

Strategy Formulation and Implementation

CHAPTER OUTLINE

Thinking Strategically
What Is Strategic Management?
Grand Strategy
Global Strategy
Purpose of Strategy
Levels of Strategy
The Strategic Management Process
Strategy Formulation Versus Implementation
Situation Analysis
Formulating Corporate-Level Strategy
Portfolio Strategy
The BCG Matrix
Formulating Business-Level Strategy
Porter's Competitive Forces and Strategies
Partnership Strategies
Formulating Functional-Level Strategy
Strategy Implementation and Control
Leadership
Structural Design
Information and Control Systems
Human Resources
Implementing Global Strategies

LEARNING OBJECTIVES

After studying this chapter, you should be able to

- 1** Define the components of strategic management.
- 2** Describe the strategic planning process and SWOT analysis.
- 3** Understand Grand Strategies for domestic and international operations
- 4** Define corporate-level strategies and explain the portfolio approach.
- 5** Describe business-level strategies, including Porter's competitive forces and strategies and partnership strategies.
- 6** Explain the major considerations in formulating functional strategies.
- 7** Enumerate the organizational dimensions used for implementing strategy.



Management Challenge

Coke might be the world's most powerful brand, but that has not helped much lately. When Douglas Daft took over as CEO of the Coca-Cola Company, he inherited a host of troubles. Soda sales had slumped in the important U.S. market and to a lesser extent around the world, and Coke had failed to match rival Pepsi's aggressive moves into nonsoda businesses. A high-profile racial discrimination suit in the United States and a soda-contamination scare overseas had damaged the company's reputation and its relationships with customers, governments, and bottlers. Under the previous CEO, M. Douglas Ivester, there was no real sense of crisis at Coke's headquarters, where managers pretty much continued business as usual. The Australian-born Daft knew that needed to change if Coca-Cola was to remain one of the world's most admired and

respected companies. During his first year on the job, Daft began dismantling the stale old regime at headquarters and brought in new top managers willing to make the tough changes to turn the company around. He also spent much of his time repairing relationships with government regulators in Europe and handling the backlash from financially strapped bottlers who charged that Coke had been trying to eke out profits at the bottlers' expense. Despite these early moves, Coke's sales and profits have stayed flat and the stock has continued to decline. The CEO knows he needs to come up with a powerful strategic plan to reignite the company in a hurry.¹

If you were the CEO of Coca-Cola, what strategies might you adopt to regain the competitive edge? How would you go about formulating and implementing a new strategic plan?

The story of Coca-Cola illustrates the importance of strategic planning. Coke had been stumbling along for years, ever since the departure of beloved Chairman and CEO Roberto Goizueta. The late Goizueta had been a master at providing vision and strategic direction for the company, but his hand-picked successor, Douglas Ivester, proved incapable of keeping Coke on the path of success. Now, employees, board members, and investors are hoping Douglas Daft can formulate and implement strategies that can ignite growth and revive the troubled company.

Every company is concerned with strategy. Japan's Fuji Photo Film Company developed a strategy of being a low-cost provider to compete with Kodak. Fuji's relentless internal cost-cutting enabled the company to offer customers lower prices and gradually gain market share over the giant U.S. firm.² Hershey devised a new strategy of being a fierce product innovator to compete with Mars in the candy wars.³ Hershey scored big with the introduction of such products as Twizzlers twisted licorice sticks, Jolly Rancher lollipops, and Bites, bite-sized pieces of favorite candy bars. Strategic blunders can hurt a company. Mattel suffered in recent years by losing sight of its core business and trying to compete as a maker of computer games. New CEO Robert A. Eckert has implemented a "back to basics" strategy that he hopes will get the toymaker back on track.⁴

Managers at Mattel, Hershey, Fuji, and Coca-Cola are all involved in strategic management. They are finding ways to respond to competitors, cope with difficult environmental changes, meet changing customer needs, and effectively use available resources. Research has shown that strategic thinking and planning positively affects a firm's performance and financial success.⁵ Strategic planning has taken on new importance in today's world of globalization, deregulation, advancing technology, and changing demographics and lifestyles. Managers are responsible for positioning their organizations for success in a world that is constantly changing. Today's top companies thrive by changing the rules of an industry to their advantage or by creating entirely new industries.⁶ For example, Champion Enterprises was going broke selling inexpensive, factory-built houses. CEO Walter Young Jr. says, "People thought we were in the trailer park business. It was a real perception problem." Young wanted to redraw the rules of the manufactured housing industry. Today, Champion is thriving by building full-size houses in its factories and offering customers such options as porches, skylights, and whirlpool baths.⁷

In this chapter, we focus on the topic of strategic management. First we define components of strategic management and then discuss a model of the strategic management process. Next we examine several models of strategy formulation. Finally, we discuss the tools managers use to implement their strategic plans.

Thinking Strategically

Chapter 7 provided an overview of the types of goals and plans that organizations use. In this chapter, we will explore strategic management, which is considered one specific type of planning. Strategic planning in for-profit business organizations typically pertains to competitive actions in the marketplace. In not-for-profit organizations such as the Red Cross, strategic planning pertains to events in the external environment. The final responsibility for strategy rests with top managers and the chief executive. For an organization to succeed, the CEO must be actively involved in making the

tough choices and trade-offs that define and support strategy.⁸ However, senior executives at such companies as General Electric, 3M, and Johnson & Johnson want middle- and low-level managers to think strategically. Some companies also are finding ways to get front-line workers involved in strategic thinking and planning. Strategic thinking means to take the long-term view and to see the big picture, including the organization and the competitive environment, and to consider how they fit together. Understanding the strategy concept, the levels of strategy, and strategy formulation versus implementation is an important start toward strategic thinking.

What Is Strategic Management?

Strategic management is the set of decisions and actions used to formulate and implement strategies that will provide a competitively superior fit between the organization and its environment so as to achieve organizational goals.⁹ Managers ask questions such as, “What changes and trends are occurring in the competitive environment? Who are our customers? What products or services should we offer? How can we offer those products and services most efficiently?” Answers to these questions help managers make choices about how to position their organization in the environment with respect to rival companies.¹⁰ Superior organizational performance is not a matter of luck. It is determined by the choices that managers make. Top executives use strategic management to define an overall direction for the organization, which is the firm’s grand strategy.

Grand Strategy

Grand strategy is the general plan of major action by which a firm intends to achieve its long-term goals.¹¹ Grand strategies fall into three general categories: growth, stability, and retrenchment. A separate grand strategy can also be defined for global operations.

Growth. *Growth* can be promoted internally by investing in expansion or externally by acquiring additional business divisions. Internal growth can include development of new or changed products, such as Starbucks’ introduction of Frappuccino, a bottled coffee drink, or expansion of current products into new markets, such as Avon’s attempt to begin selling products in major retail stores. External growth typically involves *diversification*, which means the acquisition of businesses that are related to current product lines or that take the corporation into new areas. The number of companies choosing to grow through mergers and acquisitions is astounding, as organizations strive to acquire the size and resources to compete on a global scale, to invest in new technology, and to control distribution channels and guarantee access to markets. WorldCom, once an obscure long-distance carrier, has acquired more than 40 companies in the past decade and expanded into local phone services, data transmission, and Internet traffic. Another strategy for international growth is the formation of a joint venture, such as WorldCom’s venture with Spanish telecom giant Telefónica, which extended WorldCom’s reach into South America.¹² This chapter’s Leading Online box describes how eBay is pursuing a growth strategy.

Stability. *Stability*, sometimes called a *pause strategy*, means that the organization wants to remain the same size or grow slowly and in a controlled fashion.

strategic management

The set of decisions and actions used to formulate and implement strategies that will provide a competitively superior fit between the organization and its environment so as to achieve organizational goals.

grand strategy

The general plan of major action by which an organization intends to achieve its long-term goals.



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Kingsley Management LLC is pursuing a growth strategy with its high-tech car washes trademarked “Swash.” So far, the Boston-based company has single-bay car washes in only three markets—Rochester, New York, Greenville, North Carolina, and Jacksonville, Florida—but founders Matthew Lieb (standing) and Chris Jones (in the driver’s seat) are aiming for growth by forming partnerships to add their state-of-the-art car washes to gas stations and hypermarkets and developing plans for multi-bay units in high-traffic areas. At Swash, a customer pulls up to an ATM-like machine, pays with cash, credit, or a pre-paid card, watches video instructions, and gets a software-controlled brushless wash, all in less than five minutes.



Leading Online

EBay: Building on Success

At a time when almost every Internet and technology company is handing out pink slips, the scene is quite different within the walls of San Jose, California-based eBay. In fact, the online auction company is planning to add to its workforce of 2,400. eBay, which began as a site for selling collectibles, is pursuing a growth strategy, successfully molding itself into a platform for selling everything from computers to clothes. Every 60 minutes on the site, 120 PCs, 10 diamond rings, and 1,200 articles of clothing are sold, and someone buys a Corvette every three hours.

EBay CEO Meg Whitman sees her biggest job as keeping the company nimble and maintaining community spirit as the organization grows. From day one, eBay has been profitable, and in the second quarter of 2001, the company reported profits of \$24.6 million, more than triple those reported a year earlier. Part of the reason for the success is because top managers have kept their focus on the community of buyers and sellers even as they have invested steadily in the company's growth.

There are several elements to eBay's strategic plan for growth. First, to branch out from its auction format, the company purchased Half.com, a site where new and used items

can be listed at a fixed price. In addition, the company added a new feature called "Buy It Now," which allows users to acquire an item immediately, omitting the time-consuming auction process altogether. About 35 percent of all items listed by sellers on eBay now offer that option, which speeds up the rate of trading on the site. Another approach has been to allow businesses such as J. C. Penney, IBM, and Sun Microsystems to set up virtual storefronts. Ebay expected to attract around 2,000 businesses, but nearly 10 times that number wanted a piece of the action, recognizing the inexpensive potential for reaching millions of consumers. On the global front, eBay has acquired iBazar, a European trading site, and invested in the growth of its German, Canadian, and U.K. operations.

Mark Goldstein, former CEO of BlueLight.com, the online unit of Kmart, says, "eBay is what all of us wanted our Internet businesses to be." Even as e-commerce stalls in today's declining economy, online shoppers-turned-bargain-hunters surf the value-priced aisles of eBay, finding anything and everything. In fact, eBay is rapidly becoming "the Wal-Mart of the Internet."

SOURCE: Miguel Helft, "What Makes eBay Unstoppable?" *The Industry Standard* (August 6–13, 2001), 32–37.

The corporation wants to stay in its current business, such as Allied Tire Stores, whose motto is, "We just sell tires." After organizations have undergone a turbulent period of rapid growth, executives often focus on a stability strategy to integrate strategic business units and ensure that the organization is working efficiently. Mattel is currently pursuing a stability strategy to recover from former CEO Jill Barad's years of big acquisitions and new businesses. The current top executive is seeking only modest new ventures to get Mattel on a slower-growth, more stable course.¹³

Retrenchment. *Retrenchment* means that the organization goes through a period of forced decline by either shrinking current business units or selling off or liquidating entire businesses. The organization may have experienced a precipitous drop in demand for its products or services, prompting managers to order across-the-board cuts in personnel and expenditures. For example, Nortel Networks, described in Chapter 3, laid off 20,000 employees and closed several business units to cope with reduced demand. Some mid-sized companies are scaling back or abandoning their Web-based businesses because of poor results and a declining economy. Gaylord Entertainment, a Nashville-based entertainment company that traces its roots to the Grand Ole Opry, had counted on digital entertainment as a growth business, but just two years later managers closed the Gaylord Digital subsidiary, cut jobs, and put the company's Web business up for sale. Top executives felt that a period of retrenchment was necessary to strengthen profitability across the company.

