Manajemen Strategik
Chapter 1 - 4

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Chapter 1
Theory Strategic Management

External Assesment

A note from David

The Nature of an External Audit

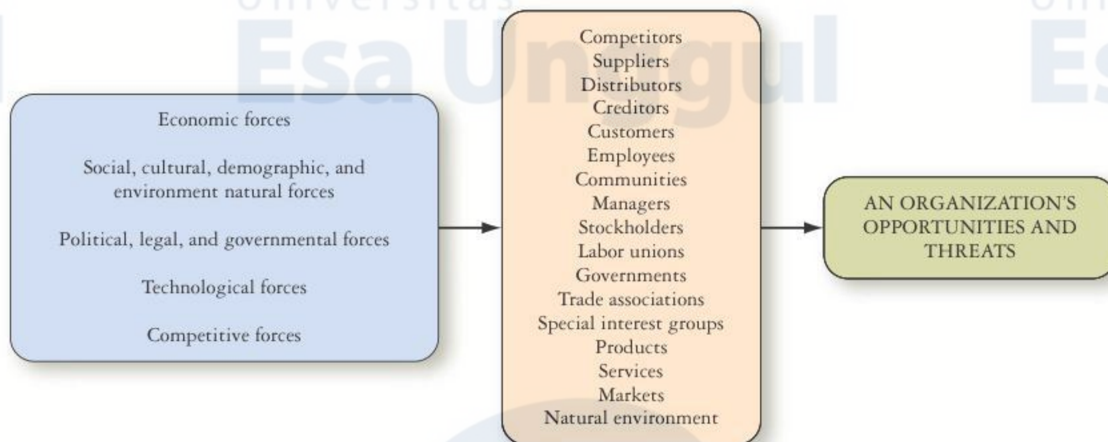
The purpose of an external audit is to develop a finite list of opportunities that could benefit a firm and threats that should be avoided. As the term finite suggests, the external audit is not aimed at developing an exhaustive list of every possible factor that could influence the business; rather, it is aimed at identifying key variables that offer actionable responses. Firms should be able to respond either offensively or defensively to the factors by formulating strategies that take advantage of external opportunities or that minimize the impact of potential threats. Figure 3-1 illustrates how the external audit fits into the strategic-management process.

Key External Forces

External forces can be divided into five broad categories: (1) economic forces; (2) social, cultural, demographic, and natural environment forces; (3) political, governmental, and legal forces; (4) technological forces; and (5) competitive forces. Relationships among these forces and an organization are depicted in Figure 3-2. External trends and events, such as the global economic recession, significantly affect products, services, markets, and organizations worldwide. The U.S. unemployment rate climbed to over 9 percent in July 2009 as more than 2.5 million jobs were lost in the United States in 2008—the most since 1945 when the country downsized from the war effort. The rate is expected to rise to 10.1 percent. All sectors witness rising unemployment rates, except for education, health-care services, and government employment. Many Americans are resorting to minimum wage jobs to make ends meet.

Changes in external forces translate into changes in consumer demand for both industrial and consumer products and services. External forces affect the types of products developed, the nature of positioning and market segmentation strategies, the type of services offered, and the choice of businesses to acquire or sell. External forces directly affect both suppliers and distributors. Identifying and evaluating external opportunities and threats enables organizations to develop a clear mission, to design strategies to achieve long-term objectives, and to develop policies to achieve annual objectives.

The increasing complexity of business today is evidenced by more countries developing the capacity and will to compete aggressively in world markets. Foreign businesses and countries are willing to learn, adapt, innovate, and invent to compete successfully in the marketplace. There are more competitive new technologies in Europe and Asia today than ever before.



The Process of Performing an External Audit

The process of performing an external audit must involve as many managers and employees as possible. As emphasized in earlier chapters, involvement in the strategic-management process can lead to understanding and commitment from organizational members. Individuals appreciate having the opportunity to contribute ideas and to gain a better understanding of their firms' industry, competitors, and markets.

To perform an external audit, a company first must gather competitive intelligence and information about economic, social, cultural, demographic, environmental, political, governmental, legal, and technological trends. Individuals can be asked to monitor various sources of information, such as key magazines, trade journals, and newspapers. These persons can submit periodic scanning reports to a committee of managers charged with performing the external audit. This approach provides a continuous stream of timely strategic information and involves many individuals in the external-audit process. The Internet provides another source for gathering strategic information, as do corporate, university, and public libraries. Suppliers, distributors, salespersons, customers, and competitors represent other sources of vital information.

Once information is gathered, it should be assimilated and evaluated. A meeting or series of meetings of managers is needed to collectively identify the most important opportunities and threats facing the firm. These key external factors should be listed on flip charts or a chalkboard. A prioritized list of these factors could be obtained by requesting that all managers rank the factors identified, from 1 for the most important opportunity/threat to 20

for the least important opportunity/threat. These key external factors can vary over time and by industry. Relationships with suppliers or distributors are often a critical success factor. Other variables commonly usedinclude market share, breadth of competing products, world economies, foreign affiliates, proprietary and key account advantages, price competitiveness, technological advancements, population shifts, interest rates, and pollution abatement.

Freund emphasized that these key external factors should be (1) important to achieving long-term and annual objectives, (2) measurable, (3) applicable to all competing firms, and (4) hierarchical in the sense that some will pertain to the overall company and others will be more narrowly focused on functional or divisional areas. 1 A final list of the most important key external factors should be communicated and distributed widely in the organization. Both opportunities and threats can be key external factors.

The Industrial Organization (I/O) View

The Industrial Organization (I/O) approach to competitive advantage advocates that external (industry) factors are more important than internal factors in a firm achieving competitive advantage. Proponents of the I/O view, such as Michael Porter, contend that organizational performance will be primarily determined by industry forces. Porter's FiveForces Model, presented later in this chapter, is an example of the I/O perspective, which focuses on analyzing external forces and industry variables as a basis for getting and keeping competitive advantage. Competitive advantage is determined largely by competitive positioning within an industry, according to I/O advocates. Managing strategically from the I/O perspective entails firms striving to compete in attractive industries, avoiding weak or faltering industries, and gaining a full understanding of key external factor relationships within that attractive industry. I/O research provides important contributions to our understanding of how to gain competitive advantage.

I/O theorists contend that external factors in general and the industry in which a firm chooses to compete has a stronger influence on the firm's performance than do the internal functional decisions managers make in marketing, finance, and the like. Firm performance, they contend, is primarily based more on industry properties, such as economies of scale, barriers to market entry, product differentiation, the economy, and level of competitiveness than on internal resources, capabilities, structure, and operations. The global economic recession's impact on both strong and weak firms has added credence of late to the notion that external forces are more important than internal. Many thousands of internally strong firms in 2006–2007 disappeared in 2008–2009.

The I/O view has enhanced our understanding of strategic management. However, it is not a question of whether external or internal factors are more important in gaining and maintaining competitive advantage. Effective integration and understanding of both external and internal factors is the key to securing and keeping a competitive advantage. In fact, as discussed in Chapter 6, matching key external opportunities/threats with key internal strengths/weaknesses provides the basis for successful strategy formulation.

Economic Forces

Increasing numbers of two-income households is an economic trend in the United States. Individuals place a premium on time. Improved customer service, immediate availability, trouble-free operation of products, and dependable maintenance and repair services are becoming more important. People today are more willing than ever to pay for good service if it limits inconvenience.

Economic factors have a direct impact on the potential attractiveness of various strategies. For example, when interest rates rise, funds needed for capital expansion become more costly or unavailable. Also, when interest rates rise, discretionary income declines, and the demand for discretionary goods falls. When stock prices increase, the desirability of equity as a source of capital for market development increases. Also, when the market rises, consumer and business wealth expands. A summary of economic variables that often represent opportunities and threats for organizations is provided in Table 3-1.

An economic variable of significant importance in strategic planning is gross domestic product (GDP), especially across countries. Table 3-2 lists the GDP of various countries in Asia for all of 2009. Unlike most countries in Europe and the Americas, most Asian countries expect positive GDP growth in 2009.

Trends in the dollar's value have significant and unequal effects on companies in different industries and in different locations. For example, the pharmaceutical, tourism, entertainment, motor vehicle, aerospace, and forest products industries benefit greatly when the dollar falls against the yen and euro. Agricultural and petroleum industries are hurt by the dollar's rise against the currencies of Mexico, Brazil, Venezuela, and Australia. Generally, a strong or high dollar makes U.S. goods more expensive in overseas markets. This worsens the U.S. trade deficit. When the value of the dollar falls, tourism-oriented firms benefit because

Americans do not travel abroaas much when the value of the dollar is low; rather, foreigners visit and vacation more in the United States.

A low value of the dollar means lower imports and higher exports; it helps U.S. companies' competitiveness in world markets. The dollar has fallen to five-year lows against the euro and yen, which makes U.S. goods cheaper to foreign consumers and combats deflation by pushing up prices of imports. However, European firms such as Volkswagen AG, Nokia Corp., and Michelin complain that the strong euro hurts their financial performance. The low value of the dollar benefits the U.S. economy in many ways. First, it helps stave off the risks of deflation in the United States and also reduces the U.S. trade deficit. In addition, the low value of the dollar raises the foreign sales and profits of domestic firms, thanks to dollar-induced gains, and encourages foreign countries to lower interest rates and loosen fiscal policy, which stimulates worldwide economic expansion. Some sectors, such as consumer staples, energy, materials, technology, and health care, especially benefit from a low value of the dollar. Manufacturers in many domestic industries in fact benefit because of a weak dollar, which forces foreign rivals to raise prices and extinguish discounts. Domestic firms with big overseas sales, such as McDonald's, greatly benefit from a weak dollar.

Between March and June 2009, the U.S. dollar weakened 11.0 percent against the euro, due to the growing United States debt, which may soon exceed $12 trillion. Table 3-3 lists some advantages and disadvantages of a weak U.S. dollar for American firms.

Rising unemployment rates across the United States have touched off a race among states to attract businesses with tax breaks and financial incentives. New Jersey has promised to send a $3,000 check to every small business that hires a new employee. Minnesota is offering tax-free zones for companies that create "green jobs." Colorado has created a $5 million fund for banks that open credit lines for small businesses. To minimize risk in incentive deals, may states write in claw-back provisions that require companies to return funds if they fail to create the promised number of jobs.

The slumping economy worldwide and depressed prices of assets has dramatically slowed the migration of people from country to country and from the city to the suburbs. Because people are not moving nearly as much as in years past, there is lower and lower demand for new or used houses. Thus the housing market is expected to remain very sluggish well into 2010 and 2011.

Key Economic Variables to Be Monitored

Shift to a service economy in the United States	Import/export factors
Availability of credit	Demand shifts for different categories of goods and services
Level of disposable income	Income differences by region and consumer groups
Propensity of people to spend	Price fluctuations
Interest rates	Export of labor and capital from the United States
Inflation rates	Monetary policies
Money market rates	Fiscal policies
Federal government budget deficits	Tax rates
Gross domestic product trend	European Economic Community (EEC) policies
Consumption patterns	Organization of Petroleum Exporting Countries (OPEC) policies
Unemployment trends	Coalitions of Lesser Developed Countries (LDC) policies
Worker productivity levels	
Value of the dollar in world markets	
Stock market trends	
Foreign countries' economic conditions	

Environment Forces

Social, cultural, demographic, and environmental changes have a major impact on virtually all products, services, markets, and customers. Small, large, for-profit, and nonprofit organizations in all industries are being staggered and challenged by the opportunities and threats arising from changes in social, cultural, demographic, and environmental variables. In every way, the United States is much different today than it was yesterday, and tomorrow promises even greater changes.

The United States is getting older and less white. The oldest members of America's 76 million baby boomers plan to retire in 2011, and this has lawmakers and younger taxpayers deeply concerned about who will pay their Social Security, Medicare, and Medicaid. Individuals age 65 and older in the United States as a percentage of the population will rise to 18.5 percent by 2025. The five "oldest" states and five "youngest" states in 2007 are given in Table 3-4.

By 2075, the United States will have no racial or ethnic majority. This forecast is aggravating tensions over issues such as immigration and affirmative action. Hawaii, California, and New Mexico already have no majority race or ethnic group.

The population of the world surpassed 7.0 billion in 2010; the United States has just over 310 million people. That leaves billions of people outside the United States who may be interested in the products and services produced through domestic firms. Remaining solely domestic is

an increasingly risky strategy, especially as the world population continues to grow to an estimated 8 billion in 2028 and 9 billion in 2054.

Social, cultural, demographic, and environmental trends are shaping the way Americans live, work, produce, and consume. New trends are creating a different type of consumer and, consequently, a need for different products, different services, and different strategies. There are now more American households with people living alone or with unrelated people than there are households consisting of married couples with children. American households are making more and more purchases online. Beer consumption in the United States is growing at only 0.5 percent per year, whereas wine consumption is growing 3.5 percent and distilled spirits consumption is growing at 2.0 percent. 2 Beer is still the most popular alcoholic beverage in the United States, but its market share has dropped from 59.5 percent in its peak year of 1995 to 56.7 percent today. For a wine company such as Gallo, this trend is an opportunity, whereas for a firm such as Adolph Coors Brewing, this trend is an external threat.

The trend toward an older America is good news for restaurants, hotels, airlines, cruise lines, tours, resorts, theme parks, luxury products and services, recreational vehicles, home builders, furniture producers, computer manufacturers, travel services, pharmaceutical firms, automakers, and funeral homes. Older Americans are especially interested in health care, financial services, travel, crime prevention, and leisure. The world's longest-living people are the Japanese, with Japanese women living to 86.3 years and men living to 80.1 years on average. By 2050, the Census Bureau projects that the number of Americans age 100 and older will increase to over 834,000 from just under 100,000 centenarians in the United States in 2000. Americans age 65 and over will increase from 12.6 percent of the U.S. population in 2000 to 20.0 percent by the year 2050.

The aging American population affects the strategic orientation of nearly all organizations. Apartment complexes for the elderly, with one meal a day, transportation, and utilities included in the rent, have increased nationwide. Called lifecare facilities, these complexes now exceed 2 million. Some well-known companies building these facilities include Avon, Marriott, and Hyatt. Individuals age 65 and older in the United States comprise 13 percent of the total population; Japan's elderly population ratio is 17 percent, and Germany's is 19 percent.

Americans were on the move in a population shift to the South and West (Sunbelt) and away from the Northeast and Midwest (Frostbelt), but the recession and housing bust nationwide has slowed

migration throughout the United States. More Americans are staying in place rather than moving. New jobs are the primary reason people move across state lines, so with 3 million less jobs in the United States in 2008–2009 alone, there is less need to move. Falling home prices also have prompted people to avoid moving. The historical trend of people moving from the Northeast and Midwest to the Sunbelt and West has dramatically slowed. The worldwide recession is also reducing international immigration, down roughly 10 percent in both 2008 and 2009. Hard number data related to this information can represent key opportunities for many firms and thus can be essential for successful strategy formulation, including where to locate new plants and distribution centers and where to focus marketing efforts.

A summary of important social, cultural, demographic, and environmental variables that represent opportunities or threats for virtually all organizations is given in Table.

Key Social, Cultural, Demographic, and Natural Environment Variables

Childbearing rates	Attitudes toward retirement
Number of special-interest groups	Attitudes toward leisure time
Number of marriages	Attitudes toward product quality
Number of divorces	Attitudes toward customer service
Number of births	Pollution control
Number of deaths	Attitudes toward foreign peoples
Immigration and emigration rates	Energy conservation
Social Security programs	Social programs
Life expectancy rates	Number of churches
Per capita income	Number of church members
Location of retailing, manufacturing, and service businesses	Social responsibility
Attitudes toward business	Attitudes toward careers
Lifestyles	Population changes by race, age, sex, and level of affluence
Traffic congestion	Attitudes toward authority
Inner-city environments	Population changes by city, county, state, region, and country
Average disposable income	Value placed on leisure time
Trust in government	Regional changes in tastes and preferences
Attitudes toward government	Number of women and minority workers
Attitudes toward work	Number of high school and college graduates by geographic area
Buying habits	Recycling
Ethical concerns	Waste management
Attitudes toward saving	Air pollution
Sex roles	Water pollution
Attitudes toward investing	Ozone depletion
Racial equality	Endangered species
Use of birth control	
Average level of education	
Government regulation	

Political, Governmental, and Legal Forces

Federal, state, local, and foreign governments are major regulators, deregulators, subsidizers, employers, and customers of organizations. Political, governmental, and legal factors, therefore, can represent key opportunities or threats for both small and large organizations.

For industries and firms that depend heavily on government contracts or subsidies, political forecasts can be the most important part of an external audit. Changes in patent laws, antitrust legislation, tax rates, and lobbying activities can affect firms significantly. The increasing global interdependence among economies, markets, governments, and organizations makes it imperative that firms consider the possible impact of political variables on the formulation and implementation of competitive strategies.

In the face of a deepening global recession, countries worldwide are resorting to protectionism to safeguard their own industries. European Union (EU) nations, for example, have tightened their own trade rules and resumed subsidies for various of their own industries while barring imports from certain other countries. The EU recently restricted imports of U.S. chicken and beef. India is increasing tariffs on foreign steel. Russia perhaps has instituted the most protectionist measures in recent months by raising tariffs on most imports and subsidizing its own exports. Russia even imposed a new toll on trucks from the EU, Switzerland, and Turkmenistan. Despite these measures taken by other countries, the United States has largely refrained from "Buy American" policies and protectionist measures, although there are increased tariffs on French cheese and Italian water. Many economists say the current rash of trade constraints will make it harder for global economic growth to recover from the global recession. Global trade is expected to decrease 2.1 percent in 2009 compared to an increase of 6.2 percent in 2008. 3 Russia has said that "protective tariffs are necessary to allow Russian companies to survive the recession." This view unfortunately is also the view at an increasing number of countries.

Governments are taking control of more and more companies as the global economic recession cripples firms considered vital to the nation's financial stability. For example, France in 2009 took a 2.35 percent equity stake in troubled car-parts maker Valeo SA. President Nicolas Sarkozy of France has created a $20 billion strategic fund to lend cash to banks and carmakers as many governments become more protectionist. The United States of course also is taking equity stakes in financial institutions and carmakers and is "bailing out" companies too.

The UK government in 2009 took a 95 percent stake in the banking giant Royal Bank of Scotland Group PLC in a dramatic move toward nationalization. The government gave the bank $37 billion and insured another $300 billion of the bank's assets. The UK government also recently increased its stake in Lloyds Banking Group PLC to 75 percent. Similarly, the U.S. government has taken over Fannie Mae and Freddie Mac and has raised its stake even in Citigroup to 40 percent.

As more and more companies around the world accept government bailouts, those companies are being forced to march to priorities set by political leaders. Even in the United States, the federal government is battling the recession with its deepest intervention in the economy since the Great Depression. The U.S. government now is a strategic manager in industries from banking to insurance to autos. Governments worldwide are under pressure to protect jobs at home and

maintain the nation's industrial base. For example, in France, Renault SA's factory in Sandouville is one of the most unproductive auto factories in the world. However, Renault has taken $3.9 billion in low-interest loans from the French government, so the company cannot close any French factories for the duration of the loan or resort to mass layoffs in France for a year.

Political relations between Japan and China have thawed considerably in recent years, which is good for the world economy because China's low-cost manufactured goods have become essential for the functioning of most industrialized nations. Chinese premier Wen Jiabao addressed the Japanese parliament in 2007, something no Chinese leader has done for more than 20 years, and Japanese prime minister Shinzo Abe has visited Beijing. Japan's largest trading partner is China, and China's third-largest trading partner is Japan—after the European Union, number one, and the United States, number two.

Local, state, and federal laws; regulatory agencies; and special-interest groups can have a major impact on the strategies of small, large, for-profit, and nonprofit organizations. Many companies have altered or abandoned strategies in the past because of political or governmental actions. In the academic world, as state budgets have dropped in recent years, so too has state support for colleges and universities. Due to the decline in monies received from the state, many institutions of higher learning are doing more fundraising on their own—naming buildings and classrooms, for example, for donors. A summary of political, governmental, and legal variables that can represent key opportunities or threats to organizations is provided in Table

Some Political, Governmental, and Legal Variables

Government regulations or deregulations	Sino-American relationships
Changes in tax laws	Russian-American relationships
Special tariffs	European-American relationships
Political action committees	African-American relationships
Voter participation rates	Import–export regulations
Number, severity, and location of government protests	Government fiscal and monetary policy changes
Number of patents	Political conditions in foreign countries
Changes in patent laws	Special local, state, and federal laws
Environmental protection laws	Lobbying activities
Level of defense expenditures	Size of government budgets
Legislation on equal employment	World oil, currency, and labor markets
Level of government subsidies	Location and severity of terrorist activities
Antitrust legislation	Local, state, and national elections

Technological Forces

Revolutionary technological changes and discoveries are having a dramatic impact on organizations. CEO Chris DeWolfe of MySpace is using technology to expand the firm's 1,600-person workforce in 2009 even as the economic recession deepens. MySpace expects a 17 percent increase in revenue in 2009. Nearly half of the site's 130 million members worldwide are 35 and older, and 76 million of the members are from the United States. This compares to rival Facebook that has 150 million members worldwide but only 55 million in the United States. MySpace is continually redesigning the site and revamping the way its members can manage their profiles and categorize their friends, and enabling consumers to listen to free streaming audio and songs. Doug Morris, CEO of Universal Music Group, says, "There is a lot of conflict between technology and content, and Chris has successfully brought both together." 4

The Internet has changed the very nature of opportunities and threats by altering the life cycles of products, increasing the speed of distribution, creating new products and services, erasing limitations of traditional geographic markets, and changing the historical trade-off

between production standardization and flexibility. The Internet is altering economies of scale, changing entry barriers, and redefining the relationship between industries and various suppliers, creditors, customers, and competitors.

To effectively capitalize on e-commerce, a number of organizations are establishing two new positions in their firms: chief information officer (CIO) and chief technology officer (CTO). This trend reflects the growing importance of information technology (IT) in strategic management. A CIO and CTO work together to ensure that information needed to formulate, implement, and evaluate strategies is available where and when it is needed. These individuals are responsible for developing, maintaining, and updating a company's information database. The CIO is more a manager, managing the firm's relationship with stakeholders; the CTO is more a technician, focusing on technical issues such as data acquisition, data processing, decision-support systems, and software and hardware acquisition.

Technological forces represent major opportunities and threats that must be considered in formulating strategies. Technological advancements can dramatically affect organizations' products, services, markets, suppliers, distributors, competitors, customers, manufacturing processes, marketing practices, and competitive position. Technological advancements can create new markets, result in a proliferation of new and improved products, change the relative competitive cost positions in an industry, and render existing products and services obsolete. Technological changes can reduce or eliminate cost barriers between businesses, create shorter production runs, create shortages in technical skills, and result in changing values and expectations of employees, managers, and customers. Technological advancements can create new competitive advantages that are more powerful than existing advantages. No company or industry today is insulated against emerging technological developments. In high-tech industries, identification and evaluation of key technological opportunities and threats can be the most important part of the external strategic-management audit.

Organizations that traditionally have limited technology expenditures to what they can fund after meeting marketing and financial requirements urgently need a reversal in thinking. The pace of technological change is increasing and literally wiping out businesses every day. An emerging consensus holds that technology management is one of the key responsibilities of strategists. Firms should pursue strategies that take advantage of technological opportunities to achieve sustainable, competitive advantages in the marketplace.

In practice, critical decisions about technology too often are delegated to lower organizational levels or are made without an understanding of their strategic implications. Many strategists spend countless hours determining market share, positioning products in terms of features and price, forecasting sales and market size, and monitoring distributors; yet too often, technology does not receive the same respect.

Not all sectors of the economy are affected equally by technological developments. The communications, electronics, aeronautics, and pharmaceutical industries are much more volatile than the textile, forestry, and metals industries. A recent article in the Wall Street Journal detailed how wireless technology will change 10 particular industries. 5 Table 3-7 provides a glimpse of this article.

Examples of the Impact of Wireless Technology
Airlines—Many airlines now offer wireless technology in flight.
Automotive—Vehicles are becoming wireless.
Banking—Visa sends text message alerts after unusual transactions.
Education—Many secondary (and even college) students may use smart phones for math because research shows this to be greatly helpful.
Energy—Smart meters now provide power on demand in your home or business.
Health Care—Patients use mobile devices to monitor their own health, such as calories consumed.
Hotels—Days Inn sends daily specials and coupons to hotel guests via text messages.
Market Research—Cell phone respondents provide more honest answers, perhaps because they are away from eavesdropping ears.
Politics—President Obama won the election partly by mobilizing Facebook and MySpace users, revolutionizing political campaigns. Obama announced his vice presidential selection of Joe Biden by a text message.
Publishing—eBooks are increasingly available.

Source: Based on Joe Mullich, "10 Industries That Wireless Will Change," *Wall Street Journal* (April 1, 2009): A12.

Competitive Forces

The top U.S. competitors in four different industries are identified in Table 3-8. An important part of an external audit is identifying rival firms and determining their strengths, weaknesses, capabilities, opportunities, threats, objectives, and strategies.

Collecting and evaluating information on competitors is essential for successful strategy formulation. Identifying major competitors is not always easy because many firms have divisions that compete in different industries. Many multidivisional firms do not provide sales and profit information on a divisional basis for competitive reasons. Also, privately held firms do not publish any financial or marketing information. Addressing questions about competitors such as those presented in Table 3-9 is important in performing an external audit.

Competition in virtually all industries can be described as intense—and sometimes as cutthroat. For example, Walgreens and CVS pharmacies are located generally across the street from each other and battle each other every day on price and customer service. Most automobile dealerships also are located close to each other. Dollar General, based in Goodlettsville, Tennessee, and Family Dollar, based in Matthews, North Carolina, compete intensely on price to attract customers. Best Buy dropped prices wherever possible to finally put Circuit City totally out of business.

Seven characteristics describe the most competitive companies:

1. Market share matters; the 90th share point isn't as important as the 91st, and nothing is more dangerous than falling to 89.
2. Understand and remember precisely what business you are in.
3. Whether it's broke or not, fix it—make it better; not just products, but the whole company, if necessary.
4. Innovate or evaporate; particularly in technology-driven businesses, nothing quite recedes like success.
5. Acquisition is essential to growth; the most successful purchases are in niches that add a technology or a related market.
6. People make a difference; tired of hearing it? Too bad.
7. There is no substitute for quality and no greater threat than failing to be cost-competitive on a global basis.

Key Questions About Competitors

1. What are the major competitors' strengths?
2. What are the major competitors' weaknesses?
3. What are the major competitors' objectives and strategies?
4. How will the major competitors most likely respond to current economic, social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive trends affecting our industry?
5. How vulnerable are the major competitors to our alternative company strategies?
6. How vulnerable are our alternative strategies to successful counterattack by our major competitors?
7. How are our products or services positioned relative to major competitors?
8. To what extent are new firms entering and old firms leaving this industry?
9. What key factors have resulted in our present competitive position in this industry?
10. How have the sales and profit rankings of major competitors in the industry changed over recent years? Why have these rankings changed that way?
11. What is the nature of supplier and distributor relationships in this industry?
12. To what extent could substitute products or services be a threat to competitors in this industry?

Competitive Intelligence Programs

What is competitive intelligence? Competitive intelligence (CI), as formally defined by the Society of Competitive Intelligence Professionals (SCIP), is a systematic and ethical process

for gathering and analyzing information about the competition's activities and general business trends to further a business's own goals (SCIP Web site).

Good competitive intelligence in business, as in the military, is one of the keys to success. The more information and knowledge a firm can obtain about its competitors, the more likely it is that it can formulate and implement effective strategies. Major competitors' weaknesses can represent external opportunities; major competitors' strengths may represent key threats.

In April 2009, Starwood Hotels & Resorts Worldwide sued Hilton Hotels Corp. for allegedly stealing more than 100,000 confidential electronic and paper documents containing "Starwood's most competitively sensitive information." The complaint alleges that two Starwood executives, Ross Klein and Amar Lalvani, resigned from Starwood to join Hilton and took this information with them. The legal complaint says, "This is the clearest imaginable case of corporate espionage, theft of trade secrets, unfair competition and computer fraud." In addition to monetary awards, Starwood is seeking to force Hilton to cancel the rollout of the Denizen hotel chain. Hilton is owned by Blackstone Group.

Hiring top executives from rival firms is also a way companies obtain competitive intelligence. Just two days after Facebook's COO, Owen Van Natta, left the company in 2009, he accepted the CEO job at MySpace, replacing then CEO and cofounder Chris DeWolfe. Van Natta had previously also been Facebook's COO, chief revenue officer, and vice president of operations. The MySpace appointment now pits CEO Van Natta against his old boss at Facebook, CEO Mark Zuckerberg. Facebook passed MySpace in visitors worldwide in 2008 and is closing in on leadership in the United States. Both firms are fierce rivals in the Internet social-networking business.

A recent article in the Wall Street Journal detailed how computer spies recently broke into the Pentagon's $300 billion Joint Strike fighter project, one of the costliest weapons programs ever. 8 This intrusion and similar episodes of late have confirmed that any information a firm has available to anyone within the firm online may be at risk of being copied and/or siphoned away by adversaries or rival firms. A recent Pentagon report says the Chinese military in particular has made "steady progress" in developing online-warfare techniques, but rival firms in many industries have expert computer engineers who may be capable of similar unethical/unlawful tactics.

Many U.S. executives grew up in times when U.S. firms dominated foreign competitors so much that gathering competitive intelligence did not seem worth the effort. Too many of these executives still cling to these attitudes—to the detriment of their organizations today. Even

most MBA programs do not offer a course in competitive and business intelligence, thus reinforcing this attitude. As a consequence, three strong misperceptions about business intelligence prevail among U.S. executives today:

- Running an intelligence program requires lots of people, computers, and other resources.
- Collecting intelligence about competitors violates antitrust laws; business intelligence equals espionage.
- Intelligence gathering is an unethical business practice.

Any discussions with a competitor about price, market, or geography intentions could violate antitrust statutes. However, this fact must not lure a firm into underestimating the need for and benefits of systematically collecting information about competitors for Strategic Planning purposes. The Internet has become an excellent medium for gathering competitive intelligence. Information gathering from employees, managers, suppliers, distributors, customers, creditors, and consultants also can make the difference between having superior or just average intelligence and overall competitiveness.

Firms need an effective competitive intelligence (CI) program. The three basic objectives of a CI program are (1) to provide a general understanding of an industry and its competitors, (2) to identify areas in which competitors are vulnerable and to assess the impact strategic actions would have on competitors, and (3) to identify potential moves that a competitor might make that would endanger a firm's position in the market. 10 Competitive information is equally applicable for strategy formulation, implementation, and evaluation decisions. An effective CI program allows all areas of a firm to access consistent and verifiable information in making decisions. All members of an organizationfrom the chief executive officer to custodians—are valuable intelligence agents and should feel themselves to be a part of the CI process. Special characteristics of a successful CI program include flexibility, usefulness, timeliness, and cross-functional cooperation.

The increasing emphasis on competitive analysis in the United States is evidenced by corporations putting this function on their organizational charts under job titles such as Director of Competitive Analysis, Competitive Strategy Manager, Director of Information Services, or Associate Director of Competitive Assessment. The responsibilities of a director of competitive analysis include planning, collecting data, analyzing data, facilitating the process of gathering and analyzing data, disseminating intelligence on a timely basis, researching special issues, and recognizing what information is important and who needs to

know. Competitive intelligence is not corporate espionage because 95 percent of the information a company needs to make strategic decisions is available and accessible to the public. Sources of competitive information include trade journals, want ads, newspaper articles, and government filings, as well as customers, suppliers, distributors, competitors themselves, and the Internet.

Unethical tactics such as bribery, wiretapping, and computer break-ins should never be used to obtain information. Marriott and Motorola—two U.S. companies that do a particularly good job of gathering competitive intelligence—agree that all the information you could wish for can be collected without resorting to unethical tactics. They keep their intelligence staffs small, usually under five people, and spend less than $200,000 per year on gathering competitive intelligence.

Unilever recently sued Procter & Gamble (P&G) over that company's corporate-espionage activities to obtain the secrets of its Unilever hair-care business. After spending $3 million to establish a team to find out about competitors in the domestic hair-care industry, P&G allegedly took roughly 80 documents from garbage bins outside Unilever's Chicago offices. P&G produces Pantene and Head & Shoulders shampoos; Unilever has hair-care brands such as ThermaSilk, Suave, Salon Selectives,and Finesse. Similarly, Oracle Corp. recently admitted that detectives it hired paid janitors to go through Microsoft Corp.'s garbage, looking for evidence to use in court.

Market Commonality and Resource Similarity

By definition, competitors are firms that offer similar products and services in the same market. Markets can be geographic or product areas or segments. For example, in the insurance industry the markets are broken down into commercial/consumer, health/life, or Europe/Asia. Researchers use the terms market commonality and resource similarity to study rivalry among competitors. Market commonality can be defined as the number and significance of markets that a firm competes in with rivals. 11 Resource similarity is the extent to which the type and amount of a firm's internal resources are comparable to a rival. 12 One way to analyze competitivenessbetween two or among several firms is to investigate market commonality and resource similarity issues while looking for areas of potential competitive advantage along each firm's value chain.

Competitive Analysis: Porter's Five-Forces Model

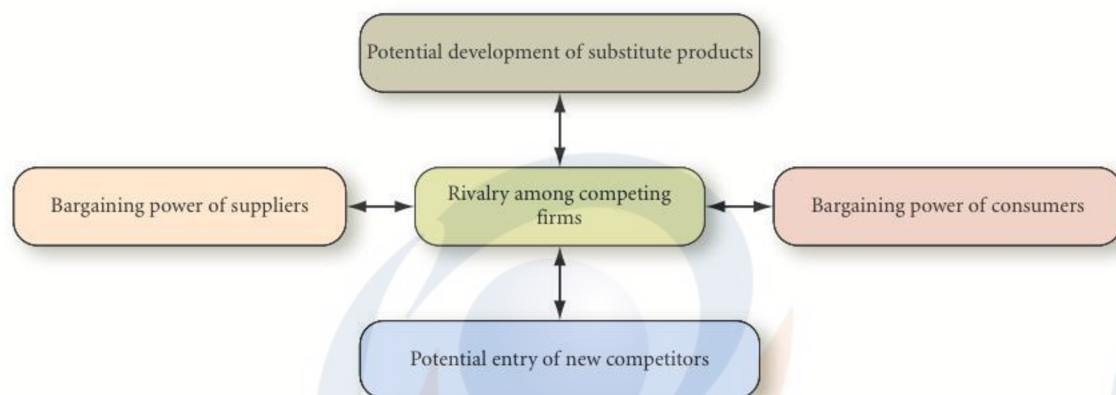
As illustrated in Figure 3-3, Porter's Five-Forces Model of competitive analysis is a widely used approach for developing strategies in many industries. The intensity of competition among firms varies widely across industries. Table 3-10 reveals the average profit margin and return on investment for firms in different industries. Note the substantial variation among industries. For example, the range in profit margin goes from 0 to 18 for food production to computer software, respectively. Intensity of competition is highest in lower-return industries. The collective impact of competitive forces is so brutal in some industries that the market is clearly "unattractive" from a profit-making standpoint. Rivalry among existing firms is severe, new rivals can enter the industry with relative ease, and both suppliers and customers can exercise considerable bargaining leverage. According to Porter, the nature of competitiveness in a given industry can be viewed as a composite of five forces:

1. Rivalry among competing firms
2. Potential entry of new competitors
3. Potential development of substitute products
4. Bargaining power of suppliers
5. Bargaining power of consumers

The following three steps for using Porter's Five-Forces Model can indicate whether competition in a given industry is such that the firm can make an acceptable profit:

- Identify key aspects or elements of each competitive force that impact the firm.
- Evaluate how strong and important each element is for the firm.

Decide whether the collective strength of the elements is worth the firm entering or staying in the industry.



Rivalry Among Competing Firms

Rivalry among competing firms is usually the most powerful of the five competitive forces. The strategies pursued by one firm can be successful only to the extent that they provide competitive advantage over the strategies pursued by rival firms. Changes in strategy by one firm may be met with retaliatory countermoves, such as lowering prices, enhancing quality, adding features, providing services, extending warranties, and increasing advertising.

Free-flowing information on the Internet is driving down prices and inflation worldwide. The Internet, coupled with the common currency in Europe, enables consumers to make price comparisons easily across countries. Just for a moment, consider the implications for car dealers who used to know everything about a new car's pricing, while you, the consumer, knew very little. You could bargain, but being in the dark, you rarely could win. Now you can shop online in a few hours at every dealership within 500 miles to find the best price and terms. So you, the consumer, can win. This is true in many, if not most, business-to-consumer and business-to-business sales transactions today.

The intensity of rivalry among competing firms tends to increase as the number of competitors increases, as competitors become more equal in size and capability, as demand for the industry's products declines, and as price cutting becomes common. Rivalry also increases when consumers can switch brands easily; when barriers to leaving the market are high; when fixed costs are high; when the product is perishable; when consumer demand is growing slowly or declines such that rivals have excess capacity and/or inventory; when the products being sold are commodities (not easily differentiated such as gasoline); when rival firms are diverse in strategies, origins, and culture; and when mergers and acquisitions are common in the industry. As rivalry among competing firms intensifies, industry profits decline, in some cases to the point where an industry becomes inherently unattractive. When rival firms sense weakness, typically they will intensify both marketing and production efforts to capitalize on the "opportunity." Table 3-11 summarizes conditions that cause high rivalry among competing firms.

Conditions That Cause High Rivalry Among Competing Firms

1. High number of competing firms
2. Similar size of firms competing
3. Similar capability of firms competing
4. Falling demand for the industry's products
5. Falling product/service prices in the industry
6. When consumers can switch brands easily
7. When barriers to leaving the market are high
8. When barriers to entering the market are low
9. When fixed costs are high among firms competing
10. When the product is perishable
11. When rivals have excess capacity
12. When consumer demand is falling
13. When rivals have excess inventory
14. When rivals sell similar products/services
15. When mergers are common in the industry

Potential Entry of New Competitors

Whenever new firms can easily enter a particular industry, the intensity of competitiveness among firms increases. Barriers to entry, however, can include the need to gain economies of scale quickly, the need to gain technology and specialized know-how, the lack of experience, strong customer loyalty, strong brand preferences, large capital requirements, lack of adequate distribution channels, government regulatory policies, tariffs, lack of access to raw materials, possession of patents, undesirable locations, counterattack by entrenched firms, and potential saturation of the market.

Despite numerous barriers to entry, new firms sometimes enter industries with higher-quality products, lower prices, and substantial marketing resources. The strategist's job, therefore, is to identify potential new firms entering the market, to monitor the new rival firms' strategies, to counterattack as needed, and to capitalize on existing strengths and opportunities. When the threat of new firms entering the market is strong, incumbent firms generally fortify their positions and take actions to deter new entrants, such as lowering prices, extending warranties, adding features, or offering financing specials.

Potential Development of Substitute Products

In many industries, firms are in close competition with producers of substitute products in other industries. Examples are plastic container producers competing with glass, paperboard,

and aluminum can producers, and acetaminophen manufacturers competing with other manufacturers of pain and headache remedies. The presence of substitute products puts a ceiling on the price that can be charged before consumers will switch to the substitute product. Price ceilings equate to profit ceilings and more intense competition among rivals. Producers of eyeglasses and contact lenses, for example, face increasing competitive pressures from laser eye surgery. Producers of sugar face similar pressures from artificial sweeteners. Newspapers and magazines face substitute-product competitive pressures from the Internet and 24-hour cable television. The magnitude of competitive pressure derived from development of substitute products is generally evidenced by rivals' plans for expanding production capacity, as well as by their sales and profit growth numbers.

Competitive pressures arising from substitute products increase as the relative price of substitute products declines and as consumers' switching costs decrease. The competitive strength of substitute products is best measured by the inroads into the market share those products obtain, as well as those firms' plans for increased capacity and market penetration.

Bargaining Power of Suppliers

The bargaining power of suppliers affects the intensity of competition in an industry, especially when there is a large number of suppliers, when there are only a few good substitute raw materials, or when the cost of switching raw materials is especially costly. It is often in the best interest of both suppliers and producers to assist each other with reasonable prices, improved quality, development of new services, just-in-time deliveries, and reduced inventory costs, thus enhancing long-term profitability for all concerned.

Firms may pursue a backward integration strategy to gain control or ownership of suppliers. This strategy is especially effective when suppliers are unreliable, too costly, or not capable of meeting a firm's needs on a consistent basis. Firms generally can negotiate more favorable terms with suppliers when backward integration is a commonly used strategy among rival firms in an industry.

However, in many industries it is more economical to use outside suppliers of component parts than to self-manufacture the items. This is true, for example, in the outdoor power equipment industry where producers of lawn mowers, rotary tillers, leaf blowers, and edgers

such as Murray generally obtain their small engines from outside manufacturers such as Briggs & Stratton who specialize in such engines and have huge economies of scale.

In more and more industries, sellers are forging strategic partnerships with select suppliers in efforts to (1) reduce inventory and logistics costs (e.g., through just-in-time deliveries); (2) speed the availability of next-generation components; (3) enhance the quality of the parts and components being supplied and reduce defect rates; and (4) squeeze out important cost savings for both themselves and their suppliers.

Bargaining Power of Consumers

When customers are concentrated or large or buy in volume, their bargaining power represents a major force affecting the intensity of competition in an industry. Rival firms may offer extended warranties or special services to gain customer loyalty whenever the bargaining power of consumers is substantial. Bargaining power of consumers also is higher when the products being purchased are standard or undifferentiated. When this is the case, consumers often can negotiate selling price, warranty coverage, and accessory packages to a greater extent.

The bargaining power of consumers can be the most important force affecting competitive advantage. Consumers gain increasing bargaining power under the following circumstances:

- If they can inexpensively switch to competing brands or substitutes
- If they are particularly important to the seller
- If sellers are struggling in the face of falling consumer demand
- If they are informed about sellers' products, prices, and costs

If they have discretion in whether and when they purchase the product

Sources of External Information

A wealth of strategic information is available to organizations from both published and unpublished sources. Unpublished sources include customer surveys, market research, speeches at professional and shareholders' meetings, television programs, interviews, and conversations with stakeholders. Published sources of strategic information include periodicals, journals, reports, government documents, abstracts, books, directories, newspapers, and manuals. The Internet has made it easier for firms to gather, assimilate, and evaluate information.

There are many excellent Web sites for gathering strategic information, but six that the author uses routinely are listed here:

- http://marketwatch.multexinvestor.com
- http://moneycentral.msn.com
- http://finance.yahoo.com
- www.clearstation.com
- https://us.etrade.com/e/t/invest/marketswww.hoovers.com

Most college libraries subscribe to Standard & Poor's (S&P's) Industry Surveys. These documents are exceptionally up-to-date and give valuable information about many different industries. Each report is authored by a Standard & Poor's industry research analyst and includes the following sections:

- Current Environment
- Industry Trends
- How the Industry Operates
- Key Industry Ratios and Statistics
- How to Analyze a Company
- Glossary of Industry Terms
- Additional Industry Information
- References
- Comparative Company Financial Analysis

Forecasting Tools and Techniques

Forecasts are educated assumptions about future trends and events. Forecasting is a complex activity because of factors such as technological innovation, cultural changes, new products, improved services, stronger competitors, shifts in government priorities, changing social values, unstable economic conditions, and unforeseen events. Managers often must rely on published forecasts to effectively identify key external opportunities and threats.

A sense of the future permeates all action and underlies every decision a person makes. People eat expecting to be satisfied and nourished in the future. People sleep assuming that in the future they will feel rested. They invest energy, money, and time because they believe their efforts will be rewarded in the future. They build highways assuming that automobiles and trucks will need them in the future. Parents educate children on the basis of forecasts that they will need certain skills,

attitudes, and knowledge when they grow up. The truth is we all make implicit forecasts throughoutour daily lives. The question, therefore, is not whether we should forecast but rather how we can best forecast to enable us to move beyond our ordinarily unarticulated assumptions about the future. Can we obtain information and then make educated assumptions (forecasts) to better guide our current decisions to achieve a more desirable future state of affairs? We should go into the future with our eyes and our minds open, rather than stumble into the future with our eyes closed.

Many publications and sources on the Internet forecast external variables. Several published examples include Industry Week's "Trends and Forecasts," BusinessWeek's "Investment Outlook," and Standard & Poor's Industry Survey. The reputation and continued success of these publications depend partly on accurate forecasts, so published sources of information can offerexcellent projections. An especially good Web site for industry forecasts is finance.yahoo.com.

Just insert a firm's stock symbol and go from there.

Sometimes organizations must develop their own projections. Most organizations forecast (project) their own revenues and profits annually. Organizations sometimes forecast market share or customer loyalty in local areas. Because forecasting is so important in strategic management and because the ability to forecast (in contrast to the ability to use a forecast) is essential, selected forecasting tools are examined further here.

Forecasting tools can be broadly categorized into two groups: quantitative techniques and qualitative techniques. Quantitative forecasts are most appropriate when historical data are available and when the relationships among key variables are expected to remain the same in the future. Linear regression, for example, is based on the assumption that the future will be just like the past—which, of course, it never is. As historical relationships become less stable, quantitative forecasts become less accurate.

No forecast is perfect, and some forecasts are even wildly inaccurate. This fact accents the need for strategists to devote sufficient time and effort to study the underlying bases for published forecasts and to develop internal forecasts of their own. Key external opportunities and threats can be effectively identified only through good forecasts. Accurate forecasts can

provide major competitive advantages for organizations. Forecasts are vital to the strategic-management process and to the success of organizations.

Making Assumptions

Planning would be impossible without assumptions. McConkey defines assumptions as the "best present estimates of the impact of major external factors, over which the manager has little if any control, but which may exert a significant impact on performance or the ability to achieve desired results." 16 Strategists are faced with countless variables and imponderables that can be neither controlled nor predicted with 100 percent accuracy. Wild guesses should never be made in formulating strategies, but reasonable assumptions based on available information must always be made.

By identifying future occurrences that could have a major effect on the firm and by making reasonable assumptions about those factors, strategists can carry the strategic-management process forward. Assumptions are needed only for future trends and events that are most likely to have a significant effect on the company's business. Based on the best information at the time, assumptions serve as checkpoints on the validity of strategies. If future occurrences deviate significantly from assumptions, strategists know that corrective actions may be needed. Without reasonable assumptions, the strategy-formulation process could not proceed effectively. Firms that have the best information generally make the most accurate assumptions, which can lead to major competitive advantages.

Chapter 2
KONSEP STRATEGI DAN VISI-MISI PERUSAHAAN

Konsep Strategi dan Visi-Misi Perusahaan

Istilah manajemen berasal dari kata management (bahasa Inggris), turunan dari kata " to manage" yang artinya mengurus atau tata laksana atau ketatalaksanaan. Sehingga manajemen dapat diartikan bagaimana cara manajer (orangnya) mengatur, membimbing dan memimpin semua orang yang menjadi pembantunya agar usaha yang sedang digarap dapat mencapai tujuan yang telah ditetapkan sebelumnya.

Pengertian Manajemen menurut beberapa ahli yaitu :

Menurut R. Terry, Manajemen merupakan suatu proses khas yang terdiri dari tindakan-tindakan perencanaan, pengorganisasian, penggerakan dan pengendalian yang dilakukan untuk menentukan serta mencapai sasaran yang telah ditentukan melalui pemanfaatan sumberdaya manusia dan sumberdaya lainnya.

Menurut James A.F. Stoner, Manajemen merupakan suatu proses perencanaan, pengorganisasian, kepemimpinan, dan pengendalian upaya dari anggota organisasi serta penggunaan semua sumber daya yang ada pada organisasi untuk mencapai tujuan organisasi yang telah ditetapkan sebelumnya.

Menurut Horold Koontz dan Cyril O'donnel, Manajemen adalah usaha untuk mencapai suatu tujuan tertentu melalui kegiatan orang lain.

Mengenai definisi manajemen, sebenarnya ada banyak versi, namun demikian pengertian manajemen itu sendiri secara umum yang bisa kita jadikan pegangan adalah bahwa "Manajemen adalah suatu proses yang terdiri dari rangkaian kegiatan, seperti perencanaan, pengorganisasian, pengarahan dan pengendalian atau pengawasan, yang dilakukan untuk menentukan dan mencapai tujuan yang telah ditetapkan melalui pemanfaatan sumberdaya manusia dan sumberdaya lainnya yang terbatas".

Pengertian Strategik

Asal kata "strategi" adalah turunan dari kata dalam bahasa Yunani, strategos.

Pengertian strategi menurut Glueck dan Jauch adalah Rencana yang disatukan, luas dan berintegrasi yang menghubungkan keunggulan strategis perusahaan dengan tantangan lingkungan, yang dirancang untuk memastikan bahwa tujuan utama dari perusahaan dapat dicapai melalui pelaksanaan yang tepat oleh organisasi.

Pengertian strategi secara umum dan khusus sebagai berikut :

Pengertian Umum

Strategi adalah proses penentuan rencana para pemimpin puncak yang berfokus pada tujuan jangka panjang organisasi, disertai penyusunan suatu cara atau upaya bagaimana agar tujuan tersebut dapat dicapai.

Pengertian Khusus

Strategi merupakan tindakan yang bersifat incremental (senantiasa meningkat) dan terus-menerus, serta dilakukan berdasarkan sudut pandang tentang apa yang diharapkan oleh para pelanggan di masa depan. Dengan demikian, strategi hampir selalu dimulai dari apa yang dapat terjadi dan bukan dimulai dari apa yang terjadi. Terjadinya kecepatan inovasi pasar yang baru dan perubahan pola konsumen memerlukan kompetensi inti (core competencies). Perusahaan perlu mencari kompetensi inti di dalam bisnis yang dilakukan.

Jadi dapat disimpulkan secara singkat bahwa strategi adalah rencana jangka panjang dengan diikuti tindakan-tindakan yang ditujukan untuk mencapai tujuan tertentu yang telah ditetapkan sebelumnya berdasarkan analisis dan pengamatan lingkungan.

Pengertian Manajemen Strategik

Pengertian Manajemen Strategik menurut beberapa ahli yaitu :

Pengertian manajemen strategis menurut J. David Hunger dan Thomas L. Wheelen adalah “Strategic Management is that a set of managerial decisions and actions that determines the long-run performance of a corporation”, dan jika diterjemahkan secara bebas maka Manajemen strategis adalah serangkaian keputusan dan tindakan manajerial yang menentukan kinerja perusahaan dalam jangka panjang.

Pengertian manajemen strategis menurut Pearch dan Robinson (1997) dikatakan bahwa manajemen stratejik adalah kumpulan dan tindakan yang menghasilkan perumusan (formulasi) dan pelaksanaan (implementasi) rencana-rencana yang dirancang untuk mencapai sasaran-sasaran organisasi.

Pengertian manajemen strategi menurut Fred R. David adalah bahwa manajemen strategi adalah seni dan ilmu untuk memformulasi, menginplementasi, dan mengevaluasi keputusan lintas fungsi yang memungkinkan organisasi dapat mencapai tujuan.

Pengertian manajemen strategis menurut Lawrence R. Jauch dan Wiliam F. Gluech (Manajemen Strategis dan Kebijakan Perusahaan, 1998) : Manajemen Strategis adalah sejumlah keputusan dan tindakan yang mengarah pada penyusunan suatu strategi atau sejumlah strategi yang efektif untuk membantu mencapai sasaran perusahaan.

Jadi secara umum dapat dijelaskan bahwa manajemen strategis merupakan proses atau rangkaian kegiatan pengambilan keputusan yang bersifat mendasar dan menyeluruh, disertai penetapan cara melaksanakannya, yang dibuat oleh pimpinan dan diimplementasikan oleh seluruh jajaran di dalam suatu organisasi, untuk mencapai tujuan.

Oleh karena itu manajemen strategi sangat penting bagi suatu organisasi/ perusahaan di dunia bisnis karena :

- Memberikan arah pencapaian tujuan organisasi/ perusahaan
- Membantu memikirkan kepentingan berbagai pihak
- Dapat mengantisipasi setiap perubahan kembali secara merata
- Berhubungan dengan efisiensi dan efektifitas

Hirarki Strategi

Strategi-strategi itu berinteraksi erat dan berkelanjutan serta harus diintegrasikan dengan baik demi kesuksesan perusahaan.Pelaksanaan khususnya sangat bervariasi antar satu perusahaan.

Manajemen strategik dimulai dari satu atau semua level hirarki dalam organisasi.Lima Elemen Dasar Proses Manajemen Strategik :

- Menetapkan visi, misi dan tujuan organisasi

- Pengamatan Lingkungan
- Perumusan dan Pemilihan Strategi
- Implementasi strategi
- Evaluasi kinerja dan Pengendalian/tindakan koreksi
- Model manajemen strategik

Model manajemen strategik dimulai dari pengamatan lingkungan ke perumusan strategi (termasuk penetapan misi, tujuan, strategi, dan kebijakan) diteruskan ke implementasi strategi (termasuk pengembangan program, anggaran, dan prosedur), dan terakhir evaluasi dan pengendalian.

MENETAPKAN TUJUAN PERUSAHAAN

Tujuan perusahaan adalah hasil akhir aktivitas perencanaan yang telah dietapkan perusahaan. Tujuan perusahaan merumuskan apa yang akan diselesaikan dan kapan akan diselesaikan, dan sebaiknya diukur jika memungkinkan. Jadi tujuan perusahaan adalah hasil akhir yang ingin dicapai perusahaan. Pencapaian tujuan perusahaan merupakan hasil dari penyelesaian misi perusahaan.

Beberapa bidang dimana perusahaan perlu membuat tujuan dan sasaran adalah :

- Profitabilitas (laba bersih yang ingin diapai)
- Efisiensi (biaya rendah)
- Pertumbuhan (kenaikan aset, total penjualan dsb)
- Kekayaan pemegang saham (dividen dan apresiasi harga saham)
- Penggunaan sumber daya (ROE atau ROI)
- Reputasi (diperhitungkan sebagai perusahaan yang “terkenal”)
- Kontribusi untuk karyawan (keamanan kerja, upah)
- Kontribusi untuk lingkungan (pajak, amal, CSR, produk bermanfaat)
- Kepemimpinan pasar (pangsa pasar)
- Kepemimpinan teknologi (inovasi, kreatifitas)
- Kelangsungan hidup (menghindari kebangkrutan); dan atau
- Kebutuhan pribadi manajemen puncak (menggunakan peruahaan untuk tujuan pribadi, seperti menyediakan pekerjaan untuk keluarga)

(Ref : Hunger & Wheelen, Strategic Management, Addison-Wesley, 2013.)

Tujuan perusahaan menyediakan dasar untuk perencanaan, pengorganisasian, permotivasian dan pengendalian. Tujuan ditetapkan sebagai petunjuk dalam pengambilan keputusan, meningkatkan efisiensi serta menjadi petunjuk untuk melakukan performance appraisal. Tanpa tujuan dan komunikasi yang efektif, perilaku dalam perusahaan dapat tersesat keberbagai arah.

Secara umum, tujuan perusahaan biasanya dikatagorikan dalam dua jenis, yaitu tujuan jangka pendek dan tujuan jangka panjang. Tujuan jangka pendek adalah sasaran perusahaan yang ingindicapai biasanya dalam kurun waktu satu sampai dua tahun. Tujuan jangka panjang adalah sasaran perusahaan yang ingin dicapai untuk kurun waktu dua sampai lima tahun.

Baik buruknya suatu tujuan secara umum biasanya ditentukan oleh bagaimana tujuan tersebut benar-benar berguna bagi perusahaan.

Beberapa petunjuk yang dapat membantu manajemen membuat tujuan yang berkualitas, yaitu :

- Mengembangkan tujuan perusahaan secara spesifik
- Menyusun tujuan perusahaan yang mampu dicapai
- Membentuk tujuan perusahaan yang sifatnya fleksibel

Membentuk tujuan perusahaan

Organisasi dibentuk untuk mencapai tujuan yang telah ditetapkan oleh pimpinan organisasi beserta anggotanya. Tujuan organisasi tidak sama, hal ini dilihat dari jenis organisasi. Organisasi bisinis mempunyai tujuan untuk meningkatkan profitabilitas atau keuntungan, sedangkan organisasi publik memiliki tujuan dalam pemberian pelayanan publik yang lebih baik atau public service.

Tujuan organisasi adalah “sebagai suatu pernyataan tentang keadaan yang diinginkan dimana organisasi bermaksud untuk merealisasikan” dan sebagai “pernyataan tentang keadaan diwaktu yang akan datang dimana organisasi sebagai kolektifitas mencoba untuk

menimbukannya. Tujuan organisasi tersebut antara lain (1) hasil akhir yang diinginkan diwaktu mendatang (2) usaha-usaha atau kegiatan-kegiatan yang diarahkan.

Konsep tujuan organisasi dipandang secara luas mempunyai beberapa fungsi penting yang bervariasi menurut waktu dan keadaan. Berbagai fungsi tujuan antara lain sebagai berikut:

- Pedoman bagi kegiatan, melalui penggambaran hasil akhir diwaktu yang akan datang. Memberikan arah dan pemusatan kegiatan organisasi mengenai apa yang harus atau tidak dilakukan.
- Sumber legitimasi, melalui pembenaran kegiatan – kegiatannya. Akan meningkatkan kemampuan organisasi untuk mendapatkan berbagai sumber daya dan dukungan dari lingkungan sekitarnya.
- Standar pelaksanaan, memberikan standar langsung bagi penilaian pelaksanaan kegiatan (prestasi organisasi).
- Sumber motivasi, karena sering memberikan insentif bagi para anggota.
- Dasar rasional pengorganisasian, karena antara tujuan dan struktur organisasi saling berinteraksi dalam kegiatan – kegiatan untuk mencapai tujuan.

Tujuan dan manfaat organisasi antara lain untuk:

- mengatasi terbatasnya kemampuan, kemauan dan sumberdaya yang dimilinya dalam mencapai tujuan;
- mencapai tujuan secara lebih efektif dan efesien dan efisien karena dikerjakan bersama-sama (motif pencapaian tujuan);
- wadah memanfaatkan smber daya dan teknologi bersama-sama;
- wadah mengembangkan potensi dan spesialisasi yang dimiliki seseorang (motif berprestasi);
- wadah mendapatkan jabatan dan pembagian kerja:
- wadah mengelola lingkungan bersama-sama;
- wadah mencari keuntungan bersama-sama (motif uang);
- wadah menggunakan kekuasaan dan pengawasan (motif kekuasaan);
- wadah mendapatkan penghargaan (motif penghargaan);

- wadah emmenuhi kebutuhan manusia yang semakin banyak dan kompleks;
- wadah menambah pergaulan;
- wadah memanfaatkan waktu luang.

Pandangan tetang tujuan organisasi di atas dapat disimpulkan bahwa, semua organisasi memiliki tujuan yang sama yakni, memajukan dan mensejahterakan orang-orang yang ada dalam organisasi tersebut. Tujuan spesifik dari organisasi bergantung pada bentuk dan jenis organisasi, sehngga tujuan spesifik tersebut bisa diwujudkan melalui jenis organisasi yang menjalankan bentuk usaha atau kegiatannya.

Sasaran (goal) organisasi adalah suatu keadaan atau kondisi yang ingin dicapai oleh suatu organisasi. Berbagai jenis sasaran dalam organisasi:

1. Organisasi bisa mempunyai sasaran lebih dari satu.
2. Organisasi dimungkinkan mempunyai sasaran yang berlawanan.
3. Sasaran saling berkaitan satu sama lain.
4. Ada berbeda pandangan terhadap sasaran yang akan ditetapkan.

Sasaran (Goal) Organisasi dan Pengukuran Efektifitas

- Sasaran ataupun tujuan merupakan alasan bagi eksistensi organisasi.
- Sasaran ataupun tujuan sangat penting bagi proses manajemen yang dijalankan dalam suatu organisasi. Memberi pengakuan, Arah bagi organisasi, pengukuran organisasi, mengurangi ketidakpastian.

Jenis-jenis Sasaran Organisasi

- Sasaran Resmi (Official goal) yakni tujuan yang telah ditetapkan secara legal sesuai dengan visi yang telah ditetapkan.
- Sasaran yang sebenarnya diinginkan (Operative goal), yakni sasraan yang dicapai, namun mengaami perubahan, sehingga dimunculkan kembali sasaran yang diinginkan, sesuai dengan tujuan semula.

Pihak yang menetapkan sasaran Organisasi

1. Pemimpin Tunggal, terjadi pada perusahaan berukuran kecil dimana pemimpin dipegang oleh pemilik.

2. Koalisi Kelompok Pimpinan, terjadi pada organisasi besar.

Sasaran adalah merupakan penjabaran dari tujuan organisasi, dalam bentuk terakhir dan akan dapat dicapai atau dihasilkan dalam jangka waktu tahunan, semesteran, atau bulanan. Sasaran juga menggambarkan hal yang ingin dicapai melalui tindakan-tindakan yang akan dilakukan untuk mencapai tujuan, oleh karena itu sasaran yang ditetapkan diharapkan dapat memberikan fokus pada penyusunan progam dan kegiatan yang bersifat spesifik, terinci, dapat diukur dan dapat dicapai. Sasaran organisasi yang ditetapkan pada dasarnya merupakan bagian dari proses perencanaan strategis dengan fokus utama berupa tindakan dan alokasi sumber daya organisasi dalam rencana kegiatan atau operasional organisasi yang akan dilaksanakan.

Pandangan tentang sasaran organisasi diatas dapat penulis simpulkan bahwa, penetapan tujuan dan sasaran didasarkan pada identifikasi faktor-faktor kunci keberhasilan yang ditetapkan setelah penetapan visi dan misi. Penetapan tujuan akan mengarah kepada perumusan sasaran, kebijakan, program dan kegiatan dalam rangka merealisasikan visi dan misi. Sasaran menggambarkan hal-hal yang ingin dicapai melalui tindakan-tindakan terfokus yang bersifat spesifik, terinci, terukur dan dapat dicapai.

Jika kita mulai dari dasar, tujuan dari strategi adalah untuk mencapai tujuan tertentu. Bagi perusahaan, tujuan dasarnya adalah untuk bertahan hidup dan sejahtera. Bertahan hidup, dalam jangka panjang, mengharuskan perusahaan mendapatkan tingkat pengembalian modal yang melebihi biaya modalnya. Ada dua cara yang mungkin untuk mencapai ini. Pertama, perusahaan dapat mencari suatu industri di mana tingkat keuntungan secara keseluruhan menarik. Kedua, perusahaan dapat mencapai posisi keuntungan vis-à-vis pesaingnya di dalam suatu industri, yang memungkinkannya untuk memperoleh laba yang melebihi rata-rata industri.

Kedua sumber kinerja superior ini menentukan dua tingkat dasar strategi dalam suatu perusahaan:

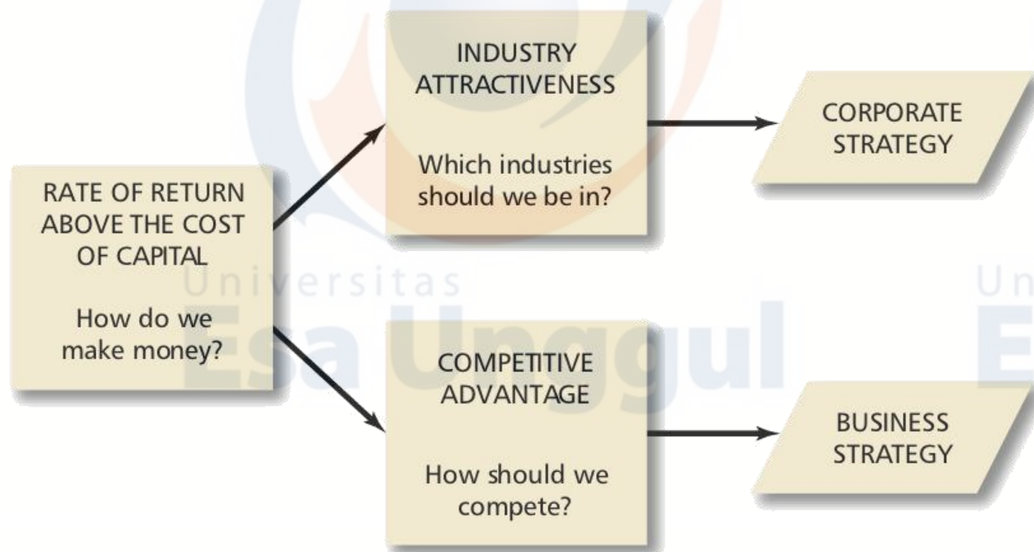
● Strategi perusahaan menentukan ruang lingkup perusahaan dalam industri dan pasar, tempat dia bersaing. Keputusan strategi perusahaan yang harus diambil adalah: diversifikasi, integrasi vertikal, akuisisi dan usaha baru; dan alokasi sumber daya antara berbagai perusahaan yang berbeda.

● Strategi bisnis berkaitan dengan bagaimana perusahaan bersaing dalam industri atau pasar tertentu. Jika perusahaan ingin berkembang dalam suatu industri, perusahaan harus membangun keunggulan kompetitif atas para pesaingnya. Oleh karena itu, bidang strategi ini juga disebut sebagai strategi kompetitif.

Perbedaan ini dapat diekspresikan dalam istilah yang lebih sederhana. Pertanyaan dasar yang dihadapi perusahaan adalah: "Bagaimana kita menghasilkan uang?" Jawaban atas pertanyaan ini sesuai dengan dua pilihan strategis dasar yang telah didentifikasi di atas: "Di mana untuk bersaing?" ("Di mana industri dan pasar seharusnya kita berada?") dan "Bagaimana seharusnya kita bersaing?"

Perbedaan antara strategi perusahaan dan strategi bisnis sesuai dengan struktur organisasi sebagian besar perusahaan besar. Strategi perusahaan adalah tanggung jawab tim manajemen puncak dan staf strategi perusahaan. Strategi bisnis terutama tanggung jawab manajemen divisi.

Sebagai pendekatan terpadu terhadap strategi perusahaan, tulisan ini membahas strategi bisnis dan perusahaan. Namun, penekanan utama saya adalah strategi bisnis. Ini karena persyaratan penting untuk kesuksesan perusahaan adalah kemampuannya untuk membangun keunggulan kompetitif. Oleh karena itu, masalah strategi bisnis mendahului strategi perusahaan. Pada saat yang sama, kedua dimensi strategi ini saling terkait: ruang lingkup bisnis perusahaan memiliki implikasi terhadap sumber keunggulan kompetitif, dan sifat keunggulan kompetitif perusahaan menentukan berbagai bisnis yang dapat berhasil di dalamnya.



Menggambarkan Strategi Perusahaan

Dua pertanyaan yang sama "Di mana perusahaan bersaing?" Dan "Bagaimana persaingannya?" Juga memberikan dasar bagi kita untuk menggambarkan strategi yang sedang ditempuh perusahaan. Pertanyaan ini memiliki beberapa dimensi, dan berkaitan dengan industri atau industri di mana perusahaan itu berada, produk yang disuplai, kelompok pelanggan yang ditargetkan, negara-negara dan tempat di mana ia beroperasi dan berbagai aktivitas vertikal yang dilakukan.

Sebagai ilustrasi, strategi Coca-Cola terdiri dari dua elemen ini:

● Coca-Cola bersaing di industri minuman ringan di mana persediaannya terkonsentrasi untuk minuman bermerek (seperti Coca-Cola, Sprite, Fanta, Tab, dan Fresca) dan memasok minuman lain (seperti Minute Maid, Hi-C, dan Five Alive jus buah, dan air botol Dasani).

● Secara geografis, Coca-Cola bersaing di seluruh dunia. Pasar utamanya adalah AS (27% penjualan) diikuti oleh Meksiko, Brasil, Jepang, dan China.

● Dalam hal ruang lingkup vertikal, kegiatan utama Coca-Cola adalah pengembangan produk, manajemen merek, dan pembuatan dan distribusi konsentrat. Produksi dan distribusi minuman ringannya dilakukan oleh perusahaan kembarnya Coca-Cola Enterprises dan pembotolan lokal waralaba.

Coca-Cola melakukan sebuah strategi diferensiasi yang bergantung pada citra merek dan dikembangkan melalui iklan dan promosi. Coca cola berusaha meraih kepemimpinan pangsa pasar melalui pemasaran massal dan melalui hubungan yang erat dengan perusahaan pembotolan di setiap negara, di mana Coca-cola melakukan bisnis. Namun, strategi tidak

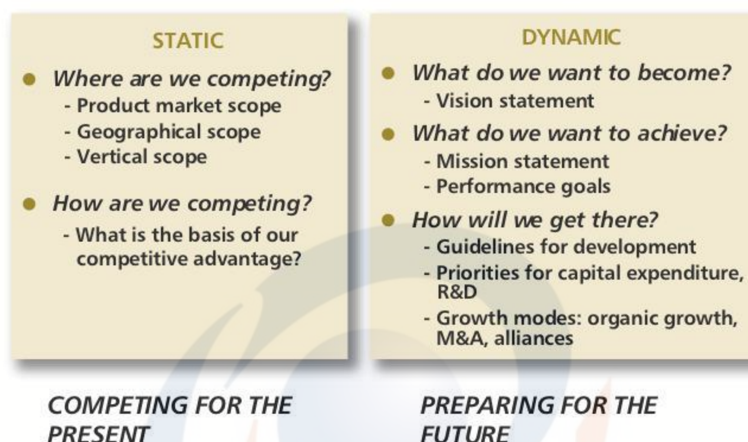
hanya tentang "bersaing untuk hari ini", melainkan juga dengan "bersaing untuk besok." Konsep strategi dinamis ini melibatkan penetapan tujuan untuk masa depan dan menentukan bagaimana tujuan tersebut akan dicapai.

Tujuan jangka panjang berhubungan dengan tujuan keseluruhan dari perusahaan (misi), apa yang ingin dicapai (visi) dan target kinerja yang spesifik. Dalam kasus Coca-Cola, dimensi strategi dinamisnya diuraikan secara luas dalam pernyataan visi (untuk menyegarkan dunia) dan misi yang diuraikan dalam dalam lima perspekti, yaitu: orang, produk, planet, mitra, dan laba.

Secara lebih spesifik tujuan perusahaan diuraikan dalam presentasi analis: jangka panjang pertumbuhan volume 3-4%, pertumbuhan pendapatan 5-6%, dan pertumbuhan laba operasional 6-8%. Tujuan-tujuan yang harus dicapai melalui pertumbuhan penjualan minuman, memanfaatkan peluang pertumbuhan di pasar negara berkembang, mempercepat inovasi dan membangunan core competency.

Bagaimana perusahaan membuat strategi telah menjadi salah satu perdebatan yang paling hangat dalam isu manajemen strategis. Penekanan pada analisis strategi memunculkan pandangan bahwa strategi adalah formulasi yang diperoleh dari manajer yang terlibat dalam proses rasional analisis. Namun, strategi mungkin juga muncul melalui adaptasi terhadap keadaan.

Describing firm strategy: competing in the present, preparing for the future



Collis dan Rukstad mengidentifikasi hirarki strategi laporan:

- Pernyataan misi adalah dasar pernyataan dari organisasi tujuan, itu alamat "mengapa kita ada."
- Pernyataan prinsip atau nilai Serikat "apa yang kita percaya dan bagaimana kita akan berperilaku."
- Pernyataan visi "kita ingin menjadi apa"
- Pernyataan strategis mengartikulasikan "apa keunggulan kompetitif kami, dan apa rencana permainan kami."

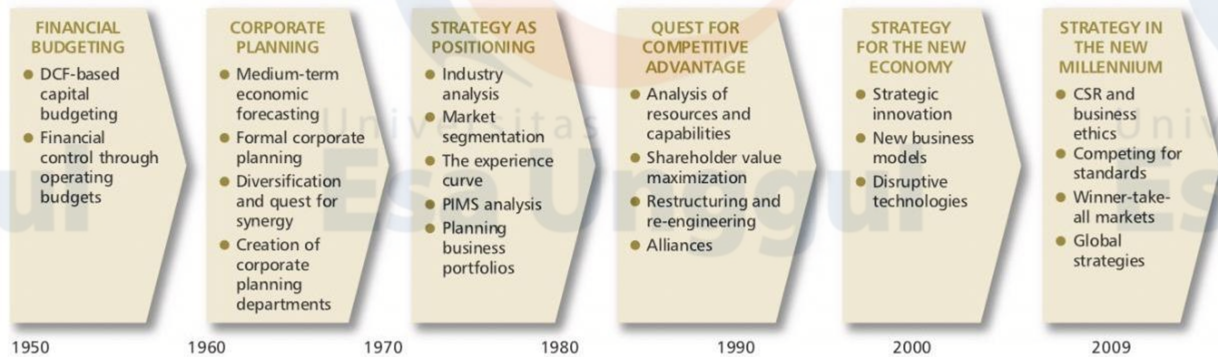
Collis dan Rukstad berpendapat bahwa pernyataan strategis ini harus terdiri tiga komponen, yaitu: tujuan, lingkup (di mana kita akan bersaing) dan keuntungan (bagaimana kita akan bersaing). Evolusi strategi bisnis telah lebih didorong dengan kebutuhan praktis bisnis daripada oleh perkembangan teori. selama tahun 1950-an dan 1960-an, eksekutif senior yang mengalami peningkatan kesulitan dalam koordinasi keputusan dan mempertahankan kontrol di perusahaan yang berkembang dalam ukuran dan kompleksitas.

Teknik perencanaan perusahaan terbukti berguna untuk mengembangkan dan membimbing diversikasi strategi yang banyak digunakan oleh perusahaan besar yang selama tahun 1960-an. Pada pertengahan 1960-an, sebagian besar perusahaan AS dan Eropa telah mendirikan departemen dalam organisasi.

Selama akhir 1970-an dan awal tahun 1980-an, perhatian difokuskan pada sumber profit dalam industri lingkungan. Michael Porter dari Harvard Business School merintis aplikasi ekonomi industri untuk menganalisis profitabilitas industri.

Michael Porter memberikan jawaban untuk pertanyaan "apa itu strategi?" Porter menekankan bahwa: "strategi kompetitif adalah sesuatu yang berbeda. Artinya sengaja memilih yang berbeda mengatur kegiatan untuk memberikan yang campuran nilai yang unik."

