Instructor’s Manual
to accompany
Crafting and Executing Strategy
The Quest for Competitive Advantage
Core Concepts
Analytical Tools
Cases

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SEVENTEENTH EDITION
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section 1

Instructor Resources, Chapter Features, and Case Overview
INSTRUCTOR RESOURCES

We strived to achieve four goals in preparing this package of Instructor Resources for the 17th Edition:

1. To equip you with all the resources and pedagogical tools you’ll need to design and deliver a course that is on the cutting-edge and solidly in the mainstream of what students need to know about crafting and executing winning strategies.

2. To give you wide flexibility in putting together a course syllabus that you are comfortable with and proud of.

3. To give you a smorgasbord of options to draw from in keeping the nature of student assignments varied and interesting.

4. To help you deliver a course with upbeat tempo that wins enthusiastic applause from students.

We believe the contents of the package will be particularly informative and helpful to faculty members teaching the strategy course for the first time but we have also tried to embellish the content with ideas and suggestions that will prove valuable to experienced faculty looking for ways to refurbish their course offering and/or to keep student assignments varied and interesting.

A QUICK OVERVIEW OF THE ENTIRE INSTRUCTOR RESOURCE PACKAGE

The Instructor’s Manual for Crafting & Executing Strategy contains:

- A quick look at the topical focus of the text’s 12 chapters (Section 1).
- An overview of the 26 cases in the text, along with a grid profiling the strategic issues that come into play in each case (Section 1 and Section 3).
- A discussion of the reasons to use a strategy simulation as an integral part of your strategy course. The two web-based strategy simulations—The Business Strategy Game or GLO-BUS—that are companions to this text incorporate the very kinds of strategic thinking, strategic analysis, and strategic decision-making described in the text chapters and connect beautifully to the chapter content. The automated online nature of both simulations entails minimal administrative time and effort on the instructor’s part. You will be pleasantly shocked (and pleased!!) at the minimal time it will take you to incorporate use of GLO-BUS or The Business Strategy Game and the added degree of student excitement and energy that either of these competition-based strategy simulations brings to the course—see Section 2 for more details.
- Tips and suggestions for effectively using either GLO-BUS or The Business Strategy Game in your course (covered in both Section 2 and Section 3).
- The merits of encouraging your students to go to the Web site for the text and take the self-scoring chapter quizzes that measure their command of the concepts and analytical tools presented in the 12 chapters (covered in both Section 1 and Section 3).
- Ideas and suggestions on course design and course organization (Section 3 and Section 4).
- Recommendations for sequencing the case assignments and guidance about how to use the cases effectively (Section 3).
- Our recommendations regarding which cases are particularly appropriate for written case assignments and oral team presentations (Section 3).
Two sample course syllabi (Section 4).

Five sample schedules of class activities and daily assignments for 15-week terms; 3 sample schedules of class activities for 10-week terms; and 3 sample daily course schedules for 5-week terms. (Section 4).

A Test Bank for the 12 chapters that consists of 1100+ questions (Section 5).

A set of Lecture Notes for each of the 12 chapters (Section 6).

A comprehensive teaching note for each of the 26 cases in Crafting & Executing Strategy (Section 7).

In addition to the Instructor’s Manual, the support package for adopters also includes:

An Online Learning Center (OLC) The instructor section of www.mhhe.com/thompson includes the Instructor’s Manual and other instructional resources. Your McGraw-Hill representative can arrange delivery of instructor support materials in a format-ready Standard Cartridge for Blackboard, WebCT and other web-based educational platforms.

PowerPoint Slides To facilitate delivery preparation of your lectures and to serve as chapter outlines, you’ll have access to comprehensive PowerPoint presentations for each of the 12 chapters. hat the authors have developed for their own classes. The collection includes 500+ professional-looking slides displaying core concepts, analytical procedures, key points, and all the figures in the text chapters.

Accompanying Case Videos Nine of the cases (Costco Wholesale, JetBlue Airways, Competition in the Movie Rental Industry, Dell, Panera Bread, Competition in Video Games, Google’s Strategy in 2008, Wal-Mart, and Southwest Airlines) have accompanying videotape segments that can be shown in conjunction with the case discussions. Suggestions for using each video are contained in the teaching note for that case.

Accompanying Chapter Videos There are accompanying videos for the chapters that you can show in conjunction with your lectures.

A Comprehensive Test Bank and EZ Test Software There is a 1100+-question test bank, consisting of both multiple choice questions and short answer/essay questions that you can use in conjunction with McGraw-Hill’s EZ Test electronic testing software to create tests from chapter- or topic-specific lists. The EZ Test software enables allows instructors to add their own questions to those that appear in the test bank. The EZ Test program gives you the capability to create and print multiple versions of the test and to administer the test via the Web at www.eztestonline.com. Tests can also be exported into a course management system such as WebCT, BlackBoard, PageOut, and Apple’s iQuiz.

Instructor’s Resource CD-ROM All instructor supplements are available to text adopters in this one-stop multimedia resource, including case and chapter videos, the complete Instructor’s Manual, EZ Test software, and PowerPoint slides.

All these Instructor Resources included in the Crafting & Executing Strategy package gives you the capability to custom-tailor your course using most any combination of the following powerful and proven teaching/learning techniques:

- Lectures (supported by Lecture Notes, PowerPoint slides, and chapter videos).
- Case discussions (supported by comprehensive teaching notes and the videos accompanying nine of the cases).
- Oral team presentations on one or more assigned cases.
- Use of either GLO-BUS or The Business Strategy Game to serve as an integrative, capstone exercise. Both simulations are a breeze to administer, are automatically graded, and provide detailed data in the form of a Learning Assurance Report showing how each student in your class performed vis-à-vis all students at all schools worldwide that have played the simulation over the last 12 months (a population of 20,000+ in the case of GLO-BUS and 40,000+ in the case of The Business Strategy Game).
• Use of the chapter-end **Assurance of Learning** exercises that may be coupled with instructor-developed scoring rubrics to assess course or program learning objectives. The exercises may also be assigned for class discussion, oral team presentations, or written reports not linked to course embedded assessment.

• Each chapter also contains **Exercises for Simulation Participants** that tightly connect chapter concepts to the issues and decisions that students wrestle with when competing in either *The Business Strategy Game* or *GLO-BUS*; these exercises are also appropriate for use with other strategy simulations.

The ability to choose among the above options, backed by the array of support materials in the Instructor Resources package, give you enormous course design flexibility and provides you with a powerful kit of teaching/learning tools. We’ve done our very best to ensure that the 17th Edition package will work especially well for you in the classroom, help you economize on the time needed to be well-prepared for each class, and cause students to conclude that your course is one of the very best they have ever taken—from the standpoint of both enjoyment and learning a lot.

**What to Expect in the 17th Edition**

In preparing our revision of the text chapters for this 17th edition, we have strived to hit the bulls-eye with respect to both content and teaching/learning effectiveness. The overriding objective has been to do three things exceptionally well:

- Thoroughly explain core concepts and analytical tools in language that students can grasp. The discussions have been carefully crafted to maximize understanding and facilitate correct application.

- Provide first-rate examples at every turn. Illustrating the connection and application of core concepts and analytical tools to real-world circumstances correctly is the only effective way to convince readers that the subject matter merits close attention and deals directly with what every student needs to know about crafting, implementing, and executing business strategies in today’s market environments.

- Incorporate well-settled strategic management principles, recent research findings and contributions to the literature of strategic management, the latest thinking of prominent academics and practitioners in the field, and the practices and behavior of real world companies—weaving these things into each chapter is essential to keep the content solidly in the mainstream of contemporary strategic thinking.

In addition, we have made a point of highlighting important strategy-related developments that permeate the world economy and many industries—the continuing march of industries and companies to wider globalization, the growing scope and strategic importance of collaborative alliances, the spread of high-velocity change to more industries and company environments, and how advancing Internet technology is driving fundamental changes in both strategy and internal operations in companies across the world. There is also coverage of corporate governance, the keys to successful diversification, and how Six Sigma, best practices, benchmarking, proper workforce compensation, and a strategy-supportive corporate culture act to promote operating excellence and effective strategy execution.

We believe this 17th edition incorporates all of the necessary elements to support your delivery of a successful undergraduate or MBA strategic management course. Chapter discussions cut straight to the chase about what students really need to know. Our explanations of core concepts and analytical tools reflect current research and are covered in enough depth to truly add value for the student—the rationale being that a shallow explanation carries almost no instructional value. All the chapters are flush with convincing examples that students can easily relate to. There’s a straightforward, integrated flow from one chapter to the next. We have deliberately adopted a pragmatic, down-to-earth writing style, not only to better communicate to an audience of students (who, for the most part, will soon be practicing managers) but also to convince readers that the subject matter deals directly what managers and companies do in the real world. All of the chapters have accompanying videos.

And, thanks to the excellent case research and case writing being done by colleagues in strategic management, this edition contains a set of high-interest cases with unusual ability to work magic in the classroom. Great cases make it far easier for you to drive home valuable lessons in the whys and hows of successfully crafting and executing strategy.
Organization, Content, and Features of the Text Chapters

The 17th Edition has been reorganized to more closely link strategic leadership with the strategic management process discussed in Chapter 2 and to consolidate the discussion of strategies supporting a company’s competitive strategy that were previously included in Chapters 6 and 8 of the 16th edition into a single chapter. As with all prior revisions, we worked diligently to make sure that this edition delivers quantum improvements in overall content appeal and ease of student comprehension. As a consequence, we think you’ll be amply convinced that no other leading text does a better job of setting forth the principles of strategic management and linking these principles to both sound theory and best practices.

Furthermore, the refreshing facelift given to every chapter as concerns sharper definitions, more thorough explanations, and highly relevant current examples has made the chapter presentations easier for students to read and understand. Effective communication of core concepts and analytical tools in the chapters reduces the need for detailed lectures on your part and frees time for more in-class debate and discussion, coverage of late-breaking stories in the business press, and other means of driving home the principles of strategy.

**No other leading strategy text comes close to matching our treatment of the resource-based theory of the firm.** The relevance and role of company resources and competitive strengths is prominently and comprehensively integrated into our coverage of crafting both single-business and multi-business strategies. Chapters 3 through 8 make it crystal clear that a company’s strategy must be matched both to its external market circumstances and to its internal resources and competitive capabilities. Moreover, Chapters 10, 11, and 12 on various aspects of executing strategy have a strong resource-based perspective that also makes it crystal clear how and why the tasks of assembling intellectual capital and building core competencies and competitive capabilities are absolutely critical to successful strategy execution and operating excellence.

**No other leading strategy text comes close to matching our coverage of business ethics, values, social responsibility, and environmental sustainability.** We have embellished the highly important chapter on “Ethical Business Strategies, Social Responsibility, and Environmental Sustainability” with new discussions and material so that it can better fulfill the important functions of (1) alerting students to the role and importance of incorporating business ethics, social responsibility, and environmental sustainability into decision-making and (2) addressing the accreditation requirements of the AACSB that business ethics be visibly and thoroughly embedded in the core curriculum. Moreover, there are substantive discussions of the roles of values and ethics in Chapters 1, 2, 10, and 12, thus providing you with a very meaty and comprehensive treatment of business ethics and socially responsible behavior as it applies to crafting and executing company strategies.

The following rundown summarizes the topical focus of each of the 12 chapters in the 17th Edition of Crafting & Executing Strategy:

- Chapter 1 is focused directly on “what is strategy and why is it important?” There are substantive discussions of what is meant by the term strategy, the different elements of a company’s strategy, and why management efforts to craft a company’s strategy tend to be squarely aimed at building sustainable competitive advantage. Considerable emphasis is given to how and why a company’s strategy is partly planned and partly reactive and why a company’s strategy tends to evolve over time. There’s an important section discussing what is meant by the term business model and how it relates to the concept of strategy. The thrust of this first chapter is to convince students that good strategy + good strategy execution = good management. The chapter is a perfect accompaniment for your opening day lecture on what the course is all about and why it matters.

- Chapter 2 concerns the managerial process of actually crafting and executing a strategy—it makes a great assignment for the second day of class and is a perfect follow-on to your first day’s lecture. The focal point of the chapter is the five-step managerial process of crafting and executing strategy: (1) forming a strategic vision of where the company is headed and why, (2) the managerial importance of developing a balanced scorecard of objectives and performance targets that measure the company’s progress, (3) crafting a strategy to achieve these targets and move the company toward its market destination, (4) implementing and executing the strategy, and (5) monitoring progress and making corrective adjustments as needed. Students are introduced to such core concepts as strategic visions, mission statements, strategic versus financial objectives, and strategic intent. An all-new section underscores that this 5-step process requires

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strong strategic leadership. There’s a robust discussion of why all managers are on a company’s strategy-making, strategy-executing team and why a company’s strategic plan is a collection of strategies devised by different managers at different levels in the organizational hierarchy. The chapter winds up with a concise but meaty section on corporate governance.

- Chapter 3 sets forth the now-familiar analytical tools and concepts of industry and competitive analysis and demonstrates the importance of tailoring strategy to fit the circumstances of a company’s industry and competitive environment. The standout feature of this chapter is a presentation of Michael Porter’s “five forces model of competition” that we think is the clearest, most straightforward discussion of any text in the field. Globalization and Internet technology are treated as potent driving forces capable of reshaping industry competition—their roles as change agents have become factors that most companies in most industries must reckon with in forging winning strategies.

- Chapter 4 presents the resource-based view of the firm and convincingly argues why a company’s strategy must be built around its resources, competencies, and competitive capabilities. The roles of core competencies and organizational resources and capabilities in creating customer value are center stage in the discussions of company resource strengths and weaknesses. SWOT analysis is cast as a simple, easy-to-use way to assess a company’s resources and overall situation. There is solid coverage of value chain analysis, benchmarking, and competitive strength assessments—standard tools for appraising a company’s relative cost position and market standing vis-à-vis rivals. An important feature of this chapter is a table showing how key financial and operating ratios are calculated and how to interpret them; students will find this table handy in doing the number-crunching needed to evaluate whether a company’s strategy is delivering good financial performance.

- Chapter 5 deals with a company’s quest for competitive advantage and is framed around the five generic competitive strategies—low-cost leadership, differentiation, best-cost provider, focused differentiation, and focused low-cost.

