Chapter 1:
What is Strategy?

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Our Learning Goals:  
*Pushing Down Through Bloom’s Taxonomy*

1. **Knowledge:** remember material; know terms, facts, procedures, basic concepts
2. **Comprehension:** grasp meaning; understand facts, interpret charts, translate verbal to math, estimate consequences
3. **Application:** use material in new situations; apply concepts to real situations, follow a procedure
4. **Analysis:** break material into components & understand structure; recognize logical fallacies, distinguish fact and inference, evaluate relevancy of data
5. **Synthesis:** integrate parts to make a new whole, integrate learning to solve a problem
6. **Evaluations:** judge logical consistency, judge whether conclusions are supported by facts
The Wisdom of Choice

• “To try and fail is at least to learn; to fail to try is to suffer the inestimable loss of what might have been.”

– Chester Barnard
(former CEO of New Jersey Bell Telephone)

• The Functions of the Executive
Chapter Case 1:
Does Twitter Have a Strategy?
Chapter Case 1: Does Twitter have a Strategy?

- **Twitter is currently not flying high**
  - In 2015, the stock was 50% lower than in 2013
  - Departure of CEO who served from 2010-2015
  - Turmoil among executive ranks

- **Overview of Twitter – “SMS of the internet”**
  - Users send short messages of 140 characters.
  - Users can follow each other
  - 300 million active users worldwide
  - Twitter appears constantly in the mass media
Chapter Case 1:
Does Twitter have a Strategy?

• **Business model**
  – Grow user base (individual users pay nothing)
  – Advertisers charged for promotion of goods/services
  – Companies pay for promoted tweets
  – Advertisements can be delivered real time

• **Twitter’s current challenges**
  – Turnover/reshuffling in management and engineering
  – Struggles to grow its user base
    • Twitter = 300 million; Facebook = 1.5 billion
    • User growth continues to slow
  – Could it be taken over?
Chapter Case 1: Does Twitter have a Strategy?

- Why is Twitter struggling?

- Why is crafting a good strategy at Twitter so difficult?

- What recommendations would you suggest to Jack Dorsey, co-founder and CEO of Twitter to improve its economic performance?
What Strategy Is:
Gaining and Sustaining Competitive Advantage
Strategic Management

- **Strategic Management:** an integrative management field that combines *analysis, formulation, and implementation* in the quest for sustainable competitive advantage (SCA).

  - Mastery of strategic management enables us to more fully view the firm in its entirety; and
  
  - It also enables us to think like a general manager to help position our firm for SCA that can be viewed as positive economic profit (taking into account the opportunity cost of capital), and which can be operationalized as positive NPV.

\[
NPV = -I + \sum_{n=0}^{N} \frac{C_n}{(1+r)^n}
\]
Strategy

- **What is Strategy?**

  - A set of goal-directed actions that a firm takes to *gain* and *sustain* superior performance (p.6)

  - It is *not* necessarily a zero-sum game
    - *Win – win scenarios* – **coopetition** (i.e., collaborative efforts among competitors for mutual gain)

  - Requires tradeoffs for strategic positioning
    - (low cost) **JCPenney vs.** (upscale) **Neiman Marcus**
    - (low cost) **Southwest Airlines vs.** (stuck in the middle) **Delta Song**
Strategy

- To achieve superior performance, organizations compete for resources:
  - New ventures: for financial and human capital
  - Charities: for donations
  - Sports teams: athletic talent
  - Universities: for the best students and professors
The AFI Strategy Framework
Three Key Elements of a Good Strategy -- AFI

• **Analysis**
  - A diagnosis of the competitive challenge, which is accomplished through strategy analysis of the firm’s external and internal environments.

• **Formulation**
  - A guiding policy, providing an overarching approach that addresses the competitive challenge, and which is accomplished through strategy *formulation*, resulting in the firm’s corporate, business, and functional strategies.

• **Implementation**
  - A set of coherent actions to implement the firm’s guiding policy, which is accomplished through clear communication, organizational structure, organizational culture, and control (p.7)
Elements of a Good Strategy: Analysis

- **Analysis**
  - Diagnosis of the competitive challenge

**Example: Twitter**

- Competitive challenge: *grow its user base*
  - Become more valuable for online advertisers

- Also: Facebook allows advertisers to target their online ads precisely based on demographic data
Elements of a Good Strategy: Formulation

• Formulation
  – Guiding policy to address the competitive challenge

Example: Twitter
• Rather than formulating a guiding policy to grow active core users, Twitter defined its user base more broadly.
  • Defined users into 3 types to compare with Facebook
  • User types were difficult to track and were less valuable to advertisers.
Elements of a Good Strategy: Implementation