Evolution of strategic management: dominant themes

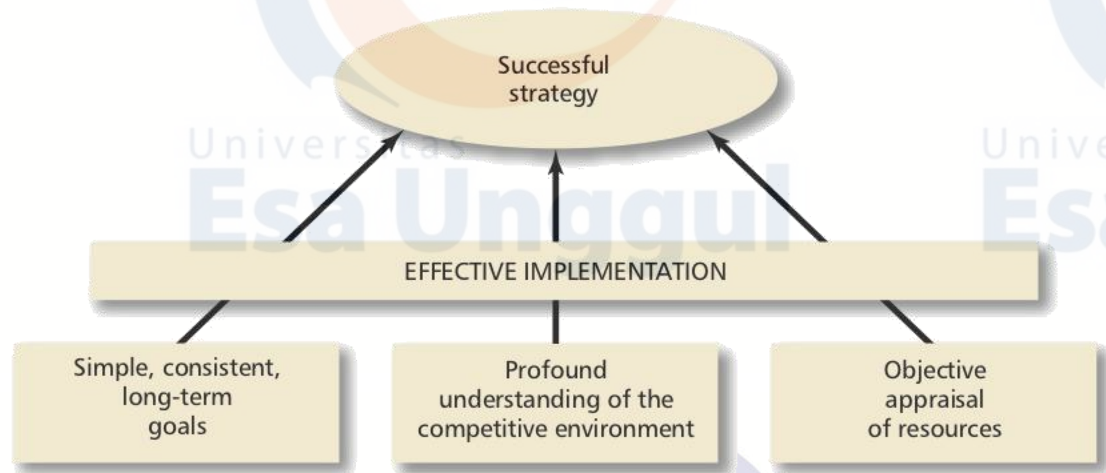


Gambar dibawah ini menunjukkan kerangka dasar untuk analisis strategi yang akan kita gunakan. Empat elemen keberhasilan strategi dirombak menjadi dua kelompok — perusahaan dan lingkungan industri — dengan strategi yang membentuk hubungan di antara keduanya. Perusahaan ini mewujudkan tiga set elemen-elemen ini:

- tujuan dan nilai ("tujuan jangka panjang yang sederhana, konsisten,"),
- sumber daya dan kemampuan ("penilaian sumber daya obyektif"), dan struktur dan sistem ("pelaksanaan yang efektif").
- Lingkungan industri ("pemahaman mendalam tentang lingkungan kompetitif") ditentukan oleh hubungan perusahaan dengan pelanggan, pesaing, dan pemasok.

Pandangan strategi ini sebagai penghubung antara perusahaan dan lingkungan industri memiliki kemiripan yang erat dengan Kerangka Kerja SWOT yang banyak digunakan, tetapi lebih sederhana. Tugas dari strategi bisnis, kemudian, adalah untuk menentukan bagaimana perusahaan akan mengerahkan sumber dayanya di dalam lingkungannya dan dengan demikian memenuhi tujuan jangka panjangnya, dan bagaimana mengatur dirinya sendiri untuk menerapkan strategi itu.

The basic framework: strategy as a link between the firm and its environmen.



Sebuah studi terbaru, peneliti menyimpulkan 90 persen dari semua perusahaan telah menggunakan sebuah pernyataan misi kadang-kadang dalam lima tahun sebelumnya. kita ingin menjadi apa? hal ini terutama penting untuk manajer dan eksekutif di setiap organisasi untuk menyepakati dasar visi bahwa perusahaan berusaha untuk mencapai tujuan dalam jangka panjang.

Sebuah pernyataan visi harus menjawab pertanyaan dasar, "kita ingin menjadi apa?" visi yang jelas memberikan dasar untuk mengembangkan pernyataan misi yang komprehensif. Pernyataan visi harus singkat, lebih disukai satu kalimat, dan banyak manajer mungkin harus memiliki masukan untuk mengembangkan pernyataan tersebut.

Untuk mengembangkan pernyataan misi, sebagian besar didasarkan pada pedoman yang ditetapkan pada pertengahan 1970-an oleh Peter Drucker, yang sering disebut "Bapa manajemen modern" karena Perintis studi di General Motors Corporation dan menulis 22 buku dan ratusan artikel. Harvard Business review telah menyebut Drucker sebagai "pemikir manajemen yang unggul."

Raja dan Cleland menyarankan agar organisasi berhati-hati dalam mengembangkan pernyataan misi untuk menuai keuntungan sebagai berikut:

- memastikan kebulatan tujuan dalam organisasi
- memberikan dasar, atau standar, untuk mengalokasikan sumber daya organisasi
- membangun iklim organisasi

- melayani sebagai titik fokus bagi individu untuk mengidentifikasi tujuan dan arah organisasi, dan untuk mencegah mereka yang tdk bisa ikut serta lebih lanjut dalam kegiatan organisas
- memfasilitasi penjabaran tujuan menjadi pekerjaan struktur yang melibatkan tugas tugas dan tanggung jawab dalam elemen organisasi
- menentukan tujuan organisasi dan kemudian menerjemahkan tujuan ini sedemikian rupa sehingga biaya, waktu, dan parameter kinerja dapat dinilai dan dikendalikan.

Sepuluh manfaat dari memiliki jelas misi dan visi

1. mencapai kejelasan tujuan di antara semua manajer dan karyawan.
2. memberikan dasar untuk semua perencanaan strategis kegiatan, termasuk internal dan eksternal penilaian, menetapkan tujuan, mengembangkan strategi, memilih antara strategi alternatif, menyusun kebijakan, membangun struktur organisasi, mengalokasikan sumber daya, dan mengevaluasi kinerja.
3. memberikan arah.
4. memberikan titik fokus untuk semua pemangku kepentingan dari perusahaan.
5. mengatasi perbedaan pandangan antara manajer.
6. mempromosikan harapan bersama di antara semua manajer dan karyawan.
7. Kelayakan proyek untuk semua pemangku kepentingan.
8. proyek teratur, termotivasi, dan mendapat dukungan yang layak.
9. mencapai kinerja organisasi yang lebih tinggi.
10. mencapai sinergi antara semua manajer dan karyawan.

Pernyataan misi memiliki variasi, tetapi harus memasukkan sembilan komponen:

- pelanggan?
- produk atau jasa paling utama?
- pasar-geografis, di manakah perusahaan bersaing?
- teknologi apakah yang digunakan perusahaan saat ini?
- perhatian untuk bertahan hidup, pertumbuhan, dan profitabilitas
- filsafat-apakah dasar keyakinan, nilai-nilai, aspirasi, dan etika prioritas perusahaan?
- konsep diri-ompetensi atau keunggulan kompetitif utama?

- perhatian untuk citra publik-apakah perusahaan responsif terhadap sosial, masyarakat, dan kepedulian lingkungan?
- perhatian untuk karyawan-apakah karyawan aset berharga dari perusahaan?

Organisasi dewasa ini perlu merumuskan visi yang jelas, misi yang mendukung pencapaian misi, tujuan yang mudah untuk dicapai dan strategi organisasi yang mempu mewujudkan. Antara Visi, Misi, dan Perencenaan Strategis memiliki hubungan yang sangat erat dan saling mebutuhkan. Visi adalah rumusan umum mengenai keadaan yang diinginkan pada akhir periode perencanaan, Misi adalah rumusan umum mengenai upaya-upaya yang akan dilaksanakan untuk mewujudkan Visi, sedangkan Perencanaan Strategis merupakan proses memutuskan program-program yang akan dilaksanakan oleh organisasi dan perkiraan jumlah sumber daya yang akan dialokasikan ke setiap program jangka panjang selama beberapa tahun ke depan.

Dengan demikian perencanaan strategis digunakan untuk menentukan / mewujutkan visi dan misi organisasi dan membagi-bagi sumber daya yang diperlukan untuk mencapainya. Jadi dapat dikatakan suatu organisasi pada mulanya memiliki cita-cita atau tujuan akhir yang ingin dicapai dalam jagka panjang yang disebut visi, selanjutnya untuk mencapai / mewujutkan visi organisasi yang telah ditentukan tersebut, organisasi merumuskan upaya-upaya umum yang hendak dilakukan yang disebut misi, kemudian untuk mewujutkan misi, organisasi membuat / merumuskan upaya-upaya khusus yang dirasa paling efektif dan efisien untuk mencapai cita-cita organisasi yang disebut perencanaan strategis.

Lebih jelasnya visi merupakan pernyataan tentang gambaran keadaan dan karakteristik yang ingin dicapai oleh suatu lembaga pada jauh dimasa yang akan datang. Misi merupakan pernyataan tentang apa yang harus dikerjakan oleh lembaga dalam usahanya mewujudkan visi, dan hubungannya dengan rencana strategis adalah memberikan arah yang akan membawa lembaga dalam mencapai tujuan yang sesuai dengan visi dan misi yang telah dirumuskan.

Berikut contoh-contoh visi yang diambil dari beberapa perusahaan, instansi, atau organisasi.

1. Contoh Visi dan Misi Organisasi

a. Visi

“Mewujudkan generasi muda yang tangguh, mandiri, terampil dan berakhlak mulia”

b. Misi

Sebagai upaya mencapai visi tersebut. maka misi organisasi kami adalah;

- Mengadakan kegiatan-kegiatan kepemudaan di masyarakat.
- Mengadakan pelatihan-pelatihan bisnis pertanian, perniagaan dan bisnis kreatif.
- Membantu dalam pengabdian dan menjaga lingkungan.
- Meningkatkan prestasi baik dalam bidang olahraga maupun bidang keilmuan lainnya.
- Mempererat tali persaudaraan dengan pertemuan-pertemuan rutin.

1. Contoh Visi dan Misi Kemenristekdikti

a. Visi

“Terwujudnya pendidikan tinggi yang bermutu serta kemampuan iptek dan inovasi untuk mendukung daya saing bangsa"

b. Misi

Sebagai upaya untuk mewujudkan visi tersebut di atas, maka misi Kemenristekdikti adalah :

- Meningkatkan akses, relevansi, dan mutu pendidikan tinggi untuk menghasilkan SDM yang berkualitas; dan
- Meningkatkan kemampuan Iptek dan inovasi untuk menghasilkan nilai tambah produk inovasi.

2. Contoh Visi dan Misi Indosatooredoo

a. Visi

Menjadi Perusahaan Telekomunikasi Digital Terdepan di Indonesia

b. Misi

- Layanan dan Produk yang Membebaskan
- Jaringan Data yang Unggul
- Memperlakukan Pelanggan Sebagai Sahabat
- Transformasi Digital

4. Contoh Visi dan Misi Universitas Indonesia (UI)

Visi 2015-2019

Mewujudkan Universitas Indonesia menjadi PTN BH yang mandiri dan unggul serta mampu menyelesaikan masalah dan tantangan pada tingkat nasional maupun global, menuju unggulan di Asia Tenggara

Misi

- Menyediakan akses yang luas dan adil, serta pendidikan dan pengajaran yang berkualitas.
- Menyelenggarakan kegiatan Tridharma yang bermutu dan relevan dengan tantangan nasional serta global.
- Menciptakan lulusan yang berintelektualitas tinggi, berbudi luhur dan mampu bersaing secara global.
- Menciptakan iklim akademik yang mampu mendukung perwujudan visi UI

4. Contoh Visi dan Misi Bahasa Inggris (Alfamart)

Visi

"To be Indonesia's largest and globally competitive widely owned retail distribution network that empowers small entrepreneurs and fulfills customer needs and expectations"

Misi

- To satisfy customer needs and expectations by focusing on high quality products and services.
- To implement ethical business practices, to be the best in all of our actions.
- To develop entrepreneurial spirits and skills in the Company and the society.
- To develop a reliable, healthy and growing organization which benefits all stakeholders.

Chapter 3
EXTERNAL ASSEMENT

External Assesment

A note from David

The Nature of an External Audit

The purpose of an external audit is to develop a finite list of opportunities that could benefit a firm and threats that should be avoided. As the term finite suggests, the external audit is not aimed at developing an exhaustive list of every possible factor that could influence the business; rather, it is aimed at identifying key variables that offer actionable responses. Firms should be able to respond either offensively or defensively to the factors by formulating strategies that take advantage of external opportunities or that minimize the impact of potential threats. Figure 3-1 illustrates how the external audit fits into the strategic-management process.

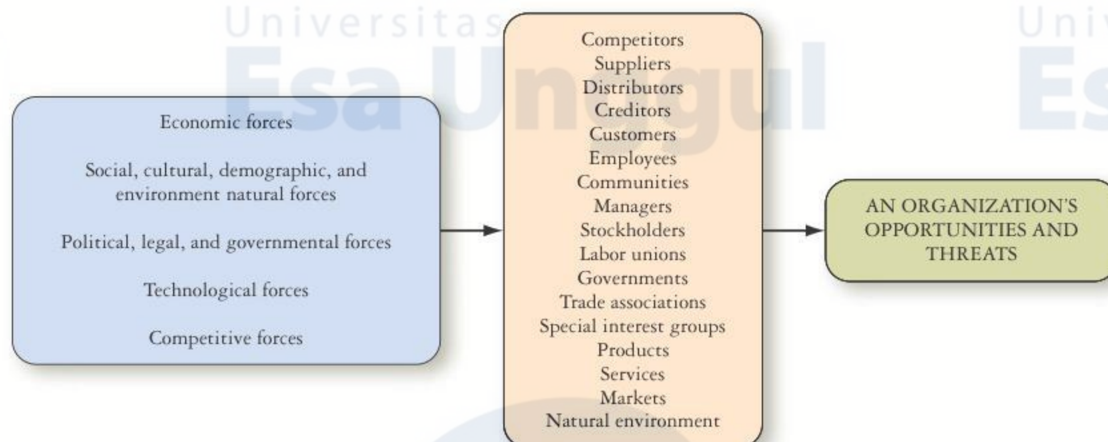
Key External Forces

External forces can be divided into five broad categories: (1) economic forces; (2) social, cultural, demographic, and natural environment forces; (3) political, governmental, and legal forces; (4) technological forces; and (5) competitive forces. Relationships among these forces and an organization are depicted in Figure 3-2. External trends and events, such as the global economic recession, significantly affect products, services, markets, and organizations worldwide. The U.S. unemployment rate climbed to over 9 percent in July 2009 as more than 2.5 million jobs were lost in the United States in 2008—the most since 1945 when the country downsized from the war effort. The rate is expected to rise to 10.1 percent. All sectors witness rising

unemployment rates, except for education, health-care services, and government employment. Many Americans are resorting to minimum wage jobs to make ends meet.

Changes in external forces translate into changes in consumer demand for both industrial and consumer products and services. External forces affect the types of products developed, the nature of positioning and market segmentation strategies, the type of services offered, and the choice of businesses to acquire or sell. External forces directly affect both suppliers and distributors. Identifying and evaluating external opportunities and threats enables organizations to develop a clear mission, to design strategies to achieve long-term objectives, and to develop policies to achieve annual objectives.

The increasing complexity of business today is evidenced by more countries developing the capacity and will to compete aggressively in world markets. Foreign businesses and countries are willing to learn, adapt, innovate, and invent to compete successfully in the marketplace. There are more competitive new technologies in Europe and Asia today than ever before.



The Process of Performing an External Audit

The process of performing an external audit must involve as many managers and employees as possible. As emphasized in earlier chapters, involvement in the strategic-management process can lead to understanding and commitment from organizational members. Individuals appreciate having the opportunity to contribute ideas and to gain a better understanding of their firms' industry, competitors, and markets.

To perform an external audit, a company first must gather competitive intelligence and information about economic, social, cultural, demographic, environmental, political, governmental, legal, and technological trends. Individuals can be asked to monitor various sources of information, such as key magazines, trade journals, and newspapers. These persons can submit periodic scanning reports to a committee of managers charged with performing the external audit. This approach provides a continuous stream of timely strategic information and involves many individuals in the external-audit process. The Internet provides another source for gathering strategic information, as do corporate, university, and public libraries. Suppliers, distributors, salespersons, customers, and competitors represent other sources of vital information.

Once information is gathered, it should be assimilated and evaluated. A meeting or series of meetings of managers is needed to collectively identify the most important opportunities and threats facing the firm. These key external factors should be listed on flip charts or a chalkboard. A prioritized list of these factors could be obtained by requesting that all managers rank the factors identified, from 1 for the most important opportunity/threat to 20 for the least important opportunity/threat. These key external factors can vary over time and by industry. Relationships with suppliers or distributors are often a critical success factor. Other variables commonly used include market share, breadth of competing products, world economies, foreign affiliates, proprietary and key

account advantages, price competitiveness, technological advancements, population shifts, interest rates, and pollution abatement.

Freund emphasized that these key external factors should be (1) important to achieving long-term and annual objectives, (2) measurable, (3) applicable to all competing firms, and (4) hierarchical in the sense that some will pertain to the overall company and others will be more narrowly focused on functional or divisional areas. 1 A final list of the most important key external factors should be communicated and distributed widely in the organization. Both opportunities and threats can be key external factors.

The Industrial Organization (I/O) View

The Industrial Organization (I/O) approach to competitive advantage advocates that external (industry) factors are more important than internal factors in a firm achieving competitive advantage. Proponents of the I/O view, such as Michael Porter, contend that organizational performance will be primarily determined by industry forces. Porter's FiveForces Model, presented later in this chapter, is an example of the I/O perspective, which focuses on analyzing external forces and industry variables as a basis for getting and keeping competitive advantage. Competitive advantage is determined largely by competitive positioning within an industry, according to I/O advocates. Managing strategically from the I/O perspective entails firms striving to compete in attractive industries, avoiding weak or faltering industries, and gaining a full understanding of key external factor relationships within that attractive industry. I/O research provides important contributions to our understanding of how to gain competitive advantage.

I/O theorists contend that external factors in general and the industry in which a firm chooses to compete has a stronger influence on the firm's performance than do the internal functional decisions managers make in marketing, finance, and the like. Firm performance, they contend, is primarily based more on industry properties, such as economies of scale,

barriers to market entry, product differentiation, the economy, and level of competitiveness than on internal resources, capabilities, structure, and operations. The global economic recession's impact on both strong and weak firms has added credence of late to the notion that external forces are more important than internal. Many thousands of internally strong firms in 2006–2007 disappeared in 2008–2009.

The I/O view has enhanced our understanding of strategic management. However, it is not a question of whether external or internal factors are more important in gaining and maintaining competitive advantage. Effective integration and understanding of both external and internal factors is the key to securing and keeping a competitive advantage. In fact, as discussed in Chapter 6, matching key external opportunities/threats with key internal strengths/weaknesses provides the basis for successful strategy formulation.

Economic Forces

Increasing numbers of two-income households is an economic trend in the United States. Individuals place a premium on time. Improved customer service, immediate availability, trouble-free operation of products, and dependable maintenance and repair services are becoming more important. People today are more willing than ever to pay for good service if it limits inconvenience.

Economic factors have a direct impact on the potential attractiveness of various strategies. For example, when interest rates rise, funds needed for capital expansion become more costly or unavailable. Also, when interest rates rise, discretionary income declines, and the demand for discretionary goods falls. When stock prices increase, the desirability of equity as a source of capital for market development increases. Also, when the market rises, consumer and business wealth expands. A summary of economic variables that often represent opportunities and threats for organizations is provided in Table 3-1.

An economic variable of significant importance in strategic planning is gross domestic product (GDP), especially across countries. Table 3-2 lists the GDP of various countries in Asia for all of 2009. Unlike most countries in Europe and the Americas, most Asian countries expect positive GDP growth in 2009.

Trends in the dollar's value have significant and unequal effects on companies in different industries and in different locations. For example, the pharmaceutical, tourism, entertainment, motor vehicle, aerospace, and forest products industries benefit greatly when the dollar falls against the yen and euro. Agricultural and petroleum industries are hurt by the dollar's rise against the currencies of Mexico, Brazil, Venezuela, and Australia. Generally, a strong or high dollar makes U.S. goods more expensive in overseas markets. This worsens the U.S. trade deficit. When the value of the dollar falls, tourism-oriented firms benefit because Americans do not travel abroaas much when the value of the dollar is low; rather, foreigners visit and vacation more in the United States.

A low value of the dollar means lower imports and higher exports; it helps U.S. companies' competitiveness in world markets. The dollar has fallen to five-year lows against the euro and yen, which makes U.S. goods cheaper to foreign consumers and combats deflation by pushing up prices of imports. However, European firms such as Volkswagen AG, Nokia Corp., and Michelin complain that the strong euro hurts their financial performance. The low value of the dollar benefits the U.S. economy in many ways. First, it helps stave off the risks of deflation in the United States and also reduces the U.S. trade deficit. In addition, the low value of the dollar raises the foreign sales and profits of domestic firms, thanks to dollar-induced gains, and encourages foreign countries to lower interest rates and loosen fiscal policy, which stimulates worldwide economic expansion. Some sectors, such as consumer staples, energy, materials, technology, and health care, especially benefit from a low value of the dollar.

Manufacturers in many domestic industries in fact benefit because of a weak dollar, which forces foreign rivals to raise prices and extinguish discounts. Domestic firms with big overseas sales, such as McDonald's, greatly benefit from a weak dollar.

Between March and June 2009, the U.S. dollar weakened 11.0 percent against the euro, due to the growing United States debt, which may soon exceed $12 trillion. Table 3-3 lists some advantages and disadvantages of a weak U.S. dollar for American firms.
Rising unemployment rates across the United States have touched off a race among states to attract businesses with tax breaks and financial incentives. New Jersey has promised to send a $3,000 check to every small business that hires a new employee. Minnesota is offering tax-free zones for companies that create "green jobs." Colorado has created a $5 million fund for banks that open credit lines for small businesses. To minimize risk in incentive deals, may states write in claw-back provisions that require companies to return funds if they fail to create the promised number of jobs.

The slumping economy worldwide and depressed prices of assets has dramatically slowed the migration of people from country to country and from the city to the suburbs. Because people are not moving nearly as much as in years past, there is lower and lower demand for new or used houses. Thus the housing market is expected to remain very sluggish well into 2010 and 2011.

Key Economic Variables to Be Monitored

Shift to a service economy in the United States	Import/export factors
Availability of credit	Demand shifts for different categories of goods and services
Level of disposable income	Income differences by region and consumer groups
Propensity of people to spend	Price fluctuations
Interest rates	Export of labor and capital from the United States
Inflation rates	Monetary policies
Money market rates	Fiscal policies
Federal government budget deficits	Tax rates
Gross domestic product trend	European Economic Community (EEC) policies
Consumption patterns	Organization of Petroleum Exporting Countries (OPEC) policies
Unemployment trends	Coalitions of Lesser Developed Countries (LDC) policies
Worker productivity levels	
Value of the dollar in world markets	
Stock market trends	
Foreign countries' economic conditions	

Environment Forces

Social, cultural, demographic, and environmental changes have a major impact on virtually all products, services, markets, and customers. Small, large, for-profit, and nonprofit organizations in all industries are being staggered and challenged by the opportunities and threats arising from changes in social, cultural, demographic, and environmental variables. In every way, the United States is much different today than it was yesterday, and tomorrow promises even greater changes.

The United States is getting older and less white. The oldest members of America's 76 million baby boomers plan to retire in 2011, and this has lawmakers and younger taxpayers deeply concerned about who will pay their Social Security, Medicare, and Medicaid. Individuals age 65 and older in the United States as a percentage of the population will rise to 18.5 percent by 2025. The five "oldest" states and five "youngest" states in 2007 are given in Table 3-4.

By 2075, the United States will have no racial or ethnic majority. This forecast is aggravating tensions over issues such as immigration and affirmative action. Hawaii, California, and New Mexico already have no majority race or ethnic group.

The population of the world surpassed 7.0 billion in 2010; the United States has just over 310 million people. That leaves billions of people outside the United States who may be interested in the products and services produced through domestic firms. Remaining solely domestic is an increasingly risky strategy, especially as the world population continues to grow to an estimated 8 billion in 2028 and 9 billion in 2054.

Social, cultural, demographic, and environmental trends are shaping the way Americans live, work, produce, and consume. New trends are creating a different type of consumer and, consequently, a need for different products, different services, and different strategies. There are now more American households with people living alone or with unrelated people than there are households consisting of married couples with children. American households are making more and more purchases online. Beer consumption in the United States is growing at only 0.5 percent per year, whereas wine consumption is growing 3.5 percent and distilled spirits consumption is growing at 2.0 percent. 2 Beer is still the most popular alcoholic beverage in the United States, but its market share has dropped from 59.5 percent in its peak year of 1995 to 56.7 percent today. For a wine company such as Gallo, this trend is an opportunity, whereas for a firm such as Adolph Coors Brewing, this trend is an external threat.

The trend toward an older America is good news for restaurants, hotels, airlines, cruise lines, tours, resorts, theme parks, luxury products and services, recreational vehicles, home builders, furniture producers, computer manufacturers, travel services, pharmaceutical firms, automakers, and funeral homes. Older Americans are especially interested in health care, financial services, travel, crime prevention, and leisure. The world's longest-living

people are the Japanese, with Japanese women living to 86.3 years and men living to 80.1 years on average. By 2050, the Census Bureau projects that the number of Americans age 100 and older will increase to over 834,000 from just under 100,000 centenarians in the United States in 2000. Americans age 65 and over will increase from 12.6 percent of the U.S. population in 2000 to 20.0 percent by the year 2050.

The aging American population affects the strategic orientation of nearly all organizations. Apartment complexes for the elderly, with one meal a day, transportation, and utilities included in the rent, have increased nationwide. Called lifecare facilities, these complexes now exceed 2 million. Some well-known companies building these facilities include Avon, Marriott, and Hyatt. Individuals age 65 and older in the United States comprise 13 percent of the total population; Japan's elderly population ratio is 17 percent, and Germany's is 19 percent.

Americans were on the move in a population shift to the South and West (Sunbelt) and away from the Northeast and Midwest (Frostbelt), but the recession and housing bust nationwide has slowed migration throughout the United States. More Americans are staying in place rather than moving. New jobs are the primary reason people move across state lines, so with 3 million less jobs in the United States in 2008–2009 alone, there is less need to move. Falling home prices also have prompted people to avoid moving. The historical trend of people moving from the Northeast and

Midwest to the Sunbelt and West has dramatically slowed. The worldwide recession is also reducing international immigration, down roughly 10 percent in both 2008 and 2009. Hard number data related to this information can represent key opportunities for many firms and thus can be essential for successful strategy formulation, including where to locate new plants and distribution centers and where to focus marketing efforts.

A summary of important social, cultural, demographic, and environmental variables that represent opportunities or threats for virtually all organizations is given in Table.

Key Social, Cultural, Demographic, and Natural Environment Variables

Childbearing rates	Attitudes toward retirement
Number of special-interest groups	Attitudes toward leisure time
Number of marriages	Attitudes toward product quality
Number of divorces	Attitudes toward customer service
Number of births	Pollution control
Number of deaths	Attitudes toward foreign peoples
Immigration and emigration rates	Energy conservation
Social Security programs	Social programs
Life expectancy rates	Number of churches
Per capita income	Number of church members
Location of retailing, manufacturing, and service businesses	Social responsibility
Attitudes toward business	Attitudes toward careers
Lifestyles	Population changes by race, age, sex, and level of affluence
Traffic congestion	Attitudes toward authority
Inner-city environments	Population changes by city, county, state, region, and country
Average disposable income	Value placed on leisure time
Trust in government	Regional changes in tastes and preferences
Attitudes toward government	Number of women and minority workers
Attitudes toward work	Number of high school and college graduates by geographic area
Buying habits	Recycling
Ethical concerns	Waste management
Attitudes toward saving	Air pollution
Sex roles	Water pollution
Attitudes toward investing	Ozone depletion
Racial equality	Endangered species
Use of birth control	
Average level of education	
Government regulation	

Political, Governmental, and Legal Forces

Federal, state, local, and foreign governments are major regulators, deregulators, subsidizers, employers, and customers of organizations. Political, governmental, and legal factors, therefore, can represent key opportunities or threats for both small and large organizations.

For industries and firms that depend heavily on government contracts or subsidies, political forecasts can be the most important part of an external audit. Changes in patent laws, antitrust legislation, tax rates, and lobbying activities can affect firms significantly. The increasing global interdependence among economies, markets, governments, and organizations makes it imperative that firms consider the possible impact of political variables on the formulation and implementation of competitive strategies.

In the face of a deepening global recession, countries worldwide are resorting to protectionism to safeguard their own industries. European Union (EU) nations, for example, have tightened their own trade rules and resumed subsidies for various of their own industries while barring imports from certain other countries. The EU recently restricted imports of U.S. chicken and beef. India is increasing tariffs on foreign steel. Russia perhaps has instituted the most protectionist measures in recent months by raising tariffs on most imports and subsidizing its own exports. Russia even imposed a new toll on trucks from the EU, Switzerland, and Turkmenistan. Despite these measures taken by other countries, the United States has largely refrained from "Buy American" policies and protectionist measures, although there are increased tariffs on French cheese and Italian water. Many economists say the current rash of trade constraints will make it harder for global economic growth to recover from the global recession. Global trade is expected to decrease 2.1 percent in 2009 compared to an increase of 6.2 percent in 2008. 3 Russia has said that "protective tariffs are necessary to allow Russian

companies to survive the recession." This view unfortunately is also the view at an increasing number of countries.

Governments are taking control of more and more companies as the global economic recession cripples firms considered vital to the nation's financial stability. For example, France in 2009 took a 2.35 percent equity stake in troubled car-parts maker Valeo SA. President Nicolas Sarkozy of France has created a $20 billion strategic fund to lend cash to banks and carmakers as many governments become more protectionist. The United States of course also is taking equity stakes in financial institutions and carmakers and is "bailing out" companies too.

The UK government in 2009 took a 95 percent stake in the banking giant Royal Bank of Scotland Group PLC in a dramatic move toward nationalization. The government gave the bank $37 billion and insured another $300 billion of the bank's assets. The UK government also recently increased its stake in Lloyds Banking Group PLC to 75 percent. Similarly, the U.S. government has taken over Fannie Mae and Freddie Mac and has raised its stake even in Citigroup to 40 percent.

As more and more companies around the world accept government bailouts, those companies are being forced to march to priorities set by political leaders. Even in the United States, the federal government is battling the recession with its deepest intervention in the economy since the Great Depression. The U.S. government now is a strategic manager in industries from banking to insurance to autos. Governments worldwide are under pressure to protect jobs at home and maintain the nation's industrial base. For example, in France, Renault SA's factory in Sandouville is one of the most unproductive auto factories in the world. However, Renault has taken $3.9 billion in low-interest loans from the French government, so the company cannot close any French factories for the duration of the loan or resort to mass layoffs in France for a year.

Political relations between Japan and China have thawed considerably in recent years, which is good for the world economy because China's low-cost manufactured goods have become essential for the functioning of most industrialized nations. Chinese premier Wen Jiabao addressed the Japanese parliament in 2007, something no Chinese leader has done for more than 20 years, and Japanese prime minister Shinzo Abe has visited Beijing. Japan's largest trading partner is China, and China's third-largest trading partner is Japan—after the European Union, number one, and the United States, number two.

Local, state, and federal laws; regulatory agencies; and special-interest groups can have a major impact on the strategies of small, large, for-profit, and nonprofit organizations. Many companies have altered or abandoned strategies in the past because of political or governmental actions. In the academic world, as state budgets have dropped in recent years, so too has state support for colleges and universities. Due to the decline in monies received from the state, many institutions of higher learning are doing more fundraising on their own—naming buildings and classrooms, for example, for donors. A summary of political, governmental, and legal variables that can represent key opportunities or threats to organizations is provided in Table

Some Political, Governmental, and Legal Variables

Government regulations or deregulations	Sino-American relationships
Changes in tax laws	Russian-American relationships
Special tariffs	European-American relationships
Political action committees	African-American relationships
Voter participation rates	Import–export regulations
Number, severity, and location of government protests	Government fiscal and monetary policy changes
Number of patents	Political conditions in foreign countries
Changes in patent laws	Special local, state, and federal laws
Environmental protection laws	Lobbying activities
Level of defense expenditures	Size of government budgets
Legislation on equal employment	World oil, currency, and labor markets
Level of government subsidies	Location and severity of terrorist activities
Antitrust legislation	Local, state, and national elections

Technological Forces

Revolutionary technological changes and discoveries are having a dramatic impact on organizations. CEO Chris DeWolfe of MySpace is using technology to expand the firm's 1,600-person workforce in 2009 even as the economic recession deepens. MySpace expects a 17 percent increase in revenue in 2009. Nearly half of the site's 130 million members worldwide are 35 and older, and 76 million of the members are from the United States. This compares to rival Facebook that has 150 million members worldwide but only 55 million in the United States. MySpace is continually redesigning the site and revamping the way its members can manage their profiles and categorize their friends, and enabling consumers to listen to free streaming audio and songs. Doug Morris, CEO of Universal Music Group, says, "There is a lot of conflict between technology and content, and Chris has successfully brought both together." 4

The Internet has changed the very nature of opportunities and threats by altering the life cycles of products, increasing the speed of distribution, creating new products and services, erasing limitations of traditional geographic markets, and changing the historical trade-off between production standardization and flexibility. The Internet is altering economies of scale, changing entry barriers, and redefining the relationship between industries and various suppliers, creditors, customers, and competitors.

To effectively capitalize on e-commerce, a number of organizations are establishing two new positions in their firms: chief information officer (CIO) and chief technology officer (CTO). This trend reflects the growing importance of information technology (IT) in strategic management. A CIO and CTO work together to ensure that information needed to formulate, implement, and evaluate strategies is available where and when it is needed. These individuals are responsible for developing, maintaining, and updating a company's information database. The CIO is more a manager, managing the firm's relationship with stakeholders; the CTO is more a technician, focusing on technical

issues such as data acquisition, data processing, decision-support systems, and software and hardware acquisition.

Technological forces represent major opportunities and threats that must be considered in formulating strategies. Technological advancements can dramatically affect organizations' products, services, markets, suppliers, distributors, competitors, customers, manufacturing processes, marketing practices, and competitive position. Technological advancements can create new markets, result in a proliferation of new and improved products, change the relative competitive cost positions in an industry, and render existing products and services obsolete. Technological changes can reduce or eliminate cost barriers between businesses, create shorter production runs, create shortages in technical skills, and result in changing values and expectations of employees, managers, and customers. Technological advancements can create new competitive advantages that are more powerful than existing advantages. No company or industry today is insulated against emerging technological developments. In high-tech industries, identification and evaluation of key technological opportunities and threats can be the most important part of the external strategic-management audit.

Organizations that traditionally have limited technology expenditures to what they can fund after meeting marketing and financial requirements urgently need a reversal in thinking. The pace of technological change is increasing and literally wiping out businesses every day. An emerging consensus holds that technology management is one of the key responsibilities of strategists. Firms should pursue strategies that take advantage of technological opportunities to achieve sustainable, competitive advantages in the marketplace.

In practice, critical decisions about technology too often are delegated to lower organizational levels or are made without an understanding of their strategic implications. Many strategists spend countless hours determining market share, positioning products in

terms of features and price, forecasting sales and market size, and monitoring distributors; yet too often, technology does not receive the same respect.

Not all sectors of the economy are affected equally by technological developments. The communications, electronics, aeronautics, and pharmaceutical industries are much more volatile than the textile, forestry, and metals industries. A recent article in the Wall Street Journal detailed how wireless technology will change 10 particular industries. 5 Table 3-7 provides a glimpse of this article.

Examples of the Impact of Wireless Technology

Airlines—Many airlines now offer wireless technology in flight.
Automotive—Vehicles are becoming wireless.
Banking—Visa sends text message alerts after unusual transactions.
Education—Many secondary (and even college) students may use smart phones for math because research shows this to be greatly helpful.
Energy—Smart meters now provide power on demand in your home or business.
Health Care—Patients use mobile devices to monitor their own health, such as calories consumed.
Hotels—Days Inn sends daily specials and coupons to hotel guests via text messages.
Market Research—Cell phone respondents provide more honest answers, perhaps because they are away from eavesdropping ears.
Politics—President Obama won the election partly by mobilizing Facebook and MySpace users, revolutionizing political campaigns. Obama announced his vice presidential selection of Joe Biden by a text message.
Publishing—eBooks are increasingly available.

Source: Based on Joe Mullich, "10 Industries That Wireless Will Change," *Wall Street Journal* (April 1, 2009): A12.

Competitive Forces

The top U.S. competitors in four different industries are identified in Table 3-8. An important part of an external audit is identifying rival firms and determining their strengths, weaknesses, capabilities, opportunities, threats, objectives, and strategies.

Collecting and evaluating information on competitors is essential for successful strategy formulation. Identifying major competitors is not always easy because many firms have divisions that compete in different industries. Many multidivisional firms do not provide

sales and profit information on a divisional basis for competitive reasons. Also, privately held firms do not publish any financial or marketing information. Addressing questions about competitors such as those presented in Table 3-9 is important in performing an external audit.

Competition in virtually all industries can be described as intense—and sometimes as cutthroat. For example, Walgreens and CVS pharmacies are located generally across the street from each other and battle each other every day on price and customer service. Most automobile dealerships also are located close to each other. Dollar General, based in Goodlettsville, Tennessee, and Family

Dollar, based in Matthews, North Carolina, compete intensely on price to attract customers. Best Buy dropped prices wherever possible to finally put Circuit City totally out of business.

Seven characteristics describe the most competitive companies:

1. Market share matters; the 90th share point isn't as important as the 91st, and nothing is more dangerous than falling to 89.
2. Understand and remember precisely what business you are in.
3. Whether it's broke or not, fix it—make it better; not just products, but the whole company, if necessary.
4. Innovate or evaporate; particularly in technology-driven businesses, nothing quite recedes like success.
5. Acquisition is essential to growth; the most successful purchases are in niches that add a technology or a related market.
6. People make a difference; tired of hearing it? Too bad.
7. There is no substitute for quality and no greater threat than failing to be cost-competitive on a global basis.

Key Questions About Competitors

1. What are the major competitors' strengths?
2. What are the major competitors' weaknesses?
3. What are the major competitors' objectives and strategies?
4. How will the major competitors most likely respond to current economic, social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive trends affecting our industry?
5. How vulnerable are the major competitors to our alternative company strategies?
6. How vulnerable are our alternative strategies to successful counterattack by our major competitors?
7. How are our products or services positioned relative to major competitors?
8. To what extent are new firms entering and old firms leaving this industry?
9. What key factors have resulted in our present competitive position in this industry?
10. How have the sales and profit rankings of major competitors in the industry changed over recent years? Why have these rankings changed that way?
11. What is the nature of supplier and distributor relationships in this industry?
12. To what extent could substitute products or services be a threat to competitors in this industry?

Competitive Intelligence Programs

What is competitive intelligence? Competitive intelligence (CI), as formally defined by the Society of Competitive Intelligence Professionals (SCIP), is a systematic and ethical process for gathering and analyzing information about the competition's activities and general business trends to further a business's own goals (SCIP Web site).

Good competitive intelligence in business, as in the military, is one of the keys to success. The more information and knowledge a firm can obtain about its competitors, the more likely it is that it can formulate and implement effective strategies. Major competitors' weaknesses can represent external opportunities; major competitors' strengths may represent key threats.

In April 2009, Starwood Hotels & Resorts Worldwide sued Hilton Hotels Corp. for allegedly stealing more than 100,000 confidential electronic and paper documents containing "Starwood's most competitively sensitive information." The complaint alleges that two Starwood executives, Ross Klein and Amar Lalvani, resigned from Starwood to join Hilton and took this information with them. The legal complaint says, "This is the clearest imaginable case of corporate espionage, theft of trade secrets, unfair competition and computer fraud." In addition to monetary awards, Starwood is seeking

to force Hilton to cancel the rollout of the Denizen hotel chain. Hilton is owned by Blackstone Group.

Hiring top executives from rival firms is also a way companies obtain competitive intelligence. Just two days after Facebook’s COO, Owen Van Natta, left the company in 2009, he accepted the CEO job at MySpace, replacing then CEO and cofounder Chris DeWolfe. Van Natta had previously also been Facebook’s COO, chief revenue officer, and vice president of operations. The MySpace appointment now pits CEO Van Natta against his old boss at Facebook, CEO Mark Zuckerberg. Facebook passed MySpace in visitors worldwide in 2008 and is closing in on leadership in the United States. Both firms are fierce rivals in the Internet social-networking business.

A recent article in the Wall Street Journal detailed how computer spies recently broke into the Pentagon’s $300 billion Joint Strike fighter project, one of the costliest weapons programs ever. 8 This intrusion and similar episodes of late have confirmed that any information a firm has available to anyone within the firm online may be at risk of being copied and/or siphoned away by adversaries or rival firms. A recent Pentagon report says the Chinese military in particular has made “steady progress” in developing online-warfare techniques, but rival firms in many industries have expert computer engineers who may be capable of similar unethical/unlawful tactics.

Many U.S. executives grew up in times when U.S. firms dominated foreign competitors so much that gathering competitive intelligence did not seem worth the effort. Too many of these executives still cling to these attitudes—to the detriment of their organizations today. Even most MBA programs do not offer a course in competitive and business intelligence, thus reinforcing this attitude. As a consequence, three strong misperceptions about business intelligence prevail among U.S. executives today:

- Running an intelligence program requires lots of people, computers, and other resources.

- Collecting intelligence about competitors violates antitrust laws; business intelligence equals espionage.
- Intelligence gathering is an unethical business practice.

Any discussions with a competitor about price, market, or geography intentions could violate antitrust statutes. However, this fact must not lure a firm into underestimating the need for and benefits of systematically collecting information about competitors for Strategic Planning purposes. The Internet has become an excellent medium for gathering competitive intelligence. Information gathering from employees, managers, suppliers, distributors, customers, creditors, and consultants also can make the difference between having superior or just average intelligence and overall competitiveness.

Firms need an effective competitive intelligence (CI) program. The three basic objectives of a CI program are (1) to provide a general understanding of an industry and its competitors, (2) to identify areas in which competitors are vulnerable and to assess the impact strategic actions would have on competitors, and (3) to identify potential moves that a competitor might make that would endanger a firm's position in the market. 10 Competitive information is equally applicable for strategy formulation, implementation, and evaluation decisions. An effective CI program allows all areas of a firm to access consistent and verifiable information in making decisions. All members of an organizationfrom the chief executive officer to custodians—are valuable intelligence agents and should feel themselves to be a part of the CI process. Special characteristics of a successful CI program include flexibility, usefulness, timeliness, and cross-functional cooperation.

The increasing emphasis on competitive analysis in the United States is evidenced by corporations putting this function on their organizational charts under job titles such as Director of Competitive Analysis, Competitive Strategy Manager, Director of Information Services, or Associate Director of Competitive Assessment. The

responsibilities of a director of competitive analysis include planning, collecting data, analyzing data, facilitating the process of gathering and analyzing data, disseminating intelligence on a timely basis, researching special issues, and recognizing what information is important and who needs to know. Competitive intelligence is not corporate espionage because 95 percent of the information a company needs to make strategic decisions is available and accessible to the public. Sources of competitive information include trade journals, want ads, newspaper articles, and government filings, as well as customers, suppliers, distributors, competitors themselves, and the Internet.

Unethical tactics such as bribery, wiretapping, and computer break-ins should never be used to obtain information. Marriott and Motorola—two U.S. companies that do a particularly good job of gathering competitive intelligence—agree that all the information you could wish for can be collected without resorting to unethical tactics. They keep their intelligence staffs small, usually under five people, and spend less than $200,000 per year on gathering competitive intelligence.

Unilever recently sued Procter & Gamble (P&G) over that company's corporate-espionage activities to obtain the secrets of its Unilever hair-care business. After spending $3 million to establish a team to find out about competitors in the domestic hair-care industry, P&G allegedly took roughly 80 documents from garbage bins outside Unilever's Chicago offices. P&G produces Pantene and Head & Shoulders shampoos; Unilever has hair-care brands such as ThermaSilk, Suave, Salon Selectives, and Finesse. Similarly, Oracle Corp. recently admitted that detectives it hired paid janitors to go through Microsoft Corp.'s garbage, looking for evidence to use in court.

Market Commonality and Resource Similarity

By definition, competitors are firms that offer similar products and services in the same market. Markets can be geographic or product areas or segments. For example, in the

insurance industry the markets are broken down into commercial/consumer, health/life, or Europe/Asia. Researchers use the terms market commonality and resource similarity to study rivalry among competitors. Market commonality can be defined as the number and significance of markets that a firm competes in with rivals. 11 Resource similarity is the extent to which the type and amount of a firm's internal resources are comparable to a rival. 12 One way to analyze competitiveness between two or among several firms is to investigate market commonality and resource similarity issues while looking for areas of potential competitive advantage along each firm's value chain.

Competitive Analysis: Porter's Five-Forces Model

As illustrated in Figure 3-3, Porter's Five-Forces Model of competitive analysis is a widely used approach for developing strategies in many industries. The intensity of competition among firms varies widely across industries. Table 3-10 reveals the average profit margin and return on investment for firms in different industries. Note the substantial variation among industries. For example, the range in profit margin goes from 0 to 18 for food production to computer software, respectively. Intensity of competition is highest in lower-return industries. The collective impact of competitive forces is so brutal in some industries that the market is clearly "unattractive" from a profit-making standpoint. Rivalry among existing firms is severe, new rivals can enter the industry with relative ease, and both suppliers and customers can exercise considerable bargaining leverage. According to Porter, the nature of competitiveness in a given industry can be viewed as a composite of five forces:

1. Rivalry among competing firms
2. Potential entry of new competitors
3. Potential development of substitute products
4. Bargaining power of suppliers
5. Bargaining power of consumers

The following three steps for using Porter's Five-Forces Model can indicate whether competition in a given industry is such that the firm can make an acceptable profit:

- Identify key aspects or elements of each competitive force that impact the firm.
- Evaluate how strong and important each element is for the firm.
- Decide whether the collective strength of the elements is worth the firm entering or staying in the industry.

Rivalry Among Competing Firms

Rivalry among competing firms is usually the most powerful of the five competitive forces. The strategies pursued by one firm can be successful only to the extent that they provide competitive advantage over the strategies pursued by rival firms. Changes in strategy by one firm may be met with retaliatory countermoves, such as lowering prices, enhancing quality, adding features, providing services, extending warranties, and increasing advertising.

Free-flowing information on the Internet is driving down prices and inflation worldwide. The Internet, coupled with the common currency in Europe, enables consumers to make price comparisons easily across countries. Just for a moment, consider the implications for car dealers who used to know everything about a new car's pricing, while you, the consumer, knew very little. You could bargain, but being in the dark, you rarely could win. Now you can shop online in a few hours at every dealership within 500 miles to find the best price and terms. So you, the consumer, can win. This is true in many, if not most, business-to-consumer and business-to-business sales transactions today.

The intensity of rivalry among competing firms tends to increase as the number of competitors increases, as competitors become more equal in size and capability, as demand for the industry's products declines, and as price cutting becomes common. Rivalry also increases when consumers can switch brands easily; when barriers to leaving the market are high; when fixed costs are high; when the product is perishable; when consumer demand is growing slowly or declines such that rivals have excess capacity and/or inventory; when the products being sold are commodities (not easily differentiated such as gasoline); when rival firms are diverse in strategies, origins, and culture; and when mergers and acquisitions are common in the industry. As rivalry among competing firms intensifies, industry profits decline, in some cases to the point where an industry becomes inherently unattractive. When rival firms sense weakness, typically they will intensify both marketing and production efforts to capitalize on the "opportunity." Table 3-11 summarizes conditions that cause high rivalry among competing firms.

Conditions That Cause High Rivalry Among Competing Firms

1. High number of competing firms
2. Similar size of firms competing
3. Similar capability of firms competing
4. Falling demand for the industry's products
5. Falling product/service prices in the industry
6. When consumers can switch brands easily
7. When barriers to leaving the market are high
8. When barriers to entering the market are low
9. When fixed costs are high among firms competing
10. When the product is perishable
11. When rivals have excess capacity
12. When consumer demand is falling
13. When rivals have excess inventory
14. When rivals sell similar products/services
15. When mergers are common in the industry

Potential Entry of New Competitors

Whenever new firms can easily enter a particular industry, the intensity of competitiveness among firms increases. Barriers to entry, however, can include the need to gain economies of scale quickly, the need to gain technology and specialized know-how, the lack of experience, strong customer loyalty, strong brand preferences, large capital requirements, lack of adequate distribution channels, government regulatory policies, tariffs, lack of access to raw materials, possession of patents, undesirable locations, counterattack by entrenched firms, and potential saturation of the market.

Despite numerous barriers to entry, new firms sometimes enter industries with higher-quality products, lower prices, and substantial marketing resources. The strategist's job, therefore, is to identify potential new firms entering the market, to monitor the new rival firms' strategies, to counterattack as needed, and to capitalize on existing strengths and opportunities. When the threat of new firms entering the market is strong, incumbent firms generally fortify their positions and take actions to deter new entrants, such as lowering prices, extending warranties, adding features, or offering financing specials.

Potential Development of Substitute Products

In many industries, firms are in close competition with producers of substitute products in other industries. Examples are plastic container producers competing with glass, paperboard, and aluminum can producers, and acetaminophen manufacturers competing with other manufacturers of pain and headache remedies. The presence of substitute products puts a ceiling on the price that can be charged before consumers will switch to the substitute product. Price ceilings equate to profit ceilings and more intense competition among rivals. Producers of eyeglasses and contact lenses, for example, face increasing competitive pressures from laser eye surgery. Producers of sugar face similar pressures from artificial sweeteners. Newspapers and magazines face substitute-product competitive pressures from the Internet and 24-hour cable television. The magnitude of competitive pressure derived from development of substitute products is generally evidenced by rivals' plans for expanding production capacity, as well as by their sales and profit growth numbers.

Competitive pressures arising from substitute products increase as the relative price of substitute products declines and as consumers' switching costs decrease. The competitive strength of substitute products is best measured by the inroads into the market share those products obtain, as well as those firms' plans for increased capacity and market penetration.

Bargaining Power of Suppliers

The bargaining power of suppliers affects the intensity of competition in an industry, especially when there is a large number of suppliers, when there are only a few good substitute raw materials, or when the cost of switching raw materials is especially costly. It is often in the best interest of both suppliers and producers to assist each other with reasonable prices, improved quality, development of new services, just-in-time deliveries, and reduced inventory costs, thus enhancing long-term profitability for all concerned

Firms may pursue a backward integration strategy to gain control or ownership of suppliers. This strategy is especially effective when suppliers are unreliable, too costly, or not capable of meeting a firm's needs on a consistent basis. Firms generally can negotiate more favorable terms with suppliers when backward integration is a commonly used strategy among rival firms in an industry.

However, in many industries it is more economical to use outside suppliers of component parts than to self-manufacture the items. This is true, for example, in the outdoor power equipment industry where producers of lawn mowers, rotary tillers, leaf blowers, and edgers such as Murray generally obtain their small engines from outside manufacturers such as Briggs & Stratton who specialize in such engines and have huge economies of scale.

In more and more industries, sellers are forging strategic partnerships with select suppliers in efforts to (1) reduce inventory and logistics costs (e.g., through just-in-time deliveries); (2) speed the availability of next-generation components; (3) enhance the quality of the parts and components being supplied and reduce defect rates; and (4) squeeze out important cost savings for both themselves and their suppliers. 13

Bargaining Power of Consumers

When customers are concentrated or large or buy in volume, their bargaining power represents a major force affecting the intensity of competition in an industry. Rival firms may offer extended warranties or special services to gain customer loyalty whenever the bargaining power of consumers is substantial. Bargaining power of consumers also is higher when the products being purchased are standard or undifferentiated. When this is the case, consumers often can negotiate selling price, warranty coverage, and accessory packages to a greater extent.

The bargaining power of consumers can be the most important force affecting competitive advantage. Consumers gain increasing bargaining power under the following circumstances:

- If they can inexpensively switch to competing brands or substitutes
- If they are particularly important to the seller
- If sellers are struggling in the face of falling consumer demand
- If they are informed about sellers' products, prices, and costs
- If they have discretion in whether and when they purchase the product 14

Sources of External Information

A wealth of strategic information is available to organizations from both published and unpublished sources. Unpublished sources include customer surveys, market research, speeches at professional and shareholders' meetings, television programs, interviews, and conversations with stakeholders. Published sources of strategic information include periodicals, journals, reports, government documents, abstracts, books, directories, newspapers, and manuals. The Internet has made it easier for firms to gather, assimilate, and evaluate information.

There are many excellent Web sites for gathering strategic information, but six that the author uses routinely are listed here:

- http://marketwatch.multexinvestor.com
- http://moneycentral.msn.com
- http://finance.yahoo.com
- www.clearstation.com
- https://us.etrade.com/e/t/invest/marketswww.hoovers.com

Most college libraries subscribe to Standard & Poor's (S&P's) Industry Surveys. These documents are exceptionally up-to-date and give valuable information about many different industries. Each report is authored by a Standard & Poor's industry research analyst and includes the following sections:

- Current Environment
- Industry Trends
- How the Industry Operates
- Key Industry Ratios and Statistics
- How to Analyze a Company
- Glossary of Industry Terms
- Additional Industry Information
- References
- Comparative Company Financial Analysis

Forecasting Tools and Techniques

Forecasts are educated assumptions about future trends and events. Forecasting is a complex activity because of factors such as technological innovation, cultural changes, new products, improved services, stronger competitors, shifts in government priorities, changing social values, unstable economic conditions, and unforeseen events. Managers

often must rely on published forecasts to effectively identify key external opportunities and threats.

A sense of the future permeates all action and underlies every decision a person makes. People eat expecting to be satisfied and nourished in the future. People sleep assuming that in the future they will feel rested. They invest energy, money, and time because they believe their efforts will be rewarded in the future. They build highways assuming that automobiles and trucks will need them in the future. Parents educate children on the basis of forecasts that they will need certain skills, attitudes, and knowledge when they grow up. The truth is we all make implicit forecasts throughout our daily lives. The question, therefore, is not whether we should forecast but rather how we can best forecast to enable us to move beyond our ordinarily unarticulated assumptions about the future. Can we obtain information and then make educated assumptions (forecasts) to better guide our current decisions to achieve a more desirable future state of affairs? We should go into the future with our eyes and our minds open, rather than stumble into the future with our eyes closed.

Many publications and sources on the Internet forecast external variables. Several published examples include Industry Week's "Trends and Forecasts," BusinessWeek's "Investment Outlook," and Standard & Poor's Industry Survey. The reputation and continued success of these publications depend partly on accurate forecasts, so published sources of information can offer excellent projections. An especially good Web site for industry forecasts is finance.yahoo.com.

Just insert a firm's stock symbol and go from there.

Sometimes organizations must develop their own projections. Most organizations forecast (project) their own revenues and profits annually. Organizations sometimes forecast market share or customer loyalty in local areas. Because forecasting is so important in strategic management and because the ability to forecast (in contrast to the

ability to use a forecast) is essential, selected forecasting tools are examined further here.

Forecasting tools can be broadly categorized into two groups: quantitative techniques and qualitative techniques. Quantitative forecasts are most appropriate when historical data are available and when the relationships among key variables are expected to remain the same in the future. Linear regression, for example, is based on the assumption that the future will be just like the past—which, of course, it never is. As historical relationships become less stable, quantitative forecasts become less accurate.

No forecast is perfect, and some forecasts are even wildly inaccurate. This fact accents the need for strategists to devote sufficient time and effort to study the underlying bases for published forecasts and to develop internal forecasts of their own. Key external opportunities and threats can be effectively identified only through good forecasts. Accurate forecasts can provide major competitive advantages for organizations. Forecasts are vital to the strategic-management process and to the success of organizations.

Making Assumptions

Planning would be impossible without assumptions. McConkey defines assumptions as the "best present estimates of the impact of major external factors, over which the manager has little if any control, but which may exert a significant impact on performance or the ability to achieve desired results." 16 Strategists are faced with countless variables and imponderables that can be neither controlled nor predicted with 100 percent accuracy. Wild guesses should never be made in formulating strategies, but reasonable assumptions based on available information must always be made.

By identifying future occurrences that could have a major effect on the firm and by making reasonable assumptions about those factors, strategists can carry the strategic-

management process forward. Assumptions are needed only for future trends and events that are most likely to have a significant effect on the company's business. Based on the best information at the time, assumptions serve as checkpoints on the validity of strategies. If future occurrences deviate significantly from assumptions, strategists know that corrective actions may be needed. Without reasonable assumptions, the strategy-formulation process could not proceed effectively. Firms that have the best information generally make the most accurate assumptions, which can lead to major competitive advantages.

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Chapter 4
COMPETITIVE FORCE

Competitive Force

A note from David and Whellan

Collecting and evaluating information on competitors is essential for successful strategy formulation. Identifying major competitors is not always easy because many firms have divisions that compete in different industries. Many multidivisional firms do not provide sales and profit information on a divisional basis for competitive reasons. Also, privately held firms do not publish any financial or marketing information. Addressing questions about competitors such as those presented in Table below is important in performing an external audit.

Key Questions About Competitors

1. What are the major competitors' strengths?
2. What are the major competitors' weaknesses?
3. What are the major competitors' objectives and strategies?
4. How will the major competitors most likely respond to current economic, social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive trends affecting our industry?
5. How vulnerable are the major competitors to our alternative company strategies?
6. How vulnerable are our alternative strategies to successful counterattack by our major competitors?
7. How are our products or services positioned relative to major competitors?
8. To what extent are new firms entering and old firms leaving this industry?
9. What key factors have resulted in our present competitive position in this industry?
10. How have the sales and profit rankings of major competitors in the industry changed over recent years? Why have these rankings changed that way?
11. What is the nature of supplier and distributor relationships in this industry?
12. To what extent could substitute products or services be a threat to competitors in this industry?

Competition in virtually all industries can be described as intense—and sometimes as cutthroat. For example, Walgreens and CVS pharmacies are located generally across the street from each other and battle each other every day on price and customer service. Most automobile dealerships also are located close to each other. Dollar General, based in Goodlettsville, Tennessee, and Family Dollar, based in Matthews, North Carolina, compete intensely on price to attract customers. Best Buy dropped prices wherever possible to finally put Circuit City totally out of business.

Seven characteristics describe the most competitive companies:

1. Market share matters; the 90th share point isn't as important as the 91st, and nothing is more dangerous than falling to 89.
2. Understand and remember precisely what business you are in.
3. Whether it's broke or not, fix it—make it better; not just products, but the whole company, if necessary.
4. Innovate or evaporate; particularly in technology-driven businesses, nothing quite recedes like success.
5. Acquisition is essential to growth; the most successful purchases are in niches that add a technology or a related market.
6. People make a difference; tired of hearing it? Too bad.
7. There is no substitute for quality and no greater threat than failing to be cost-competitive on a global basis.

Competitive Intelligence Programs

What is competitive intelligence? Competitive intelligence (CI), as formally defined by the Society of Competitive Intelligence Professionals (SCIP), is a systematic and ethical process for gathering and analyzing information about the competition's activities and general business trends to further a business's own goals (SCIP Web site).

Good competitive intelligence in business, as in the military, is one of the keys to success. The more information and knowledge a firm can obtain about its competitors, the more likely it is that it can formulate and implement effective strategies. Major competitors' weaknesses can represent external opportunities; major competitors' strengths may represent key threats.

In April 2009, Starwood Hotels & Resorts Worldwide sued Hilton Hotels Corp. for allegedly stealing more than 100,000 confidential electronic and paper documents containing "Starwood's most competitively sensitive information." The complaint alleges that two Starwood executives, Ross Klein and Amar Lalvani, resigned from Starwood to join Hilton and took this information with them. The legal complaint says, "This is the clearest imaginable case of corporate espionage, theft of trade secrets, unfair competition and computer fraud." In addition to monetary

awards, Starwood is seeking to force Hilton to cancel the rollout of the Denizen hotel chain. Hilton is owned by Blackstone Group.

Hiring top executives from rival firms is also a way companies obtain competitive intelligence. Just two days after Facebook's COO, Owen Van Natta, left the company in 2009, he accepted the CEO job at MySpace, replacing then CEO and cofounder Chris DeWolfe. Van Natta had previously also been Facebook's COO, chief revenue officer, and vice president of operations. The MySpace appointment now pits CEO Van Natta against his old boss at Facebook, CEO Mark Zuckerberg. Facebook passed MySpace in visitors worldwide in 2008 and is closing in on leadership in the United States. Both firms are fierce rivals in the Internet social-networking business.

A recent article in the Wall Street Journal detailed how computer spies recently broke into the Pentagon's $300 billion Joint Strike fighter project, one of the costliest weapons programs ever. This intrusion and similar episodes of late have confirmed that any information a firm has available to anyone within the firm online may be at risk of being copied and/or siphoned away by adversaries or rival firms. A recent Pentagon report says the Chinese military in particular has made "steady progress" in developing online-warfare techniques, but rival firms in many industries have expert computer engineers who may be capable of similar unethical/unlawful tactics.

Many U.S. executives grew up in times when U.S. firms dominated foreign competitors so much that gathering competitive intelligence did not seem worth the effort. Too many of these executives still cling to these attitudes—to the detriment of their organizations today. Even most MBA programs do not offer a course in competitive and business intelligence, thus reinforcing this attitude. As a consequence, three strong misperceptions about business intelligence prevail among U.S. executives today:

1. Running an intelligence program requires lots of people, computers, and other resources.
2. Collecting intelligence about competitors violates antitrust laws; business intelligence equals espionage.
3. Intelligence gathering is an unethical business practice.

Any discussions with a competitor about price, market, or geography intentions could violate antitrust statutes. However, this fact must not lure a firm into underestimating the need for and

benefits of systematically collecting information about competitors for Strategic Planning purposes. The Internet has become an excellent medium for gathering competitive intelligence. Information gathering from employees, managers, suppliers, distributors, customers, creditors, and consultants also can make the difference between having superior or just average intelligence and overall competitiveness.

Firms need an effective competitive intelligence (CI) program. The three basic objectives of a CI program are (1) to provide a general understanding of an industry and its competitors, (2) to identify areas in which competitors are vulnerable and to assess the impact strategic actions would have on competitors, and (3) to identify potential moves that a competitor might make that would endanger a firm's position in the market. Competitive information is equally applicable for strategy formulation, implementation, and evaluation decisions. An effective CI program allows all areas of a firm to access consistent and verifiable information in making decisions. All members of an organizationfrom the chief executive officer to custodians—are valuable intelligence agents and should feel themselves to be a part of the CI process. Special characteristics of a successful CI program include flexibility, usefulness, timeliness, and cross-functional cooperation.

The increasing emphasis on competitive analysis in the United States is evidenced by corporations putting this function on their organizational charts under job titles such as Director of Competitive Analysis, Competitive Strategy Manager, Director of Information Services, or Associate Director of Competitive Assessment. The responsibilities of a director of competitive analysis include planning, collecting data, analyzing data, facilitating the process of gathering and analyzing data, disseminating intelligence on a timely basis, researching special issues, and recognizing what information is important and who needs to know. Competitive intelligence is not corporate espionage because 95 percent of the information a company needs to make strategic decisions is available and accessible to the public. Sources of competitive information include trade journals, want ads, newspaper articles, and government filings, as well as customers, suppliers, distributors, competitors themselves, and the Internet.

Unethical tactics such as bribery, wiretapping, and computer break-ins should never be used to obtain information. Marriott and Motorola—two U.S. companies that do a particularly good job of gathering competitive intelligence—agree that all the information you could wish for can be

collected without resorting to unethical tactics. They keep their intelligence staffs small, usually under five people, and spend less than $200,000 per year on gathering competitive intelligence.

Unilever recently sued Procter & Gamble (P&G) over that company's corporate-espionage activities to obtain the secrets of its Unilever hair-care business. After spending $3 million to establish a team to find out about competitors in the domestic hair-care industry, P&G allegedly took roughly 80 documents from garbage bins outside Unilever's Chicago offices. P&G produces Pantene and Head & Shoulders shampoos; Unilever has hair-care brands such as ThermaSilk, Suave, Salon Selectives, and Finesse. Similarly, Oracle Corp. recently admitted that detectives it hired paid janitors to go through Microsoft Corp.'s garbage, looking for evidence to use in court.

Much external environmental scanning is done on an informal and individual basis. Information is obtained from a variety of sources—suppliers, customers, industry publications, employees, industry experts, industry conferences, and the Internet. For example, scientists and engineers working in a firm's R&D lab can learn about new products and competitors' ideas at professional meetings; someone from the purchasing department, speaking with supplier-representatives' personnel, may also uncover valuable bits of information about a competitor. A study of product innovation found that 77% of all product innovations in scientific instruments and 67% in semiconductors and printed circuit boards were initiated by the customer in the form of inquiries and complaints. In these industries, the sales force and service departments must be especially vigilant.

A recent survey of global executives by McKinsey & Company found that the single factor contributing most to the increasing competitive intensity in their industries was the improved capabilities of competitors. Yet, without competitive intelligence, companies run the risk of flying blind in the marketplace. In a 2008 survey of global executives, the majority revealed that their companies typically learned about a competitor's price change or significant innovation too late to respond before it was introduced into the market. According to work by Ryall, firms can have competitive advantages simply because their rivals have erroneous beliefs about them. This is why competitive intelligence has become an important part of environmental scanning in most companies.

Competitive intelligence is a formal program of gathering information on a company's competitors. Often called business intelligence, it is one of the fastest growing fields within strategic management. Research indicates that there is a strong association between corporate performance and competitive intelligence activities. 68 According to a survey of competitive intelligence professionals, the primary reasons for practicing competitive intelligence are to build industry awareness (90.6%), support the strategic planning process (79.2%), develop new products (73.6%), and create new marketing strategies and tactics. As early as the 1990s, 78% of large U.S. corporations conducted competitive intelligence activities. In about a third of the firms, the competitive/business intelligence function is housed in its own unit, with the remainder being housed within marketing, strategic planning, information services, business development (merger & acquisitions), product development, or other units. According to a 2007 survey of 141 large American corporations, spending on competitive intelligence activities was rising from $1 billion in 2007 to $10 billion by 2012. At General Mills, for example, all employees have been trained to recognize and tap sources of competitive information. Janitors no longer simply place orders with suppliers of cleaning materials; they also ask about relevant practices at competing firms!

Source of Competitive Intellegence

Most corporations use outside organizations to provide them with environmental data. Firms such as A. C. Nielsen Co. provide subscribers with bimonthly data on brand share, retail prices, percentages of stores stocking an item, and percentages of stock-out stores. Strategists can use this data to spot regional and national trends as well as to assess market share. Information on market conditions, government regulations, industry competitors, and new products can be bought from "information brokers" such as Market Research.com (Findex), LexisNexis (company and country analyses), and Finsbury Data Services. Company and industry profiles are generally available from the Hoover's Web site, at www.hoovers.com. Many business corporations have established their own in-house libraries and computerized information systems to deal with the growing mass of available information.

The Internet has changed the way strategists engage in environmental scanning. It provides the quickest means to obtain data on almost any subject. Although the scope and quality of Internet information is increasing geometrically, it is also littered with "noise," misinformation, and utter nonsense. For example, a number of corporate Web sites are sending unwanted guests to specially

constructed bogus Web sites. Unlike the library, the Internet lacks the tight bibliographic control standards that exist in the print world. There is no ISBN or Dewey Decimal System to identify, search, and retrieve a document. Many Web documents lack the name of the author and the date of publication. A Web page providing useful information may be accessible on the Web one day and gone the next. Unhappy ex-employees, far-out environmentalists, and prank-prone hackers create "blog" Web sites to attack and discredit an otherwise reputable corporation. Rumors with no basis in fact are spread via chat rooms and personal Web sites. This creates a serious problem for researchers. How can one evaluate the information found on the Internet?

Some companies choose to use industrial espionage or other intelligence-gathering techniques to get their information straight from their competitors. According to a survey by the American Society for Industrial Security, PricewaterhouseCoopers, and the United States Chamber of Commerce, Fortune 1000 companies lost an estimated $59 billion in one year alone due to the theft of trade secrets. 74 By using current or former competitors' employees and private contractors, some firms attempt to steal trade secrets, technology, business plans, and pricing strategies. For example, Avon Products hired private investigators to retrieve from a public dumpster documents (some of them shredded) that Mary Kay Corporation had thrown away. Oracle Corporation also hired detectives to obtain the trash of a think tank that had defended the pricing practices of its rival Microsoft. Studies reveal that 32% of the trash typically found next to copy machines contains confidential company data, in addition to personal data (29%) and gossip (39%). 75 Even P&G, which defends itself like a fortress from information leaks, is vulnerable. A competitor was able to learn the precise launch date of a concentrated laundry detergent in Europe when one of its people visited the factory where machinery was being made. Simply asking a few questions about what a certain machine did, whom it was for, and when it would be delivered was all that was necessary.

Some of the firms providing investigatory services are Kroll Inc. with 4,000 employees in 25 countries, Fairfax, Security Outsourcing Solutions, Trident Group, and Diligence Inc. 76 Trident, for example, specializes in helping American companies enter the Russian market and is a U.S.-based corporate intelligence firm founded and managed by former veterans of Russian intelligence services, like the KGB.

To combat the increasing theft of company secrets, the United States government passed the Economic Espionage Act in 1996. The law makes it illegal (with fines up to $5 million and 10

years in jail) to steal any material that a business has taken “reasonable efforts” to keep secret and that derives its value from not being known. 78 The Society of Competitive Intelligence Professionals (www.scip.org) urges strategists to stay within the law and to act ethically when searching for information. The society states that illegal activities are foolish because the vast majority of worthwhile competitive intelligence is available publicly via annual reports, Web sites, and libraries. Unfortunately, a number of firms hire “kites,” consultants with questionable reputations, who do what is necessary to get information when the selected methods do not meet SPIC ethical standards or are illegal. This allows the company that initiated the action to deny that it did anything wrong.

Monitoring Competitors for Strategic Planning

The primary activity of a competitive intelligence unit is to monitor competitors—organizations that offer same, similar, or substitutable products or services in the business area in which a particular company operates. To understand a competitor, it is important to answer the following 10 questions:

1. Why do your competitors exist? Do they exist to make profits or just to support another unit?
2. Where do they add customer value—higher quality, lower price, excellent credit terms, or better service?
3. Which of your customers are the competitors most interested in? Are they cherry-picking your best customers, picking the ones you don’t want, or going after all of them?
4. What is their cost base and liquidity? How much cash do they have? How do they get their supplies?
5. Are they less exposed with their suppliers than your firm? Are their suppliers better than yours?
6. What do they intend to do in the future? Do they have a strategic plan to target your market segments? How committed are they to growth? Are there any succession issues?
7. How will their activity affect your strategies? Should you adjust your plans and operations?
8. How much better than your competitor do you need to be in order to win customers? Do either of you have a competitive advantage in the marketplace?

9. Will new competitors or new ways of doing things appear over the next few years? Who is a potential new entrant?
10. If you were a customer, would you choose your product over those offered by your competitors? What irritates your current customers? What competitors solve these particular customer complaints?

To answer these and other questions, competitive intelligence professionals utilize a number of analytical techniques. In addition to the previously discussed SWOT analysis, Michael Porter's industry forces analysis, and strategic group analysis, some of these techniques are Porter's four-corner exercise, Treacy and Wiersema's value disciplines, Gilad's blind spot analysis, and war gaming.

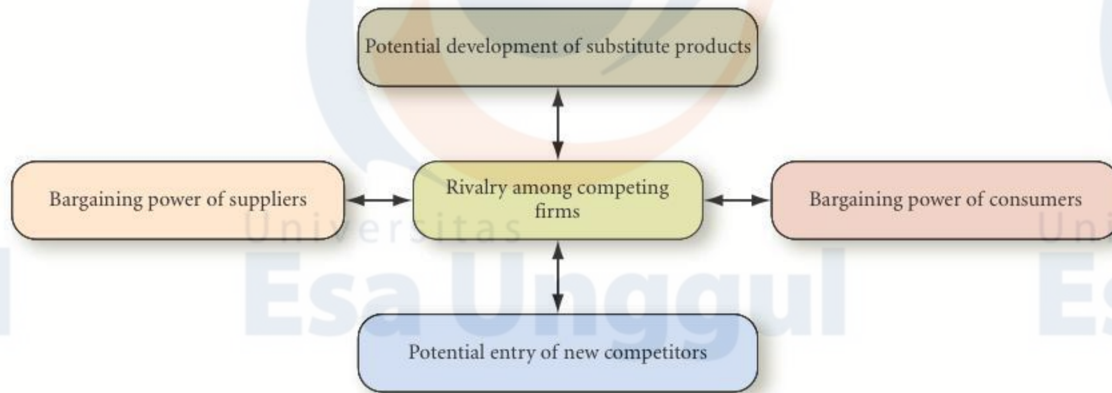
Done right, competitive intelligence is a key input to strategic planning. Avnet Inc., one of the world's largest distributors of electronic components, uses competitive intelligence in its growth by acquisition strategy.

Market Commonality and Resource Similarity

By definition, competitors are firms that offer similar products and services in the same market. Markets can be geographic or product areas or segments. For example, in the insurance industry the markets are broken down into commercial/consumer, health/life, or Europe/Asia. Researchers use the terms market commonality and resource similarity to study rivalry among competitors. Market commonality can be defined as the number and significance of markets that a firm competes in with rivals. Resource similarity is the extent to which the type and amount of a firm's internal resources are comparable to a rival. One way to analyze competitiveness between two or among several firms is to investigate market commonality and resource similarity issues while looking for areas of potential competitive advantage along each firm's value chain.

Competitive Analysis: Porter's Five-Forces Model

As illustrated in Figure below, Porter's Five-Forces Model of competitive analysis is a widely used approach for developing strategies in many industries. The intensity of competition among firms varies widely across industries.



According to Porter, the nature of competitiveness in a given industry can be viewed as a composite of five forces:

1. Rivalry among competing firms
2. Potential entry of new competitors
3. Potential development of substitute products
4. Bargaining power of suppliers
5. Bargaining power of consumers

The following three steps for using Porter's Five-Forces Model can indicate whether competition in a given industry is such that the firm can make an acceptable profit:

1. Identify key aspects or elements of each competitive force that impact the firm.
2. Evaluate how strong and important each element is for the firm.
3. Decide whether the collective strength of the elements is worth the firm entering or staying in the industry.

Rivalry Among Competing Firms

Rivalry among competing firms is usually the most powerful of the five competitive forces. The strategies pursued by one firm can be successful only to the extent that they provide competitive advantage over the strategies pursued by rival firms. Changes in strategy by one firm may be met with retaliatory countermoves, such as lowering prices, enhancing quality, adding features, providing services, extending warranties, and increasing advertising.

Free-flowing information on the Internet is driving down prices and inflation worldwide. The Internet, coupled with the common currency in Europe, enables consumers to make price comparisons easily across countries. Just for a moment, consider the implications for car dealers who used to know everything about a new car's pricing, while you, the consumer, knew very little. You could bargain, but being in the dark, you rarely could win. Now you can shop online in a few hours at every dealership within 500 miles to find the best price and terms. So you, the consumer, can win. This is true in many, if not most, business-to-consumer and business-to-business sales transactions today.

The intensity of rivalry among competing firms tends to increase as the number of competitors increases, as competitors become more equal in size and capability, as demand for the industry's products declines, and as price cutting becomes common. Rivalry also increases when consumers can switch brands easily; when barriers to leaving the market are high; when fixed costs are high; when the product is perishable; when consumer demand is growing slowly or declines such that rivals have excess capacity and/or inventory; when the products being sold are commodities (not easily differentiated such as gasoline); when rival firms are diverse in strategies, origins, and culture; and when mergers and acquisitions are common in the industry. As rivalry among competing firms intensifies, industry profits decline, in some cases to the point where an industry becomes inherently unattractive. When rival firms sense weakness, typically they will intensify both marketing and production efforts to capitalize on the "opportunity." Table below summarizes conditions that cause high rivalry among competing firms.