- A much revamped Chapter 6 extends the coverage of the previous chapter and deals with what other strategic actions a company can take to complement its choice of a basic competitive strategy and to employ a strategy that is wisely matched to both industry and competitive conditions and to company resources and capabilities. The chapter features sections on what use to make of strategic alliances and collaborative partnerships; merger and acquisition strategies; vertical integration strategies; outsourcing strategies; and the broad strategy options for companies competing in six representative industry and competitive situations: (1) emerging industries, (2) rapid growth industries; (3) mature, slow-growth industries, (4) stagnant or declining industries, (5) turbulent, high velocity industries, and (6) fragmented industries. The concluding section of this chapter covers first-mover advantages and disadvantages, including the first-mover benefits of pursuing a blue ocean strategy.

- Chapter 7 explores the full range of strategy options for competing in foreign markets: export strategies, licensing, franchising, multicity strategies, global strategies, and collaborative strategies involving heavy reliance on strategic alliances and joint ventures. The spotlight is trained on two strategic issues unique to competing multinationally: (1) whether to customize the company’s offerings in each different country market to better match the tastes and preferences of local buyers or whether to offer a mostly standardized product worldwide and (2) whether to employ essentially the same basic competitive strategy in the markets of all countries where it operates or whether to modify the company’s competitive approach country-by-country as may be needed to fit the specific market conditions and competitive circumstances it encounters. There’s also coverage of the special issues of competing in the markets of emerging countries and the strategies that local companies in emerging countries can use to defend against global giants.

- Our rather meaty treatment of diversification strategies for multibusiness enterprises in Chapter 8 begins by laying out the various paths for becoming diversified, explains how a company can use diversification to create or compound competitive advantage for its business units, and examines the strategic options an already-diversified company has to improve its overall performance. In the middle part of the chapter, the analytical spotlight is on the techniques and procedures for assessing the strategic attractiveness of a
Crafting & Executing Strategy 17th Edition

The discipline of strategy merits their rapt attention, then it will have fulfilled its purpose.

The ultimate test of this or any text, of course, is the positive pedagogical impact it has in the classroom. If this edition sets a more effective stage for your lectures and does a better job of helping you persuade students that the strategy in competent fashion; (2) allocating ample resources to strategy-critical activities; (3) ensuring that policies and procedures facilitate rather than impede strategy execution; (4) instituting best practices and pushing for continuous improvement in how value chain activities are performed; (5) installing information and operating systems that enable company personnel to better carry out their strategic roles proficiently; (6) tying rewards and incentives directly to the achievement of performance targets and good strategy execution; (7) shaping the work environment and corporate culture to fit the strategy; and (8) exerting the internal leadership needed to drive execution forward.

The recurring theme throughout these three chapters is that implementing and executing strategy entails figuring out the specific actions, behaviors, and conditions that are needed for a smooth strategy-supportive operation and then following through to get things done and deliver results—the goal here is to ensure that students understand the strategy-implementing/strategy-executing phase is a make-things-happen and make-them-happen-right kind of managerial exercise that leads to operating excellence and good performance.

We have done our best to ensure that the 12 chapters hit the bulls-eye in covering the concepts, analytical tools, and approaches to strategic thinking that should comprise a senior/MBA course in strategy. There are new and updated “strategy in action” capsules in each chapter that tie core concepts to real-world management practice and that complement the fresh examples and illustrations in each chapter. There are accompanying videos for the chapters. We’ve provided a host of interesting chapter-end Assurance of Learning Exercises that you can use as a basis for class discussion or written assignments or team presentations used for assessment purposes. In the event you have opted to utilize a strategy simulation as part of your course offering, we have created chapter-end Exercises for Simulation Participants that provide a terrific way to tie the chapter coverage to the situational circumstances that confront students in running their simulation company. We are confident you’ll find this 12-chapter presentation superior to our prior editions as concerns coverage, readability, and convincing examples. The ultimate test of this or any text, of course, is the positive pedagogical impact it has in the classroom. If this edition sets a more effective stage for your lectures and does a better job of helping you persuade students that the discipline of strategy merits their rapt attention, then it will have fulfilled its purpose.

Chapter 9 provides comprehensive coverage of some increasingly pertinent front-burner strategic issues: (1) whether and why a company has a duty or obligation to contribute to the betterment of society independent of the needs and preferences of the customers it serves. Is there a credible business case for operating ethically and/or operating in a socially responsible manner? Why should a company’s strategy measure up to the standards of being environmentally sustainable? The opening section of the chapter addresses whether ethical standards are universal (as maintained by the school of ethical universalism) or dependent on local norms and situational circumstances (as maintained by the school of ethical relativism) or a combination of both (as maintained by integrative social contracts theory). Following this are sections on the three categories of managerial morality (moral, immoral, and amoral), the drivers of unethical strategies and shady business behavior, the approaches to managing a company’s ethical conduct, the concept of a “social responsibility strategy”, the moral and business cases for both ethical strategies and socially responsible behavior, the concept of environmental sustainability, and why every company’s strategy should be crafted in a manner that promotes environmental sustainability. The contents of this chapter will definitely give students some things to ponder and, hopefully, will make them far more ethically-aware and conscious of why all companies should conduct their business in a socially responsible and sustainable manner. Chapter 9 has been written as a “stand-alone” chapter that can be assigned in the early, middle, or late part of the course.

The three-chapter module on executing strategy (Chapters 10-12) is anchored around a pragmatic, compelling conceptual framework: (1) building the resource strengths and organizational capabilities needed to execute the strategy in competent fashion; (2) allocating ample resources to strategy-critical activities; (3) ensuring that policies and procedures facilitate rather than impede strategy execution; (4) instituting best practices and pushing for continuous improvement in how value chain activities are performed; (5) installing information and operating systems that enable company personnel to better carry out their strategic roles proficiently; (6) tying rewards and incentives directly to the achievement of performance targets and good strategy execution; (7) shaping the work environment and corporate culture to fit the strategy; and (8) exerting the internal leadership needed to drive execution forward.

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THE CASE COLLECTION IN THE 17th EDITION

The 26-case line-up in this edition is flush with interesting companies and valuable lessons for students in the art and science of crafting and executing strategy.

- There’s a good blend of cases from a length perspective—close to a fifth are under 15 pages, yet offer plenty for students to chew on; about a fourth are medium-length cases; and the remainder are detail-rich cases that call for more sweeping analysis.
- At least 21 of the 26 cases involve companies, products, or people that students will have heard of, know about from personal experience, or can easily identify with.
- The lineup includes at least 11 cases that will provide students with insight into the special demands of competing in industry environments where technological developments are an everyday event, product life cycles are short, and competitive maneuvering among rivals comes fast and furious.
- 18 of the cases involve situations where company resources and competitive capabilities play as large a role in the strategy-making, strategy-executing scheme of things as industry and competitive conditions do.
- Scattered throughout the lineup are 9 cases concerning non-U.S. companies, globally competitive industries, and/or cross-cultural situations; these cases, in conjunction with the globalized content of the text chapters, provide abundant material for linking the study of strategic management tightly to the ongoing globalization of the world economy.
- 3 cases deal with the strategic problems of family-owned or relatively small entrepreneurial businesses.
- 22 cases involve public companies, thus allowing students to do further research on the Internet regarding recent developments at these companies.
- 9 of the 26 cases (Costco Wholesale, JetBlue Airways, Competition in the Movie Rental Industry, Dell, Panera Bread, Competition in Video Games, Google’s Strategy in 2008, Wal-Mart, and Southwest Airlines) have accompanying videotape segments that can be shown in conjunction with the case discussions.

A grid showing the issues that are prominent in each of the 26 cases in this edition is presented in Table 1.

Suggestions for sequencing the case assignments can be found in Section 3 of this IM. The 11 sample course outlines and daily schedules of class activities in Section 4 provide further suggestions about the sequencing of case assignments and how to integrate your coverage of the 12 chapters, the various case assignments, and use of a strategy simulation.

Specific details about how to utilize each case (including recommended assignment questions and recommended oral team presentation assignments are contained in the teaching notes for each of the cases (the TNs appear in Section 7).

Sample course syllabi displaying possible case sequencing and suggested case assignments are presented in Section 4 of this volume of the IM.

*It is worth mentioning at this juncture that there is a comprehensive table of financial ratios in Chapter 4 that provides the formulas and brief explanations of what each ratio reveals. Adopters of prior editions have told us that students find this table extremely helpful in guiding their analyses of the financial statements contained in the cases. You will probably want to call this table to the attention of class members and urge that they make full use of the information it contains.*

We believe you will find the collection of 26 cases quite appealing, eminently teachable, and very suitable for drilling students in the use of the concepts and analytical treatments in Chapters 1 through 12. With this case lineup, you should have no difficulty whatsoever assigning cases that will capture the interest of students from start to finish.
Table 1  A Quick Profile of the Cases in the 17th Edition of Crafting and Executing Strategy

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<td>Loblaw Companies Limited: Preparing for Wal-Mart Supercenters</td>
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<td>Adidas in 2008: Has Corporate Restructuring Increased Shareholder Value?</td>
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<td>Southwest Airlines in 2008: Culture, Values, and Operating Practices</td>
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<td>Case 26</td>
<td>Detecting Unethical Practices at Supplier Factories: The Monitoring and Remediation Challenges</td>
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VALUE-ADDING STUDENT SUPPORT MATERIALS FOR THE 17th EDITION OF CRAFTING & EXECUTING STRATEGY

The text and text website include several kinds of support materials to help students grasp the material.

**Key Points Summaries** At the end of each chapter is a synopsis of the core concepts, analytical tools and other key points discussed in the chapter. These chapter-end synopses help students focus on basic strategy principles, digest the messages of each chapter, and prepare for tests.

**Online Learning Center (OLC)** The following helpful aids are available to students via the publisher’s OLC at [www.mhhe.com/thompson](http://www.mhhe.com/thompson):

- **Self-Graded Chapter Quizzes** The OLC contains 20-question quizzes for each chapter to allow students to measure their grasp of the material presented in each of the 12 chapters.
- **Guide to Case Analysis** This brief guide—designed especially for students unfamiliar with the case method of teaching/learning—explains what a case is, why cases are a standard part of courses in strategy, how to prepare for a class discussion of a case, how to prepare a written case analysis, what is expected in an oral presentation, and the financial ratio calculations that are used to assess a company’s financial condition. We suggest having students read this Guide prior to the first class discussion of a case.
- **Study Questions for Assigned Cases** A set of PDF files containing study questions for each of the 26 cases in this edition are posted; the ready accessibility of these files to class members eliminates the need for you to provide study questions for assigned cases. The study questions provided to students match those appearing in the teaching notes for these cases.
- **Accompanying Case Videos** Some of the brief video segments that accompany cases are available on the student portion of the textbook website.
- **PowerPoint Slides** There is a selection of PowerPoint slides for each of the 12 chapters.

**The Business Strategy Game and GLO-BUS Online Simulations** Using one of the two companion strategy simulations is a powerful and constructive way of emotionally connecting students to the subject matter of the course. We know of no more effective and interesting way to stimulate the competitive energy of students and prepare them for the rigors of real-world business decision-making than to have them match strategic wits with classmates in running a company in head-to-head competition for global market leadership.

In Section 2 of this IM, we outline why using a competition-based strategy simulation as a course centerpiece makes great sense and provide you with detailed suggestions for successfully incorporating either The Business Strategy Game or GLO-BUS in your strategic management course.

Should you decide to incorporate use one of the two simulations in your course, the simplest (and usually the cheapest) way for students to obtain the simulation is via a credit card purchase at [www.bsg-online.com](http://www.bsg-online.com) (if you opt to use The Business Strategy Game) or at [www.glo-bus.com](http://www.glo-bus.com) (if you opt to use GLO-BUS). Purchasing the simulation direct at the web site allows students to bypass paying sometimes hefty bookstore markups (a savings that can amount to $10-$15). The second way for students to register for the simulation is by using a pre-paid access code that comes bundled with the 16th Edition when you order the text-simulation package through your bookstore—this requires use of a separate ISBN (the 17th Edition bundled with either simulation has a different ISBN number than just the 17th Edition ordered alone. Your McGraw-Hill rep can provide you with the correct ISBN for ordering the combination text-simulation package through your bookstore(s).
section 2

Using a Strategy Simulation in Your Course: The Compelling Benefits, What’s Involved, and How to Proceed
The Business Strategy Game and GLO-BUS: Developing Winning Competitive Strategies—two competition-based strategy simulations that are delivered online and that feature automated processing of decisions and grading of performance—are being marketed by the publisher as companion supplements for use with the 17th edition of Crafting and Executing Strategy. The Business Strategy Game is the world’s all-time leading strategy simulation, having been played by 500,000+ undergraduate and MBA students at 600+ universities across the world. GLO-BUS, introduced in 2004, has been used at more than 150 universities worldwide in courses involving over 50,000 students.

Both simulations are very tightly linked to the material that your class members will be reading about in the text chapters—the senior author of this text is a co-author of both The Business Strategy Game and GLO-BUS and deliberately designed both simulations as a means for giving class members an immediate opportunity to apply the chapter content to a company they are running and a market environment where their company is competing. Furthermore, there are “Exercises for Simulation Participants” at the end of each text chapter that give you an additional way for class members to practice using specific concepts and tools of strategic analysis to assess their company’s situation and demonstrate the practical relevance of the chapter content.

Moreover, both simulations were painstakingly developed with an eye towards economizing on instructor course preparation time and grading. You’ll be pleasantly surprised—and we think quite pleased—at how little time it takes to gear up for and to administer a fully automated online simulation like The Business Strategy Game or GLO-BUS.

In both The Business Strategy Game (BSG) and GLO-BUS, class members are divided into management teams of 1 to 5 persons and assigned to run a company in head-to-head competition against companies run by other class members. In BSG, the co-managers of each team run an athletic footwear company, producing and marketing both branded and private-label footwear. In GLO-BUS, the co-managers of each team operate a digital camera company that designs, assembles, and markets entry-level digital cameras and upscale, multi-featured cameras. In both simulations, companies compete in a global market arena, selling their products in four geographic regions—Europe-Africa, North America, Asia-Pacific, and Latin America. There are decisions relating to plant operations, workforce compensation, pricing and marketing, social responsibility/citizenship, and finance.