- Implementation
  - A set of coherent actions to implement the firm’s guiding policy

  **Example: Twitter**

- Different user definitions confused management and limited guidance for employees. Tradeoffs were not considered (i.e., evaluate what not to do)

- Consequences of the unclear mission:
  - Frustration among managers and engineers
  - Turnover of key personnel

- Internal turmoil resulted, including management demotions and promotions of CEO friends.
Gaining and Sustaining Competitive Advantage

• What is Competitive Advantage?
  ➢ Superior performance relative to competitors
    ❖ In digital advertising: Google has a competitive advantage over Facebook, Twitter, and Yahoo
    ❖ In smartphones: Apple has a competitive advantage over Samsung, Microsoft, and BlackBerry

• What is Sustainable Competitive Advantage?
  ➢ Sustainable competitive advantage occurs when a firm implements a value-creating strategy of which other companies are unable to duplicate the benefits over a prolonged period of time or find it too costly to imitate.
    ❖ To assess sustainable competitive advantage compare firm performance to a benchmark such as opportunity cost (WACC).
Definitions of Strategy

• "The term 'strategy' is intended to focus on the interdependence of the adversaries’ decisions and on their expectations about each other’s behavior.” (Thomas Schelling, The Strategy of Conflict)

• “Strategy can be defined as the determination of the basic long-term goals and objectives of an enterprise, and the adoption of courses of action and the allocation of resources necessary for carrying out those goals.” (Alfred D. Chandler, Strategy and Structure)

• Strategy is: “The pattern or plan that integrates an organization’s major goals, policies, and action sequences into a cohesive whole. A well formulated strategy helps to marshal and allocate an organization’s resources into a unique and viable posture based on its relative internal competencies and shortcomings, anticipated changes in the environment, and contingent moves by intelligent opponents.” (James Brian Quinn, Logical Incrementalism)
Strategy as a Theory of How to Compete to Create Superior Value, While Containing the Cost to Create It

The greater the difference between the value creation and cost, the greater the firm’s *economic contribution* and the more likely it will achieve sustainable competitive advantage (SCA).

- Wal-mart's Sam Walton's assumptions about low costs, low prices, and high volume to drive profitability
- Apple’s Steve Jobs wanted to “put a ding in the universe”
- Facebook’s Mark Zuckerberg wanted to “make the world open and connected”
- Google’s Larry Page and Sergio Brin wanted to make information accessible (p.8)
What is Strategy?

Definition: Strategy is the quest to create, capture, and sustain competitive advantage.

- Managers’ theories/maps about how to sustain advantage.

- Deciding what to do, and what not to do (i.e., economic tradeoffs are considered; opportunity cost).

- It has alternatives, consequences, and choices involving significant resources, typically made under some level of uncertainty.

- It requires long-term commitments that are not easily reversible.

- Being different from the rivals.

- Combines a set of activities to stake out a unique position.
Unique Positioning

• The key to successful strategy: combine activities for a unique position in an industry

• Competitive advantage has to come from:
  – performing different activities or
  – performing the same activities differently than rivals

• Example: Wal-mart’s strategic activities strengthen its position as cost leader (p.9)
  – Big stores in rural locations; regional distribution centers, IT systems
  – High purchasing power
  – Low corporate overhead
  – Low base wages
Threadless: Leveraging Crowdsourcing to Design Cool T-Shirts (p.10)

• Online design community and apparel: Threadless
  ➢ Started in 2000 with $1,000 by 2 students – Jake Nickell and Jacob Dehart
  ➢ “Prosumers” – a hybrid supplier/customer
    ❖ Shirt designs are submitted by the online community
    ❖ Designs are voted on by the online community
      – Only winning designs are produced and sold
      – Leverages “crowdsourcing”: volunteers for tasks
      – Customers are important throughout the value chain
        – Idea generation
        – Design
        – Marketing
        – Demand Forecasting
        – Distribution
Key Drivers of Value Creation and Sustainable Competitive Advantage (SCA)

Generating **economic value** can be accomplished through:

- **REVENUE** drivers
- **COST** drivers
- **RISK** drivers

\[ NPV = CF_0 + \frac{CF_1}{(1+k)^1} + \frac{CF_2}{(1+k)^2} + \ldots + \frac{CF_n}{(1+k)^n} = \sum_{t=0}^{n} \frac{CF_t}{(1+k)^t} \]
Value and Cost Drivers

Value Drivers
- Technology
- Quality
- Delivery
- Breadth of Line
- Service
- Customization

Cost Drivers
- Economies of Scale
- Economies of Scope
- Learning Curve
- Low Input Costs
- Organizational Practices
- Vertical Integration

Geography
- Risk Assumption
- Brand/Reputation
- Network Externalities
- Environmental Policy
- Complements
Industry, Firm, and Other Effects Explaining Superior Firm Performance

Exhibit 1.1
Sources of Superior Profitability

RATE OF PROFIT ABOVE THE COMPETITIVE LEVEL

INDUSTRY ATTRACTION
Which businesses should we be in?