TABLE 3-11 Conditions That Cause High Rivalry Among Competing Firms

1. High number of competing firms
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15. When mergers are common in the industry

Potential Entry of New Competitors

Whenever new firms can easily enter a particular industry, the intensity of competitiveness among firms increases. Barriers to entry, however, can include the need to gain economies of scale quickly, the need to gain technology and specialized know-how, the lack of experience, strong customer loyalty, strong brand preferences, large capital requirements, lack of adequate distribution channels, government regulatory policies, tariffs, lack of access to raw materials, possession of patents, undesirable locations, counterattack by entrenched firms, and potential saturation of the market.

Despite numerous barriers to entry, new firms sometimes enter industries with higher-quality products, lower prices, and substantial marketing resources. The strategist's job, therefore, is to identify potential new firms entering the market, to monitor the new rival firms' strategies, to counterattack as needed, and to capitalize on existing strengths and opportunities. When the threat of new firms entering the market is strong, incumbent firms generally fortify their positions and take actions to deter new entrants, such as lowering prices, extending warranties, adding features, or offering financing specials.

Potential Development of Substitute Products

In many industries, firms are in close competition with producers of substitute products in other industries. Examples are plastic container producers competing with glass, paperboard, and aluminum can producers, and acetaminophen manufacturers competing with other manufacturers of pain and headache remedies. The presence of substitute products puts a ceiling on the price that can be charged before consumers will switch to the substitute product. Price ceilings equate to profit ceilings and more intense competition among rivals. Producers of eyeglasses and contact lenses, for example, face increasing competitive pressures from laser eye surgery. Producers of sugar face similar pressures from artificial sweeteners. Newspapers and magazines face substitute-product competitive pressures from the Internet and 24-hour cable television. The magnitude of competitive pressure derived from development of substitute products is generally evidenced by rivals' plans for expanding production capacity, as well as by their sales and profit growth numbers.

Competitive pressures arising from substitute products increase as the relative price of substitute products declines and as consumers' switching costs decrease. The competitive strength of substitute products is best measured by the inroads into the market share those products obtain, as well as those firms' plans for increased capacity and market penetration.

Bargaining Power of Suppliers

The bargaining power of suppliers affects the intensity of competition in an industry, especially when there is a large number of suppliers, when there are only a few good substitute raw materials, or when the cost of switching raw materials is especially costly. It is often in the best interest of both suppliers and producers to assist each other with reasonable prices, improved quality, development of new services, just-in-time deliveries, and reduced inventory costs, thus enhancing long-term profitability for all concerned.

Firms may pursue a backward integration strategy to gain control or ownership of suppliers. This strategy is especially effective when suppliers are unreliable, too costly, or not capable of meeting a firm's needs on a consistent basis. Firms generally can negotiate more favorable terms with suppliers when backward integration is a commonly used strategy among rival firms in an industry.

However, in many industries it is more economical to use outside suppliers of component parts than to self-manufacture the items. This is true, for example, in the outdoor power equipment industry where producers of lawn mowers, rotary tillers, leaf blowers, and edgers such as Murray generally obtain their small engines from outside manufacturers such as Briggs & Stratton who specialize in such engines and have huge economies of scale.

In more and more industries, sellers are forging strategic partnerships with select suppliers in efforts to (1) reduce inventory and logistics costs (e.g., through just-in-time deliveries); (2) speed the availability of next-generation components; (3) enhance the quality of the parts and components being supplied and reduce defect rates; and (4) squeeze out important cost savings for both themselves and their suppliers.

Bargaining Power of Consumers

When customers are concentrated or large or buy in volume, their bargaining power represents a major force affecting the intensity of competition in an industry. Rival firms may offer extended warranties or special services to gain customer loyalty whenever the bargaining power of consumers is substantial. Bargaining power of consumers also is higher when the products being purchased are standard or undifferentiated. When this is the case, consumers often can negotiate selling price, warranty coverage, and accessory packages to a greater extent.

The bargaining power of consumers can be the most important force affecting competitive advantage. Consumers gain increasing bargaining power under the following circumstances:

1. If they can inexpensively switch to competing brands or substitutes
2. If they are particularly important to the seller
3. If sellers are struggling in the face of falling consumer demand
4. If they are informed about sellers' products, prices, and costs
5. If they have discretion in whether and when they purchase the product

Sources of External Information

A wealth of strategic information is available to organizations from both published and unpublished sources. Unpublished sources include customer surveys, market research, speeches at professional and shareholders' meetings, television programs, interviews, and conversations with stakeholders. Published sources of strategic information include periodicals, journals, reports, government documents, abstracts, books, directories, newspapers, and manuals. The Internet has made it easier for firms to gather, assimilate, and evaluate information.

There are many excellent Web sites for gathering strategic information, but six that the author uses routinely are listed here:

1. http://marketwatch.multexinvestor.com
2. http://moneycentral.msn.com
3. http://finance.yahoo.com
4. www.clearstation.com
5. https://us.etrade.com/e/t/invest/markets
6. www.hoovers.com

Most college libraries subscribe to Standard & Poor's (S&P's) Industry Surveys. These documents are exceptionally up-to-date and give valuable information about many different industries. Each report is authored by a Standard & Poor's industry research analyst and includes the following sections:

1. Current Environment
2. Industry Trends
3. How the Industry Operates
4. Key Industry Ratios and Statistics
5. How to Analyze a Company
6. Glossary of Industry Terms
7. Additional Industry Information
8. References
9. Comparative Company Financial Analysis

Forecasting Tools and Techniques

Forecasts are educated assumptions about future trends and events. Forecasting is a complex activity because of factors such as technological innovation, cultural changes, new products, improved services, stronger competitors, shifts in government priorities, changing social values, unstable economic conditions, and unforeseen events. Managers often must rely on published forecasts to effectively identify key external opportunities and threats.

A sense of the future permeates all action and underlies every decision a person makes. People eat expecting to be satisfied and nourished in the future. People sleep assuming that in the future they will feel rested. They invest energy, money, and time because they believe their efforts will be rewarded in the future. They build highways assuming that automobiles and trucks will need them in the future. Parents educate children on the basis of forecasts that they will need certain skills, attitudes, and knowledge when they grow up. The truth is we all make implicit forecasts throughout our daily lives. The question, therefore, is not whether we should forecast but rather how we can best forecast to enable us to move beyond our ordinarily unarticulated assumptions about the future. Can we obtain information and then make educated assumptions (forecasts) to better guide our current

decisions to achieve a more desirable future state of affairs? We should go into the future with our eyes and our minds open, rather than stumble into the future with our eyes closed.

Many publications and sources on the Internet forecast external variables. Several published examples include Industry Week's "Trends and Forecasts," BusinessWeek's "Investment Outlook," and Standard & Poor's Industry Survey. The reputation and continued success of these publications depend partly on accurate forecasts, so published sources of information can offer excellent projections. An especially good Web site for industry forecasts is finance.yahoo.com. Just insert a firm's stock symbol and go from there.

Sometimes organizations must develop their own projections. Most organizations forecast (project) their own revenues and profits annually. Organizations sometimes forecast market share or customer loyalty in local areas. Because forecasting is so important in strategic management and because the ability to forecast (in contrast to the ability to use a forecast) is essential, selected forecasting tools are examined further here.

Forecasting tools can be broadly categorized into two groups: quantitative techniques and qualitative techniques. Quantitative forecasts are most appropriate when historical data are available and when the relationships among key variables are expected to remain the same in the future. Linear regression, for example, is based on the assumption that the future will be just like the past—which, of course, it never is. As historical relationships become less stable, quantitative forecasts become less accurate.

No forecast is perfect, and some forecasts are even wildly inaccurate. This fact accents the need for strategists to devote sufficient time and effort to study the underlying bases for published forecasts and to develop internal forecasts of their own. Key external opportunities and threats can be effectively identified only through good forecasts. Accurate forecasts can provide major competitive advantages for organizations. Forecasts are vital to the strategic-management process and to the success of organizations.

Making Assumptions

Planning would be impossible without assumptions. McConkey defines assumptions as the "best present estimates of the impact of major external factors, over which the manager has little if any control, but which may exert a significant impact on performance or the ability to achieve desired results." Strategists are faced with countless variables and imponderables that can be neither controlled nor predicted with 100 percent accuracy. Wild guesses should never be made in formulating strategies, but reasonable assumptions based on available information must always be made.

By identifying future occurrences that could have a major effect on the firm and by making reasonable assumptions about those factors, strategists can carry the strategic-management process forward. Assumptions are needed only for future trends and events that are most likely to have a significant effect on the company's business. Based on the best information at the time, assumptions serve as checkpoints on the validity of strategies. If future occurrences deviate significantly from assumptions, strategists know that corrective actions may be needed. Without reasonable assumptions, the strategy-formulation process could not proceed effectively. Firms that have the best information generally make the most accurate assumptions, which can lead to major competitive advantages.

Industry Evolution

Over time, most industries evolve through a series of stages from growth through maturity to eventual decline. The strength of each of the six forces mentioned earlier varies according to the stage of industry evolution. The industry life cycle is useful for explaining and predicting trends among the six forces that drive industry competition. For example, when an industry is new, people often buy the product, regardless of price, because it fulfills a unique need. This usually occurs in a fragmented industry—where no firm has large market share, and each firm serves only a small piece of the total market in competition with others (for example, cleaning services). As new competitors enter the industry, prices drop as a result of competition. Companies use the experience curve and economies of scale to reduce costs faster than the competition. Companies integrate to reduce costs even further by acquiring their suppliers and distributors. Competitors

try to differentiate their products from one another's in order to avoid the fierce price competition common to a maturing industry.

By the time an industry enters maturity, products tend to become more like commodities. This is now a consolidated industry—dominated by a few large firms, each of which struggles to differentiate its products from those of the competition. As buyers become more sophisticated over time, purchasing decisions are based on better information. Price becomes a dominant concern, given a minimum level of quality and features, and profit margins decline. The automobile, petroleum, and major home appliance industries are examples of mature, consolidated industries each controlled by a few large competitors. In the case of the United States major home appliance industry, the industry changed from being a fragmented industry (pure competition) composed of hundreds of appliance manufacturers in the industry's early years to a consolidated industry (mature oligopoly) composed of three companies controlling over 90% of United States appliance sales. A similar consolidation is occurring now in European major home appliances.

As an industry moves through maturity toward possible decline, its products' growth rate of sales slows and may even begin to decrease. To the extent that exit barriers are low, firms begin converting their facilities to alternate uses or sell them to other firms. The industry tends to consolidate around fewer but larger competitors. The tobacco industry is an example of an industry currently in decline.

Categorizing International Industries

According to Porter, world industries vary on a continuum from multidomestic to global. Multidomestic industries are specific to each country or group of countries. This type of international industry is a collection of essentially domestic industries, such as retailing and insurance. The activities in a subsidiary of a multinational corporation (MNC) in this type of industry are essentially independent of the activities of the MNC's subsidiaries in other countries. Within each country, it has a manufacturing facility to produce goods for sale within that country. The MNC is thus able to tailor its products or services to the very specific needs of consumers in a particular country or group of countries having similar societal environments.

Global industries, in contrast, operate worldwide, with MNCs making only small adjustments for country-specific circumstances. In a global industry an MNC's activities in one country are significantly affected by its activities in other countries. MNCs in global industries produce products or services in various locations throughout the world and sell them, making only minor adjustments for specific country requirements. Examples of global industries are commercial aircraft, television sets, semiconductors, copiers, automobiles, watches, and tires. The largest industrial corporations in the world in terms of sales revenue are, for the most part, MNCs operating in global industries.

The factors that tend to determine whether an industry will be primarily multidomestic or primarily global are:

1. Pressure for coordination within the MNCs operating in that industry
2. Pressure for local responsiveness on the part of individual country markets

To the extent that the pressure for coordination is strong and the pressure for local responsiveness is weak for MNCs within a particular industry, that industry will tend to become global. In contrast, when the pressure for local responsiveness is strong and the pressure for coordination is weak for multinational corporations in an industry, that industry will tend to be multidomestic. Between these two extremes lie a number of industries with varying characteristics of both multidomestic and global industries. These are regional industries, in which MNCs primarily coordinate their activities within regions, such as the Americas or Asia. The major home appliance industry is a current example of a regional industry becoming a global industry. Japanese appliance makers, for example, are major competitors in Asia, but only minor players in Europe or America. The dynamic tension between the pressure for coordination and the pressure for local responsiveness is contained in the phrase, "Think globally but act locally."

International Risk Assessment

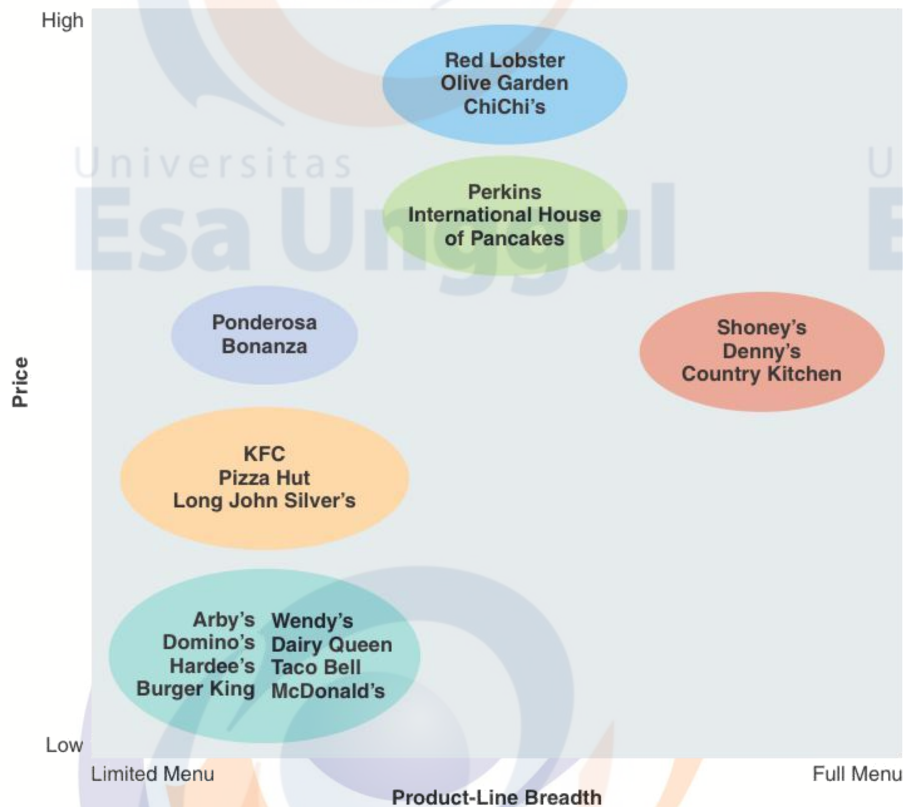
Some firms develop elaborate information networks and computerized systems to evaluate and rank investment risks. Small companies may hire outside consultants, such as Boston's Arthur D. Little Inc., to provide political-risk assessments. Among the many systems that exist to assess political and economic risks are the Business Environment Risk Index, the Economist Intelligence Unit, and Frost and Sullivan's World Political Risk Forecasts. The Economist Intelligence Unit, for example, provides a constant flow of analysis and forecasts on more than 200 countries and eight key industries. Regardless of the source of data, a firm must develop its own method of assessing risk. It must decide on its most important risk factors and then assign weights to each.

Strategic Groups

A strategic group is a set of business units or firms that "pursue similar strategies with similar resources." Categorizing firms in any one industry into a set of strategic groups is very useful as a way of better understanding the competitive environment. Research shows that some strategic groups in the same industry are more profitable than others. Because a corporation's structure and culture tend to reflect the kinds of strategies it follows, companies or business units belonging to a particular strategic group within the same industry tend to be strong rivals and tend to be more similar to each other than to competitors in other strategic groups within the same industry.

For example, although McDonald's and Olive Garden are a part of the same industry, the restaurant industry, they have different missions, objectives, and strategies, and thus they belong to different strategic groups. They generally have very little in common and pay little attention to each other when planning competitive actions. Burger King and Hardee's, however, have a great deal in common with McDonald's in terms of their similar strategy of producing a high volume of low-priced meals targeted for sale to the average family. Consequently, they are strong rivals and are organized to operate similarly.

Strategic groups in a particular industry can be mapped by plotting the market positions of industry competitors on a two-dimensional graph, using two strategic variables as the vertical and horizontal axes (See Figure below):



1. Select two broad characteristics, such as price and menu, that differentiate the companies in an industry from one another.
2. Plot the firms, using these two characteristics as the dimensions.
3. Draw a circle around those companies that are closest to one another as one strategic group, varying the size of the circle in proportion to the group's share of total industry sales. (You could also name each strategic group in the restaurant industry with an identifying title, such as quick fast food or buffet-style service.)

Other dimensions, such as quality, service, location, or degree of vertical integration, could also be used in additional graphs of the restaurant industry to gain a better understanding of how the various firms in the industry compete. Keep in mind, however, that the two dimensions should not be highly correlated; otherwise, the circles on the map will simply lie along the diagonal, providing very little new information other than the obvious.

Strategic Types

In analyzing the level of competitive intensity within a particular industry or strategic group, it is useful to characterize the various competitors for predictive purposes. A strategic type is a category of firms based on a common strategic orientation and a combination of structure, culture, and processes consistent with that strategy. According to Miles and Snow, competing firms within a single industry can be categorized into one of four basic types on the basis of their general strategic orientation. This distinction helps explain why companies facing similar situations behave differently and why they continue to do so over long periods of time. These general types have the following characteristics:

1. Defenders are companies with a limited product line that focus on improving the efficiency of their existing operations. This cost orientation makes them unlikely to innovate in new areas. With its emphasis on efficiency, Lincoln Electric is an example of a defender.
2. Prospectors are companies with fairly broad product lines that focus on product innovation and market opportunities. This sales orientation makes them somewhat inefficient. They tend to emphasize creativity over efficiency. Rubbermaid's emphasis on new product development makes it an example of a prospector.
3. Analyzers are corporations that operate in at least two different product-market areas, one stable and one variable. In the stable areas, efficiency is emphasized. In the variable areas, innovation is emphasized. Multidivisional firms, such as IBM and Procter & Gamble, which operate in multiple industries, tend to be analyzers.
4. Reactors are corporations that lack a consistent strategy-structure-culture relationship. Their (often ineffective) responses to environmental pressures tend to be piecemeal strategic changes. Most major U.S. airlines have recently tended to be reactors—given the way they have been forced to respond to new entrants such as Southwest and JetBlue.

Dividing the competition into these four categories enables the strategic manager not only to monitor the effectiveness of certain strategic orientations, but also to develop scenarios of future industry developments (discussed later in this chapter).

Hypercompetition

Most industries today are facing an ever-increasing level of environmental uncertainty. They are becoming more complex and more dynamic. Industries that used to be multidomestic are becoming global. New flexible, aggressive, innovative competitors are moving into established markets to rapidly erode the advantages of large previously dominant firms. Distribution channels vary from country to country and are being altered daily through the use of sophisticated information systems. Closer relationships with suppliers are being forged to reduce costs, increase quality, and gain access to new technology. Companies learn to quickly imitate the successful strategies of market leaders, and it becomes harder to sustain any competitive advantage for very long. Consequently, the level of competitive intensity is increasing in most industries.

Richard D'Aveni contends that as this type of environmental turbulence reaches more industries, competition becomes hypercompetition. According to D'Aveni:
hypercompetition the frequency, boldness, and aggressiveness of dynamic movement by the players accelerates to create a condition of constant disequilibrium and change. Market stability is threatened by short product life cycles, short product design cycles, new technologies, frequent entry by unexpected outsiders, repositioning by incumbents, and tactical redefinitions of market boundaries as diverse industries merge. In other words, environments escalate toward higher and higher levels of uncertainty, dynamism, heterogeneity of the players and hostility.

In hypercompetitive industries such as computers, competitive advantage comes from an upto-date knowledge of environmental trends and competitive activity coupled with a willingness to risk a current advantage for a possible new advantage. Companies must be willing to cannibalize their own products (that is, replace popular products before competitors do so) in order to sustain their competitive advantage.

Using Key Success Factors to Create an Industry Matrix

Within any industry there are usually certain variables—key success factors—that a company's management must understand in order to be successful. Key success factors are variables that can significantly affect the overall competitive positions of companies within any particular industry. They typically vary from industry to industry and are crucial to determining a company's ability to succeed within that industry. They are usually determined by the economic and technological characteristics of the industry and by the competitive weapons on which the firms in the industry

have built their strategies. For example, in the major home appliance industry, a firm must achieve low costs, typically by building large manufacturing facilities dedicated to making multiple versions of one type of appliance, such as washing machines. Because 60% of major home appliances in the United States are sold through "power retailers" such as Sears and Best Buy, a firm must have a strong presence in the mass merchandiser distribution channel. It must offer a full line of appliances and provide a just-in-time delivery system to keep store inventory and ordering costs to a minimum. Because the consumer expects reliability and durability in an appliance, a firm must have excellent process R&D. Any appliance manufacturer that is unable to deal successfully with these key success factors will not survive long in the U.S. market.

TABLE 4–4 Industry Matrix

Key Success Factors	Weight	Company A Rating	Company A Weighted Score	Company B Rating	Company B Weighted Score
1	2	3	4	5	6
Total	1.00		═		═

SOURCE: T. L. Wheelen and J. D. Hunger, *Industry Matrix*. Copyright © 1997, 2001, and 2005 by Wheelen & Hunger Associates. Reprinted with permission.

An industry matrix summarizes the key success factors within a particular industry. As shown in Table above, the matrix gives a weight for each factor based on how important that factor is for success within the industry. The matrix also specifies how well various competitors in the industry are responding to each factor. To generate an industry matrix using two industry competitors (called A and B), complete the following steps for the industry being analyzed:

1. In Column 1 (Key Success Factors), list the 8 to 10 factors that appear to determine success in the industry.

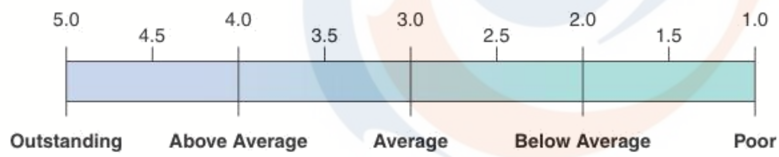
2. In Column 2 (Weight), assign a weight to each factor, from 1.0 (Most Important) to 0.0 (Not Important) based on that factor's probable impact on the overall industry's current and future success. (All weights must sum to 1.0 regardless of the number of strategic factors.)
3. In Column 3 (Company A Rating), examine a particular company within the industry—for example, Company A. Assign a rating to each factor from 5 (Outstanding) to 1 (Poor) based on Company A's current response to that particular factor. Each rating is a judgment regarding how well that company is specifically dealing with each key success factor.

4. In Column 4 (Company A Weighted Score), multiply the weight in Column 2 for each factor by its rating in Column 3 to obtain that factor's weighted score for Company A.

5. In Column 5 (Company B Rating), examine a second company within the industry - in this case, Company B. Assign a rating to each key success factor from 5.0 (Outstanding) to 1.0 (Poor), based on Company B's current response to each particular factor.

6. In Column 6 (Company B Weighted Score), multiply the weight in Column 2 for each factor times its rating in Column 5 to obtain that factor's weighted score for Company B.

7. Finally, add the weighted scores for all the factors in Columns 4 and 6 to determine the total weighted scores for companies A and B. The total weighted score indicates how well each company is responding to current and expected key success factors in the industry's environment. Check to ensure that the total weighted score truly reflects the company's current performance in terms of profitability and market share. (An average company should have a total weighted score of 3.)



The industry matrix can be expanded to include all the major competitors within an industry through the addition of two additional columns for each additional competitor.

Modul Manajemen Strategik
Chapter 5 - 8

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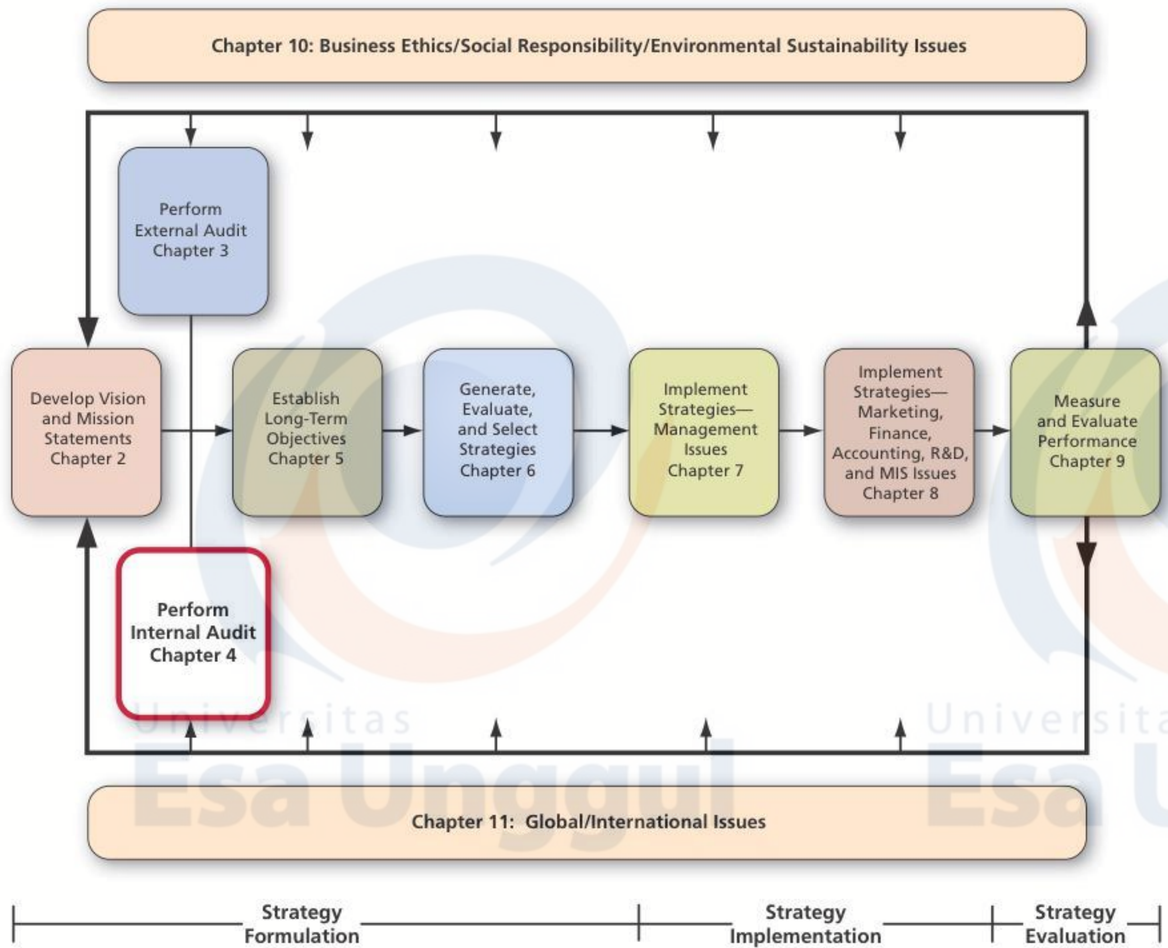
2019

Chapter 5
INTERNAL ANALYSIS

Internal Analysis

A note from David



Source: Fred R. David, "How Companies Define Their Mission," *Long Range Planning* 22, no. 3 (June 1988): 40.

The Nature of an Internal Audit

All organizations have strengths and weaknesses in the functional areas of business. No enterprise is equally strong or weak in all areas. Maytag, for example, is known for excellent production and product design, whereas Procter & Gamble is known for superb marketing. Internal strengths/weaknesses, coupled with external opportunities/threats and a clear statement of mission, provide the basis for establishing objectives and strategies. Objectives and strategies are established with the intention of capitalizing upon internal strengths and overcoming weaknesses. The internal-audit part of the strategic-management process is illustrated in Figure above.

Key Internal Forces

It is not possible in a strategic-management text to review in depth all the material presented in courses such as marketing, finance, accounting, management, management information systems, and production/operations; there are many subareas within these functions, such as customer service, warranties, advertising, packaging, and pricing under marketing.

For different types of organizations, such as hospitals, universities, and government agencies, the functional business areas, of course, differ. In a hospital, for example, functional areas may include cardiology, hematology, nursing, maintenance, physician support, and receivables. Functional areas of a university can include athletic programs, placement services, housing, fund-raising, academic research, counseling, and intramural programs. Within large organizations, each division has certain strengths and weaknesses.

A firm's strengths that cannot be easily matched or imitated by competitors are called distinctive competencies. Building competitive advantages involves taking advantage of distinctive competencies. For example, 3M exploits its distinctive competence in research and development by producing a wide range of innovative products. Strategies are designed in part to improve on a firm's weaknesses, turning them into strengths—and maybe even into distinctive competencies.

Figure below illustrates that all firms should continually strive to improve on their weaknesses, turning them into strengths, and ultimately developing distinctive competencies that can provide the firm with competitive advantages over rival firms.

The Process of Gaining Competitive Advantage in a Firm

Weaknesses ⇒ Strengths ⇒ Distinctive Competencies ⇒ Competitive Advantage

The Process of Performing an Internal Audit

The process of performing an internal audit closely parallels the process of performing an external audit. Representative managers and employees from throughout the firm need to be involved in determining a firm's strengths and weaknesses. The internal audit requires gathering and assimilating information about the firm's management, marketing, finance/accounting, production/operations, research and development (R&D), and management information systems operations. Key factors should be prioritized so that the firm's most important strengths and weaknesses can be determined collectively.

Compared to the external audit, the process of performing an internal audit provides more opportunity for participants to understand how their jobs, departments, and divisions fit into the whole organization. This is a great benefit because managers and employees perform better when they understand how their work affects other areas and activities of the firm. For example, when marketing and manufacturing managers jointly discuss issues related to internal strengths and weaknesses, they gain a better appreciation of the issues, problems, concerns, and needs of all the functional areas. In organizations that do not use strategic management, marketing, finance, and manufacturing managers often do not interact with each other in significant ways. Performing an internal audit thus is an excellent vehicle or forum for improving the process of communication in the organization. Communication may be the most important word in management.

Performing an internal audit requires gathering, assimilating, and evaluating information about the firm's operations. Critical success factors, consisting of both strengths and weaknesses, can be identified and prioritized. According to William King, a task force of managers from different units of the organization, supported by staff, should be charged with determining the 10 to 20 most important strengths and weaknesses that should influence the future of the organization. He says:

"The development of conclusions on the 10 to 20 most important organizational strengths and weaknesses can be, as any experienced manager knows, a difficult task, when it involves

managers representing various organizational interests and points of view. Developing a 20-page list of strengths and weaknesses could be accomplished relatively easily, but a list of the 10 to 15 most important ones involves significant analysis and negotiation. This is true because of the judgments that are required and the impact which such a list will inevitably have as it is used in the formulation, implementation, and evaluation of strategies."

Strategic management is a highly interactive process that requires effective coordination among management, marketing, finance/accounting, production/operations, R&D, and management information systems managers. Although the strategic-management process is overseen by strategists, success requires that managers and employees from all functional areas work together to provide ideas and information. Financial managers, for example, may need to restrict the number of feasible options available to operations managers, or R&D managers may develop products for which marketing managers need to set higher objectives. A key to organizational success is effective coordination and understanding among managers from all functional business areas. Through involvement in performing an internal strategic-management audit, managers from different departments and divisions of the firm come to understand the nature and effect of decisions in other functional business areas in their firm. Knowledge of these relationships is critical for effectively establishing objectives and strategies.

A failure to recognize and understand relationships among the functional areas of business can be detrimental to strategic management, and the number of those relationships that must be managed increases dramatically with a firm's size, diversity, geographic dispersion, and the number of products or services offered. Governmental and nonprofit enterprises traditionally have not placed sufficient emphasis on relationships among the business functions. Some firms place too great an emphasis on one function at the expense of others. Ansoff explained:

"During the first fifty years, successful firms focused their energies on optimizing the performance of one of the principal functions: production/operations, R&D, or marketing. Today, due to the growing complexity and dynamism of the environment, success increasingly depends on a judicious combination of several functional influences. This transition from a single function focus to a multifunction focus is essential for successful strategic management."

Financial ratio analysis exemplifies the complexity of relationships among the functional areas of business. A declining return on investment or profit margin ratio could be the result of ineffective marketing, poor management policies, research and development errors, or a weak management information system. The effectiveness of strategy formulation, implementation, and evaluation activities hinges upon a clear understanding of how major business functions affect one another. For strategies to succeed, a coordinated effort among all the functional areas of business is needed. In the case of planning, George wrote:

We may conceptually separate planning for the purpose of theoretical discussion and analysis, but in practice, neither is it a distinct entity nor is it capable of being separated. The planning function is mixed with all other business functions and, like ink once mixed with water, it cannot be set apart. It is spread throughout and is a part of the whole of managing an organization.

The Resource-Based View (RBV)

Some researchers emphasize the importance of the internal audit part of the strategic-management process by comparing it to the external audit. Robert Grant concluded that the internal audit is more important, saying:

"In a world where customer preferences are volatile, the identity of customers is changing, and the technologies for serving customer requirements are continually evolving, an externally focused orientation does not provide a secure foundation for formulating long-term strategy. When the external environment is in a state of flux, the firm's own resources and capabilities may be a much more stable basis on which to define its identity. Hence, a definition of a business in terms of what it is capable of doing may offer a more durable basis for strategy than a definition based upon the needs which the business seeks to satisfy."

The Resource-Based View (RBV) approach to competitive advantage contends that internal resources are more important for a firm than external factors in achieving and sustaining competitive advantage. In contrast to the I/O theory presented in the previous chapter, proponents of the RBV view contend that organizational performance will primarily be determined by internal resources that can be grouped into three all-encompassing categories: physical resources, human resources, and organizational resources. 5 Physical resources include

all plant and equipment, location, technology, raw materials, machines; human resources include all employees, training, experience, intelligence, knowledge, skills, abilities; and organizational resources include firm structure, planning processes, information systems, patents, trademarks, copyrights, databases, and so on. RBV theory asserts that resources are actually what helps a firm exploit opportunities and neutralize threats.

The basic premise of the RBV is that the mix, type, amount, and nature of a firm's internal resources should be considered first and foremost in devising strategies that can lead to sustainable competitive advantage. Managing strategically according to the RBV involves developing and exploiting a firm's unique resources and capabilities, and continually maintaining and strengthening those resources. The theory asserts that it is advantageous for a firm to pursue a strategy that is not currently being implemented by any competing firm. When other firms are unable to duplicate a particular strategy, then the focal firm has a sustainable competitive advantage, according to RBV theorists.

For a resource to be valuable, it must be either (1) rare, (2) hard to imitate, or (3) not easily substitutable. Often called empirical indicators, these three characteristics of resources enable a firm to implement strategies that improve its efficiency and effectiveness and lead to a sustainable competitive advantage. The more a resource(s) is rare, non-imitable, and nonsubstitutable, the stronger a firm's competitive advantage will be and the longer it will last.

Rare resources are resources that other competing firms do not possess. If many firms have the same resource, then those firms will likely implement similar strategies, thus giving no one firm a sustainable competitive advantage. This is not to say that resources that are common are not valuable; they do indeed aid the firm in its chance for economic prosperity. However, to sustain a competitive advantage, it is more advantageous if the resource(s) is also rare.

It is also important that these same resources be difficult to imitate. If firms cannot easily gain the resources, say RBV theorists, then those resources will lead to a competitive advantage more so than resources easily imitable. Even if a firm employs resources that are rare, a sustainable competitive advantage may be achieved only if other firms cannot easily obtain these resources.

The third empirical indicator that can make resources a source of competitive advantage is substitutability. Borrowing from Porter's Five-Forces Model, to the degree that there are no viable substitutes, a firm will be able to sustain its competitive advantage. However, even if a competing firm cannot perfectly imitate a firm's resource, it can still obtain a sustainable competitive advantage of its own by obtaining resource substitutes.

The RBV has continued to grow in popularity and continues to seek a better understanding of the relationship between resources and sustained competitive advantage in strategic management. However, one cannot say with any degree of certainty that either external or internal factors will always or even consistently be more important in seeking competitive advantage. Understanding both external and internal factors, and more importantly, understanding the relationships among them, will be the key to effective strategy formulation (discussed in Chapter 6). Because both external and internal factors continually change, strategists seek to identify and take advantage of positive changes and buffer against negative changes in a continuing effort to gain and sustain a firm's competitive advantage. This is the essence and challenge of strategic management, and oftentimes survival of the firm hinges on this work.

Integrating Strategy and Culture

Relationships among a firm's functional business activities perhaps can be exemplified best by focusing on organizational culture, an internal phenomenon that permeates all departments and divisions of an organization. Organizational culture can be defined as "a pattern of behavior that has been developed by an organization as it learns to cope with its problem of external adaptation and internal integration, and that has worked well enough to be considered valid and to be taught to new members as the correct way to perceive, think, and feel." This definition emphasizes the importance of matching external with internal factors in making strategic decisions.

Organizational culture captures the subtle, elusive, and largely unconscious forces that shape a workplace. Remarkably resistant to change, culture can represent a major strength or weakness for the firm. It can be an underlying reason for strengths or weaknesses in any of the major business functions.

Defined in Table below, cultural products include values, beliefs, rites, rituals, ceremonies, myths, stories, legends, sagas, language, metaphors, symbols, heroes, and heroines. These products or dimensions are levers that strategists can use to influence and direct strategy formulation, implementation, and evaluation activities. An organization's culture compares to an individual's personality in the sense that no two organizations have the same culture and no two individuals have the same personality. Both culture and personality are enduring and can be warm, aggressive, friendly, open, innovative, conservative, liberal, harsh, or likable.

At Google, the culture is very informal. Employees are encouraged to wander the halls on employee-sponsored scooters and brainstorm on public whiteboards provided everywhere.

Example Cultural Products Defined

Rites	Planned sets of activities that consolidate various forms of cultural expressions into one event.
Ceremonial	Several rites connected together.
Ritual	A standardized set of behaviors used to manage anxieties.
Myth	A narrative of imagined events, usually not supported by facts.
Saga	A historical narrative describing the unique accomplishments of a group and its leaders.
Legend	A handed-down narrative of some wonderful event, usually not supported by facts.
Story	A narrative usually based on true events.
Folktale	A fictional story.
Symbol	Any object, act, event, quality, or relation used to convey meaning.
Language	The manner in which members of a group communicate.
Metaphors	Shorthand of words used to capture a vision or to reinforce old or new values
Values	Life-directing attitudes that serve as behavioral guidelines
Belief	An understanding of a particular phenomenon
Heroes/Heroines	Individuals greatly respected.

Source: Based on H. M. Trice and J. M. Beyer, "Studying Organizational Cultures through Rites and Ceremonials," *Academy of Management Review* 9, no. 4 (October 1984): 655.

In contrast, the culture at Procter & Gamble (P&G) is so rigid that employees jokingly call themselves "Proctoids." Despite this difference, the two companies are swapping employees and participating in each other's staff training sessions. Why? Because P&G spends more money on advertising than any other company and Google desires more of P&G's $8.7 billion annual advertising expenses; P&G has come to realize that the next generation of laundry-detergent, toilet-paper, and skin-cream customers now spend more time online than watching TV. Consumers age 18 to 27 say they use the Internet nearly 13 hours a week, compared to 10 hours of TV, according to market-data firm Forrester Research.

Dimensions of organizational culture permeate all the functional areas of business. It is something of an art to uncover the basic values and beliefs that are deeply buried in an organization's rich collection of stories, language, heroes, and rituals, but cultural products can represent both important strengths and weaknesses. Culture is an aspect of an organization that can no longer be taken for granted in performing an internal strategic-management audit because culture and strategy must work together.

Table below provides some example (possible) aspects of an organization's culture. Note you could ask employees/managers to rate the degree that the dimension characterizes the firm. When one firm acquires another firm, integrating the two cultures can be important. For

example, in Table below, one firm may score mostly 1's and the other firm may score mostly 5's, which would present a challenging strategic problem.

The strategic-management process takes place largely within a particular organization's culture. Lorsch found that executives in successful companies are emotionally committed to the firm's culture, but he concluded that culture can inhibit strategic management in two basic ways. First, managers frequently miss the significance of changing external conditions because they are blinded by strongly held beliefs. Second, when a particular culture has been effective in the past, the natural response is to stick with it in the future, even during times of major strategic change. 8 An organization's culture must support the collective commitment of its people to a common purpose. It must foster competence and enthusiasm among managers and employees.

Organizational culture significantly affects business decisions and thus must be evaluated during an internal strategic-management audit. If strategies can capitalize on cultural strengths, such as a strong work ethic or highly ethical beliefs, then management often can swiftly and easily implement changes. However, if the firm's culture is not supportive, strategic changes may be ineffective or even counterproductive. A firm's culture can become antagonistic to new strategies, with the result being confusion and disorientation.

Fifteen Example (Possible) Aspects of an Organization's Culture

Dimension	Degree				
1. Strong work ethic; arrive early and leave late	1	2	3	4	5
2. High ethical beliefs; clear code of business ethics followed	1	2	3	4	5
3. Formal dress; shirt and tie expected	1	2	3	4	5
4. Informal dress; many casual dress days	1	2	3	4	5
5. Socialize together outside of work	1	2	3	4	5
6. Do not question supervisor's decision	1	2	3	4	5
7. Encourage whistle-blowing	1	2	3	4	5
8. Be health conscious; have a wellness program	1	2	3	4	5
9. Allow substantial "working from home"	1	2	3	4	5
10. Encourage creativity/innovation/openmindness	1	2	3	4	5
11. Support women and minorities; no glass ceiling	1	2	3	4	5
12. Be highly socially responsible; be philanthropic	1	2	3	4	5
13. Have numerous meetings	1	2	3	4	5
14. Have a participative management style	1	2	3	4	5
15. Preserve the natural environment; have a sustainability program	1	2	3	4	5

An organization's culture should infuse individuals with enthusiasm for implementing strategies.

Allarie and Firsirotu emphasized the need to understand culture:

Culture provides an explanation for the insuperable difficulties a firm encounters when it attempts to shift its strategic direction. Not only has the "right" culture become the essence and foundation of corporate excellence, it is also claimed that success or failure of reforms hinges on management's sagacity and ability to change the firm's driving culture in time and in time with required changes in strategies.

The potential value of organizational culture has not been realized fully in the study of strategic management. Ignoring the effect that culture can have on relationships among the functional areas of business can result in barriers to communication, lack of coordination, and an inability to adapt to changing conditions. Some tension between culture and a firm's strategy is inevitable, but the tension should be monitored so that it does not reach a point at which relationships are severed and the culture becomes antagonistic. The resulting disarray among members of the organization would disrupt strategy formulation, implementation, and evaluation. In contrast, a supportive organizational culture can make managing much easier.

Internal strengths and weaknesses associated with a firm's culture sometimes are overlooked because of the interfunctional nature of this phenomenon. It is important, therefore, for strategists to understand their firm as a sociocultural system. Success is often determined by linkages between a firm's culture and strategies. The challenge of strategic management today is to bring about the changes in organizational culture and individual mind-sets that are needed to support the formulation, implementation, and evaluation of strategies.

Management

The functions of management consist of five basic activities: planning, organizing, motivating, staffing, and controlling. An overview of these activities is provided in Table below.

TABLE 4-3 The Basic Functions of Management

Function	Description	Stage of Strategic-Management Process When Most Important
Planning	Planning consists of all those managerial activities related to preparing for the future. Specific tasks include forecasting, establishing objectives, devising strategies, developing policies, and setting goals.	Strategy Formulation
Organizing	Organizing includes all those managerial activities that result in a structure of task and authority relationships. Specific areas include organizational design, job specialization, job descriptions, job specifications, span of control, unity of command, coordination, job design, and job analysis.	Strategy Implementation
Motivating	Motivating involves efforts directed toward shaping human behavior. Specific topics include leadership, communication, work groups, behavior modification, delegation of authority, job enrichment, job satisfaction, needs	Strategy Implementation

Planning

The only thing certain about the future of any organization is change, and planning is the essential bridge between the present and the future that increases the likelihood of achieving desired results. Planning is the process by which one determines whether to attempt a task, works out the most effective way of reaching desired objectives, and prepares to overcome unexpected difficulties with adequate resources. Planning is the start of the process by which an individual or business may turn empty dreams into achievements. Planning enables one to avoid the trap of working extremely hard but achieving little.

Planning is an up-front investment in success. Planning helps a firm achieve maximum effect from a given effort. Planning enables a firm to take into account relevant factors and focus on the critical ones. Planning helps ensure that the firm can be prepared for all reasonable eventualities and for all changes that will be needed. Planning enables a firm to gather the resources needed and carry out tasks in the most efficient way possible. Planning enables a firm to conserve its own resources, avoid wasting ecological resources, make a fair profit, and be seen as an effective, useful firm. Planning enables a firm to identify precisely what is to be achieved and to detail precisely the who, what, when, where, why, and how needed to achieve desired objectives. Planning enables a firm to assess whether the effort, costs, and implications associated with achieving desired objectives are warranted. 10 Planning is the cornerstone of effective strategy formulation. But even though it is considered the foundation of management, it is commonly the task that managers neglect most. Planning is essential for successful strategy implementation and strategy evaluation, largely because organizing, motivating, staffing, and controlling activities depend upon good planning.

The process of planning must involve managers and employees throughout an organization. The time horizon for planning decreases from two to five years for top-level to less than six months for lower-level managers. The important point is that all managers do planning and should involve subordinates in the process to facilitate employee understanding and commitment.

Planning can have a positive impact on organizational and individual performance. Planning allows an organization to identify and take advantage of external opportunities as well as

minimize the impact of external threats. Planning is more than extrapolating from the past and present into the future. It also includes developing a mission, forecasting future events and trends, establishing objectives, and choosing strategies to pursue.

An organization can develop synergy through planning. Synergy exists when everyone pulls together as a team that knows what it wants to achieve; synergy is the 2 + 2 = 5 effect. By establishing and communicating clear objectives, employees and managers can work together toward desired results. Synergy can result in powerful competitive advantages. The strategic-management process itself is aimed at creating synergy in an organization.

Planning allows a firm to adapt to changing markets and thus to shape its own destiny. Strategic management can be viewed as a formal planning process that allows an organization to pursue proactive rather than reactive strategies. Successful organizations strive to control their own futures rather than merely react to external forces and events as they occur. Historically, organisms and organizations that have not adapted to changing conditions have become extinct. Swift adaptation is needed today more than ever because changes in markets, economies, and competitors worldwide are accelerating. Many firms did not adapt to the global recession of late and went out of business.

Organizing

The purpose of organizing is to achieve coordinated effort by defining task and authority relationships. Organizing means determining who does what and who reports to whom. There are countless examples in history of well-organized enterprises successfully competing against—and in some cases defeating—much stronger but less-organized firms. A well-organized firm generally has motivated managers and employees who are committed to seeing the organization succeed. Resources are allocated more effectively and used more efficiently in a well-organized firm than in a disorganized firm.

The organizing function of management can be viewed as consisting of three sequential activities: breaking down tasks into jobs (work specialization), combining jobs to form departments (departmentalization), and delegating authority. Breaking down tasks into jobs requires the development of job descriptions and job specifications. These tools clarify for both

managers and employees what particular jobs entail. In The Wealth of Nations, published in 1776, Adam Smith cited the advantages of work specialization in the manufacture of pins:

One man draws the wire, another straightens it, a third cuts it, a fourth points it, a fifth grinds it at the top for receiving the head. Ten men working in this manner can produce 48,000 pins in a single day, but if they had all wrought separately and independently, each might at best produce twenty pins in a day.

Combining jobs to form departments results in an organizational structure, span of control, and a chain of command. Changes in strategy often require changes in structure because positions may be created, deleted, or merged. Organizational structure dictates how resources are allocated and how objectives are established in a firm. Allocating resources and establishing objectives geographically, for example, is much different from doing so by product or customer.

The most common forms of departmentalization are functional, divisional, strategic business unit, and matrix.

Delegating authority is an important organizing activity, as evidenced in the old saying "You can tell how good a manager is by observing how his or her department functions when he or she isn't there." Employees today are more educated and more capable of participating in organizational decision making than ever before. In most cases, they expect to be delegated authority and responsibility and to be held accountable for results. Delegation of authority is embedded in the strategic-management process.

Motivating

Motivating can be defined as the process of influencing people to accomplish specific objectives. Motivation explains why some people work hard and others do not. Objectives, strategies, and policies have little chance of succeeding if employees and managers are not motivated to implement strategies once they are formulated. The motivating function of management includes at least four major components: leadership, group dynamics, communication, and organizational change.

When managers and employees of a firm strive to achieve high levels of productivity, this indicates that the firm's strategists are good leaders. Good leaders establish rapport with subordinates, empathize with their needs and concerns, set a good example, and are trustworthy and fair. Leadership includes developing a vision of the firm's future and inspiring people to work hard to achieve that vision. Kirkpatrick and Locke reported that certain traits also characterize effective leaders: knowledge of the business, cognitive ability, self-confidence, honesty, integrity, and drive.

Research suggests that democratic behavior on the part of leaders results in more positive attitudes toward change and higher productivity than does autocratic behavior. Drucker said:

Leadership is not a magnetic personality. That can just as well be demagoguery. It is not "making friends and influencing people." That is flattery. Leadership is the lifting of a person's vision to higher sights, the raising of a person's performance to a higher standard, the building of a person's personality beyond its normal limitations.

Group dynamics play a major role in employee morale and satisfaction. Informal groups or coalitions form in every organization. The norms of coalitions can range from being very positive to very negative toward management. It is important, therefore, that strategists identify the composition and nature of informal groups in an organization to facilitate strategy formulation, implementation, and evaluation. Leaders of informal groups are especially important in formulating and implementing strategy changes.

Communication, perhaps the most important word in management, is a major component in motivation. An organization's system of communication determines whether strategies can be implemented successfully. Good two-way communication is vital for gaining support for departmental and divisional objectives and policies. Top-down communication can encourage bottom-up communication. The strategic-management process becomes a lot easier when subordinates are encouraged to discuss their concerns, reveal their problems, provide recommendations, and give suggestions. A primary reason for instituting strategic management is to build and support effective communication networks throughout the firm.

The manager of tomorrow must be able to get his people to commit themselves to the business, whether they are machine operators or junior vice-presidents. The key issue will be empowerment, a term whose strength suggests the need to get beyond merely sharing a little information and a bit of decision making.

Staffing

The management function of staffing, also called personnel management or human resource management, includes activities such as recruiting, interviewing, testing, selecting, orienting, training, developing, caring for, evaluating, rewarding, disciplining, promoting, transferring, demoting, and dismissing employees, as well as managing union relations.

Staffing activities play a major role in strategy-implementation efforts, and for this reason, human resource managers are becoming more actively involved in the strategic-management process. It is important to identify strengths and weaknesses in the staffing area.

The complexity and importance of human resource activities have increased to such a degree that all but the smallest organizations now need a full-time human resource manager. Numerous court cases that directly affect staffing activities are decided each day. Organizations and individuals can be penalized severely for not following federal, state, and local laws and guidelines related to staffing. Line managers simply cannot stay abreast of all the legal developments and requirements regarding staffing. The human resources department coordinates staffing decisions in the firm so that an organization as a whole meets legal requirements. This department also provides needed consistency in administering company rules, wages, policies, and employee benefits as well as collective bargaining with unions.

Human resource management is particularly challenging for international companies. For example, the inability of spouses and children to adapt to new surroundings can be a staffing problem in overseas transfers. The problems include premature returns, job performance slumps, resignations, discharges, low morale, marital discord, and general discontent. Firms such as Ford Motor and ExxonMobil screen and interview spouses and children before assigning persons to overseas positions. 3M Corporation introduces children to peers in the target country and offers spouses educational benefits.

Controlling

The controlling function of management includes all of those activities undertaken to ensure that actual operations conform to planned operations. All managers in an organization have controlling responsibilities, such as conducting performance evaluations and taking necessary action to minimize inefficiencies. The controlling function of management is particularly important for effective strategy evaluation. Controlling consists of four basic steps:

1. Establishing performance standards
2. Measuring individual and organizational performance
3. Comparing actual performance to planned performance standards
4. Taking corrective actions

Measuring individual performance is often conducted ineffectively or not at all in organizations. Some reasons for this shortcoming are that evaluations can create confrontations that most managers prefer to avoid, can take more time than most managers are willing to give, and can require skills that many managers lack. No single approach to measuring individual performance is without limitations. For this reason, an organization should examine various methods, such as the graphic rating scale, the behaviorally anchored rating scale, and the critical incident method, and then develop or select a performance-appraisal approach that best suits the firm's needs. Increasingly, firms are striving to link organizational performance with managers' and employees' pay.

Management Audit Checklist of Questions

The following checklist of questions can help determine specific strengths and weaknesses in the functional area of business. An answer of no to any question could indicate a potential weakness, although the strategic significance and implications of negative answers, of course, will vary by organization, industry, and severity of the weakness. Positive or yes answers to the checklist questions suggest potential areas of strength.

1. Does the firm use strategic-management concepts?
2. Are company objectives and goals measurable and well communicated?

3. Do managers at all hierarchical levels plan effectively?
4. Do managers delegate authority well?
5. Is the organization's structure appropriate?
6. Are job descriptions and job specifications clear?
7. Is employee morale high?
8. Are employee turnover and absenteeism low?
9. Are organizational reward and control mechanisms effective?

Marketing

Marketing can be described as the process of defining, anticipating, creating, and fulfilling customers' needs and wants for products and services. There are seven basic functions of marketing: (1) customer analysis, (2) selling products/services, (3) product and service planning, (4) pricing, (5) distribution, (6) marketing research, and (7) opportunity analysis. 16 Understanding these functions helps strategists identify and evaluate marketing strengths and weaknesses.

Customer Analysis

Customer analysis—the examination and evaluation of consumer needs, desires, and wants—involves administering customer surveys, analyzing consumer information, evaluating market positioning strategies, developing customer profiles, and determining optimal market segmentation strategies. The information generated by customer analysis can be essential in developing an effective mission statement. Customer profiles can reveal the demographic characteristics of an organization's customers. Buyers, sellers, distributors, salespeople, managers, wholesalers, retailers, suppliers, and creditors can all participate in gathering information to successfully identify customers' needs and wants. Successful organizations continually monitor present and potential customers' buying patterns.

Selling Products/Services

Successful strategy implementation generally rests upon the ability of an organization to sell some product or service. Selling includes many marketing activities, such as advertising, sales promotion, publicity, personal selling, sales force management, customer relations, and dealer relations. These activities are especially critical when a firm pursues a market penetration strategy.

The effectiveness of various selling tools for consumer and industrial products varies. Personal selling is most important for industrial goods companies, and advertising is most important for consumer goods companies.

U.S. advertising expenditures are expected to fall 6.2 percent in 2009 to $161.8 billion. 17 One aspect of ads in a recession is that they generally take more direct aim at competitors, and this marketing practice is holding true in our bad economic times. Nick Brien at Mediabrands says, "Ads have to get combative in bad times. It's a dog fight, and it's about getting leaner and meaner." Marketers in 2009 also say ads will be less lavish and glamorous in a recession. Table 4-4 lists specific characteristics of ads forthcoming in late 2009 and 2010 in response to the economic hard times people nationwide and worldwide are facing. Total U.S. online advertising sending is expected to decline 0.3 percent to $36.9 billion in 2009, after growing 8.5 percent in 2008.

A 30-second advertisement on the Super Bowl in 2009 was $3 million. The NBC network airing the Super Bowl took in $206 million of ad revenue from the broadcast as just over 95 million people watched the Pittsburgh Steelers defeat the Arizona Cardinals in Super Bowl XLIII. The most watched television show in history was the 1983 season finale of M*A*S*H, which drew 106 million viewers.

Visa in 2009 launched a $140 million advertising campaign that includes print, TV, outdoor, and Internet ads designed to persuade consumers that debit cards "are more convenient, safer, and secure than cash or checks."

Pharmaceutical companies on average reduced their spending on consumer advertising of prescription drugs by 8 percent in 2008 to $4.4 billion. This was the first annual decrease since 1997 in their efforts to get patients to request a particular medicine from their doctor.

Determining organizational strengths and weaknesses in the selling function of marketing is an important part of performing an internal strategic-management audit. With regard to advertising products and services on the Internet, a new trend is to base advertising rates exclusively on sales rates. This new accountability contrasts sharply with traditional broadcast and print advertising, which bases rates on the number of persons expected to see a given advertisement. The new cost-

per-sale online advertising rates are possible because any Web site can monitor which user clicks on which advertisement and then can record whether that consumer actually buys the product. If there are no sales, then the advertisement is free.

Product and Service Planning

Product and service planning includes activities such as test marketing; product and brand positioning; devising warranties; packaging; determining product options, features, style, and quality; deleting old products; and providing for customer service. Product and service planning is particularly important when a company is pursuing product development or diversification.

One of the most effective product and service planning techniques is test marketing. Test markets allow an organization to test alternative marketing plans and to forecast future sales of new products. In conducting a test market project, an organization must decide how many cities to include, which cities to include, how long to run the test, what information to collect during the test, and what action to take after the test has been completed. Test marketing is used more frequently by consumer goods companies than by industrial goods companies. Test marketing can allow an organization to avoid substantial losses by revealing weak products and ineffective marketing approaches before large-scale production begins. Starbucks is currently test marketing selling beer and wine in its stores to boost its "after 5 PM" sales.

Pricing

Five major stakeholders affect pricing decisions: consumers, governments, suppliers, distributors, and competitors. Sometimes an organization will pursue a forward integration strategy primarily to gain better control over prices charged to consumers. Governments can impose constraints on price fixing, price discrimination, minimum prices, unit pricing, price advertising, and price controls. For example, the Robinson-Patman Act prohibits manufacturers and wholesalers from discriminating in price among channel member purchasers (suppliers and distributors) if competition is injured.

Competing organizations must be careful not to coordinate discounts, credit terms, or condition of sale; not to discuss prices, markups, and costs at trade association meetings; and not to arrange to issue new price lists on the same date, to rotate low bids on contracts, or to uniformly restrict

production to maintain high prices. Strategists should view price from both a short-run and a long-run perspective, because competitors can copy price changes with relative ease. Often a dominant firm will aggressively match all price cuts by competitors.

With regard to pricing, as the value of the dollar increases, U.S. multinational companies have a choice. They can raise prices in the local currency of a foreign country or risk losing sales and market share. Alternatively, multinational firms can keep prices steady and face reduced profit when their export revenue is reported in the United States in dollars.

Intense price competition, created by the global economic recession, coupled with Internet price-comparative shopping has reduced profit margins to bare minimum levels for most companies. For example, airline tickets, rental car prices, hotel room rates, and computer prices are lower today than they have been in many years.

In response to the economic recession, the family-dining chain Denny's did something that no family-dining chain had ever done before: give away breakfast from 6 AM until 2 PM on February 8, 2009, at all of its restaurants in the United States. More than 2 million people took advantage of the free breakfast at all but two of Denny's 1,550 restaurants nationwide. The entire promotion, including food, labor, and airing an ad on the Super Bowl the Sunday before, cost Denny's about $5 million. However, the firm reaped tons of positive public relations as well as $50 million of free news coverage nationwide and greatly increased customer loyalty. "People love free stuff when money's tight," says Dan Ariely, a business professor at Duke University. Other firms recently set a price of zero on their products, including McDonald's, Starbucks, Dunkin' Donuts, and Panera Bread. Denny's CEO Nelson Marchioli says that Denny's did better than break even on the free breakfast day, and it may do this promotion again.

Distribution

Distribution includes warehousing, distribution channels, distribution coverage, retail site locations, sales territories, inventory levels and location, transportation carriers, wholesaling, and retailing. Most producers today do not sell their goods directly to consumers. Various marketing entities act as intermediaries; they bear a variety of names such as wholesalers, retailers, brokers, facilitators, agents, vendors—or simply distributors.

Distribution becomes especially important when a firm is striving to implement a market development or forward integration strategy. Some of the most complex and challenging decisions facing a firm concern product distribution. Intermediaries flourish in our economy because many producers lack the financial resources and expertise to carry out direct marketing. Manufacturers who could afford to sell directly to the public often can gain greater returns by expanding and improving their manufacturing operations.

Successful organizations identify and evaluate alternative ways to reach their ultimate market. Possible approaches vary from direct selling to using just one or many wholesalers and retailers. Strengths and weaknesses of each channel alternative should be determined according to economic, control, and adaptive criteria. Organizations should consider the costs and benefits of various wholesaling and retailing options. They must consider the need to motivate and control channel members and the need to adapt to changes in the future. Once a marketing channel is chosen, an organization usually must adhere to it for an extended period of time.

Marketing Research

Marketing research is the systematic gathering, recording, and analyzing of data about problems relating to the marketing of goods and services. Marketing research can uncover critical strengths and weaknesses, and marketing researchers employ numerous scales, instruments, procedures, concepts, and techniques to gather information. Marketing research activities support all of the major business functions of an organization. Organizations that possess excellent marketing research skills have a definite strength in pursuing generic strategies.

The President of PepsiCo said, “Looking at the competition is the company’s best form of market research. The majority of our strategic successes are ideas that we borrow from the marketplace, usually from a small regional or local competitor. In each case, we spot a promising new idea, improve on it, and then out-execute our competitor.”

Cost/Benefit Analysis

The seventh function of marketing is cost/benefit analysis, which involves assessing the costs, benefits, and risks associated with marketing decisions. Three steps are required to perform a

cost/benefit analysis: (1) compute the total costs associated with a decision, (2) estimate the total benefits from the decision, and (3) compare the total costs with the total benefits. When expected benefits exceed total costs, an opportunity becomes more attractive. Sometimes the variables included in a cost/benefit analysis cannot be quantified or even measured, but usually reasonable estimates can be made to allow the analysis to be performed. One key factor to be considered is risk. Cost/benefit analysis should also be performed when a company is evaluating alternative ways to be socially responsible.

Marketing Audit Checklist of Questions

The following questions about marketing must be examined in strategic planning:

1. Are markets segmented effectively?
2. Is the organization positioned well among competitors?
3. Has the firm's market share been increasing?
4. Are present channels of distribution reliable and cost effective?
5. Does the firm have an effective sales organization?
6. Does the firm conduct market research?
7. Are product quality and customer service good?
8. Are the firm's products and services priced appropriately?
9. Does the firm have an effective promotion, advertising, and publicity strategy?
10. Are marketing, planning, and budgeting effective?
11. Do the firm's marketing managers have adequate experience and training?
12. Is the firm's Internet presence excellent as compared to rivals?

Finance/Accounting

Financial condition is often considered the single best measure of a firm's competitive position and overall attractiveness to investors. Determining an organization's financial strengths and weaknesses is essential to effectively formulating strategies. A firm's liquidity, leverage, working capital, profitability, asset utilization, cash flow, and equity can eliminate some strategies as being feasible alternatives. Financial factors often alter existing strategies and change implementation plans.

Finance/Accounting Functions

According to James Van Horne, the functions of finance/accounting comprise three decisions: the investment decision, the financing decision, and the dividend decision. 20 Financial ratio analysis is the most widely used method for determining an organization's strengths and weaknesses in the investment, financing, and dividend areas. Because the functional areas of business are so closely related, financial ratios can signal strengths or weaknesses in management, marketing, production, research and development, and management information systems activities. It is important to note here that financial ratios are equally applicable in for-profit and nonprofit organizations. Even though nonprofit organizations obviously would not have return-on-investment or earnings-per-share ratios, they would routinely monitor many other special ratios. For example, a church would monitor the ratio of dollar contributions to number of members, while a zoo would monitor dollar food sales to number of visitors. A university would monitor number of students divided by number of professors. Therefore, be creative when performing ratio analysis for nonprofit organizations because they strive to be financially sound just as for-profit firms do.

The investment decision, also called capital budgeting, is the allocation and reallocation of capital and resources to projects, products, assets, and divisions of an organization. Once strategies are formulated, capital budgeting decisions are required to successfully implement strategies. The financing decision determines the best capital structure for the firm and includes examining various methods by which the firm can raise capital (for example, by issuing stock, increasing debt, selling assets, or using a combination of these approaches). The financing decision must consider both short-term and long-term needs for working capital. Two key financial ratios that indicate whether a firm's financing decisions have been effective are the debt-to-equity ratio and the debt-to-total-assets ratio.

Dividend decisions concern issues such as the percentage of earnings paid to stockholders, the stability of dividends paid over time, and the repurchase or issuance of stock. Dividend decisions determine the amount of funds that are retained in a firm compared to the amount paid out to stockholders. Three financial ratios that are helpful in evaluating a firm's dividend decisions are the earnings-per-share ratio, the dividends-per-share ratio, and the price-earnings ratio. The benefits of paying dividends to investors must be balanced against the benefits of internally retaining funds, and there is no set formula on how to balance this trade-off. For the reasons

listed here, dividends are sometimes paid out even when funds could be better reinvested in the business or when the firm has to obtain outside sources of capital:

1. Paying cash dividends is customary. Failure to do so could be thought of as a stigma. A dividend change is considered a signal about the future.
2. Dividends represent a sales point for investment bankers. Some institutional investors can buy only dividend-paying stocks.
3. Shareholders often demand dividends, even in companies with great opportunities for reinvesting all available funds.
4. A myth exists that paying dividends will result in a higher stock price

A Summary of Key Financial Ratios

Ratio	How Calculated	What It Measures
Liquidity Ratios		
Current Ratio	Current assets / Current liabilities	The extent to which a firm can meet its short-term obligations
Quick Ratio	Current assets minus inventory / Current liabilities	The extent to which a firm can meet its short-term obligations without relying upon the sale of its inventories
Leverage Ratios		
Debt-to-Total-Assets Ratio	Total debt / Total assets	The percentage of total funds that are provided by creditors
Debt-to-Equity Ratio	Total debt / Total stockholders' equity	The percentage of total funds provided by creditors versus by owners
Long-Term Debt-to-Equity Ratio	Long-term debt / Total stockholders' equity	The balance between debt and equity in a firm's long-term capital structure
Times-Interest-Earned Ratio	Profits before interest and taxes / Total interest charges	The extent to which earnings can decline without the firm becoming unable to meet its annual interest costs
Activity Ratios		
Inventory Turnover	Sales / Inventory of finished goods	Whether a firm holds excessive stocks of inventories and whether a firm is slowly selling its inventories compared to the industry average
Fixed Assets Turnover	Sales / Fixed assets	Sales productivity and plant and equipment utilization
Total Assets Turnover	Sales / Total assets	Whether a firm is generating a sufficient volume of business for the size of its asset investment
Accounts Receivable Turnover	Annual credit sales / Accounts receivable	The average length of time it takes a firm to collect credit sales (in percentage terms)
Average Collection Period	Accounts receivable / Total credit sales/365 days	The average length of time it takes a firm to collect on credit sales (in days)
Profitability Ratios		
Gross Profit Margin	Sales minus cost of goods sold / Sales	The total margin available to cover operating expenses and yield a profit
Operating Profit Margin	Earnings before interest and taxes (EBIT) / Sales	Profitability without concern for taxes and interest
Net Profit Margin	Net income / Sales	After-tax profits per dollar of sales
Return on Total Assets (ROA)	Net income / Total assets	After-tax profits per dollar of assets; this ratio is also called return on investment (ROI)
Return on Stockholders' Equity (ROE)	Net income / Total stockholders' equity	After-tax profits per dollar of stockholders' investment in the firm

(continued)

TABLE 4-6 A Summary of Key Financial Ratios—continued

Ratio	How Calculated	What It Measures
Profitability Ratios		
Earnings Per Share (EPS)	$\frac{\text{Net income}}{\text{Number of shares of common stock outstanding}}$	Earnings available to the owners of common stock
Price-Earnings Ratio	$\frac{\text{Market price per share}}{\text{Earnings per share}}$	Attractiveness of firm on equity markets
Growth Ratios		
Sales	Annual percentage growth in total sales	Firm's growth rate in sales
Net Income	Annual percentage growth in profits	Firm's growth rate in profits
Earnings Per Share	Annual percentage growth in EPS	Firm's growth rate in EPS
Dividends Per Share	Annual percentage growth in dividends per share	Firm's growth rate in dividends per share

Production/Operations

The production/operations function of a business consists of all those activities that transform inputs into goods and services. Production/operations management deals with inputs, transformations, and outputs that vary across industries and markets. A manufacturing operation transforms or converts inputs such as raw materials, labor, capital, machines, and facilities into finished goods and services. As indicated in Table below, Roger Schroeder suggested that production/operations management comprises five functions or decision areas: process, capacity, inventory, workforce, and quality.

The Basic Functions (Decisions) Within Production/Operations

Decision Areas	Example Decisions
1. Process	These decisions include choice of technology, facility layout, process flow analysis, facility location, line balancing, process control, and transportation analysis. Distances from raw materials to production sites to customers are a major consideration.
2. Capacity	These decisions include forecasting, facilities planning, aggregate planning, scheduling, capacity planning, and queuing analysis. Capacity utilization is a major consideration.
3. Inventory	These decisions involve managing the level of raw materials, work-in-process, and finished goods, especially considering what to order, when to order, how much to order, and materials handling.
4. Workforce	These decisions involve managing the skilled, unskilled, clerical, and managerial employees by caring for job design, work measurement, job enrichment, work standards, and motivation techniques.
5. Quality	These decisions are aimed at ensuring that high-quality goods and services are produced by caring for quality control, sampling, testing, quality assurance, and cost control.

Source: Adapted from R. Schroeder, *Operations Management* (New York: McGraw-Hill, 1981): 12.

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Most automakers require a 30-day notice to build vehicles, but Toyota Motor fills a buyer's new car order in just 5 days. Honda Motor was considered the industry's fastest producer, filling orders in 15 days. Automakers have for years operated under just-in-time inventory systems, but Toyota's 360 suppliers are linked to the company via computers on a virtual assembly line. The new Toyota production system was developed in the company's Cambridge, Ontario, plant and now applies to its Solara, Camry, Corolla, and Tacoma vehicles.

Production/operations activities often represent the largest part of an organization's human and capital assets. In most industries, the major costs of producing a product or service are incurred within operations, so production/operations can have great value as a competitive weapon in a company's overall strategy. Strengths and weaknesses in the five functions of production can mean the success or failure of an enterprise.

Many production/operations managers are finding that cross-training of employees can help their firms respond faster to changing markets. Cross-training of workers can increase efficiency, quality, productivity, and job satisfaction. For example, at General Motors' Detroit gear and axle plant, costs related to product defects were reduced 400 percent in two years as a result of cross-training workers. A shortage of qualified labor in the United States is another reason cross-training is becoming a common management practice.

Singapore rivals Hong Kong as an attractive site for locating production facilities in Southeast Asia. Singapore is a city-state near Malaysia. An island nation of about 4 million, Singapore is changing from an economy built on trade and services to one built on information technology. A large-scale program in computer education for older (over age 26) residents is very popular. Singapore children receive outstanding computer training in schools. All government services

are computerized nicely. Singapore lures multinational businesses with great tax breaks, world-class infrastructure, excellent courts that efficiently handle business disputes, exceptionally low tariffs, large land giveaways, impressive industrial parks, excellent port facilities, and a government very receptive to and cooperative with foreign businesses. Foreign firms now account for 70 percent of manufacturing output in Singapore.

In terms of ship container traffic processed annually, Singapore has the largest and busiest seaport in the world, followed by Hong Kong, Shanghai, Los Angeles, Busan (South Korea), Rotterdam, Hamburg, New York, and Tokyo. The Singapore seaport is five times the size of the New York City seaport.

There is much reason for concern that many organizations have not taken sufficient account of the capabilities and limitations of the production/operations function in formulating strategies. Scholars contend that this neglect has had unfavorable consequences on corporate performance in America. As shown in Table below, James Dilworth outlined implications of several types of strategic decisions that a company might make.

Implications of Various Strategies on Production/Operations

Various Strategies	Implications
1. Low-cost provider	Creates high barriers to entry
	Creates larger market
	Requires longer production runs and fewer product changes
2. A high-quality provider	Requires more quality-assurance efforts
	Requires more expensive equipment
	Requires highly skilled workers and higher wages
3. Provide great customer service	Requires more service people, service parts, and equipment
	Requires rapid response to customer needs or changes in customer tastes
	Requires a higher inventory investment
4. Be the first to introduce new products	Has higher research and development costs
	Has high retraining and tooling costs
5. Become highly automated	Requires high capital investment
	Reduces flexibility
	May affect labor relations
	Makes maintenance more crucial
6. Minimize layoffs	Serves the security needs of employees and may develop employee loyalty
	Helps to attract and retain highly skilled employees

Source: Based on: J. Dilworth, *Production and Operations Management: Manufacturing and Nonmanufacturing*, 2nd ed. Copyright © 1983 by Random House, Inc.

Value Chain Analysis (VCA)

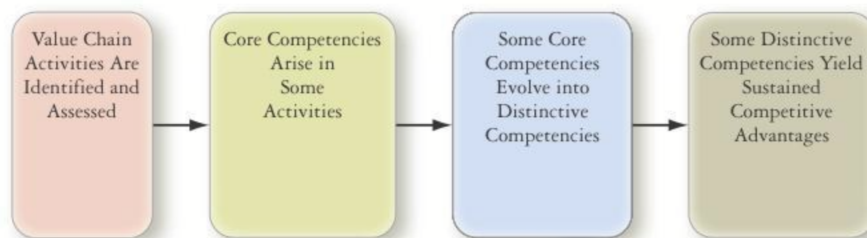
According to Porter, the business of a firm can best be described as a value chain, in which total revenues minus total costs of all activities undertaken to develop and market a product or service yields value. All firms in a given industry have a similar value chain, which includes activities such as obtaining raw materials, designing products, building manufacturing facilities, developing cooperative agreements, and providing customer service. A firm will be profitable as long as total revenues exceed the total costs incurred in creating and delivering the product or service. Firms should strive to understand not only their own value chain operations but also their competitors', suppliers', and distributors' value chains.

Value chain analysis (VCA) refers to the process whereby a firm determines the costs associated with organizational activities from purchasing raw materials to manufacturing product(s) to marketing those products. VCA aims to identify where low-cost advantages or disadvantages exist anywhere along the value chain from raw material to customer service activities. VCA can enable a firm to better identify its own strengths and weaknesses, especially as compared to competitors' value chain analyses and their own data examined over time.

