (shown vacuuming a plane) announced that he was launching a new airline company, people were aghast. Although the airline industry as a whole is losing money, JetBlue has found a way to prosper by effectively aligning the five elements of its strategy that is both internally consistent, and externally generates great market demand. The strategy includes low-fare but upscale service, complete with leather seats and satellite TV.

costs are significantly lower than industry averages. Indeed, in 2006 JetBlue had the lowest costs per airline seat mile of any major airline (with Southwest a close second). These cost advantages appear to come from an *ability to perform key tasks in ways that are fundamentally less expensive* than those of competitors. By flying only one make of aircraft that is relatively fuel efficient, JetBlue also keeps maintenance and training costs down. By securing a home base at JFK at a time when the New York Port Authority was anxious to attract more air traffic, JetBlue secured lower airport fees. Locating in secondary locations (Long Beach instead of Los Angeles International Airport, Fort Lauderdale instead of Miami) also means lower-than-average airport fees. On the revenue side, although JetBlue offers very low fares, it wins customers from competitors and uses its low-cost incentive as a means to convert non-fliers to JetBlue customers. It has also attracted customers by

concentrating on underserved, high-priced routes. As a result, it now boasts the highest load factor of any major airline.

As you can see in Exhibit 1.7, walking through JetBlue's strategy diamond helps illustrate its strategy. The plan looks sound, but what is required to implement such a plan? The next sections of this chapter provide an overview of this critical issue.

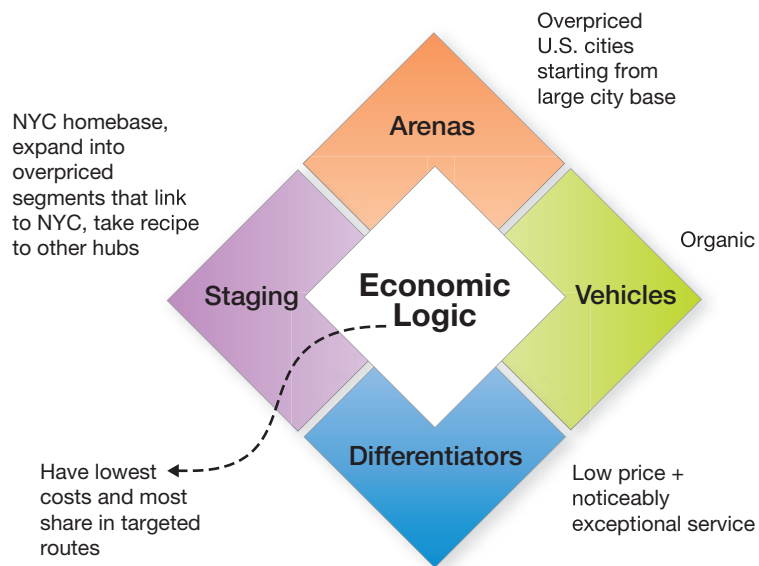


Exhibit 1.7 The Strategy Diamond for JetBlue

Sources: JetBlue Airways Corp., 2002–2006 Annual Reports on Form 10-K, included on the "Investor Relations" link on JetBlue's Web page.

process of implementation also encompasses the refinement, or change, of a strategy as more information is made available through early implementation efforts. The goal of implementation is twofold:

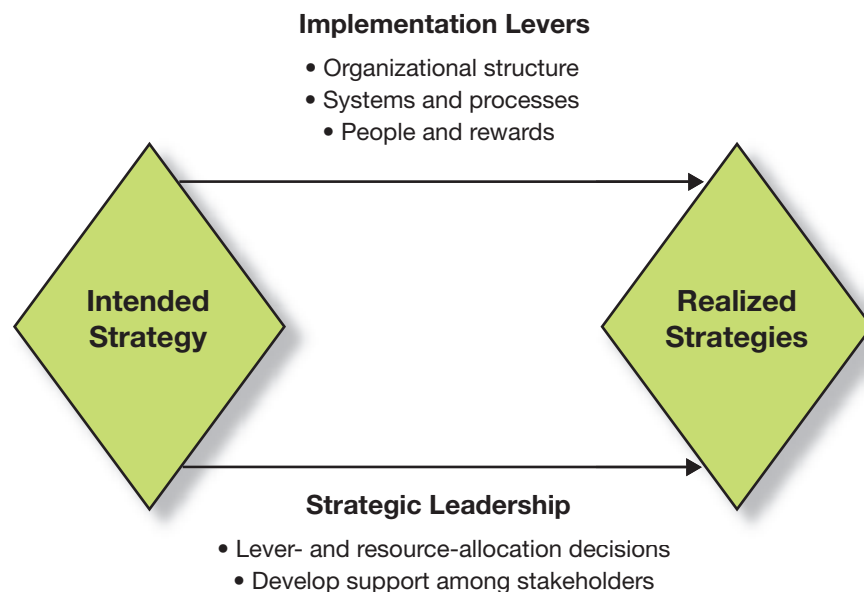
- To make sure that strategy formulation is comprehensive and well informed
- To translate good ideas into actions that can be executed (and sometimes to use execution to generate or identify good ideas)

In sports, a coach's play-calling is only as good as the excellence with which the players execute it. Likewise in business: The value of a firm's strategy is determined by its ability to carry it out. "Any strategy," says Michael Porter, one of the preeminent writers on the subject, "... is only as good as its execution."²⁰ Adds Peter Drucker, one of our most prolific writers on management: "The important decisions, the decisions that really matter, are strategic. ... [But] more important and more difficult is to make effective the course of action decided upon."²¹

Strategy implementation is usually studied in business school graduate courses, and it's the subject of hundreds of books in business school libraries. We don't intend to supplant the results of all of this study, but we do want you to focus on the implications of a very basic fact: *The processes of strategy formulation and strategy implementation are inextricably linked.* The five elements of strategy, for instance, are related to both formulation and implementation. Good implementation means that an organization coordinates resources and capabilities and uses structure, systems, processes, and strategic leadership to translate a deliberate strategy into a realized strategy and to positive bottom-line results. Throughout the text we help you to see the relationship between formulation and implementation. Chapter 2 introduces you to the role of strategic leadership, and Chapter 11 drills down much deeper into our implementation framework. At this point, and in order to help you consider the complexity of implementing a strategy, we introduce you to just the basic ideas of strategic leadership and implementation.

To implement strategies, organization leaders have numerous levers at their disposal. The framework summarizing these levers is shown in Exhibit 1.8.²² We categorize these levers into three broad categories: (1) *organization structure*, (2) *systems and processes*, and (3) *people and rewards*. The strategist uses these tools to test for alignment, which is the need for all of the firm's activities to complement each other and support the strategy.

Exhibit 1.8
Implementation Framework



In addition, strategic leadership engages in a few activities related to implementing the strategy that are unique to their positional authority. As the exhibit suggests, implementation includes the activities carried out by the organization that are aimed at executing a particular strategy. Often, the strategy that is realized through these implementation efforts are somewhat different from the original plan. Ideally, these deviations from the original plan are a result of explicit alterations of the strategy that result from feedback during early implementation efforts as well as from the exploitation of serendipitous opportunities that were not anticipated when the strategy was formulated.

Organization Structure Structure is the manner in which responsibilities, tasks, and people are organized. It includes the organization's authority, hierarchy, units, divisions, and coordinating mechanisms. At this point, we just need to remind ourselves of a few key questions that managers must consider when implementing a strategy:

- Is the current structure appropriate for the intended strategy?
- Are reporting relationships and the delegation of authority set up to execute the strategic plan?
- Is the organization too centralized (or decentralized) for the strategy?

Systems and Processes Systems are all the organizational processes and procedures used in daily operations. Obviously, these include control and incentive systems, resource-allocation procedures, information systems, budgeting, distribution, and so forth.