You can schedule 1 or 2 practice rounds and 4 to 10 regular (scored) decision rounds; each decision round represents a year of company operations. When the instructor-specified deadline for a decision round arrives, the algorithms built into the simulation award sales and market shares to the competing companies, region by region. Each company’s sales are totally governed by how its prices compare against the prices of rival brands, how its product quality compares against the quality of rival brands, how its product line breadth and selection compares, how its advertising effort compares, and so on for a total of 11 competitive factors that determine unit sales and market shares. The competitiveness of each company’s product offering relative to rivals is all-decisive—this is what makes them “competition-based” strategy simulations. Once sales and market shares are awarded, the company and industry reports are then generated and all the results made available 15-20 minutes after the decision deadline.

This remainder of this section provides you with information about the two strategy simulation supplements for your course and suggestions for using them successfully. Here is a quick reference guide to the contents of this section:

| The Compelling Case for Using a Strategy Simulation in Your Course | 17 |
| How Much Time Will It Take for You to Learn About and Conduct a Simulation | 19 |
| A Birdseye View of The Business Strategy Game | 20 |
| A Birdseye View of GLO-BUS | 23 |
| Special Features and Extras of Both Strategy Simulations | 24 |
| Which Simulation Makes the Most Sense for Your Course | 27 |
| Course Setup: A Quick, 5-Step Procedure | 30 |
| How Do Class Members Register and Gain Full Access to the Simulation Website? | 31 |
| How Much Should a Simulation Exercise Count in the Total Course Grade? | 33 |
| How Company Performances Are Scored: A Balanced Scorecard Approach | 33 |
| What to Do If You Opt to Use Either of the Companion Simulations | 35 |
THE COMPELLING CASE FOR USING A STRATEGY SIMULATION IN YOUR COURSE

There are four exceptionally important benefits associated with using a competition-based simulation in strategy courses taken by seniors and MBA students:

1. **Having class members run a company in head-to-head competition against companies managed by other class members results in a truly powerful learning experience that engages students in the subject matter of the course and helps achieve course learning objectives.** (The Learning Assurance Report accompanying The Business Strategy Game and GLO-BUS quantifies how well each class member performs on 9 skills/learning measures versus tens of thousands of students worldwide that have completed the simulation in the past 12 months.)

   - *Using both case analysis and a competition-based strategy simulation to drive home the lessons that class members are expected to learn is far more pedagogically powerful and lasting than case analysis alone.* Both cases and strategy simulations drill students in thinking strategically and applying what they read in your text, thus helping them connect theory with practice and gradually building better business judgment. What cases do is show that a simulation cannot is give class members broad exposure to a variety of companies and industry situations and insight into the kinds of strategy-related problems managers face. But what a competition-based simulation does far better than case analysis is thrust class members squarely into an active managerial role where they have to take the analysis of market conditions, the actions of competitors, and their company’s situation seriously. Because they are held fully accountable for their decisions and their company’s performance, co-managers are strongly motivated to dig deeply into company operations, probe for ways to be more cost-efficient, and ferret out strategic moves and decisions calculated to boost company performance. Such diligent and purposeful actions on the part of company co-managers translate into a productive experience with strong retention of the lessons learned.

   - The achievement of course learning objectives is further enhanced because of the extremely tight connection between The Business Strategy Game or GLO-BUS and the most popular strategic management texts. The issues and decisions that co-managers face in running their simulation company embrace the very concepts, analytical tools, and strategy options they encounter in the text chapters; moreover, you will find that the “Exercises for Simulation Participants” that appear at the end of each of the 12 text chapters in the 17th edition are exceptionally appropriate and effective for having class members apply the content of the chapters to the circumstances of running their simulation company. Giving class members immediate “learn-by-doing” opportunity to apply and experiment with the material covered in their text, while at the same time honing their business and decision-making skills, generates solid learning results.

   - Since it doesn’t take long for a spirited rivalry to emerge among the management teams of competing companies and for co-managers to become emotionally invested in figuring out what strategic moves to make to out-compete rivals, class members become more receptive to reading the text chapters, listening to your lectures, and wrestling with assigned cases—partly in the hope they will come across ideas and approaches that will help their company outperform rivals and partly because they begin to see the practical relevance of the subject matter and the value of taking the course. As a consequence, the three-pronged text-case-simulation course model delivers significantly more teaching-learning power than the traditional text-case model.

2. **The competitive nature of a strategy simulation arouses positive energy and classroom excitement and steps up the whole tempo of the course by a notch or two.**

   - The healthy rivalry that emerges among the management teams of competing companies stirs competitive juices and spurs class members to fully exercise their strategic wits, analytical skills, and decision-making prowess—much more so than occurs with case assignments. Nothing energizes a class quicker or better
than concerted efforts on the part of class members to gain a high industry ranking and avoid the perilous consequences of falling too far behind the best-performing companies. It is hard to duplicate the steady interest and excitement that occurs when the results of the latest decision round become available and co-managers renew their quest for strategic moves and actions that will strengthen company performance.

- **Participating in a competition-based strategy simulation is a stimulating and enjoyable way to learn.**
  As soon as your students start to say “Wow! Not only is this fun but I am learning a lot”, which they will, you have won the battle of engaging students in the subject matter and moved the value of taking your course to a much higher plateau in the business school curriculum. This translates into a **livelier, richer learning experience from a student perspective and better instructor-course evaluations**.

3. **Use of a fully automated online simulation reduces the time instructors spend on course preparation and course administration.**

- Since the simulation exercise involves a 20 to 30-hour workload for student-teams (roughly 2 hours per decision round times 10-12 rounds, plus optional assignments), simulation adopters often compensate by trimming the number of assigned cases from, say, 10 to 12 to perhaps 4 to 6, which significantly reduces the time instructors spend reading cases, studying teaching notes, and otherwise getting ready to lead class discussion of a case or grade oral team presentations. The cases-for-simulation tradeoff is a sound one because class members will learn as much or more from their experience managing their simulation company and retain it longer, as compared to the learning gleaned from covering 4 to 6 more cases.

- Course preparation time is further cut because you can use several class days to have students meet in the computer lab to work on upcoming decisions or a 3-year strategic plan (in lieu of lecturing on a chapter or covering an additional assigned case). Lab sessions provide a splendid opportunity for you to visit with teams, observe the interplay among co-managers, and view the caliber of the learning experience that is going on.

- The speed and ease with which you can conduct a fully-automated strategy simulation for your course frees time for other activities. Plus, every task can be performed from an office or home PC that has an Internet connection and an Internet browser and is loaded with Microsoft Excel (versions 2000, XP, 2003, 2007, or 2009).

4. **The time that instructors spend grading can be significantly reduced.** Not only does use of a simulation permit assigning fewer cases, but it also permits you to eliminate at least one assignment that entails considerable grading on your part. Grading one less written case or essay exam or other written assignment saves enormous time. With BSG and GLO-BUS, grading is effortless and takes only minutes; once you enter percentage weights for each assignment in your online grade book, a suggested overall grade is calculated for you.

Instructors who have used state-of-the-art simulations in their strategy courses quickly become enthusiastic converts because the added spark to the course and student excitement surfaces rapidly and the resulting teaching/learning benefits are undeniable. Moreover, the word about the effectiveness of using a top-notch strategy simulation seems to be spreading. Recent market data indicates that close to 2,000 instructors worldwide are now using strategy simulations exercise in courses taken by 120,000+ students annually and that the number of students participating in strategy simulations is growing 10-15% annually.
HOW MUCH TIME WILL IT TAKE TO LEARN ABOUT AND CONDUCT EITHER ONE OF THE SIMULATIONS FOR YOUR COURSE?

One of the biggest factors probably weighing on your mind if you are contemplating being a first-time user is “how much time will it take me to learn about The Business Strategy Game or GLO-BUS and then conduct the simulation exercise for my course?” Here are some honest estimates of what you can expect:

- It will take perhaps 30 minutes for you to explore the 4-page Quick Guide to Getting Started for instructors that speeds the gear-up process—this online guide will have you up and running the simulation for your class in about an hour, plus it has built-in links to additional information if you want to know more about particular facets of the simulation. You might also want to skim through the Participant’s Guide if you want to explore what running a company is all about from a student perspective—but this can be deferred until later if you wish. It will, of course, take a couple of hours to really digest the contents of both the Quick Guide and the Participant’s Guide.

- To launch either one of the simulations for your course, you must complete a 5-step Course Setup procedure that entails specifying the number of companies you want to create to compete head-to-head (which is a function of expected class size and how many people you want to co-manage each company), selecting dates/times for each decision round to be completed, indicating which optional assignments you want company co-managers to complete (the quizzes, strategic plans, peer evaluations, and company presentation exercise), and distributing company registration codes and/or registration procedures to hand out to class members. Recommendations for handling each of the options are provided in the Quick Guide to Getting Started (and recommendations and thorough explanations are also provided in the links accompanying Course Setup right on your Instructor Center screen). It will take you about 30 minutes or so to complete the Course Setup procedure the first time you do it and about 15 minutes each time thereafter.

- It will take you 15-20 minutes to familiarize yourself with the PowerPoint slides that you can use to introduce the mechanics of the simulation to class members.

- You will get very few questions from class members about “how things work.” Site navigation is simple and quickly learned. The Participant’s Guide and the Help sections for all the decision screens and reports contain easy to understand explanations and provide complete guidance and decision-making tips. If a few of your students seem to be full of questions, it’s because they are coming to you for hand-holding and not taking the time to read and absorb the information at their fingertips.

- Once the Course Setup routine is completed, class members are registered, and the decision rounds are underway, everything occurs automatically until the exercise is complete. At this juncture, it’s your call on how much time to spend—whether to simply be an interested observer or play a more active, hands-on role. Expect to spend no more than 10-20 minutes per decision round if you just want to provide encouragement, review the scoreboard of company performances on your Instructor Center web page, solicit feedback from co-managers about how things are going, and deal with special problems—like moving co-managers to another team if there’s conflict among team members or adjusting the dates for decision deadlines for whatever reason.

If you want to follow the competition more closely, you can spend 15-20 minutes after each decision round browsing the industry report (which shows the details of each company’s performance and provides assorted financial and operating statistics) and the special Administrator’s Report (which provides a quick, convenient summary of select decisions and outcomes for each company that will keep you abreast of “what’s happening”).

Should you opt to be even more proactive and intimately involved, then after each decision round you can have a 5 to 10-minute “debriefing” on what’s happening in the industry (using information you’ve gleaned from the industry report and the Administrator’s Report). Because there is tight connection between the
issues that co-managers face in running their companies and the chapters in most every mainstream strategy text, there is ample opportunity—if you are so inclined—to use the happenings and managerial challenges class members encounter in the simulation as examples for your lectures. You can also opt to issue special news flashes altering certain costs or import tariffs, and you may wish to offer to coach the co-managers of troubled companies on how to achieve better company performance.

When all the decision rounds are completed, you will have to spend perhaps 30 minutes assigning grades (maybe longer if your class has 40+ students and you elect to peruse each class member’s peer evaluations and/or activity log). Your online grade book automatically records and reports performance scores for all companies for all decision rounds and also contains each co-manager’s scores for all assignments (quizzes, strategic plans, and peer evaluations). Once you enter weights for each of the assignments, final scores for each class member are automatically calculated. You will have to decide whether to scale the scores or not. If you want to examine data pertaining to each co-manager’s use of the simulation website as part of the grade assignment process, there’s an activity log that reports the frequency and length of log-ons, how many times decision entries were saved to the server each decision round, and how many times each set of reports was viewed each decision round.

A BIRDS-EYE VIEW OF THE BUSINESS STRATEGY GAME

The Business Strategy Game (BSG) is modeled to mirror the global athletic footwear industry (where the longtime industry leaders are Nike and Adidas-Reebok). Athletic footwear makes an excellent setting for a simulation because it is a product that students are intimately familiar with and the workings of the industry can easily be grasped by students—conditions which greatly enhance the effectiveness of a simulation from a teaching/learning perspective. The global athletic footwear industry is particularly suitable for a strategy simulation because the product is used worldwide, there’s competition among companies from several continents, production is concentrated in low-cost locations, and the real-world marketplace is populated with companies employing a variety of competitive approaches and business strategies.

Using a strategy simulation with a global industry setting is especially desirable because globalization of the marketplace is an ever-widening reality and global strategy issues are a standard part of the strategic management course. Plus, of course, accreditation standards for business school programs routinely require that the core curriculum include international business topics and the managerial challenges of operating in a globally competitive marketplace.

In running their footwear companies, the challenge for each management team is to craft and execute a competitive strategy that results in a respected brand image, keeps their company in contention for global market leadership, and produces good financial performance as measured by earnings per share, return on equity investment, stock price appreciation, and credit rating.

All companies begin the exercise with equal sales volume, global market share, revenues, profits, costs, product quality and performance, brand recognition, and so on. Global demand for athletic footwear grows at the rate of 7-9% annually for the first five years and 5-7% annually for the second five years. However, market growth rates vary by geographic region, and growth rates are also affected by the aggressiveness with which companies go after additional sales by making their product offerings more appealing.

Each company typically seeks to enhance its performance and build competitive advantage via more attractive pricing, a bigger selection of footwear styles and models, more appealing footwear styling and quality, greater advertising, bigger mail-in rebates, contracting with celebrities to endorse its brand, providing more merchandising and promotional support to retailers, shorter shipping and delivery times, and more aggressive promotion of online purchases at its Web site.

Any and all competitive strategy options—low-cost leadership, differentiation, best-cost provider, focused low-cost, and focused differentiation—are viable options. A company can try to gain an edge over rivals with more advertising or a wider selection of models or more appealing styling/quality or bigger rebates or securing
more appealing celebrity endorsements, and so on. It can focus on one or two geographic regions or strive for geographic balance. It can pursue essentially the same strategy worldwide or craft slightly or very different strategies for each of the four geographic regions. It can alter its emphasis on selling branded shoes through footwear retailers or at the company’s Web site. It can place more or less emphasis on winning bids to produce private-label footwear for chain retailers.