Substantial judgment may be required in performing a VCA because different items along the value chain may impact other items positively or negatively, so there exist complex interrelationships. For example, exceptional customer service may be especially expensive yet may reduce the costs of returns and increase revenues. Cost and price differences among rival firms can have their origins in activities performed by suppliers, distributors, creditors, or even shareholders. Despite the complexity of VCA, the initial step in implementing this procedure is to divide a firm's operations into specific activities or business processes. Then the analyst attempts to attach a cost to each discrete activity, and the costs could be in terms of both time and money. Finally, the analyst converts the cost data into information by looking for competitive cost strengths and weaknesses that may yield competitive advantage or disadvantage. Conducting a VCA is supportive of the RBV's examination of a firm's assets and capabilities as sources of distinctive competence.

When a major competitor or new market entrant offers products or services at very low prices, this may be because that firm has substantially lower value chain costs or perhaps the rival firm is just waging a desperate attempt to gain sales or market share. Thus value chain analysis can be critically important for a firm in monitoring whether its prices and costs are competitive. An

example value chain is illustrated in Figure below. There can be more than a hundred particular value-creating activities associated with the business of producing and marketing a product or service, and each one of the activities can represent a competitive advantage or disadvantage for the firm. The combined costs of all the various activities in a company's value chain define the firm's cost of doing business. Firms should determine where cost advantages and disadvantages in their value chain occur relative to the value chain of rival firms.



Value chains differ immensely across industries and firms. Whereas a paper products company, such as Stone Container, would include on its value chain timber farming, logging, pulp mills, and papermaking, a computer company such as Hewlett-Packard would include programming, peripherals, software, hardware, and laptops. A motel would include food, housekeeping, check-in and check-out operations, Web site, reservations system, and so on. However all firms should use value chain analysis to develop and nurture a core competence and convert this competence into a distinctive competence. A core competence is a value chain activity that a firm performs especially well. When a core competence evolves into a major competitive advantage, then it is called a distinctive competence.

More and more companies are using VCA to gain and sustain competitive advantage by being especially efficient and effective along various parts of the value chain. For example, Wal-Mart has built powerful value advantages by focusing on exceptionally tight inventory control, volume purchasing of products, and offering exemplary customer service. Computer companies in contrast compete aggressively along the distribution end of the value chain. Of course, price competitiveness is a key component of effectiveness among both mass retailers and computer firms.

Benchmarking

Benchmarking is an analytical tool used to determine whether a firm's value chain activities are competitive compared to rivals and thus conducive to winning in the marketplace. Benchmarking entails measuring costs of value chain activities across an industry to determine "best practices" among competing firms for the purpose of duplicating or improving upon those best practices. Benchmarking enables a firm to take action to improve its competitiveness by identifying (and improving upon) value chain activities where rival firms have comparative advantages in cost, service, reputation, or operation.

The hardest part of benchmarking can be gaining access to other firms' value chain activities with associated costs. Typical sources of benchmarking information, however, include published reports, trade publications, suppliers, distributors, customers, partners, creditors, shareholders, lobbyists, and willing rival firms. Some rival firms share benchmarking data. However, the International Benchmarking Clearinghouse provides guidelines to help ensure that restraint of trade, price fixing, bid rigging, bribery, and other improper business conduct do not arise between participating firms.

Due to the popularity of benchmarking today, numerous consulting firms such as Accenture, AT Kearney, Best Practices Benchmarking & Consulting, as well as the Strategic Planning Institute's Council on Benchmarking, gather benchmarking data, conduct benchmarking studies, and distribute benchmark information without identifying the sources.

The Internal Factor Evaluation (IFE) Matrix

A summary step in conducting an internal strategic-management audit is to construct an Internal Factor Evaluation (IFE) Matrix. This strategy-formulation tool summarizes and evaluates the major strengths and weaknesses in the functional areas of a business, and it also provides a basis for identifying and evaluating relationships among those areas. Intuitive judgments are required in developing an IFE Matrix, so the appearance of a scientific approach should not be interpreted to mean this is an all-powerful technique. A thorough understanding of the factors included is more important than the actual numbers. Similar to the EFE Matrix and Competitive Profile Matrix, an IFE Matrix can be developed in five steps:

1. List key internal factors as identified in the internal-audit process. Use a total of from 10 to 20 internal factors, including both strengths and weaknesses. List strengths first and then weaknesses. Be as specific as possible, using percentages, ratios, and comparative numbers. Recall that Edward Deming said, “In God we trust. Everyone else bring data.”
2. Assign a weight that ranges from 0.0 (not important) to 1.0 (all-important) to each factor. The weight assigned to a given factor indicates the relative importance of the factor to being successful in the firm’s industry. Regardless of whether a key factor is an internal strength or weakness, factors considered to have the greatest effect on organizational performance should be assigned the highest weights. The sum of all weights must equal 1.0.
3. Assign a 1-to-4 rating to each factor to indicate whether that factor represents a major weakness (rating = 1), a minor weakness (rating = 2), a minor strength (rating = 3), or a major strength (rating = 4). Note that strengths must receive a 3 or 4 rating and weaknesses must receive a 1 or 2 rating. Ratings are thus company-based, whereas the weights in step 2 are industry-based.
4. Multiply each factor’s weight by its rating to determine a weighted score for each variable.
5. Sum the weighted scores for each variable to determine the total weighted score for the organization.

Regardless of how many factors are included in an IFE Matrix, the total weighted score can range from a low of 1.0 to a high of 4.0, with the average score being 2.5. Total weighted scores well below 2.5 characterize organizations that are weak internally, whereas scores significantly above 2.5 indicate a strong internal position. Like the EFE Matrix, an IFE Matrix should include from 10 to 20 key factors. The number of factors has no effect upon the range of total weighted scores because the weights always sum to 1.0.

When a key internal factor is both a strength and a weakness, the factor should be included twice in the IFE Matrix, and a weight and rating should be assigned to each statement. For example, the Playboy logo both helps and hurts Playboy Enterprises; the logo attracts customers to Playboy magazine, but it keeps the Playboy cable channel out of many markets. Be as quantitative as possible when stating factors. Use monetary amounts, percentages, numbers, and ratios to the extent possible.

An example of an IFE Matrix is provided in Table below for a retail computer store. Note that the two most important factors to be successful in the retail computer store business are “revenues from repair/service in the store” and “location of the store.” Also note that the store is doing best on “average customer purchase amount” and “in-store technical support.” The store is having major problems with its carpet, bathroom, paint, and checkout procedures. Note also that the matrix contains substantial quantitative data rather than vague statements; this is excellent. Overall, this store receives a 2.5 total weighted score, which on a 1-to-4 scale is exactly average/halfway, indicating there is definitely room for improvement in store operations, strategies, policies, and procedures.

The IFE Matrix provides important information for strategy formulation. For example, this retail computer store might want to hire another checkout person and repair its carpet, paint, and bathroom problems. Also, the store may want to increase advertising for its repair/services, because that is a really important (weight 0.15) factor to being successful in this business.

In multidivisional firms, each autonomous division or strategic business unit should construct an IFE Matrix. Divisional matrices then can be integrated to develop an overall corporate IFE Matrix.

TABLE 4.10 A Sample Internal Factor Evaluation Matrix for a Retail Computer Store

Key Internal Factors	Weight	Rating	Weighted Score
Strengths			
1. Inventory turnover increased from 5.8 to 6.7	0.05	3	0.15
2. Average customer purchase increased from $97 to $128	0.07	4	0.28
3. Employee morale is excellent	0.10	3	0.30
4. In-store promotions resulted in 20 percent increase in sales	0.05	3	0.15
5. Newspaper advertising expenditures increased 10 percent	0.02	3	0.06
6. Revenues from repair/service segment of store up 16 percent	0.15	3	0.45
7. In-store technical support personnel have MIS college degrees	0.05	4	0.20
8. Store’s debt-to-total assets ratio declined to 34 percent	0.03	3	0.09
9. Revenues per employee up 19 percent	0.02	3	0.06
Weaknesses			
1. Revenues from software segment of store down 12 percent	0.10	2	0.20
2. Location of store negatively impacted by new Highway 34	0.15	2	0.30
3. Carpet and paint in store somewhat in disrepair	0.02	1	0.02
4. Bathroom in store needs refurbishing	0.02	1	0.02
5. Revenues from businesses down 8 percent	0.04	1	0.04
6. Store has no Web site	0.05	2	0.10
7. Supplier on-time delivery increased to 2.4 days	0.03	1	0.03
8. Often customers have to wait to check out	0.05	1	0.05
Total	**1.00**		**2.50**

Chapter 6
Strategic Analysis and Choice

Strategy Analysis and Choice

A note from David

The Nature of Strategy Analysis and Choice

As indicated by Figure 6-1, this chapter focuses on generating and evaluating alternative strategies, as well as selecting strategies to pursue. Strategy analysis and choice seek to determine alternative courses of action that could best enable the firm to achieve its mission and objectives. The firm's present strategies, objectives, and mission, coupled with the external and internal audit information, provide a basis for generating and evaluating feasible alternative strategies. Unless a desperate situation confronts the firm, alternative strategies will likely represent incremental steps that move the firm from its present position to a desired future position. Alternative strategies do not come out of the wild blue yonder; they are derived from the firm's vision, mission, objectives, external audit, and internal audit; they are consistent with, or build on, past strategies that have worked well.

The Process of Generating and Selecting Strategies

Strategists never consider all feasible alternatives that could benefit the firm because there are an infinite number of possible actions and an infinite number of ways to implement those actions. Therefore, a manageable set of the most attractive alternative strategies must be developed. The advantages, disadvantages, trade-offs, costs, and benefits of these strategies should be determined. This section discusses the process that many firms use to determine an appropriate set of alternative strategies. Identifying and evaluating alternative strategies should involve many of the managers and employees who earlier assembled the organizational vision and mission statements, performed the external audit, and conducted the internal audit. Representatives from each department and division of the firm should be included in this process, as was the case in previous strategy-formulation activities. Recall that involvement provides the best opportunity for managers and employees to gain an understanding of what the firm is doing and why and to become committed to helping the firm accomplish its objectives. All participants in the strategy analysis and choice activity should have the firm's external and internal audit information by their sides. This information, coupled with the firm's mission statement, will help participants crystallize in their own minds particular strategies that they believe could benefit the firm most. Creativity should be encouraged in this thought process. Alternative strategies proposed by participants should be considered and discussed in a meeting or series of meetings. Proposed strategies should be listed in writing. When all feasible strategies identified by participants are given and understood, the strategies should be ranked in order of attractiveness by all

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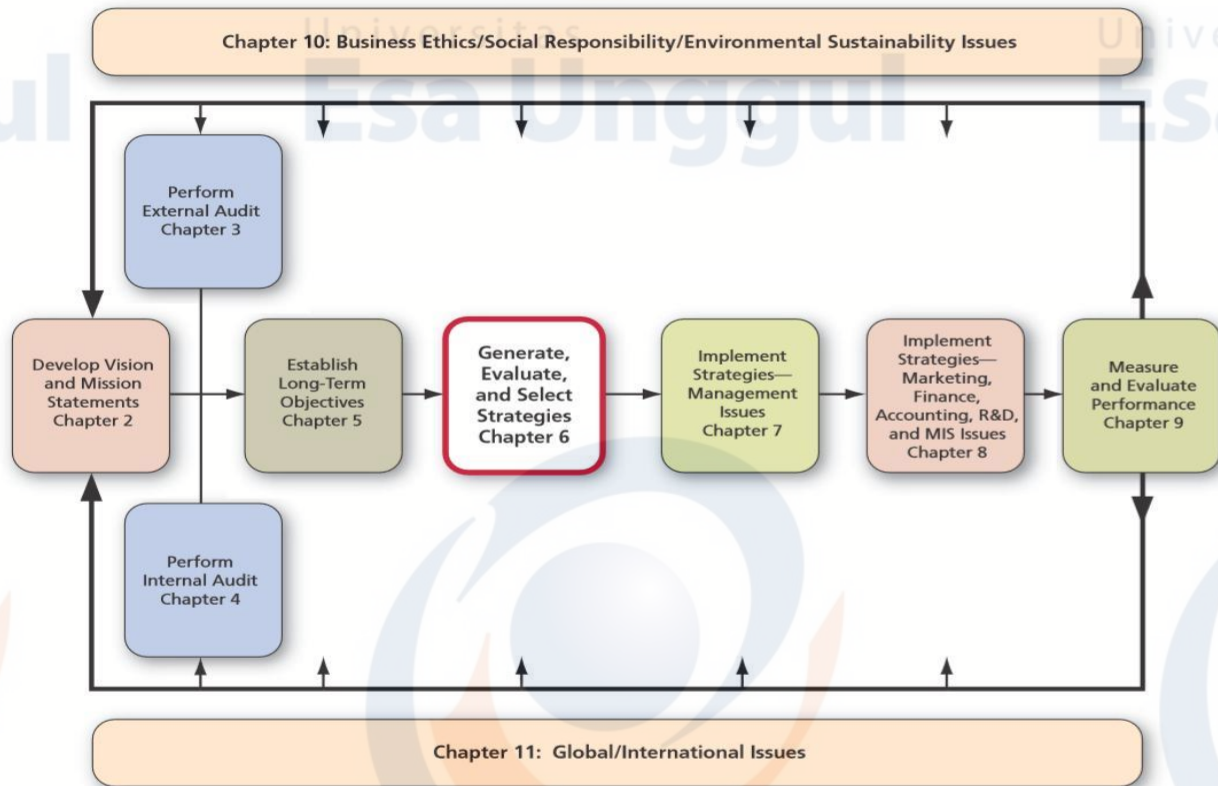
participants, with 1 = should not be implemented, 2 = possibly should be implemented, 3 = probably should be implemented, and 4 = definitely should be implemented. This process will result in a prioritized list of best strategies that reflects the collective wisdom of the group.

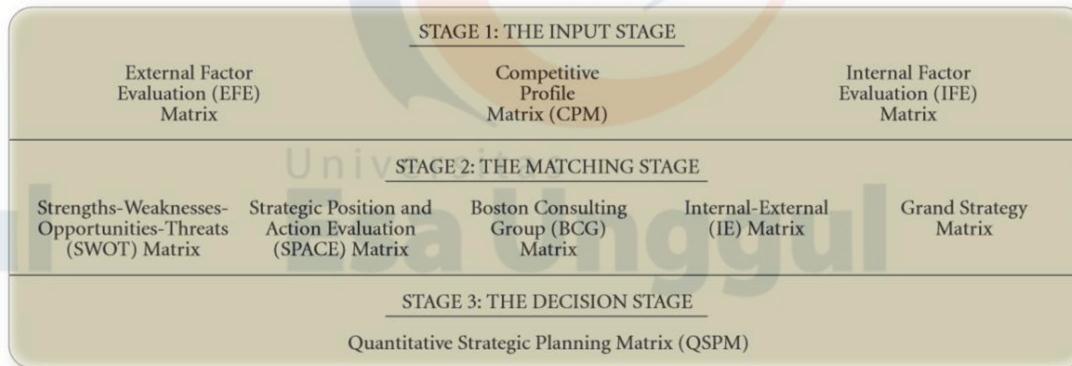


A Comprehensive Strategy-Formulation Framework

Important strategy-formulation techniques can be integrated into a three-stage decisionmaking framework, as shown in Figure 6-2. The tools presented in this framework are applicable to all sizes and types of organizations and can help strategists identify, evaluate, and select strategies. Stage 1 of the formulation framework consists of the EFE Matrix, the IFE Matrix, and the Competitive Profile Matrix (CPM). Called the Input Stage,Stage 1 summarizes the basic input information needed to formulate strategies. Stage 2, called the Matching Stage, focuses upon generating feasible alternative strategies by aligning key external and internal factors. Stage 2 techniques include the Strengths-Weaknesses-Opportunities-Threats (SWOT) Matrix, the Strategic Position and Action Evaluation (SPACE) Matrix, the Boston Consulting Group (BCG) Matrix, the Internal-External (IE) Matrix, and the Grand Strategy Matrix. Stage 3, called the Decision Stage, involves a single technique, the Quantitative Strategic Planning Matrix (QSPM). A QSPM uses input information from Stage 1 to objectively evaluate feasible alternative strategies identified in Stage 2. A QSPM reveals the relative attractiveness of alternative strategies and thus provides objective basis for selecting specific strategies.

FIGURE 6-2

The Strategy-Formulation Analytical Framework



All nine techniques included in the strategy-formulation framework require the integration of intuition and analysis. Autonomous divisions in an organization commonly use strategy-formulation techniques to develop strategies and objectives. Divisional analyses provide a basis for identifying, evaluating, and selecting among alternative corporate-level strategies. Strategists themselves, not analytic tools, are always responsible and accountable for strategic decisions. Lenz emphasized that the shift from a words-oriented to a numbersoriented planning process can give rise to a false sense of certainty; it can reduce dialogue, discussion, and argument as a means for exploring understandings, testing assumptions, and fostering organizational learning.1 Strategists, therefore, must be wary of this possibility and use analytical tools to facilitate, rather than to diminish, communication. Without objective information and analysis, personal biases, politics, emotions, personalities, and halo error (the tendency to put too much weight on a single factor) unfortunately may play a dominant role in the strategy-formulation process.

The Input Stage

Procedures for developing an EFE Matrix, an IFE Matrix, and a CPM were presented in Chapters 3 and 4. The information derived from these three matrices provides basic input information for the matching and decision stage matrices described later in this chapter. The input tools require strategists to quantify subjectivity during early stages of the strategy-formulation process. Making small decisions in the input matrices regarding the relative importance of external and internal factors allows strategists to more effectively generate and evaluate alternative strategies. Good intuitive judgment is always needed in determining appropriate weights and ratings.

The Matching Stage

Strategy is sometimes defined as the match an organization makes between its internal resources and skills and the opportunities and risks created by its external factors.2 The matching stage of the strategy-formulation framework consists of five techniques that can be used in any sequence: the SWOT Matrix, the SPACE Matrix, the BCG Matrix, the IE Matrix, and the Grand Strategy Matrix. These tools rely upon information derived from the input stage to match external opportunities and threats with internal strengths and weaknesses. Matching external and internal critical success factors is the key to effectively generating feasible alternative strategies. For example, a firm with excess working capital (an internal strength) could take advantage of the cell phone industry's 20 percent annual growth rate (an external opportunity) by acquiring Cellfone, Inc., a firm in the cell phone industry.

TABLE 6-1 Matching Key External and Internal Factors to Formulate Alternative Strategies

Key Internal Factor		Key External Factor		Resultant Strategy
Excess working capital (an internal strength)	+	20 percent annual growth in the cell phone industry (an external opportunity)	=	Acquire Cellfone, Inc.
Insufficient capacity (an internal weakness)	+	Exit of two major foreign competitors from the industry (an external opportunity)	=	Pursue horizontal integration by buying competitors' facilities
Strong R&D expertise (an internal strength)	+	Decreasing numbers of younger adults (an external threat)	=	Develop new products for older adults
Poor employee morale (an internal weakness)	+	Rising healthcare costs (an external threat)	=	Develop a new wellness program

This example portrays simple one-to-one matching. In most situations, external and internal relationships are more complex, and the matching requires multiple alignments for each strategy generated. The basic concept of matching is illustrated in Table 6-1. Any organization, whether military, product-oriented, service-oriented, governmental, or even athletic, must develop and execute good strategies to win. A good offense without a good defense, or vice versa, usually leads to defeat. Developing strategies that use strengths to capitalize on opportunities could be considered an offense, whereas strategies designed to improve upon weaknesses while avoiding threats could be termed defensive. Every organization has some external opportunities and threats and internal strengths and weaknesses that can be aligned to formulate feasible alternative strategies.

The Strengths-Weaknesses-Opportunities-Threats (SWOT) Matrix

The Strengths-Weaknesses-Opportunities-Threats (SWOT) Matrix is an important matching tool that helps managers develop four types of strategies: SO (strengths-opportunities) Strategies, WO (weaknesses-opportunities) Strategies, ST (strengths-threats) Strategies, and WT (weaknesses-threats) Strategies.3 Matching key external and internal factors is the most difficult part of developing a SWOT Matrix and requires good judgment—and there is no one best set of matches. Note in Table 6-1 that the first, second, third, and fourth strategies are SO, WO, ST, and WT strategies, respectively. SO Strategies use a firm's internal strengths to take advantage of external opportunities. All managers would like their organizations to be in a position in which

internal strengths can be used to take advantage of external trends and events. Organizations generally will pursue WO, ST, or WT strategies to get into a situation in which they can apply SO Strategies. When a firm has major weaknesses, it will strive to overcome them and make them strengths. When an organization faces major threats, it will seek to avoid them to concentrate on opportunities. WO Strategies aim at improving internal weaknesses by taking advantage of external opportunities. Sometimes key external opportunities exist, but a firm has internal weaknesses that prevent it from exploiting those opportunities. For example, there may be a high demand for electronic devices to control the amount and timing of fuel injection in automobile engines (opportunity), but a certain auto parts manufacturer may lack the technology required for producing these devices (weakness). One possible WO Strategy would be to acquire this technology by forming a joint venture with a firm having competency in this area. An alternative WO Strategy would be to hire and train people with the required technical capabilities. ST Strategies use a firm's strengths to avoid or reduce the impact of external threats. This does not mean that a strong organization should always meet threats in the external environment head-on. An example of ST Strategy occurred when Texas Instruments used an excellent legal department (a strength) to collect nearly $700 million in damages and royalties from nine Japanese and Korean firms that infringed on patents for semiconductor memory chips (threat).

Rival firms that copy ideas, innovations, and patented products are a major threat in many industries. This is still a major problem for U.S. firms selling products in China. WT Strategies are defensive tactics directed at reducing internal weakness and avoiding external threats. An organization faced with numerous external threats and internal weaknesses may indeed be in a precarious position. In fact, such a firm may have to fight for its survival, merge, retrench, declare bankruptcy, or choose liquidation. A schematic representation of the SWOT Matrix is provided in Figure 6-3. Note that a SWOT Matrix is composed of nine cells. As shown, there are four key factor cells, four strategy cells, and one cell that is always left blank (the upper-left cell). The four strategy cells, labeled SO, WO, ST, and WT, are developed after completing four key factor cells, labeled S, W, O, and T. There are eight steps involved in constructing a SWOT Matrix:

1. List the firm's key external opportunities.
2. List the firm's key external threats.
3. List the firm's key internal strengths.
4. List the firm's key internal weaknesses.
5. Match internal strengths with external opportunities, and record the resultant SO Strategies in the appropriate cell.
6. Match internal weaknesses with external opportunities, and record the resultant WO Strategies.

7. Match internal strengths with external threats, and record the resultant ST Strategies.
8. Match internal weaknesses with external threats, and record the resultant WT Strategies.

Some important aspects of a SWOT Matrix are evidenced in Figure 6-3. For example, note that both the internal/external factors and the SO/ST/WO/WT Strategies are stated in quantitative terms to the extent possible. This is important. For example, regarding the second SO #2 and ST #1 strategies, if the analyst just said, “Add new repair/service persons,” the reader might think that 20 new repair/service persons are needed. Actually only two are needed. Always be specific to the extent possible in stating factors and strategies. It is also important to include the “S1, O2” type notation after each strategy in a SWOT Matrix. This notation reveals the rationale for each alternative strategy. Strategies do not rise out of the blue. Note in Figure 6-3how this notation reveals the internal/external factors that were matched to formulate desirable strategies. For example, note that this retail computer store business may need to “purchase land to build new store” because a new Highway 34 will make its location less desirable. The notation (W2, O2) and (S8, T3) in Figure 6-3 exemplifies this matching process. The purpose of each Stage 2 matching tool is to generate feasible alternative strategies, not to select or determine which strategies are best. Not all of the strategies developed in the SWOT Matrix, therefore, will be selected for implementation. The strategy-formulation guidelines provided in Chapter 5 can enhance the process of matching key external and internal factors. For example, when an organization has both the capital and human resources needed to distribute its own products (internal strength) and distributors are unreliable, costly, or incapable of meeting the firm’s needs (external threat), forward integration can be an attractive ST Strategy. When a firm has excess production capacity (internal weakness) and its basic industry is experiencing declining annual sales and profits (external threat), related diversification can be an effective WT Strategy. Although the SWOT matrix is widely used in strategic planning, the analysis does have some limitations.4 First, SWOT does not show how to achieve a competitive advantage, so it must not be an end in itself. The matrix should be the starting point for a discussion on how proposed strategies could be implemented as well as cost-benefit considerations that ultimately could lead to competitive advantage. Second, SWOT is a static assessment (or snapshot) in time. A SWOT matrix can be like studying a single frame of a motion picture where you see the lead characters and the setting but have no clue as to the plot. As circumstances, capabilities, threats, and strategies change, the dynamics of a competitive environment may not be revealed in a single matrix.

FIGURE 6-3

A SWOT Matrix for a Retail Computer Store

	Strengths	Weaknesses
	1. Inventory turnover up 5.8 to 6.7 2. Average customer purchase up $97 to $128 3. Employee morale is excellent 4. In-store promotions = 20% increase in sales 5. Newspaper advertising expenditures down 10% 6. Revenues from repair/service in-store up 16% 7. In-store technical support persons have MIS degrees 8. Store's debt-to-total assets ratio down 34%	1. Software revenues in store down 12% 2. Location of store hurt by new Hwy 34 3. Carpet and paint in store in disrepair 4. Bathroom in store needs refurbishing 5. Total store revenues down 8% 6. Store has no Web site 7. Supplier on-time-delivery up to 2.4 days 8. Customer checkout process too slow 9. Revenues per employee up 19%
Opportunities	**SO Strategies**	**WO Strategies**
1. Population of city growing 10% 2. Rival computer store opening 1 mile away 3. Vehicle traffic passing store up 12% 4. Vendors average six new products/yr 5. Senior citizen use of computers up 8% 6. Small business growth in area up 10% 7. Desire for Web sites up 18% by Realtors 8. Desire for Web sites up 12% by small firms	1. Add 4 new in-store promotions monthly (S4,O3) 2. Add 2 new repair/service persons (S6, O5) 3. Send flyer to all seniors over age 55 (S5, O5)	1. Purchase land to build new store (W2, O2) 2. Install new carpet/paint/bath (W3, W4, O1) 3. Up Web site services by 50% (W6, O7, O8) 4. Launch mailout to all Realtors in city (W5, O7)
Threats	**ST Strategies**	**WT Strategies**
1. Best Buy opening new store in 1yr nearby 2. Local university offers computer repair 3. New bypass Hwy 34 in 1 yr will divert traffic 4. New mall being built nearby 5. Gas prices up 14% 6. Vendors raising prices 8%	1. Hire two more repair persons and market these new services (S6, S7, T1) 2. Purchase land to build new store (S8, T3) 3. Raise out-of-store service calls from $60 to $80 (S6, T5)	1. Hire 2 new cashiers (W8, T1, T4) 2. Install new carpet/paint/bath (W3, W4, T1)

Third, SWOT analysis may lead the firm to overemphasize a single internal or external factor in formulating strategies. There are interrelationships among the key internal and external factors that SWOT does not reveal that may be important in devising strategies.

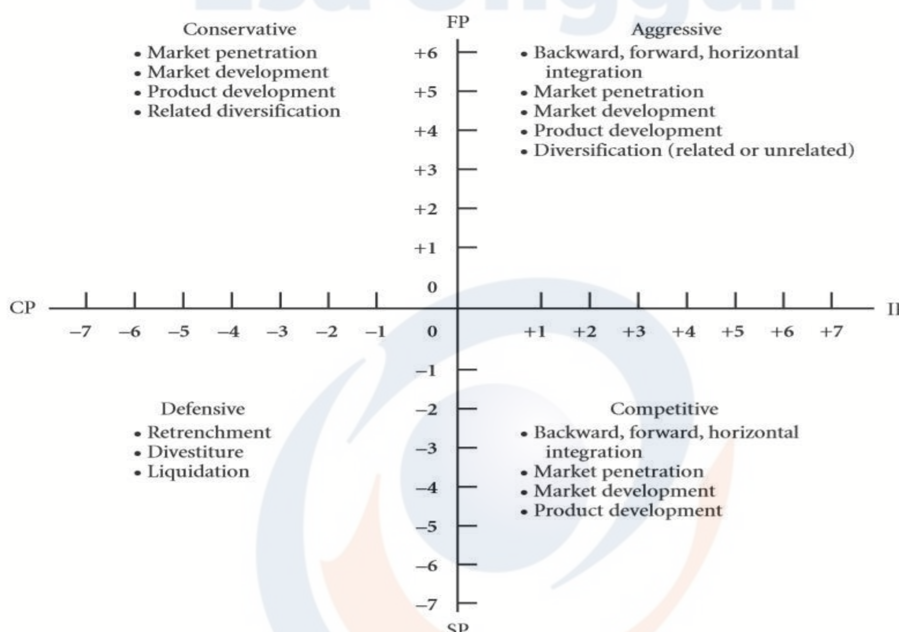
The Strategic Position and Action Evaluation (SPACE) Matrix

The Strategic Position and Action Evaluation (SPACE) Matrix, another important Stage 2 matching tool, is illustrated in Figure 6-4. Its four-quadrant framework indicates whether aggressive, conservative, defensive, or competitive strategies are most appropriate for a given organization. The axes of the SPACE Matrix represent two internal dimensions (financial position [FP] and competitive position [CP]) and two external dimensions (stability position [SP]and industry position [IP]). These four factors are perhaps the most important determinants of an organization's overall strategic position.5

Depending on the type of organization, numerous variables could make up each of the dimensions represented on the axes of the SPACE Matrix. Factors that were included earlier in the firm's EFE and IFE Matrices should be considered in developing a SPACE Matrix. Other variables commonly included are given in Table 6-2. For example, return on investment, leverage, liquidity, working capital, and cash flow are commonly considered to be determining factors of an organization's financial strength. Like the SWOT Matrix, the SPACE Matrix should be both tailored to the particular organization being studied and based on factual information as much as possible.

FIGURE 6-4

The SPACE Matrix



Source: Adapted from H. Rowe, R. Mason, and K. Dickel, *Strategic Management and Business Policy: A Methodological Approach* (Reading, MA: Addison-Wesley Publishing Co. Inc., © 1982): 155.

TABLE 6-2 Example Factors That Make Up the SPACE Matrix Axes

Internal Strategic Position	External Strategic Position
Financial Position (FP)	*Stability Position (SP)*
Return on investment	Technological changes
Leverage	Rate of inflation
Liquidity	Demand variability
Working capital	Price range of competing products
Cash flow	Barriers to entry into market
Inventory turnover	Competitive pressure
Earnings per share	Ease of exit from market
Price earnings ratio	Price elasticity of demand
	Risk involved in business
Competitive Position (CP)	*Industry Position (IP)*
Market share	Growth potential
Product quality	Profit potential
Product life cycle	Financial stability
Customer loyalty	Extent leveraged
Capacity utilization	Resource utilization
Technological know-how	Ease of entry into market
Control over suppliers and distributors	Productivity, capacity utilization

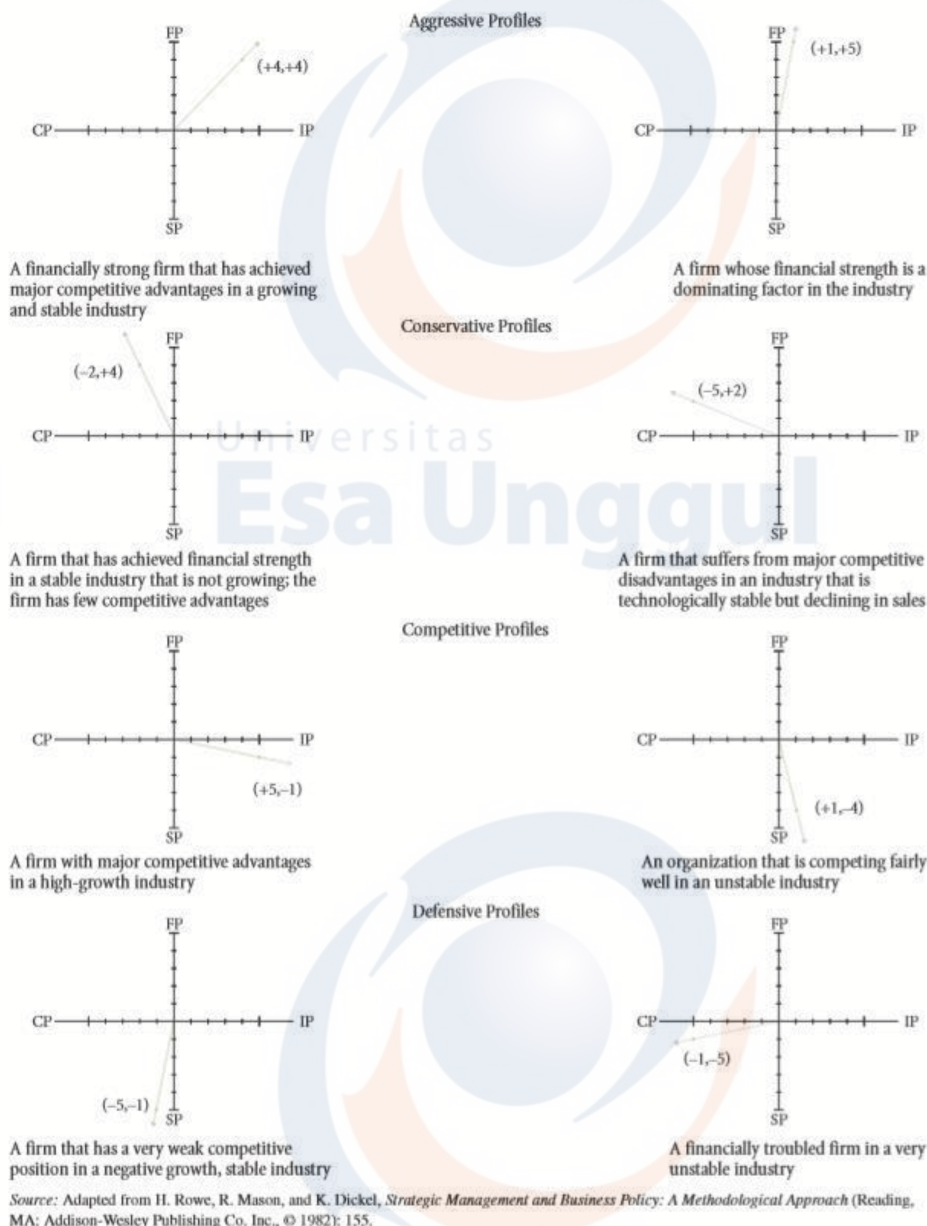
Source: Adapted from H. Rowe, R. Mason, and K. Dickel, *Strategic Management and Business Policy: A Methodological Approach* (Reading, MA: Addison-Wesley Publishing Co. Inc., © 1982): 155–156.

The steps required to develop a SPACE Matrix are as follows:

1. Select a set of variables to define financial position (FP), competitive position (CP), stability position (SP), and industry position (IP).
2. Assign a numerical value ranging from +1 (worst) to +7 (best) to each of the variables that make up the FP and IP dimensions. Assign a numerical value ranging from -1 (best) to -7 (worst) to each of the variables that make up the SP and CP dimensions. On the FP and CP axes, make comparison to competitors. On the IP and SP axes, make comparison to other industries.
3. Compute an average score for FP, CP, IP, and SP by summing the values given to the variables of each dimension and then by dividing by the number of variables included in the respective dimension.
4. Plot the average scores for FP, IP, SP, and CP on the appropriate axis in the SPACE Matrix.
5. Add the two scores on the x-axis and plot the resultant point on X. Add the two scores on the y-axis and plot the resultant point on Y. Plot the intersection of the new xy point.

6. Draw a directional vector from the origin of the SPACE Matrix through the new intersection point. This vector reveals the type of strategies recommended for the organization: aggressive, competitive, defensive, or conservative.

Some examples of strategy profiles that can emerge from a SPACE analysis are shown in Figure 6-5. The directional vector associated with each profile suggests the type of strategies to pursue: aggressive, conservative, defensive, or competitive. When a firm's directional vector is located in the aggressive quadrant(upper-right quadrant) of the SPACE Matrix, an organization is in an excellent position to use its internal strengths to (1) take advantage of external opportunities, (2) overcome internal weaknesses, and (3) avoid external threats. Therefore, market penetration, market development, product development, backward integration, forward integration, horizontal integration, or diversification, can be feasible, depending on the specific circumstances that face the firm.



When a particular company is known, the analyst must be much more specific in terms of implied strategies. For example, instead of saying market penetration is a recommended strategy when your vector goes in the Conservative quadrant, say that adding 34 new stores in India is a recommended strategy. This is a very important point for students doing case analyses because a particular company is generally known, and terms such as market development are too vague to use. That term could refer to adding a manufacturing plant in Thailand or Mexico or South Africa—so students—Be specific to the extent possible regarding implications of all the matrices presented in Chapter 6.

The directional vector may appear in the conservative quadrant (upper-left quadrant) of the SPACE Matrix, which implies staying close to the firm's basic competencies and not taking excessive risks. Conservative strategies most often include market penetration, market development, product development, and related diversification. The directional vector may be located in the lower-left or defensive quadrant of the SPACE Matrix, which suggests that the firm should focus on rectifying internal weaknesses and avoiding external threats. Defensive strategies include retrenchment, divestiture, liquidation, and related diversification. Finally, the directional vector may be located in the lower-right or competitive quadrantof the SPACE Matrix, indicating competitive strategies. Competitive strategies include backward, forward, and horizontal integration; market penetration; market development and product development.

A SPACE Matrix analysis for a bank is provided in Table 6-3. Note that competitive type strategies are recommended.

TABLE 6-3 A SPACE Matrix for a Bank

Financial Position (FP)	Ratings
The bank's primary capital ratio is 7.23 percent, which is 1.23 percentage points over the generally required ratio of 6 percent.	1.0
The bank's return on assets is negative 0.77, compared to a bank industry average ratio of positive 0.70.	1.0
The bank's net income was $183 million, down 9 percent from a year earlier.	3.0
The bank's revenues increased 7 percent to $3.46 billion.	4.0
	9.0
Industry Position (IP)	
Deregulation provides geographic and product freedom.	4.0
Deregulation increases competition in the banking industry.	2.0
Pennsylvania's interstate banking law allows the bank to acquire other banks in New Jersey, Ohio, Kentucky, the District of Columbia, and West Virginia.	4.0
	10.0
Stability Position (SP)	
Less-developed countries are experiencing high inflation and political instability.	−4.0
Headquartered in Pittsburgh, the bank historically has been heavily dependent on the steel, oil, and gas industries. These industries are depressed.	−5.0
Banking deregulation has created instability throughout the industry.	−4.0
	−13.0
Competitive Position (CP)	
The bank provides data processing services for more than 450 institutions in 38 states.	−2.0
Superregional banks, international banks, and nonbanks are becoming increasingly competitive.	−5.0
The bank has a large customer base.	−2.0
	−9.0

Conclusion

SP Average is −13.0 ÷ 3 = −4.33 IP Average is +10.0 ÷ 3 = 3.33

CP Average is −9.0 ÷ 3 = −3.00 FP Average is +9.0 ÷ 4 = 2.25

Directional Vector Coordinates: x-axis: −3.00 + (+3.33) = +0.33

y-axis: −4.33 + (+2.25) = −2.08

The bank should pursue Competitive Strategies.

The Boston Consulting Group (BCG) Matrix

Autonomous divisions (or profit centers) of an organization make up what is called a business portfolio. When a firm's divisions compete in different industries, a separate strategy often must be developed for each business. The Boston Consulting Group (BCG) Matrix and the Internal-External (IE) Matrix are designed specifically to enhance a multidivisional firm's efforts to formulate strategies. (BCG is a private management consulting firm based in Boston. BCG employs about 4,300 consultants worldwide.)

In a Form 10K or Annual Report, some companies do not disclose financial information by segment, so a BCG portfolio analysis is not possible by external entities. Reasons to disclose by-division financial information in the author's view, however, more than offset the reasons not to disclose, as indicated in Table 6-4.

The BCG Matrix graphically portrays differences among divisions in terms of relative market share position and industry growth rate. The BCG Matrix allows a multidivisional organization to manage its portfolio of businesses by examining the relative market share position and the industry growth rate of each division relative to all other divisions in the organization.

Relative market share position is defined as the ratio of a division's own market share (or revenues) in a particular industry to the market share (or revenues) held by the largest rival firm in that industry. Note in Table 6-5 that other variables can be in this analysis besides revenues. Relative market share position for Heineken could also be determined by dividing Heineken's revenues by the leader Corona Extra's revenues. Relative market share position is given on the x-axis of the BCG Matrix. The midpoint on the x-axis usually is set at .50, corresponding to a division that has half the market share of the leading firm in the industry. The y-axis represents the industry growth rate in sales, measured in percentage terms. The growth rate percentages on the y-axis could range from -20 to +20 percent, with 0.0 being the midpoint. The average annual increase in revenues for several leading firms in the industry would be a good estimate of the value. Also, various sources such as the S&P Industry Survey would provide this value. These numerical ranges on the x- and y-axes are often used, but other numerical values could be established as deemed appropriate for particular organizations, such as –10 to +10 percent.

The basic BCG Matrix appears in Figure 6-6. Each circle represents a separate division. The size of the circle corresponds to the proportion of corporate revenue generated by that business unit, and the pie slice indicates the proportion of corporate profits generated by that division. Divisions located in Quadrant I of the BCG Matrix are called "Question Marks,"

those located in Quadrant II are called "Stars," those located in Quadrant III are called "Cash Cows," and those divisions located in Quadrant IV are called "Dogs."

1. Question Marks—Divisions in Quadrant I have a low relative market share position, yet they compete in a high-growth industry. Generally these firms' cash needs are high and their cash generation is low. These businesses are called Question Marks because the organization must decide whether to strengthen them by pursuing an intensive strategy (market penetration, market development, or product development) or to sell them.

TABLE 6-4 Reasons to (or Not to) Disclose Financial Information by Segment (by Division)

Reasons to Disclose	Reasons Not to Disclose
1. Transparency is a good thing in today's world of Sarbanes-Oxley	1. Can become free competitive information for rival firms
2. Investors will better understand the firm, which can lead to greater support	2. Can hide performance failures
3. Managers/employees will better understand the firm, which should lead to greater commitment	3. Can reduce rivalry among segments
4. Disclosure enhances the communication process both within the firm and with outsiders	

TABLE 6-5 Market Share Data for Selected Industries in 2009

U.S. Top Five Airlines by Number of Passengers Boarded in 2008 (in millions; estimate)	
Southwest	7.5
American	5.0
Delta	4.5
United	4.0
US Airways	3.5
U.S. Top Five Imported Beers in 2008 (in millions of barrels imported)	
Corona Extra	8.0
Heineken	5.0
Modelo Especial	2.0
Tecate	1.5
Guinness	1.0

Source: Based on David Kesmodel, "U.S. Beer Imports Lose Their Fizz," *Wall Street Journal* (February 20, 2009): B5; S&P Industry Surveys and Company *Form 10-K* Reports.

2. Stars—Quadrant II businesses (Stars) represent the organization's best long-run opportunities for growth and profitability. Divisions with a high relative market share and a high industry growth rate should receive substantial investment to maintain or strengthen their dominant positions. Forward, backward, and horizontal integration;

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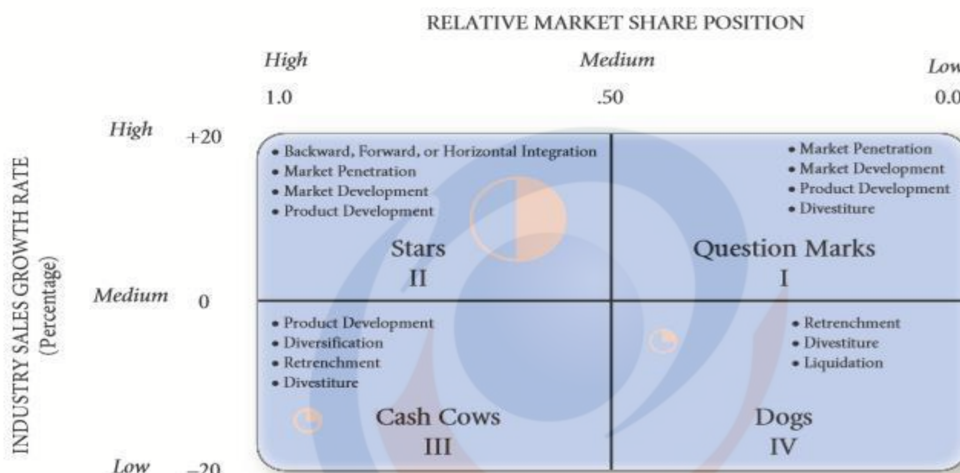
market penetration; market development; and product development are appropriate strategies for these divisions to consider, as indicated in Figure 6-6.

3. Cash Cows—Divisions positioned in Quadrant III have a high relative market share position but compete in a low-growth industry. Called Cash Cows because they generate cash in excess of their needs, they are often milked. Many of today's Cash Cows were yesterday's Stars. Cash Cow divisions should be managed to maintain their strong position for as long as possible. Product development or diversification may be attractive strategies for strong Cash Cows. However, as a Cash Cow division becomes weak, retrenchment or divestiture can become more appropriate.

4. Dogs—Quadrant IV divisions of the organization have a low relative market share position and compete in a slow- or no-market-growth industry; they are Dogs in the firm's portfolio.

   Because of their weak internal and external position, these businesses are often liquidated, divested, or trimmed down through retrenchment. When a division first becomes a Dog, retrenchment can be the best strategy to pursue because many Dogs have bounced back, after strenuous asset and cost reduction, to become viable, profitable divisions.



Source: Adapted from the BCG Portfolio Matrix from the Product Portfolio Matrix, © 1970, The Boston Consulting Group.

The major benefit of the BCG Matrix is that it draws attention to the cash flow, investment characteristics, and needs of an organization's various divisions. The divisions of many firms evolve over time: Dogs become Question Marks, Question Marks become Stars, Stars become Cash Cows, and Cash Cows become Dogs in an ongoing counterclockwise motion. Less frequently, Stars become Question Marks, Question Marks become Dogs, Dogs become Cash Cows, and Cash Cows become Stars (in a clockwise motion). In some organizations, no cyclical motion is apparent. Over time, organizations should strive to achieve a portfolio of divisions that are Stars.

An example BCG Matrix is provided in Figure 6-7, which illustrates an organization composed of five divisions with annual sales ranging from $5,000 to $60,000. Division 1 has the greatest sales volume, so the circle representing that division is the largest one in the matrix. The circle

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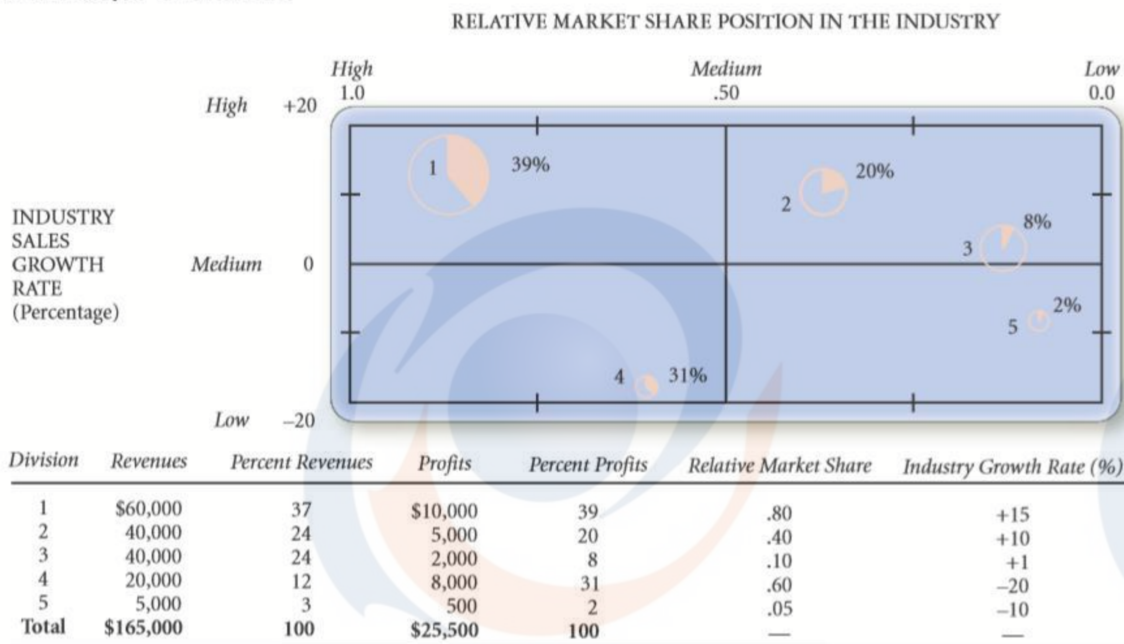
corresponding to Division 5 is the smallest because its sales volume ($5,000) is least among all the divisions. The pie slices within the circles reveal the percent of corporate profits contributed by each division. As shown, Division 1 contributes the highest profit percentage, 39 percent. Notice in the diagram that Division 1 is considered a Star, Division 2 is a Question Mark, Division 3 is also a Question Mark, Division 4 is a Cash Cow, and Division 5 is a Dog.

FIGURE 6-7

An Example BCG Matrix



Division	Revenues	Percent Revenues	Profits	Percent Profits	Relative Market Share	Industry Growth Rate (%)
1	$60,000	37	$10,000	39	.80	+15
2	40,000	24	5,000	20	.40	+10
3	40,000	24	2,000	8	.10	+1
4	20,000	12	8,000	31	.60	–20
5	5,000	3	500	2	.05	–10
Total	**$165,000**	**100**	**$25,500**	**100**	—	—

The BCG Matrix, like all analytical techniques, has some limitations. For example, viewing every business as either a Star, Cash Cow, Dog, or Question Mark is an oversimplification; many businesses fall right in the middle of the BCG Matrix and thus are not easily classified. Furthermore, the BCG Matrix does not reflect whether or not various divisions or their industries are growing over time; that is, the matrix has no temporal qualities, but rather it is a snapshot of an organization at a given point in time. Finally, other variables besides relative market share position and industry growth rate in sales, such as size of the market and competitive advantages, are important in making strategic decisions about various divisions. An example BCG Matrix is provided in Figure 6-8. Note in Figure 6-8 that Division 5 had an operating loss of $188 million. Take note how the percent profit column is still calculated because oftentimes a firm will have a division that incurs a loss for a year. In terms of the pie

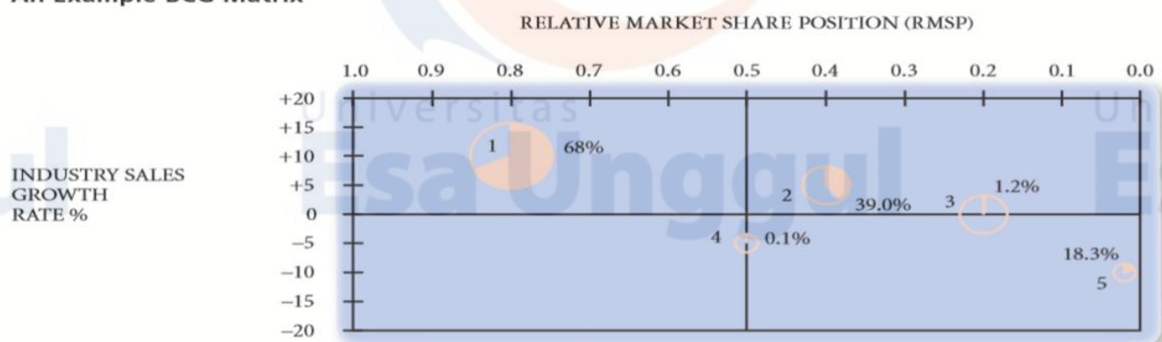
slice in circle 5 of the diagram, note that it is a different color from the positive profit segments in the other circles.

The Internal-External (IE) Matrix T

he Internal-External (IE) Matrix positions an organization's various divisions in a ninecell display, illustrated in Figure 6-9. The IE Matrix is similar to the BCG Matrix in that both tools involve plotting organization divisions in a schematic diagram; this is why they are both called "portfolio matrices." Also, the size of each circle represents the percentage sales contribution of each division, and pie slices reveal the percentage profit contribution of each division in both the BCG and IE Matrix. But there are some important differences between the BCG Matrix and the IE Matrix. First, the axes are different. Also, the IE Matrix requires more information about the divisions than the BCG Matrix. Furthermore, the strategic implications of each matrix are different. For these reasons, strategists in multidivisional firms often develop both the BCG Matrix and the IE Matrix in formulating alternative strategies. A common practice is to develop a BCG Matrix and an IE Matrix for the present and then develop projected matrices to reflect expectations of the future. This before-and-after analysis forecast the expected effect of strategic decisions on an organization's portfolio of divisions.

FIGURE 6-8

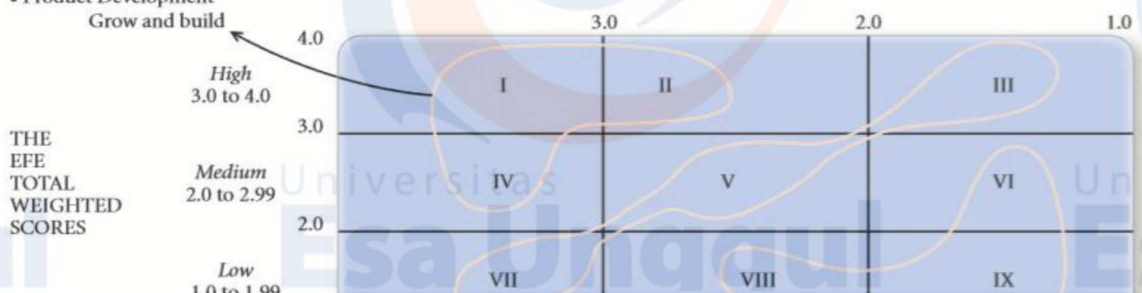
An Example BCG Matrix



Division	*$ Sales (millions)*	*% Sales*	*$ Profits (millions)*	*% Profits*	*RMSP*	*IG Rate %*
1.	$5,139	51.5	$799	68.0	0.8	10
2.	2,556	25.6	400	39.0	0.4	05
3.	1,749	17.5	12	1.2	0.2	00
4.	493	4.9	4	0.1	0.5	−05
5.	42	0.5	−188	(18.3)	.02	−10
Total	**$9,979**	**100.0**	**$1,027**	**100.0**		

FIGURE 6-9

The Internal–External (IE) Matrix



The IE Matrix is based on two key dimensions: the IFE total weighted scores on the x-axis and the EFE total weighted scores on the y-axis. Recall that each division of an organization should construct an IFE Matrix and an EFE Matrix for its part of the organization. The total weighted scores derived from the divisions allow construction of the corporate-level IE Matrix. On the x-axis of the IE Matrix, an IFE total weighted score of 1.0 to 1.99 represents a weak internal position; a score of 2.0 to 2.99 is considered average; and a score of 3.0 to 4.0 is strong. Similarly, on the y-axis, an EFE total weighted score of 1.0 to 1.99 is considered low; a score of 2.0 to 2.99 is medium; and a score of 3.0 to 4.0 is high.

The IE Matrix can be divided into three major regions that have different strategy implications. First, the prescription for divisions that fall into cells I, II, or IV can be described as grow and build. Intensive (market penetration, market development, and product development) or integrative (backward integration, forward integration, and horizontal integration) strategies can be most appropriate for these divisions. Second, divisions that fall into cells III, V, or VII can be managed best with hold and maintain strategies; market penetration and product development are two commonly employed strategies for these types of divisions. Third, a common prescription for divisions that fall into cells VI, VIII, or IX is harvest or divest. Successful organizations are able to achieve a portfolio of businesses positioned in or around cell I in the IE Matrix.

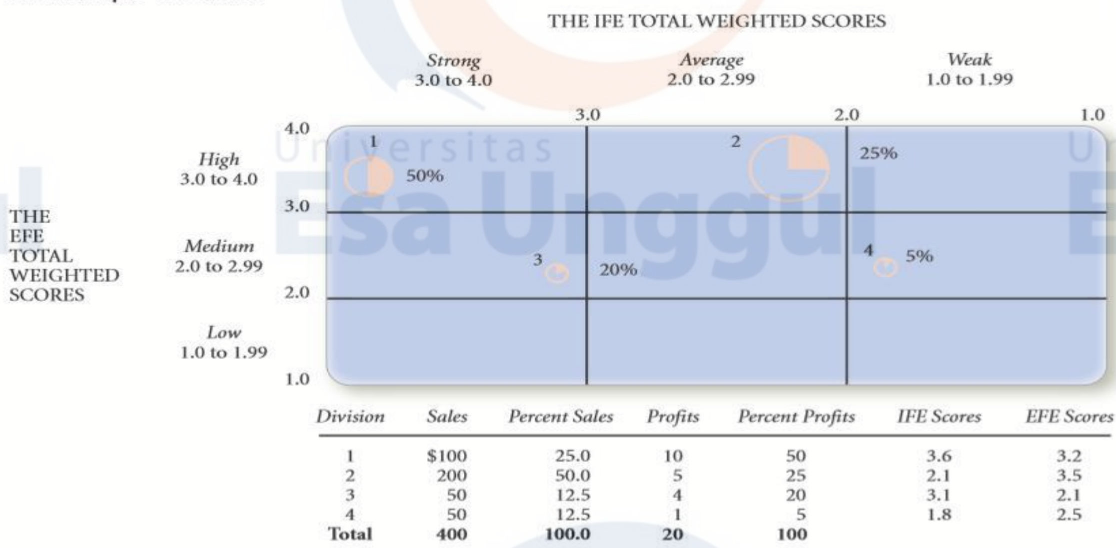
An example of a completed IE Matrix is given in Figure 6-10, which depicts an organization composed of four divisions. As indicated by the positioning of the circles, grow and build

strategies are appropriate for Division 1, Division 2, and Division 3. Division 4 is a candidate for harvest or divest. Division 2 contributes the greatest percentage of company sales and thus is represented by the largest circle. Division 1 contributes the greatest proportion of total profits; it has the largest-percentage pie slice.

As indicated in Figure 6-11, the IE Matrix has five product segments. Note that Division #1 has the largest revenues (as indicated by the largest circle) and the largest profits (as indicated by the largest pie slice) in the matrix. It is common for organizations to develop both geographic and product-based IE Matrices to more effectively formulate strategies and allocate resources among divisions. In addition, firms often prepare an IE (or BCG) Matrix for competitors. Furthermore, firms will often prepare "before and after" IE (or BCG) Matrices to reveal the situation at present versus the expected situation after one year. This latter idea minimizes the limitation of these matrices being a "snapshot in time." In performing case analysis, feel free to estimate the IFE and EFE scores for the various divisions based upon your research into the company and industry—rather than preparing a separate IE Matrix for each division.

FIGURE 6-10

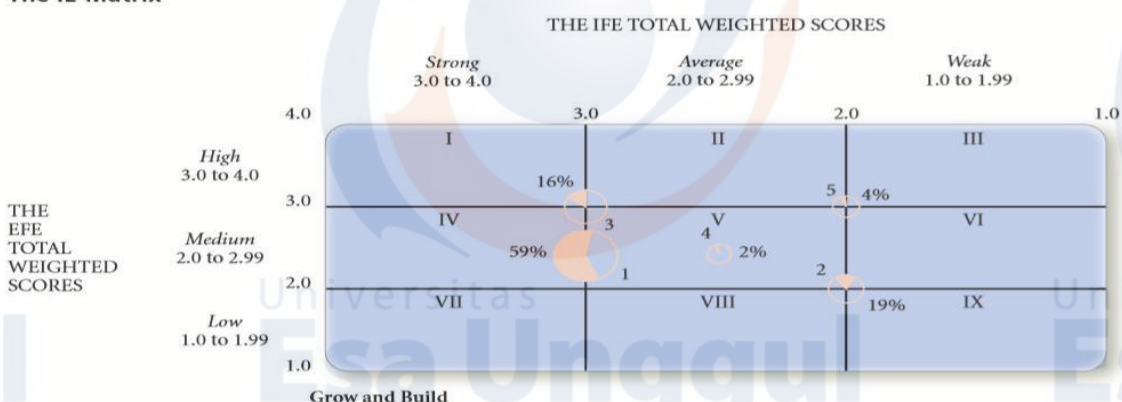
An Example IE Matrix



Division	Sales	Percent Sales	Profits	Percent Profits	IFE Scores	EFE Scores
1	$100	25.0	10	50	3.6	3.2
2	200	50.0	5	25	2.1	3.5
3	50	12.5	4	20	3.1	2.1
4	50	12.5	1	5	1.8	2.5
Total	**400**	**100.0**	**20**	**100**		

FIGURE 6-11

The IE Matrix



The Grand Strategy Matrix

In addition to the SWOT Matrix, SPACE Matrix, BCG Matrix, and IE Matrix, the Grand Strategy Matrix has become a popular tool for formulating alternative strategies. All organizations can be positioned in one of the Grand Strategy Matrix’s four strategy quadrants. A firm’s divisions likewise could be positioned. As illustrated in Figure 6-12, the Grand Strategy Matrix is based on two evaluative dimensions: competitive position and market (industry) growth. Any industry whose annual growth in sales exceeds 5 percent could be considered to have rapid growth. Appropriate strategies for an organization to consider are listed in sequential order of attractiveness in each quadrant of the matrix.

Firms located in Quadrant I of the Grand Strategy Matrix are in an excellent strategic position. For these firms, continued concentration on current markets (market penetration and market development) and products (product development) is an appropriate strategy. It is unwise for a Quadrant I firm to shift notably from its established competitive advantages. When a Quadrant I organization has excessive resources, then backward, forward, or horizontal integration may be effective strategies. When a Quadrant I firm is too heavily committed to a single product, then related diversification may reduce the risks associated with a narrow product line. Quadrant I firms can afford to take advantage of external opportunities in several areas. They can take risks aggressively when necessary.

Firms positioned in Quadrant II need to evaluate their present approach to the marketplace seriously. Although their industry is growing, they are unable to compete effectively, and they need to determine why the firm’s current approach is ineffective and how the company can

FIGURE 6-12

The Grand Strategy Matrix

best change to improve its competitiveness. Because Quadrant II firms are in a rapid-market-growth industry, an intensive strategy (as opposed to integrative or diversification) is usually the first option that should be considered. However, if the firm is lacking a distinctive competence or competitive advantage, then horizontal integration is often a desirable alternative. As a last resort, divestiture or liquidation should be considered. Divestiture can provide funds needed to acquire other businesses or buy back shares of stock.

Quadrant III organizations compete in slow-growth industries and have weak competitive positions. These firms must make some drastic changes quickly to avoid further decline and possible liquidation. Extensive cost and asset reduction (retrenchment) should be pursued first. An alternative strategy is to shift resources away from the current business into different areas (diversify). If all else fails, the final options for Quadrant III businesses are divestiture or liquidation.

Finally, Quadrant IV businesses have a strong competitive position but are in a slowgrowth industry. These firms have the strength to launch diversified programs into more promising growth areas: Quadrant IV firms have characteristically high cash-flow levels and limited internal growth needs and often can pursue related or unrelated diversification successfully. Quadrant IV firms also may pursue joint ventures.

The Decision Stage

Analysis and intuition provide a basis for making strategy-formulation decisions. The matching techniques just discussed reveal feasible alternative strategies. Many of these

strategies will likely have been proposed by managers and employees participating in the strategy analysis and choice activity. Any additional strategies resulting from the matching analyses could be discussed and added to the list of feasible alternative options. As indicated earlier in this chapter, participants could rate these strategies on a 1 to 4 scale so that a prioritized list of the best strategies could be achieved.

The Quantitative Strategic Planning Matrix (QSPM)

Other than ranking strategies to achieve the prioritized list, there is only one analytical technique in the literature designed to determine the relative attractiveness of feasible

alternative actions. This technique is the Quantitative Strategic Planning Matrix (QSPM), which comprises Stage 3 of the strategy-formulation analytical framework.6 This technique objectively indicates which alternative strategies are best. The QSPM uses input from Stage 1 analyses and matching results from Stage 2 analyses to decide objectively among alternative strategies. That is, the EFE Matrix, IFE Matrix, and Competitive Profile Matrix that make up Stage 1, coupled with the SWOT Matrix, SPACE Matrix, BCG Matrix, IE Matrix, and Grand Strategy Matrix that make up Stage 2, provide the needed information for setting up the QSPM (Stage 3). The QSPM is a tool that allows strategists to evaluate alternative strategies objectively, based on previously identified external and internal critical success factors. Like other strategy-formulation analytical tools, the QSPM requires good intuitive judgment.

The basic format of the QSPM is illustrated in Table 6-6. Note that the left column of a QSPM consists of key external and internal factors (from Stage 1), and the top row consists of feasible alternative strategies (from Stage 2). Specifically, the left column of a QSPM consists of information obtained directly from the EFE Matrix and IFE Matrix. In a column adjacent to the critical success factors, the respective weights received by each factor in the EFE Matrix and the IFE Matrix are recorded.

The top row of a QSPM consists of alternative strategies derived from the SWOT Matrix, SPACE Matrix, BCG Matrix, IE Matrix, and Grand Strategy Matrix. These matching tools usually generate similar feasible alternatives. However, not every strategy suggested by the matching techniques has to be evaluated in a QSPM. Strategists should use good intuitive judgment in selecting strategies to include in a QSPM.

TABLE 6-6 The Quantitative Strategic Planning Matrix—QSPM

		Strategic Alternatives		
Key Factors	Weight	Strategy 1	Strategy 2	Strategy 3
Key External Factors				
Economy				
Political/Legal/Governmental				
Social/Cultural/Demographic/Environmental				

Conceptually, the QSPM determines the relative attractiveness of various strategies based on the extent to which key external and internal critical success factors are capitalized upon or improved. The relative attractiveness of each strategy within a set of alternatives is computed by determining the cumulative impact of each external and internal critical success factor. Any number of sets of alternative strategies can be included in the QSPM, and any number of strategies can make up a given set, but only strategies within a given set are evaluated relative to each other. For example, one set of strategies may include diversification, whereas another set may include issuing stock and selling a division to raise needed capital. These two sets of strategies are totally different, and the QSPM evaluates strategies only within sets. Note in Table 6-6that three strategies are included, and they make up just one set.

A QSPM for a retail computer store is provided in Table 6-7. This example illustrates all the components of the QSPM: Strategic Alternatives, Key Factors, Weights, Attractiveness Scores (AS), Total Attractiveness Scores (TAS), and the Sum Total Attractiveness Score. The three new terms just introduced—(1) Attractiveness Scores, (2) Total Attractiveness Scores, and (3) the Sum Total Attractiveness Score—are defined and explained as the six steps required to develop a QSPM are discussed:

Step 1 Make a list of the firm's key external opportunities/threats and internal strengths/weaknesses in the left column of the QSPM. This information should be taken directly from the EFE Matrix and IFE Matrix. A minimum of 10 external key success factors and 10 internal key success factors should be included in the QSPM.

Step 2 Assign weights to each key external and internal factor. These weights are identical to those in the EFE Matrix and the IFE Matrix. The weights are presented in a straight column just to the right of the external and internal critical success factors. S

Step 3 Examine the Stage 2 (matching) matrices, and identify alternative strategies that the organization should consider implementing. Record these strategies in the top row of the QSPM. Group the strategies into mutually exclusive sets if possible.

Step 4 Determine the Attractiveness Scores (AS) defined as numerical values that indicate the relative attractiveness of each strategy in a given set of alternatives. Attractiveness Scores (AS) are determined by examining each key external or internal factor, one at a time, and asking the question "Does this factor affect the choice of strategies being made?" If the answer to this question is yes, then the strategies should be compared relative to that key factor. Specifically, Attractiveness Scores should be assigned to each strategy to indicate the relative attractiveness of one strategy over others, considering the particular factor. The range for Attractiveness Scores is 1 = not attractive, 2 = somewhat attractive, 3 = reasonably attractive, and 4 = highly attractive. By attractive, we mean the extent that one strategy, compared to others, enables the firm to either capitalize on the strength, improve on the weakness, exploit the opportunity, or avoid the threat. Work row by row in developing a QSPM. If the answer to the previous question is no, indicating that the respective key factor has no effect upon the specific choice being made, then do not assign Attractiveness Scores to the strategies in that set. Use a dash to indicate that the key factor does not affect the choice being made. Note: If you assign an AS score to one strategy, then assign AS score(s) to the other. In other words, if one strategy receives a dash, then all others must receive a dash in a given row.

Step 5 Compute the Total Attractiveness Scores. Total Attractiveness Scores (TAS) are defined as the product of multiplying the weights (Step 2) by the Attractiveness Scores (Step 4) in each row. The Total Attractiveness Scores indicate the relative attractiveness of each alternative strategy, considering only the impact of the adjacent external or internal critical success factor. The higher the Total Attractiveness Score, the more attractive the strategic alternative (considering only the adjacent critical success factor).

Step 6 Compute the Sum Total Attractiveness Score. Add Total Attractiveness Scores in each strategy column of the QSPM. The Sum Total Attractiveness Scores (STAS) reveal which strategy is most attractive in each set of alternatives. Higher scores indicate more attractive strategies, considering all the relevant external and internal factors that could affect the strategic decisions. The magnitude of the difference between the Sum Total Attractiveness Scores in a given set of strategic alternatives indicates the relative desirability of one strategy over another.

TABLE 6-7 A QSPM for a Retail Computer Store

		STRATEGIC ALTERNATIVES			
		1		2	
		Buy New Land and Build New Larger Store		Fully Renovate Existing Store	
Key Factors	*Weight*	*AS*	*TAS*	*AS*	*TAS*
Opportunities					
1. Population of city growing 10%	0.10	4	0.40	2	0.20
2. Rival computer store opening 1 mile away	0.10	2	0.20	4	0.40
3. Vehicle traffic passing store up 12%	0.08	1	0.08	4	0.32
4. Vendors average six new products/year	0.05	—		—	
5. Senior citizen use of computers up 8%	0.05	—		—	
6. Small business growth in area up 10%	0.10	—		—	
7. Desire for Web sites up 18% by Realtors	0.06	—		—	
8. Desire for Web sites up 12% by small firms	0.06	—		—	
Threats					
1. Best Buy opening new store nearby in 1 year	0.15	4	0.60	3	0.45
2. Local university offers computer repair	0.08	—		—	
3. New bypass for Hwy 34 in 1 year will divert traffic	0.12	4	0.48	1	0.12
4. New mall being built nearby	0.08	2	0.16	4	0.32
5. Gas prices up 14%	0.04	—		—	
6. Vendors raising prices 8%	0.03	—		—	
	1.00				
Strengths					
1. Inventory turnover increased from 5.8 to 6.7	0.05	—		—	
2. Average customer purchase increased from $97 to $128	0.07	2	0.14	4	0.28
3. Employee morale is excellent	0.10	—		—	
4. In-store promotions resulted in 20% increase in sales	0.05	—		—	
5. Newspaper advertising expenditures increased 10%	0.02	—		—	
6. Revenues from repair/service segment of store up 16%	0.15	4	0.60	3	0.45
7. In-store technical support personnel have MIS college degrees	0.05	—		—	
8. Store's debt-to-total assets ratio declined to 34%	0.03	4	0.12	2	0.06
9. Revenues per employee up 19%	0.02	—		—	
Weaknesses					
1. Revenues from software segment of store down 12%	0.10	—		—	
2. Location of store negatively impacted by new Hwy 34	0.15	4	0.60	1	0.15
3. Carpet and paint in store somewhat in disrepair	0.02	1	0.02	4	0.08
4. Bathroom in store needs refurbishing	0.02	1	0.02	4	0.08
5. Revenues from businesses down 8%	0.04	3	0.12	4	0.16
6. Store has no Web site	0.05	—		—	
7. Supplier on-time delivery increased to 2.4 days	0.03	—		—	
8. Often customers have to wait to check out	0.05	2	0.10	4	0.20
Total	1.00		4.36		3.27

In Table 6-7, two alternative strategies—(1) buy new land and build new larger store and (2) fully renovate existing store—are being considered by a computer retail store. Note by sum total attractiveness scores of 4.63 versus 3.27 that the analysis indicates the business should buy new land and build a new larger store. Note the use of dashes to indicate which factors do not affect the strategy choice being considered. If a particular factor affects one strategy but not the other, it affects the choice being made, so attractiveness scores should be recorded for both strategies. Never rate one strategy and not the other. Note also in Table 6-7that there are no double 1's, 2's, 3's, or 4's in a row. Never duplicate scores in a row. Never work column by column; always prepare a QSPM working row by row. If you have more than one strategy in the QSPM, then let the AS scores range from 1 to "the number of strategies being evaluated." This will enable you to have a different AS score for each strategy. These are all important guidelines to follow in developing a QSPM. In actual practice, the store did purchase the new land and build a new store; the business also did some minor refurbishing until the new store was operational.

There should be a rationale for each AS score assigned. Note in Table 6-7 in the first row that the "city population growing 10 percent annually" opportunity could be capitalized on best by strategy 1, "building the new, larger store," so an AS score of 4 was assigned to Strategy 1. AS scores, therefore, are not mere guesses; they should be rational, defensible, and reasonable.

Avoid giving each strategy the same AS score. Note in Table 6-7 that dashes are inserted all the way across the row when used. Also note that double 4's, or double 3's, or double 2's, or double 1's are never in a given row. Again work row by row, not column by column. These are important guidelines to follow in constructing a QSPM.

Positive Features and Limitations of the QSPM

A positive feature of the QSPM is that sets of strategies can be examined sequentially or simultaneously. For example, corporate-level strategies could be evaluated first, followed by division-level strategies, and then function-level strategies. There is no limit to the number of strategies that can be evaluated or the number of sets of strategies that can be examined at once using the QSPM.

Another positive feature of the QSPM is that it requires strategists to integrate pertinent external and internal factors into the decision process. Developing a QSPM makes it less likely that key factors will be overlooked or weighted inappropriately. A QSPM draws attention to important relationships that affect strategy decisions.

Although developing a QSPM requires a number of subjective decisions, making small decisions along the way enhances the probability that the final strategic decisions will be best for the organization. A QSPM can be adapted for use by small and large for-profit and nonprofit organizations so can be applied to virtually any type of organization. A QSPM can especially enhance strategic choice in multinational firms because many key factors and strategies can be considered at once. It also has been applied successfully by a number of small businesses.7

The QSPM is not without some limitations. First, it always requires intuitive judgments and educated assumptions. The ratings and attractiveness scores require judgmental decisions, even though they should be based on objective information. Discussion among strategists, managers, and employees throughout the strategy-formulation process, including development of a QSPM, is constructive and improves strategic decisions. Constructive discussion during strategy analysis and choice may arise because of genuine differences of interpretation of information and varying opinions. Another limitation of the QSPM is that it can be only as good as the prerequisite information and matching analyses upon which it is based.

Cultural Aspects of Strategy Choice

All organizations have a culture. Culture includes the set of shared values, beliefs, attitudes, customs, norms, personalities, heroes, and heroines that describe a firm. Culture is the unique way an organization does business. It is the human dimension that creates solidarity and meaning, and it inspires commitment and productivity in an organization when strategy changes are made. All human beings have a basic need to make sense of the world, to feel in control, and to make meaning. When events threaten meaning, individuals react defensively. Managers and employees may even sabotage new strategies in an effort to recapture the status quo.