Liquidation means selling off a business unit for the cash value of the assets, thus terminating its existence. An example is the liquidation of Minnie Pearl Fried Chicken. *Divestiture* involves the selling off of businesses that no longer seem central to the corporation. Germany's Siemens recently sold businesses that make power cables, automatic teller machines, and diesel locomotives because these businesses no longer seemed central to the company, which is staking much of its future on telecommunications.¹⁴ Studies show that between 33 percent and 50 percent of all acquisitions are later divested. When Figgies International Inc. sold 15 of its 22 business divisions, including crown jewel Rawlings Sporting Goods, and when Sears sold its financial services businesses, both corporations were going through periods of retrenchment, also called *downsizing*.¹⁵

Global Strategy

In addition to the three preceding alternatives—growth, stability, and retrenchment—companies may pursue a separate grand strategy as the focus of global business. In today's global corporations, senior executives try to formulate coherent strategies to provide synergy among worldwide operations for the purpose of fulfilling common goals. A systematic strategic planning process for deciding on the appropriate strategic alternative should be used. The grand strategy of growth is a major motivation for both small and large businesses going international. Each country or region represents a new market with the promise of increased sales and profits.

In the international arena, companies face a strategic dilemma between global integration and national responsiveness. Organizations must decide whether they want each global affiliate to act autonomously or whether activities should be standardized and centralized across countries. This choice leads managers to select a basic grand strategy alternative such as globalization versus multidomestic strategy. Some corporations may seek to achieve both global integration and national responsiveness by using a transnational strategy. The three global strategies are shown in Exhibit 8.1.

Globalization. When an organization chooses a strategy of **globalization**, it means that its product design and advertising strategies are standardized throughout the world.¹⁶ This approach is based on the assumption that a single global market exists for many consumer and industrial products. The theory is that people everywhere want to buy the same products and live the same way. People everywhere want to drink Coca-Cola and eat McDonald's hamburgers.¹⁷ A globalization strategy can help an organization reap efficiencies by standardizing product design and manufacturing, using common suppliers, introducing products around the world faster, coordinating prices, and eliminating overlapping facilities. Ford Motor Company's Ford 2000 initiative built a single global automotive operation. By sharing technology, design, suppliers, and manufacturing standards worldwide, Ford saved \$5 billion during the first three years.¹⁸ Similarly, Gillette Company, which makes grooming products such as the Mach3 for men and the Venus razor for women, has large production facilities that use common suppliers and processes to manufacture products whose technical specifications are standardized around the world.¹⁹

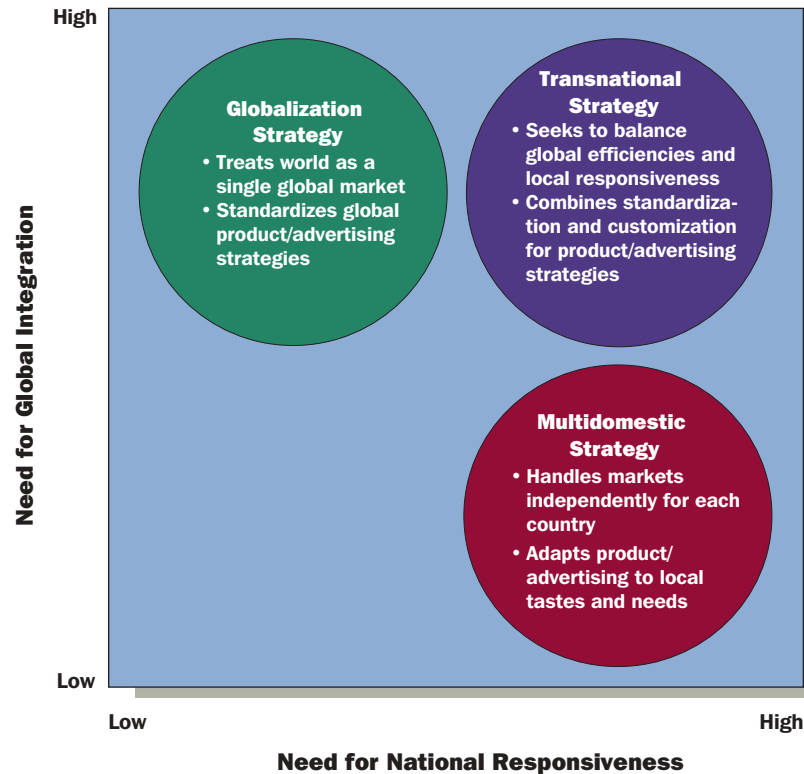
Globalization enables marketing departments alone to save millions of dollars. For example, Colgate-Palmolive Company sells Colgate toothpaste in more than 40 countries. For every country where the same commercial runs,

globalization

The standardization of product design and advertising strategies throughout the world.

Exhibit 8.1

Global Corporate Strategies



SOURCE: Based on Michael A. Hitt, R. Duane Ireland, and Robert E. Hoskisson, *Strategic Management: Competitiveness and Globalization* (St. Paul, Minn.: West, 1995), 239.

multidomestic strategy

The modification of product design and advertising strategies to suit the specific needs of individual countries.

transnational strategy

A strategy that combines global coordination to attain efficiency with flexibility to meet specific needs in various countries.

it saves \$1 million to \$2 million in production costs alone. More millions have been saved by standardizing the look and packaging of brands.²⁰

Multidomestic Strategy. When an organization chooses a **multidomestic strategy**, it means that competition in each country is handled independently of industry competition in other countries. Thus, a multinational company is present in many countries, but it encourages marketing, advertising, and product design to be modified and adapted to the specific needs of each country.²¹ Many companies reject the idea of a single global market. They have found that the French do not drink orange juice for breakfast, that laundry detergent is used to wash dishes in parts of Mexico, and that people in the Middle East prefer toothpaste that tastes spicy. Procter & Gamble standardized diaper design across European markets, but discovered that Italian mothers preferred diapers that covered the baby's navel. This design feature was so important to the successful sale of diapers in Italy that the company eventually incorporated it specifically for the Italian market. Baskin-Robbins introduced a green-tea flavored ice cream in Japan, and Häagen-Dazs developed a new flavor called *dulce de leche* primarily for sale in Argentina.²²

Transnational Strategy. A **transnational strategy** seeks to achieve both global integration and national responsiveness.²³ A true transnational strategy is difficult to achieve, because one goal requires close global coordination while the other goal requires local flexibility. However, many industries are finding that, although increased competition means they must achieve global efficiency, growing pressure to meet local needs demands national responsiveness.²⁴ One company that effectively uses a transnational strategy is



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These KitKat candy bars, being stocked by a salesperson in a Malaysian shop, are manufactured with locally grown beans—at a price 30 percent below imports. Nestlé, the world's biggest branded food company, rejects the idea of a single global market, opting for a multidomestic strategy that handles competition in each country independently. The Switzerland-based powerhouse is charging across the developing world by hiring people in the region, manipulating ingredients or technology for local conditions, and slapping on one of the company's 8,000 brand names. Of those 8,000 worldwide brands, only 750 are registered in more than one country.

Caterpillar, Inc., a heavy equipment manufacturer. Caterpillar achieves global efficiencies by designing its products to use many identical components and centralizing manufacturing of components in a few large-scale facilities. However, assembly plants located in each of Caterpillar's major markets add certain product features tailored to meet local needs.²⁵

Although most multinational companies want to achieve some degree of global integration to hold costs down, even global products may require some customization to meet government regulations in various countries or some tailoring to fit consumer preferences. In addition, some products are better suited for standardization than others. Most large multinational corporations with diverse products will attempt to use a partial multidomestic strategy for some product lines and global strategies for others. Coordinating global integration with a responsiveness to the heterogeneity of international markets is a difficult balancing act for managers, but an increasingly important one in today's global business world.

Purpose of Strategy

Within the overall grand strategy of an organization, executives define an explicit **strategy**, which is the plan of action that describes resource allocation and activities for dealing with the environment and attaining the organization's goals. The essence of formulating strategy is choosing how the organization will be different.²⁶ Managers make decisions about whether the company will perform different activities or will execute similar activities differently than competitors do. Strategy necessarily changes over time to fit environmental conditions, but to remain competitive, companies develop strategies that focus on core competencies, develop synergy, and create value for customers.

Core Competence. A company's **core competence** is something the organization does especially well in comparison to its competitors. A core competence represents a competitive advantage because the company acquires expertise that competitors do not have. A core competence may be in the area

strategy

The plan of action that prescribes resource allocation and other activities for dealing with the environment and helping the organization attain its goals.

core competence

A business activity that an organization does particularly well in comparison to competitors.

of superior research and development, expert technological know-how, process efficiency, or exceptional customer service.²⁷ At Amgen, a pharmaceutical company, strategy focuses on the company's core competence of high-quality scientific research. Rather than starting with a specific disease and working backward, Amgen takes brilliant science and finds unique uses for it.²⁸ Boeing Corporation has a core competence in flexible design and assembly of aircraft.²⁹ And Home Depot thrives because of a strategy focused on superior customer service. Managers stress to all employees that listening to customers and helping them solve their do-it-yourself worries takes precedence over just making a sale.³⁰ In each case, leaders identified what their company does particularly well and built strategy around it. Dell Computer has succeeded with its core competencies of speed and cost efficiency.

DELL COMPUTER
<http://www.dell.com>

Dell Computer is constantly changing, adapting, and finding new ways to master its environment, but one thing hasn't changed from the days when Michael Dell first began building computers in his dorm room: the focus on speed and low cost. Most observers agree that a major factor in Dell's success is that it has retained a clear image of what it does best. The company spent years developing a core competence in speedy delivery by squeezing time lags and inefficiencies out of the manufacturing and assembly process, then extended the same brutal standards to the supply chain. Good relationships with a few key suppliers and precise coordination mean that Dell can sometimes receive parts in minutes rather than days.

The system is most evident at Dell's new OptiPlex factory in Austin, Texas, where Dell first introduced a new way of making PCs, called Metric 12, that combines just-in-time inventory delivery with a complicated, integrated computer system that practically hands a worker the right part—whether it be any of a dozen different microprocessors or a combination of software—at just the right time. The goal of the new system is not only to cut costs, but also to save time by decreasing the number of worker touches per machine. Rather than building computers in progressive, assembly-line fashion, small teams of workers at OptiPlex build a complete machine by following precise guidelines and using the components that arrive in carefully indicated racks in front of them. A small glassed-in office above the factory floor functions as a control tower, where employees take orders, alert suppliers, order parts, and arrange shipping, much of this handled over the Internet. By using sophisticated supply-chain software, Dell can keep a few hours' worth of parts on hand and replenish only what it needs throughout the day. Dell's just-in-time system works so smoothly that nearly 85 percent of orders are built, customized, and shipped within eight hours.