People and Rewards The *people and rewards* lever of the model underscores the importance of using all of the organization's members to implement a strategy. Regardless of your strategy, at the end of the day, it's your people who will have implemented it. Competitive advantage is generally tied to your human resources.²³ Successful implementation depends on having the right people and then developing and training them in ways that support the firm's strategy. In addition, rewards—how you pay your people—can accelerate the implementation of your strategy or undermine it. We have all seen instances in which unintended consequences happen because a manager rewards “A” while hoping for “B.”²⁴

STRATEGIC LEADERSHIP

Strategic leadership plays two critical roles in successful strategy implementation, and it is important to highlight them here so that you can incorporate them into your own assessment of a strategy's feasibility as well as ensure that you include these roles in your implementation plans. Specifically, as will be discussed in greater detail in Chapter 11, strategic leadership is responsible for (1) making substantive implementation lever and resource-allocation decisions and (2) developing support for the strategy from key stakeholders. Kevin Plank at Under Armour obviously spends a lot of time deciding what needs to be done, such as which new products to launch next, which markets to enter, and which suppliers and distributors to use. However, he also spends a significant amount of time talking to analysts at large U.S. brokerage firms, mutual funds, and pension funds. Why? Because he must keep these key financial stakeholders and shareholders abreast of what Under Armour is doing so that they retain confidence in the firm.

A successful strategy is not generally formulated just by a single person or a small group of leaders. Strategic leadership requires involving the right people in critical decisions because key information may be widely dispersed within the firm. In addition, successful strategy implementation requires active leadership to ensure that what emerges and what is realized are desirable and that needed changes of course are detected before it is too late.

What Is Competitive Advantage?

Earlier we defined *strategy* as the means by which a firm will achieve its objectives. We noted that within a firm's business operations, its objectives will generally encompass some notion of being successful at selling products or services to customers. Because virtually all firms face competition when trying to serve these customers, to achieve its objectives, a firm will have to be perceived by at least some customers as superior to its competition. Thus, the concept of strategy suggests a relationship between strategy on the one hand and performance and competitive advantage on the other. Specifically, we explained that a strategy encompasses the pattern of actions taken by a firm to achieve its objectives. These premises lead us to a logical conclusion: The activities of strategic management are based on the assumption that *firms attempt to achieve a position of competitive advantage over their rivals when serving target customers.*²⁵ Or, to put it another way: Firms prefer to be winners in their respective industries rather than subpar or even average performers. This leads us to define **competitive advantage** as a firm's ability to create *value* in a way that its rivals cannot.

competitive advantage A firm's ability to create value in a way that its rivals cannot

Performance itself, however, is not competitive advantage; it's merely a result of it. A firm may achieve relatively high short-term performance levels without gaining any substantial advantage over its rivals. Maybe the company just had an unusually good year or took drastic measures to cut costs (perhaps to unsustainably low levels). By the same token, a firm may enjoy significant competitive advantage in some lines of business but still perform more poorly than its competitors because of other underperforming business units or because it chooses to keep prices lower than its competitive position would otherwise allow. For instance, a firm with a competitive advantage may desire to gain additional market share. Alternatively, it may keep prices lower than its competitive position would otherwise allow to avoid regulators' or competitors' attention.

The question that we now want to answer is: *Why are some firms able to achieve greater advantages over rivals than other firms?* All firms are not alike. For many years, Dell, for example, seemed to have some capabilities that other computer manufacturers, such as Hewlett-Packard and IBM, were unable to duplicate. Thus, for many years Dell sustained a competitive advantage which only recently may have been neutralized by Hewlett-Packard and IBM. Toyota enjoys a similar advantage in the automotive industry. In some industries, we see new entrants quickly out maneuver incumbents. For instance, why has Under Armour been able to enter an industry with some very formidable incumbents and still be able to earn very good profits? Most industries are *not* accurately characterized by the theoretical condition of perfect competition that you likely learned about in micro economics (i.e., in perfect competition firms can only earn "normal" profits because super normal profits will attract new entrant and this additional competition will drive profits down). In reality, many industries have one or more companies that earn more than "normal" profits for many years. In addition, some firms appear to outperform competitors consistently, which is likely an indication that they have some form of competitive advantage over their rivals. As we will see, however, it's become increasingly difficult for any one firm to sustain a competitive advantage over a long period of time.²⁶