There’s no built-in bias favoring any one strategy and no “secret” to being an industry leader. Which strategies end up delivering the best performance in any given group of 4 to 12 companies that are competing head-to-head always depends on the competitive interplay among the specific decisions and strategies of rival companies—there absolutely is no “magic bullet” strategy that co-managers are challenged to discover in trying to out-compete their rivals. As is made crystal clear for company co-managers in the Participant’s Guide and as is definitely designed into the algorithms, most any well-conceived, well-executed competitive approach is capable of succeeding, provided it is not overpowered by the strategies of competitors or defeated by the presence of too many copycat strategies that dilute its effectiveness.

The Decisions That Company Managers Have to Make

In BSG, company co-managers make up to 53 types of decisions each period, spread across the functional spectrum as follows:

- Production operations (up to 10 decisions for each plant, with a maximum of 4 plants)
- Plant capacity additions/sales/upgrades (up to 6 decisions per plant)
- Worker compensation and training (3 decisions per plant)
- Shipping (up to 8 decisions each plant)
- Pricing and marketing (up to 10 decisions in each of 4 geographic regions)
- Bids to sign celebrities (2 decision entries per bid)
- Corporate social responsibility and citizenship (up to 6 decision entries)
- Financing of company operations (up to 8 decision entries)

Company Operations

Companies begin the simulation producing branded and private-label footwear in two plants, one in North America and one in Asia. Both plants can be operated at overtime to boost annual capacity by 20%. Management has the option to establish production facilities in Latin America and Europe-Africa as the simulation proceeds, either by constructing new plants or buying previously-constructed plants that have been sold by competing companies. At management’s direction, a company’s design staff can come up with more footwear models, new features, and stylish new designs to keep the company’s branded product line fresh and in keeping with the latest fashion. Private-label footwear must be produced to the specifications of chain footwear retailers with private label brands.

Each company markets its brand of athletic footwear to footwear retailers worldwide and to individuals buying online at the company’s web site. If a company has more production capacity than is needed to meet the demand for its branded footwear, it can enter into competitive bidding for contracts to produce footwear sold under the private-label brands of large chain retailers. Company co-managers exercise control over production costs based on the styling and quality they opt to manufacture, plant location (wages and incentive compensation vary from region to region), the use of best practices and six sigma programs to reduce the production of defective footwear and to boost worker productivity, and compensation practices.

All newly-produced footwear is shipped in bulk containers to one of four regional distribution centers (North America, Latin America, Asia-Pacific, and Europe-Africa). All incoming orders from internet customers and retailers in a geographic region are filled from footwear inventories in that same regional distribution center. Since internet and retailer orders cannot be filled from inventories in a distribution center in another region
(because of prohibitively high shipping and distribution costs), company co-managers have to be careful to match shipments from plants to the expected internet and retailer demand in each geographic region. Costs at the four regional distribution centers are a function of inventory storage costs, packing and shipping fees, import tariffs paid on incoming pairs shipped from foreign plants, and exchange rate impacts.

Many countries have import tariffs on footwear produced at plants outside their geographic region; at the start of the simulation, import tariffs average $4 per pair in Europe-Africa, $6 per pair in Latin America, and $8 in the Asia-Pacific region. However, the Free Trade Treaty of the Americas allows tariff-free movement of footwear between all the countries of North America and Latin America. The countries of North America, which strongly support free trade policies worldwide, currently have no import tariffs on footwear made in either Europe-Africa or Asia-Pacific. Instructors have the option to alter tariffs as the game progresses.

### On-Screen Support Calculations

Each time participants make a decision entry, an assortment of on-screen calculations instantly shows the projected effects on unit sales, revenues, market shares, total profit, earnings per share, ROE, unit costs, and other operating statistics. All of these on-screen calculations help team members evaluate the relative merits of one decision entry versus another. Company managers can try out as many different decision combinations as they wish in stitching the separate decisions into a cohesive and integrated whole.

Each time co-managers make a decision entry, an assortment of on-screen calculations instantly shows the projected effects on unit sales, revenues, market shares, total profit, earnings per share, ROE, unit costs, and other operating outcomes. All of these on-screen calculations help co-managers evaluate the relative merits of one decision entry versus another. Company managers can try out as many different decision combinations as they wish in stitching the separate decisions into a cohesive strategy that holds promise for producing good company performance.

All cause-effect relationships and underlying algorithms in *The Business Strategy Game* are based on sound business and economic principles and are closely matched to the real-world athletic footwear market. The “real-world” character of the competitive environment and company operations that have been designed into *The Business Strategy Game* allows company co-managers to think rationally and logically as they go about the tasks of diagnosing the competitive moves of rival companies and deciding how to manage their athletic footwear company. The thesis is that the more *BSG* mirrors real-world market conditions and real-world managerial decision-making, the more pedagogical value it has. Why? Because tight linkages between the functioning of *BSG* and “the real world” provide class members with a *valid* learning experience, a *valid* means of building their skills in analyzing markets and the actions of competitors, and a *valid* way to practice making business-like decisions and applying the knowledge they have gained in business school.

### Time Requirements for Students

Data from our servers indicates that each company team spends an average of about 2 hours working on each decision round. The first couple of decision rounds take longer not only because co-managers have to explore the menus, familiarize themselves with the information on the screens, and absorb the relevance of the calculations shown whenever new decisions are entered but also because it takes time for them to establish a working relationship with one another and debate what sort of long-term direction and strategy to pursue.

The total workload for each team of students/participants ends up between 20 and 30 hours, given an average of 2 hours per decision round, 9 to 12 decision rounds (including practice rounds), and the time needed to complete optional assignments (quizzes, strategic plans, company presentation, and peer evaluations). As discussed earlier, you can offset the hours students spend on the simulation by trimming the number of case assignments, eliminating a written case assignment (which can take students 10-15 hours to prepare), and perhaps allocating one or more regularly-scheduled class periods to having class members meet in a computer lab to work on their decisions or do the 3-Year Strategic Plan assignment.
It will consume part of a class period to introduce class members to the simulation and get things under way. Thereafter, the simulation becomes an *out-of-class group exercise* where co-managers spend most of their time working on a PC (in a lab or at a co-manager’s place of residence).

All activity for *The Business Strategy Game* takes place at [www.bsg-online.com](http://www.bsg-online.com).

**A BIRDS-EYE VIEW OF GLO-BUS**

The industry setting for GLO-BUS is the digital camera industry. Global market demand grows at the rate of 8-10% annually for the first five years and 4-6% annually for the second five years. Retail sales of digital cameras are seasonal, with about 20 percent of consumer demand coming in each of the first three quarters of each calendar year and 40 percent coming during the big fourth-quarter retailing season.

Companies produce entry-level and upscale, multi-featured cameras of varying designs and quality in a Taiwan assembly facility and ship assembled cameras directly to retailers in North America, Asia-Pacific, Europe-Africa, and Latin America. All cameras are assembled as retail orders come in and shipped immediately upon completion of the assembly process—companies maintain no finished goods inventories and all parts and components are delivered on a just-in-time basis (which eliminates the need to track inventories and simplifies the accounting for plant operations and costs). Company co-managers exercise control over production costs based on the designs and components they specify for their cameras, work force compensation and training, the length of warranties offered (which affects warranty costs), the amount spent for technical support provided to buyers of the company’s cameras, and their management of the assembly process.

Competition in each of the two product market segments (entry-level and multi-featured digital cameras) is based on 10 factors: price, camera performance and quality, number of quarterly sales promotions, length of promotions in weeks, the size of the promotional discounts offered, advertising, the number of camera models, size of retail dealer network, warranty period, and the amount/caliber of technical support provided to camera buyers. Low-cost leadership, differentiation strategies, best-cost provider strategies, and focus strategies are all viable competitive options. Rival companies can strive to be the clear market leader in either entry-level cameras or upscale multi-featured cameras or both. They can focus on one or two geographic regions or strive for geographic balance. They can pursue essentially the same strategy worldwide or craft slightly or very different strategies for the Europe-Africa, Asia-Pacific, Latin America, and North America markets. Just as with *The Business Strategy Game*, most any well-conceived, well-executed competitive approach is capable of succeeding, provided it is not overpowered by the strategies of competitors or defeated by the presence of too many copycat strategies that dilute its effectiveness.

Company co-managers make as many as 50 types of decisions each period:

- R&D, camera components, and camera performance (up to 10 decisions)
- Production operations and worker compensation (up to 15 decisions)
- Pricing and marketing (up to 15 decisions)
- Corporate social responsibility and citizenship (as many as 6 decisions)
- Financing of company operations (as many as 4 decisions).

Each time participants make a decision entry, an assortment of on-screen calculations instantly shows the projected effects on unit sales, revenues, market shares, unit costs, profit, earnings per share, ROE, and other operating statistics. These on-screen calculations help team members evaluate the relative merits of one decision entry versus another and stitch the separate decisions into a cohesive and promising strategy. Company performance is judged on five criteria: earnings per share, return on equity investment (ROE), stock price, credit rating and brand image.
Using a Strategy Simulation in Your Course

Just as with *The Business Strategy Game*, there are onscreen support calculations, but the time requirements are somewhat less because there are only 8 market segments (versus 12 in *The Business Strategy Game*), students have only one plant to operate (versus as many as 4 in BSG), and newly-assembled cameras are shipped directly to camera retailers, eliminating the need to manage finished goods inventories and operate distribution centers. All activity for *GLO-BUS* occurs at [www.glo-bus.com](http://www.glo-bus.com).

**SPECIAL BSG/GLO-BUS FEATURES AND NOTEWORTHY EXTRAS**

The Internet delivery and user-friendly designs of both *BSG* and *GLO-BUS* make them incredibly easy to administer, even for first-time users. And the menus and controls for *BSG* and *GLO-BUS* are so similar that you can readily switch between the two simulations or use one in your undergraduate class and the other in an MBA class. If you have not yet used either of the two simulations, you may find the following of particular interest:

- **Time requirements for instructors are minimal.** Setting up the simulation for your course is done online and takes about 10-15 minutes. Once set-up is completed, no other administrative actions are required beyond that of moving participants to a different team (should the need arise) and monitoring the progress of the simulation (to whatever extent desired). There is a 4-page Getting Started Guide for first-time adopters that guides you through the steps to set up the simulation for your course, describes the administrative tasks, explains the scoring, and provides suggestions for using the simulation effectively.

- **An online Instructor Center serves as your hub for conducting all administrative activities and monitoring the results of the company decisions.** The Instructor Center is the page you are sent to when you enter your user name and password to log-in. Every function and feature that you need for using the simulation in your course is on the Instructor Center page or accessible from it. An online grade book provides you with a numerical score indicating each company’s and each participant’s performance on each phase of the simulation. Once you enter percentage weights to put on each performance measure, overall scores are automatically calculated (which you can scale or not as you see fit).

- **There are no disks to fool with or software downloads or cumbersome program installations for computer lab personnel.** Both participants and instructors conduct all activities online (at [www.bsg-online.com](http://www.bsg-online.com) for *The Business Strategy Game* and at [www.glo-bus.com](http://www.glo-bus.com) for *GLO-BUS*).

- **Class members have anywhere, anytime access** to [www.bsg-online.com](http://www.bsg-online.com) and [www.glo-bus.com](http://www.glo-bus.com) on any Windows-based PC or Apple Mac connected to the Internet, provided the PC has a Web browser (such as Internet Explorer or Firefox or Safari) and Flash 9.0 (or later)—Users of PCs without the needed version of Flash already installed will be automatically directed to the Flash site where the latest version can be downloaded and installed free of charge in a few minutes. *As long as class members have a live internet connection, they will have 24/7/365 access to the BSG and GLO-BUS web sites*. The speed for participants using dial-up modems is quite satisfactory.

- **The PC requirements for instructors are a bit different**—instructors will need to use a Windows-based PC (or an Apple Mac running Windows XP or Vista) connected to the Internet and loaded with Microsoft Excel (2000, XP, 2003, 2007, and 2009 versions) and a Web browser (such as Internet Explorer or Firefox or Safari).

- **Team members running the same company can use the built-in on-screen chat system or phones to collaborate when working online at the same time from different locations.**

- **Both simulations are quite suitable for use in distance-learning or online courses** (and are currently being used in many such courses).

- **Everything that class members will need during the course of the simulation, including the Participant’s Guide, is delivered at the Web site**—students can read the Participant’s Guide and other accompanying content on their monitors or make print outs, as they prefer.
The deadlines for each decision round and other related assignments are set and totally controlled by the instructor (and can be changed at any time for any reason). Decision rounds can be scheduled once per week, twice per week, daily, or even twice daily, depending on how you want to conduct the exercise. You will be able to peruse sample decision schedules when you are settling on the times and dates for the deadlines.

Sample course outlines for integrating BSG or GLO-BUS into your strategy course can be found in Section 4 of the IM.

The management teams for each company can range from 1 to 5 co-managers, and the number of companies competing head-to-head in a single market group or “industry” can range from 4 to 12. If you have a large class and need more than 12 companies, the Course Setup procedure will automatically create two or more industries for your class. In a small class, there can be no fewer than 4 company teams—two-person teams will work just fine. (For classes with fewer than 8 students, please call us at 205-722-9149 or e-mail us at athompso@cba.ua.edu to discuss how best to proceed.)

In the course of running their company (making decision entries and viewing reports) class members have instant access to “Help” pages containing detailed explanations of (a) the information on each decision entry screen, (b) the information on each page of the Industry Reports, and (c) the numbers presented in the Company Reports. The clear and complete Help page discussions allow company co-managers to figure things out for themselves, thereby curbing their need to run to the instructor with questions about “how things work.”

The entries that co-managers make each decision round are saved directly to the BSG or GLO-BUS server; once the deadline passes, the decisions of all companies are then “processed” automatically. Complete results are available 15-20 minutes after the decision deadline.

Participants and instructors are notified via e-mail when the decision outcomes are ready. Company co-managers learn the details of “what happened” in a 7-page Industry Report, a 1-page Competitive Intelligence report for each geographic region that includes strategic group maps and bulleted lists of competitive strengths and weaknesses, and a 5-page set of Company Reports (income statement, balance sheet, cash flow statement, and assorted sales, cost, and operating statistics).