Dell's fixation with speed and thrift comes directly from the top. Michael Dell believes the core competencies that made Dell a star in PCs and servers can also make the company a winner as it moves into developing low-cost storage systems and Internet services. To anyone who doubts that Dell can compete in this new market, he says, "Bring them on. We're coming right at them."³¹ ♦

synergy

The condition that exists when the organization's parts interact to produce a joint effect that is greater than the sum of the parts acting alone.

Synergy. When organizational parts interact to produce a joint effect that is greater than the sum of the parts acting alone, **synergy** occurs. The organization may attain a special advantage with respect to cost, market power, technology, or management skill. When properly managed, synergy can create additional value with existing resources, providing a big boost to the bottom line.³² A good example is PepsiCo's new "Power of One" strategy, which is aimed at leveraging

the synergies of its soft drink and snack-food divisions to achieve greater market power. PepsiCo CEO Roger Enrico has used the company's clout with supermarkets to move Pepsi drinks next to Frito-Lay snacks on store shelves, increasing the chance that when shoppers pick up chips and soda, the soda of choice will be a Pepsi product. Managers are betting that the strength of Frito-Lay, which enjoys near-total dominance of the snack-food market, will gain not only greater shelf space for Pepsi, but increased market share as well.³³

Synergy can also be obtained by good relations with suppliers, as at Dell Computer, or by strong alliances among companies. Sweden's appliance giant Electrolux partnered with Ericsson, the Swedish telecommunications giant, in a joint venture called *e2 Home* to create a new way to make and sell appliances. Together, Electrolux and Ericsson are offering products such as the Screenfridge, a refrigerator with Internet connections that enables users to check traffic conditions, order take-out, or buy groceries, and an experimental *pay-per-use* washing machine. Neither company could have offered these revolutionary products on its own. "The technology was there, the appliances were there, but we needed a way to connect those two elements—to add value for consumers," said Per Grunewald, *e2 Home's* president.³⁴

Value Creation. Delivering value to the customer should be at the heart of strategy. Value can be defined as the combination of benefits received and costs paid by the customer. Managers help their companies create value by devising strategies that exploit core competencies and attain synergy. Managers at California's Gallo Winery are finding new ways to use core competencies to create better value. Gallo, long-famous for its inexpensive wines, produces one of every four bottles of wine sold in the U.S. Today, the company is pouring \$100 million into Gallo of Sonoma, a line of upscale wines with value prices. As the low-cost producer, Gallo is able to sell upscale wines for \$1 to \$30 less per bottle than comparable-quality competitors.³⁵ Likewise, McDonald's made a thorough study of how to use its core competencies to create better value for customers, resulting in the introduction of "Extra Value Meals" and the decision to open restaurants in different locations, such as inside Wal-Mart and Sears stores.³⁶

Levels of Strategy

Another aspect of strategic management concerns the organizational level to which strategic issues apply. Strategic managers normally think in terms of three levels of strategy—corporate, business, and functional—as illustrated in Exhibit 8.2.³⁷

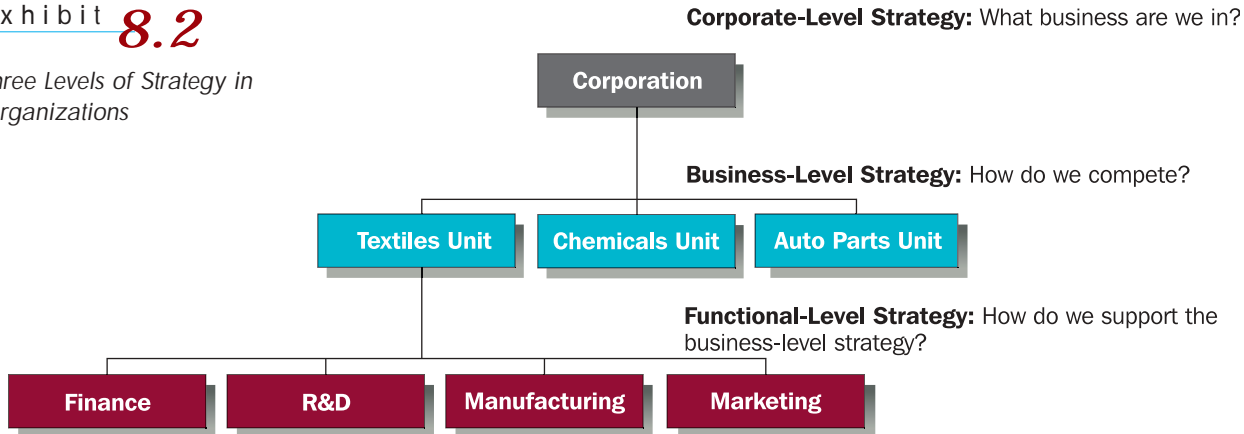
Corporate-Level Strategy. The question, "*What business are we in?*" concerns **corporate-level strategy**. Corporate-level strategy pertains to the organization as a whole and the combination of business units and product lines that make up the corporate entity. Strategic actions at this level usually relate to the acquisition of new businesses; additions or divestments of business units, plants, or product lines; and joint ventures with other corporations in new areas. An example of corporate-level strategy is Cisco Systems, which bought 71 companies between the years of 1993 and 2000 to complement the company's core business of selling hardware and software for the Internet. Rather than pouring money into research, Cisco managers' strategy has been to buy companies that make products that will round out Cisco's existing product line and move the company into new markets. Now, many analysts

corporate-level strategy

The level of strategy concerned with the question, "What business are we in?" Pertains to the organization as a whole and the combination of business units and product lines that make it up.

Exhibit 8.2

Three Levels of Strategy in Organizations



business-level strategy

The level of strategy concerned with the question “How do we compete?” Pertains to each business unit or product line within the organization.

functional-level strategy

The level of strategy concerned with the question “How do we support the business-level strategy?” Pertains to all of the organization’s major departments.

think it is time for Cisco to take the opposite approach and begin shedding some businesses, such as the ATM and frame relay businesses, that no longer make sense as part of the company’s overall business.³⁸

Business-Level Strategy. The question, “*How do we compete?*” concerns **business-level strategy**. Business-level strategy pertains to each business unit or product line. It focuses on how the business unit competes within its industry for customers. Strategic decisions at the business level concern amount of advertising, direction and extent of research and development, product changes, new-product development, equipment and facilities, and expansion or contraction of product lines. For example, top managers at Clorox sparked amazing new growth with simple product changes and advertising campaigns that make old brands seem new again. Making the household cleaner Pine-Sol smell like lemon and masking the odor of chlorine in Clorox bleach has made sales of these products take off. Similarly, Procter & Gamble is trying to stay competitive in the slow-growing consumer products industry by bringing out new versions of long-standing products, such as Tide Free, Tide WearCare, and Tide Kick, and by beefing up advertising budgets.³⁹

Many companies are opening e-commerce units as a part of business-level strategy. For example, Hallmark’s Web site is a marketing vehicle for the company’s products and retail stores, as well as a place to sell gifts and flowers online.⁴⁰

Functional-Level Strategy. The question, “*How do we support the business-level competitive strategy?*” concerns **functional-level strategy**. It pertains to the major functional departments within the business unit. Functional strategies involve all of the major functions, including finance, research and development, marketing, and manufacturing. The functional-level strategy for Procter & Gamble’s research and development department, for example, is to invest heavily in developing new formulations of existing products, particularly its famous Tide laundry detergent. Another good example of functional-level strategy was when Sherwin-Williams’ marketing department developed an advertising campaign several years ago aimed at specific markets for its paint. The Dutch Boy brand, touted as “the look that gets the looks,” was advertised primarily to do-it-yourselfers who shopped the discount chains. The still-popular “Ask Sherwin-Williams” advertisements were targeted toward professionals. This marketing strategy helped the company increase sales at a time when total industry sales had fallen flat.⁴¹



Courtesy of Merck & Co., Inc.

Merck has a business-level strategy of competing through product innovation. Merck researchers like Amy Cheung and Thomas Rano, using advanced technology, are producing more new compounds in less time than has ever been possible. Merck spends more than \$2 billion on research and development and uses every means possible to reduce by months the drug discovery, development, and application processes. Merck maintains a competitive edge by having innovative products in many therapeutic categories for human and animal health.

The Strategic Management Process

The overall strategic management process is illustrated in Exhibit 8.3. It begins when executives evaluate their current position with respect to mission, goals, and strategies. They then scan the organization's internal and external environments and identify strategic factors that might require change. Internal or external events might indicate a need to redefine the mission or goals or to formulate a new strategy at either the corporate, business, or functional level. The final stage in the strategic management process is implementation of the new strategy.

Strategy Formulation Versus Implementation

Strategy formulation includes the planning and decision making that lead to the establishment of the firm's goals and the development of a specific strategic plan.⁴² Strategy formulation may include assessing the external environment and internal problems and integrating the results into goals and strategy. This is in contrast to **strategy implementation**, which is the use of managerial and organizational tools to direct resources toward accomplishing strategic results.⁴³ Strategy implementation is the administration and execution of the strategic plan. Managers may use persuasion, new equipment, changes in organization structure, or a reward system to ensure that employees and resources are used to make formulated strategy a reality.

strategy formulation

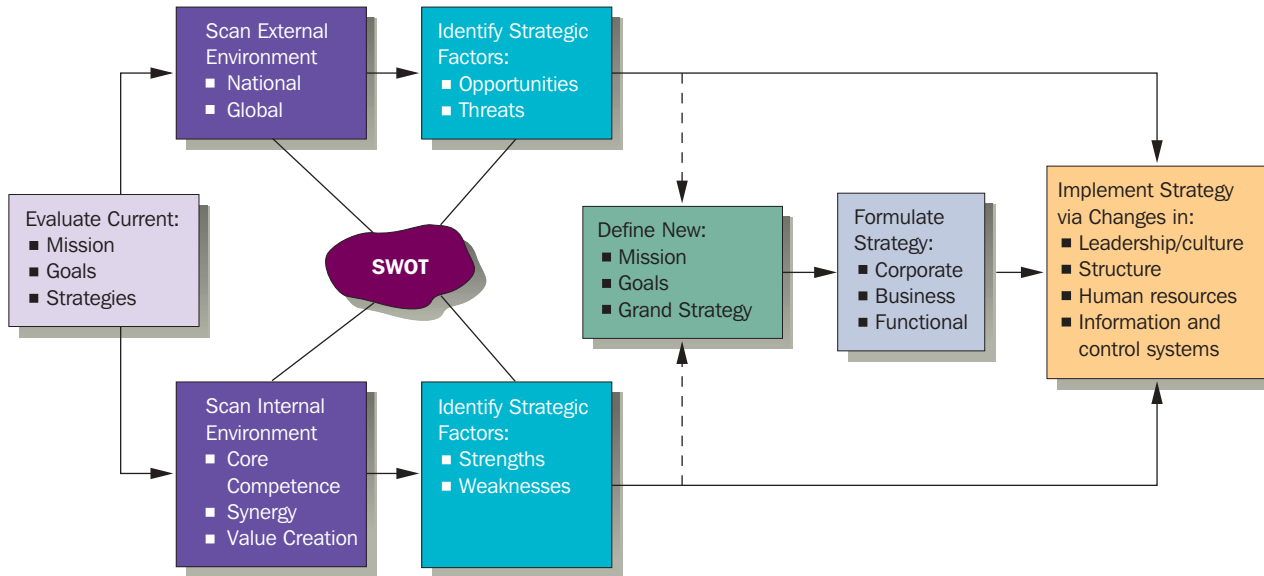
The stage of strategic management that involves the planning and decision making that lead to the establishment of the organization's goals and of a specific strategic plan.

strategy implementation

The stage of strategic management that involves the use of managerial and organizational tools to direct resources toward achieving strategic outcomes.