DETERMINANTS OF COMPETITIVE ADVANTAGE

The field of strategic management focuses on explanations for competitive advantage—on the reasons why companies experience above- and below-normal rates of returns. In other words, strategic management offers theories and models that help us understand why some firms perform better than others, and more to the point, offers managers tools to help their

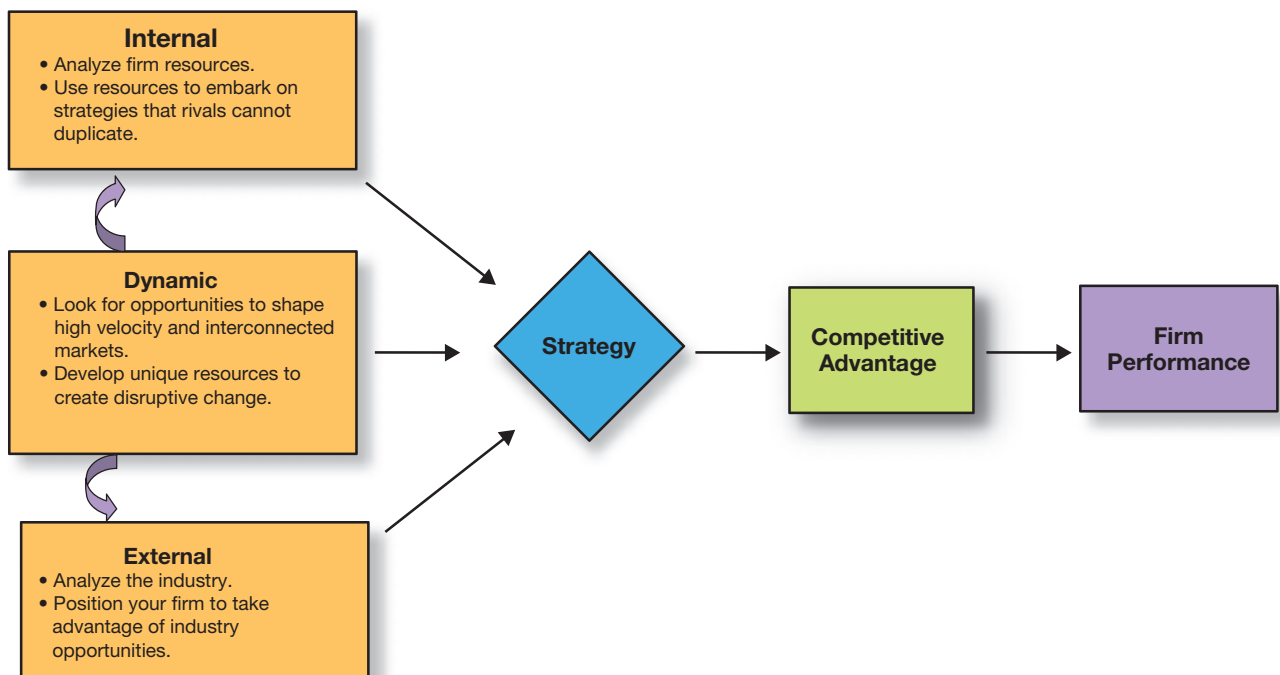
firm obtain a competitive advantage and perform better than the competition. Generally speaking, as summarized in Exhibit 1.9, there are three primary perspectives on this issue (perspectives that, as we shall see, reflect contrasting but complementary points of view):

- The *internal perspective* focuses on resources and capabilities as internal sources of uniqueness that allow firms to beat the competition.
- The *external perspective* focuses on the structure of industries and the ways in which firms can position themselves within them for competitive advantage.
- The *dynamic perspective*, which bridges the internal and external perspectives, is a third view of competitive advantage. This view helps explain why competitive advantages do not typically last over long periods of time.

Let's examine each of these perspectives, or theories, more closely.