It is beneficial to view strategic management from a cultural perspective because success often rests upon the degree of support that strategies receive from a firm’s culture. If a firm’s strategies are supported by cultural products such as values, beliefs, rites, rituals, ceremonies, stories,

symbols, language, heroes, and heroines, then managers often can implement changes swiftly and easily. However, if a supportive culture does not exist and is not cultivated, then strategy changes may be ineffective or even counterproductive. A firm's culture can become antagonistic to new strategies, and the result of that antagonism may be confusion and disarray.

Strategies that require fewer cultural changes may be more attractive because extensive changes can take considerable time and effort. Whenever two firms merge, it becomes especially important to evaluate and consider culture-strategy linkages.

Culture provides an explanation for the difficulties a firm encounters when it attempts to shift its strategic direction, as the following statement explains:

Not only has the "right" corporate culture become the essence and foundation of corporate excellence, but success or failure of needed corporate reforms hinges on management's sagacity and ability to change the firm's driving culture in time and in tune with required changes in strategies.8

The Politics of Strategy Choice

All organizations are political. Unless managed, political maneuvering consumes valuable time, subverts organizational objectives, diverts human energy, and results in the loss of some valuable employees. Sometimes political biases and personal preferences get unduly embedded in strategy choice decisions. Internal politics affect the choice of strategies in all organizations. The hierarchy of command in an organization, combined with the career aspirations of different people and the need to allocate scarce resources, guarantees the formation of coalitions of individuals who strive to take care of themselves first and the organization second, third, or fourth. Coalitions of individuals often form around key strategy issues that face an enterprise. A major responsibility of strategists is to guide the development of coalitions, to nurture an overall team concept, and to gain the support of key individuals and groups of individuals. In the absence of objective analyses, strategy decisions too often are based on the politics of the moment. With development of improved strategy-formation tools, political factors become less important in making strategic decisions.

In the absence of objectivity, political factors sometimes dictate strategies, and this is unfortunate. Managing political relationships is an integral part of building enthusiasm and esprit de corps in an organization.

A classic study of strategic management in nine large corporations examined the political tactics of successful and unsuccessful strategists.9 Successful strategists were found to let weakly supported ideas and proposals die through inaction and to establish additional hurdles or tests for strongly supported ideas considered unacceptable but not openly opposed. Successful strategists kept a low political profile on unacceptable proposals and strived to let most negative decisions come from subordinates or a group consensus, thereby reserving their personal vetoes for big issues and crucial moments.

Successful strategists did a lot of chatting and informal questioning to stay abreast of how things were progressing and to know when to intervene. They led strategy but did not dictate it. They gave few orders, announced few decisions, depended heavily on informal questioning, and sought to probe and clarify until a consensus emerged.

Successful strategists generously and visibly rewarded key thrusts that succeeded. They assigned responsibility for major new thrusts to champions, the individuals most strongly identified with the idea or product and whose futures were linked to its success. They stayed alert to the symbolic impact of their own actions and statements so as not to send false signals that could stimulate movements in unwanted directions.

Successful strategists ensured that all major power bases within an organization were represented in, or had access to, top management. They interjected new faces and new views into considerations of major changes. This is important because new employees and managers generally have more enthusiasm and drive than employees who have been with the firm a long time. New employees do not see the world the same old way; nor do they act as screens against changes. Successful strategists minimized their own political exposure on highly controversial issues and in circumstances in which major opposition from key power centers was likely. In combination, these findings provide a basis for managing political relationships in an organization.

Because strategies must be effective in the marketplace and capable of gaining internal commitment, the following tactics used by politicians for centuries can aid strategists:

1. **Equifinality—It** is often possible to achieve similar results using different means or paths. Strategists should recognize that achieving a successful outcome is more important than imposing the method of achieving it. It may be possible to generate new alternatives that give equal results but with far greater potential for gaining commitment.
2. **Satisfying**—Achieving satisfactory results with an acceptable strategy is far better than failing to achieve optimal results with an unpopular strategy.
3. **Generalization**—Shifting focus from specific issues to more general ones may increase strategists' options for gaining organizational commitment.
4. **Focus on Higher-Order Issues**—By raising an issue to a higher level, many shortterm interests can be postponed in favor of long-term interests. For instance, by focusing on issues of survival, the airline and automotive industries were able to persuade unions to make concessions on wage increases.
5. **Provide Political Access on Important Issues**—Strategy and policy decisions with significant negative consequences for middle managers will motivate intervention behavior from them. If middle managers do not have an opportunity to take a position on such decisions in appropriate political forums, they are capable of successfully resisting the decisions after they are made. Providing such political access provides strategists with information that otherwise might not be available and that could be useful in managing intervention behavior.10

Governance Issues

A "director," according to Webster's Dictionary, is "one of a group of persons entrusted with the overall direction of a corporate enterprise." A board of directors is a group of individuals who are elected by the ownership of a corporation to have oversight and guidance over management and who look out for shareholders' interests. The act of oversight and direction is referred to as governance. The National Association of Corporate Directors defines governance as "the characteristic of ensuring that long-term strategic objectives and plans are established and that the proper management structure is in place to achieve those objectives, while at the same time making sure that the structure functions to maintain the corporation's integrity, reputation, and responsibility to its various constituencies." This broad scope of responsibility for the board shows how boards are being held accountable for the entire performance of the firm. In the

Worldcom, Tyco, and Enron bankruptcies and scandals, the firms' boards of directors were sued by shareholders for mismanaging their interests. New accounting rules in the United States and Europe now enhance corporate-governance codes and require much more extensive financial disclosure among publicly held firms. The roles and duties of a board of directors can be divided into four broad categories, as indicated in Table 6-8.

The recession and credit crunch of 2008–2009 prompted shareholders to become more wary of boards of directors. Shareholders of hundreds of firms are demanding that their boards do a better job of governing corporate America.11 New compensation policies are needed as well as direct shareholder involvement in some director activities. For example, boards could require CEOs to groom possible replacements from inside the firm because exorbitant compensation is most often paid to new CEOs coming from outside the firm.

TABLE 6-8 Board of Director Duties and Responsibilities

1. CONTROL AND OVERSIGHT OVER MANAGEMENT
   a. Select the Chief Executive Officer (CEO).
   b. Sanction the CEO's team.
   c. Provide the CEO with a forum.
   d. Ensure managerial competency.
   e. Evaluate management's performance.
   f. Set management's salary levels, including fringe benefits.
   g. Guarantee managerial integrity through continuous auditing.
   h. Chart the corporate course.
   i. Devise and revise policies to be implemented by management.
2. ADHERENCE TO LEGAL PRESCRIPTIONS
   a. Keep abreast of new laws.
   b. Ensure the entire organization fulfills legal prescriptions.
   c. Pass bylaws and related resolutions.
   d. Select new directors.
   e. Approve capital budgets.
   f. Authorize borrowing, new stock issues, bonds, and so on.
3. CONSIDERATION OF STAKEHOLDERS' INTERESTS
   a. Monitor product quality.
   b. Facilitate upward progression in employee quality of work life.
   c. Review labor policies and practices.
   d. Improve the customer climate.
   e. Keep community relations at the highest level.
   f. Use influence to better governmental, professional association, and educational contacts.
   g. Maintain good public image.
4. ADVANCEMENT OF STOCKHOLDERS' RIGHTS
   a. Preserve stockholders' equity.
   b. Stimulate corporate growth so that the firm will survive and flourish.
   c. Guard against equity dilution.
   d. Ensure equitable stockholder representation.
   e. Inform stockholders through letters, reports, and meetings.
   f. Declare proper dividends.
   g. Guarantee corporate survival.

Shareholders are also upset at boards for allowing CEOs to receive huge end-of-year bonuses when the firm's stock price drops drastically during the year.12 For example, Chesapeake Energy Corp. and its board of directors are under fire from shareholders for paying Chairman and CEO Aubrey McClendon $112 million in 2008 as the firm's stock price plummeted. Investor Jeffrey Bronchick wrote in a letter to the Chesapeake board that the CEO's compensation was a "near perfect illustration of the complete collapse of appropriate corporate governance."

Until recently, boards of directors did most of their work sitting around polished wooden tables. However, Hewlett-Packard's directors, among many others, now log on to their own special board Web site twice a week and conduct business based on extensive confidential briefing information posted there by the firm's top management team. Then the board members meet face to face and fully informed every two months to discuss the biggest issues facing the firm. Even the decision of whether to locate operations in countries with low corporate tax rates would be reviewed by a board of directors.

Today, boards of directors are composed mostly of outsiders who are becoming more involved in organizations' strategic management. The trend in the United States is toward much greater board member accountability with smaller boards, now averaging 12 members rather than 18 as they did a few years ago. BusinessWeek recently evaluated the boards of most large U.S. companies and provided the following "principles of good governance":

1. No more than two directors are current or former company executives.
2. No directors do business with the company or accept consulting or legal fees from the firm.
3. The audit, compensation, and nominating committees are made up solely of outside directors.
4. Each director owns a large equity stake in the company, excluding stock options.
5. At least one outside director has extensive experience in the company's core business and at least one has been CEO of an equivalent-size company.
6. Fully employed directors sit on no more than four boards and retirees sit on no more than seven.
7. Each director attends at least 75 percent of all meetings.
8. The board meets regularly without management present and evaluates its own performance annually.

9. The audit committee meets at least four times a year.
10. The board is frugal on executive pay, diligent in CEO succession oversight responsibilities, and prompt to act when trouble arises.
11. The CEO is not also the chairperson of the board.
12. Shareholders have considerable power and information to choose and replace directors.
13. Stock options are considered a corporate expense.
14. There are no interlocking directorships (where a director or CEO sits on another director's board).13

Being a member of a board of directors today requires much more time, is much more difficult, and requires much more technical knowledge and financial commitment than in the past. Jeff Sonnerfeld, associate dean of the Yale School of Management, says, "Boards of directors are now rolling up their sleeves and becoming much more closely involved with management decision making." Since the Enron and Worldcom scandals, company CEOs and boards are required to personally certify financial statements; company loans to company executives and directors are illegal; and there is faster reporting of insider stock transactions.

Just as directors are beginning to place more emphasis on staying informed about an organization's health and operations, they are also taking a more active role in ensuring that publicly issued documents are accurate representations of a firm's status. It is becoming widely recognized that a board of directors has legal responsibilities to stockholders and society for all company activities, for corporate performance, and for ensuring that a firm has an effective strategy. Failure to accept responsibility for auditing or evaluating a firm's strategy is considered a serious breach of a director's duties. Stockholders, government agencies, and customers are filing legal suits against directors for fraud, omissions, inaccurate disclosures, lack of due diligence, and culpable ignorance about a firm's operations with increasing frequency. Liability insurance for directors has become exceptionally expensive and has caused numerous directors to resign.

The Sarbanes-Oxley Act resulted in scores of boardroom overhauls among publicly traded companies. The jobs of chief executive and chairman are now held by separate persons, and board audit committees must now have at least one financial expert as a member. Board audit committees now meet 10 or more times per year, rather than 3 or 4 times as they did prior to

the act. The act put an end to the “country club” atmosphere of most boards and has shifted power from CEOs to directors. Although aimed at public companies, the act has also had a similar impact on privately owned companies.14

In Sweden, a new law has recently been passed requiring 25 percent female representation in boardrooms. The Norwegian government has passed a similar law that requires 40 percent of corporate director seats to go to women. In the United States, women currently hold about 13 percent of board seats at S&P500 firms and 10 percent at S&P1,500 firms. The Investor Responsibility Research Center in Washington, D.C. reports that minorities hold just 8.8 percent of board seats of S&P1,500 companies. Progressive firms realize that women and minorities ask different questions and make different suggestions in boardrooms than white men, which is helpful because women and minorities comprise much of the consumer base everywhere.

Adirect response of increased pressure on directors to stay informed and execute their responsibilities is that audit committees are becoming commonplace. Aboard of directors should conduct an annual strategy audit in much the same fashion that it reviews the annual financial audit. In performing such an audit, a board could work jointly with operating management and/or seek outside counsel. Boards should play a role beyond that of performing a strategic audit. They should provide greater input and advice in the strategyformulation process to ensure that strategists are providing for the long-term needs of the firm. This is being done through the formation of three particular board committees: nominating committees to propose candidates for the board and senior officers of the firm; compensation committees to evaluate the performance of top executives and determine the terms and conditions of their employment; and audit committees to give board-level attention to company accounting and financial policies and performance.

Chapter 7
BALANCED SCORECARD - SUSTAINABLE DEVELOPMENT TOOL

BALANCED SCORECARD – SUSTAINABLE DEVELOPMENT TOOL

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Abstract

The sustainable management of a business requires the consideration of all the business components, both the economic activity and the aspects related to its impact on the environment and its social implications. The Balanced Scorecard (BSC) is a management tool supporting the successful implementation of corporative strategies. This helps connecting operational and non-financial activities that have a significant impact on the economic success of a business. BSC is therefore a promising starting point to include in a company's management system both the social and environmental aspects. This paper deals with the traditional BSC and the current BSC development trends, which consider sustainability.

Keywords: balanced scorecard, sustainable development, performance

1. INTRODUCTION

According to Harvard Business Review, the Balanced Scorecard (BSC) is one of the most important management concepts of this century. In addition to the measuring of current performance in financial terms, the novelty brought about by this method consists of the evaluation of a company's efforts focused on future performance. The term "scorecard" involves the measuring of performance that can be quantified, while "balanced" illustrates the fact that the system has to have equilibrium, as it has to consider the following: medium and long-term objectives, financial and non-financial measures, a set of specific indices, as well as internal and external performance, etc [8]. The classical entity performance measuring methods refer to a short period of time and they rely mainly on a post-factum analysis. For this reason,

the outcome of such analysis is not useful on the long run, as a comprehensive analysis is necessary, which focuses on future income forecasts, on the evaluation of the current state of the business as well as on future trends, in general.

The Balanced Scorecard is a strategic management system able to handle the entity's activities depending on its vision and strategies. The reason for BSC implementation was the avoidance of the deficiencies occurring within the traditional management systems, which rely primarily on financial values. This concept was first presented in 1992 by the professors Robert Kaplan and David Norton and it supports the need to use a performance measuring system based both on financial and non-financial indices [3]. According to the authors, the Balanced Scorecard preserves the traditional financial indices, which provide information on past events, but which are inadequate when it comes to guiding companies towards value creation by investing in the relations with their customers, suppliers, employees, as well as in technology and innovation. Thus, Kaplan and Norton state that, *according to the studies carried out, it has been found that a specific type of evaluation is often preferred to another. Therefore, a balanced presentation is necessary of both the financial and operational evaluation. The study consisted of performance evaluation and developed a "global performance indicator", that is a set of evaluations allowing the management to have the complete picture of the company they run [9].*

BSC has both quantitative and qualitative objectives. The main advantage of this tool is that it includes strategic long-term objectives and short-term actions. Most company management and control systems are designed around financial indices and objectives and they place a small emphasis on long-term strategic objectives, which leads to discrepancies between strategy drafting and strategy implementation. Unlike traditional performance measuring systems, which rely mostly on financial indices, the Balanced Scorecard first identifies the company vision and strategy, which it transposes in performance indicators. Depending on the developed methodology and starting from the entity strategy, strategic objectives for each single component are identified, and the extent of objective achievement is

measured using the chosen indicators [2]. Both monetary and non-monetary indicators are defined in order to ensure the reliability of the information on the achievements in the vital entity business sectors, which indicators refer to, for instance, to customer satisfaction, in-house process functionality or innovations.

The Balanced Scorecard concept supports strategic planning and implementation by coordinating all the entity activities around common goals and by creating a strategy evaluation and improvement tool. BSC concept implementation is an ongoing process, which starts at the central level of strategic units and is implemented all the way to the operational level. Since the BSC concept implementation actually consists of introducing a new strategic management system and not an indicator project, the active top management involvement is essential.

2. THE "CLASSIC" BALANCED SCORECARD

The preset goal of BSC implementation is turning the company mission or strategy into objectives as concrete as possible for the company's current business, so that the contribution of each person involved becomes as clear and transparent as possible. Balanced Scorecard implementation is aimed at [8]:

- getting the support of the strategic management;
- achieving the consensus as concerns terminology and notations;
- establishing the assessment criteria for the most important objectives;
- implementing the management processes;
- periodically assessing the performance;
- evaluating the performance improvement opportunities.

When assessing the company performance, the managers using BSC no longer rely on short-term financial indices alone. Actually, the BSC allows the use of 4 processes, which contribute to the correlation between long-term objectives and short-term actions (strategy and vision definition, communication and relations, business planning, innovation and learning).

Strategy and vision definition is the process helping managers to reach a consensus as regards the development strategy. Despite the strategic management's good intentions, most of the times, statements such as "the best in the x category" or "the number one supplier" are not easily transposed in operational terms able to provide action directions at local level [1]. In order for people to act according to the strategy statements, the latter should be expressed in an integrated set of objectives and measures, agreed on by all the managers, describing the long-term success factors.

Communication and relations definition allows managers to communicate the strategy both upstream and downstream and to connect it to individual and department objectives. Traditionally speaking, departments are evaluated according to their financial performance, while the financial motivations are related to short-term financial objectives. The BSC gives the managers the certainty that all the hierarchy levels understand the long-term strategy and that both individual and department objectives are aligned to the former.

Business planning enables entities to integrate their financial and operational plans. Almost all companies implement change programs, each having its own project managers and consultants, being all in competition for the executive managers' time, energy and resources, which often leads to disappointments related to the outcome of those programs [4]. But when managers use ambitious objectives for the BSC as a means to allot resources and set priorities, they are able to understand and coordinate those initiatives meant to achieve the preset long-term strategies.

Innovation and learning is the fourth BSC process and offers a strategic learning possibility. The existence of feedback and the evaluation of processes impacting the entity, its departments or individual employees, ensures the achievement of the preset financial objectives.

The performance indicators set by the BSC help setting the objectives and measuring the results, with a view to objective achievement [5]. The indicators that the Balanced Scorecard model relies on may be divided in the first stage into early

indicators and late indicators. Early indicators are used at the beginning, in the incipient stage of a process, and they are set according to specific forecasts. They measure the activities that need to establish with great accuracy the profit or cash flow of the entity after 5 years. Early indicators show to what extent the customer's desires and expectations have been studied and, also, how familiar the customer is with the means of production of the desired product or service, before signing the contract. This is the way to establish the direction to follow in order to provide services that meet the customer's needs, which enables the company to consolidate its position on the market. Late indicators are calculated at the end of a process and they indicate, in a retrospective approach, the way in which the activity was conducted (for instance, the turnover, the profit, the employees' satisfaction, etc.) [8].

The BSC indicators are generally delineated depending on the manager's priorities, into four categories corresponding to four dimensions of the classical model [4]:

- **the financial perspective** generally approaches aspects regarding profitability, turnover, value added, new products, new customers, etc. The profitability strategy considers the costs structure designed to reduce expenses and ensure a more efficient assets use;
- **the customer perspective** includes indicators that should answer at least two questions: "who are the target customers?" and "what is the value that the entity offers to its customers?". Entities generally choose one of the following three directions: operational excellence (small prices and high quality), product leader (providing the best product) or customer familiarity (interest in a long-term cooperation instead of short-term relations) [1]. This perspective actually tackles the connection between internal processes and customer relations, the main goal being customer satisfaction, and it is aimed at determining indicators like the number of goods returned by the customers, the market share held, etc;
- **the internal processes perspective** identifies the critical activities and considers the indicators assigned to the company's key processes, which need to be subjected to continuous surveillance and improvement in order to add value

to the services to the customers, such as the delivery service, development, reporting, innovation and development of new products designed to penetrate new markets or to attract new customers, product quality, production duration, faulty goods percentage, etc. [5];

- **the innovation and learning perspective** comprises indicators on the employees' degree of satisfaction, availability, information dissemination extent, etc. [7]

Within each of these categories (financial performance, in-house processes, customer relations and innovation), the entity must accurately define the following components (Fig. 1):

- *objectives*, more precisely the strategies that have to be fulfilled at the strategic level;
- *measures,* the actual progress assessment for a particular objective;
- *targets,* the value estimates for each action;
- *initiatives,* the actions that will be taken to facilitate the fulfillment of the proposed goals.

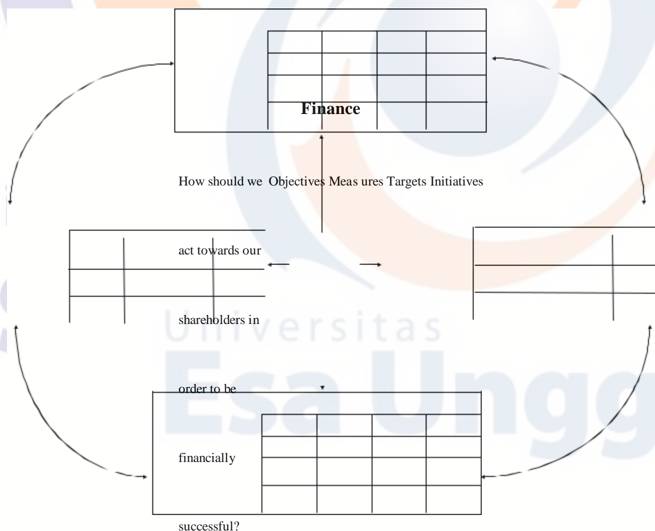

Fig. 1. *The methodology of the Balanced Scorecard*

How can we foster objectives measures targets intiative our potentials to change and growth in order to realize our vision.

Source: CMA Canada, *Application et mise en oeuvre du tableau de bord équilibré*, Collection gestion stratégique, 1999, www.cma-canada.org, p.5

Among the main advantages of the Balanced Scorecard concept implementation and use, we distinguish the minimization of the amount of information used by the reduction of the number of indicators employed, the management focusing mainly on the critical indicators related to the entity's current and future performance, the simultaneous obtaining of information on the different competitiveness levels, the priority orientation towards customer relations, the reduction of the time of reaction to the external environment changes, the improvement of the product and service quality, a better teamwork spirit, the reduction of the time needed for launching new products, the easy implementation of an efficient manager and employee motivation and performance assessment system, etc.

3. ECO BALANCED SCORECARD

Over the last few decades, an increasing number of specialists have been analyzing the idea of using the Balanced Scorecard model as the basis for a sustainable management [6]. The question that arises therefore is how sustainability may be measured using the Balanced Scorecard. The starting point of a good environmental management is to acknowledge the costs generated by the damages caused to the environment and their consideration during the decision-making process. The "Triple Bottom Line" approach should be therefore chosen, as it includes the three sustainable development pillars: economic, social and environment performance (Fig. 2).

Fig. 2. *Sustainable development "pyramid"*

Several management systems have been developed for the three components of the "Triple Bottom Line" approach:

- the *financial management* systems have been obviously used for centuries (although it has been recently proven that they may be further improved);

- the *environment management* systems were developed in the early 1990s with the implementation of the ISO 14000 (Environmental Management Systems) worldwide and of the European Eco-Management and Audit Scheme – EMAS, in Europe;

- the late 1990s witnessed the development of a set of *social accountability management systems* - SA 8000 (Social Accountability 8000), AA 1000, etc.

Also, in addition to the three systems abovementioned that focus each on a particular aspect, certain reporting systems combining several aspects (Corporate Social Responsibility – CSR, Global Reporting Initiative – GRI, developing sustainable development indicators: economic, social and environmental indicators) have also been acquiring a growing popularity.

In addition to these preoccupations related to individual management, specialists have tried to develop a system able to incorporate them as a whole and to ensure better management.

Given the impact and usefulness of the classical BSC, numerous debates have been organized in the last few years meant to extend it to include also sustainable development issues. According to the supporters of this idea, the four traditional perspectives should only be a general framework, a structure applicable and adaptable to the ever-changing needs and not a strait jacket limiting them.

There are several opposite opinions as concerns this approach, and several studies have been carried out lately on this issue. For instance, Zingales & Hockerts conducted a study on the inclusion of the environmental and social indicators in the Balanced Scorecard, in companies operating in the telecommunication, oil and gas / energy business, or in the pharmaceutical field [12]. Crawford & Scaletta analyzed how the measures proposed by GRI could be included in the four traditional BSC perspectives [5]. Möller & Schaltegger suggested that the eco-efficiency analysis requires a tight relation between the traditional BSC indicators and those regarding the evaluation of the product shelf life and the sustainable development [10].

Two main approaches have been singled out during the debates on the identification of the best possible ways to include the sustainable development aspects in the BSC. The first requires that each of the four traditional perspectives should be developed to include both the environmental and social aspects. Fig. 3 shows this approach, and the environmental issues are often presented at the confluence between traditional perspectives.

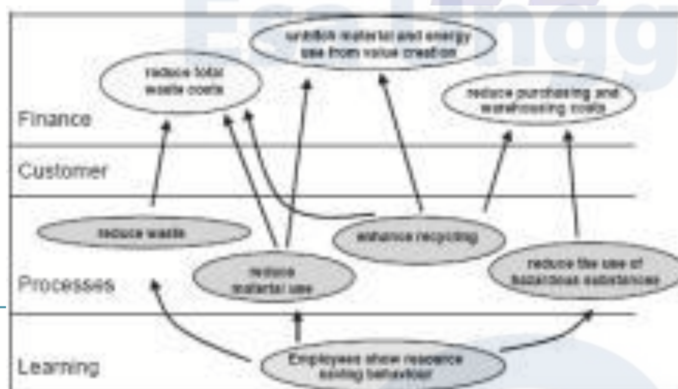

Fig. 3 *Inclusion of the environment-related issues into the BSC*

Source: Capron, M., Quairel, F., *Evaluer les stratégies de développement durable des entreprises: l'utopie mobilisatrice de la performance globale*, Journée développement durable

- AIMS - IAE d'Aix en Provence, 11/05/2005, http://www.strategie-aims.com/dd04 /comdd/ quairel-capron05%20.pdf, p.12

The second approach proposes the extension of the BSC framework to include, in addition to the four traditional approaches, two new ones, that is the social and environmental ones (Fig. 4). Due to this inclusion, the environmental and social factors will be considered to ground the decisions made, which may impede upon the current activity and business continuity [5]. This is actually imposed by the principles of sustainable development, which entities should consider in their decision-making processes.

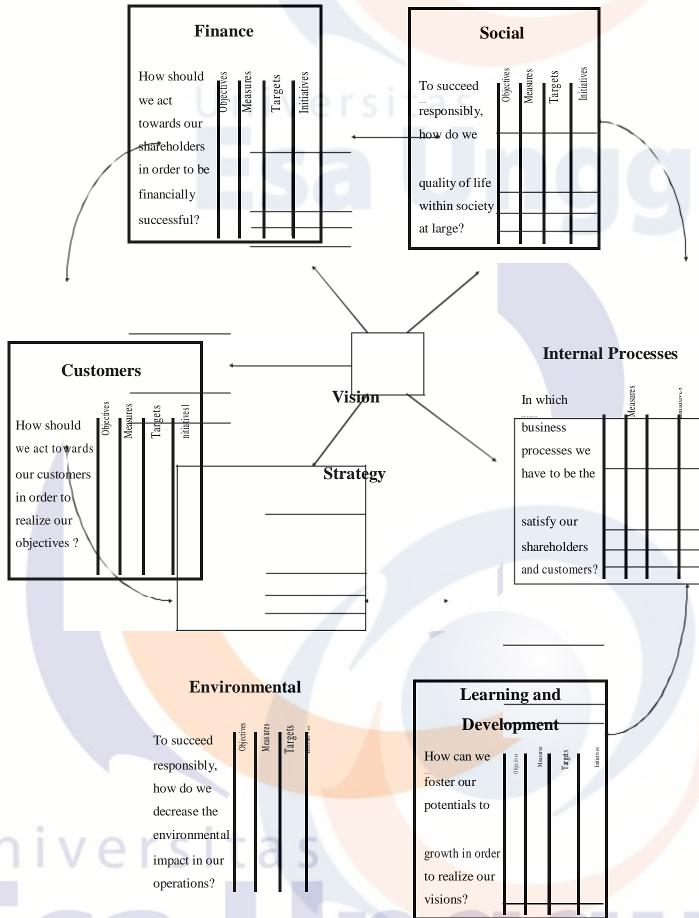
Finance
How should we act towards our shareholders in order to be financially successful?
Objectives
Measures
Targets
Initiatives
Social
To succeed responsibly, how do we
quality of life within society at large?
Objectives
Measures
Targets
Initiatives
Customers
How should we act towards our customers in order to realize our objectives ?
Objectives
Measures
Targets
nitiatives
Vision
Strategy
Internal Processes
In which business processes we have to be the
satisfy our shareholders and customers?
Measures
Environmental
To succeed responsibly, how do we decrease the environmental impact in our operations?
Objectives
Measures
Targets
Learning and Development
How can we foster our potentials to
growth in order to realize our visions?
Objectives
Measures
Targets
Initiatives

Fig. 4. *The BSC framework including the social and environmental perspectives*

Source: Reingruber, M., *The (Un) Balanced Scorecard*, http://www.plexsci.com/site/pdf/the_unbalanced_score card.pdf , p.3

This approach proposes the setting of the strategic objectives from each of the six perspectives, which will be then communicated at the operational level, thus ensuring the horizontal inclusion. The communication on each of the six perspectives provides complete focus and development, which means that the lack of objectives for each perspective would be noticed immediately. This approach actually facilitates objective development at all organizational levels, by establishing various responsibilities, so that every manager or employee may be able to understand the way in which the environment and social aspects influence company performance, achieving thus good business coordination. The degree of strategy concretization will increase depending on objectives, units of measurement, and actions carried out. The BSC actually prevents one from placing a disproportionate emphasis on the financial perspective alone, which strongly influences the whole system of indictors employed.

It seems that the BSC development including the six perspectives is preferred. Considering that any economic activity has strong economic, social and environmental influences, and given the fact that these effects are long-term, involving the whole shelf life of the products, an increasing number of companies choose to invest to reduce the negative effects and they try to combine to the best of their abilities. Thus, the large companies have published such information in their annual reports, in the last few years, although they do not always include explicit information on the BSC. In its annual report for 2009, Novo Nordisk presents the

BSC indicators, both financial and especially non-financial indicators, since many environment-related aspects cannot be easily assessed [13].

Due to the fact that the Balanced Scorecard supports strategic planning and implementation by coordinating the activities of all the company components around common objectives and by creating a strategy assessment and improvement tool, it has been gaining an increasing number of fans.

4. CONCLUSIONS

The Balanced Scorecard is a powerful sustainable corporative management tool, since it enables decision makers to discuss strategies from the very stage of their development. Although this strategic management concept has been built on a well-balanced system of financial and non-financial indicators, it is especially useful for the managers' in-house information needs. The relevance of the information provided by the Balanced Scorecard requires the use of this concept as a standard communication with the exterior tool in the process of reporting the information to the investors on the capital market, since the latter are no longer interested in the financial performance alone, and the decisions they make also depend on factors such as management quality, new product launching, strategy quality and strategy implementation degree, etc. Also, in addition to the financial viewpoint, one should also consider the impact of the business of a company on the environment. The BSC model has proven, these last few years, an extremely valuable tool in strategy operationalization, as it develops well-balanced and transparent communication relations. This is one of the most important tools used by companies to improve its performance.

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Chapter 8
IMPLEMENTING STRATEGIES: MANAGEMENT OPERATIONAL AND OPERATIONS ISSUES

Implementing Strategies: Management Operational and Operations Issues

A note from David

The Nature of Strategy Implementation

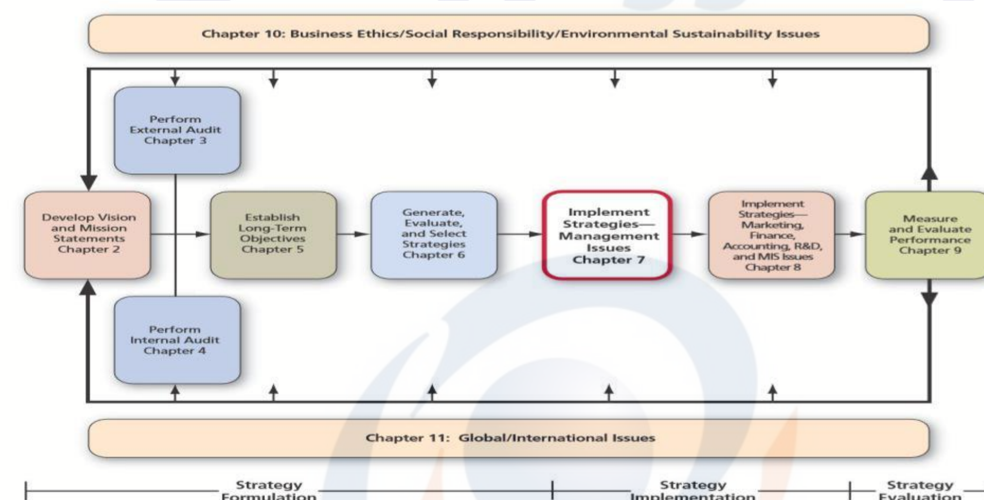
The strategic-management process does not end when the firm decides what strategy or strategies to pursue. There must be a translation of strategic thought into strategic action. This translation is much easier if managers and employees of the firm understand the business, feel a part of the company, and through involvement in strategy-formulation activities have become committed to helping the organization succeed. Without understanding and commitment, strategy-implementation efforts face major problems. Implementing strategy affects an organization from top to bottom; it affects all the functional and divisional areas of a business. It is beyond the purpose and scope of this text to examine all of the business administration concepts and tools important in strategy implementation. This chapter focuses on management issues most central to implementing strategies in 2010–2011 and Chapter 8 focuses on marketing, finance/accounting, R&D, and management information systems issues.
Even the most technically perfect strategic plan will serve little purpose if it is not implemented. Many organizations tend to spend an inordinate amount of time, money, and effort on developing the strategic plan, treating the means and circumstances under which it will be implemented as afterthoughts! Change comes through implementation and evaluation, not through the plan. A technically imperfect plan that is implemented well will achieve more than the perfect plan that never gets off the paper on which it is typed.

The strategy-implementation stage of strategic management is revealed in Figure 7-1. Successful strategy formulation does not guarantee successful strategy implementation. It is always more difficult to do something (strategy implementation) than to say you are going to do it (strategy formulation)! Although inextricably linked, strategy implementation is fundamentally different from strategy formulation. Strategy formulation and implementation can be contrasted in the following ways:

1. Strategy formulation is positioning forces before the action.
2. Strategy implementation is managing forces during the action.

3. Strategy formulation focuses on effectiveness.
4. Strategy implementation focuses on efficiency.
5. Strategy formulation is primarily an intellectual process.
6. Strategy implementation is primarily an operational process.
7. Strategy formulation requires good intuitive and analytical skills.
8. Strategy implementation requires special motivation and leadership skills.
9. Strategy formulation requires coordination among a few individuals.
10. Strategy implementation requires coordination among many individuals.

Strategy-formulation concepts and tools do not differ greatly for small, large, for-profit, or nonprofit organizations. However, strategy implementation varies substantially among different types and sizes of organizations. Implementing strategies requires such actions as altering sales territories, adding new departments, closing facilities, hiring new employees, changing an organization's pricing strategy, developing financial budgets, developing new employee benefits, establishing cost-control procedures, changing advertising strategies, building new facilities, training new employees, transferring managers among divisions, and building a better management information system. These types of activities obviously differ greatly between manufacturing, service, and governmental organizations.



Source: Fred R. David, "How Companies Define Their Mission," *Long Range Planning* 22, no. 3 (June 1988): 40.

Management Perspectives

In all but the smallest organizations, the transition from strategy formulation to strategy implementation requires a shift in responsibility from strategists to divisional and functional managers. Implementation problems can arise because of this shift in responsibility, especially if strategy-formulation decisions come as a surprise to middle- and lower-level managers. Managers and employees are motivated more by perceived self-interests than by organizational interests, unless the two coincide. Therefore, it is essential that divisional and functional managers be involved as much as possible in strategy-formulation activities. Of equal importance, strategists should be involved as much as possible in strategy-implementation activities.

As indicated in Table 7-1, management issues central to strategy implementation include establishing annual objectives, devising policies, allocating resources, altering an existing organizational structure, restructuring and reengineering, revising reward and incentive plans, minimizing resistance to change, matching managers with strategy, developing a strategysupportive culture, adapting production/operations processes, developing an effective human resources function, and, if necessary, downsizing. Management changes are necessarily more extensive when strategies to be implemented move a firm in a major new direction.

TABLE 7-1 Some Management Issues Central to Strategy Implementation
Establish annual objectives
Devise policies
Allocate resources
Alter an existing organizational structure
Restructure and reengineer
Revise reward and incentive plans
Minimize resistance to change
Match managers with strategy
Develop a strategy-supportive culture
Adapt production/operations processes
Develop an effective human resources function
Downsize and furlough as needed
Link performance and pay to strategies

Managers and employees throughout an organization should participate early and directly in strategy-implementation decisions. Their role in strategy implementation should build upon prior involvement in strategy-formulation activities. Strategists' genuine personal commitment to implementation is a necessary and powerful motivational force for managers and employees. Too often, strategists are too busy to actively support strategy-implementation efforts, and their lack of interest can be detrimental to organizational success. The rationale for objectives and strategies should be understood and clearly communicated throughout an organization. Major competitors' accomplishments, products, plans, actions, and performance should be apparent to all organizational members. Major external opportunities and threats should be clear, and managers' and employees' questions should be answered. Topdown flow of communication is essential for developing bottom-up support.

Firms need to develop a competitor focus at all hierarchical levels by gathering and widely distributing competitive intelligence; every employee should be able to benchmark her or his efforts against best-in-class competitors so that the challenge becomes personal. For example, Starbucks Corp. in 2009–2010 is instituting "lean production/operations" at its 11,000 U.S. stores. This system eliminates idle employee time and unnecessary employee motions, such as walking, reaching, and bending. Starbucks says 30 percent of employees' time is motion and the company wants to reduce that. They say "motion and work are two different things."

Annual Objectives

Establishing annual objectives is a decentralized activity that directly involves all managers in an organization. Active participation in establishing annual objectives can lead to acceptance and commitment. Annual objectives are essential for strategy implementation because they (1) represent the basis for allocating resources; (2) are a primary mechanism for evaluating managers; (3) are the major instrument for monitoring progress toward achieving long-term objectives; and (4) establish organizational, divisional, and departmental priorities. Considerable time and effort should be devoted to ensuring that annual objectives are well conceived, consistent with long-term objectives, and supportive of strategies to be implemented. Approving,

revising, or rejecting annual objectives is much more than a rubber-stamp activity. The purpose of annual objectives can be summarized as follows:

Annual objectives serve as guidelines for action, directing and channeling efforts and activities of organization members. They provide a source of legitimacy in an enterprise by justifying activities to stakeholders. They serve as standards of performance.

They serve as an important source of employee motivation and identification. They give incentives for managers and employees to perform. They provide a basis for organizational design.

Clearly stated and communicated objectives are critical to success in all types and sizes of firms. Annual objectives, stated in terms of profitability, growth, and market share by business segment, geographic area, customer groups, and product, are common in organizations. Figure 7-2 illustrates how the Stamus Company could establish annual objectives based on long-term objectives. Table 7-2 reveals associated revenue figures that correspond to the objectives outlined in Figure 7-2. Note that, according to plan, the Stamus Company will slightly exceed its long-term objective of doubling company revenues between 2010 and 2012.

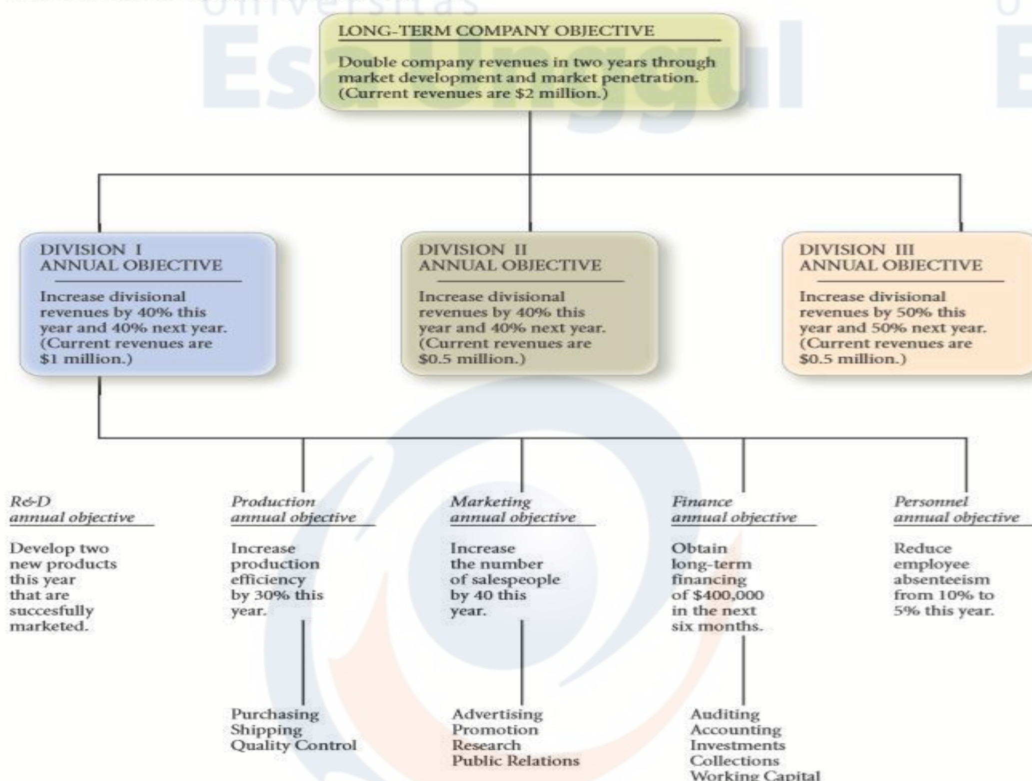


TABLE 7-2 The Stamus Company's Revenue Expectations (in $Millions)

	2010	2011	2012
Division I Revenues	1.0	1.400	1.960
Division II Revenues	0.5	0.700	0.980
Division III Revenues	0.5	0.750	1.125
Total Company Revenues	**2.0**	**2.850**	**4.065**

Figure 7-2 also reflects how a hierarchy of annual objectives can be established based on an organization's structure. Objectives should be consistent across hierarchical levels and form a network of supportive aims. Horizontal consistency of objectives is as important as vertical consistency of objectives. For instance, it would not be effective for manufacturing to achieve more than its annual objective of units produced if marketing could not sell the additional units.

Annual objectives should be measurable, consistent, reasonable, challenging, clear, communicated throughout the organization, characterized by an appropriate time dimension, and accompanied by commensurate rewards and sanctions. Too often, objectives are stated in generalities, with little operational usefulness. Annual objectives, such as "to improve communication" or "to improve performance," are not clear, specific, or measurable. Objectives should state quantity, quality, cost, and time—and also be verifiable. Terms and phrases such as maximize, minimize, as soon as possible, and adequate should be avoided.

Annual objectives should be compatible with employees' and managers' values and should be supported by clearly stated policies. More of something is not always better. Improved quality or reduced cost may, for example, be more important than quantity. It is important to tie rewards and sanctions to annual objectives so that employees and managers understand that achieving objectives is critical to successful strategy implementation. Clear annual objectives do not guarantee successful strategy implementation, but they do increase the likelihood that personal and organizational aims can be accomplished. Overemphasis on achieving objectives can result in undesirable conduct, such as faking the numbers, distorting the records, and letting objectives become ends in themselves. Managers must be alert to these potential problems.

Policies

Changes in a firm's strategic direction do not occur automatically. On a day-to-day basis, policies are needed to make a strategy work. Policies facilitate solving recurring problems and guide the implementation of strategy. Broadly defined, policy refers to specific guidelines, methods, procedures, rules, forms, and administrative practices established to support and encourage work toward stated goals. Policies are instruments for strategy implementation. Policies set boundaries, constraints, and limits on the kinds of administrative actions that can be taken to reward and sanction behavior; they clarify what can and cannot be done in pursuit of an organization's objectives. For example, Carnival's Paradiseship has a no smoking policy anywhere, anytime aboard ship. It is the first cruise ship to ban smoking comprehensively. Another example of corporate policy relates to surfing the Web while at work. About 40 percent of companies today do not have a formal policy preventing employees from surfing the Internet, but software is being marketed now that allows firms to monitor how, when, where, and how long various employees use the Internet at work.

Policies let both employees and managers know what is expected of them, thereby increasing the likelihood that strategies will be implemented successfully. They provide a basis for management control, allow coordination across organizational units, and reduce the amount of time managers spend making decisions. Policies also clarify what work is to be done and by whom. They promote delegation of decision making to appropriate managerial levels where various problems usually arise. Many organizations have a policy manual that serves to guide and direct behavior. Wal-Mart has a policy that it calls the "10 Foot" Rule, whereby customers can find assistance within 10 feet of anywhere in the store. This is a welcomed policy in Japan, where Wal-Mart is trying to gain a foothold; 58 percent of all retailers in Japan are mom-and-pop stores and consumers historically have had to pay "top yen" rather than "discounted prices" for merchandise.

Policies can apply to all divisions and departments (for example, "We are an equal opportunity employer"). Some policies apply to a single department ("Employees in this department must take at least one training and development course each year"). Whatever their scope and form, policies serve as a mechanism for implementing

strategies and obtaining objectives. Policies should be stated in writing whenever possible. They represent the means for carrying out strategic decisions. Examples of policies that support a company strategy, a divisional objective, and a departmental objective are given in Table 7-3. Some example issues that may require a management policy are provided in Table 7-4.

TABLE 7-3 A Hierarchy of Policies

Company Strategy

Acquire a chain of retail stores to meet our sales growth and profitability objectives.

Supporting Policies

1. "All stores will be open from 8 A.M. to 8 P.M. Monday through Saturday." (This policy could increase retail sales if stores currently are open only 40 hours a week.)
2. "All stores must submit a Monthly Control Data Report." (This policy could reduce expense-to-sales ratios.)
3. "All stores must support company advertising by contributing 5 percent of their total monthly revenues for this purpose." (This policy could allow the company to establish a national reputation.)
4. "All stores must adhere to the uniform pricing guidelines set forth in the Company Handbook." (This policy could help assure customers that the company offers a consistent product in terms of price and quality in all its stores.)

Divisional Objective

Increase the division's revenues from $10 million in 2009 to $15 million in 2010.

Supporting Policies

1. "Beginning in January 2010, each one of this division's salespersons must file a weekly activity report that includes the number of calls made, the number of miles traveled, the number of units sold, the dollar volume sold, and the number of new accounts opened." (This policy could ensure that salespersons do not place too great an emphasis in certain areas.)
2. "Beginning in January 2010, this division will return to its employees 5 percent of its gross revenues in the form of a Christmas bonus." (This policy could increase employee productivity.)
3. "Beginning in January 2010, inventory levels carried in warehouses will be decreased by 30 percent in accordance with a just-in-time (JIT) manufacturing approach." (This policy could reduce production expenses and thus free funds for increased marketing efforts.)

Production Department Objective

Increase production from 20,000 units in 2009 to 30,000 units in 2010.

Supporting Policies

1. "Beginning in January 2010, employees will have the option of working up to 20 hours of overtime per week." (This policy could minimize the need to hire additional employees.)
2. "Beginning in January 2010, perfect attendance awards in the amount of $100 will be given to all employees who do not miss a workday in a given year." (This policy could decrease absenteeism and increase productivity.)
3. "Beginning in January 2010, new equipment must be leased rather than purchased." (This policy could reduce tax liabilities and thus allow more funds to be invested in modernizing production processes.)

TABLE 7-4 Some Issues That May Require a Management Policy

- To offer extensive or limited management development workshops and seminars
- To centralize or decentralize employee-training activities
- To recruit through employment agencies, college campuses, and/or newspapers
- To promote from within or to hire from the outside
- To promote on the basis of merit or on the basis of seniority
- To tie executive compensation to long-term and/or annual objectives
- To offer numerous or few employee benefits
- To negotiate directly or indirectly with labor unions
- To delegate authority for large expenditures or to centrally retain this authority
- To allow much, some, or no overtime work
- To establish a high- or low-safety stock of inventory
- To use one or more suppliers
- To buy, lease, or rent new production equipment
- To greatly or somewhat stress quality control
- To establish many or only a few production standards
- To operate one, two, or three shifts
- To discourage using insider information for personal gain
- To discourage sexual harassment
- To discourage smoking at work
- To discourage insider trading
- To discourage moonlighting

Resource Allocation

Resource allocation is a central management activity that allows for strategy execution. In organizations that do not use a strategic-management approach to decision making, resource allocation is often based on political or personal factors. Strategic management enables resources to be allocated according to priorities established by annual objectives.

Nothing could be more detrimental to strategic management and to organizational success than for resources to be allocated in ways not consistent with priorities indicated by approved annual objectives.

All organizations have at least four types of resources that can be used to achieve desired objectives: financial resources, physical resources, human resources, and technological resources. Allocating resources to particular divisions and departments does not mean that strategies will be successfully implemented. A number of factors commonly prohibit effective resource allocation, including an overprotection of resources, too great an emphasis on short-run financial criteria, organizational politics, vague strategy targets, a reluctance to take risks, and a lack of sufficient knowledge.

Below the corporate level, there often exists an absence of systematic thinking about resources allocated and strategies of the firm. Yavitz and Newman explain why:

Managers normally have many more tasks than they can do. Managers must allocate time and resources among these tasks. Pressure builds up. Expenses are too high. The CEO wants a good financial report for the third quarter. Strategy formulation and implementation activities often get deferred. Today's problems soak up available energies and resources. Scrambled accounts and budgets fail to reveal the shift in allocation away from strategic needs to currently squeaking wheels.

The real value of any resource allocation program lies in the resulting accomplishment of an organization's objectives. Effective resource allocation does not guarantee successful strategy implementation because programs, personnel,

controls, and commitment must breathe life into the resources provided. Strategic management itself is sometimes referred to as a "resource allocation process."

TABLE 7-5 Some Management Trade-Off Decisions Required in Strategy Implementation

To emphasize short-term profits or long-term growth
To emphasize profit margin or market share
To emphasize market development or market penetration
To lay off or furlough
To seek growth or stability
To take high risk or low risk
To be more socially responsible or more profitable
To outsource jobs or pay more to keep jobs at home
To acquire externally or to build internally
To restructure or reengineer
To use leverage or equity to raise funds
To use part-time or full-time employees

Managing Conflict

Interdependency of objectives and competition for limited resources often leads to conflict. Conflict can be defined as a disagreement between two or more parties on one or more issues. Establishing annual objectives can lead to conflict because individuals have different expectations and perceptions, schedules create pressure, personalities are incompatible, and misunderstandings between line managers (such as production supervisors) and staff managers (such as human resource specialists) occur. For example, a collection manager's objective of reducing bad debts by 50 percent in a given year may conflict with a divisional objective to increase sales by 20 percent.

Establishing objectives can lead to conflict because managers and strategists must make trade-offs, such as whether to emphasize short-term profits or long-term growth, profit margin or market share, market penetration or market development, growth or stability, high risk or low risk, and social responsiveness or profit maximization. Trade-offs are necessary because no firm has sufficient resources pursue all strategies to would benefit the firm. Table 7-5 reveals some important management trade-off decisions required in strategy implementation.

Conflict is unavoidable in organizations, so it is important that conflict be managed and resolved before dysfunctional consequences affect organizational performance.

Conflict is not always bad. An absence of conflict can signal indifference and apathy. Conflict can serve to energize opposing groups into action and may help managers identify problems.

Various approaches for managing and resolving conflict can be classified into three categories: avoidance, defusion, and confrontation. Avoidance includes such actions as ignoring the problem in hopes that the conflict will resolve itself or physically separating the conflicting individuals (or groups). Defusion can include playing down differences between conflicting parties while accentuating similarities and common interests, compromising so that there is neither a clear winner nor loser, resorting to majority rule, appealing to a higher authority, or redesigning present positions.

Confrontation is exemplified by exchanging members of conflicting parties so that each can gain an appreciation of the other's point of view or holding a meeting at which conflicting parties present their views and work through their differences.

Matching Structure with Strategy

Changes in strategy often require changes in the way an organization is structured for two major reasons. First, structure largely dictates how objectives and policies will be established. For example, objectives and policies established under a geographic organizational structure are couched in geographic terms. Objectives and policies are stated largely in terms of products in an organization whose structure is based on product groups. The structural strategy-implementation activities.

The second major reason why changes in strategy often require changes in structure is that structure dictates how resources will be allocated. If an organization's structure is based on customer groups, then resources will be allocated in that manner. Similarly, if an organization's structure is set up along functional business lines, then resources are allocated by functional areas. Unless new or revised strategies place emphasis in the same areas as old strategies, structural reorientation commonly becomes a part of strategy implementation.

Changes in strategy lead to changes in organizational structure. Structure should be designed to facilitate the strategic pursuit of a firm and, therefore, follow strategy. Without a strategy or reasons for being (mission), companies find it difficult to design an effective structure. Chandler found a particular structure sequence to be repeated

often as organizations grow and change strategy over time; this sequence is depicted in Figure 7-3.

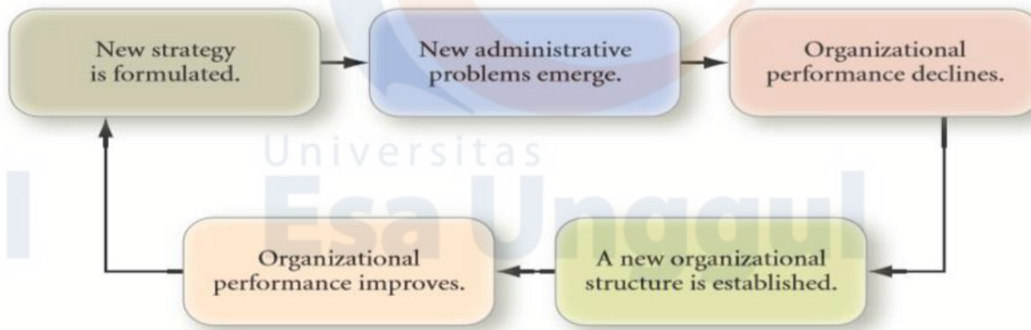
There is no one optimal organizational design or structure for a given strategy or type of organization. What is appropriate for one organization may not be appropriate for a similar firm, although successful firms in a given industry do tend to organize themselves in a similar way. For example, consumer goods companies tend to emulate the divisional structure-by-product form of organization. Small firms tend to be functionally structured (centralized). Medium-sized firms tend to be divisionally structured (decentralized). Large firms tend to use a strategic business unit (SBU) or matrix structure. As organizations grow, their structures generally change from simple to complex as a result of concatenation, or the linking together of several basic strategies.

Numerous external and internal forces affect an organization; no firm could change its structure in response to every one of these forces, because to do so would lead to chaos. However, when a firm changes its strategy, the existing organizational structure may become ineffective. As indicated in Table 7-6, symptoms of an ineffective organizational structure include too many levels of management, too many meetings attended by too many people, too much attention being directed toward solving interdepartmental conflicts, too large a span of control, and too many unachieved objectives. Changes in structure can facilitate strategy-implementation efforts, but changes in structure should not be expected to make a bad strategy good, to make bad managers good, or to make bad products sell.

Structure undeniably can and does influence strategy. Strategies formulated must be workable, so if a certain new strategy required massive structural changes it would not be an attractive choice. In this way, structure can shape the choice of strategies. But a more important concern is determining what types of structural changes are needed to implement new strategies and how these changes can best be accomplished. We examine this issue by focusing on seven basic types of organizational structure: functional, divisional by geographic area, divisional by product, divisional by customer, divisional process, strategic business unit (SBU), and matrix.

FIGURE 7-3

Chandler's Strategy-Structure Relationship



Source: Adapted from Alfred Chandler, *Strategy and Structure* (Cambridge, MA: MIT Press, 1962).

TABLE 7-6 Symptoms of an Ineffective Organizational Structure

1. Too many levels of management
2. Too many meetings attended by too many people
3. Too much attention being directed toward solving interdepartmental conflicts
4. Too large a span of control
5. Too many unachieved objectives
6. Declining corporate or business performance
7. Losing ground to rival firms
8. Revenue and/or earnings divided by number of employees and/or number of managers is low compared to rival firms

The Functional Structure

The most widely used structure is the functional or centralized type because this structure is the simplest and least expensive of the seven alternatives. A functional structure groups tasks and activities by business function, such as production/operations, marketing, finance/accounting, research and development, and management information systems. A university may structure its activities by major functions that include academic affairs, student services, alumni relations, athletics, maintenance, and accounting. Besides being simple and inexpensive, a functional structure also promotes specialization of labor, encourages efficient use of managerial and technical talent, minimizes the need for an elaborate control system, and allows rapid decision making.

Some disadvantages of a functional structure are that it forces accountability to the top, minimizes career development opportunities, and is sometimes characterized by low employee morale, line/staff conflicts, poor delegation of authority, and inadequate planning for products and markets.

A functional structure often leads to short-term and narrow thinking that may undermine what is best for the firm as a whole. For example, the research and development department may strive to overdesign products and components to achieve technical elegance, while manufacturing may argue for low-frills products that can be mass produced more easily. Thus, communication is often not as good in a functional structure. Schein gives an example of a communication problem in a functional structure:

The word “marketing” will mean product development to the engineer, studying customers through market research to the product manager, merchandising to the salesperson, and constant change in design to the manufacturing manager. Then when these managers try to work together, they often attribute disagreements to personalities and fail to notice the deeper, shared assumptions that vary and dictate how each function thinks.

Most large companies have abandoned the functional structure in favor of decentralization and improved accountability. However, two large firms that still successfully use a functional structure are Nucor Steel, based in Charlotte, North Carolina, and Sharp, the $17 billion consumer electronics firm. Table 7-7summarizes the advantages and disadvantages of a functional organizational structure.

The Divisional Structure

The divisional or decentralized structure is the second most common type used by U.S. businesses. As a small organization grows, it has more difficulty managing different products and services in different markets. Some form of divisional structure generally becomes necessary to motivate employees, control operations, and compete successfully in diverse locations. The divisional structure can be organized in one of four ways: by geographic area, by product or service, by customer, or by process. With

a divisional structure, functional activities are performed both centrally and in each separate division.

TABLE 7-7 Advantages and Disadvantages of a Functional Organizational Structure

Advantages	Disadvantages
1. Simple and inexpensive	1. Accountability forced to the top
2. Capitalizes on specialization of business activities such as marketing and finance	2. Delegation of authority and responsibility not encouraged
3. Minimizes need for elaborate control system	3. Minimizes career development
4. Allows for rapid decision making	4. Low employee/manager morale
	5. Inadequate planning for products and markets
	6. Leads to short-term, narrow thinking
	7. Leads to communication problems

Cisco Systems recently discarded its divisional structure by customer and reorganized into a functional structure. CEO John Chambers replaced the threecustomer structure based on big businesses, small businesses, and telecoms, and now the company has centralized its engineering and marketing units so that they focus on technologies such as wireless networks. Chambers says the goal was to eliminate duplication, but the change should not be viewed as a shift in strategy. Chambers's span of control in the new structure is reduced from 15 to 12 managers reporting directly to him. He continues to operate Cisco without a chief operating officer or a number-two executive.

Sun Microsystems recently reduced the number of its business units from seven to four. Kodak recently reduced its number of business units from seven by-customer divisions to five by-product divisions. As consumption patterns become increasingly similar worldwide, a by-product structure is becoming more effective than a by-customer or a by-geographic type divisional structure. In the restructuring, Kodak eliminated its global operations division and distributed those responsibilities across the new by-product divisions.

A divisional structure has some clear advantages. First and perhaps foremost, accountability is clear. That is, divisional managers can be held responsible for sales and profit levels. Because a divisional structure is based on extensive delegation of authority, managers and employees can easily see the results of their good or bad

performances. As a result, employee morale is generally higher in a divisional structure than it is in a centralized structure. Other advantages of the divisional design are that it creates career development opportunities for managers, allows local control of situations, leads to a competitive climate within an organization, and allows new businesses and products to be added easily.

The divisional design is not without some limitations, however. Perhaps the most important limitation is that a divisional structure is costly, for a number of reasons. First, each division requires functional specialists who must be paid. Second, there exists some duplication of staff services, facilities, and personnel; for instance, functional specialists are also needed centrally (at headquarters) to coordinate divisional activities. Third, managers must be well qualified because the divisional design forces delegation of authority; better-qualified individuals require higher salaries. A divisional structure can also be costly because it requires an elaborate, headquarters-driven control system. Fourth, competition between divisions may become so intense that it is dysfunctional and leads to limited sharing of ideas and resources for the common good of the firm. Table 7-8 summarizes the advantages and disadvantages of divisional organizational structure.

TABLE 7-8 Advantages and Disadvantages of a Divisional Organizational Structure

Advantages	Disadvantages
1. Accountability is clear	1. Can be costly
2. Allows local control of local situations	2. Duplication of functional activities
3. Creates career development chances	3. Requires a skilled management force
4. Promotes delegation of authority	4. Requires an elaborate control system
5. Leads to competitive climate internally	5. Competition among divisions can become so intense as to be dysfunctional
6. Allows easy adding of new products or regions	6. Can lead to limited sharing of ideas and resources
7. Allows strict control and attention to products, customers, and/or regions	7. Some regions/products/customers may receive special treatment

Ghoshal and Bartlett, two leading scholars in strategic management, note the following: As their label clearly warns, divisions divide. The divisional model fragments companies' resources; it creates vertical communication channels that insulate business units and prevents them from sharing their strengths with one another. Consequently, the whole of the corporation is often less than the sum of its parts. A final limitation of the divisional design is that certain regions, products, or customers may sometimes receive special treatment, and it may be difficult to

maintain consistent, companywide practices. Nonetheless, for most large organizations and many small firms, the advantages of a divisional structure more than offset the potential limitations.5 A divisional structure by geographic area is appropriate for organizations whose strategies need to be tailored to fit the particular needs and characteristics of customers in different geographic areas. This type of structure can be most appropriate for organizations that have similar branch facilities located in widely dispersed areas.

A divisional structure by geographic area allows local participation in decision making and improved coordination within a region. Hershey Foods is an example of a company organized using the divisional by geographic region type of structure. Hershey's divisions are United States, Canada, Mexico, Brazil, and Other. Analysts contend that this type of structure may not be best for Hershey because consumption patterns for candy are quite similar worldwide. An alternative—and perhaps better—type of structure for Hershey would be divisional by product because the company produces and sells three types of products worldwide: (1) chocolate, (2) nonchocolate, and (3) grocery.

The divisional structure by product (or services) is most effective for implementing strategies when specific products or services need special emphasis. Also, this type of structure is widely used when an organization offers only a few products or services or when an organization's products or services differ substantially. The divisional structure allows strict control over and attention to product lines, but it may also require a more skilled management force and reduced top management control. General Motors, DuPont, and Procter & Gamble use a divisional structure by product to implement strategies. Huffy, the largest bicycle company in the world, is another firm that is highly decentralized based on a divisional-by-product structure. Based in Ohio, Huffy's divisions are the Bicycle division, the Gerry Baby Products division, the Huffy Sports division, YLC Enterprises, and Washington Inventory Service. Harry Shaw, Huffy's chairman, believes decentralization is one of the keys to Huffy's success.

Eastman Chemical established a new by-product divisional organizational structure. The company's two new divisions, Eastman Company and Voridian Company, focus

on chemicals and polymers, respectively. The Eastman division focuses on coatings, adhesives, inks, and plastics, whereas the Voridian division focuses on fibers, polyethylene, and other polymers. Microsoft recently reorganized the whole corporation into three large divisions-by-product. Headed by a president, the new divisions are (1) platform products and services, (2) business, and (3) entertainment and devices. The Swiss electrical-engineering company ABB Ltd. recently scrapped its two core divisions, (1) power technologies and (2) automation technologies, and replaced them with five new divisions: (1) power products, (2) power systems, (3) automation products, (4) process automation, and (5) robotics.

When a few major customers are of paramount importance and many different services are provided to these customers, then a divisional structure by customercan be the most effective way to implement strategies. This structure allows an organization to cater effectively to the requirements of clearly defined customer groups. For example, book publishing companies often organize their activities around customer groups, such as colleges, secondary schools, and private commercial schools. Some airline companies have two major customer divisions: passengers and freight or cargo services.

Merrill Lynch is organized into separate divisions that cater to different groups of customers, including wealthy individuals, institutional investors, and small corporations. Motorola's semiconductor chip division is also organized divisionally by customer, having three separate segments that sell to (1) the automotive and industrial market, (2) the mobile phone market, and (3) the data-networking market. The automotive and industrial segment is doing well, but the other two segments are faltering, which is a reason why Motorola is trying to divest its semiconductor operations. A divisional structure by process is similar to a functional structure, because activities are organized according to the way work is actually performed. However, a key difference between these two designs is that functional departments are not accountable for profits or revenues, whereas divisional process departments are evaluated on these criteria. An example of a divisional structure by process is a manufacturing business organized into six divisions: electrical work, glass cutting, welding, grinding, painting, and foundry work. In this case, all operations related to

these specific processes would be grouped under the separate divisions. Each process (division) would be responsible for generating revenues and profits.

A divisional structure by process is similar to a functional structure, because activities are organized according to the way work is actually performed. However, a key difference between these two designs is that functional departments are not accountable for profits or revenues, whereas divisional process departments are evaluated on these criteria. An example of a divisional structure by process is a manufacturing business organized into six divisions: electrical work, glass cutting, welding, grinding, painting, and foundry work. In this case, all operations related to these specific processes would be grouped under the separate divisions. Each process (division) would be responsible for generating revenues and profits. The divisional structure by process can be particularly effective in achieving objectives when distinct production processes represent the thrust of competitiveness in an industry.

The Strategic Business Unit (SBU) Structure

As the number, size, and diversity of divisions in an organization increase, controlling and evaluating divisional operations become increasingly difficult for strategists. Increases in sales often are not accompanied by similar increases in profitability. The span of control becomes too large at top levels of the firm. For example, in a large conglomerate organization composed of 90 divisions, such as ConAgra, the chief executive officer could have difficulty even remembering the first names of divisional presidents. In multidivisional organizations, an SBU structure can greatly facilitate strategy-implementation efforts. ConAgra has put its many divisions into three primary SBUs: (1) food service (restaurants), (2) retail (grocery stores), and (3) agricultural products.

The SBU structure groups similar divisions into strategic business units and delegates authority and responsibility for each unit to a senior executive who reports directly to the chief executive officer. This change in structure can facilitate strategy implementation by improving coordination between similar divisions and channeling accountability to distinct business units. In a 100-division conglomerate, the divisions could perhaps be regrouped into 10 SBUs according to certain common characteristics,

such as competing in the same industry, being located in the same area, or having the same customers.

Two disadvantages of an SBU structure are that it requires an additional layer of management, which increases salary expenses. Also, the role of the group vice president is often ambiguous. However, these limitations often do not outweigh the advantages of improved coordination and accountability. Another advantage of the SBU structure is that it makes the tasks of planning and control by the corporate office more manageable.

Citigroup in 2009 reorganized the whole company into two SBUs: (1) Citigroup, which includes the retail bank, the corporate and investment bank, the private bank, and global transaction services; and (2) Citi Holdings, which includes Citi's asset management and consumer finance segments, CitiMortgage, CitiFinancial, and the joint brokerage operations with Morgan Stanley. Citigroup's CEO, Vikram Pandit, says the restructuring will allow the company to reduce operating costs and to divest (spin off) Citi Holdings.

The huge computer firm Dell Inc., reorganized in 2009 into two SBUs. One SBU is Consumer Products and the other is Commercial. As part of its reorganization, Dell deleted the geographic divisions within its Consumer Products segment. However within its Commercial segment, there are now three worldwide units: (1) large enterprise, (2) public sector, and (3) small and midsize businesses. Dell is also closing a manufacturing facility in Austin, Texas, and laying off more employees as the company struggles to compete. Computer prices and demand are falling as competition increases. Atlantic Richfield Fairchild Industries, and Honeywell International are examples of firms that successfully use an SBU-type structure.
As illustrated in Figure 7-4, Sonoco Products Corporation, based in Hartsville, South Carolina, utilizes an SBU organizational structure. Note that Sonoco's

SBUs—Industrial Products and Consumer Products—each have four autonomous divisions that have their own sales, manufacturing, R&D, finance, HRM, and MIS functions.

The Matrix Structure

A matrix structure is the most complex of all designs because it depends upon both vertical and horizontal flows of authority and communication (hence the term matrix). In contrast, functional and divisional structures depend primarily on vertical flows of authority and communication. A matrix structure can result in higher overhead because it creates more management positions. Other disadvantages of a matrix structure that contribute to overall complexity include dual lines of budget authority (a violation of the unity-of-command principle), dual sources of reward and punishment, shared authority, dual reporting channels, and a need for an extensive and effective communication system.

Despite its complexity, the matrix structure is widely used in many industries, including construction, health care, research, and defense. As indicated in Table 7-9, some advantages of a matrix structure are that project objectives are clear, there are many channels of communication, workers can see the visible results of their work, and shutting down a project can be accomplished relatively easily. Another advantage of a matrix structure is that it facilitates the use of specialized personnel, equipment, and facilities. Functional resources are shared in a matrix structure, rather than duplicated as in a divisional structure. Individuals with a high degree of expertise can divide their time as needed among projects, and they in turn develop their own skills and competencies more than in other structures. Walt Disney Corp. relies on a matrix structure.

FIGURE 7-4

Sonoco Products' SBU Organizational Chart

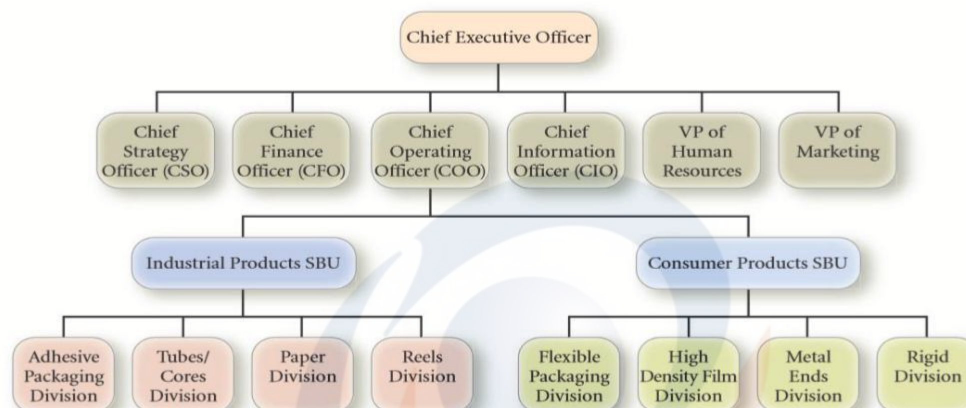


TABLE 7-9 Advantages and Disadvantages of a Matrix Structure

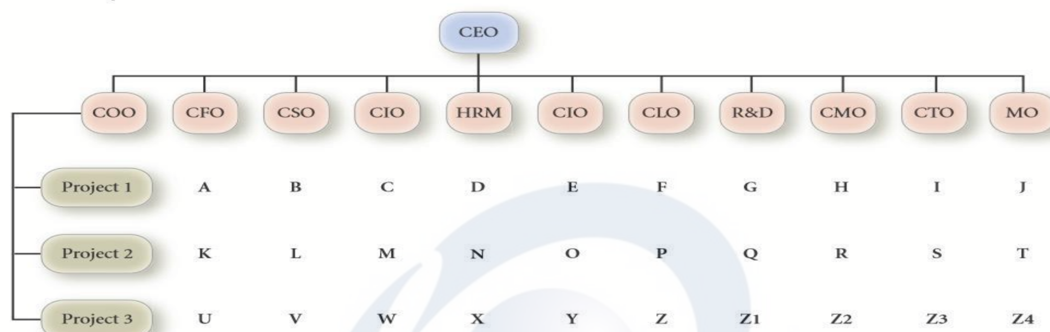
Advantages	Disadvantages
1. Project objectives are clear	1. Requires excellent vertical and horizontal flows of communication
2. Employees can clearly see results of their work	2. Costly because creates more manager positions
3. Shutting down a project is easily accomplished	3. Violates unity of command principle
4. Facilitates uses of special equipment/ personnel/facilities	4. Creates dual lines of budget authority
5. Functional resources are shared instead of duplicated as in a divisional structure	5. Creates dual sources of reward/punishment
	6. Creates shared authority and reporting
	7. Requires mutual trust and understanding

A typical matrix structure is illustrated in Figure 7-5. Note that the letters (A through Z4) refer to managers. For example, if you were manager A, you would be responsible for financial aspects of Project 1, and you would have two bosses: the Project 1 Manager on site and the CFO off site.

For a matrix structure to be effective, organizations need participative planning, training, clear mutual understanding of roles and responsibilities, excellent internal communication, and mutual trust and confidence. The matrix structure is being used more frequently by U.S. businesses because firms are pursuing strategies that add new products, customer groups, and technology to their range of activities. Out of these changes are coming product managers, functional managers, and geographic-area managers, all of whom have important strategic responsibilities. When several variables, such as product, customer, technology, geography, functional area, and line of business, have roughly equal strategic priorities, a matrix organization can be an effective structural form.

FIGURE 7-5

An Example Matrix Structure



Notes: Titles spelled out as follows.
Chief Executive Officer (CEO)
Chief Finance Officer (CFO)
Chief Strategy Officer (CSO)
Chief Information Officer (CIO)
Human Resources Manager (HRM)
Chief Operating Officer (COO)
Chief Legal Officer (CLO)
Research & Development Officer (R&D)
Chief Marketing Officer (CMO)
Chief Technology Officer (CTO)
Competitive Intelligence Officer (CIO)
Maintenance Officer (MO)

Some Do's and Don'ts in Developing Organizational Charts

Students analyzing strategic management cases are often asked to revise and develop a firm's organizational structure. This section provides some basic guidelines for this endeavor. There are some basic do's and don'ts in regard to devising or constructing organizational charts, especially for midsize to large firms. First of all, reserve the title CEO for the top executive of the firm. Don't use the title "president" for the top person; use it for the division top managers if there are divisions within the firm. Also, do not use the title "president" for functional business executives. They should have the title "chief," or "vice president," or "manager," or "officer," such as "Chief Information Officer," or "VP of Human Resources." Further, do not recommend a dual title (such as "CEO and president") for just one executive. The chairman of the board and CEO of Bristol-Myers Squibb, Peter Dolan, recently gave up his title as chairman. However, Pfizer's CEO, Jeffrey Kindler, recently added chairman of the board to his title when he succeeded Hank McKinnell as chairman of Pfizer's board. And Comverse Technology recently named Andre Dahan as its president, chief executive officer, and board director. Actually, "chairperson" is much better than "chairman" for this title.