Exhibit 8.3

The Strategic Management Process



Situation Analysis

situation analysis

Analysis of the strengths, weaknesses, opportunities, and threats (SWOT) that affect organizational performance.

Formulating strategy often begins with an assessment of the internal and external factors that will affect the organization's competitive situation. **Situation analysis** typically includes a search for SWOT—strengths, weaknesses, opportunities, and threats that affect organizational performance. Situation analysis is important to all companies but is crucial to those considering globalization because of the diverse environments in which they will operate. External information about opportunities and threats may be obtained from a variety of sources, including customers, government reports, professional journals, suppliers, bankers, friends in other organizations, consultants, or association meetings. Many firms hire special scanning organizations to provide them with newspaper clippings, Internet research, and analyses of relevant domestic and global trends. Some firms use more subtle techniques to learn about competitors, such as asking potential recruits about their visits to other companies, hiring people away from competitors, debriefing former employees or customers of competitors, taking plant tours posing as “innocent” visitors, and even buying competitors' garbage.⁴⁴ In addition, many companies are hiring competitive intelligence professionals to scope out competitors, as we discussed in Chapter 3.

Executives acquire information about internal strengths and weaknesses from a variety of reports, including budgets, financial ratios, profit and loss statements, and surveys of employee attitudes and satisfaction. Managers spend 80 percent of their time giving and receiving information. Through frequent face-to-face discussions and meetings with people at all levels of the hierarchy, executives build an understanding of the company's internal strengths and weaknesses.

Internal Strengths and Weaknesses. *Strengths* are positive internal characteristics that the organization can exploit to achieve its strategic performance goals. *Weaknesses* are internal characteristics that might inhibit or

restrict the organization's performance. Some examples of what executives evaluate to interpret strengths and weaknesses are given in Exhibit 8.4. The information sought typically pertains to specific functions such as marketing, finance, production, and R & D. Internal analysis also examines overall organization structure, management competence and quality, and human resource characteristics. Based on their understanding of these areas, managers can determine their strengths or weaknesses vis-à-vis other companies. For example, Citigroup has been able to grow rapidly because of its financial strength and reliable business processes. The company has developed sophisticated financial and product know-how in the United States and was able to leverage that knowledge to support its global strategy and provide more than 100 million customers worldwide with any financial service, in any currency, reliably and at a low cost.⁴⁵

External Opportunities and Threats. *Threats* are characteristics of the external environment that may prevent the organization from achieving its strategic goals. *Opportunities* are characteristics of the external environment that have the potential to help the organization achieve or exceed its strategic goals. Executives evaluate the external environment with information about the nine sectors described in Chapter 3. The task environment sectors are the most relevant to strategic behavior and include the behavior of competitors, customers, suppliers, and the labor supply. The general environment contains those sectors that have an indirect influence on the organization but nevertheless must be understood and incorporated into strategic behavior. The general environment includes technological developments, the economy, legal-political and international events, and sociocultural changes. Additional areas that might reveal opportunities or threats include pressure groups, interest groups, creditors, natural resources, and potentially competitive industries.

An example of how external analysis can uncover a threat occurred in Kellogg Company's cereal business. Scanning the environment revealed that Kellogg's once-formidable share of the U.S. cold-cereal market had dropped nearly 10 percent. Information from the competitor and customer sectors



© Alan Levinson

Bill Gross knows that the primary strengths of his company, idealab!, are creativity and rapid product development. Product innovation keeps idealab! at the forefront of the Net revolution with ventures such as cooking.com, tickets.com, and Wedding Channel.com. Since Gross recognized that he is better at starting companies than at running them, he turned control of the remaining business functions over to his brother, Larry, whom he credits with the company's survival.

Management and Organization	Marketing	Human Resources
Management quality	Distribution channels	Employee experience, education
Staff quality	Market share	Union status
Degree of centralization	Advertising efficiency	Turnover, absenteeism
Organization charts	Customer satisfaction	Work satisfaction
Planning, information, control systems	Product quality	Grievances
	Service reputation	
	Sales force turnover	
Finance	Production	Research and Development
Profit margin	Plant location	Basic applied research
Debt-equity ratio	Machinery obsolescence	Laboratory capabilities
Inventory ratio	Purchasing system	Research programs
Return on investment	Quality control	New-product innovations
Credit rating	Productivity/efficiency	Technology innovations

Exhibit 8.4

Checklist for Analyzing Organizational Strengths and Weaknesses

indicated that major rivals were stepping up new-product innovations and cutting prices. In addition, private-label versions of such standbys as cornflakes were cutting into Kellogg's sales. Kellogg executives used knowledge of this threat as a basis for a strategic response.

The value of situation analysis in helping executives formulate the correct strategy is illustrated by Toys 'R' Us.

TOYS 'R' US

<http://www.toysrus.com>

Toys 'R' Us was started in a bicycle shop more than 50 years ago and grew to become the hottest toy store around during the 1980s. But by the mid-1990s, the once high-flying company was struggling just to stay aloft. John Eyler is the third CEO since 1994 to try to fix the company's massive problems. He has developed a new strategic direction for Toys 'R' Us that can be explained with SWOT analysis.

One of the company's greatest *strengths* is its reputation for carrying the widest selection of toys around. No other store carries the broad variety of toys and games found on Toys 'R' Us shelves. In addition, the company has tremendous market presence. With more than 700 U.S. stores, most people have a Toys 'R' Us store within easy reach—and many still think of Toys 'R' Us as *the* place to go if they are shopping specifically for toys. Unfortunately, the company's *weaknesses* far outweigh these strengths, including deplorable customer service, dirty and dilapidated stores, crowded aisles and poor product displays, and weak inventory management that puts too many slow-selling toys in stores and too few of the latest "must-have" products.

The biggest *threat* to the company is increased competition. A few years ago, Wal-Mart overtook Toys 'R' Us as the No. 1 U.S. toy seller. Other discount chains have also increased their toy selection and become more sophisticated toy retailers. In addition, online toy sellers hurt the company's sales during the late 1990s. However, Eyler and other managers also see a tremendous *opportunity* to become a unique kind of toy store.

To capitalize on the company's strengths and opportunities, Eyler has formulated a business-level strategy that attempts to provide the magic of upscale toy vendor FAO Schwarz at a reasonable Toys 'R' Us price. Rather than trying to compete with discount competitors on price, Toys 'R' Us will focus on superior customer service and creating a unique shopping environment. Eyler is remodeling and reorganizing stores, revamping inventory management, beefing up staffing and training, and increasing the percentage of private-label proprietary toys that will be sold exclusively at Toys 'R' Us. The new look of Toys 'R' Us does away with the warehouse-style aisles and replaces them with toys clustered by interest groups in cul-de-sacs and bright, interesting displays that are determined by factors such as age level and gender. Proprietary products, such as the Animal Planet line of animatronic wild animals and the new collection of licensed *E.T.* toys and gizmos, will be displayed in cubby holes close to the entrance to make them more visible and to give Toys 'R' Us a hit product that discount competitors cannot match.⁴⁶ ❖

Formulating Corporate-Level Strategy

Portfolio Strategy

Portfolio strategy pertains to the mix of business units and product lines that fit together in a logical way to provide synergy and competitive advantage for the corporation. For example, an individual might wish to diversify in an

investment portfolio with some high-risk stocks, some low-risk stocks, some growth stocks, and perhaps a few income bonds. In much the same way, corporations like to have a balanced mix of business divisions called **strategic business units (SBUs)**. An SBU has a unique business mission, product line, competitors, and markets relative to other SBUs in the corporation.⁴⁷ Executives in charge of the entire corporation generally define the grand strategy and then bring together a portfolio of strategic business units to carry it out. One useful way to think about portfolio strategy is the BCG matrix.

The BCG Matrix

The BCG (for Boston Consulting Group) matrix is illustrated in Exhibit 8.5. The **BCG matrix** organizes businesses along two dimensions—business growth rate and market share.⁴⁸ *Business growth rate* pertains to how rapidly the entire industry is increasing. *Market share* defines whether a business unit has a larger or smaller share than competitors. The combinations of high and low market share and high and low business growth provide four categories for a corporate portfolio.

The *star* has a large market share in a rapidly growing industry. The star is important because it has additional growth potential, and profits should be plowed into this business as investment for future growth and profits. The star is visible and attractive and will generate profits and a positive cash flow even as the industry matures and market growth slows.

The *cash cow* exists in a mature, slow-growth industry but is a dominant business in the industry, with a large market share. Because heavy investments in advertising and plant expansion are no longer required, the corporation earns a positive cash flow. It can milk the cash cow to invest in other, riskier businesses.

portfolio strategy

A type of corporate-level strategy that pertains to the organization's mix of SBUs and product lines that fit together in such a way as to provide the corporation with synergy and competitive advantage.

strategic business unit (SBU)

A division of the organization that has a unique business mission, product line, competitors, and markets relative to other SBUs in the same corporation.

BCG matrix

A concept developed by the Boston Consulting Group that evaluates SBUs with respect to the dimension of business growth rate and market share.

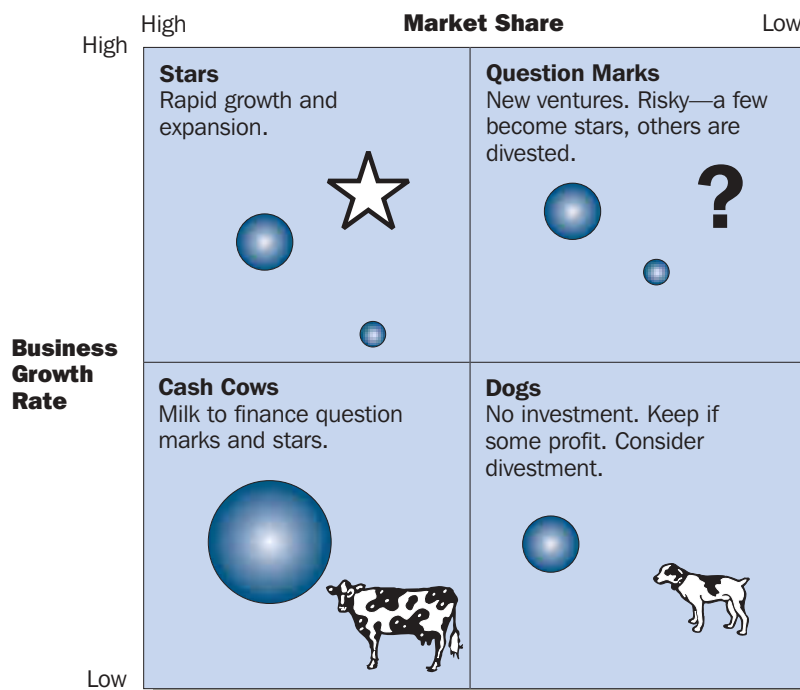


Exhibit 8.5

The BCG Matrix

The *question mark* exists in a new, rapidly growing industry but has only a small market share. The question mark business is risky: it could become a star, or it could fail. The corporation can invest the cash earned from cash cows in question marks with the goal of nurturing them into future stars.