COMPETITIVE ADVANTAGE
How should we compete?

CORPORATE STRATEGY

BUSINESS STRATEGY
Levels of Strategy

- **Corporate Level**: Typically involves decision-making by the top management team that includes the CEO, senior executives, the board of directors, and the corporate staff. Decisions include vertical integration, diversification, strategic alliances, acquisitions, new ventures, and restructuring.

- **Business Level**: Includes the strategic choice of *generic strategy* (cost leadership, differentiation, focus) and the benefits and costs of first-mover advantages. Often an enterprise participating in multiple businesses will have different business strategies.

- **Functional Level**: Typically directed at improving the effectiveness of functional operations within a company, such as manufacturing, materials management, human resources, marketing, R&D and operations management.
Strategy Formulation and Implementation Across Levels: Corporate, Business, and Functional Strategy

- Headquarters
  - Corporate Strategy
    - Where to Compete?

- SBU 1
  - Business Strategy
    - How to Compete?

- SBU 2
  - Business Strategy
    - How to Compete?

- SBU 3
  - Business Strategy
    - How to Compete?

- Business Function 1
  - Functional Strategy
    - How to Implement Business Strategy?

- Business Function 2
  - Functional Strategy
    - How to Implement Business Strategy?

- Business Function 3
  - Functional Strategy
    - How to Implement Business Strategy?

- Business Function 4
  - Functional Strategy
    - How to Implement Business Strategy?
Strategy Across the Levels

• Where to Compete?
  ➢ Should GE move more aggressively into the health care industry?

• How to Compete?
  ➢ Should GE jet engines have better fuel efficiency than Rolls Royce?

• How to Implement?
  ➢ Should GE human resources recruit more science graduates?

• CORPORATE STRATEGY

• BUSINESS STRATEGY

• FUNCTIONAL STRATEGY
Stakeholders and Competitive Advantage
Value Creation for Society

- Companies with a good strategy generate value for society
  - Firms compete in their own self-interest while following laws and regulations, and acting ethically

- Companies with a good strategy:
  - Provide products or services to consumers at an affordable price
  - Make an economic profit
  - Make society better
Value Creation for Society

- Successful companies create value for the economy:
  - Education, public safety, and health care

- Superior performance enables a firm to reinvest some of its profits for growth
  - More opportunities for employment

- Example: Google (p.12)
  - Employs 55,000 people; worth $350 billion
  - People rely on Google for information
Strategic Failure is Expensive

• Hewlett-Packard (HP) has not been able to address the competitive challenges effectively:
  – Stakeholders suffered
  – Shareholder value was destroyed
  – Had to lay off thousands of employees
  – Customers no longer received innovative products

• Google and HP illustrate the relationship between individual firms and society at large (p.13)
Black Swan Events

- In the past, most people assumed all swans were white; when they first encountered swans that were black, they were surprised.

- Today, the metaphor of a black swan describes the high impact of a highly improbable event:
  - E.g., the fall of the Berlin Wall
  - The 9/11 terrorist attack
  - The Fukushima nuclear disaster in Japan
  - Arab Spring (p.13)
Black Swan Events

• Trust between corporations and society have deteriorated because of black swans
  – Accounting Scandals: Enron, Arthur Andersen, WorldCom, Tyco, Adelphia Communications, and Parmalat (of Italy) [“Europe’s Enron”]
  – Real Estate Bubble: 2008 financial crisis

• Managerial actions can affect the well-being of people around the globe
  – Most black swan events result from executive actions (or inactions)
The Manager’s Role in Balancing Expectations

• **Business Roundtable:**
  ➢ “Balancing the shareholder’s expectations of maximum return against other priorities is one of the fundamental problems confronting corporate management.”

• Understanding corporate strategy means understanding the competing value claims of multiple stakeholders.

• **Stakeholders** are the individuals and groups who can affect, and are affected by, the strategic outcomes achieved and who have enforceable claims on a firm’s performance.
Internal and External Stakeholders in an Exchange Relationship with the Firm

External Stakeholders
- Customers
- Suppliers
- Alliance Partners
- Creditors
- Unions
- Communities
- Governments
- Media

Internal Stakeholders
- Employees
- Stockholders
- Board Members

Exhibit 1.2
Stakeholder Theory: Inducements- Contribution Balance

• If any stakeholder withholds participation in the firm’s exchange relationships, it can negatively affect firm performance. The aerospace firm, Boeing, for example, has a long history of acrimonious labor relations, leading to walkouts and strikes. This, in turn, has not only delayed production of airplanes but also raised costs.