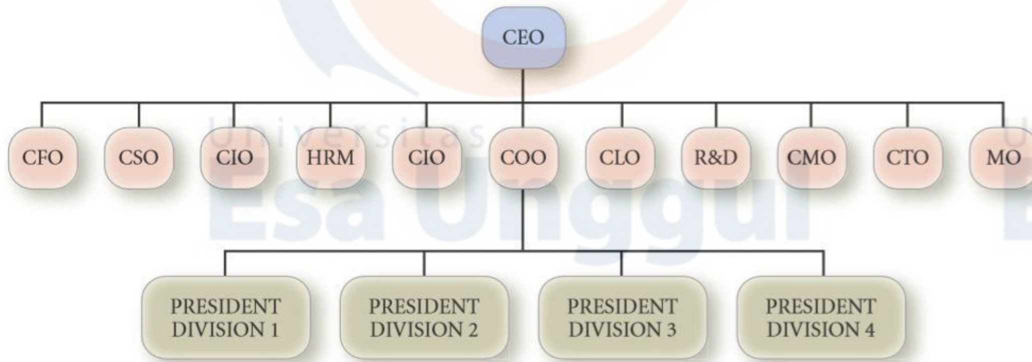
A significant movement began among corporate America in mid-2009 to split the chairperson of the board and the CEO positions in publicly held companies.6 The movement includes asking the New York Stock Exchange and Nasdaq to adopt listing rules that would require separate positions. About 37 percent of companies in the S&P 500 stock index have separate positions, up from 22 percent in 2002, but this still leaves plenty of room for improvement. Among European and Asian companies, the split in these two positions is much more common. For example, 79 percent of British companies split the positions, and all German and Dutch companies split the position.
Directly below the CEO, it is best to have a COO (chief operating officer) with any division presidents reporting directly to the COO. On the same level as the COO and also reporting to the CEO, draw in your functional business executives, such as a CFO (chief financial officer), VP of human resources, a CSO (chief strategy officer), a CIO (chief information officer), a CMO (chief marketing Officer), a VP of R&D, a VP of legal affairs, an investment relations officer, maintenance officer, and so on. Note in Figure 7-6 that these positions are labeled and placed appropriately. Note that a controller and/or treasurer would normally report to the CFO.

In developing an organizational chart, avoid having a particular person reporting tomore than one person above in the chain of command. This would violate the unity-of-command principle of management that “every employee should have just one boss.” Also, do not have the CFO, CIO, CSO, human resource officer, or other functional positions report to the COO. All these positions report directly to the CEO.
A key consideration in devising an organizational structure concerns the divisions. Note whether the divisions (if any) of a firm presently are established based upon geography, customer, product, or process. If the firm’s organizational chart is not available, you often can devise a chart based on the titles of executives. An important case analysis activity is for you to decide how the divisions of a firm should be organized for maximum effectiveness. Even if the firm presently has no divisions, determine whether the firm would operate better with divisions. In other words, which type of divisional breakdown do you (or your group or team) feel would be best for the firm in allocating resources, establishing objectives, and devising compensation incentives? This important strategic decision faces many midsize and large firms (and teams of students analyzing a strategic-management case). As consumption patterns become more and more similar worldwide, the divisionalby-product form of structure is increasingly the most effective. Be mindful that all firms have functional staff below their top executive and often readily provide this information, so be wary of concluding prematurely that a particular firm utilizes a functional structure. If you see the word “president” in the titles of executives, coupled with financial-reporting segments, such as by product or geographic region, then the firm is divisionally structured.

If the firm is large with numerous divisions, decide whether an SBU type of structure would be more appropriate to reduce the span of control reporting to the COO. Note in Figure 7-4 that the Sonoco Products’ strategic business units (SBUs) are based on product groupings. An alternative SBU structure would have been to base the division groupings on location. One never knows for sure if a proposed or actual structure is indeed most effective for a particular firm. Note from Chandler’s strategy-structure relationship (p. 221) illustrated previously in this chapter that declining financial performance signals a need for altering the structure.

FIGURE 7-6

Typical Top Managers of a Large Firm



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Chief Legal Officer (CLO)
Research & Development Officer (R&D)
Chief Marketing Officer (CMO)
Chief Technology Officer (CTO)
Competitive Intelligence Officer (CIO)
Maintenance Officer (MO)

Restructuring, Reengineering, and E-Engineering

Restructuring and reengineering are becoming commonplace on the corporate landscape across the United States and Europe. Restructuring—also called downsizing, rightsizing, or delayering—involves reducing the size of the firm in terms of number of employees, number of divisions or units, and number of hierarchical levels in the firm's organizational structure. This reduction in size is intended to improve both efficiency and effectiveness. Restructuring is concerned primarily with shareholder well-being rather than employee well-being.

Recessionary economic conditions have forced many European companies to downsize, laying off managers and employees. This was almost unheard of prior to the mid-1990s because European labor unions and laws required lengthy negotiations or huge severance checks before workers could be terminated. In contrast to the United States, labor union executives of large European firms sit on most boards of directors.

Job security in European companies is slowly moving toward a U.S. scenario, in which firms lay off almost at will. From banks in Milan to factories in Mannheim, European employers are starting to show people the door in an effort to streamline operations, increase efficiency, and compete against already slim and trim U.S. firms. Massive U.S.-style layoffs are still rare in Europe, but unemployment rates throughout the continent are rising quite rapidly. European firms still prefer to downsize by attrition and retirement rather than by blanket layoffs because of culture, laws, and unions.

In contrast, reengineering is concerned more with employee and customer well-being than shareholder well-being. Reengineering—also called process management, process innovation, or process redesign—involves reconfiguring or redesigning work, jobs, and processes for the purpose of improving cost, quality, service, and speed. Reengineering does not usually affect the organizational structure or chart, nor does it imply job loss or employee layoffs. Whereas restructuring is concerned with eliminating or establishing, shrinking or enlarging, and moving organizational departments and divisions, the focus of reengineering is changing the way work is actually carried out. Reengineering is characterized by many tactical (short-term, business-function-specific) decisions, whereas restructuring is characterized by strategic (long-term, affecting all business functions) decisions. Developed by Motorola in 1986 and made famous by CEO Jack Welch at General Electric and more recently by Robert Nardelli, former CEO of Home Depot, Six Sigma is a quality-boosting process improvement technique that entails training several key persons in the firm in the techniques to monitor, measure, and improve processes and eliminate defects. Six Sigma has been widely applied across industries from retailing to financial services. CEO Dave Cote at Honeywell and CEO Jeff Immelt at General Electric spurred acceptance of Six Sigma, which aims to improve work processes and eliminate waste by training "select" employees who are given judo titles such as Master Black Belts, Black Belts, and Green Belts. Six Sigma was criticized in a 2007 Wall Street Journal article that cited many example firms whose stock price fell for a number of years after adoption of Six Sigma. The technique's reliance on the special group of trained employees is problematic and its use within retail firms such as Home Depot has not been as successful as in manufacturing firms.7

Restructuring

Firms often employ restructuring when various ratios appear out of line with competitors as determined through benchmarking exercises. Recall that benchmarking simply involves comparing a firm against the best firms in the industry on a wide variety of performancerelated criteria. Some benchmarking ratios commonly used in rationalizing the need for restructuring are headcount-to-sales-volume, or corporate-staff-to-operating-employees, or span-of-control figures.

The primary benefit sought from restructuring is cost reduction. For some highly bureaucratic firms, restructuring can actually rescue the firm from global competition and demise. But the downside of restructuring can be reduced employee commitment, creativity, and innovation that accompanies the uncertainty and trauma associated with pending and actual employee layoffs. In 2009, Walt Disney merged its ABC television network with its ABC Studios television production as part of a restructuring to cope with declining advertising and shrinking viewership. Disney also is laying off employees and offering buyouts to more than 600 executives. The Disney restructuring is paralleled by rival General Electric Company's merger of its NBC Network with its Universal Media Studios, which is also a bid to cut costs. Ad revenues at the four largest television networks in the United States fell 3 percent in 2009.

Another downside of restructuring is that many people today do not aspire to become managers, and many present-day managers are trying to get off the management track.8 Sentiment against joining management ranks is higher today than ever. About 80 percent of employees say they want nothing to do with management, a major shift from just a decade ago when 60 to 70 percent hoped to become managers. Managing others historically led to enhanced career mobility, financial rewards, and executive perks; but in today's global, more competitive, restructured arena, managerial jobs demand more hours and headaches with fewer financial rewards. Managers today manage more people spread over different locations, travel more, manage diverse functions, and are change agents even when they have nothing to do with the creation of the plan or disagree with its approach. Employers today are looking for people who can do things, not for people who make other people do things. Restructuring in many firms has made a manager's job an invisible, thankless role. More workers today are self-managed, entrepreneurs, interpreneurs, or team-managed. Managers today need to be counselors, motivators, financial advisors, and psychologists. They also run the risk

of becoming technologically behind in their areas of expertise. "Dilbert" cartoons commonly portray managers as enemies or as morons.

Reengineering

The argument for a firm engaging in reengineering usually goes as follows: Many companies historically have been organized vertically by business function. This arrangement has led over time to managers' and employees' mind-sets being defined by their particular functions rather than by overall customer service, product quality, or corporate performance. The logic is that all firms tend to bureaucratize over time. As routines become entrenched, turf becomes delineated and defended, and politics takes precedence over performance. Walls that exist in the physical workplace can be reflections of "mental" walls.

In reengineering, a firm uses information technology to break down functional barriers and create a work system based on business processes, products, or outputs rather than on functions or inputs. Cornerstones of reengineering are decentralization, reciprocal interdependence, and information sharing. A firm that exemplifies complete information sharing is Springfield Remanufacturing Corporation, which provides to all employees a weekly income statement of the firm, as well as extensive information on other companies' performances.

The Wall Street Journal noted that reengineering today must go beyond knocking down internal walls that keep parts of a company from cooperating effectively; it must also knock down the external walls that prohibit or discourage cooperation with other firms—even rival firms.9 A maker of disposable diapers echoes this need differently when it says that to be successful "cooperation at the firm must stretch from stump to rump."

Hewlett-Packard is a good example of a company that has knocked down the external barriers to cooperation and practices modern reengineering. The HP of today shares its forecasts with all of its supply-chain partners and shares other critical information with its distributors and other stakeholders. HP does all the buying of resin for its many manufacturers, giving it a volume discount of up to 5 percent. HP has established many alliances and cooperative agreements of the kind discussed in Chapter 5.

A benefit of reengineering is that it offers employees the opportunity to see more clearly how their particular jobs affect the final product or service being marketed by the firm. However, reengineering can also raise manager and employee anxiety, which, unless calmed, can lead to corporate trauma.

Linking Performance and Pay to Strategies

Caterpillar Inc. is slashing its executive compensation by roughly 50 percent in 2009 and cutting pay for senior managers by up to 35 percent. Wages of other Caterpillar managers and employees are being lowered 15 percent. The company is cutting 20,000 more jobs amid a global slowdown in construction. Caterpillar's sales for 2009 are projected to be $40 billion, down sharply from $51.32 billion in 2008.

CEOs at Japanese companies with more than $10 billion in annual revenues are paid about $1.3 million annually, including bonuses and stock options.10 This compares to an average CEO pay among European firms of $6 million and an average among U.S. firms of $12 million. As firms acquire other firms in other countries, these pay differences can cause resentment and even turmoil. Larger pay packages of American CEOs are socially less acceptable in many other countries. For example, in Japan, seniority rather than performance has been the key factor in determining pay, and harmony among managers is emphasized over individual excellence.

How can an organization's reward system be more closely linked to strategic performance? How can decisions on salary increases, promotions, merit pay, and bonuses be more closely aligned to support the long-term strategic objectives of the organization? There are no widely accepted answers to these questions, but a dual bonus system based on both annual objectives and long-term objectives is becoming common. The percentage of a manager's annual bonus attributable to short-term versus long-term results should vary by hierarchical level in the organization. A chief executive officer's annual bonus could, for example, be determined on a 75 percent shortterm and 25 percent long-term basis. It is important that bonuses not be based solely on short-term results because such a system ignores long-term company strategies and objectives.

Wal-Mart Stores recently revamped its bonus program for hourly employees as the firm began paying bonuses based on sales, profit, and inventory performance at

individual stores on a quarterly, rather than annual, basis. The average full-time employee at WalMart in the United States is paid $10.51 per hour, but this is significantly below the $17.46 average paid to Costco Wholesale Corp. employees.11 One aspect of the deepening global recession is that companies are instituting policies to allow their shareholders to vote on executive compensation policies. A "sayon-pay" policy was installed at 14 large companies in 2008–2009. Aflac was the first U.S. corporation to voluntarily give shareholders an advisory vote on executive compensation. Aflac did this back in 2007. Apple did this in 2008, as did H&R Block. Several companies that instituted say-on-pay policies in 2009 were Ingersoll-Rand, Verizon, and Motorola. In 2010 and 2011, Occidental Petroleum and Hewlett-Packard are expected to institute such policies. These new policies underscore how the financial crisis and shareholder outrage about top executive pay has affected compensation practice. None of the shareholder votes are binding on the companies, however, at least not so far. The U.S. House of Representatives recently passed a bill to formalize this shareholder tactic, which is gaining steam across the country as a means to combat exorbitant executive pay.

In an effort to cut costs and increase productivity, more and more Japanese companies are switching from seniority-based pay to performance-based approaches. Toyota has switched to a full merit system for 20,000 of its 70,000 white-collar workers. Fujitsu, Sony, Matsushita Electric Industrial, and Kao also have switched to merit pay systems. This switching is hurting morale at some Japanese companies, which have trained workers for decades to cooperate rather than to compete and to work in groups rather than individually.

Richard Brown, CEO of Electronic Data Systems (EDS), once said,
You have to start with an appraisal system that gives genuine feedback and differentiates performance. Some call it ranking people. That seems a little harsh. But you can't have a manager checking a box that says you're either stupendous, magnificent, very good, good, or average. Concise, constructive feedback is the fuel workers use to get better. A company that doesn't differentiate performance risks losing its best people.

Profit sharing is another widely used form of incentive compensation. More than 30 percent of U.S. companies have profit sharing plans, but critics emphasize that too

many factors affect profits for this to be a good criterion. Taxes, pricing, or an acquisition would wipe out profits, for example. Also, firms try to minimize profits in a sense to reduce taxes.

Still another criterion widely used to link performance and pay to strategies is gain sharing. Gain sharing requires employees or departments to establish performance targets; if actual results exceed objectives, all members get bonuses. More than 26 percent of U.S. companies use some form of gain sharing; about 75 percent of gain sharing plans have been adopted since 1980. Carrier, a subsidiary of United Technologies, has had excellent success with gain sharing in its six plants in Syracuse, New York; Firestone's tire plant in Wilson, North Carolina, has experienced similar success with gain sharing.

Criteria such as sales, profit, production efficiency, quality, and safety could also serve as bases for an effective bonus system.If an organization meets certain understood, agreedupon profit objectives, every member of the enterprise should share in the harvest. A bonus system can be an effective tool for motivating individuals to support strategy-implementation efforts. BankAmerica, for example, recently overhauled its incentive system to link pay to sales of the bank's most profitable products and services. Branch managers receive a base salary plus a bonus based both on the number of new customers and on sales of bank products. Every employee in each branch is also eligible for a bonus if the branch exceeds its goals. Thomas Peterson, a top BankAmerica executive, says, "We want to make people responsible for meeting their goals, so we pay incentives on sales, not on controlling costs or on being sure the parking lot is swept."

Five tests are often used to determine whether a performance-pay plan will benefit an organization:

1. Does the plan capture attention? Are people talking more about their activities and taking pride in early successes under the plan?
2. Do employees understand the plan? Can participants explain how it works and what they need to do to earn the incentive?
3. Is the plan improving communication? Do employees know more than they used to about the company's mission, plans, and objectives?

4. Does the plan pay out when it should? Are incentives being paid for desired results—and being withheld when objectives are not met?
5. Is the company or unit performing better? Are profits up? Has market share grown? Have gains resulted in part from the incentives?

In addition to a dual bonus system, a combination of reward strategy incentives, such as salary raises, stock options, fringe benefits, promotions, praise, recognition, criticism, fear, increased job autonomy, and awards, can be used to encourage managers and employees to push hard for successful strategic implementation. The range of options for getting people, departments, and divisions to actively support strategy-implementation activities in a particular organization is almost limitless. Merck, for example, recently gave each of its 37,000 employees a 10-year option to buy 100 shares of Merck stock at a set price of $127. Steven Darien, Merck's vice president of human resources, says, "We needed to find ways to get everyone in the workforce on board in terms of our goals and objectives. Company executives will begin meeting with all Merck workers to explore ways in which employees can contribute more."

Many countries worldwide are curbing executive pay in the wake of a global financial crisis. For example, the German cabinet recently imposed a $650,000 annual salary cap on banks that receive any government-backed capital injections. The German cabinet also imposed a ban on bank executive bonuses, stock options, and severance payments through 2012. Companies worldwide that participate in government bailouts or capital infusions are increasingly being constrained in executive compensation. The U.S. House of Representatives and Senate members severely criticized the CEOs of Ford, GM, and Chrysler for being paid so much in the face of failing companies.

There is rising public resentment over executive pay, and there are government restrictions on compensation. Based in Thousand Oaks, California, Amgen recently directed all shareholders to a 10-item questionnaire asking them what they think about the firm's compensation plan. Schering-Plough Corp. was going to use a similar

survey just as it agreed to be acquired by Merck & Co. Home Depot now meets with shareholders regularly to hear their concerns. In April 2009, Royal Bank of Scotland Group PLC voted 9-to-1 against the bank's 2008 compensation package.

Executive pay declined slightly in 2008 and is expected to decrease somewhat substantially in 2009 as pressure for shareholders and government subsidy constraints lower payouts. The five CEOs who in 2008 received the highest compensation in a recent survey are Sanjay Jha at Motorola ($104 million), Ray Irani at Occidental Petroleum ($49.9 million), Robert Iger at Walt Disney ($49.7 million), Vikram Pandit at Citigroup ($38.2 million), and Louis Camilleri at Philip Morris ($36.4 million).

Managing Resistance to Change

No organization or individual can escape change. But the thought of change raises anxieties because people fear economic loss, inconvenience, uncertainty, and a break in normal social patterns. Almost any change in structure, technology, people, or strategies has the potential to disrupt comfortable interaction patterns. For this reason, people resist change. The strategic-management process itself can impose major changes on individuals and processes. Reorienting an organization to get people to think and act strategically is not an easy task.

Resistance to changecan be considered the single greatest threat to successful strategy implementation. Resistance regularly occurs in organizations in the form of sabotaging production machines, absenteeism, filing unfounded grievances, and an unwillingness to cooperate. People often resist strategy implementation because they do not understand what is happening or why changes are taking place. In that case, employees may simply need accurate information. Successful strategy implementation hinges upon managers' ability to develop an organizational climate conducive to change. Change must be viewed as an opportunity rather than as a threat by managers and employees.

Resistance to change can emerge at any stage or level of the strategy-implementation process. Although there are various approaches for implementing changes, three commonly used strategies are a force change strategy, an educative change strategy, and a rational or self-interest change strategy. A force change strategy involves giving orders and enforcing those orders; this strategy has the advantage of being fast, but it

is plagued by low commitment and high resistance. The educative change strategy is one that presents information to convince people of the need for change; the disadvantage of an educative change strategy is that implementation becomes slow and difficult. However, this type of strategy evokes greater commitment and less resistance than does the force change strategy. Finally, a rational or self-interest change strategy is one that attempts to convince individuals that the change is to their personal advantage. When this appeal is successful, strategy implementation can be relatively easy. However, implementation changes are seldom to everyone's advantage.

The rational change strategy is the most desirable, so this approach is examined a bit further. Managers can improve the likelihood of successfully implementing change by carefully designing change efforts. Jack Duncan described a rational or self-interest change strategy as consisting of four steps. First, employees are invited to participate in the process of change and in the details of transition; participation allows everyone to give opinions, to feel a part of the change process, and to identify their own self-interests regarding the recommended change. Second, some motivation or incentive to change is required; self-interest can be the most important motivator. Third, communication is needed so that people can understand the purpose for the changes. Giving and receiving feedback is the fourth step: everyone enjoys knowing how things are going and how much progress is being made.

Because of diverse external and internal forces, change is a fact of life in organizations. The rate, speed, magnitude, and direction of changes vary over time by industry and organization. Strategists should strive to create a work environment in which change is recognized as necessary and beneficial so that individuals can more easily adapt to change. Adopting a strategic-management approach to decision making can itself require major changes in the philosophy and operations of a firm.
Strategists can take a number of positive actions to minimize managers' and employees' resistance to change. For example, individuals who will be affected by a change should be involved in the decision to make the change and in decisions about how to implement the change. Strategists should anticipate changes and develop and offer training and development workshops so that managers and employees can adapt to those changes. They also need to effectively communicate the need for changes. The strategic-management process can be described as a process of managing change.

Organizational change should be viewed today as a continuous process rather than as a project or event. The most successful organizations today continuously adapt to changes in the competitive environment, which themselves continue to change at an accelerating rate. It is not sufficient today to simply react to change. Managers need to anticipate change and ideally be the creator of change. Viewing change as a continuous process is in stark contrast to an old management doctrine regarding change, which was to unfreeze behavior, change the behavior, and then refreeze the new behavior. The new “continuous organizational change” philosophy should mirror the popular “continuous quality improvement philosophy.”

Creating a Strategy-Supportive

Culture Strategists should strive to preserve, emphasize, and build upon aspects of an existing culture that support proposed new strategies. Aspects of an existing culture that are antagonistic to a proposed strategy should be identified and changed. Substantial research indicates that new strategies are often market-driven and dictated by competitive forces. For this reason, changing a firm’s culture to fit a new strategy is usually more effective than changing a strategy to fit an existing culture. As indicated in Table 7-10, numerous techniques are available to alter an organization’s culture, including recruitment, training, transfer, promotion, restructure of an organization’s design, role modeling, positive reinforcement, and mentoring.

Schein indicated that the following elements are most useful in linking culture to strategy:

1. Formal statements of organizational philosophy, charters, creeds, materials used for recruitment and selection, and socialization.
2. Designing of physical spaces, facades, buildings.
3. Deliberate role modeling, teaching, and coaching by leaders.
4. Explicit reward and status system, promotion criteria.
5. Stories, legends, myths, and parables about key people and events.
6. What leaders pay attention to, measure, and control.

7. Leader reactions to critical incidents and organizational crises.

8. How the organization is designed and structured.
9. Organizational systems and procedures.
10. Criteria used for recruitment, selection, promotion, leveling off, retirement, and "excommunication" of people.

TABLE 7-10 Ways and Means for Altering an Organization's Culture

1. Recruitment
2. Training
3. Transfer
4. Promotion
5. Restructuring
6. Reengineering
7. Role modeling
8. Positive reinforcement
9. Mentoring
10. Revising vision and/or mission
11. Redesigning physical spaces/facades
12. Altering reward system
13. Altering organizational policies/procedures/practices

In the personal and religious side of life, the impact of loss and change is easy to see. Memories of loss and change often haunt individuals and organizations for years. Ibsen wrote, "Rob the average man of his life illusion and you rob him of his happiness at the same stroke." When attachments to a culture are severed in an organization's attempt to change direction, employees and managers often experience deep feelings of grief. This phenomenon commonly occurs when external conditions dictate the need for a new strategy. Managers and employees often struggle to find meaning in a situation that changed many years before. Some people find comfort in memories; others find solace in the present. Weak linkages between strategic management and organizational culture can jeopardize performance and success. Deal and Kennedy emphasized that making strategic changes in an organization always threatens a culture:

People form strong attachments to heroes, legends, the rituals of daily life, the hoopla of extravaganza and ceremonies, and all the symbols of the workplace. Change strips relationships and leaves employees confused, insecure, and often angry. Unless something can be done to provide support for transitions from old to new, the force of a culture can neutralize and emasculate strategy changes

Production/Operations Concerns When Implementing Strategies

Production/operations capabilities, limitations, and policies can significantly enhance or inhibit the attainment of objectives. Production processes typically constitute more than 70 percent of a firm's total assets. A major part of the strategy-implementation process takes place at the production site. Production-related decisions on plant size, plant location, product design, choice of equipment, kind of tooling, size of inventory, inventory control, quality control, cost control, use of standards, job specialization, employee training, equipment and resource utilization, shipping and packaging, and technological innovation can have a dramatic impact on the success or failure of strategy-implementation efforts. Examples of adjustments in production systems that could be required to implement various strategies are provided in Table 7-11 for both for-profit and nonprofit organizations. For instance, note that when a bank formulates and selects a strategy to add 10 new branches, a production-related implementation concern is site location. The largest bicycle company in the United States, Huffy, recently ended its own production of bikes and now contracts out those services to Asian and Mexican manufacturers. Huffy focuses instead onthe design, marketing, and distribution of bikes, but it no longer produces bikes itself. The Dayton, Ohio, company closed its plants in Ohio, Missouri, and Mississippi.

TABLE 7-11 Production Management and Strategy Implementation

Type of Organization	Strategy Being Implemented	Production System Adjustments
Hospital	Adding a cancer center (Product Development)	Purchase specialized equipment and add specialized people.
Bank	Adding 10 new branches (Market Development)	Perform site location analysis.
Beer brewery	Purchasing a barley farm operation (Backward Integration)	Revise the inventory control system.
Steel manufacturer	Acquiring a fast-food chain (Unrelated Diversification)	Improve the quality control system.
Computer company	Purchasing a retail distribution chain (Forward Integration)	Alter the shipping, packaging, and transportation systems.

Just-in-time (JIT) production approaches have withstood the test of time. JIT significantly reduces the costs of implementing strategies. With JIT, parts and materials are delivered to a production site just as they are needed, rather than being stockpiled as a hedge against later deliveries. Harley-Davidson reports that at one plant alone, JIT freed $22 million previously tied up in inventory and greatly reduced reorder lead time.

Factors that should be studied before locating production facilities include the availability of major resources, the prevailing wage rates in the area, transportation costs related to shipping and receiving, the location of major markets, political risks in the area or country, and the availability of trainable employees.

For high-technology companies, production costs may not be as important as production flexibility because major product changes can be needed often. Industries such as biogenetics and plastics rely on production systems that must be flexible enough to allow frequent changes and the rapid introduction of new products. An article in the Harvard Business Review explained why some organizations get into trouble:

They too slowly realize that a change in product strategy alters the tasks of a production system. These tasks, which can be stated in terms of requirements for cost, product flexibility, volume flexibility, product performance, and product consistency, determine which manufacturing policies are appropriate. As strategies shift over time, so must production policies covering the location and scale of manufacturing facilities, the choice of manufacturing process, the degree of vertical integration of each manufacturing facility, the use of R&D units, the control of the production system, and the licensing of technology.

A common management practice, cross-training of employees, can facilitate strategy implementation and can yield many benefits. Employees gain a better understanding

of the whole business and can contribute better ideas in planning sessions. Cross-training employees can, however, thrust managers into roles that emphasize counseling and coaching over directing and enforcing and can necessitate substantial investments in training and incentives.

Human Resource Concerns When Implementing Strategies

More and more companies are instituting furloughs to cut costs as an alternative to laying off employees. Furloughs are temporary layoffs and even white-collar managers are being given furloughs, once confined to blue-collar workers. A few organizations furloughing professional workers in 2009 included Gulfstream Aerospace, Media General, Gannett, the University of Maryland, Clemson University, and Spansion. Recent research shows that 11 percent of larger U.S. companies implemented furloughs during the global economic recession.21 Winnebago Industries, for example, required all salaried employees to take a week-long furlough, which saved the company $850,000. The Port of Seattle saved $2.9 million by furloughing all of its 800 nonunion workers, mostly professionals, for two weeks. Table 7-12 lists ways that companies today are reducing labor costs to stay financially sound.

The job of human resource manager is changing rapidly as companies continue to downsize and reorganize. Strategic responsibilities of the human resource manager include assessing the staffing needs and costs for alternative strategies proposed during strategy formulation and developing a staffing plan for effectively implementing strategies. This plan must consider how best to manage spiraling health care insurance costs. Employers' health coverage expenses consume an average 26 percent of firms' net profits, even though most companies now require employees to pay part of their health insurance premiums. The plan must also include how to motivate employees and managers during a time when layoffs are common and workloads are high.

TABLE 7-12 Labor Cost-Saving Tactics

Labor Cost-Saving Tactics
Salary freeze
Hiring freeze
Salary reductions
Reduce employee benefits
Raise employee contribution to health-care premiums
Reduce employee 401(k)/403(b) match
Reduce employee workweek
Mandatory furlough
Voluntary furlough
Hire temporary instead of full-time employees
Hire contract employees instead of full-time employees
Volunteer buyouts (Walt Disney is doing this)
Halt production for 3 days a week (Toyota Motor is doing this)
Layoffs
Early retirement
Reducing/eliminating bonuses

Source: Based on Dana Mattioli, "Employers Make Cuts Despite Belief Upturn Is Near," *Wall Street Journal* (April 23, 2009): B4.

The human resource department must develop performance incentives that clearly link performance and pay to strategies. The process of empowering managers and employees through their involvement in strategic-management activities yields the greatest benefits when all organizational members understand clearly how they will benefit personally if the firm does well. Linking company and personal benefits is a major new strategic responsibility of human resource managers. Other new responsibilities for human resource managers may include establishing and administering an employee stock ownership plan (ESOP), instituting an effective child-care policy, and providing leadership for managers and employees in a way that allows them to balance work and family.

A well-designed strategic-management system can fail if insufficient attention is given to the human resource dimension. Human resource problems that arise when businesses implement strategies can usually be traced to one of three causes: (1) disruption of social and political structures, (2) failure to match individuals' aptitudes with implementation tasks, and (3) inadequate top management support for implementation activities.

Strategy implementation poses a threat to many managers and employees in an organization. New power and status relationships are anticipated and realized. New formal and informal groups' values, beliefs, and priorities may be largely unknown. Managers and employees may become engaged in resistance behavior as their roles,

prerogatives, and power in the firm change. Disruption of social and political structures that accompany strategy execution must be anticipated and considered during strategy formulation and managed during strategy implementation.

A concern in matching managers with strategy is that jobs have specific and relatively static responsibilities, although people are dynamic in their personal development. Commonly used methods that match managers with strategies to be implemented include transferring managers, developing leadership workshops, offering career development activities, promotions, job enlargement, and job enrichment. A number of other guidelines can help ensure that human relationships facilitate rather than disrupt strategy-implementation efforts. Specifically, managers should do a lot of chatting and informal questioning to stay abreast of how things are progressing and to know when to intervene. Managers can build support for strategy-implementation efforts by giving few orders, announcing few decisions, depending heavily on informal questioning, and seeking to probe and clarify until a consensus emerges. Key thrusts that succeed should be rewarded generously and visibly.

It is surprising that so often during strategy formulation, individual values, skills, and abilities needed for successful strategy implementation are not considered. It is rare that a firm selecting new strategies or significantly altering existing strategies possesses the right line and staff personnel in the right positions for successful strategy implementation. The need to match individual aptitudes with strategy-implementation tasks should be considered in strategy choice.

Inadequate support from strategists for implementation activities often undermines organizational success. Chief executive officers, small business owners, and government agency heads must be personally committed to strategy implementation and express this commitment in highly visible ways. Strategists' formal statements about the importance of strategic management must be consistent with actual support and rewards given for activities completed and objectives reached. Otherwise, stress created by inconsistency can cause uncertainty among managers and employees at all levels.

Perhaps the best method for preventing and overcoming human resource problems in strategic management is to actively involve as many managers and employees as

possible in the process. Although time consuming, this approach builds understanding, trust, commitment, and ownership and reduces resentment and hostility. The true potential of strategy formulation and implementation resides in people.

Employee Stock Ownership Plans (ESOPs)

An ESOP is a tax-qualified, defined-contribution, employee-benefit plan whereby employees purchase stock of the company through borrowed money or cash contributions. ESOPs empower employees to work as owners; this is a primary reason why the number of ESOPs have grown dramatically to more than 10,000 firms covering more than 10 million employees. ESOPs now control more than $600 billion in corporate stock in the United States.

Besides reducing worker alienation and stimulating productivity, ESOPs allow firms other benefits, such as substantial tax savings. Principal, interest, and dividend payments on ESOP-funded debt are tax deductible. Banks lend money to ESOPs at interest rates below prime. This money can be repaid in pretax dollars, lowering the debt service as much as 30 percent in some cases. "The ownership culture really makes a difference, when management is a facilitator, not a dictator," says Corey Rosen, executive director of the National Center for Employee Ownership. Fifteen employee-owned companies are listed in Table 7-13.

TABLE 7-13 Fifteen Example ESOP Firms

Firm	Headquarters Location
Publix Supermarkets	Florida
Science Applications	California
Lifetouch	Minnesota
John Lewis Partnership	United Kingdom
Mondragon Cooperative	Spain
Houchens Industries	Kentucky
Amsted Industries	Illinois
Mast General Store	North Carolina
HDR, Inc.	Nebraska
Yoke's Fresh Market	Washington
SPARTA, Inc.	California
Hy-Vee	Iowa
Bi-Mart	Washington
Ferrellgas Partners	Kansas

Source: Based on Edward Iwata, "ESOPs Can Offer Both Upsides, Drawbacks," *USA Today* (April 3, 2007): 2B.

If an ESOP owns more than 50 percent of the firm, those who lend money to the ESOP are taxed on only 50 percent of the income received on the loans. ESOPs are not for every firm, however, because the initial legal, accounting, actuarial, and appraisal fees to set up an ESOP are about $50,000 for a small or midsized firm, with annual administration expenses of about $15,000. Analysts say ESOPs also do not work well in firms that have fluctuating payrolls and profits. Human resource managers in many firms conduct preliminary research to determine the desirability of an ESOP, and then they facilitate its establishment and administration if benefits outweigh the costs.

Wyatt Cafeterias, a southwestern United States operator of 120 cafeterias, also adopted the ESOP concept to prevent a hostile takeover. Employee productivity at Wyatt greatly increased since the ESOP began, as illustrated in the following quote:
The key employee in our entire organization is the person serving the customer on the cafeteria line. In the past, because of high employee turnover and entry-level wages for many line jobs, these employees received far less attention and recognition than managers. We now tell the tea cart server, “You own the place. Don’t wait for the manager to tell you how to do your job better or how to provide better service. You take care of it.” Sure, we’re looking for productivity increases, but since we began pushing decisions down to the level of people who deal directly with customers, we’ve discovered an awesome side effect— suddenly the work crews have this “happy to be here” attitude that the customers really love.

Balancing Work Life and Home Life

Work/family strategies have become so popular among companies today that the strategies now represent a competitive advantage for those firms that offer such benefits as elder care assistance, flexible scheduling, job sharing, adoption benefits, an on-site summer camp, employee help lines, pet care, and even lawn service referrals. New corporate titles such as work/life coordinator and director of diversity are becoming common.

Working Mother magazine annually published its listing of “The 100 Best Companies for Working Mothers” (www.workingmother.com). Three especially important variables used in the ranking were availability of flextime, advancement opportunities,

and equitable distribution of benefits among companies. Other important criteria are compressed weeks, telecommuting, job sharing, childcare facilities, maternity leave for both parents, mentoring, career development, and promotion for women. Working Mother's top eight best companies for working women in 2009 are provided in Table 7-14. Working Mother also conducts extensive research to determine the best U.S. firms for women of color.

TABLE 7-14 A Few Excellent Workplaces for Women

1. Abbott—An elaborate child care center at headquarters serves 670 infants, toddlers, and pre-schoolers; employees can visit their children during the day.
2. Allstate Insurance—Child care centers are abundant: all employees have access to discounted child care.
3. American Express—Flex scheduling and tuition reimbursement enable most employees to continue their education.
4. Citi—Telecommuting for employees makes caring for family a priority.
5. Fannie Mae—Reimburses tuition-related expenses up to $10,000 per child; provides four weeks of paid maternity leave.
6. IBM—Work/life balance is an integral part of the IBM culture.
7. Johnson & Johnson—Nearly all employees say you never have to choose between family and work at J&J.
8. Merck & Company—Flextime and tuition reimbursement are available to nearly all Merck employees.

Source: Based on 2009 Web site, http://www.workingmother.com/web?service=direct/1/ViewArticlePage/dlinkFullArticle&sp=1780&sp=94.

Human resource managers need to foster a more effective balancing of professional and private lives because nearly 60 million people in the United States are now part of two-career families. A corporate objective to become more lean and mean must today include consideration for the fact that a good home life contributes immensely to a good work life.

The work/family issue is no longer just a women's issue. Some specific measures that firms are taking to address this issue are providing spouse relocation assistance as an employee benefit; providing company resources for family recreational and educational use; establishing employee country clubs, such as those at IBM and Bethlehem Steel; and creating family/work interaction opportunities. A study by Joseph Pleck of Wheaton College found that in companies that do not offer paternity leave for fathers as a benefit, most men take short, informal paternity leaves anyway by combining vacation time and sick days.

Some organizations have developed family days, when family members are invited into the workplace, taken on plant or office tours, dined by management, and given a chance to see exactly what other family members do each day. Family days are

inexpensive and increase the employee's pride in working for the organization. Flexible working hours during the week are another human resource response to the need for individuals to balance work life and home life. The work/family topic is being made part of the agenda at meetings and thus is being discussed in many organizations.

Only 2.6 percent of Fortune 500 firms have a woman CEO. However, recent studies have found that companies with more female executives and directors outperform other firms.24 Judy Rosener at the University of California, Irvine, says, "Brain scans prove that men and women think differently, so companies with a mix of male and female executives will outperform competitors that rely on leadership of a single sex." It is not that women are better than men, Rosener says. It is the mix of thinking styles that is key to management effectiveness.

During the first week of 2009, Ellen Kullman replaced Chad Holliday as CEO of DuPont, which brought to 13 the number of female CEOs running the 500 largest public firms in the United States. Thirteen is a record number, but only one more than the total for the prior year. Lynn Elsenhans became CEO of Sunoco in 2008. In 2008, two Fortune 500 women CEOs departed: Meg Whitman at eBay and Paula Reynolds at Safeco.

USA Today tracks the performance of women CEOs versus male CEOs, and their research shows virtually no difference in the two groups.25 The year 2008 saw the S&P 500 stocks fall 38.5 percent, its worst year since 1937. The stock of firms that year with women CEOs fell 42.7 percent, but some firms run by women CEOs did much better, such as Kraft Foods, down only 18 percent under Irene Rosenfeld. Two firms doing great under woman CEOs are Avon under Andrea Jung and Reynolds American under Susan Ivey. Those stocks are up 65.4 percent and 20.8 percent, respectively, since those women became CEO. Table 7-15 gives the 13 Fortune 500 Women CEOs in 2009.

TABLE 7-15 Fortune 500 Women CEOs in 2009

CEO	Company	Fortune 500 Rank
Angela Braly	WellPoint	33
Patricia Woertz	Archer Daniels Midland	52
Lynn Elsenhans	Sunoco	56
Indra Nooyi	PepsiCo	59
Irene Rosenfeld	Kraft Foods	63
Carol Meyrowitz	TJX	132
Mary Sammons	Rite Aid	142
Anne Mulcahy	Xerox	144
Brenda Barnes	Sara Lee	203
Andrea Jung	Avon Products	265
Susan Ivey	Reynolds American	290
Christina Gold	Western Union	473

There is great room for improvement in removing the glass ceilingdomestically, especially considering that women make up 47 percent of the U.S. labor force. Glass ceiling refers to the invisible barrier in many firms that bars women and minorities from top-level management positions. The United States leads the world in promoting women and minorities into mid- and top-level managerial positions in business.

Boeing's firing of CEO Harry Stonecipher for having an extramarital affair raised public awareness of office romance. However, just 12 percent of 391 companies surveyed by the American Management Association have written guidelines on office dating.26 The fact of the matter is that most employers in the United States turn a blind eye to marital cheating. Some employers, such as Southwest Airlines, which employs more than 1,000 married couples, explicitly allow consensual office relationships. Research suggests that more men than women engage in extramarital affairs at work, roughly 22 percent to 15 percent; however, the percentage of women having extramarital affairs is increasing steadily, whereas the percentage of men having affairs with co-workers is holding steady.27 If an affair is disrupting your work, then "the first step is to go to the offending person privately and try to resolve the matter. If that fails, then go to the human-resources manager seeking assistance."28 Filing a discrimination lawsuit based on the affair is

recommended only as a last resort because courts generally rule that co-workers' injuries are not pervasive enough to warrant any damages.

Benefits of a Diverse Workforce

Toyota has committed almost $8 billion over 10 years to diversify its workforce and to use more minority suppliers. Hundreds of other firms, such as Ford Motor Company and CocaCola, are also striving to become more diversified in their workforces. TJX Companies, the parent of 1,500 T. J. Maxx and Marshall's stores, has reaped great benefits and is an exemplary company in terms of diversity.

An organization can perhaps be most effective when its workforce mirrors the diversity of its customers. For global companies, this goal can be optimistic, but it is a worthwhile goal.

Corporate Wellness

Programs A recent BusinessWeek cover story article details how firms are striving to lower the accelerating costs of employees' health-care insurance premiums.29 Many firms such as Scotts Miracle-Gro Company (based in Marysville, Ohio), IBM, and Microsoft are implementing wellness programs, requiring employees to get healthier or pay higher insurance premiums. Employees that do get healthier win bonuses, free trips, and pay lower premiums; nonconforming employees pay higher premiums and receive no "healthy" benefits. Wellness of employees has become a strategic issue for many firms. Most firms require a health examination as a part of an employment application, and healthiness is more and more becoming a hiring factor. Michael Porter, coauthor of Redefining Health Care, says, "We have this notion that you can gorge on hot dogs, be in a pie-eating contest, and drink every day, and society will take care of you. We can't afford to let individuals drive up company costs because they're not willing to address their own health problems."

Slightly more than 60 percent of companies with 10,000 or more employees had a wellness program in 2008, up from 47 percent in 2005.30 Among firms with wellness programs, the average cost per employee was $7,173. However, in the weak economy of

late, companies are cutting back on their wellness programs. Many employees say they are so stressed about work and finances they have little time to eat right and exercise. PepsiCo in 2008 introduced a $600 surcharge for all its employees that smoke; the company has a smoking-cessation program. PepsiCo's smoking quit rate among employees increased to 34 percent in 2008 versus 20 percent in 2007.

Wellness programs provide counseling to employees and seek lifestyle changes to achieve healthier living. For example, trans fats are a major cause of heart disease. Near elimination of trans fats in one's diet will reduce one's risk for heart attack by as much as 19 percent, according to a recent article. New York City now requires restaurants to inform customers about levels of trans fat being served in prepared foods. Chicago is considering a similar ban on trans fats. Denmark in 2003 became the first country to strictly regulate trans fats.

Restaurant chains are only slowly reducing trans fat levels in served foods because (1) trans fat oils make fried foods crispier, (2) trans fats give baked goods a longer shelf life, (3) trans fat oils can be used multiple times compared to other cooking oils, and
(4) trans fat oils taste better. Three restaurant chains have switched to oils free of trans fat—Chili's, Ruby Tuesday, and Wendy's—but some chains still may use trans fat oils, including Kentucky Fried Chicken, McDonald's, Dunkin' Donuts, Taco Bell, and Burger King. Marriott International in February 2007 eliminated trans fats from the food it serves at its 2,300 North American hotels, becoming the first big hotel chain to do so, although the 18-hotel Lowes luxury chain is close behind. Marriott's change includes its Renaissance, Courtyard, and Residence Inn brands.
Saturated fats are also bad, so one should avoid eating too much red meat and dairy products, which are high in saturated fats. Seven key lifestyle habits listed in Table 7-16 may significantly improve health and longevity.

Modul Manajemen Strategik
Chapter 9 - 12

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Chapter 9
IMPLEMENTING STRATEGIES: MARKETING, FINANCE/ACCOUNTING, R&D, MIS ISSUES

Implementing Strategies: Marketing, Finance/Accounting, R&D, and MIS Issues

A note from David

Strategies have no chance of being implemented successfully in organizations that do not market goods an d services well, in firms that cannot raise needed working capital, in firms that produce technologically inferior products, or in firms that have a weak information system. This chapter examines marketing, finance/accounting, R&D, and management information systems (MIS) issues that are central to effective strategy implementation. Special topics include market segmentation, market positioning, evaluating the worth of a business, determining to what extent debt and/or stock should be used as a source of capital, developing projected financial statements, contracting R&D outside the firm, and creating an information support system. Manager and employee involvement and participation are essential for success in marketing, finance/accounting, R&D, and MIS activities.

The Nature of Strategy Implementation The quarterback can call the best play possible in the huddle, but that does not mean the play will go for a touchdown. The team may even lose yardage unless the play is executed (implemented) well. Less than 10 percent of strategies formulated are successfully implemented! There are many reasons for this low success rate, including failing to appropriately segment markets, paying too much for a new acquisition, and falling behind competitors in R&D. Johnson & Johnson implements strategies well. Strategy implementation directly affects the lives of plant managers, division managers, department managers, sales managers, product managers, project managers, personnel managers, staff managers, supervisors, and all employees. In some situations, individuals may not have participated in the strategy-formulation process at all and may not appreciate, understand, or even accept the work and thought that went into strategy formulation. There may even be foot dragging or resistance on their part. Managers and employees who do not understand the business and are not committed to the business may attempt to sabotage strategy-implementation efforts in hopes that the organization will return to its old ways. The strategy-implementation stage of the strategic-management process is highlighted in Figure 8-1.

Current Marketing Issues

Countless marketing variables affect the success or failure of strategy implementation, and the scope of this text does not allow us to address all those issues. Some examples of marketing decisions that may require policies are as follows:

1. To use exclusive dealerships or multiple channels of distribution
2. To use heavy, light, or no TV advertising
3. To limit (or not) the share of business done with a single customer
4. To be a price leader or a price follower
5. To offer a complete or limited warranty
6. To reward salespeople based on straight salary, straight commission, or a combination salary/commission
7. To advertise online or not

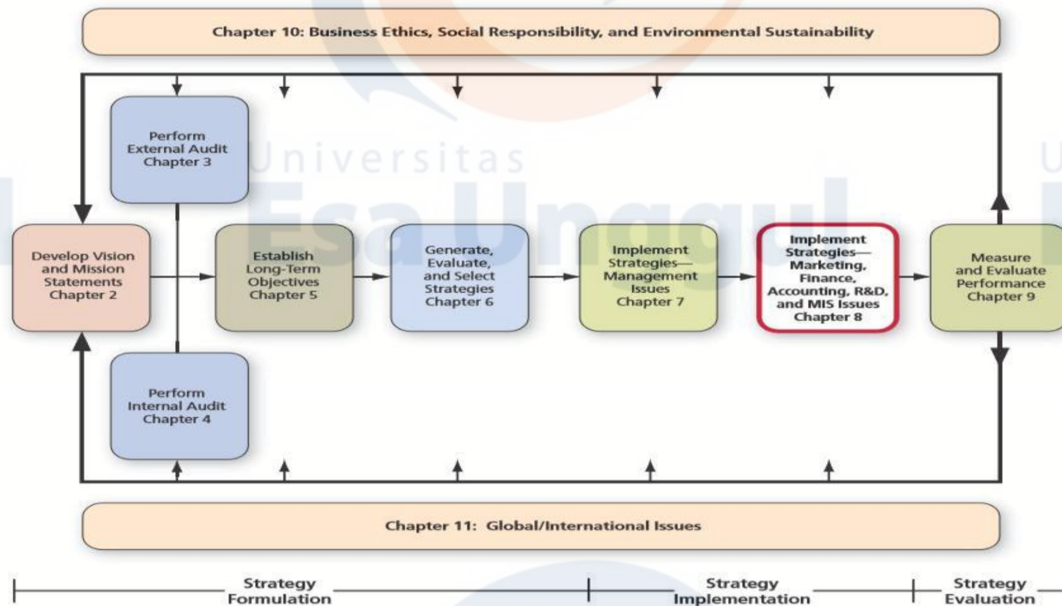
A marketing issue of increasing concern to consumers today is the extent to which companies can track individuals' movements on the Internet—and even be able to identify an individual by name and e-mail address. Individuals' wanderings on the Internet are no longer anonymous, as many persons still believe. Marketing companies such as DoubleClick, Flycast, AdKnowledge, AdForce, and Real Media have sophisticated methods to identify who you are and your particular interests.1 If

you are especially concerned about being tracked, visit the www.networkadvertising.org Web site, which gives details about how marketers today are identifying you and your buying habits.

Marketing of late has become more about building a two-way relationship with consumers than just informing consumers about a product or service. Marketers today must get their customers involved in their company Web site and solicit suggestions from customers in terms of product development, customer service, and ideas. The online community is much quicker, cheaper, and effective than traditional focus groups and surveys. Companies and organizations should encourage their employees to create wikis—Web sites that allows users to add, delete, and edit content regarding frequently asked questions and information across the firm's whole value chain of activities. The most common wiki is Wikipedia, but think of wikis as user-generated content. Know that anyone can change the content in a wiki but the group and other editors can change the content or changes that you submit.

FIGURE 8-1

A Comprehensive Strategic-Management Model



Source: Fred R. David, "How Companies Define Their Mission," *Long Range Planning* 22, no. 3 (June 1988): 40.

Firms should provide incentives to consumers to share their thoughts, opinions, and experiences on the company Web site. Encourage consumers to network among themselves on topics of their choosing on the company Web site. So the company Web site must not be all about the company—it must be all about the customer too. Perhaps offer points or discounts for customers who provide ideas and suggestions. This practice will not only encourage participation but will allow both the company and other customers to interact with "experts."

New Principles of Marketing

Today a business or organization's Web site must provide clear and simple instructions for customers to set up a blog and/or contribute to a wiki. Customers trust each others' opinions more than a company's marketing pitch, and the more they talk freely, the more the firm can learn how to improve its product, service, and marketing. Marketers today monitor blogs daily to determine, evaluate, and influence opinions being formed by customers. Customers must not feel like they are a captive audience for advertising at a firm's Web site. Table 8-1 provides new principles of marketing according to Parise, Guinan, and Weinberg.2

Wells Fargo and Bank of America in 2009 began to tweet customers, meaning they posted messages of 140 characters or less on Twitter.com to describe features of bank products. Some banks are placing marketing videos on YouTube. Discover Financial,

American Express, and Citigroup all now have Facebook or My Space pages. UMB Financial of Kansas City, Missouri, tweets about everything from the bank's financial stability to the industry's prospects. Steve Furman, Discover's director of e-commerce, says the appeal of social networking is that it provides "pure, instant" communication with customers.3

When the big three U.S. automakers were asking lawmakers for bailout funding, all three firms launched extensive Internet marketing campaigns to garner support for their requests and plans for the future. Ford's online marketing campaign was anchored by the Web site www.TheFordStory.com. In addition to a new Web site of its own, Chrysler launched a new marketing YouTube Channel named Grab Democracy and also posted ad information to its blog. GM employed similar marketing tactics to drive visitors to its main Web site. Once any controversial topic arises in a company or industry, millions of people are out there googling, yahooing, aoling, youtubing, facebooking, and myspacing to find out more information in order to form their own opinions and preferences.4

Although the exponential increase in social networking and business online has created huge opportunities for marketers, it also has produced some severe threats. Perhaps the greatest threat is that any king of negative publicity travels fast online. For example, Dr Pepper recently suffered immensely when an attorney for the rock band Guns N' Roses accused the company of not following through on giving every American a soft drink if they released their album Chinese Democracy. Other examples abound, such as Motrin ads that lightheartedly talked about Mom's back pain from holding babies in slings, and Burger King's Whopper Virgin campaign, which featured a taste test of a Whopper versus a McDonald's Big Mac in remote areas of the world. Even Taco Bell suffered from its ads that featured asking 50 Cent (aka Curtis Jackson) if he would change his name to 79 Cent or 89 Cent for a day in exchange for a $10,000 donation to charity. Seemingly minor ethical and questionable actions can catapult these days into huge public relations problems for companies as a result of the monumental online social and business communications. For example, Domino's, the nation's largest pizza delivery chain, spent a month in 2009 trying to dispel the video on YouTube and Facebook showing two of its employees doing gross things to a Domino's sub sandwich, including passing gas on salami.5

In increasing numbers, people living in underdeveloped and poor nations around the world have cell phones but no computers, so the Internet is rapidly moving to cell phone platforms. This is opening up even larger markets to online marketing. People in remote parts of Indonesia, Egypt, and Russia represent the fastest growing customer base for Opera Software ASA, a Norwegian maker of Internet browsers for mobile devices. Actually, persons who cannot afford computers live everywhere in every country, and many of these persons will soon be on the Internet on their cell phones. Cell phones are rapidly becoming used for data transfer, not just for phone calls. Companies such as Nokia, AT&T, Purple Labs SA of France, Japan's Access, Vodafone Group PLC, Siemens AG, Research in Motion, and Apple are spurring this transition by developing new and improved Web-capable mobile products every day.6

TABLE 8-1 The New Principles of Marketing

1. Don't just talk at consumers—work with them throughout the marketing process.
2. Give consumers a reason to participate.
3. Listen to—and join—the conversation outside your company's Web site.
4. Resist the temptation to sell, sell, sell. Instead attract, attract, attract.
5. Don't control online conversations; let it flow freely.
6. Find a "marketing technologist," a person who has three excellent skill sets (marketing, technology, and social interaction).
7. Embrace instant messaging and chatting.

Source: Based on Salvatore Parise, Patricia Guinan, and Bruce Weinberg, "The Secrets of Marketing in a Web 2.0 World," *Wall Street Journal* (December 15, 2008): R1.

Advertising Media

Recent research by Forrester Research reveals that people ages 18 to 27 spend more time weekly on the Internet than watching television, listening to the radio, or watching DVDs or VHS tapes. Table 8-2 reveals why companies are rapidly coming to the realization that social networking sites and video sites are better means of reaching their customers than spending so many marketing dollars on traditional yellow pages or television, magazine, radio, or newspaper ads. Note the time that people spend on the Internet. And it is not just the time. Television viewers are passive viewers of ads, whereas Internet users take an active role in choosing what to look at—so customers on the Internet are tougher for marketers to reach.7

TABLE 8-2 Average Amount of Time That 18- to 27-Year-Olds Spend Weekly on Various Media (in hours)

Media	Hours
On the Internet	High-13.0
Watching television	↓
On their cell phone	
Listening to the Radio	Medium-7.0
Watching DVDs or VHSs	↓
Playing video games	
Reading magazines	Low-1.0

Source: Based on Ellen Byron, "A New Odd Couple: Google, P&G Swap Workers to Spur Innovation," *Wall Street Journal* (November 19, 2008): A1.

New companies such as Autonet Mobile based in San Francisco are selling new technology equipment for cars so the front passenger may conduct an iChat video conference while persons in the back each have a laptop and watch a YouTube video or download music or wirelessly transfer pictures from a digital camera. Everyone in the vehicle can be online except, of course, the driver. This technology is now available for installation in nearly all cars and is accelerating the movement from hard media to Webbased media. With this technology also, when the vehicle drives into a new location, you may instantly download information on shows, museums, hotels, and other attractions around you.

Growth of Internet advertising is expected to decline from a 16 percent increase in 2008 to a 5 percent increase in 2009. With this slowdown, companies are changing the restrictions they previously imposed on the categories and formats of advertising. For example, marketers are more and more allowed to create bigger, more intrusive ads that take up more space on the Web page. And Web sites are allowing lengthier ads to run before short video clips play. And blogs are creating more content that doubles also as an ad. Companies are also waiving minimum ad purchases. Companies are redesigning their Web sites to be much more interactive and are building new sponsorship programs and other enticements on their sites. Editorial content and advertising content are increasingly being mixed on blogs.

In 2009–2011, consumers will act rationally. JC Penney CEO Mike Ullman says, "Consumers now shop for what they 'need' and less for what they 'want.' And they

don't need much." Essentials, such as food, health-care products, and beauty aids are selling, but even in those industries, consumers are shifting to less costly brands and stores. There is a need for marketers to convince consumers that their brand will make life easier or better. Consumers now often wait until prices are slashed 75 percent or more to buy. Consumers today are very cautious about how they spend their money. Gone are the days when retailers could convince consumers to buy something they do not need.

JC Penney is among many firms that today have revamped their marketing to be more digital related. Penney's is segmenting its e-mail databases according to customers' shopping behaviors and then sending out relevant messages. Penney's corporate director of brand communications recently said, "Tailoring the e-mail insures that our customers are receiving timely, relevant information."

Expectations for total U.S. advertising spending in 2009 may decline anywhere from 6.2 percent to 3 percent to about $160 billion as the fallout from global financial crises continues to cut into ad spending.8 Global ad spending is expected to decline about 0.5 percent. One bright spot, however, is online advertising expenditures that are expected to increase 5 percent in 2009 following a 16 percent increase in 2008. Companies are shifting ad dollars from newspaper, magazine, and radio to online media.

Purpose-Based Marketing

The global marketing chief at Procter & Gamble, Jim Stengel, recently started his own LLC business to try to persuade companies that the best way to sell in a weak economy is to "show customers how they can improve their lives" with your product or service. Stengel calls this "purpose-based marketing," and hundreds of firms have now adopted this approach successfully. He says there is need in an ad to build trust and an emotional connection to the customer in order to differentiate your product or service.9

In a weak economy when consumers are more interested in buying cheaper brands, Stengel acknowledges that ads must promote price, but he says ads must also show the intrinsic value of the product or service to be cost effective. Stengel contends that ads

should do both: promote low price and build emotional equity through "purpose-based appeal."

The Coca-Cola Company is leading the way to another new kind of selling in a weak economy. CEO Muhtar Kent at Coke says marketing today must "employ optimism." That is why Coca-Cola launched a new global ad campaign in 2009 appealing to consumers' longing for comfort and optimism. The new campaign features the new slogan "Open Happiness," which replaced Coke's prior popular slogan of three years, "The Coke Side of Life." The Coke CEO says marketers must use feel-good messages to counter the fallout from the economic crisis. Firms must today project to customers that their products or services offer a beacon of comfort and optimism. Coke's cola volume declined 4.0 percent in the United States in 2008. Coke Classic's U.S. volume fell about 16 percent from 1998 through 2007 as customers switched to bottled water, enhanced teas, and other alternative drinks.10

Market Segmentation

Two variables are of central importance to strategy implementation: market segmentation and product positioning. Market segmentation and product positioning rank as marketing's most important contributions to strategic management.

Market segmentation is widely used in implementing strategies, especially for small and specialized firms. Market segmentation can be defined as the subdividing of a market into distinct subsets of customers according to needs and buying habits.

TABLE 8-3 The Marketing Mix Component Variables

Product	Place	Promotion	Price
Quality	Distribution channels	Advertising	Level
Features and options	Distribution coverage	Personal selling	Discounts and allowances
Style	Outlet location	Sales promotion	Payment terms
Brand name	Sales territories	Publicity	
Packaging	Inventory levels and locations		
Product line	Transportation carriers		
Warranty			
Service level			
Other services			

Source: From E. Jerome McCarthy, *Basic Marketing: A Managerial Approach*, 9th ed. (Homewood, IL: Richard D. Irwin, Inc., 1987): 37–44. Used with permission.

Market segmentation is an important variable in strategy implementation for at least three major reasons. First, strategies such as market development, product development, market penetration, and diversification require increased sales through new markets and products. To implement these strategies successfully, new or improved market-segmentation approaches are required. Second, market segmentation allows a firm to operate with limited resources because mass production, mass distribution, and mass advertising are not required. Market segmentation enables a small firm to compete successfully with a large firm by maximizing per-unit profits and per-segment sales. Finally, market segmentation decisions directly affect marketing mix variables: product, place, promotion, and price, as indicated in Table 8-3. For example, SnackWells, a pioneer in reduced-fat snacks, has shifted its advertising emphasis from low-fat to great taste as part of its new market-segmentation strategy.

Perhaps the most dramatic new market-segmentation strategy is the targeting of regional tastes. Firms from McDonald's to General Motors are increasingly modifying their products to meet different regional preferences within the United States. Campbell's has a spicier version of its nacho cheese soup for the Southwest, and Burger King offers breakfast burritos in New Mexico but not in South Carolina. Geographic and demographic bases for segmenting markets are the most commonly employed, as illustrated in Table 8-4.

Evaluating potential market segments requires strategists to determine the characteristics and needs of consumers, to analyze consumer similarities and differences, and to develop consumer group profiles. Segmenting consumer markets is generally much simpler and easier than segmenting industrial markets, because industrial products, such as electronic circuits and forklifts, have multiple applications and appeal to diverse customer groups.

Segmentation is a key to matching supply and demand, which is one of the thorniest problems in customer service. Segmentation often reveals that large, random fluctuations in demand actually consist of several small, predictable, and manageable patterns. Matching supply and demand allows factories to produce desirable levels without extra shifts, overtime, and subcontracting. Matching supply and demand also minimizes the number and severity of stock-outs. The demand for hotel rooms, for

example, can be dependent on foreign tourists, businesspersons, and vacationers. Focusing separately on these three market segments, however, can allow hotel firms to more effectively predict overall supply and demand.

Banks now are segmenting markets to increase effectiveness. “You’re dead in the water if you aren’t segmenting the market,” says Anne Moore, president of a bank consulting firm in Atlanta. The Internet makes market segmentation easier today because consumers naturally form “communities” on the Web.

Does the Internet Make Market Segmentation Easier? Yes. The segments of people whom marketers want to reach online are much more precisely defined than the segments of people reached through traditional forms of media, such as television, radio, and magazines. For example, Quepasa.com is widely visited by Hispanics. Marketers aiming to reach college students, who are notoriously difficult to reach via traditional media, focus on sites such as collegeclub.com and studentadvantage.com. The gay and lesbian population, which is estimated to comprise about 5 percent of the U.S. population, has always been difficult to reach via traditional media but now can be focused on at sites such as gay.com. Marketers can reach persons interested in specific topics, such as travel or fishing, by placing banners on related Web sites.

People all over the world are congregating into virtual communities on the Web by becoming members/customers/visitors of Web sites that focus on an endless range of topics. People in essence segment themselves by nature of the Web sites that comprise their “favorite places,” and many of these Web sites sell information regarding their “visitors.” Businesses and groups of individuals all over the world pool their purchasing power in Web sites to get volume discounts.

TABLE 8-4 Alternative Bases for Market Segmentation

Variable	Typical Breakdowns
	Geographic
Region	Pacific, Mountain, West North Central, West South Central, East North Central, East South Central, South Atlantic, Middle Atlantic, New England
County Size	A, B, C, D
City Size	Under 5,000; 5,000–20,000; 20,001–50,000; 50,001–100,000; 100,001–250,000; 250,001–500,000; 500,001–1,000,000; 1,000,001–4,000,000; 4,000,001 or over
Density	Urban, suburban, rural
Climate	Northern, southern
	Demographic
Age	Under 6, 6–11, 12–19, 20–34, 35–49, 50–64, 65+
Gender	Male, female
Family Size	1–2, 3–4, 5+
Family Life Cycle	Young, single; young, married, no children; young, married, youngest child under 6; young, married, youngest child 6 or over; older, married, with children; older, married, no children under 18; older, single; other
Income	Under $10,000; $10,001–$15,000; $15,001–$20,000; $20,001–$30,000; $30,001–$50,000; $50,001–$70,000; $70,001–$100,000; over $100,000
Occupation	Professional and technical; managers, officials, and proprietors; clerical and sales; craftspeople; foremen; operatives; farmers; retirees; students; housewives; unemployed
Education	Grade school or less; some high school; high school graduate; some college; college graduate
Religion	Catholic, Protestant, Jewish, Islamic, other
Race	White, Asian, Hispanic, African American
Nationality	American, British, French, German, Scandinavian, Italian, Latin American, Middle Eastern, Japanese
	Psychographic
Social Class	Lower lowers, upper lowers, lower middles, upper middles, lower uppers, upper uppers
Personality	Compulsive, gregarious, authoritarian, ambitious
	Behavioral
Use Occasion	Regular occasion, special occasion
Benefits Sought	Quality, service, economy
User Status	Nonuser, ex-user, potential user, first-time user, regular user
Usage Rate	Light user, medium user, heavy user
Loyalty Status	None, medium, strong, absolute
Readiness Stage	Unaware, aware, informed, interested, desirous, intending to buy
Attitude Toward Product	Enthusiastic, positive, indifferent, negative, hostile

Source: Adapted from Philip Kotler, *Marketing Management: Analysis, Planning and Control*, © 1984: 256. Adapted by permission of Prentice-Hall, Inc., Upper Saddle River, New Jersey.

Product Positioning

After markets have been segmented so that the firm can target particular customer groups, the next step is to find out what customers want and expect. This takes analysis and research. A severe mistake is to assume the firm knows what customers want and expect. Countless research studies reveal large differences between how customers define service and rank the importance of different service activities and how producers view services. Many firms have become successful by filling the gap between what customers and producers see as good service. What the customer believes is good service is paramount, not what the producer believes service should be.

Identifying target customers to focus marketing efforts on sets the stage for deciding how to meet the needs and wants of particular consumer groups. Product positioning is widely used for this purpose. Positioning entails developing schematic representations that reflect how your products or services compare to competitors' on dimensions most important to success in the industry. The following steps are required in product positioning:

1. Select key criteria that effectively differentiate products or services in the industry.
2. Diagram a two-dimensional product-positioning map with specified criteria on each axis.
3. Plot major competitors' products or services in the resultant four-quadrant matrix.
4. Identify areas in the positioning map where the company's products or services could be most competitive in the given target market. Look for vacant areas (niches).
5. Develop a marketing plan to position the company's products or services appropriately.

Because just two criteria can be examined on a single product-positioning map, multiple maps are often developed to assess various approaches to strategy implementation. Multidimensional scalingcould be used to examine three or more criteria simultaneously, but this technique requires computer assistance and is beyond the scope of this text. Some examples of product-positioning maps are illustrated in Figure 8-2.

Some rules for using product positioning as a strategy-implementation tool are the following:

1. Look for the hole or vacant niche. The best strategic opportunity might be an unserved segment.
2. Don't serve two segments with the same strategy. Usually, a strategy successful with one segment cannot be directly transferred to another segment.
3. Don't position yourself in the middle of the map. The middle usually means a strategy that is not clearly perceived to have any distinguishing characteristics. This rule can vary with the number of competitors. For example, when there are only two competitors, as in U.S. presidential elections, the middle becomes the preferred strategic position.11

An effective product-positioning strategy meets two criteria: (1) it uniquely distinguishes a company from the competition, and (2) it leads customers to expect slightly less service than a company can deliver. Firms should not create expectations that exceed the service the firm can or will deliver. Network Equipment Technology is an example of a company that keeps customer expectations slightly below perceived performance. This is a constant challenge for marketers. Firms need to inform customers about what to expect and then exceed the promise. Underpromise and then overdeliver is the key!

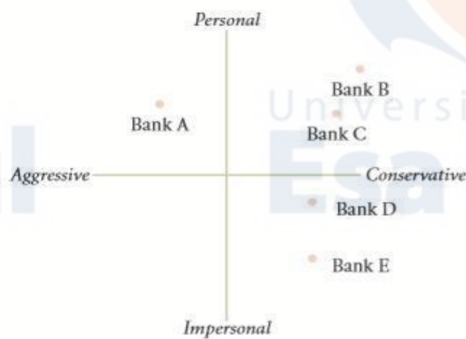
Finance/Accounting

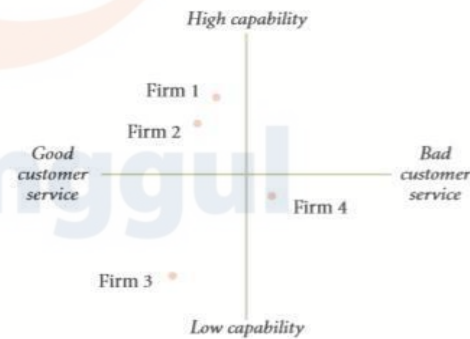
Issues In this section, we examine several finance/accounting concepts considered to be central to strategy implementation: acquiring needed capital, developing projected financial statements, preparing financial budgets, and evaluating the worth of a business. Some examples of decisions that may require finance/accounting policies are these:

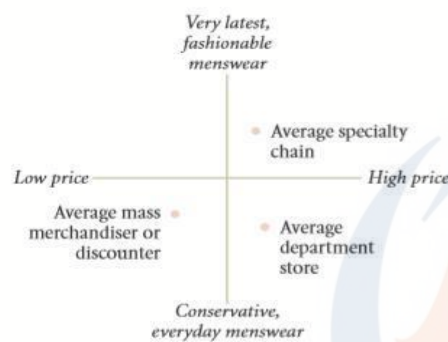
1. To raise capital with short-term debt, long-term debt, preferred stock, or common stock
2. To lease or buy fixed assets
3. To determine an appropriate dividend payout ratio
4. To use LIFO (Last-in, First-out), FIFO (First-in, First-out), or a market-value accounting approach
5. To extend the time of accounts receivable
6. To establish a certain percentage discount on accounts within a specified period of time
7. To determine the amount of cash that should be kept on hand

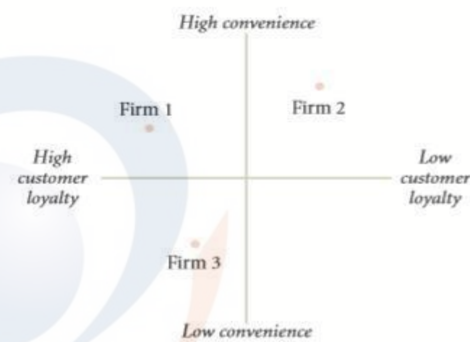
FIGURE 8-2

Examples of Product-Positioning Maps









Acquiring Capital to Implement Strategies

Successful strategy implementation often requires additional capital. Besides net profit from operations and the sale of assets, two basic sources of capital for an organization are debt and equity. Determining an appropriate mix of debt and equity in a firm's capital structure can be vital to successful strategy implementation. An Earnings Per Share/Earnings Before Interest and Taxes (EPS/EBIT) analysis is the most widely used technique for determining whether debt, stock, or a combination of debt and stock is the best alternative for raising capital to implement strategies. This technique involves an examination of the impact that debt versus stock financing has on earnings per share under various assumptions as to EBIT.

Theoretically, an enterprise should have enough debt in its capital structure to boost its return on investment by applying debt to products and projects earning more than the cost of the debt. In low earning periods, too much debt in the capital structure of an organization can endanger stockholders' returns and jeopardize company survival.

Fixed debt obligations generally must be met, regardless of circumstances. This does not mean that stock issuances are always better than debt for raising capital. Some special concerns with stock issuances are dilution of ownership, effect on stock price, and the need to share future earnings with all new shareholders.

Without going into detail on other institutional and legal issues related to the debt versus stock decision, EPS/EBIT may be best explained by working through an example. Let's say the Brown Company needs to raise $1 million to finance implementation of a market-development strategy. The company's common stock currently sells for $50 per share, and 100,000 shares are outstanding. The prime interest rate is 10 percent, and the company's tax rate is 50 percent. The company's earnings before interest and taxes next year are expected to be $2 million if a recession occurs, $4 million if the economy stays as is, and $8 million if the economy significantly improves. EPS/EBIT analysis can be used to determine if all stock, all debt, or some combination of stock and debt is the best capital financing alternative. The EPS/EBIT analysis for this example is provided in Table 8-5.

As indicated by the EPS values of 9.5, 19.50, and 39.50 in Table 8-5, debt is the best financing alternative for the Brown Company if a recession, boom, or normal year is expected. An EPS/EBIT chart can be constructed to determine the break-even point, where one financing alternative becomes more attractive than another. Figure 8-3 indicates that issuing common stock is the least attractive financing alternative for the Brown Company. EPS/EBIT analysis is a valuable tool for making the capital financing decisions needed to implement strategies, but several considerations should be made whenever using this technique. First, profit levels may be higher for stock or debt alternatives when EPS levels are lower. For example, looking only at the earnings after taxes (EAT) values in Table 8-5, you can see that the common stock option is the best alternative, regardless of economic conditions. If the Brown Company's mission includes strict profit maximization, as opposed to the maximization of stockholders' wealth or some other criterion, then stock rather than debt is the best choice of financing.

TABLE 8-5 EPS/EBIT Analysis for the Brown Company (in millions)

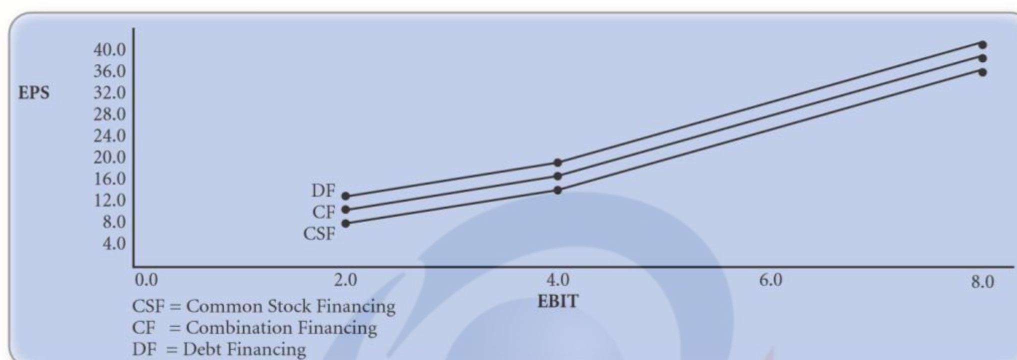
	Common Stock Financing			Debt Financing			Combination Financing		
	Recession	*Normal*	*Boom*	*Recession*	*Normal*	*Boom*	*Recession*	*Normal*	*Boom*
EBIT	$2.0	$ 4.0	$ 8.0	$2.0	$ 4.0	$ 8.0	$2.0	$ 4.0	$ 8.0
Interest[a]	0	0	0	.10	.10	.10	.05	.05	.05
EBT	2.0	4.0	8.0	1.9	3.9	7.9	1.95	3.95	7.95
Taxes	1.0	2.0	4.0	.95	1.95	3.95	.975	1.975	3.975
EAT	1.0	2.0	4.0	.95	1.95	3.95	.975	1.975	3.975
#Shares[b]	.12	.12	.12	.10	.10	.10	.11	.11	.11
EPS[c]	8.33	16.66	33.33	9.5	19.50	39.50	8.86	17.95	36.14

[a]The annual interest charge on $1 million at 10% is $100,000 and on $0.5 million is $50,000. This row is in $, not %.
[b]To raise all of the needed $1 million with stock, 20,000 new shares must be issued, raising the total to 120,000 shares outstanding. To raise one-half of the needed $1 million with stock, 10,000 new shares must be issued, raising the total to 110,000 shares outstanding.
[c]EPS = Earnings After Taxes (EAT) divided by shares (number of shares outstanding).