The *dog* is a poor performer. It has only a small share of a slow-growth market. The dog provides little profit for the corporation and may be targeted for divestment or liquidation if turnaround is not possible.

The circles in Exhibit 8.5 represent the business portfolio for a hypothetical corporation. Circle size represents the relative size of each business in the company's portfolio. Most organizations, such as Gillette, have businesses in more than one quadrant, thereby representing different market shares and growth rates.

GILLETTE COMPANY <http://www.gillette.com>

The most famous cash cow in Gillette's portfolio is the shaving division, which accounts for more than half of the company's profits and holds a large share of a stable market. Gillette's razors hold a commanding share of the U.S. market, and sales in other countries are also strong. The Oral-B division with its steady stream of new products has also been a cash cow, although sales have slowed in recent years.

The Braun subsidiary has star status, and managers are pumping money into research and development of new electric toothbrushes, personal diagnostic equipment, and other products. The Duracell division is a question mark. When Gillette purchased the division in 1996, it hoped Duracell would be a vehicle for rapid growth, becoming a star and eventually as big a cash cow as razors and blades. However, so far, the heavy investment in batteries is not paying off. Rivals Energizer and Rayovac have pummeled Duracell's new high-priced, long-lasting batteries with price cuts and special promotions. Rather than charging up Gillette's bottom line, Duracell has proven to be a serious drain on company profits. The toiletries division is also a question mark. A line of women's toiletries aimed at the European market failed, and products such as Right Guard and Soft & Dri deodorant have enjoyed only cyclical success. A new line of men's toiletries, including a gel-based deodorant, a gel shaving cream, and a new body wash, has had only limited success. Some critics believe the division is a dog, but Gillette is still trying to come up with some new products to save it from the fate of the Cricket disposable lighter several years ago. Bic dominated the disposable lighter line so completely that Gillette had to recognize Cricket as a dog and put it out of its misery through liquidation. Gillette is investing heavily in its question marks, particularly Duracell, to ensure that its portfolio will continue to include stars and cash cows in the future.⁴⁹ ❖

Formulating Business-Level Strategy

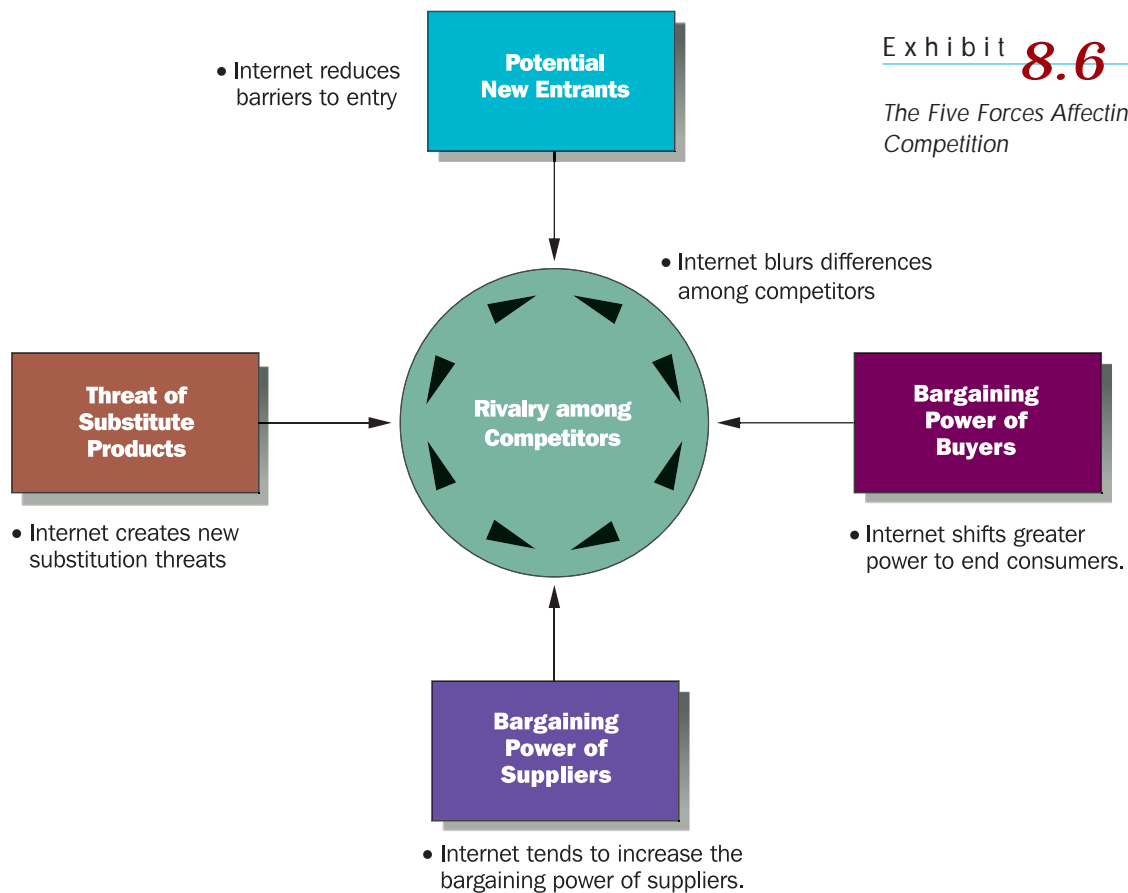
Now we turn to strategy formulation within the strategic business unit, in which the concern is how to compete. The same three generic strategies—growth, stability, and retrenchment—apply at the business level, but they are accomplished through competitive actions rather than the acquisition or divestment of business divisions. One model for formulating strategy is Porter's competitive strategies, which provides a framework for business unit competitive action.

Porter's Competitive Forces and Strategies

Michael E. Porter studied a number of business organizations and proposed that business-level strategies are the result of five competitive forces in the company's environment.⁵⁰ More recently, Porter has examined the impact of the Internet on business-level strategy.⁵¹ New Web-based technology is influencing industries in both positive and negative ways, and understanding this impact is essential for managers to accurately analyze their competitive environments and design appropriate strategic actions.

Five Competitive Forces. Exhibit 8.6 illustrates the competitive forces that exist in a company's environment and indicates some ways Internet technology is affecting each area. These forces help determine a company's position vis-à-vis competitors in the industry environment.

1. *Potential new entrants.* Capital requirements and economies of scale are examples of two potential barriers to entry that can keep out new competitors. It is far more costly to enter the automobile industry, for example, than to start a specialized mail-order business. In general, Internet technology has made it much easier for new companies to enter an industry, for example, by curtailing the need for such organizational elements as an





Talk about a differentiation strategy! By 2007, entrepreneurs at Space Island Group plan to offer tourists a trip to a privately-funded space station, complete with hotels, restaurants, and attractions. Founder and president Gene Meyers is enlisting the help of more than 150 high-level engineers, many of whom worked on the original NASA space shuttle program. Space Island plans on building a fleet of 50 commercial shuttles at a cost of \$300 million each over the next ten years. The first should be up and running by 2005, with the first commercial station scheduled for full operations by 2007. Space Island will rely on superior technological know-how, employee creativity, and strong marketing abilities to make its unique project a success.

established sales force, physical assets such as buildings and machinery, or access to existing supplier and sales channels.

2. *Bargaining power of buyers.* Informed customers become empowered customers. The Internet provides easy access to a wide array of information about products, services, and competitors, thereby greatly increasing the bargaining power of end consumers. For example, a customer shopping for a car can gather extensive information about various options, such as wholesale prices for new cars or average value for used vehicles, detailed specifications, repair records, and even whether a used car has ever been involved in an accident
3. *Bargaining power of suppliers.* The concentration of suppliers and the availability of substitute suppliers are significant factors in determining supplier power. The sole supplier of engines to a manufacturer of small airplanes will have great power, for example. The impact of the Internet in this area can be both positive and negative. That is, procurement over the Web tends to give a company greater power over suppliers, but the Web also gives suppliers access to a greater number of customers, as well as the ability to reach end users. Overall, the Internet tends to raise the bargaining power of suppliers.
4. *Threat of substitute products.* The power of alternatives and substitutes for a company's product may be affected by cost changes or trends such as increased health consciousness that will deflect buyer loyalty to companies. Companies in the sugar industry suffered from the growth of sugar substitutes; manufacturers of aerosol spray cans lost business as environmentally conscious consumers chose other products. The Internet has created a greater threat of new substitutes by enabling new approaches to meeting customer needs. For example, traditional travel agencies have been hurt by the offering of low-cost airline tickets over the Internet.
5. *Rivalry among competitors.* As illustrated in Exhibit 8.6, rivalry among competitors is influenced by the preceding four forces, as well as by cost and product differentiation. With the leveling force of the Internet and information technology, it has become more difficult for many companies to find ways to distinguish themselves from their competitors, so rivalry has intensified.

Porter referred to the “advertising slugfest” when describing the scrambling and jockeying for position that often occurs among fierce rivals within an industry. Famous examples include the competitive rivalry between Pepsi and Coke and between UPS and FedEx. IBM and Oracle Corp. are currently involved in a fight for the No. 1 spot in the \$50 billion corporate-software market. IBM recently rented a billboard near Oracle's headquarters proclaiming a “search for intelligent software.” A few days later, Oracle fired the next shot with a competing billboard retorting, “Then you've come to the right place.”⁵²

Competitive Strategies. In finding its competitive edge within these five forces, Porter suggests that a company can adopt one of three strategies: differentiation, cost leadership, and focus. Companies can use the Internet to support and strengthen the strategic approach they choose. The organizational characteristics typically associated with each strategy are summarized in Exhibit 8.7.

1. *Differentiation.* The **differentiation** strategy involves an attempt to distinguish the firm's products or services from others in the industry. The organization may use advertising, distinctive product features, exceptional

differentiation

A type of competitive strategy with which the organization seeks to distinguish its products or services from competitors'.

Strategy	Organizational Characteristics
Differentiation	<ul style="list-style-type: none"> Acts in a flexible, loosely knit way, with strong coordination among departments Strong capability in basic research Creative flair, thinks "out of the box" Strong marketing abilities Rewards employee innovation Corporate reputation for quality or technological leadership
Cost Leadership	<ul style="list-style-type: none"> Strong central authority; tight cost controls Maintains standard operating procedures Easy-to-use manufacturing technologies Highly efficient procurement and distribution systems Close supervision; finite employee empowerment Frequent, detailed control reports
Focus	<ul style="list-style-type: none"> May use combination of above policies directed at particular strategic target Values and rewards flexibility and customer intimacy Measures cost of providing service and maintaining customer loyalty Pushes empowerment to employees with customer contact

SOURCES: Based on Michael E. Porter, *Competitive Strategy: Techniques for Analyzing Industries and Competitors* (New York: The Free Press, 1980); Michael Treacy and Fred Wiersema, "How Market Leaders Keep Their Edge," *Fortune*, February 6, 1995, 88–98; and Michael A. Hitt, R. Duane Ireland, and Robert E. Hoskisson, *Strategic Management* (St. Paul, Minn.: West, 1995), 100–113.

