chapter 1 lecture notes

What Is Strategy and Why Is It Important?

Chapter Summary

Chapter 1 defines the concept of strategy and describes its many facets. The chapter explains what is meant by a competitive advantage, discusses the relationship between a company's strategy and its business model, and introduces the student to the kinds of competitive strategies that can give a company an advantage over rivals in attracting customers and earning above-average profits. The chapter examines what sets a winning strategy apart from others and why the caliber of a company's strategy determines whether it will enjoy a competitive advantage over other firms or be burdened by competitive disadvantage. By the end of this chapter, the student will have a clear idea of why the tasks of crafting and executing strategy are core management functions and why excellent execution of an excellent strategy is the most reliable recipe for turning a company into a standout performer over the long term.

Lecture Outline

I. Introduction

Chapter one explores the fundamental concepts surrounding organizational strategy. It begins with an explanation of the term strategy and discusses why companies need a distinctive strategy in order to compete successfully. Next, it explores why a company must have a viable business model and the five most dependable strategic approaches for setting a company apart. The chapter wraps up with an illustration of how a company's strategy tends to evolve over time due to changing business conditions and the three tests for winning strategies.

II. What Do We Mean by Strategy?

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Consider adding a LearnSmart assignment requiring the student to review this section of the chapter as an interactive question and answer review. The assignment can be graded and posted automatically.

1. A company's **strategy** is the coordinated set of actions that its managers take in order to outperform the company's competitors and achieve superior profitability. In effect, it represents a managerial commitment to an integrated array of considered choices about how to compete.

2. Normally, companies have a wide degree of strategic freedom in choosing the "hows" of strategy:

   - How to position the company in the marketplace.
   - How to attract customers.
   - How to compete against rivals.
   - How to achieve the company's performance targets.

- How to capitalize on opportunities to grow the business.
- How to respond to changing economic and market conditions.

CORE CONCEPT

A company's **strategy** is the coordinated set of actions that its managers take in order to outperform the company's competitors and achieve superior profitability.

3. **Strategy Is about Competing Differently**—A strategy stands a better chance of succeeding when it is predicated on actions, business approaches, and competitive moves aimed at:

   a. appealing to buyers in ways that set a company apart from its rivals and

   b. staking out a market position that is not crowded with strong competitors.

4. **Figure 1.1—Identifying a Company's Strategy—What to Look For**, shows what to look for in identifying the substance of a company's overall strategy. These are the visible actions taken that signal what strategy the company is pursuing.

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Consider adding a File Attachment assignment requiring the student to develop a response to this Illustration Capsule. You can post instructions for the student within the assignment and collect their attachments for grading.

III. Strategy and the Quest for Competitive Advantage

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Consider adding a LearnSmart assignment requiring the student to review this section of the chapter as an interactive question and answer review. The assignment can be graded and posted automatically.

1. The heart and soul of any strategy is the actions and moves in the market place that managers are taking to improve the company's financial performance, strengthen its long-term competitive position, and gain a competitive edge over rivals.

2. A company achieves a competitive advantage whenever it has some type of edge over rivals in attracting buyers and coping with competitive forces.

3. Strategy is about competing differently from rivals or doing what competitors don't do or, even better, can't do. In this sense, every strategy needs a distinctive element that attracts customers and produces a competitive edge.

4. What makes a competitive advantage **sustainable** (or durable), as opposed to temporary, are elements of the strategy that give buyers lasting reasons to prefer a company's products or services over those of competitors

CORE CONCEPT

A company achieves a **competitive advantage** when it provides buyers with superior value compared to rival sellers or offers the same value at a lower cost to the firm. The advantage is **sustainable** if it persists despite the best efforts of competitors to match or surpass this advantage.

5. Five of the most frequently used strategic approaches to setting a company apart from rivals and achieving a sustainable competitive advantage are:

   a. Low Cost Provider—Achieving a cost-based advantage over rivals.

   b. Broad Differentiation—Seeking to differentiate the company's product or service from rivals' in ways that will appeal to a broad spectrum of buyers.

   c. Focused Low Cost—Concentrating on a narrow buyer segment (or market niche) and outcompeting rivals by having lower costs than rivals and thus being able to serve niche members at a lower priced.

   d. Focused Differentiation—Concentrating on a narrow buyer segment (or market niche) and outcompeting rivals by offering niche members customized attributes that meet their tastes and requirements better than rivals' products.

   e. Best Cost Provider—Giving customers more value for the money by satisfying buyers' expectations on key quality/features/performance/service attributes, while beating their price expectations.