Another consideration when using EPS/EBIT analysis is flexibility. As an organization's capital structure changes, so does its flexibility for considering future capital needs. Using all debt or all stock to raise capital in the present may impose fixed obligations, restrictive covenants, or other constraints that could severely reduce a firm's ability to raise additional capital in the future. Control is also a concern. When additional stock is issued to finance strategy implementation, ownership and control of the enterprise are diluted. This can be a serious concern in today's business environment of hostile takeovers, mergers, and acquisitions.

FIGURE 8-3

An EPS/EBIT Chart for the Brown Company



Dilution of ownership can be an overriding concern in closely held corporations in which stock issuances affect the decision-making power of majority stockholders. For example, the Smucker family owns 30 percent of the stock in Smucker's, a well-known jam and jelly company. When Smucker's acquired Dickson Family, Inc., the company used mostly debt rather than stock in order not to dilute the family ownership.

When using EPS/EBIT analysis, timing in relation to movements of stock prices, interest rates, and bond prices becomes important. In times of depressed stock prices, debt may prove to be the most suitable alternative from both a cost and a demand standpoint. However, when cost of capital (interest rates) is high, stock issuances become more attractive.

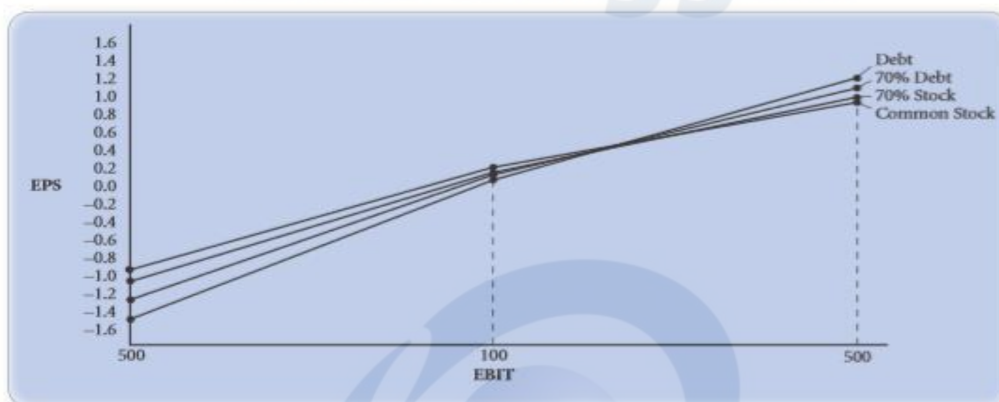
Tables 8-6 and 8-7 provide EPS/EBIT analyses for two companies—Gateway and Boeing. Notice in those analyses that the combination stock/debt options vary from 30/70 to 70/30. Any number of combinations could be explored. However, sometimes in preparing the EPS/EBIT graphs, the lines will intersect, thus revealing break-even points at which one financing alternative becomes more or less attractive than another. The slope of these lines will be determined by a combination of factors including stock price, interest rate, number of shares, and amount of capital needed. Also, it should be noted here that the best financing alternatives are indicated by the highest EPS values. In Tables 8-6 and 8-7, note that the tax rates for the companies vary considerably and should be computed from the respective income statements by dividing taxes paid by income before taxes.

In Table 8-6, the higher EPS values indicate that Gateway should use stock to raise capital in recession or normal economic conditions but should use debt financing under boom conditions. Stock is the best alternative for Gateway under all three conditions if EAT (profit maximization) were the decision criteria, but EPS (maximize shareholders' wealth) is the better ratio to make this decision. Firms can do many things in the short run to maximize profits, so investors and creditors consider maximizing shareholders' wealth to be the better criteria for making financing decisions.

TABLE 8-6 EPS/EBIT Analysis for Gateway (M = In Millions)

Amount Needed: $1,000 M
EBIT Range: – $500 M to + $100 M to + $500 M
Interest Rate: 5%
Tax Rate: 0% (because the firm has been incurring a loss annually)
Stock Price: $6.00
# of Shares Outstanding: 371 M

	Common Stock Financing			Debt Financing		
	Recession	*Normal*	*Boom*	*Recession*	*Normal*	*Boom*
EBIT	(500.00)	100.00	500.00	(500.00)	100.00	500.00
Interest	0.00	0.00	0.00	50.00	50.00	50.00
EBT	(500.00)	100.00	500.00	(550.00)	50.00	450.00
Taxes	0.00	0.00	0.00	0.00	0.00	0.00
EAT	(500.00)	100.00	500.00	(550.00)	50.00	450.00
#Shares	537.67	537.67	537.67	371.00	371.00	371.00
EPS	**(0.93)**	**0.19**	**0.93**	**(1.48)**	**0.13**	**1.21**
	70 Percent Stock—30 Percent Debt			70 Percent Debt—30 Percent Stock		
	Recession	*Normal*	*Boom*	*Recession*	*Normal*	*Boom*
EBIT	(500.00)	100.00	500.00	(500.00)	100.00	500.00
Interest	15.00	15.00	15.00	35.00	35.00	35.00
EBT	(515.00)	85.00	485.00	(535.00)	65.00	465.00
Taxes	0.00	0.00	0.00	0.00	0.00	0.00
EAT	(515.00)	85.00	485.00	(535.00)	65.00	465.00
#Shares	487.67	487.67	487.67	421.00	421.00	421.00
EPS	**(1.06)**	**0.17**	**0.99**	**(1.27)**	**0.15**	**1.10**



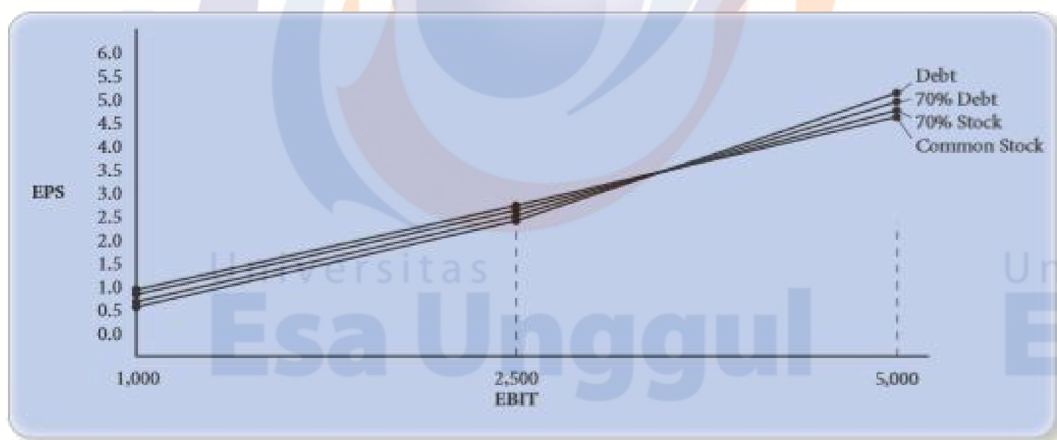
Conclusion: Gateway should use common stock to raise capital in recession or normal economic conditions but should use debt financing under boom conditions. Note that stock is the best alternative under all three conditions according to EAT (profit maximization), but EPS (maximize shareholders' wealth) is the better ratio to make this decision.

TABLE 8-7 EPS/EBIT Analysis for Boeing (M = In Millions)

Amount Needed: $10,000 M
Interest Rate: 5%
Tax Rate: 7%
Stock Price: $53.00
# of Shares Outstanding: 826 M

	Common Stock Financing			Debt Financing		
	Recession	*Normal*	*Boom*	*Recession*	*Normal*	*Boom*
EBIT	1,000.00	2,500.00	5,000.00	1,000.00	2,500.00	5,000.00
Interest	0.00	0.00	0.00	500.00	500.00	500.00
EBT	1,000.00	2,500.00	5,000.00	500.00	2,000.00	4,500.00
Taxes	70.00	175.00	350.00	35.00	140.00	315.00
EAT	930.00	2,325.00	4,650.00	465.00	1,860.00	4,185.00
# Shares	1,014.68	1,014.68	1,014.68	826.00	826.00	826.00
EPS	**0.92**	**2.29**	**4.58**	**0.56**	**2.25**	**5.07**

	70% Stock—30% Debt			70% Debt—30% Stock		
	Recession	*Normal*	*Boom*	*Recession*	*Normal*	*Boom*
EBIT	1,000.00	2,500.00	5,000.00	1,000.00	2,500.00	5,000.00
Interest	150.00	150.00	150.00	350.00	350.00	350.00
EBT	850.00	2,350.00	4,850.00	650.00	2,150.00	4,650.00
Taxes	59.50	164.50	339.50	45.50	150.50	325.50
EAT	790.50	2,185.50	4,510.50	604.50	1,999.50	4,324.50
# Shares	958.08	958.08	958.08	882.60	882.60	882.60
EPS	**0.83**	**2.28**	**4.71**	**0.68**	**2.27**	**4.90**



Conclusion: Boeing should use common stock to raise capital in recession (see 0.92) or normal (see 2.29) economic conditions but should use debt financing under boom conditions (see 5.07). Note that a dividends row is absent from this analysis. The more shares outstanding, the more dividends to be paid (if the firm pays dividends), which would lower the common stock EPS values.

In Table 8-7, note that Boeing should use stock to raise capital in recession (see 0.92) or normal (see 2.29) economic conditions but should use debt financing under boom conditions (see 5.07). Let's calculate here the number of shares figure of 1014.68 given under Boeing's stock alternative. Divide $10,000 M funds needed by the stock price of $53 = 188.68 M new shares to be issued + the 826 M shares outstanding

already = 1014.68 M shares under the stock scenario. Along the final row, EPS is the number of shares outstanding divided by EAT in all columns.
Note in Table 8-6 and Table 8-7 that a dividends row is absent from both the Gateway and Boeing analyses. The more shares outstanding, the more dividends to be paid (if the firm indeed pays dividends). Paying dividends lowers EAT, which lowers the stock EPS values whenever this aspect is included. To consider dividends in an EPS/EBIT analysis, simply insert another row for "Dividends" right below the "EAT" row and then insert an "Earnings After Taxes and Dividends" row. Considering dividends would make the analysis more robust.

Note in both the Gateway and Boeing graphs, there is a break-even point between the normal and boom range of EBIT where the debt option overtakes the 70% Debt/30% Stock option as the best financing alternative. A break-even point is where two lines cross each other. A break-even point is the EBIT level where various financing alternative represented by lines crossing are equally attractive in terms of EPS. Both the Gateway and Boeing graphs indicate that EPS values are highest for the 100 percent debt option at high EBIT levels. The two graphs also reveal that the EPS values for 100 percent debt increase faster than the other financing options as EBIT levels increase beyond the break-even point. At low levels of EBIT however, both the Gateway and Boeing graphs indicate that 100 percent stock is the best financing alternative because the EPS values are highest.

New Source of Funding

Credit unions were not involved in the subprime-loan market, so many of them are flush with cash and are making loans, especially to small businesses. Deposits to credit unions were also up when many investors abandoned the stock market. Roughly 27 percent of the 8,147 U.S. credit unions offer business loans.12 The amount of businesses loans was up 18 percent in 2008 to $33 billion, and the average loan size was $215,000.

Many credit unions want to give more business loans, but the 1998 federal law (Credit Union Membership Access Act) caps the amount of business loans credit unions can have at 12.25 percent of their assets. Credit unions are trying to get this law changed,

but of course banks are lobbying hard to have the law remain in place. Credit unions are chartered as nonprofit cooperative institutions owned by their members. Thus credit unions are taxexempt organizations. Bankers argue that allowing credit unions to give more business loans would give them an unfair competitive advantage over traditional banks.

Projected Financial Statements

Projected financial statement analysisis a central strategy-implementation technique because it allows an organization to examine the expected results of various actions and approaches. This type of analysis can be used to forecast the impact of various implementation decisions (for example, to increase promotion expenditures by 50 percent to support a market-development strategy, to increase salaries by 25 percent to support a market-penetration strategy, to increase research and development expenditures by 70 percent to support product development, or to sell $1 million of common stock to raise capital for diversification). Nearly all financial institutions require at least three years of projected financial statements whenever a business seeks capital. Aprojected income statement and balance sheet allow an organization to compute projected financial ratios under various strategy-implementation scenarios.
When compared to prior years and to industry averages, financial ratios provide valuable insights into the feasibility of various strategy-implementation approaches.

Primarily as a result of the Enron collapse and accounting scandal and the ensuing Sarbanes-Oxley Act, companies today are being much more diligent in preparing projected financial statements to “reasonably rather than too optimistically” project future expenses and earnings. There is much more care not to mislead shareholders and other constituencies.13
A 2011 projected income statement and a balance sheet for the Litten Company are provided in Table 8-8. The projected statements for Litten are based on five assumptions: (1) The company needs to raise $45 million to finance expansion into foreign markets; (2) $30 million of this total will be raised through increased debt and $15 million through common stock; (3) sales are expected to increase 50 percent; (4) three new facilities, costing a total of $30 million, will be constructed in foreign

markets; and (5) land for the new facilities is already owned by the company. Note in Table 8-8 that Litten's

TABLE 8-8 A Projected Income Statement and Balance Sheet for the Litten Company (in millions)

	Prior Year 2010	Projected Year 2011	Remarks
PROJECTED INCOME STATEMENT			
Sales	$100	$150.00	50% increase
Cost of Goods Sold	70	105.00	70% of sales
Gross Margin	30	45.00	
Selling Expense	10	15.00	10% of sales
Administrative Expense	5	7.50	5% of sales
Earnings Before Interest and Taxes	15	22.50	
Interest	3	3.00	
Earnings Before Taxes	12	19.50	
Taxes	6	9.75	50% rate
Net Income	**6**	**9.75**	
Dividends	2	5.00	
Retained Earnings	4	4.75	
PROJECTED BALANCE SHEET			
Assets			
Cash	5	7.75	Plug figure
Accounts Receivable	2	4.00	100% increase
Inventory	20	45.00	
Total Current Assets	27	56.75	
Land	15	15.00	
Plant and Equipment	50	80.00	Add three new plants at $10 million each
Less Depreciation	10	20.00	
Net Plant and Equipment	40	60.00	
Total Fixed Assets	55	75.00	
Total Assets	**82**	**131.75**	
Liabilities			
Accounts Payable	10	10.00	
Notes Payable	10	10.00	
Total Current Liabilities	20	20.00	
Long-term Debt	40	70.00	Borrowed $30 million
Additional Paid-in-Capital	20	35.00	Issued 100,000 shares at $150 each
Retained Earnings	2	6.75	$2 + $4.75
Total Liabilities and Net Worth	**82**	**131.75**	

strategies and their implementation are expected to result in a sales increase from $100 million to $150 million and in a net increase in income from $6 million to $9.75 million in the forecasted year.

There are six steps in performing projected financial analysis:

1. Prepare the projected income statement before the balance sheet. Start by forecasting sales as accurately as possible. Be careful not to blindly push historical percentages into the future with regard to revenue (sales) increases. Be mindful of what the firm did to achieve those past sales increases, which may not be appropriate for the future unless the firm takes similar or analogous actions (such as opening a similar number of stores, for example). If dealing with a manufacturing firm, also be mindful that if the firm is operating at 100 percent

capacity running three eighthour shifts per day, then probably new manufacturing facilities (land, plant, and equipment) will be needed to increase sales further.

2. Use the percentage-of-sales method to project cost of goods sold (CGS) and the expense items in the income statement. For example, if CGS is 70 percent of sales in the prior year (as it is in Table 8-8), then use that same percentage to calculate CGS in the future year—unless there is a reason to use a different percentage. Items such as interest, dividends, and taxes must be treated independently and cannot be forecasted using the percentage-of-sales method.
3. Calculate the projected net income.
4. Subtract from the net income any dividends to be paid for that year. This remaining net income is retained earnings (RE). Bring this retained earnings amount for that year (NI - DIV = RE) over to the balance sheet by adding it to the prior year's RE shown on the balance sheet. In other words, every year a firm adds its RE for that particular year (from the income statement) to its historical RE total on the balance sheet. Therefore, the RE amount on the balance sheet is a cumulative number rather than money available for strategy implementation! Note that RE is the first projected balance sheet item to be entered. Due to this accounting procedure in developing projected financial statements, the RE amount on the balance sheet is usually a large number. However, it also can be a low or even negative number if the firm has been incurring losses. The only way for RE to decrease from one year to the next on the balance sheet is (1) if the firm incurred an earnings loss that year or (2) the firm had positive net income for the year but paid out dividends more than the net income. Be mindful that RE is the key link between a projected income statement and balance sheet, so be careful to make this calculation correctly.
5. Project the balance sheet items, beginning with retained earnings and then forecasting stockholders' equity, long-term liabilities, current liabilities, total liabilities, total assets, fixed assets, and current assets (in that order). Use the cash account as the plug figure—that is, use the cash account to make the assets total the liabilities and net worth. Then make appropriate adjustments. For example, if the cash needed to balance the statements is too small (or too large), make appropriate changes to borrow more (or less) money than planned.

6. List comments (remarks) on the projected statements. Any time a significant change is made in an item from a prior year to the projected year, an explanation (remark) should be provided. Remarks are essential because otherwise pro formas are meaningless.

Projected Financial Statement Analysis for Mattel,Inc.

Because so many strategic management students have limited experience developing projected financial statements, let's apply the steps outlined on the previous pages to Mattel, the huge toy company headquartered in El Segundo, California. Mattel designs, manufactures, and markets toy products from fashion dolls to children's books. The company Web site is www.mattel.com. Mattel's recent income statements and balance sheets are provided in Table 8-9 and Table 8-10 respectively.

TABLE 8-9 Mattel's Actual Income Statements (in thousands)

	2006	2005	2004
Total Revenue	$5,650,156	5,179,016	5,102,786
Cost of Revenue	3,038,363	2,806,148	2,692,061
Gross Profit	2,611,793	2,372,868	2,410,725
Operating Expenses			
Research Development	-	-	-
Selling General and Administrative	1,882,975	1,708,339	1,679,908
Non-Recurring	-	-	-
Others	-	-	-
Total Operating Expenses	-	-	-
Operating Income or Loss	728,818	664,529	730,817
Income from Continuing Operations			
Total Other Income/Expenses Net	34,791	64,010	43,201
Earnings Before Interest and Taxes	763,609	728,539	774,018
Interest Expense	79,853	76,490	77,764
Income Before Tax	683,756	652,049	696,254
Income Tax Expense	90,829	235,030	123,531
Minority Interest	-	-	-
Net Income from Continuing Ops	592,927	417,019	572,723
Non-Recurring Events			
Discontinued Operations	-	-	-
Extraordinary Items	-	-	-
Effect of Accounting Changes	-	-	-
Other Items	-	-	-
Net Income	592,927	417,019	572,723
Preferred Stock and Other Adjustments	-	-	-
Net Income Applicable to Common Shares	$592,927	$417,019	$572,723

In Tables 8-11 and 8-12, Mattel's projected income statements and balance sheets respectively for 2007, 2008, and 2009 are provided based on the firm pursuing the following strategies:

1. The company desires to build 20 Mattel stores annually at a cost of $1 million each.
2. The company plans to develop new toy products at an annual cost of $10 million.
3. The company plans to increase its advertising/promotion expenditures 30 percent over three years, at a cost of $30 million ($10 million per year).
4. The company plans to buy back $100 million of its own stock (called Treasury stock) annually for the next three years.
5. The company expects revenues to increase 10 percent annually with the above strategies. Mattel can handle this increase with existing production facilities.
6. Dividend payout will be increased from 57 percent of net income to 60 percent.
7. To finance the $380 million total cost for the above strategies, Mattel plans to use long-term debt for $150 million ($50 million per year for three years) and $230 million by issuing stock ($77 million per year for three years).

The Mattel projected financial statements were prepared using the six steps outlined on prior pages and the above seven strategy statements. Note the cash account is used as the plug figure, and it is too high, so Mattel could reduce this number and concurrently reduce a liability and/or equity account the same amount to keep the statement in balance. Rarely is the cash account perfect on the first pass through, so adjustments are needed and made. However, these adjustments are not made on the projected statements given in

TABLE 8-10 Mattel's Actual Balance Sheets (in thousands)

	2006	2005	2004
Assets			
Current Assets			
Cash and Cash Equivalents	$1,205,552	997,734	1,156,835
Short-Term Investments	–	–	–
Net Receivables	943,813	760,643	759,033
Inventory	383,149	376,897	418,633
Other Current Assets	317,624	277,226	302,649
Total Current Assets	2,850,138	2,412,500	2,637,150
Long-Term Investments	–	–	–
Property, Plant, and Equipment	536,749	547,104	586,526
Goodwill	845,324	718,069	735,680
Intangible Assets	70,593	20,422	22,926
Accumulated Amortization	–	–	–
Other Assets	149,912	178,304	201,836
Deferred Long-Term Asset Charges	503,168	495,914	572,374
Total Assets	$4,955,884	4,372,313	4,756,492
Liabilities			
Current Liabilities			
Accounts Payable	$1,518,234	1,245,191	1,303,822
Short/Current Long-Term Debt	64,286	217,994	423,349
Other Current Liabilities	–	–	–
Total Current Liabilities	1,582,520	1,463,185	1,727,171
Long-Term Debt	635,714	525,000	400,000
Other Liabilities	304,676	282,395	243,509
Deferred Long-Term Liability Charges	–	–	–
Minority Interest	–	–	–
Negative Goodwill	–	–	–
Total Liabilities	2,522,910	2,270,580	2,370,680
Stockholders' Equity			
Misc. Stocks, Options, Warrants	–	–	–
Redeemable Preferred Stock	–	–	–
Preferred Stock	–	–	–
Common Stock	441,369	441,369	441,369
Retained Earnings	1,652,140	1,314,068	1,093,288
Treasury Stock	(996,981)	(935,711)	(473,349)
Capital Surplus	1,613,307	1,589,281	1,594,332
Other Stockholders' Equity	(276,861)	(307,274)	(269,828)
Total Stockholders' Equity	2,432,974	2,101,733	2,385,812
Total Liabilities and SE	$4,955,884	4,372,313	4,756,492

Tables 8-11 and 8-12, so that the seven strategy statements above can be more readily seen on respective rows. Note the author's comments on Tables 8-11 and 8-12 that help explain changes in the numbers. The U.S. Securities and Exchange Commission (SEC) conducts fraud investigations if projected numbers are misleading or if they omit information that's important to investors. Projected statements must conform with generally accepted accounting principles (GAAP) and must not be designed to hide poor expected results. The Sarbanes-Oxley Act requires CEOs and CFOs of corporations to personally sign their firms' financial statements attesting to their accuracy. These executives could thus be held personally liable for misleading or inaccurate statements. The collapse of the Arthur Andersen accounting firm, along with its client Enron, fostered a "zero tolerance" policy among auditors and shareholders with regard to a firm's financial statements. But plenty of firms still "inflate" their financial projections and call them "pro formas," so investors,

shareholders, and other stakeholders must still be wary of different companies' financial projections.14

TABLE 8-11 Mattel's Projected Income Statements (in thousands)

	2009	2008	2007	Author Comment
Total Revenue	$7,520,357	6,836,688	6,215,171	up 10% annually
Cost of Revenue	4,060,992	3,691,811	3,356,192	remains 54%
Gross Profit	3,459,365	3,144,877	2,858,979	subtraction
Operating Expenses				
Research Development	10,000	10,000	10,000	total $30M new
Selling General and Administrative	2,491,717	2,256,107	2,051,006	remains 33% + $10 M annually
Non-Recurring	-	-	-	
Others	-	-	-	
Total Operating Expenses	-	-	-	
Operating Income or Loss	957,648	878,770	797,973	subtraction
Income from Continuing Operations				
Total Other Income/Expenses Net	34,791	34,791	34,791	keep it the same
Earnings Before Interest and Taxes	992,439	913,561	832,764	addition
Interest Expense	97,823	91,423	85,442	up 7%; LTD up 7%
Income Before Tax	894,616	822,138	737,322	
Income Tax Expense	90,829	90,829	90,829	keep it the same
Minority Interest	-	-	-	
Net Income from Continuing Ops	803,787	731,309	646,493	subtraction
Discontinued Operations	-	-	-	
Extraordinary Items	-	-	-	
Effect of Accounting Changes	-	-	-	
Other Items	-	-	-	
Net Income	803,787	731,309	646,493	
Preferred Stock and Other Adjustments	-	-	-	
Net Income Applicable to Common Shares	$803,787	731,309	646,493	

On financial statements, different companies use different terms for various items, such as revenues or sales used for the same item by different companies. For net income, many firms use the term earnings, and many others use the term profits.

Financial Budgets

A financial budget is a document that details how funds will be obtained and spent for a specified period of time. Annual budgets are most common, although the period of time for a budget can range from one day to more than 10 years. Fundamentally, financial budget ing is a method for specifying what must be done to complete strategy implementation successfully. Financial budgeting should not be thought of as a tool for limiting expenditures but rather as a method for obtaining the most productive and profitable use of an organization's resources. Financial budgets can be viewed as the planned allocation of a firm's resources based on forecasts of the future. There are almost as many different types of financial budgets as there are types of organizations. Some common types of budgets include cash budgets, operating

budgets, sales budgets, profit budgets, factory budgets, capital budgets, expense budgets, divisional

TABLE 8-12 Mattel's Projected Balance Sheets (in thousands)

	2009	2008	2007	Author Comment
Assets				
Current Assets				
Cash and Cash Equivalents	$3,232,406	2,972,664	2,570,635	too high, could reduce this and pay off some LTD to keep balance
Short-Term Investments	-	-	-	
Net Receivables	943,813	760,643	759,033	
Inventory	509,969	463,609	421,463	up 10% annually
Other Current Assets	317,624	317,624	317,624	keep it the same
Total Current Assets				
Long-Term Investments	-	-	-	
Property, Plant, and Equipment	596,749	576,749	556,749	up $20M annually
Goodwill	845,324	845,324	845,324	keep it the same
Intangible Assets	70,593	70,593	70,593	keep it the same
Accumulated Amortization	-	-	-	
Other Assets	149,912	149,912	149,912	keep it the same
Deferred Long-Term Asset Charges	503,168	503,168	503,168	keep it the same
Total Assets	7,169,558	6,660,286	6,194,501	
Liabilities				
Current Liabilities				
Accounts Payable	1,518,234	1,518,234	1,518,234	keep it the same
Short/Current Long-Term Debt	64,286	64,286	64,286	keep it the same
Other Current Liabilities	-	-	-	
Total Current Liabilities	1,582,520	1,582,520	1,582,520	
Long-Term Debt	785,714	735,714	685,714	up $50M annually
Other Liabilities	304,676	304,676	304,676	keep it the same
Deferred Long-Term Liability Charges	-	-	-	
Minority Interest	-	-	-	
Negative Goodwill	-	-	-	
Total Liabilities	2,672,910	2,622,910	2,572,910	
Stockholders' Equity				
Misc. Stocks, Options, Warrants	-	-	-	
Redeemable Preferred Stock	-	-	-	
Preferred Stock	-	-	-	
Common Stock	441,369	441,369	441,369	keep it the same
Retained Earnings	2,961,092	2,478,820	2,040,035	60% of NI = div
Treasury Stock	(1,296,981)	(1,196,981)	(1,096,981)	up $100M annually
Capital Surplus	2,114,307	2,037,307	1,960,307	up $77M annually
Other Stockholders' Equity	(276,861)	(276,861)	(276,861)	keep it the same
Total Stockholders' Equity	4,496,648	4,037,376	3,621,591	addition
Total Liabilities and SE	$7,169,558	6,660,286	6,194,501	addition

budgets, variable budgets, flexible budgets, and fixed budgets. When an organization is experiencing financial difficulties, budgets are especially important in guiding strategy implementation.

Perhaps the most common type of financial budget is the *cash budget*. The Financial Accounting Standards Board (FASB) has mandated that every publicly held company in

the United States must issue an annual cash-flow statement in addition to the usual financial reports. The statement includes all receipts and disbursements of cash in operations, investments, and financing. It supplements the Statement on Changes in Financial Position formerly included in the annual reports of all publicly held companies. A cash budget for the year 2011 for the Toddler Toy Company is provided in Table 8-13. Note that Toddler is not expecting to have surplus cash until November 2011.

Financial budgets have some limitations. First, budgetary programs can become so detailed that they are cumbersome and overly expensive. Overbudgeting or underbudgeting can cause problems. Second, financial budgets can become a substitute for objectives. A budget is a tool and not an end in itself. Third, budgets can hide inefficiencies if based solely on precedent rather than on periodic evaluation of circumstances and standards. Finally, budgets are sometimes used as instruments of tyranny that result in frustration, resentment, absenteeism, and high turnover. To minimize the effect of this last concern, managers should increase the participation of subordinates in preparing budgets.

Evaluating the Worth of a Business

Evaluating the worth of a business is central to strategy implementation because integrative, intensive, and diversification strategies are often implemented by acquiring other firms. Other strategies, such as retrenchment and divestiture, may result in the sale of a division of an organization or of the firm itself. Thousands of transactions occur each year in which businesses are bought or sold in the United States. In all these cases, it is necessary to establish the financial worth or cash value of a business to successfully implement strategies.

All the various methods for determining a business's worth can be grouped into three main approaches: what a firm owns, what a firm earns, or what a firm will bring in the market. But it is important to realize that valuation is not an exact science. The valuation of a firm's worth is based on financial facts, but common sense and intuitive judgment must enter into the process. It is difficult to assign a monetary value to some

factors—such as a loyal customer base, a history of growth, legal suits pending, dedicated employees, a favorable lease, a bad credit rating, or good patents—that may

TABLE 8-13 Six-Month Cash Budget for the Toddler Toy Company in 2011

Cash Budget (in thousands)	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.
Receipts							
Collections	$12,000	$21,000	$31,000	$35,000	$22,000	$18,000	$11,000
Payments							
Purchases	14,000	21,000	28,000	14,000	14,000	7,000	
Wages and Salaries	1,500	2,000	2,500	1,500	1,500	1,000	
Rent	500	500	500	500	500	500	
Other Expenses	200	300	400	200	—	100	
Taxes	—	8,000	—	—	—	—	
Payment on Machine	—	—	10,000	—	—	—	
Total Payments	$16,200	$31,800	$41,400	$16,200	$16,000	$8,600	
Net Cash Gain (Loss) During Month	−4,200	−10,800	−10,400	18,800	6,000	9,400	
Cash at Start of Month if No Borrowing Is Done	6,000	1,800	−9,000	−19,400	−600	5,400	
Cumulative Cash (Cash at start plus gains or minus losses)	1,800	−9,000	−19,400	−600	5,400	14,800	
Less Desired Level of Cash	−5,000	−5,000	−5,000	−5,000	−5,000	−5,000	
Total Loans Outstanding to Maintain $5,000 Cash Balance	$3,200	$14,000	$24,400	$5,600	—	—	
Surplus Cash	—	—	—	—	400	9,800	

not be reflected in a firm's financial statements. Also, different valuation methods will yield different totals for a firm's worth, and no prescribed approach is best for a certain situation. Evaluating the worth of a business truly requires both qualitative and quantitative skills.

TABLE 8-14 Company Worth Analysis for Mattel, Nordstrom, and Pfizer (year-end 2008, in $millions, except stock price and EPS)

Input Data	Mattel	Nordstrom	Pfizer
Shareholders' Equity	$2,117	$1,210	$57,556
Net Income (NI)	379	401	8,104
Stock Price	15	10	15
EPS	1.03	1.83	1.19
# of Shares Outstanding	358	215	6,750
Goodwill + Intangibles	815	53	21,464
Total Assets	235	0	17,721
Company Worth Analyses			
1. Shareholders' Equity + Goodwill + Intangibles	$3,167	$1,263	$ 96,741
2. Net Income × 5	1,895	2,005	40,520
3. (Stock Price/EPS) × NI	5,519	2,191	102,151
4. # of Shares Out × Stock Price	5,340	2,150	101,250
5. Four Method Average	3,988	1,902	76,049
$Goodwill/$Total Assets	17.4%	0.94%	19.3%

The first approach in evaluating the worth of a business is determining its net worth or stockholders' equity. Net worth represents the sum of common stock, additional paid-in capital, and retained earnings. After calculating net worth, add or subtract an appropriate amount for goodwill, overvalued or undervalued assets, and intangibles.

Whereas intangibles include copyrights, patents, and trademarks, goodwill arises only if a firm acquires another firm and pays more than the book value for that firm.

It should be noted that Financial Accounting Standards Board (FASB) Rule 142 requires companies to admit once a year if the premiums they paid for acquisitions, called goodwill, were a waste of money. Goodwill is not a good thing to have on a balance sheet. Note in Table 8-14 that Mattel's goodwill of $815 million as a percent of its total assets ($4,675 million) is 17.4 percent, which is extremely high compared to Nordstrom's goodwill of $53 million as a percentage of its total assets ($5,661 million), 0.94 percent. Pfizer's goodwill to total assets percentage also is high at 19.3 percent.

At year-end 2008, Mattel, Nordstrom, and Pfizer had $815 million, $53 million, and $21,464 billion in goodwill, respectively, on their balance sheets. Most creditors and investors feel that goodwill indeed should be added to the stockholders' equity in calculating worth of a business, but some feel it should be subtracted, and still others feel it should not be included at all. Perhaps whether you are buying or selling the business may determine whether you negotiate to add or subtract goodwill in the analysis. Goodwill is sometimes listed as intangibles on the balance sheet, but technically intangibles refers to patents, trademarks, and copyrights, rather than the value a firm paid over book value for an acquisition, which is goodwill. If a firm paid less than book value for an acquisition, that could be called negative goodwill—which is a line item on Mattel's balance sheets.

The second approach to measuring the value of a firm grows out of the belief that the worth of any business should be based largely on the future benefits its owners may derive through net profits. A conservative rule of thumb is to establish a business's worth as five times the firm's current annual profit. A five-year average profit level could also be used.

When using the approach, remember that firms normally suppress earnings in their financial statements to minimize taxes.

The third approach is called the price-earnings ratio method. To use this method, divide the market price of the firm's common stock by the annual earnings per share and multiply this number by the firm's average net income for the past five years.

The fourth method can be called the outstanding shares method. To use this method, simply multiply the number of shares outstanding by the market price per share and add a premium. The premium is simply a per-share dollar amount that a person or firm is willing to pay to control (acquire) the other company. A pharmaceutical company based in Tokyo, Astellas Pharma Inc., recently launched an unsolicited takeover of biotechnology company CV Therapeutics Inc., based in Palo Alto, California. Astellas offered $16 a share, or nearly $1 billion, which represented a 41 percent premium over CV's closing stock price of $11.35 on the Nasdaq stock market. The CEO of Astellas said, "We are disappointed that CV's board of directors has rejected outright what we believe is a very compelling all-cash proposal that would deliver stockholders significant immediate value that we believe far exceeds what CV can achieve as a stand-alone company."

Business evaluations are becoming routine in many situations. Businesses have many strategy-implementation reasons for determining their worth in addition to preparing to be sold or to buy other companies. Employee plans, taxes, retirement packages, mergers, acquisitions, expansion plans, banking relationships, death of a principal, divorce, partnership agreements, and IRS audits are other reasons for a periodic valuation. It is just good business to have a reasonable understanding of what your firm is worth. This knowledge protects the interests of all parties involved.

Table 8-14 provides the cash value analyses for three companies—Mattel, Nordstrom, and Pfizer—for year-end 2008. Notice that there is significant variation among the four methods used to determine cash value. For example, the worth of the toy company Mattel ranged from $1,895 billion to $5,519 billion. Obviously, if you were selling your company, you would seek the larger values, while if purchasing a company you would seek the lower values. In practice, substantial negotiation takes place in reaching a final compromise (or averaged) amount. Also recognize that if a firm's net income is negative, theoretically the approaches involving that figure would result in a negative number, implying that the firm would pay you to acquire them. Of course, you obtain all of the firm's debt and liabilities in an acquisition, so theoretically this would be possible.

Deciding Whether to Go Public

Going public means selling off a percentage of your company to others in order to raise capital; consequently, it dilutes the owners' control of the firm. Going public is not recommended for companies with less than $10 million in sales because the initial costs can be too high for the firm to generate sufficient cash flow to make going public worthwhile. One dollar in four is the average total cost paid to lawyers, accountants, and underwriters when an initial stock issuance is under $1 million; 1 dollar in 20 will go to cover these costs for issuances over $20 million.

In addition to initial costs involved with a stock offering, there are costs and obligations associated with reporting and management in a publicly held firm. For firms with more than $10 million in sales, going public can provide major advantages: It can allow the firm to raise capital to develop new products, build plants, expand, grow, and market products and services more effectively.

Research and Development (R&D) Issues

Research and development (R&D) personnel can play an integral part in strategy implementation. These individuals are generally charged with developing new products and improving old products in a way that will allow effective strategy implementation. R&D employees and managers perform tasks that include transferring complex technology, adjusting processes to local raw materials, adapting processes to local markets, and altering products to particular tastes and specifications. Strategies such as product development, market penetration, and related diversification require that new products be successfully developed and that old products be significantly improved. But the level of management support for R&D is often constrained by resource availability.

Technological improvements that affect consumer and industrial products and services shorten product life cycles. Companies in virtually every industry are relying on the development of new products and services to fuel profitability and growth.15 Surveys suggest that the most successful organizations use an R&D strategy that ties external opportunities to internal strengths and is linked with objectives. Well-formulated R&D policies match market opportunities with internal capabilities. R&D policies can enhance strategy implementation efforts to:

1. Emphasize product or process improvements.
2. Stress basic or applied research.
3. Be leaders or followers in R&D.
4. Develop robotics or manual-type processes.
5. Spend a high, average, or low amount of money on R&D.
6. Perform R&D within the firm or to contract R&D to outside firms.
7. Use university researchers or private-sector researchers.

Pfizer Inc. has only a few new drugs in its pipeline to show for its $7.5 billion R&D budget, so the firm is laying off 5,000 to 8,000 of its researchers and scientists in labs around the world. Cash-strapped consumers are filling fewer prescriptions and are turning more and more to generic drugs. Pfizer is bracing for the 2011 expiration of its patent on cholesterol fighter Lipitor, the world's top-selling drug that alone accounts for a quarter of Pfizer's roughly $48 billion in annual revenue. Pfizer's $7.5 billion R&D budget is the largest of any drug maker. The firm recently scrapped two drugs nearly ready to go to market—insulin spray Exubera and a Lipitor successor drug—after spending billions to develop them. Research areas that Pfizer is exiting include anemia, bone health, gastrointestinal disorders, obesity, liver disease, osteoarthritis, and peripheral artery disease.

There must be effective interactions between R&D departments and other functional departments in implementing different types of generic business strategies. Conflicts between marketing, finance/accounting, R&D, and information systems departments can be minimized with clear policies and objectives. Table 8-15 gives some examples of R&D activities that could be required for successful implementation of various strategies. Many U.S. utility, energy, and automotive companies are employing their research and development departments to determine how the firm can effectively reduce its gas emissions.

TABLE 8-15 Research and Development Involvement in Selected Strategy-Implementation Situations

Type of Organization	Strategy Being Implemented	R&D Activity
Pharmaceutical company	Product development	Test the effects of a new drug on different subgroups.
Boat manufacturer	Related diversification	Test the performance of various keel designs under various conditions.
Plastic container manufacturer	Market penetration	Develop a biodegradable container.
Electronics company	Market development	Develop a telecommunications system in a foreign country.

Many firms wrestle with the decision to acquire R&D expertise from external firms or to develop R&D expertise internally. The following guidelines can be used to help make this decision:

1. If the rate of technical progress is slow, the rate of market growth is moderate, and there are significant barriers to possible new entrants, then in-house R&D is the preferred solution. The reason is that R&D, if successful, will result in a temporary product or process monopoly that the company can exploit.
2. If technology is changing rapidly and the market is growing slowly, then a major effort in R&D may be very risky, because it may lead to the development of an ultimately obsolete technology or one for which there is no market.
3. If technology is changing slowly but the market is growing quickly, there generally is not enough time for in-house development. The prescribed approach is to obtain R&D expertise on an exclusive or nonexclusive basis from an outside firm.
4. If both technical progress and market growth are fast, R&D expertise should be obtained through acquisition of a well-established firm in the industry.16

There are at least three major R&D approaches for implementing strategies. The first strategy is to be the first firm to market new technological products. This is a glamorous and exciting strategy but also a dangerous one. Firms such as 3M and General Electric have been successful with this approach, but many other pioneering firms have fallen, with rival firms seizing the initiative.

A second R&D approach is to be an innovative imitator of successful products, thus minimizing the risks and costs of start-up. This approach entails allowing a pioneer firm to develop the first version of the new product and to demonstrate that a market

exists. Then, laggard firms develop a similar product. This strategy requires excellent R&D personnel and an excellent marketing department.

A third R&D strategy is to be a low-cost producer by mass-producing products similar to but less expensive than products recently introduced. As a new product is accepted by customers, price becomes increasingly important in the buying decision. Also, mass marketing replaces personal selling as the dominant selling strategy. This R&D strategy, requires substantial investment in plant and equipment but fewer expenditures in R&D than the two approaches described previously.

R&D activities among U.S. firms need to be more closely aligned to business objectives. There needs to be expanded communication between R&D managers and strategists. Corporations are experimenting with various methods to achieve this improved communication climate, including different roles and reporting arrangements for managers and new methods to reduce the time it takes research ideas to become reality.

Perhaps the most current trend in R&D management has been lifting the veil of secrecy whereby firms, even major competitors, are joining forces to develop new products. Collaboration is on the rise due to new competitive pressures, rising research costs, increasing regulatory issues, and accelerated product development schedules. Companies not only are working more closely with each other on R&D, but they are also turning to consortia at universities for their R&D needs. More than 600 research consortia are now in operation in the United States. Lifting of R&D secrecy among many firms through collaboration has allowed the marketing of new technologies and products even before they are available for sale. For example, some firms are collaborating on the efficient design of solar panels to power homes and businesses.

Management Information Systems (MIS)

Issues Firms that gather, assimilate, and evaluate external and internal information most effectively are gaining competitive advantages over other firms. Having an effective management information system (MIS) may be the most important factor in differentiating successful from unsuccessful firms. The process of strategic management is facilitated immensely in firms that have an effective information system.

Information collection, retrieval, and storage can be used to create competitive advantages in ways such as cross-selling to customers, monitoring suppliers, keeping managers and employees informed, coordinating activities among divisions, and managing funds. Like inventory and human resources, information is now recognized as a valuable organizational asset that can be controlled and managed. Firms that implement strategies using the best information will reap competitive advantages in the twenty-first century.

A good information system can allow a firm to reduce costs. For example, online orders from salespersons to production facilities can shorten materials ordering time and reduce inventory costs. Direct communications between suppliers, manufacturers, marketers, and customers can link together elements of the value chain as though they were one organization. Improved quality and service often result from an improved information system.

Firms must increasingly be concerned about computer hackers and take specific measures to secure and safeguard corporate communications, files, orders, and business conducted over the Internet. Thousands of companies today are plagued by computer hackers who include disgruntled employees, competitors, bored teens, sociopaths, thieves, spies, and hired agents. Computer vulnerability is a giant, expensive headache.

Dun & Bradstreet is an example company that has an excellent information system. Every D&B customer and client in the world has a separate nine-digit number. The database of information associated with each number has become so widely used that it is like a business Social Security number. D&B reaps great competitive advantages from its information system.

In many firms, information technology is doing away with the workplace and allowing employees to work at home or anywhere, anytime. The mobile concept of work allows employees to work the traditional 9-to-5 workday across any of the 24 time zones around the globe. Affordable desktop videoconferencing software allows employees to “beam in” whenever needed. Any manager or employee who travels a lot away from the office is a good candidate for working at home rather than in an

office provided by the firm. Salespersons or consultants are good examples, but any person whose job largely involves talking to others or handling information could easily operate at home with the proper computer system and software.

Many people see the officeless office trend as leading to a resurgence of family togetherness in U.S. society. Even the design of homes may change from having large open areas to having more private small areas conducive to getting work done.17

Chapter 10
STRATEGY REVIEW, EVALUATION AND CONTROL

Strategy Review, Evaluation, and Control

A note from David

The best formulated and best implemented strategies become obsolete as a firm's external and internal environments change. It is essential, therefore, that strategists systematically review, evaluate, and control the execution of strategies. This chapter presents a framework that can guide managers' efforts to evaluate strategic-management activities, to make sure they are working, and to make timely changes. Management information systems being used to evaluate strategies are discussed. Guidelines are presented for formulating, implementing, and evaluating strategies. Family Dollar Stores evaluates strategies well.

The Nature of Strategy Evaluation The strategic-management process results in decisions that can have significant, longlasting consequences. Erroneous strategic decisions can inflict severe penalties and can be exceedingly difficult, if not impossible, to reverse. Most strategists agree, therefore, that strategy evaluation is vital to an organization's well-being; timely evaluations can alert management to problems or potential problems before a situation becomes critical. Strategy evaluation includes three basic activities: (1) examining the underlying bases of a firm's strategy, (2) comparing expected results with actual results, and (3) taking corrective actions to ensure that performance conforms to plans. The strategy-evaluation stage of the strategic-management process is illustrated in Figure 9-1.

Adequate and timely feedback is the cornerstone of effective strategy evaluation. Strategy evaluation can be no better than the information on which it is based. Too much pres sure from top managers may result in lower managers contriving numbers they think will be satisfactory. Strategy evaluation can be a complex and sensitive undertaking. Too much emphasis on evaluating strategies may be expensive and

counterproductive. No one likes to be evaluated too closely! The more managers attempt to evaluate the behavior of others, the less control they have. Yet too little or no evaluation can create even worse problems. Strategy evaluation is essential to ensure that stated objectives are being achieved. In many organizations, strategy evaluation is simply an appraisal of how well an organization has performed. Have the firm's assets increased? Has there been an increase in profitability? Have sales increased? Have productivity levels increased? Have profit margin, return on investment, and earnings-per-share ratios increased? Some firms argue that their strategy must have been correct if the answers to these types of questions are affirmative. Well, the strategy or strategies may have been correct, but this type of reasoning can be misleading because strategy evaluation must have both a long-run and short-run focus. Strategies often do not affect short-term operating results until it is too late to make needed changes.

It is impossible to demonstrate conclusively that a particular strategy is optimal or even to guarantee that it will work. One can, however, evaluate it for critical flaws. Richard Rumelt offered four criteria that could be used to evaluate a strategy: consistency, consonance, feasibility, and advantage. Described in Table 9-1, consonance and advantage are mostly based on a firm's external assessment, whereas consistency and feasibility are largely based on an internal assessment. Strategy evaluation is important because organizations face dynamic environments in which

key external and internal factors often change quickly and dramatically. Success today is no guarantee of success tomorrow! An organization should never be lulled into complacency with success. Countless firms have thrived one year only to struggle for survival the following year. Organizational trouble can come swiftly, as further evidenced by the examples described in Table 9-2.

TABLE 9-1 Rumelt's Criteria for Evaluating Strategies

Consistency

A strategy should not present inconsistent goals and policies. Organizational conflict and interdepartmental bickering are often symptoms of managerial disorder, but these problems may also be a sign of strategic inconsistency. Three guidelines help determine if organizational problems are due to inconsistencies in strategy:

- If managerial problems continue despite changes in personnel and if they tend to be issue-based rather than people-based, then strategies may be inconsistent.
- If success for one organizational department means, or is interpreted to mean, failure for another department, then strategies may be inconsistent.
- If policy problems and issues continue to be brought to the top for resolution, then strategies may be inconsistent.

Consonance

Consonance refers to the need for strategists to examine *sets of trends*, as well as individual trends, in evaluating strategies. A strategy must represent an adaptive response to the external environment and to the critical changes occurring within it. One difficulty in matching a firm's key internal and external factors in the formulation of strategy is that most trends are the result of interactions among other trends. For example, the day-care explosion came about as a combined result of many trends that included a rise in the average level of education, increased inflation, and an increase in women in the workforce. Although single economic or demographic trends might appear steady for many years, there are waves of change going on at the interaction level.

Feasibility

A strategy must neither overtax available resources nor create unsolvable subproblems. The final broad test of strategy is its feasibility; that is, can the strategy be attempted within the physical, human, and financial resources of the enterprise? The financial resources of a business are the easiest to quantify and are normally the first limitation against which strategy is evaluated. It is sometimes forgotten, however, that innovative approaches to financing are often possible. Devices, such as captive subsidiaries, sale-leaseback arrangements, and tying plant mortgages to long-term contracts, have all been used effectively to help win key positions in suddenly expanding industries. A less quantifiable, but actually more rigid, limitation on strategic choice is that imposed by individual and organizational capabilities. In evaluating a strategy, it is important to examine whether an organization has demonstrated in the past that it possesses the abilities, competencies, skills, and talents needed to carry out a given strategy.

Advantage

A strategy must provide for the creation and/or maintenance of a competitive advantage in a selected area of activity. Competitive advantages normally are the result of superiority in one of three areas: (1) resources, (2) skills, or (3) position. The idea that the positioning of one's resources can enhance their combined effectiveness is familiar to military theorists, chess players, and diplomats. Position can also play a crucial role in an organization's strategy. Once gained, a good position is defensible—meaning that it is so costly to capture that rivals are deterred from full-scale attacks. Positional advantage tends to be self-sustaining as long as the key internal and environmental factors that underlie it remain stable. This is why entrenched firms can be almost impossible to unseat, even if their raw skill levels are only average. Although not all positional advantages are associated with size, it is true that larger organizations tend to operate in markets and use procedures that turn their size into advantage, while smaller firms seek product/market positions that exploit other types of advantage. The principal characteristic of good position is that it permits the firm to obtain advantage from policies that would not similarly benefit rivals without the same position. Therefore, in evaluating strategy, organizations should examine the nature of positional advantages associated with a given strategy.

Source: Adapted from Richard Rumelt, "The Evaluation of Business Strategy," in W. F. Glueck (ed.), *Business Policy and Strategic Management* (New York: McGraw-Hill, 1980): 359–367. Used with permission.

TABLE 9-2 Examples of Organizational Demise

A. Some Large Companies That Experienced a Large Drop in Revenues in 2008 vs. 2007		B. Some Large Companies That Experienced a Large Drop in Profits in 2008 vs. 2007	
Molson Coors Brewing	–23%	UAL	–1,427%
Citigroup	–29%	Sonic Automotive	–818%
Morgan Stanley	–29%	Citigroup	–865%
Goldman Sachs Group	–39%	CBS	–1,036%
Fannie Mae	–48%	Rite Aid	–4,122%
Freddie Mac	–71%	Pilgrim's Pride	–2,224%
Weyerhaeuser	–32%	Centex	–1,090%
Centex	–41%	Harrah's Entertainment	–939%
Pulte Homes	–32%	American International Group	–1,701%
Massachusetts Mutual Life	–26%	Gannett	–730%
Allstate	–20%	OfficeMax	–899%
American International Group	–90%	Brunswick	–806%
Hartford Financial	–64%	Brightpoint	–822%
Atria Group	–58%	Owens Corning	–974%

Strategy evaluation is becoming increasingly difficult with the passage of time, for many reasons. Domestic and world economies were more stable in years past, product life cycles were longer, product development cycles were longer, technological advancement was slower, change occurred less
frequently, there were fewer competitors, foreign companies were weak, and there were more regulated industries. Other reasons why strategy evaluation is more difficult today include the following trends:

1. A dramatic increase in the environment's complexity
2. The increasing difficulty of predicting the future with accuracy
3. The increasing number of variables
4. The rapid rate of obsolescence of even the best plans
5. The increase in the number of both domestic and world events affecting organizations
6. The decreasing time span for which planning can be done with any degree of certainty1

A fundamental problem facing managers today is how to control employees effectively in light of modern organizational demands for greater flexibility, innovation, creativity, and initiative from employees.2 How can managers today ensure that empowered employees acting in an entrepreneurial manner do not put the well-being of the business at risk? Recall that Kidder, Peabody & Company lost $350 million when one of its traders allegedly booked fictitious profits; Sears, Roebuck and Company took a $60 million charge against earnings after admitting that its automobile service businesses were performing unnecessary repairs. The costs to companies such as these in terms of damaged reputations, fines, missed opportunities, and diversion of management's attention are enormous.

When empowered employees are held accountable for and pressured to achieve specific goals and are given wide latitude in their actions to achieve them, there can be dysfunctional behavior. For example, Nordstrom, the upscale fashion retailer known for outstanding customer service, was subjected to lawsuits and fines when employees underreported hours worked in order to increase their sales per hour—the company's primary performance criterion. Nordstrom's customer service and earnings were enhanced until the misconduct was reported, at which time severe penalties were levied against the firm.

The Process of Evaluating Strategies

Strategy evaluation is necessary for all sizes and kinds of organizations. Strategy evaluation should initiate managerial questioning of expectations and assumptions, should trigger a review of objectives and values, and should stimulate creativity in generating alternatives and formulating criteria of evaluation.3 Regardless of the size of the organization, a certain amount of management by wandering around at all levels is essential to effective strategy evaluation. Strategy-evaluation activities should be performed on a continuing basis, rather than at the end of specified periods of time or just after problems occur. Waiting until the end of the year, for example, could result in a firm closing the barn door after the horses have already escaped.

Evaluating strategies on a continuous rather than on a periodic basis allows benchmarks of progress to be established and more effectively monitored. Some strategies take years to implement; consequently, associated results may not become apparent for years. Successful strategies combine patience with a willingness to promptly take corrective actions when necessary. There always comes a time when corrective actions are needed in an organization! Centuries ago, a writer (perhaps Solomon) made the following observations about change:

There is a time for everything, A time to be born and a time to die, A time to plant and a time to uproot, A time to kill and a time to heal, A time to tear down and a time to build, A time to weep and a time to laugh, A time to mourn and a time to dance, A time to scatter stones and a time to gather them, A time to embrace and a time to refrain, A time to search and a time to give up, A time to keep and a time to throw away, A time to tear and a time to mend, A time to be silent and a time to speak, A time to love and a time to hate, A time for war and a time for peace.4

Managers and employees of the firm should be continually aware of progress being made toward achieving the firm's objectives. As critical success factors change, organizational members should be involved in

determining appropriate corrective actions. If assumptions and expectations deviate significantly from forecasts, then the firm should renew strategy-formulation activities, perhaps sooner than planned. In strategy evaluation, like strategy formulation and strategy implementation, people make the difference. Through involvement in the process of evaluating strategies, managers and employees become committed to keeping the firm moving steadily toward achieving objectives.

A Strategy-Evaluation Framework

Table 9-3 summarizes strategy-evaluation activities in terms of key questions that should be addressed, alternative answers to those questions, and appropriate actions for an organization to take. Notice that corrective actions are almost always needed except when (1) external and internal factors have not significantly changed and (2) the firm is progressing satisfactorily toward achieving stated objectives. Relationships among strategy-evaluation activities are illustrated in Figure 9-2.

Reviewing Bases of Strategy

As shown in Figure 9-2, reviewing the underlying bases of an organization's strategy could be approached by developing a revised EFE Matrix and IFE Matrix. A revised IFE Matrix should focus on changes in the organization's management, marketing, finance/accounting,production/operations, R&D, and management information systems strengths and weaknesses. A revised EFE Matrix should indicate how effective a firm's strategies have been in response to key opportunities and threats. This analysis could also address such questions as the following:

TABLE 9-3 A Strategy-Evaluation Assessment Matrix

Have Major Changes Occurred in the Firm Internal Strategic Position?	Have Major Changes Occurred in the Firm External Strategic Position?	Has the Firm Progressed Satisfactorily Toward Achieving Its Stated Objectives?	Result
No	No	No	Take corrective actions
Yes	Yes	Yes	Take corrective actions
Yes	Yes	No	Take corrective actions
Yes	No	Yes	Take corrective actions
Yes	No	No	Take corrective actions
No	Yes	Yes	Take corrective actions
No	Yes	No	Take corrective actions
No	No	Yes	Continue present strategic course

1. How have competitors reacted to our strategies?
2. How have competitors' strategies changed?
3. Have major competitors' strengths and weaknesses changed?
4. Why are competitors making certain strategic changes?
5. Why are some competitors' strategies more successful than others?
6. How satisfied are our competitors with their present market positions and profitability?
7. How far can our major competitors be pushed before retaliating?
8. How could we more effectively cooperate with our competitors?

Numerous external and internal factors can prevent firms from achieving long-term and annual objectives. Externally, actions by competitors, changes in demand, changes in technology, economic changes, demographic shifts, and governmental actions may prevent objectives from being accomplished. Internally, ineffective strategies may have been chosen or implementation activities may have been poor. Objectives may have been too optimistic. Thus, failure to achieve objectives may not be the result of unsatisfactory work by managers and employees. All organizational members need to know this to encourage their support for strategy-evaluation activities. Organizations desperately need to know as soon as possible when their strategies are not effective. Sometimes managers and employees on the front lines discover this well before strategists. External opportunities and threats and internal strengths and weaknesses that represent the bases of current strategies should continually be monitored for change. It is not really a question of whether these factors will change but rather when they will change and in what ways. Here are some key questions to address in evaluating strategies:

1. Are our internal strengths still strengths?
2. Have we added other internal strengths? If so, what are they?
3. Are our internal weaknesses still weaknesses?
4. Do we now have other internal weaknesses? If so, what are they?

5. Are our external opportunities still opportunities?
6. Are there now other external opportunities? If so, what are they?
7. Are our external threats still threats?
8. Are there now other external threats? If so, what are they?
9. Are we vulnerable to a hostile takeover?

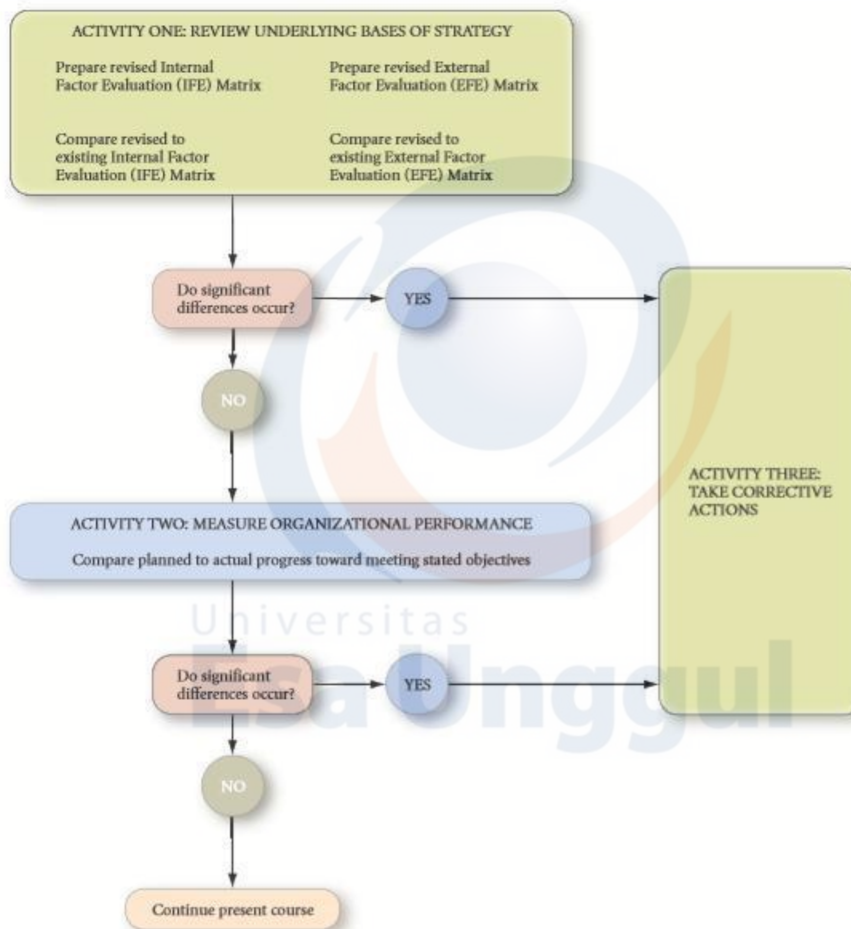
Measuring Organizational Performance

Another important strategy-evaluation activity is measuring organizational performance. This activity includes comparing expected results to actual results, investigating deviations from plans, evaluating individual performance, and examining progress being made toward meeting stated objectives. Both long-term and annual objectives are commonly used in this process. Criteria for evaluating strategies should be measurable and easily verifiable. Criteria that predict results may be more important than those thatreveal what already has happened. For example, rather than simply being informed that sales in the last quarter were 20 percent under what was expected, strategists need to know that sales in the next quarter may be 20 percent below standard unless some action is taken to counter the trend. Really effective control requires accurate forecasting. Failure to make satisfactory progress toward accomplishing long-term or annual objectives signals a need for corrective actions. Many factors, such as unreasonable policies, unexpected turns in the economy, unreliable suppliers or distributors, or ineffective strategies, can result in unsatisfactory progress toward meeting objectives. Problems can result from ineffectiveness (not doing the right things) or inefficiency (poorly doing the right things). Many variables can and should be included in measuring organizational performance. As indicated in Table 9-4, typically a favorable or unfavorable variance is recorded monthly, quarterly, and annually, and resultant actions needed are then determined. Determining which objectives are most important in the evaluation of strategies can be difficult. Strategy evaluation is based on both quantitative and qualitative

criteria. Selecting the exact set of criteria for evaluating strategies depends on a particular organization's size, industry, strategies, and management philosophy. An organization pursuing a retrenchment strategy, for example, could have an entirely different set of evaluative criteria from an organization pursuing a market-development strategy. Quantitative criteria commonly used to evaluate strategies are financial ratios, which strategists use to make three critical comparisons:

FIGURE 9-2

A Strategy-Evaluation Framework



(1) comparing the firm's performance over different time periods, (2) comparing the firm's performance to competitors', and (3) comparing the firm's performance to industry averages. Some key financial ratios that are particularly useful as criteria for strategy evaluation are as follows:

1. Return on investment (ROI)
2. Return on equity (ROE)
3. Profit margin
4. Market share
5. Debt to equity
6. Earnings per share
7. Sales growth
8. Asset growt

TABLE 9-4 A Sample Framework for Measuring Organizational Performance

Factor	Actual Result	Expected Result	Variance	Action Needed
Corporate Revenues				
Corporate Profits				
Corporate ROI				
Region 1 Revenues				
Region 1 Profits				
Region 1 ROI				
Region 2 Revenues				
Region 2 Profits				
Region 2 ROI				
Product 1 Revenues				
Product 1 Profits				
Product 1 ROI				
Product 2 Revenues				
Product 2 Profits				
Product 2 ROI				

But some potential problems are associated with using quantitative criteria for evaluating strategies. First, most quantitative criteria are geared to annual objectives rather than long-term objectives. Also, different accounting methods can provide different results on many quantitative criteria. Third, intuitive judgments are almost always involved in deriving quantitative criteria. For these and other reasons, qualitative criteria are also important in evaluating strategies. Human factors such as high absenteeism and turnover rates, poor production quality and quantity rates,

or low employee satisfaction can be underlying causes of declining performance. Marketing, finance/accounting, R&D, or management information systems factors can also cause financial problems. Some additional key questions that reveal the need for qualitative or intuitive judgments in strategy evaluation are as follows:

1. How good is the firm's balance of investments between high-risk and low-risk projects?
2. How good is the firm's balance of investments between long-term and short-term projects?
3. How good is the firm's balance of investments between slow-growing markets and fast-growing markets?
4. How good is the firm's balance of investments among different divisions?
5. To what extent are the firm's alternative strategies socially responsible?
6. What are the relationships among the firm's key internal and external strategic factors?
7. How are major competitors likely to respond to particular strategies?

Taking Corrective Actions

The final strategy-evaluation activity, taking corrective actions, requires making changes to competitively reposition a firm for the future. As indicated in Table 9-5, examples of changes that may be needed are altering an organization's structure, replacing one or more key individuals, selling a division, or revising a business mission. Other changes could include establishing or revising objectives, devising new policies, issuing stock to raise capital, adding additional salespersons, differently allocating resources, or developing new performance incentives. Taking corrective actions does not necessarily mean that existing strategies will be abandoned or even that new strategies must be formulated.

The probabilities and possibilities for incorrect or inappropriate actions increase geometrically with an arithmetic increase in personnel.

Any person directing an overall undertaking must check on the actions of the participants as well as the results that they have achieved. If either the actions or results do not comply with preconceived or planned achievements, then corrective actions are needed.5

No organization can survive as an island; no organization can escape change. Taking corrective actions is necessary to keep an organization on track toward achieving stated objectives. In his thought-provoking books Future Shock and The Third Wave, Alvin Toffler argued that business environments are becoming so dynamic and complex that they threaten people and organizations with future shock, which occurs when the nature, types, and speed of changes overpower an individual's or organization's ability and capacity to adapt. Strategy evaluation enhances an organization's ability to adapt successfully to changing circumstances. Taking corrective actions raises employees' and managers' anxieties. Research suggests that participation in strategy-evaluation activities is one of the best ways to overcome individuals' resistance to change. According to Erez and Kanfer, individuals accept change best when they have a cognitive understanding of the changes, a sense of control over the situation, and an awareness that necessary actions are going to be taken to implement the changes.6 Strategy evaluation can lead to strategy-formulation changes, strategy-implementation changes, both formulation and implementation changes, or no changes at all. Strategists cannot escape having to revise strategies and implementation approaches sooner or later. Hussey and Langham offered the following insight on taking corrective actions:

Resistance to change is often emotionally based and not easily overcome by rational argument. Resistance may be based on such feelings as loss of status, implied criticism of present competence, fear of failure in the new situation, annoyance at not being consulted, lack of understanding of the need for change, or insecurity in changing from well-known and fixed methods. It is necessary, therefore, to overcome such resistance by

creating situations of participation and full explanation when changes are envisaged.7

Corrective actions should place an organization in a better position to capitalize upon internal strengths; to take advantage of key external opportunities; to avoid, reduce, or mitigate external threats; and to improve internal weaknesses. Corrective actions should have a proper time horizon and an appropriate amount of risk. They should be internally consistent and socially responsible. Perhaps most important, corrective actions strengthen an organization's competitive position in its basic industry. Continuous strategy evaluation keeps strategists close to the pulse of an organization and provides information needed for an effective strategic-management system. Carter Bayles described the benefits of strategy evaluation as follows:

Evaluation activities may renew confidence in the current business strategy or point to the need for actions to correct some weaknesses, such as erosion of product superiority or technological edge. In many cases, the benefits of strategy evaluation are much more far-reaching, for the outcome of the process may be a fundamentally new strategy that will lead, even in a business that is already turning a respectable profit, to substantially increased earnings. It is this possibility that justifies strategy evaluation, for the payoff can be very large.8

TABLE 9-5 Corrective Actions Possibly Needed to Correct Unfavorable Variances

1. Alter the firm's structure
2. Replace one or more key individuals
3. Divest a division
4. Alter the firm's vision and/or mission
5. Revise objectives
6. Alter strategies
7. Devise new policies
8. Install new performance incentives
9. Raise capital with stock or debt
10. Add or terminate salespersons, employees, or managers
11. Allocate resources differently
12. Outsource (or rein in) business functions

The Balanced Scorecard

Introduced earlier in the Chapter 5 discussion of objectives, the Balanced Scorecard is an important strategy-evaluation tool. It is a process that allows firms to evaluate strategies from four perspectives: financial performance, customer knowledge, internal business processes, and learning and growth. The Balanced Scorecard analysis requires that firms seek answers to the following questions and utilize that information, in conjunction with financial measures, to adequately and more effectively evaluate strategies being implemented:

1. How well is the firm continually improving and creating value along measures such as innovation, technological leadership, product quality, operational process efficiencies, and so on?
2. How well is the firm sustaining and even improving upon its core competencies and competitive advantages?
3. How satisfied are the firm's customers?

A sample Balanced Scorecard is provided in Table 9-6. Notice that the firm examines six key issues in evaluating its strategies: (1) Customers, (2) Managers/Employees, (3) Operations/Processes, (4) Community/Social Responsibility, (5) Business Ethics/Natural Environment, and (6) Financial. The basic form of a Balanced Scorecard may differ for different organizations. The Balanced Scorecard approach to strategy evaluation aims to balance long-term with short-term concerns, to balance financial with nonfinancial concerns, and to balance internal with external concerns. It can be an excellent management tool, and it is used successfully today by Chemical Bank, Exxon/Mobil Corporation, CIGNA Property and Casualty Insurance, and numerous other firms. The Balanced Scorecard would be constructed differently, that is, adapted, to particular firms in various industries with the underlying theme or thrust being the same,

which is to evaluate the firm's strategies based upon both key quantitative and qualitative measures.

TABLE 9-6 An Example Balanced Scorecard

Area of Objectives	Measure or Target	Time Expectation	Primary Responsibility
Customers			
1.			
2.			
3.			
4.			
Managers/Employees			
1.			
2.			
3.			
4.			
Operations/Processes			
1.			
2.			
3.			
4.			
Community/Social Responsibility			
1.			
2.			
3.			
4.			
Business Ethics/Natural Environment			
1.			
2.			
3.			
4.			
Financial			
1.			
2.			
3.			
4.			

Published Sources of Strategy-Evaluation Information

A number of publications are helpful in evaluating a firm's strategies. For example, Fortune annually identifies and evaluates the Fortune 1,000 (the largest manufacturers) and the Fortune 50 (the largest retailers, transportation companies, utilities, banks, insurance companies, and diversified financial corporations in the United States). Fortune ranks the best and worst performers on various factors, such as return on investment, sales volume, and profitability. In its March issue each year, Fortune publishes its strategy-evaluation research in an article entitled "America's Most Admired Companies." Eight key attributes serve as evaluative criteria: people management; innovativeness; quality of products or services; financial soundness; social responsibility; use of corporate assets; long-term investment; and quality of management. In October of each year, Fortune publishes additional strategy-evaluation research in an article

entitled "The World's Most Admired Companies." Fortune's 2009 evaluation in Table 9-7 reveals the firms most admired (best managed) in their industry. The most admired company in the world in 2009 was Nike, followed by Anheuser-Busch, Nestle, and Procter & Gamble.9 Another excellent evaluation of corporations in America, "The Annual Report on American Industry," is published annually in the January issue of Forbes. It provides a detailed and comprehensive evaluation of hundreds of U.S. companies in many different industries.BusinessWeek,Industry Week, and Dun's Business Monthalso periodically publish detailed evaluations of U.S. businesses and industries. Although published sources of strategy-evaluation information focus primarily on large, publicly held businesses, the comparative ratios and related information are widely used to evaluate small businesses and privately owned firms as well.

TABLE 9-7 The Most Admired Company in Various Industries (2009)

Industry	The Most Admired Company
Apparel	Nike
Beverages	Anheuser-Busch
Consumer food products	Nestle
Soaps and cosmetics	Procter & Gamble
Credit card services	Visa
Insurance	Berkshire Hathaway
Megabanks	Bank of America
Forest and paper products	International Paper
Pharmaceuticals	Johnson & Johnson
Petroleum refining	Exxon Mobil
Electronics	General Electric
Food services	McDonald's
Railroads	Union Pacific
Motor vehicles	BMW
Industrial and farm equipment	Caterpillar
Airlines	Continental Airlines
Aerospace and defense	United Technologies
Metals	Alcoa

Source: Based on Adam Lashinsky, "The World's Most Admired Companies," *Fortune* (March 16, 2009): 81–91.

Characteristics of an Effective Evaluation System

Strategy evaluation must meet several basic requirements to be effective. First, strategyevaluation activities must be economical; too much information can be just as bad as too little information; and too many controls can do more harm than good. Strategy-evaluation activities also should be meaningful; they should specifically relate to a firm's objectives. They should provide managers with useful information about tasks over which they have control and influence. Strategy-evaluation activities should provide timely information; on occasion and in some areas, managers may daily need information. For example, when a firm has diversified by acquiring another firm, evaluative information may be needed frequently. However, in an R&D department, daily or even weekly evaluative information could be dysfunctional. Approximate information that is timely is generally more desirable as a basis for strategy evaluation than accurate information that does not depict the present. Frequent measurement and rapid reporting may frustrate control rather than give better control. The time dimension of control must coincide with the time span of the event being measured. Strategy evaluation should be designed to provide a true picture of what is happening. For example, in a severe economic downturn, productivity and profitability ratios may drop alarmingly, although employees and managers are actually working harder. Strategy evaluations should fairly portray this type of situation. Information derived from the strategy-evaluation process should facilitate action and should be directed to those individuals in the organization who need to take action based on it. Managers commonly ignore evaluative reports that are provided only for informational purposes; not all managers need to receive all reports. Controls need to be action-oriented rather than information-oriented. The strategy-evaluation process should not dominate decisions; it should foster mutual understanding, trust, and common sense. No department should fail to cooperate with another in evaluating strategies. Strategy evaluations

should be simple, not too cumbersome, and not too restrictive. Complex strategy-evaluation systems often confuse people and accomplish little. The test of an effective evaluation system is its usefulness, not its complexity. Large organizations require a more elaborate and detailed strategy-evaluation system because it is more difficult to coordinate efforts among different divisions and functional areas. Managers in small companies often communicate daily with each other and their employees and do not need extensive evaluative reporting systems. Familiarity with local environments usually makes gathering and evaluating information much easier for small organizations than for large businesses. But the key to an effective strategy-evaluation system may be the ability to convince participants that failure to accomplish certain objectives within a prescribed time is not necessarily a reflection of their performance. There is no one ideal strategy-evaluation system. The unique characteristics of an organization, including its size, management style, purpose, problems, and strengths, can determine a strategy-evaluation and control system's final design. Robert Waterman offered the following observation about successful organizations' strategy-evaluation and control systems:

Successful companies treat facts as friends and controls as liberating. Morgan Guaranty and Wells Fargo not only survive but thrive in the troubled waters of bank deregulation, because their strategy evaluation and control systems are sound, their risk is contained, and they know themselves and the competitive situation so well. Successful companies have a voracious hunger for facts. They see information where others see only data. They love comparisons, rankings, anything that removes decision making from the realm of mere opinion. Successful companies maintain tight, accurate financial controls. Their people don't regard controls as an imposition of autocracy but as the benign checks and balances that allow them to be creative and free.10

Contingency Planning

A basic premise of good strategic management is that firms plan ways to deal with unfavorable and favorable events before they occur. Too many organizations prepare contingency plans just for unfavorable events; this is a mistake, because both minimizing threats and capitalizing on opportunities can improve a firm's competitive position. Regardless of how carefully strategies are formulated, implemented, and evaluated, unforeseen events, such as strikes, boycotts, natural disasters, arrival of foreign competitors, and government actions, can make a strategy obsolete. To minimize the impact of potential threats, organizations should develop contingency plans as part of their strategy-evaluation process. Contingency plans can be defined as alternative plans that can be put into effect if certain key events do not occur as expected. Only high-priority areas require the insurance of contingency plans. Strategists cannot and should not try to cover all bases by planning for all possible contingencies. But in any case, contingency plans should be as simple as possible. Some contingency plans commonly established by firms include the following: If a major competitor withdraws from particular markets as intelligence reports indicate, what actions should our firm take?