• Borrowers who purchased subprime mortgages are stakeholders (in this case, customers) of financial institutions. When they defaulted in large numbers, they threatened the survival of these financial institutions and, ultimately, of the entire financial system.
Stakeholder Management

• Target Corporation has numerous awards that reflect its strong relationship with its stakeholders. It has been named on lists such as best places to work, most admired companies, most ethical companies, best in class for corporate governance, and grassroots innovation. Since its founding, Target has given 5% of its profits to education, the arts, and social services in the communities in which it operates, and reached the milestone of contributing $4 million per week in 2012 (p.15).

• To demonstrate its commitment to minorities and women, Target launched a program to bring minority- and women-owned businesses into its supply chain. Volunteerism and corporate giving strengthen the relationship Target has with its employees, consumers, local communities, and suppliers. These actions, along with many others, can help Target gain competitive advantage as a retailer as long as the benefits Target accrues from its stakeholder strategy exceed the costs of such programs.
Stakeholder Impact Analysis

Exhibit 1.3

STEP 1: Who are our stakeholders?

STEP 2: What are our stakeholders’ interests and claims?

STEP 3: What opportunities and threats do our stakeholders present?

STEP 4: What economic, legal, ethical, and philanthropic responsibilities do we have to our stakeholders?

STEP 5: What should we do to effectively address the stakeholder concerns?
Step 1: Identify Stakeholders

- Focus on the firm’s stakeholders that currently have, or potentially can have, a material effect on the company
- Identify: powerful internal and external stakeholders and their needs
  - For public-stock companies: shareholders and suppliers of capital
  - Also: customers, suppliers, and unions
- Example: Boeing
  - Its new 787 Dreamliner will be built in its non-unionized South Carolina factory
Step 2: Identify Stakeholder Interests

- Specify and assess the interests and claims of stakeholders.
  - Use power, legitimacy, and urgency criteria

- Shareholders:
  - Have legitimate claims on a company’s profits

- Employees can be turned into shareholders through ESOPs
  - Coca-Cola, Google, Microsoft, Southwest Airlines, Starbucks, Walmart, and Whole Foods all offer employee stock ownership plans (ESOPs).

- ‘Shareholder activists’ (e.g., Carl Icahn and T. Boone Pickens) put public pressure on a company to change its strategy (such as on eBay to sell PayPal, which it did).
Step 3: Identify Opportunities and Threats

- Opportunities and threats are two sides of the same coin.
  - Example: consumer boycotts can be a credible threat.
    - Example: PETA: called for a boycott of McDonald’s due to alleged animal-rights abuses.

- Managers should try to transform threats into opportunities.
  - Example: Sony
    - Dutch government blocked PlayStation shipments due to a toxic cable.
    - Sony’s response included a redesign of its supplier management system, turning “green to gold.”
Step 4: Identify Societal Responsibilities

The Pyramid of Corporate Social Responsibility

Step 5: Address Stakeholder Concerns

• Managers decide the appropriate course of action.

• The attributes of power, legitimacy, and urgency help to prioritize legitimate claims.

  – We consider next how the US government legitimized claims by thousands of businesses and individuals in the aftermath of the BP oil spill in the Gulf of Mexico, causing the claims to become of greater urgency to BP.
Strategy Highlight 1.2
BP Grossly Negligent in Gulf of Mexico Disaster

• On April 20, 2010, an explosion occurred.
  – At a drilling rig off the Louisiana coastline
  – Killed 11 workers
• The oil spill continued for over three months.
• It released an estimated 5 million barrels of crude oil into the Gulf of Mexico (The largest environmental disaster in U.S. history)
• The cleanup cost was $14 billion
• Tony Hayward, BP’s CEO at the time, was fired.
• Experts said BP’s problems were systemic:
  – Management repeatedly failed to put a safety culture in place.
BP faced thousands of claims by many small business owners.
   - Mainly in the tourism and seafood industries

Collectively, small business owners became powerful BP stakeholders and BP paid over $25 billion to settle their claims.

Total cost for this incident: $60 billion

The Environmental Protection Agency (EPA) banned BP from any new contracts with the U.S. government.

This ban puts BP at a major competitive disadvantage.
Strategy Highlight 1.2
BP Grossly Negligent in Gulf of Mexico Disaster

• What advice would you give to BP’s managers to help them continue to rebuild stakeholder relationships in the Gulf region and beyond?

• How can BP repair its damaged reputation?