ILLUSTRATION CAPSULE 1.1

Apple Inc.: Exemplifying a Successful Strategy

Discussion Question: Describe Apple's strategic approach in the computer industry

Answer: The student should be able to discuss that Apple uses a Focused Differentiation strategic approach. The company focuses on the upper end of the computer buyer market and offers a premium product. The company designs its own operating system, hardware, and application software through continuous investments in R&D. These higher cost approaches to the market place are offset by premium pricing that the niche market can support.

IV. Why a Company's Strategy Evolves over Time

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Consider adding a LearnSmart assignment requiring the student to review this section of the chapter as an interactive question and answer review. The assignment can be graded and posted automatically.

1. Every company must be willing and ready to modify the strategy in response to changing market conditions, advancing technology, unexpected moves by competitors, shifting buyer needs, emerging market opportunities, and mounting evidence that the strategy is not working well.

2. Most of the time, a company's strategy evolves incrementally from management's ongoing efforts to fine-tune the strategy and to adjust certain strategy elements in response to new learning and unfolding events.

3. Industry environments characterized by high velocity change require companies to repeatedly adapt their strategies.

4 The important point is that the task of crafting strategy is not a one-time event but always a work in progress.

V. A Company's Strategy Is Partly Proactive and Partly Reactive

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Consider adding a LearnSmart assignment requiring the student to review this section of the chapter as an interactive question and answer review. The assignment can be graded and posted automatically.

1. The evolving nature of a company's strategy means that the typical company strategy is a blend of (1) *proactive,* planned initiatives to improve the company's financial performance and secure a competitive edge, and (2) *reactive* responses to unanticipated developments and fresh market conditions.

CORE CONCEPT

A company's **deliberate strategy** consists of *proactive* strategy elements that are both planned and realized as planned; its **emergent strategy** consists of *reactive* strategy elements that emerge as changing conditions warrant.

2. The biggest portion of a company's current strategy flows from ongoing actions that have proven themselves in the marketplace and newly launched initiatives aimed at building a larger lead over rivals and further boosting financial performance.—Deliberate Strategy
3. Managers must always be willing to supplement or modify the proactive strategy elements with as-needed reactions to unanticipated conditions.—Emergent Strategy
4. In total, these two elements combine to form the company's Realized Strategy. **Figure 1.2, A Company's Strategy is a Blend of Proactive Initiatives and Reactive Adjustments,** illustrates the elements of strategy that become the Realized Strategy.

VI. Strategy and Ethics: Passing the Test of Moral Scrutiny

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Consider adding a LearnSmart assignment requiring the student to review this section of the chapter as an interactive question and answer review. The assignment can be graded and posted automatically.

1. Managers must be careful to embrace actions that can pass the test of moral scrutiny. This goes beyond just staying within the bounds of what is legal.
2. Ethical and moral standards are not fully governed by what is legal, they are concerned with right vs. wrong and a sense of duty.
3. While the legal realm deals with must or must not, the ethical/ moral realm deals with should or should not.
4. Senior executives with strong ethical convictions are generally proactive in linking strategic action and ethics.

VII. What Makes a Strategy a Winner?

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Consider adding a LearnSmart assignment requiring the student to review this section of the chapter as an interactive question and answer review. The assignment can be graded and posted automatically.

CORE CONCEPT

A company's **business model** sets forth the logic for how its strategy will create value for customers, while at the same time generate revenues sufficient to cover costs and realize a profit.

1. A business model is management's blueprint for delivering a valuable product or service to customers in a manner that will generate revenues sufficient to cover costs and yield an attractive profit.
2. The two elements of a company's business model are (1) its customer value proposition and (2) its profit formula.
3. The customer value proposition lays out the company's approach to satisfying buyer wants and needs at a price customers will consider a good value.
4. The profit formula describes the company's approach to determining a cost structure that will allow for acceptable profits, given the pricing tied to its customer value proposition.
5. Figure 1.3 illustrates the elements of the business model in terms of what is known as the Value-Price-Cost Framework highlighting the relationship between the Customer's Value Proposition (V-P) and the Profit Formula (P-C).

ILLUSTRATION CAPSULE 1.2

Pandora, Sirius XM, and Over-the-Air Broadcast Radio: Three Contrasting Business Models

Discussion Question 1: What is the prominent difference between the business models of these three organizations?