A “scoreboard of company performance” incorporates two performance measures: (1) how well each company meets “investor expectations” on earnings per share, return on shareholders’ equity (ROE), stock price appreciation, credit rating, and image rating and (2) how well each company stacks up against the “best-in-industry performer” on each of these same 5 measures.

You have the option to assign two “open-book” multiple choice tests of 20 questions. Quiz 1 covers the contents of the Participant’s Guide. Quiz 2 checks understanding of key aspects of company operations. The self-scoring quizzes are taken online, with scores reported instantaneously to participants and recorded in your online grade book.

There is a built-in 3-year strategic plan feature that entails having each company’s management team (1) articulate a strategic vision for their company (in a few sentences), (2) set performance targets for EPS, ROE, stock price appreciation, credit rating, and image rating for each of the next three years, (3) state the competitive strategy the company will pursue, (4) cite data showing that the chosen strategy either is currently on track or requires further managerial actions, and (5) develop a projected income statement for the each of the next three years based upon expected unit sales, revenues, costs, and profits. Each company’s strategic plan is automatically graded on a scale of 1 to 100, with points being earned for meeting or beating the performance targets that were established. The scores are recorded in your online grade book.

At the conclusion of the simulation, you have the option to have each company management team prepare a slide presentation reviewing their athletic footwear company’s performance and strategy. A Company Presentation link in each co-manager’s Corporate Lobby provides explicit slide-by-slide suggestions of what to cover in the presentation. The software allows co-managers to copy bar charts...
showing their company’s revenues, earnings per share, ROE, stock price, credit rating and image rating during the course of the simulation directly onto slides in less than five minutes.

- There is a comprehensive 12-question peer evaluation form that co-managers can complete to help you gauge the caliber of effort each co-manager has put into the exercise. Peer evaluations are automatically scored on a scale of 1 to 100, and the scores are recorded in your online grade book.

- There are sets of “Exercises for Simulation Participants” that you can use to aid class members in connecting the issues/challenges they face in running their simulation company to the content of the 12 chapters in the 17th Edition. These exercises appear at the end of each chapter in the 17th Edition and can also be accessed via a link in your Instructor Center for the simulation. One of the biggest teaching/learning benefits of using a strategy simulation like BSG or GLO-BUS in your course is the array of opportunities it presents for class members to immediately utilize and apply the concepts and analytical tools covered in the text chapters. Some of these exercises are suitable for open class discussion (immediately during or following your lectures on the chapters) and some are best used for team assignments, with the answers provided confidentially to the instructor in a brief report (because the answers involve competitively sensitive analysis and thinking on the part of each company team that they will definitely not want to share with class members managing rival companies).

- There is an Activity Log that provides an informative summary of each co-manager’s use of various parts of the website—the frequency and length of log-ons, how many times decision entries were saved to the server each decision round, and how many times each set of reports was viewed each decision round. The combined information from the peer evaluations and the Activity Log provide good evidence about whether a co-manager was a strong or weak contributor.

- A Learning Assurance Report provides you with solid empirical data concerning how well your students performed versus other students playing the simulation worldwide over the past 12 months. The report measures 9 areas of student proficiency, business know-how, and decision-making skill, and provides potent benchmark evidence valid for gauging the extent to which your school’s academic curriculum is delivering the desired degree of student learning as concerns accreditation standards. The LAR is useful in two very important respects. One, it provides you with a clear overview of how well your students rank relative to students at other schools worldwide who have gone through this competition-based simulation exercise over the past 12 months. Two, because the report provides highly credible evidence regarding the caliber of business proficiency and decision-making prowess of your students, it can be used to help assess whether your school’s academic curriculum in business is providing students with the desired degree of business understanding and decision-making acumen. Professors, department chairs, and deans at many business schools worldwide are engaged in developing ongoing evidence of whether their academic programs meet the Assurance of Learning Standards now being applied by the Association to Advance Collegiate Schools of Business (AACSB); a prime goal of this Learning Assurance Report is to contribute significantly to this effort.

- There is a weekly ranking of the best-performing companies worldwide posted on the homepage—all co-managers and instructors whose companies appear in the rankings are automatically notified by e-mail. You can browse through the latest rankings by clicking on the icon in the center of the homepage.

- The co-managers of the overall best-performing company in your class are automatically e-mailed an “Industry Champion” certificate suitable for framing when the simulation ends. This certificate serves to document an award or achievement they can put on their resumés.

- The co-managers of each industry-winning company playing the two simulations across the world are invited to participate in the “Best Strategy Invitational.” The BSIs for GLO-BUS and The Business Strategy Game are held twice annually—in late April/early May and in late November/early December. Those teams that accept are divided into industries of 11-12 companies and compete for a period of 10 decision rounds for “Global Industry Championships.” All participants who complete the competition receive frame-able certificates and the industry winners get a “Grand Champion” certificate. Receipt of these certificates also merits a line on a student’s resumé.
The industry winners of the Best Strategy Invitational and their professors are inducted into a Hall of Fame (which is viewable by clicking on the Hall of Fame icon in the middle of the simulation home page).

**Comprehensive support, question-answering, and problem-solving is provided to all adopters of the two simulations by co-authors Greg Stappenbeck and Art Thompson**—just use the tech support link in the Instructor Center to send an e-mail, call us at 205-722-9149, or send an e-mail to athompso@cba.ua.edu to learn more about either simulation. We will be glad to provide you with a personal tour of either or both of the Web sites (while you are on your PC) and walk you through the many features that are built into the simulations. If there are multiple instructors at your school who teach the course, we will be happy to set up a Web teleconference for you and your colleagues, give you a guided tour of the Web site, and answer whatever questions you may have.

Alternatively, you can go to www.bsg-online.com and/or www.glo-bus.com, register as an Instructor, and gain full access to the Web sites. Once you register (there’s no obligation), you’ll be able to access the 4-page *Quick Guide to Getting Started*, the complete 33-page *Instructor’s Guide* and the *Participant’s Guide* for the simulations and peruse the Instructor Center menus on your own.

We are more than happy to give personal assistance to new and ongoing users any time questions or problems arise.

For those who are worried about “bugs” or flaws, we would say we are way past the stage where software “glitches” and system malfunctions are still being ironed out. *The Web site and related software have long since been thoroughly “de-bugged” and have been working quite smoothly since December 2004. There is a staff that monitors and maintains the functioning of the two Web sites 24/7/365—if a user can get connection to the Internet, then the chances of the system being “down” are virtually nil.*

Adopters of the text who also want to incorporate use of one of the two simulation supplements can either have students register at the simulation website via a credit card or you can instruct your bookstores to order the “book-simulation package”—the publisher has a special ISBN number for new texts that contain a special card shrink-wrapped with each text; printed on the enclosed card is a pre-paid access code that student can use to register for either simulation and gain full access to the student portion of the Web site. Please consult with your McGraw-Hill sales representative for details about the bundled book-simulation package. However, be aware that bookstore markups on the book-simulation package often result in a $10-$15 higher student cost for the simulation than will registering via credit card at the website.

**WHICH SIMULATION MAKES THE MOST SENSE FOR YOUR COURSE?**

Both *The Business Strategy Game* and *GLO-BUS* are suitable for either senior-level or MBA-level courses. Whether to use *The Business Strategy Game* or go with *GLO-BUS* is really a matter of preference, how much time you are comfortable with having class members spend working on the simulation exercise, and the degree to which the faculty believe that there should be a clear distinction between the content and rigor of a senior-level course in strategy and the MBA-level course in strategy.

The time that class members will spend on *GLO-BUS* typically works out to be a bit less than for *The Business Strategy Game*. With *GLO-BUS*, you can expect that class members will spend an average of 1½-2 hours per decision. With BSG, it will take company co-managers about 2-2¼ hours per decision. Company co-managers can speed through their *GLO-BUS* decision-making a bit quicker than in *BSG* because all production of digital cameras takes place in a single plant and there are no finished goods inventories (newly-assembled cameras are built-to-order and shipped directly to retailers). *The Business Strategy Game* is a bit more robust because company co-managers have the option to build and operate up to four plants (one in each geographic region of the world), they must operate four distribution centers (1 in each geographic region) and manage the finished goods inventories in these centers, companies compete in 12 market segments (versus 8 in *GLO-BUS*), and sales forecasting is a bit more elaborate. Both simulations have 2 built-in quizzes, strategic plan assignments, company presentation capabilities, and peer evaluations (each of which can be required or skipped as you see fit). See Table 1 for comparisons of the two simulations.
<table>
<thead>
<tr>
<th><strong>Industry setting</strong></th>
<th><strong>GLO-BUS</strong></th>
<th><strong>The Business Strategy Game</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Market scope</td>
<td>Worldwide. Production occurs at a single plant and sales are made to retailers in 4 major geographic regions: North America, Latin America, Europe-Africa, Asia Pacific.</td>
<td>Worldwide. Both production and sales activities can be pursued in any or all of 4 major geographic segments: North America, Latin America, Europe-Africa, Asia Pacific.</td>
</tr>
<tr>
<td>Number of market segments</td>
<td>8</td>
<td>12</td>
</tr>
<tr>
<td></td>
<td>• 4 segments for entry-level camera sales to retailers in each geographic region.</td>
<td>• 4 segments for branded footwear sales to retailers in each geographic region.</td>
</tr>
<tr>
<td></td>
<td>• 4 geographic segments for multi-featured camera sales to retailers in each geographic region.</td>
<td>• 4 segments for online sales of footwear direct to consumers in each geographic region.</td>
</tr>
<tr>
<td></td>
<td>• Character and performance of the camera line (up to 10 decision entries each for entry-level and multi-featured cameras).</td>
<td>• Production (up to 13 decision entries each plant, with a maximum of 4 plants).</td>
</tr>
<tr>
<td></td>
<td>• Production operations and worker compensation (up to 15 decision entries).</td>
<td>• HR/compensation (up to 3 decisions each plant).</td>
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<tr>
<td></td>
<td>• Pricing and marketing (up to 15 decision entries in 4 areas).</td>
<td>• Shipping (up to 8 decisions each plant).</td>
</tr>
<tr>
<td></td>
<td>• Financing of company operations (up to 4 decision entries).</td>
<td>• Pricing and marketing (up to 10 decision entries in 4 regions).</td>
</tr>
<tr>
<td></td>
<td>• Social responsibility and citizenship (as many as 6 decision entries).</td>
<td>• Internet marketing (up to 3 decision entries in 4 regions).</td>
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<tr>
<td></td>
<td>Competitive variables used to determine market share.</td>
<td>Financing of company operations (up to 8 decision entries).</td>
</tr>
<tr>
<td></td>
<td>• Price</td>
<td>• Price</td>
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<td></td>
<td>• Performance/quality rating</td>
<td>• Number of models/styles</td>
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<tr>
<td></td>
<td>• Number of quarterly sales promotions</td>
<td>• Styling/quality rating</td>
</tr>
<tr>
<td></td>
<td>• Length of promotions in weeks</td>
<td>• Advertising</td>
</tr>
<tr>
<td></td>
<td>• Promotional discounts</td>
<td>• Size of retailer network</td>
</tr>
<tr>
<td></td>
<td>• Advertising</td>
<td>• Celebrity endorsements</td>
</tr>
<tr>
<td></td>
<td>• Number of camera models</td>
<td>• Delivery time</td>
</tr>
<tr>
<td></td>
<td>• Size of dealer network</td>
<td>• Retailer support</td>
</tr>
<tr>
<td></td>
<td>• Warranty period</td>
<td>• Mail-in rebates</td>
</tr>
<tr>
<td></td>
<td>• Technical support</td>
<td>• Shipping charges (Internet sales only)</td>
</tr>
<tr>
<td></td>
<td>All sales and market share differences are the direct result of differing competitive efforts among rival companies</td>
<td>All sales and market share differences are the direct result of differing competitive efforts among rival companies</td>
</tr>
<tr>
<td>Time frame of decisions</td>
<td>One year, with an instructor-triggered option to update as many as 8 of the 50 decisions quarterly</td>
<td>One year</td>
</tr>
<tr>
<td>Measures on which company performance is judged (all company scores are automatically recorded in instructor’s online grade book for each decision period)</td>
<td>• Earnings per share</td>
<td>• Earnings per share</td>
</tr>
<tr>
<td></td>
<td>• Return on shareholders’ equity</td>
<td>• Return on shareholders’ equity</td>
</tr>
<tr>
<td></td>
<td>• Stock price</td>
<td>• Stock price</td>
</tr>
<tr>
<td></td>
<td>• Credit rating</td>
<td>• Credit rating</td>
</tr>
<tr>
<td></td>
<td>• Image rating</td>
<td>• Image rating</td>
</tr>
</tbody>
</table>