Exhibit 8.7

Organizational Characteristics of Porter's Competitive Strategies

service, or new technology to achieve a product perceived as unique. The differentiation strategy can be profitable because customers are loyal and will pay high prices for the product. Examples of products that have benefited from a differentiation strategy include Mercedes-Benz automobiles, Maytag appliances, and Tommy Hilfiger clothing, all of which are perceived as distinctive in their markets. Service companies, such as American Express and Hilton Hotels, can also use a differentiation strategy. The Harleysville Group uses its corporate culture to differentiate itself in the insurance industry, as described in this chapter's Putting People First box.

Companies that pursue a differentiation strategy typically need strong marketing abilities, a creative flair, and a reputation for leadership.⁵³ A differentiation strategy can reduce rivalry with competitors if buyers are loyal to a company's brand. Consider the example of online company eBay, described earlier in the chapter. Rather than cutting prices when Amazon.com and other rivals entered the online auction business, eBay continued to focus on building a distinctive community, offering customers services and experiences they could not get on other sites. Customers stayed loyal to eBay rather than switching to low-cost rivals. Successful differentiation can also reduce the bargaining power of large buyers because other products are less attractive, and this also helps the firm fight off threats of substitute products. In addition, differentiation erects entry barriers in the form of customer loyalty that a new entrant into the market would have difficulty overcoming.

2. **Cost Leadership.** With a **cost leadership** strategy, the organization aggressively seeks efficient facilities, pursues cost reductions, and uses tight cost controls to produce products more efficiently than competitors. A low-cost position means that the company can undercut competitors' prices and still offer comparable quality and earn a reasonable profit. Comfort Inn and

cost leadership

A type of competitive strategy with which the organization aggressively seeks efficient facilities, cuts costs, and employs tight cost controls to be more efficient than competitors.



Putting People First

Happy Employees Want to Stay at the Harleysville Group

The Harleysville Group is not your average, run-of-the-mill insurance company, and employees as well as customers know it. At Harleysville, managers strive to provide their employees with an appealing atmosphere and plenty of perks. The goal is to create a work environment that makes people want to stay. They must be doing things right, because the Harleysville Group boasts a 95 percent retention rate over the past several years. That translates into experienced, knowledgeable employees who can provide top-quality service. Customers who have grown tired of working with companies where the staff is constantly changing can appreciate the difference that comes from working with people who are happy and knowledgeable.

Harleysville does plenty to keep employees happy. Besides an impressive vacation plan, extensive medical benefits, a cafeteria that serves freshly made food, and snack carts that go about the building selling coffee and pastries, the company also provides onsite ATMs and a clothes-cleaning service that includes pick-up and delivery. A massage therapist comes in once a week, and employees pay 10 dollars for a 15-minute session, far below the market rate. The CEO pays for a 15-minute session each week and often gives it away to an employee as a way to say thanks for some extra effort. Two other, highly important perks are the company's project bonuses

and matching 401(k) investments. It is not unusual for the company to hand out checks for \$1,500 or \$2,000 to reward people for excellent work on a team project. For the 401(k) plan, Harleysville will match an employee's contribution anywhere from 25 percent to 100 percent, depending on company performance. In the last four years, the company has matched contributions one-to-one. For example, if an employee put in \$5,000, the company would add that amount.

Other perks are aimed at increasing employees' knowledge and career skills. Tech-savvy workers are critical to the Harleysville Group, so the company spends more than \$600,000 every year in technical training for the IS department alone. And that doesn't include the corporate funding for employees who are taking college courses and working toward higher degrees. To make it even easier, the company brings community college professors to the company campus so employees can take some courses without having to travel at the end of their work day.

Harleysville refuses to pay sky-high salaries, but the extensive benefits and the people-friendly work environment help the company stand out in the insurance industry. Inevitably, some employees do leave, but it usually isn't for a \$5,000 raise, notes CEO Wayne Ratz. "It's more for an extravagant opportunity or for a lifestyle change."

SOURCE: Erik Sherman, "Happy in Harleysville," *CIO* (October 15, 2000), 84-86.

Motel 6 are low-priced alternatives to Holiday Inn and Ramada Inn. Dell Computer, described earlier in the chapter, has squeezed every cent possible out of the cost of building and selling PCs, making it the undisputed low-cost leader and the number-one maker of personal computers.

Being a low-cost producer provides a successful strategy to defend against the five competitive forces in Exhibit 8.6. For example, the most efficient, low-cost company is in the best position to succeed in a price war while still making a profit. For example, Dell declared a brutal price war in mid-2001, just as the PC industry entered its worst slump ever. The result? Dell racked up \$361 million in profits while the rest of the industry reported losses of \$1.1 billion. Likewise, the low-cost producer is protected from powerful customers and suppliers, because customers cannot find lower prices elsewhere, and other buyers would have less slack for price negotiation with suppliers. If substitute products or potential new entrants occur, the low-cost producer is better positioned than higher-cost rivals to prevent loss of market share. The low price acts as a barrier against new entrants and substitute products.⁵⁴

focus

A type of competitive strategy that emphasizes concentration on a specific regional market or buyer group.

3. **Focus.** With a **focus** strategy, the organization concentrates on a specific regional market or buyer group. The company will use either a differentiation or low-cost approach, but only for a narrow target market.

Enterprise Rent-A-Car has made its mark by focusing on a market the major companies such as Hertz and Avis don't even play in—the low-budget insurance replacement market. Drivers whose cars have been wrecked or stolen have one less thing to worry about when Enterprise delivers a car right to their driveway. By using a focus strategy, Enterprise has been able to grow rapidly.⁵⁵

Managers think carefully about which strategy will provide their company with its competitive advantage. Gibson Guitar Corp., famous in the music world for its innovative, high-quality products, found that switching to a low-cost strategy to compete against Japanese rivals such as Yamaha and Ibanez actually hurt the company. When managers realized people wanted Gibson products because of their reputation, not their price, they went back to a differentiation strategy and invested in new technology and marketing.⁵⁶ In his studies, Porter found that some businesses did not consciously adopt one of these three strategies and were stuck with no strategic advantage. Without a strategic advantage, businesses earned below-average profits compared with those that used differentiation, cost leadership, or focus strategies. In addition, because the Internet is having such a profound impact on the competitive environment in all industries, it is more important than ever that companies distinguish themselves through careful strategic positioning in the marketplace.⁵⁷

Partnership Strategies

So far, we have been discussing strategies that are based on how to compete with other companies. An alternative approach to strategy emphasizes collaboration. In some situations, companies can achieve competitive advantages by cooperating with other firms rather than competing. Partnership strategies are becoming increasingly popular as firms in all industries join with other organizations to promote innovation, expand markets, and pursue joint goals. Partnering was once a strategy adopted primarily by small firms that needed greater marketing muscle or international access. Today, however, it has become a way of life for most companies, large and small. The question is no longer whether to collaborate, but rather where, how much, and with whom to collaborate.⁵⁸ Competition and cooperation often exist at the same time. In New York City, Time Warner (now AOL Time Warner) refused to carry Fox's 24-hour news channel on its New York City cable systems. The two companies engaged in all-out war that included court lawsuits and front-page headlines. This conflict, however, masked a simple fact: the two companies can't live without each other. Fox and Time Warner are wedded to one another in separate business deals around the world. They will never let the local competition in New York upset their larger cooperation on a global scale.⁵⁹

The Internet is both driving and supporting the move toward partnership thinking. The ability to rapidly and smoothly conduct transactions, communicate information, exchange ideas, and collaborate on complex projects via the Internet means that companies such as Citigroup, Dow Chemical, and Herman Miller have been able to enter entirely new businesses by partnering in business areas that were previously unimaginable. IBM is collaborating with numerous partners around the world on the Internet, including competitors such as Dell and Hewlett-Packard, to develop, enhance, and market Linux-based software and services.⁶⁰

Mutual dependencies and partnerships have become a fact of life, but the degree of collaboration varies. Organizations can choose to build cooperative relationships in many ways, such as through preferred suppliers, strategic business partnering, joint ventures, or mergers and acquisitions. Exhibit 8.8 illustrates these major types of strategic business relationships according to the degree of collaboration involved. With preferred supplier relationships, a company such as Wal-Mart, for example, develops a special relationship with a key supplier such as Procter & Gamble that eliminates middlemen by sharing complete information and reducing the costs of salespeople and distributors. Preferred supplier arrangements provide long-term security for both organizations, but the level of collaboration is relatively low. Strategic business partnering requires a higher level of collaboration. Toys 'R' Us and Amazon.com have negotiated a strategic partnership to sell toys online. Amazon agreed to provide warehousing, order fulfillment, and site design, and in return got warrants to purchase 5 percent of toysrus.com, plus up-front payments and a share of the site's sales.⁶¹

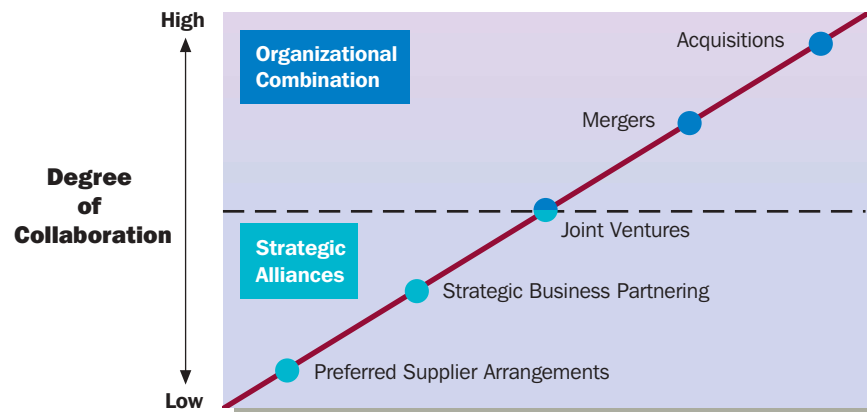
A still higher degree of collaboration is reflected in joint ventures, which are separate entities created with two or more active firms as sponsors. For example, MTV Networks was originally created as a joint venture of Warner Communications and American Express in the late 1970s. In a joint venture, organizations share the risks and costs associated with the new venture. It is estimated that the rate of joint venture formation between U.S. and international companies has been growing by 27 percent annually since 1985. Merck has put together major ventures with such competitors as Johnson & Johnson DuPont, and AstraZeneca.⁶²

Mergers and acquisitions represent the ultimate step in collaborative relationships. U.S. business has been in the midst of a tremendous merger and acquisition boom. The U.S. pharmaceuticals company Upjohn merged with Sweden's Pharmacia. Boeing acquired McDonnell Douglas to form the industry's largest company, and Phillips Petroleum and Conoco recently merged to create the nation's third largest oil and gas company.