The Internal Perspective The first of the two fundamental perspectives on competitive advantage is an internal one. It is often called the *resource-based view of the firm*. This perspective suggests that no two firms are identical because they possess resources and capabilities of different qualities. The advantage goes to the firms with superior resources and capabilities. Proponents of this theory argue that a firm gains an advantage by obtaining valuable and rare resources and developing the capability to utilize these resources to drive customers toward their products and services at the expense of competitors. As a result, firms with superior resources and capabilities enjoy competitive advantage over other firms.²⁷ This advantage makes it relatively easier for these firms to achieve consistently higher levels of performance than competitors. Competitive advantage, therefore, arises when a company's resources allow its products, services, or businesses to compete

Exhibit 1.9 Three Perspectives on Competitive Advantage



successfully against rival firms in the same industries. According to this perspective, the objective for managers is to determine what resources and capabilities offer the most potential value, to acquire them if they are lacking, and then to leverage those specific resources in executing the firm's strategy. The resource-based view also holds that a firm's bundle of resources may either hinder or help its entry into new businesses—an idea that we'll explore further in later chapters.²⁸

The External Perspective The second fundamental perspective on competitive advantage contends that variations in firms' competitive advantage and performance are primarily a function of industry attractiveness and the *position* of firms within the industry relative to competitors. Thus, this external perspective suggests that competitive advantage comes from a firm's positioning within the competitive business environment.

The seminal work supporting this approach is Michael Porter's work on competitive strategy.²⁹ Porter's theory—sometimes called *industrial organization economics* (I/O economics)—suggests that firms should do one of two things: (1) position themselves to compete in attractive industries or (2) adopt strategies that will make their current industries more attractive. In some countries, for instance, carmakers lobby for import tariffs in order to make their domestic markets more attractive. When the strategy works, the access of foreign manufacturers to the market is limited, and the cost of participating in it is higher. (In later chapters, we'll explore in more detail the theoretical models and tools that help managers analyze, understand, and shape a firm's competitive environments.)

The Dynamic Perspective In addition, the two fundamental perspectives that focus on internal and external determinants of competitive advantage, some industries or market segments are less stable than others. Not surprisingly, competitive advantage is more likely to endure in stable markets than in unstable ones. Conversely, the competitive advantage held by one firm over another tends to change very slowly in stable markets but more quickly in unstable ones. As a result of current or possible future changes in the competitive environment, strategies need to be dynamic in nature. The greater the degree of change in the environment, the greater will need be the dynamism of the strategy.

The global chocolate industry, for example, is a relatively stable environment because a few firms—notably, M&M/Mars, Nestlé, and Hershey—dominate it in terms of both size and brands. In addition, demand for chocolate is relatively stable, growing with population growth. To stimulate growth, large companies try to formulate new candy bars. However, this type of growth is rather incremental and predictable. Smaller companies carve out niches in which to offer differentiated products, but this generally does not result in any significant upheaval of market position. In such stable contexts, fundamental theories of competitive advantage usually explain most economic facts. The external (or positional) view of strategy tends to dominate questions of strategy formulation and implementation. Why? Because a firm's current market position, as gauged by market share or some other criterion, may be a good indicator of competitive advantage and provides a relatively accurate predictor of future performance. This view also tends to assume that industries are clearly defined, that competition is predictable, and that the future doesn't hold many surprises.

But what about dynamic industries—such as computer chips or laser printers or medical products—in which it seems that competitive advantage can shift in a matter of months or even days simply because of a new product release or some other technological breakthrough?³⁰ A so-called *dynamic perspective* on competitive advantage has become increasingly important in explaining the economic facts in such industries in which markets converge, technologies rapidly change competitive conditions, capital markets become increasingly impatient, firms compete in multiple markets and multiple industries against common rivals, and the costs of establishing a competitive position soar (and so increase

dramatically the cost of failure). The dynamic perspective suggests that a firm's current market position or competitive advantage is *not* an accurate predictor of future performance or sustainable competitive advantage. Why not? Because current market position itself is not a competitive advantage, but rather an outcome of past competitive activities. Consequently, as the competitive environment changes, new leaders may be past leaders, new entrants, or prior incumbents who are better positioned for the future state of the industry. From the dynamic perspective, we look to the past for clues about how the firm arrived at its current position and to the future in an effort to predict the look of the new competitive landscape.