*continued*
<table>
<thead>
<tr>
<th></th>
<th><strong>GLO-BUS</strong></th>
<th><strong>The Business Strategy Game</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Scoring standards</strong></td>
<td>Choice of</td>
<td>Choice of</td>
</tr>
<tr>
<td></td>
<td>• Investor Expectations (benchmarked against industry growth)</td>
<td>• Investor Expectations (benchmarked against industry growth)</td>
</tr>
<tr>
<td></td>
<td>• Best-in-Industry</td>
<td>• Best-in-Industry</td>
</tr>
<tr>
<td></td>
<td>• A combination of both, with instructors determining the weights for each</td>
<td>• A combination of both, with instructors determining the weights for each (50-50 is</td>
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<tr>
<td></td>
<td>(50-50 is recommended)</td>
<td>recommended)</td>
</tr>
<tr>
<td><strong>Degree of complexity</strong></td>
<td>Moderate</td>
<td>More robust/”complex” than GLO-BUS because</td>
</tr>
<tr>
<td></td>
<td>Less complex than BSG because all production is in a single plant and there</td>
<td>• Companies can operate up to four plants (one in each geographic area) and plant operations</td>
</tr>
<tr>
<td></td>
<td>are no finished goods inventories (newly-assembled cameras are built-to-order</td>
<td>are a bit more involved</td>
</tr>
<tr>
<td></td>
<td>and shipped directly to retailers)</td>
<td>• Shipments are made to company distribution centers and there are finished goods inventories</td>
</tr>
<tr>
<td></td>
<td></td>
<td>to manage</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• There are 12 market segments instead of 8</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Players have to develop make a sales forecast based on their competitive strategy and the</td>
</tr>
<tr>
<td></td>
<td></td>
<td>expected competitive efforts of rivals</td>
</tr>
<tr>
<td><strong>Time required to make a</strong></td>
<td>About 1.75 hours per decision (once players gain familiarity with software</td>
<td>2 to 2.25 hours per decision (once players gain familiarity with software and reports)</td>
</tr>
<tr>
<td>complete decision**</td>
<td>and reports)</td>
<td></td>
</tr>
<tr>
<td><strong>Industry reports</strong></td>
<td>A 6-page report that includes</td>
<td>A 7-page report that includes</td>
</tr>
<tr>
<td>(automatically provided to</td>
<td>• Complete scoreboard of company performances on all five performance</td>
<td>• Complete scoreboard of company performances on all five performance measures (3 pages)</td>
</tr>
<tr>
<td>all participants at website</td>
<td>measures (3 pages)</td>
<td>• Selected industry statistics</td>
</tr>
<tr>
<td>within 15 minutes following</td>
<td>• Selected industry statistics</td>
<td>• Financial statistics for each company</td>
</tr>
<tr>
<td>each decision deadline)</td>
<td>• Financial statistics for each company</td>
<td>• Benchmarking statistics</td>
</tr>
<tr>
<td></td>
<td>• Benchmarking statistics</td>
<td>• Status of celebrity endorsements</td>
</tr>
<tr>
<td></td>
<td>A 1-page competitive intelligence report for each geographic region that</td>
<td>A 1-page competitive intelligence report for each geographic region that shows</td>
</tr>
<tr>
<td></td>
<td>shows</td>
<td>• Each company’s publicly visible competitive effort (prices, advertising, warranties, etc.)</td>
</tr>
<tr>
<td></td>
<td>• Each company’s publicly visible competitive effort (prices,</td>
<td>• Strategic group maps of competitors in the entry-level and multi-featured camera segments</td>
</tr>
<tr>
<td></td>
<td>advertising, warranties, etc.)</td>
<td>• A list of the company’s competitive strengths and weaknesses in that region</td>
</tr>
<tr>
<td></td>
<td>• Strategic group maps of competitors in the entry-level and multi-featured</td>
<td></td>
</tr>
<tr>
<td></td>
<td>camera segments</td>
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<tr>
<td></td>
<td>• A list of the company’s competitive strengths and weaknesses in that</td>
<td></td>
</tr>
<tr>
<td></td>
<td>region</td>
<td></td>
</tr>
<tr>
<td><strong>Company reports</strong></td>
<td>A 6-page report that includes</td>
<td>A 5-page report that includes</td>
</tr>
<tr>
<td>(automatically provided to</td>
<td>• An income statement</td>
<td>• An income statement</td>
</tr>
<tr>
<td>all participants at website</td>
<td>• A balance sheet</td>
<td>• A balance sheet</td>
</tr>
<tr>
<td>within 15 minutes following</td>
<td>• A cash flow statement</td>
<td>• A cash flow statement</td>
</tr>
<tr>
<td>each decision deadline)</td>
<td>• Production operations</td>
<td>• Plant operations statistics</td>
</tr>
<tr>
<td></td>
<td>• Sales and costs in each geographic area</td>
<td>• Distribution and warehousing statistics</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Branded and private-label sales statistics</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Detailed marketing and administrative costs</td>
</tr>
<tr>
<td><strong>Participant’s manual</strong></td>
<td>25 pages</td>
<td>33 pages</td>
</tr>
<tr>
<td>(delivered online)</td>
<td></td>
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</tbody>
</table>
Section 2  Using a Strategy Simulation in Your Course

Usage data confirms that you can have a successful experience with either simulation in both senior and MBA courses. We have adopters who are using GLO-BUS on an ongoing basis for undergraduate courses and for graduate courses. Likewise, we have adopters who are using BSG on an ongoing basis for undergraduate courses and for graduate courses. Here are our thoughts about which simulation to use:

- If you want the simulation to count only about 20% of the course grade and keep the simulation workload down to a “minimum”, then GLO-BUS is perhaps the better choice.
- GLO-BUS is definitely the better choice for courses below the senior-level.
- If you want the simulation to be a truly major part of the course (and count 25-30% of the course grade), then our recommendation would be to use The Business Strategy Game.
- We see little reason for you to be concerned that the slightly longer decision times for BSG mean that it is “too much” for or “above the heads” of senior-level undergraduates. During the past 4 years, BSG has been used for undergraduate courses at well over 400 campuses worldwide. You can peruse the schools of the best-performing companies worldwide by clicking on the Top 25 icons in the middle section of the homepages for the two simulations (www.bsg-online.com and www.glo-bus.com)—these listings will let you confirm for yourself that the best-performing companies involve a wide diversity of schools/campuses.
- The Business Strategy Game is definitely the better choice for an MBA-level class. (Our data indicates that BSG is used for graduate-level courses far more frequently than is GLO-BUS.)
- If many of your school’s undergraduate students also go on to be part of your school’s MBA program (thus making it desirable to provide them with a differentiated strategy simulation experience in the undergraduate versus the graduate courses), then it probably makes sense to use GLO-BUS in one course (we would recommend the senior-level course) and BSG in the other course (the MBA course).
- If school policy is to maintain a clear-cut distinction between the content and rigor of the senior-level course and the MBA-level course, then it probably makes sense to use GLO-BUS in the senior-level course and BSG in the MBA course.
- Since the instructor-related aspects of conducting the two simulations are virtually identical (in the sense that the course setup procedures, menus, and administrative tasks are virtually mirror images of one another), you will have no problem in using both simulations at the same time if you teach both the undergraduate course and MBA course in the same term. We made a point of designing the Instructor Centers for BSG and GLO-BUS to be as much alike as possible—moreover, the quiz features, the scoring of company performance, the strategic plan feature and scoring, the company presentation feature, and the peer evaluation form are also very close to identical.
- Either simulation can be used for executive courses; participants will definitely be able to make a complete decision in half a day—one in the morning and one in the afternoon. But if the time available for decisions is constrained to less than half a day (say, 2½ hours or maybe less), then we recommend use of GLO-BUS.

THE 5-STEP COURSE SETUP PROCEDURE

Setting up either of the two simulations for your course entails a simple, straightforward process that is fully covered in the 4-page Quick Guide to Getting Started:

1. Deciding what size management teams you want (anywhere between 1 and 5 persons).
2. Specifying a Course ID and indicating the whether the participants will be primarily undergraduates, graduate students, corporate trainees, or “other.”
3. Specifying the number of companies—a minimum of 4 companies and a maximum of 12 companies can compete head-to-head in a single group or “industry.”

4. Specifying deadlines for the practice and regular (scored) decision rounds—you can have either 1 or 2 practice rounds and anywhere from 4 to 10 decision rounds that are scored and used in calculating individual grades for the simulation exercise. As part of creating a decision schedule, you will also need to indicate whether you want to have students (a) complete either or both of the two optional quizzes, (b) do one of two 3-year strategic plans for their company, (c) prepare a PowerPoint presentation about their company’s performance and operations at the conclusion of the simulation exercise, and (d) complete Peer Evaluations of their co-managers. Our recommendations for handling these optional assignments are presented in the Quick Guide for Getting Started.

5. Generating and printing the company registration codes that you will need to give each class member to use in registering for the simulation. You must give each class member on each team/company the appropriate company registration code prior to having them register because this code is used to (1) enroll the student in your class, (2) designate the student as a co-manager of the assigned company, (3) restrict a co-manager’s access to only the industry and company you assigned them, and (4) enter the student’s name in your online grade book. When students register, they will be asked to enter the company registration code you provide them—class members cannot register without the registration code for their particular industry and company.

That’s all there is to it. You’ll find that you can complete the Course Setup routine in no more than 30 minutes the first time you use the simulation. Once you have used been through the Course Setup routine and become comfortable with how you want to administer the exercise, it should take no more than 15 minutes in succeeding terms to have everything ready to go.

You’ll need to remember to take a printout of the company registration codes to class and make sure each student is given the appropriate code for their assigned company. A good procedure is to give each class member a copy of the printout of the company registration codes and have them circle the code for the company they have been assigned to manage. Each different company goes by a letter of the alphabet (A, B, C, etc.). Each co-manager of Company A will need the registration code ending in the letter A to complete the registration process; each co-manager of Company B will need the code ending in B, and so on. If you have 6 companies, then the corresponding company letters appearing at the each of each code number will be A, B, C, D, E, and F. Once co-managers register, they can create a name for their company that begins with their corresponding company letter.

HOW DO CLASS MEMBERS REGISTER AND GAIN FULL ACCESS TO THE SIMULATION WEB SITE?

When class members complete the registration process at either www.bsg-online.com or www.glo-bus.com, they gain instant access to the Web site, ability to view/print the Participant’s Guide, and full navigation privileges to everything needed to run their company and complete the various optional assignments. For co-managers to register, you will first have to provide them with their Company Registration Code in the manner just discussed in the prior section. Registration is accomplished in one of three ways:

1. Credit Card Registration—When a student creates a user account, the registration fee plus applicable sales taxes can be paid online by credit card (Visa, MasterCard, or American Express) during the registration process. (Credit card payment is currently used by about 65% of all registrants.) Rest assured that the Web site for credit card payment is fully secured; credit card registrants will receive a receipt confirming their payment.

2. Prepaid Access—If you adopt a McGraw-Hill text or create a custom McGraw-Hill text for your course, you have the option of “packaging” prepaid use of The Business Strategy Game or GLO-BUS with your text. A bundled text-simulation package is ordered through your local book store using a special ISBN code
provided by McGraw-Hill. When your book store places an order for the text-simulation bundle, McGraw-Hill will shrink-wrap a Prepaid Access Code card for the simulation with the new or custom text and ship it to your book store where class members purchase the text-simulation package in the normal manner. Class members then register online using the Prepaid Access Code printed on the card. About 30 percent of all registrants use a prepaid access code. To obtain the special ISBN for the text-simulation package and place a bookstore order, please contact your local McGraw-Hill account representative for details or e-mail Michael Gedatus, McGraw-Hill Marketing Specialist (Michael_Gedatus@McGraw-Hill.com). However, you should be aware that aggressive bookstore markups often result in class members paying the book store as much as $10-$15 more for the simulation in a combination text-simulation package than they would pay via credit card at the Web site.

3. **Direct-Billing**—If your college/university includes the cost of text books and other course materials in the tuition fee for the course (and a McGraw-Hill text-simulation package has not been ordered for your course), then you or an appropriate school official can obtain Prepaid Access Codes for student registration (one for each class member) directly from McGraw-Hill for which McGraw-Hill can direct-bill your department/college/university. For your convenience, we can supply you or your school with the desired number of Prepaid Access Codes within minutes of receiving a request (before McGraw-Hill even sends an invoice). For more information on this option, please e-mail CustomerService@bsg-online.com or call Greg Stappenbeck at (205) 722-9149.

*If some of your students do not have a credit card or a Prepaid Access Code, the easiest way for them to register is to arrange to use a friend’s or co-manager’s credit card and reimburse them directly with cash or a check.*

**The Corporate Lobby Web Page for Company Co-Managers.** Upon completing the registration process, company co-managers are immediately transferred to their company’s “Corporate Lobby” page. Each time they log-on at the simulation home page (by entering their user name and password), they go directly to their Corporate Lobby page. The Corporate Lobby is the gateway or hub that co-managers use to **access all needed information and work on all assigned tasks.**

*Company co-managers have 24/7/365 access to their Corporate Lobby page from any Windows-based or Apple Mac PC connected to the Internet,* so long as the PC is equipped with Internet Explorer or Firefox or Safari and Flash 9.0(or later)—Users of PCs without the needed version of Flash already installed will be automatically directed to the Flash site where the latest version can be downloaded and installed free of charge in a few minutes. *As long as class members have a live internet connection, they will have 24/7/365 access to the BSG and GLO-BUS web sites.* The speed for participants using dial-up modems is quite satisfactory.

Each company’s Corporate Lobby prominently displays the last date and time of every co-manager’s log-in. *If some or all co-managers are logged in simultaneously from different locations* (or from adjacent PCs in a PC lab), *co-managers at different locations can use the built-in chat box that is on every screen or telephone to stay in close communication* and collaborate on their decision entries. If any one co-manager opts to save decision entries to the server, then all other co-managers that are also logged on, then the other co-managers that are logged on are instantly notified and given the option to override their own entries by importing the newly-saved entries onto their PC screens—this, along with the chat boxes that appear on every screen, greatly facilitates use of either simulation for distance-learning or online courses where company co-managers may not find it easy to meet face-to-face.
HOW MUCH SHOULD THE SIMULATION EXERCISE COUNT IN THE TOTAL COURSE GRADE?

Whether class members take the simulation exercise seriously hinges in large part on whether you make their performance count enough in the overall course grade to get their attention. As a general rule, we recommend having performance on the simulation count at least 20% of the overall course grade and probably no more than 40% of the total grade. If it counts less than 20%, then class member effort is weakened to an undesirable extent and some of the learning potential slips through the cracks. If it counts more than 40%, then the simulation exercise may take something away from the emphasis you want to give to other aspects of the course.

However, growing numbers of users are making an online strategy simulation the dominant centerpiece of their courses (particularly in online and distance learning courses where case analysis is difficult to use effectively). When the simulation functions as the primary part of the course (aside from the content of the chapters in the textbook you have adopted), then counting the simulation as 50-60% (or more) of the final grade is reasonable, given that you can use the quizzes, one or two 3-year strategic plan assignments, and perhaps an end-of-simulation presentation to an invited panel of 3 or 4 persons (who act as a company board of directors) as a substitute for assigning students a larger number of cases to analyze.

HOW COMPANY PERFORMANCES ARE SCORED—A BALANCED SCORECARD APPROACH

Each company’s performance is tracked annually against 5 performance measures which, taken together, constitute a “balanced scorecard” set of performance measures (the balanced scorecard concept is discussed in Chapter 2 of this text). Given the nature of growing market demand, board members and shareholders/investors expect the company’s new management team to meet or beat the following performance standards:

- Grow earnings per share at least X% annually. (The target rate of growth in EPS is different for BSG versus GLO-BUS.)