Today's companies simultaneously embrace both competition and cooperation. Few companies can go it alone under a constant onslaught of international competition, changing technology, and new regulations. In this new environment, businesses choose a combination of competitive and partnership strategies that add to their overall sustainable advantage.⁶³

Exhibit 8.8

A Continuum of Partnership Strategies



SOURCE: Adapted from Roberta Maynard, "Striking the Right Match," *Nation's Business* (May 1996), 18–28.

Formulating Functional-Level Strategy

Functional-level strategies are the action plans adopted by major departments to support the execution of business-level strategy. Major organizational functions include marketing, production, finance, human resources, and research and development. Senior managers in these departments adopt strategies that are coordinated with the business-level strategy to achieve the organization's strategic goals.⁶⁴

For example, consider a company that has adopted a differentiation strategy and is introducing new products that are expected to experience rapid growth. The human resources department should adopt a strategy appropriate for growth, which would mean recruiting additional personnel and training middle managers for movement into new positions. The marketing department should undertake test marketing, aggressive advertising campaigns, and consumer product trials. The finance department should adopt plans to borrow money, handle large cash investments, and authorize construction of new production facilities.

A company with mature products or a low-cost strategy will have different functional strategies. The human resources department should develop strategies for retaining and developing a stable work force, including transfers, advancements, and incentives for efficiency and safety. Marketing should stress brand loyalty and the development of established, reliable distribution channels. Production should maintain long production runs, routinization, and cost reduction. Finance should focus on net cash flows and positive cash balances.

Strategy Implementation and Control

The final step in the strategic management process is *implementation*—how strategy is put into action. Some people argue that strategy implementation is the most difficult and important part of strategic management.⁶⁵ No matter how creative the formulated strategy, the organization will not benefit if it is incorrectly implemented. In today's competitive environment, there is an increasing recognition of the need for more dynamic approaches to formulating as well as implementing strategies. Strategy is not a static, analytical process; it requires vision, intuition, and employee participation.⁶⁶ Many organizations are abandoning central planning departments, and strategy is becoming an everyday part of the job for workers at all levels. Strategy implementation involves using several tools—parts of the firm that can be adjusted to put strategy into action—as illustrated in Exhibit 8.9. Once a new strategy is selected, it is implemented through changes in leadership, structure, information and control systems, and human resources.⁶⁷ For strategy to be implemented successfully, all aspects of the organization need to be in congruence with the strategy. Implementation involves regularly making difficult decisions about doing things in a way that supports rather than undermines the organization's chosen strategy. Remaining chapters of this book examine in detail topics such as leadership, organizational structure, information and control systems, and human resource management.

Leadership

The primary key to successful strategy implementation is leadership. *Leadership* is the ability to influence people to adopt the new behaviors needed

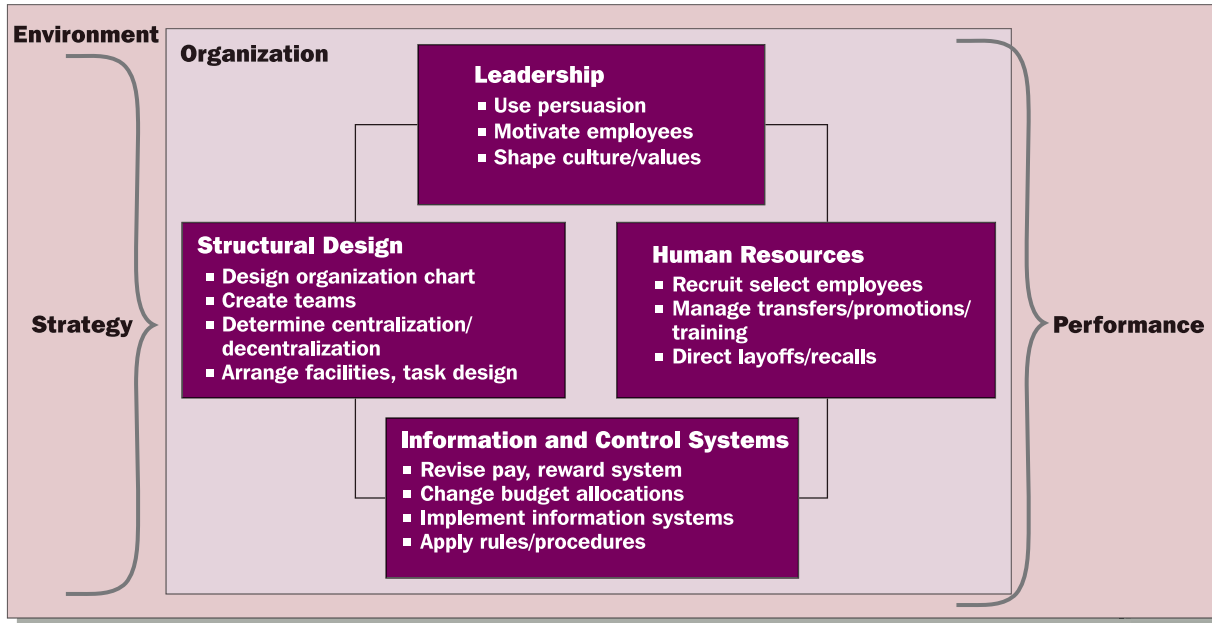


Exhibit 8.9

Tools for Putting Strategy into Action

SOURCE: Adapted from Jay R. Galbraith and Robert K. Kazanjian, *Strategy Implementation: Structure, Systems, and Process*, 2d ed. (St. Paul, Minn.: West, 1986), 115. Used with permission.

for strategy implementation. An important part of implementing strategy is building consensus. People throughout the organization have to believe in the new strategy and have a strong commitment to achieving the vision and goals. Leadership means using persuasion, motivating employees, and shaping culture and values to support the new strategy. Managers may make speeches to employees, build coalitions of people who support the new strategic direction, and persuade middle managers to go along with their vision for the company. Michael Dell of Dell Computer is a master of strategic leadership. Dell builds support for his vision and strategy at each year's employee meeting, where he has a chance to tell employees face-to-face exactly where he wants them to take the company in the year ahead. Dell's charisma and persuasive leadership keep employees fired up about his goals for the company.⁶⁸ With a clear sense of direction and a shared purpose, employees feel motivated, challenged, and empowered to pursue new strategic goals. Another way leaders build consensus and commitment is through broad participation. When people participate in strategy formulation, implementation is easier because managers and employees already understand the reasons for the new strategy and feel more committed to it.

Structural Design

Structural design typically begins with the organization chart. It pertains to managers' responsibilities, their degree of authority, and the consolidation of facilities, departments, and divisions. Structure also pertains to such matters as centralization versus decentralization, the design of job tasks, and the organization's production technology. Structure will be discussed in detail in Chapter 10.

In many cases, implementing a new strategy requires making changes in organizational structure, such as adding or changing positions, reorganizing to teams, redesigning jobs, or shifting managers' responsibility and accountability. For example, a cereal manufacturing company that wanted to reduce costs and improve efficiency to pursue a low-cost leadership strategy revised task design by combining several packing positions into one job and cross-training employees to operate all of the packing line's equipment. This reduced the number of workers needed during peak times and avoided leaving some workers idle during slow periods. The structural changes cut overall plant costs and manufacturing expenses while significantly increasing the factory's productivity and yield, thus helping to implement the new strategy.⁶⁹ At Limited Inc., a chain of specialty stores including Express and Victoria's Secret, founder and chairman Leslie Wexner decided to shift to a centralized organizational structure to implement a differentiation strategy. Limited was losing its fashion direction and customer insight, with many different stores pursuing their own goals and ideas. The new centralized structure, which includes a "corporate brain trust" of executives who oversee design, marketing, and distribution across the company's nearly 5,000 stores, has gotten the company refocused.⁷⁰

Information and Control Systems

Information and control systems include reward systems, pay incentives, budgets for allocating resources, information technology systems, and the organization's rules, policies, and procedures. Changes in these systems represent major tools for putting strategy into action. For example, managers can reassign resources from research and development to marketing if a new strategy requires increased advertising but no product innovations. Managers and employees must also be rewarded for adhering to the new strategy and making it a success.⁷¹

At ConAgra, maker of Healthy Choice and Banquet brands, top executives instituted top-down cost controls in the corporation's operating units and developed new systems for pooling resources to reduce purchasing, warehousing, and transportation costs. To ensure that managers embraced the new strategy of cooperation and efficiency, leaders tied 25 percent of their bonuses directly to savings targets. Division heads saved \$100 million in the first fiscal year. Top leaders also made changes in information systems by introducing a computerized network to track how much suppliers charge each ConAgra unit.⁷²

Human Resources

The organization's *human resources* are its employees. The human resource function recruits, selects, trains, transfers, promotes, and lays off employees to achieve strategic goals. For example, training employees can help them understand the purpose and importance of a new strategy or help them develop the necessary specific skills and behaviors. Sometimes employees may have to be let go and replaced. One newspaper shifted its strategy from an evening to a morning paper to compete with a large newspaper from a nearby city. The new strategy fostered resentment and resistance among department heads. In order to implement it, 80 percent of the department heads had to be let go because they refused to cooperate. New people were recruited and placed in those positions, and the morning newspaper strategy was a resounding success.⁷³

Mannie Jackson revived the Harlem Globetrotters, an organization on the brink of bankruptcy and irrelevancy, by recruiting new players who could recapture the glory the Globetrotters enjoyed in the 1960s and 1970s. Jackson rates potential players on their skill, charisma, punctuality, and attitude. He wants only top athletes who can promote the Globetrotter brand and are willing to be role models.⁷⁴

Implementing Global Strategies

The difficulty of implementing strategy is greater when a company goes global. In the international arena, flexibility and superb communication emerge as mandatory leadership skills. Likewise, structural design must merge successfully with foreign cultures as well as link foreign operations to the home country. Managers must make decisions about how to structure the organization to achieve the desired level of global integration and local responsiveness, as described earlier. Information and control systems must fit the needs and incentives within local cultures. In a country such as Japan or China, financial bonuses for star performance would be humiliating to an individual, whereas group motivation and reward are acceptable. As in North America, control is typically created through timetables and budgets and by monitoring progress toward desired goals. Finally, the recruitment, training, transfer, promotion, and layoff of international human resources create an array of problems not confronted in North America. Labor laws, guaranteed jobs, and cultural traditions of keeping unproductive employees on the job provide special problems for strategy implementation.

In summary, strategy implementation is essential for effective strategic management. Managers implement strategy through the tools of leadership, structural design, information and control systems, and human resources. Without effective implementation, even the most creative strategy will fail.

Summary and Management Solution

This chapter described important concepts of strategic management. Strategic management begins with an evaluation of the organization's current mission, goals, and strategy. This evaluation is followed by situation analysis (called SWOT analysis), which examines opportunities and threats in the external environment as well as strengths and weaknesses within the organization. Situation analysis leads to the formulation of explicit strategic plans, which then must be implemented.

Strategy formulation takes place at three levels: corporate, business, and functional. Corporate grand strategies include growth, stability, retrenchment, and global. One framework for accomplishing them is the BCG matrix. An approach to business-level strategy is Porter's competitive forces and strategies. The Internet

is having a profound impact on the competitive environment, and managers should consider this when analyzing the five competitive forces and formulating business strategies. An alternative approach to strategic thought emphasizes cooperation rather than competition. Partnership strategies include preferred supplier arrangements, strategic business partnering, joint ventures, and mergers and acquisitions. Most of today's companies choose a mix of competitive and partnership strategies. Once business strategies have been formulated, functional strategies for supporting them can be developed.