1. If our sales objectives are not reached, what actions should our firm take to avoid profit losses?
2. If demand for our new product exceeds plans, what actions should our firm take to meet the higher demand?
3. If certain disasters occur—such as loss of computer capabilities; a hostile takeover attempt; loss of patent protection; or destruction of manufacturing facilities because of earthquakes, tornadoes or hurricanes—what actions should our firm take?

4. If a new technological advancement makes our new product obsolete sooner than expected, what actions should our firm take?

Too many organizations discard alternative strategies not selected for implementation although the work devoted to analyzing these options would render valuable information. Alternative strategies not selected for implementation can serve as contingency plans in case the strategy or strategies selected do not work. U.S. companies and governments are increasingly considering nuclear-generated electricity as the most efficient means of power generation. Many contingency plans certainly call for nuclear power rather than for coaland gas-derived electricity.

When strategy-evaluation activities reveal the need for a major change quickly, an appropriate contingency plan can be executed in a timely way. Contingency plans can promote a strategist's ability to respond quickly to key changes in the internal and external bases of an organization's current strategy. For example, if underlying assumptions about the economy turn out to be wrong and contingency plans are ready, then managers can make appropriate changes promptly.

In some cases, external or internal conditions present unexpected opportunities. When such opportunities occur, contingency plans could allow an organization to quickly capitalize on them. Linneman and Chandran reported that contingency planning gave users, such as DuPont, Dow Chemical, Consolidated Foods, and Emerson Electric, three major benefits: (1) It permitted quick response to change, (2) it prevented panic in crisis situations, and (3) it made managers more adaptable by encouraging them to appreciate just how variable the future can be. They suggested that effective contingency planning involves a seven-step process:

1. Identify both beneficial and unfavorable events that could possibly derail the strategy or strategies.

2. Specify trigger points. Calculate about when contingent events are likely to occur.

3. Assess the impact of each contingent event. Estimate the potential benefit or harm of each contingent event.
4. Develop contingency plans. Be sure that contingency plans are compatible with current strategy and are economically feasible.
5. Assess the counterimpact of each contingency plan. That is, estimate how much each contingency plan will capitalize on or cancel out its associated contingent event. Doing this will quantify the potential value of each contingency plan.
6. Determine early warning signals for key contingent events. Monitor the early warning signals.
7. For contingent events with reliable early warning signals, develop advance action plans to take advantage of the available lead time.11

Auditing

A frequently used tool in strategy evaluation is the audit. Auditing is defined by the American Accounting Association (AAA) as "a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between these assertions and established criteria, and communicating the results to interested users."12

Auditors examine the financial statement of firms to determine whether they have been prepared according to generally accepted accounting principles (GAAP) and whether they fairly represent the activities of the firm. Independent auditors use a set of standards called generally accepted auditing standards (GAAS). Public accounting firms often have a consulting arm that provides strategy-evaluation services. The SEC in late 2009 charged General

Electric with accounting fraud, specifically for inflating its earnings and revenues in prior years. GE has agreed to pay $50 million to settle the charges. (Students—when preparing projected financial statements as described in Chapter 8, do not inflate the numbers.)

The new era of international financial reporting standards (IFRS) appears unstoppable, and businesses need to go ahead and get ready to use IFRS. Many U.S. companies now report their finances using both the old generally accepted accounting standards (GAAP) and the new IFRS. “If companies don’t prepare, if they don’t start three years in advance,” warns business professor Donna Street at the University of Dayton, “they’re going to be in big trouble.” GAAP standards comprised 25,000 pages, whereas IFRS comprises only 5,000 pages, so in that sense IFRS is less cumbersome. This accounting switch from GAAP to IFRS in the United States is going to cost businesses millions of dollars in fees and upgraded software systems and training. U.S. CPAs need to study global accounting principles intensely, and business schools should go ahead and begin teaching students the new accounting standards.

All companies have the option to use the IFRS procedures in 2011, and then all companies are required to use IFRS in 2014, unless that timetable is changed. The U.S. Chamber of Commerce supports the change, saying it will lead to much more cross-border commerce and will help the United States compete in the world economy. Already the European Union and 113 nations have adopted or soon plan to use international rules, including Australia, China, India, Mexico, and Canada. So the United States likely will also adopt IFRS rules on schedule, but this switch could unleash a legal and regulatory nightmare. The United States lags the rest of the world in global accounting. But a few U.S. multinational firms already use IFRS for their foreign subsidiaries, such as United Technologies (UT). UT derives more than 60 percent of its revenues from abroad and is already training its entire staff to use

IFRS. UT has redone its 2007 through 2009 financial statements in the IFRS format.

Movement to IFRS from GAAP encompasses a company's entire operations, including auditing, oversight, cash management, taxes, technology, software, investing, acquiring, merging, importing, exporting, pension planning, and partnering. Switching from GAAP to IFRS is also likely to be plagued by gaping differences in business customs, financial regulations, tax laws, politics, and other factors. One critic of the upcoming switch is Charles Niemeier of the Public Company Accounting Oversight Board, who says the switch "has the potential to be a Tower of Babel," costing firms millions when they do not even have thousands to spend.

Others say the switch will help U.S. companies raise capital abroad and do business with firms abroad. Perhaps the biggest upside of the switch is that IFRS rules are more streamlined and less complex than GAAP. Lenovo, the China-based technology firm that bought IBM's personal computer business, is a big advocate of IFRS. Lenovo's view is that they desire to be a world company rather than a U.S. or Chinese company, so the faster the switch to IFRS, the better for them. The bottom line is that IFRS is coming to the United States, sooner than later, so we all need to gear up for this switch as soon as possible.13

Twenty-First-Century Challenges in Strategic Management

Three particular challenges or decisions that face all strategists today are (1) deciding whether the process should be more an art or a science, (2) deciding whether strategies should be visible or hidden from stakeholders, and (3) deciding whether the process should be more top-down or bottom-up in their firm.14

The Art or Science Issue

This textbook is consistent with most of the strategy literature in advocating that strategic management be viewed more as a science than an art. This perspective contends that firms need to systematically assess their external and internal environments, conduct research, carefully evaluate the pros and cons of various alternatives, perform analyses, and then decide upon a particular course of action. In contrast, Mintzberg's notion of "crafting" strategies embodies the artistic model, which suggests that strategic decision making be based primarily on holistic thinking, intuition, creativity, and imagination.15 Mintzberg and his followers reject strategies that result from objective analysis, preferring instead subjective imagination. "Strategy scientists" reject strategies that emerge from emotion, hunch, creativity, and politics. Proponents of the artistic view often consider strategic planning exercises to be time poorly spent. The Mintzberg philosophy insists on informality, whereas strategy scientists (and this text) insist on more formality. Mintzberg refers to strategic planning as an "emergent" process whereas strategy scientists use the term "deliberate" process.16

The answer to the art versus science question is one that strategists must decide for themselves, and certainly the two approaches are not mutually exclusive. In deciding which approach is more effective, however, consider that the business world today has become increasingly complex and more intensely competitive. There is less room for error in strategic planning. Recall that Chapter 1 discussed the importance of intuition and experience and subjectivity in strategic planning, and even the weights and ratings discussed in Chapters 3, 4, and 6certainly require good judgment. But the idea of deciding on strategies for any firm without thorough research and analysis, at least in the mind of this writer, is unwise. Certainly, in smaller firms there can be more informality in the process compared to larger firms, but even for smaller firms, a wealth of competitive information is available on the Internet and elsewhere and should be collected, assimilated, and evaluated before

deciding on a course of action upon which survival of the firm may hinge. The livelihood of countless employees and shareholders may hinge on the effectiveness of strategies selected. Too much is at stake to be less than thorough in formulating strategies. It is not wise for a strategist to rely too heavily on gut feeling and opinion instead of research data, competitive intelligence, and analysis in formulating strategies.

The Visible or Hidden Issue

An interesting aspect of any competitive analysis discussion is whether strategies themselves should be secret or open within firms. The Chinese warrior Sun Tzu and military leaders today strive to keep strategies secret, as war is based on deception. However, for a business organization, secrecy may not be best. Keeping strategies secret from employees and stakeholders at large could severely inhibit employee and stakeholder communication, understanding, and commitment and also forgo valuable input that these persons could have regarding formulation and/or implementation of that strategy. Thus strategists in a particular firm must decide for themselves whether the risk of rival firms easily knowing and exploiting a firm's strategies is worth the benefit of improved employee and stakeholder motivation and input. Most executives agree that some strategic information should remain confidential to top managers, and that steps should be taken to ensure that such information is not disseminated beyond the inner circle. For a firm that you may own or manage, would you advocate openness or secrecy in regard to strategies being formulated and implemented? There are certainly good reasons to keep the strategy process and strategies themselves visible and open rather than hidden and secret. There are also good reasons to keep strategies hidden from all but top-level executives.

Strategists must decide for themselves what is best for their firms. This text comes down largely on the side of being visible and open, but certainly this may not be best for all strategists and all firms. As pointed out in Chapter 1, Sun Tzu argued that all war is based on deception and that the best maneuvers are those not easily predicted by rivals. Business and war are analogous. Some reasons to be completely open with the strategy process and resultant decisions are these:

1. Managers, employees, and other stakeholders can readily contribute to the process. They often have excellent ideas. Secrecy would forgo many excellent ideas.
2. Investors, creditors, and other stakeholders have greater basis for supporting a firm when they know what the firm is doing and where the firm is going.
3. Visibility promotes democracy, whereas secrecy promotes autocracy. Domestic firms and most foreign firms prefer democracy over autocracy as a management style.
4. Participation and openness enhance understanding, commitment, and communication within the firm.

Reasons why some firms prefer to conduct strategic planning in secret and keep strategies hidden from all but the highest-level executives are as follows:

1. Free dissemination of a firm's strategies may easily translate into competitive intelligence for rival firms who could exploit the firm given that information.
2. Secrecy limits criticism, second guessing, and hindsight.
3. Participants in a visible strategy process become more attractive to rival firms who may lure them away.

4. Secrecy limits rival firms from imitating or duplicating the firm's strategies and undermining the firm.

The obvious benefits of the visible versus hidden extremes suggest that a working balance must be sought between the apparent contradictions. Parnell says that in a perfect world all key individuals both inside and outside the firm should be involved in strategic planning, but in practice particularly sensitive and confidential information should always remain strictly confidential to top managers.17 This balancing act is difficult but essential for survival of the firm.

The Top-Down or Bottom-Up Approach

Proponents of the top-down approach contend that top executives are the only persons in the firm with the collective experience, acumen, and fiduciary responsibility to make key strategy decisions. In contrast, bottom-up advocates argue that lower- and middle-level managers and employees who will be implementing the strategies need to be actively involved in the process of formulating the strategies to ensure their support and commitment. Recent strategy research and this textbook emphasize the bottom-up approach, but earlier work by Schendel and Hofer stressed the need for firms to rely on perceptions of their top managers in strategic planning.18 Strategists must reach a working balance of the two approaches in a manner deemed best for their firms at a particular time, while cognizant of the fact that current research supports the bottom-up approach, at least among U.S. firms. Increased education and diversity of the workforce at all levels are reasons why middle- and lower-level managers—and even nonmanagers—should be invited to participate in the firm's strategic planning process, at least to the extent that they are willing and able to contribute.

Chapter 11
BUSINESS ETHICS/SOCIAL RESPONSIBILITY/ ENVIRONMENTAL SUSTAINABILITY

Business Ethics/ Social Responsibility/ Environmental Sustainability

A note from David

Although the three sections of this chapter (Business Ethics, Social Responsibility, and Sustainability) are distinct, the topics are quite related. Many people, for example, consider it unethical for a firm to be socially irresponsible. Social responsibility refers to actions an organization takes beyond what is legally required to protect or enhance the well-being of living things. Sustainability refers to the extent that an organization's operations and actions protect, mend, and preserve rather than harm or destroy the natural environment. Polluting the environment, for example, is unethical, irresponsible, and in many cases illegal. Business ethics, social responsibility, and sustainability issues therefore are interrelated and impact all areas of the comprehensive strategicmanagement model, as illustrated in Figure 10.1 on page 312.

A sample company that adheres to the highest ethical standards and that has excelled during the recent weak economy is Walt Disney. Disney in March 2009 published an elaborate corporate social responsibility/business ethics/sustainability report that can be found online at http://disney.go.com/crreport/home.html. In that report, the Disney CEO says:

Our Corporate Responsibility team has developed a cohesive strategy for the company with that in mind, incorporating existing outreach, safety, nutrition, environmental and labor programs and working with executives across Disney, ABC and ESPN to coordinate and strengthen our company-wide efforts. They've organized our approach around five broad areas—Children & Family, Content & Products, Environment, Community and Workplaces—with the goal of further embedding corporate responsibility into Disney's business DNA, making sure it continues to be taken into consideration in decisions big and small.1

Business Ethics

Good ethics is good business. Bad ethics can derail even the best strategic plans. This chapter provides an overview of the importance of business ethics in strategic management. Business ethics can be defined as principles of conduct within

organizations that guide decision making and behavior. Good business ethics is a prerequisite for good strategic management; good ethics is just good business!

A rising tide of consciousness about the importance of business ethics is sweeping the United States and the rest of the world. Strategists such as CEOs and business owners are the individuals primarily responsible for ensuring that high ethical principles are espoused and practiced in an organization. All strategy formulation, implementation, and evaluation decisions have ethical ramifications.

Newspapers and business magazines daily report legal and moral breaches of ethical conduct by both public and private organizations. Being unethical can be very expensive. For example, some of the largest payouts for class-action legal fraud suits ever were against Enron ($7.16 billion), WorldCom ($6.16 billion), Cendant ($3.53 billion), Tyco ($2.98 billion), AOL Time Warner ($2.5 billion), Nortel Networks ($2.47 billion), and Royal Ahold ($1.09 billion). A company named Coast IRB LLC in Colorado recently was forced to close after the Food and Drug Administration (FDA) discovered in a sting operation that the firm conducted a fake medical study.

Coast is one of many firms paid by pharmaceutical firms to oversee clinical trials and independently ensure that patient safety is protected.

Other business actions considered to be unethical include misleading advertising or labeling, causing environmental harm, poor product or service safety, padding expense accounts, insider trading, dumping banned or flawed products in foreign markets, not providing equal opportunities for women and minorities, overpricing, moving jobs overseas, and sexual harassment.

Code of Business Ethics

A new wave of ethics issues related to product safety, employee health, sexual harassment, AIDS in the workplace, smoking, acid rain, affirmative action, waste disposal, foreign business practices, cover-ups, takeover tactics, conflicts of interest, employee privacy, inappropriate gifts, and security of company records has accentuated the need for strategists to develop a clear code of business ethics. Internet fraud, hacking into company computers, spreading viruses, and identity theft are other unethical activities that plague every sector of online commerce.

United Technologies has a 21-page code of ethics and a vice president of business ethics. Baxter Travenol Laboratories, IBM, Caterpillar Tractor, Chemical Bank, ExxonMobil, Dow Corning, and Celanese are firms that have formal codes of business

ethics. A code of business ethics is a document that provides behavioral guidelines that cover daily activities and decisions within an organization.

Merely having a code of ethics, however, is not sufficient to ensure ethical business behavior. A code of ethics can be viewed as a public relations gimmick, a set of platitudes, or window dressing. To ensure that the code is read, understood, believed, and remembered, periodic ethics workshops are needed to sensitize people to workplace circumstances in which ethics issues may arise.2 If employees see examples of punishment for violating the code as well as rewards for upholding the code, this reinforces the importance of a firm's code of ethics. The Web site www.ethicsweb.ca/codes provides guidelines on how to write an effective code of ethics.

An Ethics Culture

An ethics "culture" needs to permeate organizations! To help create an ethics culture, Citicorp developed a business ethics board game that is played by thousands of employees worldwide. Called "The Word Ethic," this game asks players business ethics questions, such as how do you deal with a customer who offers you football tickets in exchange for a new, backdated IRA? Diana Robertson at the Wharton School of Business believes the game is effective because it is interactive. Many organizations have developed a codeof-conduct manual outlining ethical expectations and giving examples of situations that commonly arise in their businesses.

Harris Corporation and other firms warn managers and employees that failing to report an ethical violation by others could bring discharge. The Securities and Exchange Commission (SEC) recently strengthened its whistle-blowing policies, virtually mandating that anyone seeing unethical activity report such behavior. Whistle-blowing refers to policies that require employees to report any unethical violations they discover or see in the firm.

An unidentified whistle-blower in 2009 filed a lawsuit against Amgen Inc., accusing the biotechnology company of illegal marketing of its blockbuster drugs Enbrel and Aranesp. The drug company Wyeth co-markets Enbrel with Amgen, and was named as a defendant too, along with wholesale drug distributor

AmerisourceBergen Corp., online health-information provider WebMD Health Corp., and others. The federal whistle-blower law protects the identity of the plaintiff. In the drug industry, such suits are often filed by former employees.

One reason strategists' salaries are high is that they must take the moral risks of the firm. Strategists are responsible for developing, communicating, and enforcing the code of business ethics for their organizations. Although primary responsibility for ensuring ethical behavior rests with a firm's strategists, an integral part of the responsibility of all managers is to provide ethics leadership by constant example and demonstration. Managers hold positions that enable them to influence and educate many people. This makes managers responsible for developing and implementing ethical decision making. Gellerman and Drucker, respectively, offer some good advice for managers:

All managers risk giving too much because of what their companies demand from them. But the same superiors, who keep pressing you to do more, or to do it better, or faster, or less expensively, will turn on you should you cross that fuzzy line between right and wrong. They will blame you for exceeding instructions or for ignoring their warnings. The smartest managers already know that the best answer to the question "How far is too far?" is don't try to find out.3

A man (or woman) might know too little, perform poorly, lack judgment and ability, and yet not do too much damage as a manager. But if that person lacks character and integrity—no matter how knowledgeable, how brilliant, how successful— he destroys. He destroys people, the most valuable resource of the enterprise. He destroys spirit. And he destroys performance. This is particularly true of the people at the head of an enterprise. For the spirit of an organization is created from the top. If an organization is great in spirit, it is because the spirit of its top people is great. If it decays, it does so because the top rots. As the proverb has it, "Trees die from the top." No one should ever become a strategist unless he or she is willing to have his or her character serve as the model for subordinates.4

No society anywhere in the world can compete very long or successfully with people stealing from one another or not trusting one another, with every bit of information requiring notarized confirmation, with every disagreement ending up in litigation, or with government having to regulate businesses to keep them honest. Being unethical is a recipe for headaches, inefficiency, and waste. History has proven

that the greater the trust and confidence of people in the ethics of an institution or society, the greater its economic strength. Business relationships are built mostly on mutual trust and reputation. Shortterm decisions based on greed and questionable ethics will preclude the necessary selfrespect to gain the trust of others. More and more firms believe that ethics training and an ethics culture create strategic advantage.

Ethics training programs should include messages from the CEO or owner of the business emphasizing ethical business practices, the development and discussion of codes of ethics, and procedures for discussing and reporting unethical behavior. Firms can align ethical and strategic decision making by incorporating ethical considerations into longterm planning, by integrating ethical decision making into the performance appraisal process, by encouraging whistle-blowing or the reporting of unethical practices, and by monitoring departmental and corporate performance regarding ethical issues.

Bribes

Bribery is defined by Black's Law Dictionary as the offering, giving, receiving, or soliciting of any item of value to influence the actions of an official or other person in discharge of a public or legal duty. A bribe is a gift bestowed to influence a recipient's conduct. The gift may be any money, good, right in action, property, preferment, privilege, emolument, object of value, advantage, or merely a promise or undertaking to induce or influence the action, vote, or influence of a person in an official or public capacity. Bribery is a crime in most countries of the world, including the United States.5

Siemens AG, the large German engineering firm, recently was fined $800 million for routinely offering bribes to various companies around the world to win overseas contracts. The U.S. Justice Department and the SEC brought suit against Siemens under the U.S. Foreign Corruptions Act. The Siemens fine was 20 times larger than any previous bribery penalty. The SEC claimed that Siemens made at least 4,283 bribe payments totaling $1.4 billion between 2001 and 2007. These bribes allegedly were paid to government officials in 10 countries.

Paying bribes is considered both illegal and unethical in the United States, but in some foreign countries, paying bribes and kickbacks is acceptable. Tipping is even considered bribery in some countries. Important antibribery and extortion initiatives are advocated by many organizations, including the World Bank, the International Monetary Fund, the European Union, the Council of Europe, the Organization of

American States, the Pacific Basin Economic Council, the Global Coalition for Africa, and the United Nations.

The U.S. Justice Department in mid-2009 increased its prosecutions of alleged acts of foreign bribery. Businesses have to be much more careful these days. For years, taking business associates to lavish dinners and giving them expensive holiday gifts and even outright cash may be expected in many countries, such as South Korea and China, but there is now stepped-up enforcement of bribery laws. Kellogg Brown and Root (KBR) and Halliburton recently paid $579 million for bribing officials in Nigeria.

Love Affairs at Work

A recent Wall Street Journal article recapped current American standards regarding bosssubordinate love affairs at work.6 Only 5 percent of all firms sampled had no restrictions on such relationships; 80 percent of firms have policies that prohibit relationships between a supervisor and a subordinate. Only 4 percent of firms strictly prohibited such relationships, but 39 percent of firms had policies that required individuals to inform their supervisors whenever a romantic relationship begins with a coworker. Only 24 percent of firms required the two persons to be in different departments.

In Europe, romantic relationships at work are largely viewed as private matters and most firms have no policies on the practice. However, European firms are increasingly adopting explicit, American-style sexual harassment laws. The U.S. military strictly bans officers from dating or having sexual relationships with enlistees. At the World Bank, sexual relations between a supervisor and an employee are considered “a de facto conflict of interest which must be resolved to avoid favoritism.” World Bank president Paul Wolfowitz recently was forced to resign due to a relationship he had with a bank staff person.

The United Nations (UN) in mid-2009 was struggling with its own sexual-harassment complaints as many women employees say the organization’s current system for handling complaints is arbitrary, unfair, and mired in bureaucracy. Sexual harassment cases at the UN can take years to adjudicate, and accusers have no access to investigative reports. The UN plans to “soon” make changes to its internal justice system for handling harassment complaints; the UN aspires to protect human rights around the world.

Social Responsibility

Some strategists agree with Ralph Nader, who proclaims that organizations have tremendous social obligations. Nader points out, for example, that Exxon/Mobil has more assets than most countries, and because of this such firms have an obligation to help society cure its many ills. Other people, however, agree with the economist Milton Friedman, who asserts that organizations have no obligation to do any more for society than is legally required. Friedman may contend that it is irresponsible for a firm to give monies to charity.

Do you agree more with Nader or Friedman? Surely we can all agree that the first social responsibility of any business must be to make enough profit to cover the costs of the future because if this is not achieved, no other social responsibility can be met. Indeed, no social need can be met by the firm if the firm fails.

Strategists should examine social problems in terms of potential costs and benefits to the firm, and focus on social issues that could benefit the firm most. For example, should a firm avoid laying off employees so as to protect the employees' livelihood, when that decision may force the firm to liquidate?

Social Policy

The term social policyembraces managerial philosophy and thinking at the highest level of the firm, which is why the topic is covered in this textbook. Social policy concerns what responsibilities the firm has to employees, consumers, environmentalists, minorities, communities, shareholders, and other groups. After decades of debate, many firms still struggle to determine appropriate social policies.

The impact of society on business and vice versa is becoming more pronounced each year. Corporate social policy should be designed and articulated during strategy formulation, set and administered during strategy implementation, and reaffirmed or changed during strategy evaluation.7

In 2009, the most admired companies for social responsibility according to Fortune magazine were as follows:

1. Anheuser-Busch
2. Marriott International
3. Integrys Energy Group
4. Walt Disney
5. Herman Miller
6. Edison

7. Starbucks
8. Steelcase
9. Union Pacific
10. Fortune Brands8

From a social responsibility perspective, these were the least admired companies in 2009:

1. Circuit City Stores
2. Family Dollar Stores
3. Dillard's
4. Sears Holdings
5. Tribune
6. Hon Hai Precision Industry
7. Fiat 8. PEMEX 9. Surgutneftegas
8. Huawei Technologies9

Firms should strive to engage in social activities that have economic benefits. Merck & Co. once developed the drug ivermectin for treating river blindness, a disease caused by a fly-borne parasitic worm endemic in poor tropical areas of Africa, the Middle East, and Latin America. In an unprecedented gesture that reflected its corporate commitment to social responsibility, Merck then made ivermectin available at no cost to medical personnel throughout the world. Merck's action highlights the dilemma of orphan drugs, which offer pharmaceutical companies no economic incentive for profitable development and distribution. Merck did however garner substantial goodwill among its stakeholders for its actions.

Social Policies on Retirement

Some countries around the world are facing severe workforce shortages associated with their aging populations. The percentage of persons age 65 or older exceeds 20 percent in Japan, Italy, and Germany—and will reach 20 percent in 2018 in France. In 2036, the percentage of persons age 65 or older will reach 20 percent in the United States and China. Unlike the United States, Japan is reluctant to rely on large-scale immigration to bolster its workforce. Instead, Japan provides incentives for its elderly to work until ages 65 to 75. Western European countries are doing the opposite, providing incentives for its elderly to retire at ages 55 to 60. The

International Labor Organization says 71 percent of Japanese men ages 60 to 64 work, compared to 57 percent of American men and just 17 percent of French men in the same age group.

Sachiko Ichioka, a typical 67-year-old man in Japan, says, “I want to work as long as I’m healthy. The extra money means I can go on trips, and I’m not a burden on my children.” Better diet and health care have raised Japan’s life expectancy now to 82, the highest in the world. Japanese women are having on average only 1.28 children compared to 2.04 in the United States. Keeping the elderly at work, coupled with reversing the old-fashioned trend of keeping women at home, are Japan’s two key remedies for sustaining its workforce in factories and businesses. This prescription for dealing with problems associated with an aging society should be considered by many countries around the world. The Japanese government is phasing in a shift from age 60 to age 65 as the date when a person may begin receiving a pension, and premiums paid by Japanese employees are rising while payouts are falling. Unlike the United States, Japan has no law against discrimination based on age.

Japan’s huge national debt, 175 percent of gross domestic product (GDP) compared to 65 percent for the United States, is difficult to lower with a falling population because Japan has fewer taxpaying workers. Worker productivity increases in Japan are not able to offset declines in number of workers, thus resulting in a decline in overall economic production. Like many countries, Japan does not view immigration as a good way to solve this problem.

Japan’s shrinking workforce has become such a concern that the government just recently allowed an unspecified number of Indonesian and Filipino nurses and caregivers to work in Japan for two years. The number of working-age Japanese—those between ages 15 and 64—is projected to shrink to 70 million by 2030, from 82 million in 2009. Using foreign workers is known as gaikokujin roudousha in Japanese. Many Filipinos have recently been hired now to work in agriculture and factories throughout Japan. The percentage of foreign workers to the total population is 20 percent in the United States, nearly 10 percent in Germany, 5 percent in the United Kingdom, and less than 1 percent in Japan. But most Japanese now acknowledge that this percentage must move upward, and perhaps quickly, for their nation’s economy to prosper.10

Environmental Sustainability

The strategies of both companies and countries are increasingly scrutinized and evaluated from a nautral environment perspective. Companies such as Wal-Mart now monitor not only the price its vendors offer for products, but also how those products are made in terms of environmental practices. A growing number of business schools offer separate courses and even a concentration in environmental management.

Businesses must not exploit and decimate the natural environment. Mark Starik at George Washington University says, "Halting and reversing worldwide ecological destruction and deterioration is a strategic issue that needs immediate and substantive attention by all businesses and managers. According to the International Standards Organization (ISO), the word environment is defined as "surroundings in which an organization operates, including air, water, land, natural resources, flora, fauna, humans, and their interrelation." This chapter illustrates how many firms are gaining competitive advantage by being good stewards of the natural environment.

Employees, consumers, governments, and society are especially resentful of firms that harm rather than protect the natural environment. Conversely people today are especially appreciative of firms that conduct operations in a way that mends, conserves, and preserves the natural environment. Consumer interest in businesses preserving nature's ecological balance and fostering a clean, healthy environment is high.

No business wants a reputation as being a polluter. A bad sustainability record will hurt the firm in the market, jeopardize its standing in the community, and invite scrutiny by regulators, investors, and environmentalists. Governments increasingly require businesses to behave responsibly and require, for example, that businesses publicly report the pollutants and wastes their facilities produce.

In terms of megawatts of wind power generated by various states in the United States, Iowa's 2,791 recently overtook California's 2,517, but Texas's 7,118 megawatts dwarfs all other states. Minnesota also is making substantial progress in wind power generation. New Jersey recently outfitted 200,000 utility poles with solar panels, which made it the nation's second-largest producer of solar energy behind California. New Jersey is also adding solar panels to corporate rooftops. The state's $514 million solar program will double its solar capacity to 160 megawatts by 2013. The state's goal is to obtain 3 percent of its electricity from the sun and 12 percent from offshore wind by 2020.

What Is a Sustainability Report?

Wal-Mart Stores is one among many companies today that annually provides a sustainability report that reveals how the firm's operations impact the natural environment. This document discloses to shareholders information about Wal-Mart's firm's labor practices, product sourcing, energy efficiency, environmental impact, and business ethics practices.

It is good business for a business to provide a sustainability report annually to the public. With 60,000 suppliers and over $350 billion in annual sales, Wal-Mart works with its suppliers to make sure they provide such reports. Wal-Mart monitors not only prices its vendors' offer for products, but also the vendors' social-responsibility and environmental practices. Many firms use the Wal-Mart sustainability report as a benchmark, guideline, and model to follow in preparing their own report.

The Global Reporting Initiative recently issued a set of detailed reporting guidelines specifying what information should go into sustainability reports. The proxy advisory firm Institutional Shareholder Services reports that an increasing number of shareholder groups are pushing firms to provide sustainability information annually.

Wal-Mart also now encourages and expects its 1.35 million U.S. employees to adopt what it calls Personal Sustainability Projects, which include such measures as organizing weight-loss or smoking-cessation support groups, biking to work, or starting recycling programs. Employee wellness can be a part of sustainability.

Wal-Mart is installing solar panels on its stores in California and Hawaii, providing as much as 30 percent of the power in some stores. Wal-Mart may go national with solar power if this test works well. Also moving to solar energy is department-store chain Kohl's Corp., which is converting 64 of its 80 California stores to using solar power. There are big subsidies for solar installations in some states.

Home Depot, the world's second largest retailer behind Wal-Mart, recently more than doubled its offering of environmentally friendly products such as all-natural insect repellent. Home Depot has made it much easier for consumers to find its organic products by using special labels similar to Timberland's (the outdoor company) Green Index tags. Another huge retailer, Target, now offers more than 500 choices of organic certified food and has 18 buildings in California alone powered

only by solar energy. The largest solar power plant in North America is the one in Nevada that powers Nellis Air Force Base outside Las Vegas.11

Managers and employees of firms must be careful not to become scapegoats blamed for company environmental wrongdoings. Harming the natural environment can be unethical, illegal, and costly. When organizations today face criminal charges for polluting the environment, they increasingly turn on their managers and employees to win leniency. Employee firings and demotions are becoming common in pollution-related legal suits. Managers were fired at Darling International, Inc., and Niagara Mohawk Power Corporation for being indirectly responsible for their firms polluting water. Managers and employees today must be careful not to ignore, conceal, or disregard a pollution problem, or they may find themselves personally liable.

Lack of Standards Changing

A few years ago, firms could get away with placing “green” terminology on their products and labels using such terms as organic, green, safe, earth-friendly, nontoxic, and/or natural because there were no legal or generally accepted definitions. Today, however, such terms as these carry much more specific connotations and expectations. Uniform standards defining environmentally responsible company actions are rapidly being incorporated into our legal landscape. It has become more and more difficult for firms to make “green” claims when their actions are not substantive, comprehensive, or even true. Lack of standards once made consumers cynical about corporate environmental claims, but those claims today are increasingly being challenged in courts. Joel Makower says, “One of the main reasons to truly become a green firm is for your employees. They’re the first group that needs assurance than any claims you make hold water.”12

Around the world, political and corporate leaders now realize that the “business green” topic will not go away and in fact is gaining ground rapidly. Strategically, companies more than ever must demonstrate to their customers and stakeholders that their green efforts are substantive and set the firm apart from competitors. A firm’s performance facts and figures must back up their rhetoric and be consistent with sustainability standards.

Obama Regulations

The Obama administration is imposing strict regulations requiring firms to conserve energy. Federal government buildings are being refitted with energy-efficient improvements. Alternative-energy firms are busy with new customers every day as the federal stimulus package includes adding alternative-energy infrastructure. Venture capitalists and lenders are funding new “clean technology” business start-ups, including solar power, wind power, biofuels, and insulation firms. Such firms are boosting marketing efforts, expanding geographically, and hiring more staff. Venture capital investments in clean technology companies totaled $8.4 billion in 2008, up nearly 40 percent from 2007.

A wide variety of firms are participating in this clean energy growth business, such as Seattle-based Verdiem Corporation. That firm sells software that provides centralized control over power consumption, such as remotely turning off computer monitors left on overnight.13 General Electric plans to achieve $20 billion in sales by 2011 in eco-friendly technologies that include cleaner coal-fired power plants, a diesel-and-electric hybrid locomotive, and agricultural silicon that cuts the amount of water and pesticide used in spraying fields. This is double GE’s sales today in “green” products. GE has a goal to improve its energy efficiency by 30 percent between 2005 and 2012.

The Environmental Protection Agency recently reported that U.S. citizens and organizations annually spend more than about $200 billion on pollution abatement. Environmental concerns touch all aspects of a business’s operations, including workplace risk exposures, packaging, waste reduction, energy use, alternative fuels, environmental cost accounting, and recycling practices.

Managing Environmental

Affairs in the Firm The ecological challenge facing all organizations requires managers to formulate strategies that preserve and conserve natural resources and control pollution. Special natural environment issues include ozone depletion, global warming, depletion of rain forests, destruction of animal habitats, protecting endangered species, developing biodegradable products and packages, waste management, clean air, clean water, erosion, destruction of natural resources, and pollution control. Firms increasingly are developing green product lines that are biodegradable and/or are made from recycled products. Green products sell well.

Managing as if "health of the planet" matters requires an understanding of how international trade, competitiveness, and global resources are connected. Managing environmental affairs can no longer be simply a technical function performed by specialists in a firm; more emphasis must be placed on developing an environmental perspective among all employees and managers of the firm. Many companies are moving environmental affairs from the staff side of the organization to the line side, thus making the corporate environmental group report directly to the chief operating officer. Firms that manage environmental affairs will enhance relations with consumers, regulators, vendors, and other industry players, substantially improving their prospects of success.

Environmental strategies could include developing or acquiring green businesses, divesting or altering environment-damaging businesses, striving to become a low-cost producer through waste minimization and energy conservation, and pursuing a differentiation strategy through green-product features. In addition, firms could include an environmental representative on their board of directors, conduct regular envrionmental audits, implement bonuses for favorable environmental results, become involved in environmental issues and programs, incorporate environmental values in mission statements, establish environmentally oriented objectives, acquire environmental skills, and provide environmental training programs for company employees and managers.

Should Students Receive Environmental Training?

The Wall Street Journal reports that companies actively consider environmental training in employees they hire. A recent study reported that 77 percent of corporate recruiters said "it is important to hire students with an awareness of social and environmental responsibility." According to Ford Motor Company's director of corporate governance, "We want students who will help us find solutions to societal challenges and we have trouble hiring students with such skills."

The Aspen Institute contends that most business schools currently do not, but should, incorporate environmental training in all facets of their core curriculum, not just in special elective courses. The institute reports that the University of Texas, the University of North Carolina, and the University of Michigan, among others, are at the cutting edge in providing environmental coverage at their respective MBA levels. Companies favor hiring graduates from such universities.

Findings from research suggest that business schools at the undergraduate level are doing a poor job of educating students on environmental issues. Business students with limited knowledge on environmental issues may make poor decisions, so business schools should address environmental issues more in their curricula. Failure to do so could result in graduates making inappropriate business decisions in regard to the natural environment. Failing to provide adequate coverage of natural environment issues and decisions in their training could make those students less attractive to employers.14

Reasons Why Firms Should "Be Green"

Preserving the environment should be a permanent part of doing business for the following reasons:

1. Consumer demand for environmentally safe products and packages is high.
2. Public opinion demanding that firms conduct business in ways that preserve the natural environment is strong.
3. Environmental advocacy groups now have over 20 million Americans as members.
4. Federal and state environmental regulations are changing rapidly and becoming more complex.
5. More lenders are examining the environmental liabilities of businesses seeking loans.

6. Many consumers, suppliers, distributors, and investors shun doing business with environmentally weak firms.
7. Liability suits and fines against firms having environmental problems are on the rise.

Be Proactive,Not Reactive

More firms are becoming environmentally proactive—doing more than the bare minimum to develop and implement strategies that preserve the environment. The old undesirable alternative of being environmentally reactive—changing practices only when forced to do so by law or consumer pressure more often today leads to high cleanup costs, liability suits, reduced market share, reduced customer loyalty, and higher medical costs. In contrast, a proactive policy views environmental pressures as opportunities and includes such actions as developing green products and packages, conserving energy, reducing waste, recycling, and creating a corporate culture that is environmentally sensitive.

New required diesel technology has reduced emissions by up to 98 percent in all new big trucks, at an average cost increase of $12,000 per truck. "Clean air is not free," says Rich Moskowitz, who handles regulatory affairs for the American Trucking Association, which supports the transition.15

ISO 14000/14001 Certification

Based in Geneva, Switzerland, the International Organization for Standardization (ISO) is a network of the national standards institutes of 147 countries, one member per country. ISO is the world's largest developer of sustainability standards. Widely accepted all over the world, ISO standards are voluntary because ISO has no legal authority to enforce their implementation. ISO itself does not regulate or legislate.

Governmental agencies in various countries, such as the Environmental Protection Agency (EPA) in the United States, have adopted ISO standards as part of their regulatory framework, and the standards are the basis of much legislation. Adoptions are sovereign decisions by the regulatory authorities, governments, and/or companies concerned.

ISO 14000refers to a series of voluntary standards in the environmental field. The ISO 14000 family of standards concerns the extent to which a firm minimizes harmful

effects on the environment caused by its activities and continually monitors and improves its own environmental performance. Included in the ISO 14000 series are the ISO 14001 standards in fields such as environmental auditing, environmental performance evaluation, environmental labeling, and life-cycle assessment.

ISO 14001 is a set of standards adopted by thousands of firms worldwide to certify to their constituencies that they are conducting business in an environmentally friendly manner. ISO 14001 standards offer a universal technical standard for environmental compliance that more and more firms are requiring not only of themselves but also of their suppliers and distributors.

The ISO 14001 standard requires that a community or organization put in place and implement a series of practices and procedures that, when taken together, result in an environmental management system (EMS). ISO 14001 is not a technical standard and as such does not in any way replace technical requirements embodied in statutes or regulations. It also does not set prescribed standards of performance for organizations. Not being ISO 14001 certified can be a strategic disadvantage for towns, counties, and companies because people today expect organizations to
minimize or, even better, to eliminate environmental harm they cause.16 The major requirements of an EMS under ISO 14001 include the following:

1. Show commitments to prevention of pollution, continual improvement in overall environmental performance, and compliance with all applicable statutory and regulatory requirements.
2. Identify all aspects of the organization's activities, products, and services that could have a significant impact on the environment, including those that are not regulated.
3. Set performance objectives and targets for the management system that link back to three policies: (1) prevention of pollution, (2) continual improvement, and (3) compliance.
4. Meet environmental objectives that include training employees, establishing work instructions and practices, and establishing the actual metrics by which the objectives and targets will be measured.
5. Conduct an audit operation of the EMS.
6. Take corrective actions when deviations from the EMS occur.

Electric Car Networks Are Coming

In August 2009, President Obama announced $2.4 billion in funding for electric car manufacturing. Grants will go to 11 companies in Michigan and 7 in Indiana that are matching the funds. The company Better Place is building a network of 250,000 electric car recharging stations in the San Francisco/Oakland Bay Area. Each station is about the size of a parking meter.

The company has already built such networks in Denmark, Israel, and Australia. City officials in the Bay Area expect that region to lead the United States in electric cars in the near future. The stations are essential because most electric cars need recharging after about 40 miles. Better Place is also building about 200 stations in the Bay Area where electric car batteries can be switched out within 15 minutes, so no waiting is needed for recharging. Even with petroleum prices at low levels, expectations are for the United States and other countries to switch to electric cars quite aggressively over the next 10 years—for pollution minimization reasons and to take advantage of government incentives and eventual mandates.

General Motors and Chrysler are pouring money into developing electric plug-in vehicles. GM is expected to launch its Chevy Volt in late 2010 in the United States. Nissan Motor Co. and Toyota Motor Co. are also quickly developing electric cars.

The Chinese auto maker BYD Co. recently unveiled the country's first all-electric vehicle for mass market. The company's F3DM vehicle runs off batteries that can be charged from a regular electrical outlet. BYD plans to sell this car in the United States in 2010. BYD sold about 10,000 F3DMs in 2009 at a price of 150,000 yuan, or $22,000 each. BYD is headquartered in Shenzhen.

Hawaii is creating an electric car network for the islands that by 2012 is expected to wean the state from near-complete dependence on oil for its energy needs. The firm Better Place is creating 70,000 to 100,000 recharging points throughout the islands to support plug-in electric cars. Under the Hawaii Clean Energy Initiative, the state intends to cut its dependence on oil to 30 percent by 2030. Hawaiians pay very high electricity prices because costly oil is burned to produce power. Electric cars have a driving range of 40 miles between charges, which is suitable for Hawaii.17

AT&T Inc. in 2009 committed to spend $565 million over 10 years to replace its 7,100 passenger cars with 8,000 hybrid-electric and natural gas vans to perform its installation and repair activities. The company is paying on average 29 percent more
for these vehicles than it would for gasoline-powered models, but this expense will be offset by lower fuel costs, less emissions, and enhanced public image. The AT&T strategy will reduce carbon emissions by 211,000 metric tons over 10 years. AT&T is working with natural gas providers to build up to 40 fueling stations across its operating region. There are only about 110,000 natural gas vehicles in the United States compared to over 10 million such vehicles worldwide. This bold move by AT&T expands on similar initiatives by United Parcel Service and PG&E.18

The March 2009 Copenhagen Meeting

More than 2,000 scientists convened together in Copenhagen in March 2009 and warned the world that global warming is worse than expected. They strongly encouraged companies and governments to "vigorously" implement all economic and technological tools available to cut emissions of heat-trapping greenhouse gases. By the end of this century, scientists warn, sea levels will rise at least 20 inches and possibly as much as 39 inches unless companies and governments implement policies to radically reduce greenhouse gas emissions.

The Kyoto Protocal expires in 2012, and the results of this March 2009 Copenhagen Meeting are expected to replace that agreement. Near-coastal areas worldwide will be under water by the end of this century if drastic actions are not implemented soon worldwide to curb greenhouse gas emissions from companies, cars, trucks, power-generating plants, and planes.

Table 10-1 reveals the impact that bad environmental policies have on two of nature's many ecosystems.

TABLE 10-1 Songbirds and Coral Reefs Need Help

Songbirds
Be a good steward of the natural environment to save our songbirds. Bluebirds are one of 76 songbird species in the United States that have dramatically declined in numbers in the last two decades. Not all birds are considered songbirds, and why birds sing is not clear. Some scientists say they sing when calling for mates or warning of danger, but many scientists now contend that birds sing for sheer pleasure. Songbirds include chickadees, orioles, swallows, mockingbirds, warblers, sparrows, vireos, and the wood thrush. "These birds are telling us there's a problem, something's out of balance in our environment," says Jeff Wells, bird conservation director for the National Audubon Society. Songbirds may be telling us that their air or water is too dirty or that we are destroying too much of their habitat. People collect Picasso paintings and save historic buildings. "Songbirds are part of our natural heritage. Why should we be willing to watch songbirds destroyed any more than allowing a great work of art to be destroyed?" asks Wells. Whatever message songbirds are singing to us today about their natural environment, the message is becoming less and less heard nationwide. Listen when you go outside today. Each of us as individuals, companies, states, and countries should do what we reasonably can to help improve the natural environment for songbirds.[19] A recent study concludes that 67 of the 800 bird species in the United States are endangered, and another 184 species are designated of "conservation concern." The birds of Hawaii are in the greatest peril.
Coral Reefs
Be a good steward of the natural environment to save our coral reefs. The ocean covers more than 71 percent of the earth. The destructive effect of commercial fishing on ocean habitats coupled with increasing pollution runoff into the ocean and global warming of the ocean have decimated fisheries, marine life, and coral reefs around the world. The unfortunate consequence of fishing over the last century has been overfishing, with the principal reasons being politics and greed. Trawl fishing with nets destroys coral reefs and has been compared to catching squirrels by cutting down forests because bottom nets scour and destroy vast areas of the ocean. The great proportion of marine life caught in a trawl is "by-catch" juvenile fish and other life that are killed and discarded. Warming of the ocean due to carbon dioxide emissions also kills thousands of acres of coral reefs annually. The total area of fully protected marine habitats in the United States is only about 50 square miles, compared to some 93 million acres of national wildlife refuges and national parks on the nation's land. A healthy ocean is vital to the economic and social future of the nation—and, indeed, all countries of the world. Everything we do on land ends up in the ocean, so we all must become better stewards of this last frontier on earth in order to sustain human survival and the quality of life.[20]

Chapter 12
GLOBAL/INTERNATIONAL ISSUES

Global/International Issues

A note from David

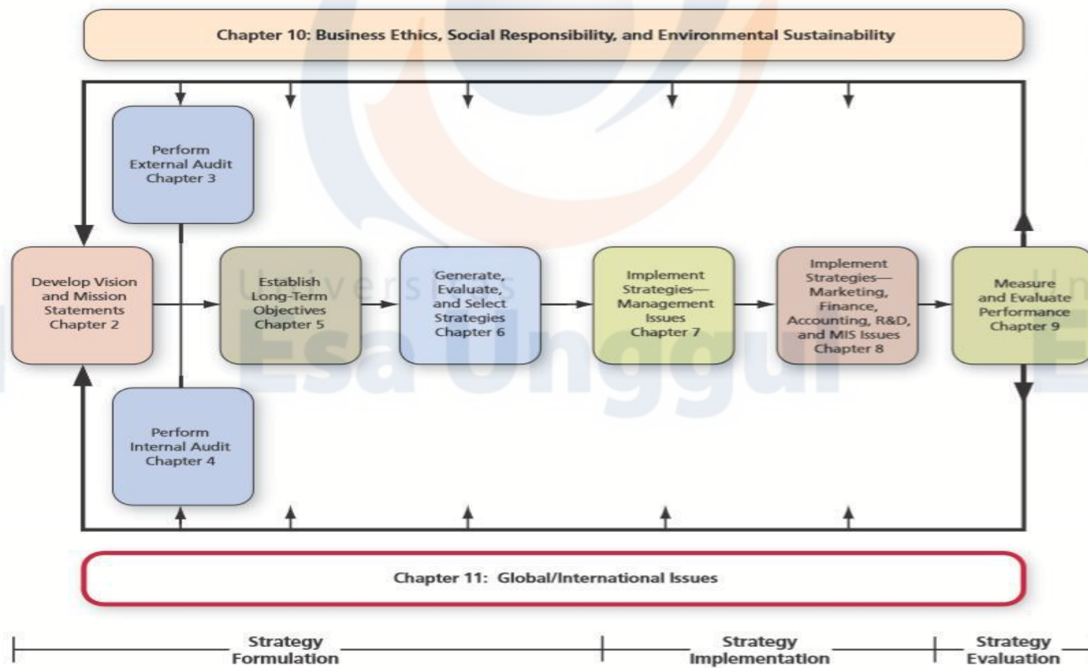
As illustrated in Figure 11-1, global considerations impact virtually all strategic decisions. The boundaries of countries no longer can define the limits of our imaginations. To see and appreciate the world from the perspective of others has become a matter of survival for businesses. The underpinnings of strategic management hinge on managers gaining an understanding of competitors, markets, prices, suppliers, distributors, governments, creditors, shareholders, and customers worldwide. The price and quality of a firm's products and services must be competitive on a worldwide basis, not just on a local basis. As indicated above, Marriott International is an example global business that performed outstandingly well during the recent global recession. The World Trade Organization (WTO) in March 2009 issued the most pessimistic report on global trade in its 62-year history: that global trade would drop by 9 percent or more in 2009.1

A world market has emerged from what previously was a multitude of distinct national markets, and the climate for international business today is more favorable than in years past. Mass communication and high technology have created similar patterns of consumption in diverse cultures worldwide. This means that many companies may find it difficult to survive by relying solely on domestic markets.

It is not exaggeration that in an industry that is, or is rapidly becoming, global, the riskiest possible posture is to remain a domestic competitor. The domestic competitor will watch as more aggressive companies use this growth to capture economies of scale and learning. The domestic competitor will then be faced with an attack on domestic markets using different (and possibly superior) technology, product design, manufacturing, marketing approaches, and economies of scale.2

FIGURE 11-1

A Comprehensive Strategic-Management Mode



Source: Fred R. David, "How Companies Define Their Mission," *Long Range Planning* 22, no. 3 (June 1988): 40.

Multinational Organizations

Organizations that conduct business operations across national borders are called international firms or multinational corporations. The strategic-management process is conceptually the same for multinational firms as for purely domestic firms; however, the process is more complex for international firms due to more variables and relationships. The social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive opportunities and threats that face a multinational corporation are almost limitless, and the number and complexity of these factors increase dramatically with the number of products produced and the number of geographic areas served.

More time and effort are required to identify and evaluate external trends and events in multinational corporations than in domestic corporations. Geographic distance, cultural and national differences, and variations in business practices often make communication between domestic headquarters and overseas operations difficult. Strategy implementation can be more difficult because different cultures have different norms, values, and work ethics. Multinational corporations (MNCs) face unique and diverse risks, such as expropriation of assets, currency losses through exchange rate fluctuations, unfavorable foreign court interpretations of contracts and agreements, social/political disturbances, import/ export restrictions, tariffs, and trade barriers. Strategists in MNCs are often confronted with the need to be globally

competitive and nationally responsive at the same time. With the rise in world commerce, government and regulatory bodies are more closely monitoring foreign business practices. The U.S. Foreign Corrupt Practices Act, for example, monitors business practices in many areas.

Before entering international markets, firms should scan relevant journals and patent reports, seek the advice of academic and research organizations, participate in international trade fairs, form partnerships, and conduct extensive research to broaden their contacts and diminish the risk of doing business in new markets. Firms can also offset some risks of doing business internationally by obtaining insurance from the U.S. government's Overseas Private Investment Corporation (OPIC). Philips Electronics NV is one of many firms moving into emerging markets. A few of Philips's acquisitions in the year 2008 alone were Medel in Italy, Meditronics in India, Alpha X-Ray Technologies in India, Dixtal Biomedica & Tecnologia in Brazil, Shenzhen Goldway Industrial in China, and VMI-Sistemes Medicos in Brazil.

Advantages and Disadvantages of International Operations

Firms have numerous reasons for formulating and implementing strategies that initiate, continue, or expand involvement in business operations across national borders. Perhaps the greatest advantage is that firms can gain new customers for their products and services, thus increasing revenues. Growth in revenues and profits is a common organizational objective and often an expectation of shareholders because it is a measure of organizational success. Potential advantages to initiating, continuing, and/or expanding international operations are as follows:

1. Firms can gain new customers for their products.
2. Foreign operations can absorb excess capacity, reduce unit costs, and spread economic risks over a wider number of markets.
3. Foreign operations can allow firms to establish low-cost production facilities in locations close to raw materials and/or cheap labor.
4. Competitors in foreign markets may not exist, or competition may be less intense than in domestic markets.

5. Foreign operations may result in reduced tariffs, lower taxes, and favorable political treatment.
6. Joint ventures can enable firms to learn the technology, culture, and business practices of other people and to make contacts with potential customers, suppliers, creditors, and distributors in foreign countries.
7. Economies of scale can be achieved from operation in global rather than solely domestic markets. Larger-scale production and better efficiencies allow higher sales volumes and lower-price offerings.
8. A firm's power and prestige in domestic markets may be significantly enhanced if the firm competes globally.

Enhanced prestige can translate into improved negotiating power among creditors, suppliers, distributors, and other important groups. The availability, depth, and reliability of economic and marketing information in different countries vary extensively, as do industrial structures, business practices, and the number and nature of regional organizations. There are also numerous potential disadvantages of initiating, continuing, or expanding business across national borders, such as the following:

1. Foreign operations could be seized by nationalistic factions.
2. Firms confront different and often little-understood social, cultural, demographic, environmental, political, governmental, legal, technological, economic, and competitive forces when doing business internationally. These forces can make communication difficult in the firm.
3. Weaknesses of competitors in foreign lands are often overestimated, and strengths are often underestimated. Keeping informed about the number and nature of competitors is more difficult when doing business internationally.
4. Language, culture, and value systems differ among countries, which can create barriers to communication and problems managing people.
5. Gaining an understanding of regional organizations such as the European Economic Community, the Latin American Free Trade Area, the International Bank for

Reconstruction and Development, and the International Finance Corporation is difficult but is often required in doing business internationally.

6. Dealing with two or more monetary systems can complicate international business operations.

The Global Challenge

Foreign competitors are battering U.S. firms in many industries. In its simplest sense, the global challenge faced by U.S. business is twofold: (1) how to gain and maintain exports to other nations and (2) how to defend domestic markets against imported goods. Few companies can afford to ignore the presence of international competition. Firms that seem insulated and comfortable today may be vulnerable tomorrow; for example, foreign banks do not yet compete or operate in most of the United States, but this too is changing.

America's economy is becoming much less American. A world economy and monetary system are emerging. Corporations in every corner of the globe are taking advantage of the opportunity to obtain customers globally. Markets are shifting rapidly and in many cases converging in tastes, trends, and prices. Innovative transport systems are accelerating the transfer of technology. Shifts in the nature and location of production systems, especially to China and India, are reducing the response time to changing market conditions.

More and more countries around the world are welcoming foreign investment and capital. As a result, labor markets have steadily become more international. East Asian countries are market leaders in labor-intensive industries, Brazil offers abundant natural resources and rapidly developing markets, and Germany offers skilled labor and technology. The drive to improve the efficiency of global business operations is leading to greater functional specialization. This is not limited to a search for the familiar low-cost labor in Latin America or Asia. Other considerations include the cost of energy, availability of resources, inflation rates, tax rates, and the nature of trade regulations.

Many countries became more protectionist during the recent global economic recession. Protectionism refers to countries imposing tariffs, taxes, and regulations on firms outside the country to favor their own companies and people. Most economists argue that protectionism harms the world economy because it inhibits trade among countries and invites retaliation. When China joined the World Trade Organization in 2001, that country agreed to respect copyright protections and liberalize restrictions on the import and distribution of foreign-made goods. However, Chinese counterfeiters still can be criminally prosecute for commercial piracy only when caught in possession of at least 500 counterfeit items.3 In China, pirated goods such as Nike running shoes, new Hollywood movies on DVD, and Microsoft software can be purchased for a fraction of their actual prices on many streets. China still has substantial barriers to sales of authentic U.S.-made copyrighted products. Former U.S. Trade Representative Susan Schwab says, "This is more than a handbag here or a logo item there; it is often theft on a grand scale." China's counterfeit trade practices contribute to an annual bilateral trade deficit of about $250 billion with the United States. Chinese pirating of products is an external threat facing many firms.

Advancements in telecommunications are drawing countries, cultures, and organizations worldwide closer together. Foreign revenue as a percentage of total company revenues already exceeds 50 percent in hundreds of U.S. firms, including Exxon/Mobil, Gillette, Dow Chemical, Citicorp, Colgate-Palmolive, and Texaco. A primary reason why most domestic firms are engaging in global operations is that growth in demand for goods and services outside the United States is considerably higher than inside. For example, the domestic food industry is growing just 3 percent per year, so Kraft Foods, the second largest food company in the world behind Nestle, is focusing on foreign acquisitions.

Shareholders and investors expect sustained growth in revenues from firms; satisfactory growth for many firms can only be achieved by capitalizing on demand outside the United States. Joint ventures and partnerships between domestic and foreign firms are becoming the rule rather than the exception!

Fully 95 percent of the world's population lives outside the United States, and this group is growing 70 percent faster than the U.S. population. The lineup of competitors in virtually all industries is global. General Motors, Ford, and Chrysler compete with Toyota and Hyundai. General Electric and Westinghouse battle Siemens and Mitsubishi. Caterpillar and John Deere compete with Komatsu. Goodyear battles Michelin, Bridgestone/Firestone, and Pirelli. Boeing competes with Airbus. Only a few U.S. industries—such as furniture, printing, retailing, consumer packaged goods, and retail banking—are not yet greatly challenged by foreign competitors. But many products and components in these industries too are now manufactured in foreign countries. International operations can be as simple as exporting a product to a single foreign country or as complex as operating manufacturing, distribution, and marketing facilities in many countries.

Globalization

Globalization is a process of doing business worldwide, so strategic decisions are made based on global profitability of the firm rather than just domestic considerations. A global strategy seeks to meet the needs of customers worldwide, with the highest value at the lowest cost. This may mean locating production in countries with the lowest labor costs or abundant natural resources, locating research and complex engineering centers where skilled scientists and engineers can be found, and locating marketing activities close to the markets to be served. A global strategy includes designing, producing, and marketing products with global needs in mind, instead of considering individual countries alone.

A global strategy integrates actions against competitors into a worldwide plan. Today, there are global buyers and sellers, and the instant transmission of money and information across continents. It is clear that different industries become global for different reasons. The need to amortize massive R&D investments over many markets is a major reason why the aircraft manufacturing industry became global. Monitoring globalization in one's industry is an important strategic-management activity.

Knowing how to use that information for one's competitive advantage is even more important. For example, firms may look around the world for the best technology and select one that has the most promise for the largest number of markets. When firms design a product, they design it to be marketable in as many countries as possible. When firms manufacture a product, they select the lowest-cost source, which may be Japan for semiconductors, Sri Lanka for textiles, Malaysia for simple electronics, and Europe for precision machinery.

A Weak Economy

A weak economy still plagues many countries around the world. The British pound reached a 23-year low against the U.S. dollar in January 2009. Two consecutive quarters of a decline in real gross domestic product is commonly used as a definition of a recession, and the last quarter of 2008 marked this occurrence in the United Kingdom. The speed and breadth at which the United Kingdom's economy shrunk makes economists think the UK recession could last through 2012. Like the U.S. government, the UK government has poured hundreds of billions of pounds into stimulus and financial bailout measures. Further interest rate cuts by the Bank of England are expected soon, although the bank's rates are already the lowest in the bank's 315-year history. The pound's fall has done little to boost exports. David Sandall, a businessman in Cheshire, Northern England, says, "It doesn't matter what the price of something is if your customer hasn't got the money." And that is the primary situation in the United Kingdom's two largest trading regions—Europe and the United States.

Unemployment rates are high across the United States and around the world. Consumer spending remains low and cautious while banks continue to be reluctant to loan money. Stock prices have rebounded, but many investors still have an appetite only for government securities. New corporate profit warnings and bankruptcies spell continued recession in many countries.

United States versus Foreign Business Cultures

To compete successfully in world markets, U.S. managers must obtain a better knowledge of historical, cultural, and religious forces that motivate and drive people in other countries. In Japan, for example, business relations operate within the context of Wa, which stresses group harmony and social cohesion. In China, business behavior revolves around guanxi, or personal relations. In South Korea, activities involve concern for inhwa, or harmony based on respect of hierarchical relationships, including obedience to authority.4

In Europe, it is generally true that the farther north on the continent, the more participatory the management style. Most European workers are unionized and enjoy more frequent vacations and holidays than U.S. workers. A 90-minute lunch break plus 20-minute morning and afternoon breaks are common in European firms. Guaranteed permanent employment is typically a part of employment contracts in Europe. In socialist countries such as France, Belgium, and the United Kingdom, the only grounds for immediate dismissal from work is a criminal offense. A six-month trial period at the beginning of employment is usually part of the contract with a European firm. Many Europeans resent pay-for-performance, commission salaries, and objective measurement and reward systems. This is true especially of workers in southern Europe. Many Europeans also find the notion of team spirit difficult to grasp because the unionized environment has dichotomized worker–management relations throughout Europe.

A weakness of some U.S. firms in competing with Pacific Rim firms is a lack of understanding of Asian cultures, including how Asians think and behave. Spoken Chinese, for example, has more in common with spoken English than with spoken Japanese or Korean. U.S. managers consistently put more weight on being friendly and liked, whereas Asian and European managers often exercise authority without this concern. Americans tend to use first names instantly in business dealings with foreigners, but foreigners find this presumptuous. In Japan, for example, first names are used only among family members and intimate friends; even longtime business associates and

coworkers shy away from the use of first names. Table 11-1 lists other cultural differences or pitfalls that

U.S. managers need to know about. U.S. managers have a low tolerance for silence, whereas Asian managers view extended periods of silence as important for organizing and evaluating one's thoughts. U.S. managers are much more action oriented than their counterparts around the world; they rush to appointments, conferences, and meetings—and then feel the day has been productive. But for many foreign managers, resting, listening, meditating, and thinking is considered productive.

TABLE 11-1 Cultural Pitfalls That May Help You Be a Better Manager

- Waving is a serious insult in Greece and Nigeria, particularly if the hand is near someone's face.
- Making a "good-bye" wave in Europe can mean "No," but it means "Come here" in Peru.
- In China, last names are written first.
- A man named Carlos Lopez-Garcia should be addressed as Mr. Lopez in Latin America but as Mr. Garcia in Brazil.
- Breakfast meetings are considered uncivilized in most foreign countries.
- Latin Americans are on average 20 minutes late to business appointments.
- Direct eye contact is impolite in Japan.
- Don't cross your legs in any Arab or many Asian countries—it's rude to show the sole of your shoe.
- In Brazil, touching your thumb and first finger—an American "Okay" sign—is the equivalent of raising your middle finger.
- Nodding or tossing your head back in southern Italy, Malta, Greece, and Tunisia means "No." In India, this body motion means "Yes."
- Snapping your fingers is vulgar in France and Belgium.
- Folding your arms across your chest is a sign of annoyance in Finland.
- In China, leave some food on your plate to show that your host was so generous that you couldn't finish.
- Do not eat with your left hand when dining with clients from Malaysia or India.
- One form of communication works the same worldwide. It's the smile—so take that along wherever you go.

Sitting through a conference without talking is unproductive in the United States, but it is viewed as positive in Japan if one's silence helps preserve unity. U.S.
managers place greater emphasis on short-term results than foreign managers. In marketing, for example, Japanese managers strive to achieve "everlasting customers," whereas many Americans strive to make a onetime sale. Marketing managers in Japan see making a sale as the beginning, not the end, of the selling process. This is an important distinction. Japanese managers often criticize U.S. managers for worrying more about shareholders, whom they do not know, than employees, whom they do know. Americans refer to "hourly employees," whereas many Japanese companies still refer to "lifetime employees." Rose Knotts recently summarized some important cultural differences between U.S. and foreign managers:5

1. Americans place an exceptionally high priority on time, viewing time as an asset. Many foreigners place more worth on relationships. This difference results in foreign managers often viewing U.S. managers as “more interested in business than people.”
2. Personal touching and distance norms differ around the world. Americans generally stand about three feet from each other when carrying on business conversations, but Arabs and Africans stand about one foot apart. Touching another person with the left hand in business dealings is taboo in some countries. American managers need to learn the personal-space rules of foreign managers with whom they interact in business.
3. Family roles and relationships vary in different countries. For example, males are valued more than females in some cultures, and peer pressure, work situations, and business interactions reinforce this phenomenon.
4. Business and daily life in some societies are governed by religious factors. Prayer times, holidays, daily events, and dietary restrictions, for example, need to be respected by American managers not familiar with these practices in some countries.
5. Time spent with the family and the quality of relationships are more important in some cultures than the personal achievement and accomplishments espoused by the traditional U.S. manager.
6. Many cultures around the world value modesty, team spirit, collectivity, and patience much more than the competitiveness and individualism that are so important in the United States.
7. Punctuality is a valued personal trait when conducting business in the United States, but it is not revered in many of the world’s societies. Eating habits also differ dramatically across cultures. For example, belching is acceptable in some countries as evidence of satisfaction with the food that has been prepared. Chinese culture considers it good manners to sample a portion of each food served.
8. To prevent social blunders when meeting with managers from other lands, one must learn and respect the rules of etiquette of others. Sitting on a toilet seat is viewed as unsanitary in most countries, but not in the United States. Leaving food or drink after

dining is considered impolite in some countries, but not in China. Bowing instead of shaking hands is customary in many countries. Some cultures view Americans as unsanitary for locating toilet and bathing facilities in the same area, whereas Americans view people of some cultures as unsanitary for not taking a bath or shower every day.

9. Americans often do business with individuals they do not know, unlike businesspersons in many other cultures. In Mexico and Japan, for example, an amicable relationship is often mandatory before conducting business.

In many countries, effective managers are those who are best at negotiating with government bureaucrats rather than those who inspire workers. Many U.S. managers are uncomfortable with nepotism and bribery, which are practiced in some countries. The United States has gained a reputation for defending women from sexual harassment and minorities from discrimination, but not all countries embrace the same values.

American managers in China have to be careful about how they arrange office furniture because Chinese workers believe in feng shui, the practice of harnessing natural forces. U.S. managers in Japan have to be careful about nemaswashio, whereby Japanese workers expect supervisors to alert them privately of changes rather than informing them in a meeting. Japanese managers have little appreciation for versatility, expecting all managers to be the same. In Japan, "If a nail sticks out, you hit it into the wall," says Brad Lashbrook, an international consultant for Wilson Learning.

Probably the biggest obstacle to the effectiveness of U.S. managers—or managers from any country working in another—is the fact that it is almost impossible to change the attitude of a foreign workforce. "The system drives you; you cannot fight the system or culture," says Bill Parker, president of Phillips Petroleum in Norway.

The Mexican Culture

Mexico is an authoritarian society in terms of schools, churches, businesses, and families. Employers seek workers who are agreeable, respectful, and obedient, rather than innovative, creative, and independent. Mexican workers tend to be activity oriented rather than problem solvers. When visitors walk into a Mexican business, they are impressed by the cordial, friendly atmosphere. This is almost always true because Mexicans desire harmony rather than conflict; desire for harmony is part of the social fabric in worker–manager relations. There is a much lower tolerance for adversarial relations or friction at work in Mexico as compared to the United States.

Mexican employers are paternalistic, providing workers with more than a paycheck, but in return they expect allegiance. Weekly food baskets, free meals, free bus service, and free day care are often part of compensation. The ideal working condition for a Mexican worker is the family model, with people all working together, doing their share, according to their designated roles. Mexican workers do not expect or desire a work environment in which self-expression and initiative are encouraged. Whereas U.S. business embodies individualism, achievement, competition, curiosity, pragmatism, informality, spontaneity, and doing more than expected on the job, Mexican businesses stress collectivism, continuity, cooperation, belongingness, formality, and doing exactly what you're told.

In Mexico, business associates rarely entertain each other at their homes, which are places reserved exclusively for close friends and family. Business meetings and entertaining are nearly always done at a restaurant. Preserving one's honor, saving face, and looking important are also exceptionally important in Mexico. This is why Mexicans do not accept criticism and change easily; many find it humiliating to acknowledge having made a mistake. A meeting among employees and managers in a business located in Mexico is a forum for giving orders and directions rather than for discussing problems or participating in decision making. Mexican workers want to be closely supervised, cared for, and corrected in a civil manner. Opinions expressed by employees are often regarded as back talk in Mexico. Mexican supervisors are viewed as weak if they explain the rationale for their orders to workers.

Mexicans do not feel compelled to follow rules that are not associated with a particular person in authority they work for or know well. Thus signs to wear earplugs or safety glasses, or attendance or seniority policies, and even one-way street signs are often ignored. Whereas Americans follow the rules, Mexicans often do not.

Life is slower in Mexico than in the United States. The first priority is often assigned to the last request, rather than to the first. Telephone systems break down. Banks may suddenly not have pesos. Phone repair can take a month. Electricity for an entire plant or town can be down for hours or even days. Business and government offices may open and close at odd hours. Buses and taxis may be hours off schedule. Meeting times for appointments are not rigid. Tardiness is common everywhere. Effectively doing business in Mexico requires knowledge of the Mexican way of life, culture, beliefs, and customs.

The Japanese Culture

The Japanese place great importance on group loyalty and consensus, a concept called Wa. Nearly all corporate activities in Japan encourage Wa among managers and employees. Wa requires that all members of a group agree and cooperate; this results in constant discussion and compromise. Japanese managers evaluate the potential attractiveness of alternative business decisions in terms of the long-term effect on the group's Wa. This is why silence, used for pondering alternatives, can be a plus in a formal Japanese meeting. Discussions potentially disruptive to Wa are generally conducted in very informal settings, such as at a bar, so as to minimize harm to the group's Wa. Entertaining is an important business activity in Japan because it strengthens Wa. Formal meetings are often conducted in informal settings. When confronted with disturbing questions or opinions, Japanese managers tend to remain silent, whereas Americans tend to respond directly, defending themselves through explanation and argument.

Most Japanese managers are reserved, quiet, distant, introspective, and other oriented, whereas most U.S. managers are talkative, insensitive, impulsive, direct, and

individual oriented. Americans often perceive Japanese managers as wasting time and carrying on pointless conversations, whereas U.S. managers often use blunt criticism, ask prying questions, and make quick decisions. These kinds of cultural differences have disrupted many potentially productive Japanese–American business endeavors. Viewing the Japanese communication style as a prototype for all Asian cultures is a stereotype that must be avoided.

Communication Differences Across Countries

Americans increasingly interact with managers in other countries, so it is important to understand foreign business cultures. Americans often come across as intrusive, manipulative, and garrulous; this impression may reduce their effectiveness in communication. Forbes recently provided the following cultural hints from Charis Intercultural Training:

1. Italians, Germans, and French generally do not soften up executives with praise before they criticize. Americans do soften up folks, and this practice seems manipulative to Europeans.
2. Israelis are accustomed to fast-paced meetings and have little patience for American informality and small talk.
3. British executives often complain that American executives chatter too much. Informality, egalitarianism, and spontaneity from Americans in business settings jolt many foreigners.
4. Europeans feel they are being treated like children when asked to wear name tags by Americans.
5. Executives in India are used to interrupting one another. Thus, when American executives listen without asking for clarification or posing questions, they are viewed by Indians as not paying attention.
6. When negotiating orally with Malaysian or Japanese executives, it is appropriate to allow periodically for a time of silence. However, no pause is needed when negotiating in Israel.

7. Refrain from asking foreign managers questions such as "How was your weekend?" That is intrusive to foreigners, who tend to regard their business and private lives as totally separate.6

Americans have more freedom to control their own fates than do the Japanese. Life in the United States and life in Japan are very different; the United States offers more upward mobility to its people. This is a great strength of the United States, as indicated here:

America is not like Japan and can never be. America's strength is the opposite: It opens its doors and brings the world's disorder in. It tolerates social change that would tear most other societies apart. This openness encourages Americans to adapt as individuals rather than as a group. Americans go west to California to get a new start; they move east to Manhattan to try to make the big time; they move to Vermont or to a farm to get close to the soil. They break away from their parents' religions or values or class; they rediscover their ethnicity. They go to night school; they change their names. 7

Worldwide Tax Rates

The lowest corporate tax rates among developed countries reside in Europe, and European countries are lowering tax rates further to attract investment. The average corporate tax rate among European Union countries is 26 percent, compared with 30 percent in the Asia-Pacific region and 38 percent in the United States and Japan. Ireland and the former Soviet-bloc nations of Eastern Europe recently slashed corporate tax rates to nearly zero, attracting substantial investment. Germany cut its corporate tax rate from 39 percent in 2007 to just under 30 percent in 2008. Great Britain cut its corporate tax rate to 28 percent from 30 percent. France cut its rate from 34 percent to 27 percent in 2008.

Other factors besides the corporate tax rate obviously affect companies' decisions to locate plants and facilities. For example, the large and affluent market and efficient

infrastructure in Germany and Britain attract companies, but the high labor costs and strict labor laws keep other companies away.

Ralph Gomory, president of the Alfred P. Sloan Foundation and a former top executive at IBM, warns of a growing divergence between the interests of U.S. corporations and interests of the U.S. government. Specifically, he says U.S. trade liberalization/ globalization policies for the last two decades have encouraged corporations to seek the lowest-cost locations for their operations. The new 1,200-worker Intel semiconductor plant in Vietnam is just one example among thousands. Gomory says the United States must use the corporate income tax to reward companies that invest in jobs here, especially high-tech jobs, and must penalize companies that move facilities overseas. We must make it in the self-interest of companies to invest in America, Gomory says. Otherwise, living standards here will inevitably decline and America will severely weaken economically.8

Joint Ventures in India

The government of India is highly in debt, 80 percent of GDP, and is cutting expenses to curtail spending, so the gap between rich and poor is widening further. (The U.S. federal debt is about 65 percent of GDP.) But India's middle class is growing, so foreign firms continue to invest. Nissan Motor is building a factory in Chennai in conjunction with Mahindra & Mahindra Ltd., India's largest maker of jeeps and tractors. The factory began operating in 2009.

Joint ventures remain mandatory for foreign companies doing business in India. Verizon Business India, a joint venture between Verizon and Videocon Group of Mumbai, is rapidly expanding its phone and Internet services in India to compete more fiercely with AT&T and other telecom companies. Almost 20 million new cell phone customers are added in India every quarter, about the same rate of increase as in China—compared with only about 2.8 million new cell phone customers added in the United States quarterly. India's Reliance Communications Ltd. is in a battle with Britain's Vodafone Group PLC for control of India's fourth-largest cellular service, Hutchison

Essar. But Vodafone must find a local partner because Indian law restricts foreign firms to 74 percent ownership of any India-based firm.

Most joint ventures among firms in India and foreign firms fail. Of 25 major joint ventures between foreign and Indian companies between 1993 and 2003, only three survive today. The Indian government has eased the joint-venture restriction in the investmentbanking industry, but not in other areas. Even Wal-Mart has an Indian partner, Bharti Enterprises Ltd. Heavy friction exists in virtually all joint-ventures in India. John Band, president of Zoom Cortex in Mumbai, says, “Anyone that gets into a joint venture in India should assume it will fail and should be comfortable with the terms of what happens when it does fail.” 9

Due to tourism growing 12 percent annually, hotel chains are scrambling to get established in India. Hilton Hotels just established a joint venture with New Delhi–based DLF Ltd. to develop 75 hotels in India in 2007–2010. Marriott, Four Seasons, and Carlson Companies are also establishing joint ventures in India and building hotels rapidly.