- Maintain a return on equity investment (ROE) of 15% or more annually. All companies start the simulation with an ROE above 15%.

- Maintain a B+ or higher credit rating. All companies start the simulation with a B+ credit rating.

- Achieve an “image rating” of 70 or higher. All companies start the simulation with an image rating of 70. A company’s image rating is a function of (1) the quality of its product offerings, (its market shares in each of the 4 geographic regions of the world market, and (3) the degree to which it conducts its operations in a socially responsible manner and strives to be a good corporate citizen.

- Achieve stock price gains averaging about X% annually. The expected stock price gains are definitely within reach if the company meets or beats the annual EPS targets and pays a rising dividend to shareholders. Each company’s stock price is a function of EPS growth, ROE, credit rating, dividend per share growth, and management’s ability to consistently deliver good results (as measured by the percentage of these 5 performance targets that each company achieves over the course of the simulation exercise).

The default weight placed on each of the five performance targets is 20%. The five 20% weights translate into 20 points out of 100 for each of the 5 performance measures, with the sum of the points adding to a total of 100 points. There is an option on your Administrative Menu for each “industry” that allows you to alter these weights however you see fit. The scoring weights are reported to students on their scoreboard of company performance; hence, they always know what the weights are.
Using the assigned weights (or corresponding number of points out of 100), each company’s performance on the 5 measures is tracked annually and company performance scores are calculated from two different angles: the “investor expectations” standard and the “best-in-industry” standard.

1. **The Investor Expectations Standard.** The investor expectations standard involves calculating an annual “Investor Expectation Score” based on each company’s success in meeting or beating the five expected performance targets each year. There is also a Game-to-Date or “all-years” Investor Expectation Score that shows each company’s success in achieving or exceeding the expected performance targets over all years of the exercise completed so far. Meeting each expected performance target is worth some number of points based on the scoring weight selected by the instructor (the default scoring weights are 20% or 20 points for each of the five performance measures). For example, if the scoring weight for EPS is 20% or 20 points, meeting the EPS target earns a score of 20 on the EPS performance measure. Beating a target results in a bonus award of 0.5% for each 1% the annual target is exceeded (up to a maximum bonus of 20%). Thus, if achieving the EPS target is worth 20 points, a company can earn a score of 24 points by beating the annual EPS target by 40% or more. Failure to achieve a target results in a score equal to a percentage of that target’s point total (based on its weight out of 100 points). For instance, if your company earns $1.33 per share of common stock at a time when the EPS target is $2.67 and achieving the $2.67 EPS target is worth 20 points, then your company’s score on the EPS target would be 10 points (50% of the 20 points awarded for meeting the EPS target). Exactly meeting each of the 5 performance targets results in an Investor Expectation Score of 100. With potential point bonuses of up to 20% for exceeding each performance target, it is possible to earn an Investor Expectation Score of 120.

2. **The Best-in-Industry Standard.** The best-in-industry scoring standard is based on how each company’s performance compares to the industry’s best performer on earnings per share, return on equity (ROE), stock price, and image rating and to the ultimate credit rating of A+. After each decision round, each company’s performance on EPS, ROE, Stock Price, and Image Rating is arrayed from highest to lowest. The best-in-industry performer on each of these 4 measures earns a perfect score (the full number of points for that measure as determined by the instructor-chosen weights)—provided the industry leader’s performance on that measure equals or exceeds the performance target established by company Boards of Directors). Each remaining company earns a fraction of the points earned by the best-in-industry performer that is equal to its performance (on EPS, ROE, stock price, and image rating) divided by the performance of the industry-leading company (on EPS, ROE, stock price, and image rating). For instance, if ROE is given a weight of 20 points, an industry-leading ROE performance of 25% gets a score of 20 points and a company with an ROE of 20% (which is 80% as good as the leader’s 25%) gets a score of 16 points (80% of 20 points). Likewise, if EPS is given a weight of 20 points, an industry-leading EPS performance of $5.00 gets a score of 20 points and a company with an EPS of $2.00 (which is 40% as good as the leader’s $5.00) gets a score of 8 points (40% of 20 points). The procedure for assigning best-in-industry scores for credit rating is a bit different. Each credit rating from A+ to C− carries a certain number of points that scales down from the maximum number of points for an A+ credit rating to 1 point for a C− rating. Each company’s combined point total on the five performance measures is its score on the best-in-industry standard. Each company receives an annual best-in-industry score and a best-in-industry score for all years completed. In order to receive a score of 100, a company must (1) be the best-in-industry performer on EPS, ROE, stock price, and image rating, (2) achieve the targets for EPS, ROE, stock price and image rating set by the company’s Board of Directors, and (3) have an A+ credit rating.

After each decision round, you will be able to review every company’s performance scores on both the investor expectations standard and the best-in-industry standard for each year completed, along with an overall “game-to-date” (G-T-D) score for each standard. Each company will also receive annual and game-to-date Overall Scores that are determined by combining the Investor Expectation Score and the Best-in-Industry Score into a single score using whatever weighting you chose (50-50 is recommended). After each decision round, all company co-managers can view or print a complete Company Scoreboard showing each company’s performance on every aspect of the scoring, including all the scoring weights. The Help sections for each page of the 3-page Company Scoreboard provide detailed, easy-to-understand explanations of the scoring so company co-managers should encounter no “mystery” factor about how the scoring works or where each company stands in the industry performance rankings.
**Concluding Comment on How Company Performances Are Scored**

Company co-managers are provided an array of information that makes it easy for them to track the performance of their company and all other companies over time. Both students and instructors always have plenty of information to gauge exactly how well every company in the industry is performing. It is always clear which companies are in the ranks of the industry leaders and which companies are being out-competed and outperformed.

One very important point about the scoring methodology warrants emphasis: it is a company’s overall score that matters (how close a company’s score is to 100-120 in the case of the Investor Expectations Standard and how close it is to 100 in the case of the Best-in-Industry Standard), not whether a company is in first or third or fifth or tenth place. Some company must necessarily be in last place, but what is truly telling is whether it is in last place with a score of 85 (which clearly signals a strong performance and a deservedly good grade) or in last place with a score of 17 (which clearly signals an abysmal performance and possibly a very disappointing grade). The scoring method for the two simulations has the considerable advantage of not “requiring” that some companies always receive low scores. Scores are based entirely on (1) whether companies achieve the benchmark performances that investors expect for EPS, ROE, credit rating, stock price appreciation, and image and (2) whether the race to be the market leader is very close from the first place company to the last place company or whether there is quite a wide disparity in the caliber of performances (with the bottom-performing companies turning in truly bad results).

As a general rule, we think that companies with an overall performance score of 90 or above should get an A. Companies with an overall performance score of 80-89 should get a B (or better if there are no companies with scores of 90 or more). Companies with an overall performance score of 70-79 above should typically get a C (or maybe better, depending on how many teams have higher scores). You may find it desirable to scale the scores if competition turns out to be so fierce or cutthroat that most all companies in the industry fail to earn good profits and meet investors’ performance expectations. If one or more companies have truly low performance scores relative to the other companies, we leave it up to you to decide what sort of scale to apply and thus how much to raise their grade. You’ll find that there’s plenty of information provided to you in your online grade book to decide what grades to assign. In most of our classes, we end up scaling the performance scores of companies with scores below 70, but there is usually at least one company (and often more) that end up with a score above 90 and thus clearly merit a grade of A (thus there is little need for scaling the final company scores on the upper end of the spectrum).

**WHAT TO DO IF YOU OPT TO USE EITHER OF THE COMPANION SIMULATIONS**

The preceding discussion is intended to give you some detailed information about the two companion simulations, how they work, and what value they add to a first course in strategy for seniors and MBA students.

If you are persuaded that using either BSG or GLO-BUS in your course would make a positive contribution, then (if you have not already done so), you should go to [www.bsg-online.com](http://www.bsg-online.com) or [www.glo-bus.com](http://www.glo-bus.com) (or both) and create an instructor account. This account gives you full access to the all the materials and information needed to run the simulations in your class. Once you have created an account, we recommend that you do three things:

1. **Click on the Quick Guide to Getting Started link that appears on the left side of your Instructor Center page/screen and spend a few minutes exploring the Guide’s 4 pages** (and any of the built-in links to additional information and explanations that are of interest). The 4-page Getting Started guide, which is designed expressly for first-time users, cuts the “gear-up time dramatically and will have you ready to conduct the simulation for an upcoming class in about an hour if you are willing to following our recommendations about what size management teams to have, whether to require completion of Quiz 1 and Quiz 2, whether to assign a 3-year strategic plan and an end-of-simulation company presentation, and whether to have company co-managers do peer evaluations. Because the Quick Guide has built-in links to additional information and more extensive explanations of how things
work, it also functions as an online Instructor’s Guide. Or, if you prefer, you can just print the complete Instructor’s Guide, spend time digesting the first 20 pages, and decide for yourself what size teams to use and what uses to make of the optional quizzes, strategic plan assignments, company presentation, and peer evaluations—the remainder of the full Instructor’s Guide can be read/skimmed later at your convenience.

We believe that the information in the Getting Started Guide and/or the full Instructor’s Guide will prove to be valuable and useful in successfully conducting a strategy simulation in your course—they contain all the wisdom that we have accumulated over the thirty-five years we have used a competition-based strategy simulation in our senior and MBA courses here at The University of Alabama.

2. **Click on the Participant’s Guide link and print a copy.** The Participant’s Guide is what class members will need to read and digest before starting to enter decisions and operating their simulation company. It sets forth all the market and company circumstances, explains how things work, and sets the stage for how company co-managers need to proceed. If you will take a few minutes to skim/read through this Guide, then you will have a very good grasp of what the simulation is all about and the value-added experience it delivers to your students.

3. **Sign up for one of our upcoming web conferences for faculty** that involve tours of the web site, explanations of how things work, and Q&A. These tours, which involve about an hour, are conducted by one (sometimes two) of the simulation co-authors.

   - If you are located in the U.S. or Canada, you can view the schedule of future web conferences and sign up at [http://formdesk.com/mhhe/strategy](http://formdesk.com/mhhe/strategy). If attending one of these web conferences proves problematic or inconvenient for you, then by all means please call Art Thompson or Greg Stappenbeck at 205-722-9149 or e-mail us at athompso@cba.ua.edu and we will arrange a personal web conference at a time that works best for you.

   - If you are located outside the U.S. or Canada, then we can schedule a special web conference using VOIP technology (which eliminates the need for expensive long distance telephone charges)—this technology is every bit as effective in providing you with a personalized tour of the web site, explaining how things work, and answering any questions or resolving any concerns you might have. Just send an e-mail to athompso@cba.ua.edu if you would like to set up a VOIP-enabled web conference.

Moreover, you can rest assured that the simulation co-authors will be only a phone call or e-mail away throughout the term, as you conduct the simulation. Do not hesitate to contact us at any time. Greg Stappenbeck, who is a co-creator of both simulations, is also the lead tech support person. The simplest way to reach us is to click on the Technical Support link in the Instructor Support box on the left side of the Instructor Center page. It provides a telephone number and an e-mail message system. We reply to all e-mails as quickly as we possibly can—usually within a few hours. Alternatively, you call us directly at 205-722-9149 or you can e-mail Art Thompson directly at athompso@cba.ua.edu.

We will be most happy to answer whatever questions you have, provide advice and guidance, and otherwise be responsive to whatever issues and concerns you may have.
section 3

Organizing Your Course, Deciding What the Workload Should Be, and Settling on Specific Assignments
THE ROLE AND OBJECTIVES OF COURSES IN STRATEGY

The cornerstones of courses in strategic management involve looking at the job of managing through strategic eyes and drilling students in the whys and hows of utilizing the tools and techniques of strategic analysis to craft, implement, and execute company strategies. The central theme of the strategic management course is that a company’s chances for sustained success are greatly improved when managers (1) develop an astute, timely strategic “game plan” for running the company and then (2) implement and execute the strategic plan with great proficiency.

The content portion of the course should explain what it means to think strategically about a company’s situation and it should instruct the student in the formal tools and techniques of strategic analysis, crafting a strategy, and then executing it successfully. The skills-building portion of the course, built around analysis and strategy simulations like GLO-BUS and The Business Strategy Game, drills students in the applications of key concepts and analytical weaponry, helps develop their ability to do strategic thinking, forces them to exercise business judgment, and gives them a modest but valuable dose of experience in making strategy-related decisions.

The ground that has to be covered content-wise is expansive and moderately rigorous in terms of core concepts and analytical tools, yet the subject matter is full of energy and practical relevance. During the term, instructors are obliged to drive home what the roles and tasks of the strategist are, to introduce students to what strategy means, to lead them through the ins and outs of crafting and executing a strategic plan, and to get them into the habit of automatically reviewing a firm’s situation and re-appraising the need for strategy revision.

The overriding pedagogical objectives are to sharpen students’ abilities to “think strategically”, to evaluate a company’s situation from the perspective of its competitiveness and performance prospects, and to draw sound conclusions about what actions a company’s management needs to take in light of all the relevant circumstances. Accomplishing these objectives entails introducing students to how an enterprise must in fact deal with all of the complexities and constraints of the business environment in which it operates, why none of these can be assumed away or ignored, and how situational factors impact strategic decisions. It means pushing students to grapple with many determining factors at once and forcing them to weigh how they shape what actions need to be taken from the perspective of the total enterprise. It means drilling students thoroughly in the tools of strategy analysis and exercising them in the managerial tasks of sizing up a company’s competitive position in the marketplace. It means systematically exposing them to the rigors of industry and competitive analysis, to the process of evaluating a company’s resources and competitive capabilities, to the ins and outs of crafting an attractive strategic plan, and to the varied managerial and leadership tasks associated with implementing and executing the chosen strategy as well as circumstances permit. It means deliberately putting them in managerial shoes and forcing them to make decisions (in an ethical and socially responsible manner!) and concoct concrete action plans capable of producing good results. The excitement and fun of it all comes from seeing the lights turn on in students’ eyes and the “a-ha, now I get it” results that signal the lessons of the course are being driven home.