Even the most creative strategies have no value if they cannot be translated into action. Managers implement strategy by aligning all parts of the organization to be in congruence with the new strategy. Four areas

that managers focus on for strategy implementation are leadership, structural design, information and control systems, and human resources.

Returning to the opening problem at Coca-Cola, CEO Douglas Daft has made several strategic moves to try to get the company back on top. Although Coke continues to use primarily a globalization strategy, Daft recognizes the growing need to be more responsive to the heterogeneity of international markets. Therefore, he is gradually shifting toward a transnational strategy. Whereas the company once sought unity in its marketing and advertising strategies, for example, it is now giving bottlers both in the United States and abroad a free hand to tailor promotions to local events and activities. Daft is pushing global managers to think outside the conventional boundaries and come up with ideas for everything from new products to new ways to gather market research. New products include calcium-fortified waters, vitamin-enriched drinks, and new products for inter-

national markets such as an Asian tea and a coffee drink. Partnerships are an important part of Coke's new business-level strategy. Coke hopes to attain synergy through a 50–50 joint venture with Procter & Gamble, by marrying Coke's distribution muscle with P&G's successful juice and snack brands. A similar partnership with Nestlé will develop new coffee and tea drinks for the global market. A deal with Warner Bros. allows Coke to co-market with the film *Harry Potter and the Sorcerer's Stone* around the world. And plans are in the works to create an "incubator" project that will provide office space and seed money to start-ups with innovative ideas that could benefit the giant corporation. The partnership approach is new for Coke, which has long been seen as an insular company bent on doing it all. According to Marketing Director Stephen C. Jones, Daft realizes that "there are too many changes now for us to have all the answers."⁷⁵

Discussion Questions

1. Assume you are the general manager of a large hotel and have formulated a strategy of renting banquet facilities to corporations for big events. At a monthly management meeting, your sales manager informed the head of food operations that a big reception in one week will require converting a large hall from a meeting room to a banquet facility in only 60 minutes—a difficult but doable operation that will require precise planning and extra help. The food operations manager is furious about not being informed earlier. What is wrong here?
2. Which is more important—strategy formulation or strategy implementation? Do they depend on each other? Is it possible for strategy implementation to occur first?
3. If an organization has hired strategic management professionals to help top managers, during which part of the strategic management process would they play the largest role?
4. Perform a situation (SWOT) analysis for the university you attend. Do you think university administrators consider these factors when devising their strategy?
5. What is meant by the core competence and synergy components of strategy? Give examples.
6. Using Porter's competitive strategies, how would you describe the strategies of Wal-Mart, Bloomingdale's, and Target? Do any of these companies also use partnership strategies? Discuss.
7. Walt Disney Company has four major strategic business units: movies (Touchstone), theme parks, consumer products, and television (primarily cable). Place each of these SBUs on the BCG matrix based on your knowledge of them.
8. As administrator for a medium-sized hospital, you and the board of directors have decided to change to a drug dependency hospital from a short-term, acute-care facility. Which organizational dimensions would you use to implement this strategy?
9. How would functional strategies in marketing, research and development, and production departments differ if a business changed from a differentiation to a low-cost strategy?
10. Describe how the Internet increases the bargaining power of consumers, one of Porter's five competitive forces. Have you felt increased power as a consumer because of the Internet? Explain.

Management in Practice: Experiential Exercise

Developing Strategy for a Small Business

Instructions: Your instructor may ask you to do this exercise individually or as part of a group. Select a local business with

which you (or group members) are familiar. Complete the following activities.

Activity 1 Perform a SWOT analysis for the business.

Strengths: _____

Opportunities: _____

Weaknesses: _____

Threats: _____

Activity 2 Write a statement of the business's current strategy.

Activity 3 Decide on a goal you would like the business to achieve in two years, and write a statement of proposed strategy for achieving that goal.

Activity 4 Write a statement describing how the proposed strategy will be implemented.

Activity 5 What have you learned from this exercise?

Management in Practice: Ethical Dilemma

A Great Deal for Whom?

It seemed like a great deal for Kevin Haley, the retired president of a small accounting firm, when he took the job. To sit on the board of Keldine Technologies, all he had to do was listen to some general talk about the company at bimonthly meetings, vote on operations issues, and collect a nice fee. He didn't worry about his lack of expertise in the company's business of manufacturing transistors, because "nothing ever changed at Keldine."

That was two years ago. Now Keldine Technologies, with 250 employees and 10 years in business, is faced with a buyout offer from Graham Industries. Chairman of the Board at Keldine, Greg Bingham, called the deal a "no-brainer."

Graham Industries' offer of \$65 a share was high, a great deal for shareholders. The problem for Haley was that he knew Graham Industries was close to bankruptcy, and that it was probably only buying Keldine to leverage some of its debt and hold off creditors. The odds were that both companies would be wiped out within a year if the sale went through. As news of a buyout offer spread, Keldine stock had changed hands rapidly, and speculators in the shareholder ranks were pressuring for a sale. Bingham asserted, "Our mission is to create as much value for shareholders as possible."

He also assured the board that the executives were protected by contingency compensation packages in the event of a "downturn for Keldine." But Haley was torn. The deal was a

short-term moneymaker but an almost guaranteed disaster for the company's future and the majority of its employees. Haley's commitment to shareholders seemed compromised by the presence of speculators in their ranks. He questioned whether the interests of loyal, long-time employees weren't a higher priority than those of speculators.

What Do You Do?

1. Vote to accept the offer of Graham Industries and assure a short-term profit for the shareholders and executives. They are your first responsibility.

2. Reject the buyout bid. Providing Keldine a future, even if uncertain because of its resistance to change, is more important than accepting what may be the best offer ever received.
3. Pass, and hope a board majority prevails without your vote. You aren't qualified to make a decision on this anyway.

SOURCE: Based on Doug Wallace, "When the Sharks Are Circling," *What Would You Do? Business Ethics*, vol. I (September–October 1991), 42–44.

Surf the Net

1. **Globalization.** McDonald's was cited in the text as an example of the globalization strategy because it has standardized its product and advertising strategies throughout the world. Go to <http://www.mcdonalds.com> and find the number of countries in which McDonald's has restaurants. In addition, find information for locations in three different parts of the world and describe for each country such characteristics as current promotions, employment opportunities, specialty food products, or community projects.
2. **Corporate-Level Strategy.** Corporate Information is a great Web resource for company profiles and research reports for foreign, domestic, public, and private companies. The content is from Wright Investor's Service, where you can find 350,000 profiles available for free. Become familiar with the features available at <http://www.corporateinformation.com>
Use the "Research Company" option to find the research report for the following companies (or your

instructor may assign other companies): Southwest Airlines, Walt Disney Company, and General Electric Company. Under the "Company Description" in each report, you will find information to help you determine each company's corporate-level strategy (What business(es) are we in?).

3. **Partnership Strategies.** As stated earlier in this chapter, IBM is collaborating with numerous partners around the world on the Internet. Go to IBM's Web site at <http://www.ibm.com> and locate the link to IBM's business partners. To understand the wealth of information contained at this site, you may want to download and view the "PartnerWorld Video" that will show you what you need to know to navigate the site. Check out the "Member Success Stories" under the "Membership Center," and write down two or three examples of partnership strategies.

Case for Critical Analysis

Starbucks Coffee

Beginning with 9 Seattle stores in 1987, Starbucks Chairman Howard Schultz has exported the company's chic cafes throughout the world. Service is anything but fast, and the price of a cup of coffee could make the Dunkin' Donuts crowd faint, but each week millions of people in cities from Atlanta to Tokyo hit Starbucks to sip cappuccinos and double lattes.

Starbucks has pursued rapid expansion both at home and abroad. Today, Starbucks boasts more than 4,600 outlets around the world, and Schultz has no plans to slow the growth. Starbucks has proven so popular in Japan, where sales per store are twice as high as in the United States, that the company recently opened its 300th store, with plans to add nearly 200 more over the next three years. The company

moved into China in 1999 and now has 35 stores, mainly in Beijing and Shanghai. A joint venture with Germany's largest department store company, KarstadtQuelle, is helping Starbucks push into Germany. The company's current six shops in Switzerland, as well as plans to open a store in Vienna in late 2001, are part of a long-term plan to open at least 650 outlets in continental Europe by the end of 2003. And in Canada, Starbucks has partnered with Interaction Restaurants, which hopes to be running 50 to 70 Starbucks in Quebec within five years. Starbucks' strategies have long been criticized as risky, but there's no arguing with success. Many analysts think the company has the flexibility and management strength to continue to grow and prosper.

Many of Starbucks' managers have years of experience from such companies as Burger King, Taco Bell, Wendy's, and Blockbuster. Schultz believes a top executive should "hire people smarter than you are and get out of their way." Equally crucial to Starbucks' success are the "baristas" who prepare coffee drinks. Starbucks recruits its workers from colleges and community groups and gives them 24 hours' training in coffeemaking and lore—a key to creating the company's hip image and quality service. When customers go to Starbucks, they are buying not just a great cup of coffee, but an experience. In a new store in Beijing, for instance, customers line up daily to have a barista dispense jolts of java from a "Mercury machine" strapped to his back. Starbucks also emphasizes listening to customers and giving them what they want. One reason the company agreed to a deal allowing Interaction to run storefront outlets in Quebec was to ensure that Starbucks adapts to local market needs, particularly in Montreal, which already has a strong coffee culture and vibrant local competitors.

A computer network links the expanding Starbucks empire, and Schultz hired a top information-technology specialist from McDonald's to design a point-of-sale system to enable managers to track sales. Every night, computers from stores around the world send information to headquarters in Seattle so that executives can spot buying trends.

Starbucks' same-store sales in mid-2001 were already the lowest since 1998, and the declining economy following the

September 11, 2001, terrorist attacks hurt sales even more. However, this does not worry Schultz and other top managers. To them, meeting such challenges is just part of the job.

Questions

1. What is Starbucks' grand strategy? Which of Porter's competitive strategies is the company using?
2. Discuss how Schultz is using leadership, structure, information and control systems, and human resources to implement strategy at Starbucks.
3. Starbucks has typically maintained a uniform look and feel to its outlets. The adaptations being made in Quebec are the first time the company has varied from this formula. What do you think this change might mean for Starbucks in terms of further international expansion?

SOURCES: Based on Dori Jones Yang, "The Starbucks Enterprise Shifts into Warp Speed," *Business Week* (October 24, 1994), 76; Michael Treacy, "You Need a Value Discipline—But Which One?" *Fortune* (April 17, 1995), 195; Nelson D. Schwartz, "Still Perking After All These Years," *Fortune* (May 24, 1999); Ken Belson, "As Starbucks Grows, Japan, Too, Is Awash," *The New York Times* (October 21, 2001), C3; "Business: Coffee with Your Tea? Starbucks in China," *The Economist* (October 6, 2001), 62; "Starbucks in Joint Venture with German Retailer," *The New York Times* (October 5, 2001), C3; and Zena Olijnyk, "Latte, S'il Vous Plait?" *Canadian Business*, (September 3, 2001), 50–52.

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