Answer: While all three provide essentially the same type of entertainment service, the business models employed by Pandora, Sirius XM, and Over-The-Air Broadcast Radio are completely different. In the area of value proposition (what the customer sees), Sirius XM provides commercial free entertainment with some local content based upon a monthly fee, while Broadcast Radio provides entertainment with some local content with interruptions for commercials without a fee. Pandora bridges these two methods. In one mode it operates more like Over-the-Air Broadcast Radio in that it provides entertainment without a fee that includes targeted advertisements, with the added benefit of allowing the listener to customize the music mix. In the other mode, listeners can elect to go ad-free for a fee using Pandora One.

For profit, Sirius XM must attract a large enough customer base in order to cover costs and provide profit, while Broadcast Radio must attract a large enough advertiser base to cover costs and provide profit. Pandora, once again bridging the two, generates profit by either an advertiser base or through ad-free services.

VIII. What Makes a Strategy a Winner?

connect ACTIVITY

Consider adding a LearnSmart assignment requiring the student to review this section of the chapter as an interactive question and answer review. The assignment can be graded and posted automatically.

1. Three questions can be used to test the merits of one strategy versus another and distinguish a winning strategy from a losing or mediocre strategy:
    a. The Fit Test: How well does the strategy fit the company's situation? To qualify as a winner, a strategy has to be well matched to industry and competitive conditions, a company's best market opportunities, and other aspects of the enterprise's external environment.
    b. The Competitive Advantage Test: Is the strategy helping the company achieve a sustainable competitive advantage? The bigger and more durable the competitive edge that a strategy helps build, the more powerful and appealing it is.
    c. The Performance Test: Is the strategy producing good company performance? Two kinds of performance improvements tell the most about the caliber of a company's strategy: (1) gains in profitability and financial strength and (2) gains in the company's competitive strength and market standing.
2. Strategies that come up short on one or more of the above questions are plainly less appealing than strategies passing all three test questions with flying colors.

IX. Why are Crafting and Executing Strategy Important?

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Consider adding a LearnSmart assignment requiring the student to review this section of the chapter as an interactive question and answer review. The assignment can be graded and posted automatically.

1. Crafting and executing strategy are top priority managerial tasks for two big reasons
    a. High-performing enterprises are nearly always the product of astute, creative, and proactive strategy making
    b. Even the best-conceived strategies will result in performance shortfalls if they are not executed proficiently.
2. Good Strategy + Good Strategy Execution = Good Management
    a. Crafting and executing strategy are core management functions.
    b. Among all the things managers do, nothing affects a company's ultimate success or failure more fundamentally than how well its management team charts the company's direction, develops competitively effective strategic moves and business approaches, and pursues what needs to be done internally to produce good day-to-day strategy execution and operating excellence.

X. The Road Ahead

1. Throughout the remaining chapters and the accompanying case collection, the spotlight is trained on the foremost question in running a business enterprise: What must managers do, and do well, to make a company a winner in the marketplace?
2. The mission of this book is to provide a solid overview of what every business student and aspiring manager needs to know about crafting and executing strategy.

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Use the Question Bank to build a quiz for the chapter to measure and reinforce learning. Consider using the questions you select to build a comprehensive mid-term and final exam for the course. The assignment can be graded and posted automatically.

ASSURANCE OF LEARNING EXERCISES

1. Based on your experiences and/or knowledge of Apple's current products and services, does Apple's strategy (as described in Illustration Capsule 1.1) seem to set it apart from rivals? Does the strategy seem to be keyed to a cost-based advantage, differentiating features, serving the unique needs of a niche, or some combination of these? What is there about Apple's strategy that can lead to sustainable competitive advantage?

connect ACTIVITY

This Assurance of Learning exercise is available as a Connect Assignment. The assignment can be graded and posted automatically.

Response:

Setting Itself Apart—The student should be able to discuss that Apple uses a Focused Differentiation strategic approach. The company focuses on the upper end of the computer buyer market and offers a premium product. They strategically place stores in areas where their target market frequent and staff them with knowledgeable people. The firm is also committed to CSR and sustainability throughout its supply chain.

Elements of Strategy—The student should identify that some of key elements of Apple's strategy include a strong focus on R&D, providing a complete hardware/software/service solution, and a strong brand identity. These elements, along with the focus on CSR and sustainability combine to form a high end value proposition for consumers that allows for premium pricing.