The External Dimension of the Dynamic Perspective Of course, the dynamic strategy perspective has both external and internal dimensions as well. On the external side, it's useful in analyzing “high-velocity” markets—markets that are changing rapidly and unpredictably.³¹ Often, such changes result from technology. For instance, the personal music player market has seen tremendous upheaval in the status quo as digital formats replaced analog devices. However, as we noted earlier, there are usually several contributing factors. The dynamic perspective is also a good tool for examining industries characterized by *multimarket competition*—those in which firms tend to encounter the same rivals in multiple markets.³² Goodyear, Michelin, and Bridgestone, for instance, compete head-to-head in tire markets around the world. Another form of multimarket competition is illustrated by Nestlé and Mars; these companies battle it out in global industries ranging from pet foods to snack foods and will often use resources from one industry to bolster competitive position in another—say, by offering retailer discounts on pet food in exchange for shelf space for snack foods. For instance, Procter & Gamble's entry into Vietnam appears to be less driven by the profit motive (P&G tends to lose money on Vietnamese soap sales) than by a determination to keep rival Unilever in check. If P&G had not entered the Vietnamese market, Unilever could have reaped monopoly-like profits and proceeded to use the windfall to pay for competitive efforts against P&G in other markets. By competing with Unilever in a market in which it has no competitive advantage (and may not even seek one), P&G's strategy reduces Unilever's ability to wage war on other fronts.

The Internal Dimension of the Dynamic Perspective The dynamic perspective can also help us to focus on a firm's resources and capabilities, particularly those that lead to a *continuous flow* of advantages in resources or market position and those that strengthen the firm's ability to embrace (and even foster) continuous and sometimes disruptive *change*. Risk taking, experimentation, improvisation, and continuous learning are—at least from the dynamic perspective—key features of successful firms. Later in the text, we will explore several relevant analytical tools for shaping strategy formulation. You'll also learn how to combine your analysis of an industry's cumulative technological development with your assessment of whether a firm can exploit an innovative product or disruptive technology through its entire life cycle or whether it must instead leap from product to product at strategically defined crossover points.

As suggested by our opening vignette on Under Armour, note that the dynamic perspective also provides valuable insight into the formulation and implementation of strategies at firms competing in ostensibly stable markets and industries. Few observers classified the men's athletic apparel market as a dynamic industry. While there were many competitors in various segments, Nike was viewed as the Goliath of the industry that led much of the innovation of new products. Under Armour entered the industry with an innovative product targeted at an underserved market. Under Armour's compression performance wear products were able to generate significant price premiums over incumbents' products (remember, \$25 to \$35 for a T-shirt). Yet, while the creation and design of the concept was proprietary to Under Armour, they used off-the-shelf technology from third-party suppliers. Consequently, in

order to successfully enter and capitalize on his idea, Kevin Plank needed to be able to marshal organizational resources to implement his plan and gain market share before he awoke the giant incumbents. By the time Under Armour appeared on Nike's and adidas' radar, it had already created and was in position to defend a rather dominant position in the performance apparel segment. You will find the same theme in stories about Amazon.com versus Barnes & Noble and U.S. mini-mills versus major steel producers.³³

Summary of Challenges

1. Understand what strategy is and identify the difference between business-level and corporate-level strategy. *Strategic management* is the process by which a firm manages the formulation and implementation of its strategy. A *strategy* is the central, integrated, externally oriented concept of how a firm will achieve its objectives. Strategies typically take one of two forms: business strategy or corporate strategy. The objective of a business strategy is to spell out how the firm plans to compete. This plan integrates choices regarding arenas (where the firm will be active), vehicles (how it will get there), differentiators (how it will win), staging (the speed and sequence of its moves), and economic logic (how it obtains its returns). The objective of corporate strategy is to spell out which businesses a firm will compete in, how ownership by the corporate parent adds value to the business, and how this particular diversification approach helps each business compete in its respective markets.