Sustainable Competitive Advantage—The student should identify that developing a sustainable competitive advantage relies on a) building competitively valuable capabilities that rivals cannot readily match and b) having a distinctive product offering. Further, they should be able to highlight that the two areas described above are both distinctive and difficult to match.

2. Elements of eBay's strategy have evolved in meaningful ways since the company's founding in 1995. After reviewing the company's history at www.ebayinc.com/our-company/our-history and all of the links at the company's investor relations site (investors.ebayinc.com), prepare a one- to two-page report that discusses how its strategy has evolved. Your report should also assess how well eBay's strategy passes the three tests of a winning strategy.

Strategy Evolution—From the information found in the links provided, the student's report should include information similar to the following.

The company was founded in 1995 with the mission of bringing together buyers and sellers in an honest and open marketplace. By mid 1996, the company had already sold $7.2 million worth of goods, and in late 1997, the name AuctionWeb was replaced with the now iconic ebay name. In 1998, the company began to focus more on the customer experience through its first of many strategic acquisitions. By mid 1999, ebay had begun its oversees expansion with moves into Germany, Australia, and the UK. In 2001, ebay continued to customize the customer experience by providing eBay stores for its sellers. The period from 2001 through 2016 are marked by continued strategic acquisitions that bolster the company's product and service offerings including paypal, stubhub, and most recently, corrigon just to name a few of the more prominent ones. Global expansion continues today with ebay available in 180 countries.

The student should conclude that all of these innovations follow a careful underlying strategy of adding services and features to the overall product mix that leverage and take advantage of developments in personal and business technology and devices as well as shifting consumer demands. The company's strategy has evolved from a simple mission of providing a market place on the internet to being a comprehensive solution for engaging in commerce, making the financial transaction as smooth as possible, and moving the merchandise effectively.

Strategy Assessment—The student's report should include specific indications that the company's strategy is a winner as follows.

a. Does the strategy fit the company's situation? Yes, the company's strategy fits the evolving world of technology, consumer behavior, and market demands.

b. Does the strategy helping the company achieve a sustainable competitive advantage? Yes, the growing base of customers and revenue streams from various services and platforms is led by continuous innovation which differentiates the company well. The growing profit stream indicates that the strategy is sustainable.

c. Does the strategy producing good company performance? Yes, but the company needs to address profit margins. The 2017 Annual Report shows that market growth is steady with $9.56 Billion for fiscal year 2017 up from $8.79 Billion in 2014. Gross profit for fiscal year 2017 was $7.34 Billion up slightly from $7.13 Billion in 2014, and operating profit for fiscal year 2017 was $2.26 Billion down slightly from $2.48 Billion in 2014. Taken together, these financial measures indicate market growth but increases in cost of sales which is driving down operating profits

3. Go to investor.siriusxm.com and check whether the SiriusXM's recent financial reports indicate that its business model is working. Are its subscription fees increasing or declining? Is its revenue stream advertising and equipment sales growing or declining? Does its cost structure allow for acceptable profit margins?

connect ACTIVITY

This Assurance of Learning exercise is available as a Connect Assignment. The assignment can be graded and posted automatically.

Response:

General—The responses developed by the students may include information such as the following. SiriusXM is a leading satellite media company that provides commercial free music from numerous genres, live play by play sports, news and talk shows, and other forms of audio entertainment streaming to the consumer's home, auto, business, or even boats within 200 miles of the coast.

Is the business model working—The student should note that the company's annual revenue has increased steadily over the last three reporting periods from $4.57B in 2015 to $5.42B in 2017, while net income has grown from $509M to $647M over the same period. This is an increase in net profit from 11.1% in 2015 to 11.9%% in 2017. This illustrates an increasing value proposition (revenue) as well as an effective and growing profit formula (earnings). The conclusion the student should reach is that the business model is working effectively.

Subscription Fees—The student should identify that the company had subscription revenue of $3.8B in 2015 and $4.47B in 2015, representing a 5.86% average annual growth.

Revenue Stream from Advertising—The student should identify that the company had advertising revenue of $122M in 2015 and $160M in 2017, representing a 10.3% average annual growth.

Revenue from Equipment—The student should identify that the company had revenue from equipment of $111M in 2015 and $131M in 2017, representing a 6% average annual growth.

Cost Structure and Profit Margins—The student should identify that the company had consistently growth in Operating Profit with $1.3B in 2013 and $1.68B in 2015, representing a 9.7% average annual growth. This demonstrates that the company's cost structure allows for attractive profit margins.