2. Understand why we study strategic management. It should be clear to you by now that strategic management is concerned with firm performance. Strategic management holds clues as to why firms survive when performance suffers. Strategy helps you to understand which activities are important and why and how a plan, absent good execution, is perhaps only as valuable as the paper it's printed on.

3. Understand the relationship between strategy formulation and implementation. *Strategy formulation* is the determination of what the firm is going to do; *strategy implementation* is how the firm goes about doing it. These two facets of strategy are linked and interdependent. This interdependence is made strikingly clear by the strategic management process (Exhibit 1.3) you are introduced to in this chapter, examples throughout the text, and the specific treatment of implementation levers in Chapter 11.

4. Describe the determinants of competitive advantage. Competitive advantage is realized when one firm creates value in ways that its competitors cannot, such that the firm clearly performs better than its competitors. Advantage is not simply higher relative performance; rather, superior performance signals the ability of a firm to do things in ways its direct competitors cannot. The two primary views of competitive advantage—internal and external—are complementary and together are used to help formulate effective strategies. The internal view portrays competitive advantage to be a function of unique, firm-specific resources and capabilities. The external view holds that a firm's performance is largely a function of its position in a particular industry or industry segment given the overall structure of the industry. Profitable industries are considered attractive, and therefore, high firm performance is attributed to a firm's position in the industry relative to the characteristics of the industry or industry segment.

5. Recognize the difference between the fundamental and dynamic views of competitive advantage. The two fundamental views of competitive advantage are characterized by a largely internal or external orientation toward competitive advantage, research shows that few firms persist in their dominance over competitors over prolonged periods of time. For most firms, therefore, competitive advantage is considered to be temporary. The dynamic perspective assumes that a firm's current market position is not an accurate predictor of future performance because position itself is not a competitive advantage. Instead, the dynamic perspective looks at the past for clues about how the firm arrived at its present position and to the future to divine what the new competitive landscape might look like. It also holds that it's possible for the firm to influence the future state of the competitive landscape.

Review Questions

1. What is strategic management?
2. What are the key components of the strategic management process?
3. How does business strategy differ from corporate strategy?
4. What is the relationship between strategy formulation and strategy implementation?
5. What five elements comprise the strategy formulation diamond?
6. What are the internal and external perspectives of competitive advantage?
7. What are the fundamental and dynamic perspectives of competitive advantage?
8. Why should you study strategic management?

Experiential Activities

Group Exercises

1. Identify the characteristics of a firm that the members of your group would like to work for and try to identify an example of this type of firm. What's the difference between business and corporate strategy at this firm? How might that affect your experiences and opportunities in that organization? Use your knowledge of the firm's strategy to construct a high-impact job application cover letter to apply for a job with this firm.
2. How is international expansion related to business and corporate strategy? Identify a firm that may be thinking of expanding into new international markets. Apply the staging element of the strategy diamond to the firm's international expansion opportunities or plans. Which markets should it target first and why?

Ethical Debates

1. Should ethics be a formal and explicit part of strategy formulation and implementation? What would you do to achieve this type of objective?
2. For many of the firms you will study in this class, competitive advantage is measured by some form of financial profitability. How should you evaluate ethical choices in terms of accounting costs and benefits?

How Would YOU DO THAT?

1. Go to Warren Buffet's *Letter to Shareholder's* page at www.berkshirehathaway.com/letters/letters.html and read the most recent letter. How many of the strategy topics covered in this chapter are referenced in the letter? Pick one of the businesses owned by Berkshire Hathaway and draft a strategy formulation diamond similar to the one outlined in the JetBlue example in the box entitled "How Would You Do That? 1.1."
2. Go back to the discussion of JetBlue in the box entitled "How Would You Do That? 1.1." Use the strategy implementation

model in Exhibit 1.8 to identify what would be necessary to successfully implement JetBlue's strategy. How would the implementation levers be different for JetBlue than for some of the major airlines?

Go on to see *How Would You Do That* at www.prenhall.com/carpenter&sanders

Endnotes

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