In the midst of all this, another major purpose of the course is being served: helping students synthesize and integrate much of the knowledge gained in the core business curriculum. Unlike most other required business courses, strategic management is a big picture course. Virtually all other business courses are narrower in scope and somewhat specialized—principles of accounting, corporate finance, principles of marketing, and so on. Some concern the “hard side” and others the “soft side” of managing. Some relate to important concepts and information, while others involve skills-building. But none can match courses in strategy in covering so much of the spectrum of managing. Weighing the ins and outs of crafting, implementing, and executing company strategies forces a total enterprise perspective, demands that many internal and external situational considerations be dealt with at once, and calls for judgments about how all the relevant factors add up. This trait is what makes strategic management an integrative, capstone course.
Suggested Course Objectives

We see courses in crafting and executing strategy as having eight very relevant objectives:

1. To develop students’ capacity to think strategically about a company, its present business position, its long-term direction, its resources and competitive capabilities, the caliber of its present strategy, and its opportunities for gaining sustainable competitive advantage.

2. To build students’ skills in conducting strategic analysis in a variety of industries and competitive situations and, especially, to provide them with a stronger understanding of the competitive challenges of a global market environment.

3. To give students hands-on experience in crafting business strategy, reasoning carefully about strategic options, using what-if analysis to evaluate action alternatives, and making sound strategic decisions.

4. To acquaint students with the managerial tasks associated with implementing and executing company strategies, drill them in the range of actions managers can take to promote competent strategy execution, and give them some confidence in being able to function effectively as part of a company’s strategy-implementing team.

5. To integrate the knowledge gained in earlier core courses in the business school curriculum, show students how the various pieces of the business puzzle fit together, and demonstrate why the different parts of a business need to be managed in strategic harmony for a company to operate in winning fashion.

6. To develop students’ powers of managerial judgment, build their skills in assessing business risk, and improve their ability to create results-oriented action plans.

7. To have students become more proficient in using personal computers to do managerial analysis and managerial work.

8. To make students more conscious about the importance of exemplary ethical principles, sound personal and company values, and socially responsible management practices.

STRUCTURING YOUR COURSE

Just as there are “many ways to skin a cat,” there are many ways to structure a good course in strategic management. Aside from just the core text and cases which you plan to use, you will have to decide:

1. Whether to include GLO-BUS or The Business Strategy Game as an integral part of your course. Using one of the two companion simulations is a powerful and constructive way of emotionally connecting students to the subject matter of the course. There is no more effective and interesting way to stimulate the competitive energy of students and prepare them for the rigors of real-world business decision-making than to have them match strategic wits with classmates in running a company in head-to-head competition for global market leadership. The simplest (and usually the cheapest) way for students to obtain the simulation is via a secured credit card transaction at www.bsg-online.com (if you opt to use The Business Strategy Game) or at www.glo-bus.com (if you opt to use GLO-BUS).

2. Whether to use outside readings and, if so, what readings to assign.

3. What balance to strike between lectures on concepts/techniques, class discussion of cases, and a “learn by doing” strategy simulation. Our suggestions for weighting various possible assignments are offered several pages below.

4. What use you wish to make of written case assignments.
5. Whether to incorporate use of the videos accompanying the text chapters in your lectures.

6. Whether to require class members to do an oral team presentation of an assigned case.

7. What use to make of the chapter-end Assurance of Learning Exercises and Exercises for Simulation Participants.

8. Whether to encourage=require students to complete the chapter self-tests at the Web site for the text (www.mhhe.com/thompson).

9. What sort of examinations to use.

If you are a veteran in teaching the course, you undoubtedly have some experience in what works for you and which pieces of the overall text package are most intriguing. But if you are wrestling with teaching the course for the first time or are looking for new ways to design your course, you may find some of the following thoughts and suggestions helpful in selecting a comfortable, suitable approach.

**Deciding on an Appropriate Workload**

The “standard” senior-level and MBA course in strategic management these days seems to involve:

1. Covering all or most of the text chapters.

2. Discussing a subset of the cases in the text—somewhere between 8 and 15.

3. Assigning one or more written cases and/or an oral team presentation.

4. Use of a strategy simulation. (We believe over two-thirds of strategy courses in the U.S. these days entail having students play a simulation game—and the percentage seems to be growing both domestically and internationally. The rapidity with which the standard pedagogy of strategy courses has changed from a two-pronged approach of relying on text chapters and cases to drive home the lessons of crafting and executing strategy to a three-pronged standard of relying on text chapters, cases, and a simulation exercise is powerful testimony to the effectiveness of simulations. In the early 1990s, we believe fewer than 25% of the senior-level and MBA courses in strategy incorporated use of a simulation.)

5. Having one or more in-class examinations over the text chapters.

These combine to make a full course, with plenty of topics to cover and ample assignments to keep students busy.

So why add more? Should use of the online chapter self-tests (described in Section 1) be voluntary or mandatory? Should you assign certain of the chapter-end Assurance of Learning Exercises in lieu of one or two cases? We think it is difficult to argue against students completing the online chapter self-tests prior to taking an exam on chapter material. Also, we have tried to design chapter-end exercises that are attractive vehicles for class discussion or student reports used for assessment purposes. It is really a matter of personal preference and departmental assessment plans whether chapter-end exercises are used to any extent or skipped to concentrate further on case analysis. Of course, the 26 case studies included in the text may be used as well to satisfy college assessment requirements.

We would value your comments on the usefulness of the online chapter tests and the two types of chapter-end exercises. Are they useful? What would make them better?
Why Incorporating a Strategy Simulation Makes Sense

Insofar as use of a simulation is concerned, we believe—based on our own experiences and the mushrooming use of simulations in strategy courses worldwide—that incorporating a simulation as a course centerpiece adds major value. As was discussed at some length in Section 2 of this IM, a strategy simulation steps up the tempo of the course a notch, emotionally involves students in the subject matter, and gives them much-needed practice in (a) applying what they have read in the 12 chapters and (b) making sound business decisions and being held accountable for the results they produce.

*Competition-based strategy simulation games give students every bit as much valuable practice as do cases in thinking strategically, diagnosing market and competitive circumstances, appraising a company’s competitiveness and financial performance, and coming up with concrete actions to improve a company’s market position and performance. What a simulation does that a case cannot is give students immediate and incontrovertible feedback of the caliber of their decisions to improve a company’s performance—in light of competitive circumstances and the company’s product offering, costs, and other situational circumstances. Since in the course of playing a simulation, students have to live with the financial results of their decisions, simulations are powerful devices for teaching students the importance of responsible, results-oriented decision-making. In contrast, in analyzing cases and making action recommendations for the company being studied, there little way to provide students with credible feedback on their caliber of their action recommendations/decisions beyond that of telling them what’s happened at the company since the case was written. We think this is why professors of strategy at many business schools have concluded that supplementing coverage of the text chapters with use of both cases and a strategy simulation is more pedagogically powerful than just relying on traditional case assignments alone.*

You can be fairly confident that if you incorporate use of GLO-BUS or The Business Strategy Game the challenges and excitement of a competition-based strategy simulation will get most students’ competitive juices flowing and make their task of learning about crafting and executing winning strategies more enjoyable. Most students find the “learn by doing” nature of a simulation more engaging. They become more emotionally and personally involved in the subject matter because they are active participants, along with their co-managers, in crafting and executing strategy for a company in which they have a stake—the decisions they make and the results these decisions produce affect their grade! Their company becomes “real” to students and takes on a life of its own as the simulation unfolds—and it doesn’t take long for students to establish a healthy rivalry with other companies run by their class members that they must compete with head-on in the marketplace. Because the competition in the simulation typically gets very personal, most students become immersed in what’s going on in their industry—as compared to the more impersonal engagement that occurs when they are assigned a case to analyze.

While incorporating the simulation will consume part of a class period to get things under way, the actual playing of the game is an out-of-class group exercise done mostly sitting around a personal computer (company team members will need to spend 1½ to 2½ hours preparing each decision, usually more for the first couple of decisions until students gain command of the software and the procedures).

Use of either GLO-BUS or The Business Strategy Game is likely to add net time to the course requirements from a student perspective. To adjust for these time requirements, you may want to have the simulation substitute for a written case assignment or a couple of class discussions of cases or an hour exam or some combination of these.

Again, should you decide to incorporate one of the two simulations in your course, the simplest (and usually the cheapest) way for students to obtain the simulation is via a secured credit card transaction at www.bsg-online.com (if you opt to use The Business Strategy Game) or at www.glo-bus.com (if you opt to use GLO-BUS). Purchasing the simulation direct at the simulation web site allows students to bypass paying sometimes hefty bookstore markups (a savings that can amount to $10-$15). The second way for students to register for the simulation is by using a pre-paid access code that comes bundled with the 17th Edition when you order the combination text-simulation package through your bookstore—this requires use of a separate ISBN (the 16th Edition bundled with either simulation has a different ISBN number than just the 16th Edition ordered alone). Your McGraw-Hill rep can provide you with the correct ISBN for ordering the text-simulation package.
Suggestions for Using the Automatically-Graded Chapter Quizzes

As indicated earlier, there is a 20-question self-scoring quiz for each of the 12 text chapters posted in the “Student Edition” section of the website for the text (www.mhhe.com/thompson). For students to realize the maximum benefit from the online chapter self-tests and for you to see the difference in their command of the core concepts and ability to use the analytical tools to analyze assigned cases, we recommend that you strongly encourage students to work through the online chapter tests immediately after reading each chapter (rather than waiting until just before the hour exam over the chapters). If you wish, you can have students e-mail you the results of their test scores—as a way of checking whether they took the test and monitoring how well they scored. The sample course syllabi and the 11 sample schedules of assignments and activities in Section 4 of this IM provide more details on how you can make use of the self-scoring chapter tests at the publisher’s web site for the text.

Suggestions for Examinations over the 12 Text Chapters

We suggest having two exams covering the text material and perhaps having a comprehensive final (although our preference is to use a comprehensive case as a final exam as opposed to a comprehensive final covering the 12 chapters). If you opt for two exams, we recommend that the first one cover Chapters 1-7 and that the second one cover Chapters 8-12. If the number of class periods is too short for two exams, a single exam covering all 12 chapters is the next best option—it can be given at the end of the course or shortly after your lectures on all the assigned chapters.

We prefer giving a test on the assigned chapters immediately following the conclusion of the lectures and before covering most of the related cases so that you can be assured that students have sufficient acquaintance with the tools and concepts to apply them in the course of preparing and discussing the cases. The sample course outlines in Section 4 indicate possible locations in the class schedule where exams on the chapters fit in.

There’s a test bank of 1200+ multiple choice and short-answer/essay questions you can choose from in making out exams. The full test bank is in both this volume of the IM and the Instructor’s Resource CD. There’s also EZ Test companion software whereby you can use the same test bank questions to quickly setup an online exam or print out a test master. —just ask your McGraw-Hill rep for the Instructor Resource CD and all the related instructor materials.

Suggested Weights in Determining Final Grades in the Course

If you are a veteran in teaching strategy, then you have no doubt arrived at a scheme for weighting all the various assignments in determining each student’s final grade in the course. And the scheme necessarily varies with the number of written case assignments, the number of hour exams, whether you are using a simulation, the weight you put on class participation, and whether you have students do oral team presentations.

In the table below, we offer some suggestions for weighting various possible assignments:

<table>
<thead>
<tr>
<th>Assignment/Activity</th>
<th>Option 1</th>
<th>Option 2</th>
<th>Option 3</th>
<th>Option 4</th>
<th>Option 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exam over Chapters 1-7</td>
<td>10%</td>
<td>10.0%</td>
<td>15%</td>
<td>12.5%</td>
<td>---</td>
</tr>
<tr>
<td>Exam over Chapters 8-12</td>
<td>10%</td>
<td>10.0%</td>
<td>15%</td>
<td>12.5%</td>
<td>---</td>
</tr>
<tr>
<td>Written Case Report #1</td>
<td>15%</td>
<td>12.5%</td>
<td>15%</td>
<td>12.5%</td>
<td>20%</td>
</tr>
<tr>
<td>Written Case Report #2</td>
<td>---</td>
<td>12.5%</td>
<td>15%</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>Oral Team Presentation</td>
<td>15%</td>
<td>15.0%</td>
<td>15%</td>
<td>---</td>
<td>20%</td>
</tr>
<tr>
<td>Company Performance on Simulation Exercise</td>
<td>35%</td>
<td>25.0%</td>
<td>---</td>
<td>30.0%</td>
<td>25%</td>
</tr>
<tr>
<td>Participation in Class Discussion of Assigned Cases</td>
<td>15%</td>
<td>15.0%</td>
<td>10%</td>
<td>15.0%</td>
<td>15%</td>
</tr>
<tr>
<td>In-class Written Case for Final Exam (2½ - 4 hours)</td>
<td>---</td>
<td>---</td>
<td>15%</td>
<td>17.5%</td>
<td>---</td>
</tr>
<tr>
<td>Final Exam over All 12 Chapters</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>20%</td>
</tr>
<tr>
<td>Total</td>
<td>100%</td>
<td>100.0%</td>
<td>100%</td>
<td>100.0%</td>
<td>100%</td>
</tr>
</tbody>
</table>
Tips and Suggestions for Effectively Incorporating Either The Business Strategy Game or GLO-BUS in Your Course

Both *The Business Strategy Game* and *GLO-BUS* are suitable for either senior-level or MBA-level courses. Which to use is really a matter of preference and the degree to which the faculty believe that there should be a clear distinction between the content and rigor of a senior-level course in strategy and the MBA-level course in strategy:

- **If you want students to spend an average of only between 1-2 hours per decision,** then we believe *GLO-BUS* is the best choice. If you want the simulation to be a truly major part of the course and serve as the main assignment for the class beyond the text chapters, then *The Business Strategy Game* is perhaps the better choice—especially for a MBA class—because it has more robust production and distribution operations and allows students to formulate somewhat more complex strategies. Both simulations have a 3-year strategic plan module (which can be made a requirement or left optional or ignored altogether).

- **If school policy is to maintain a clear-cut distinction between the content and rigor of the senior-level course and the MBA-level course then it probably makes sense to use GLO-BUS in one course (probably the senior-level course) and BSG in the other course (the MBA course).**

- **If many of your school’s undergraduate students also go on to be part of your school’s MBA program (thus making it desirable to provide them with a differentiated simulation experience in the two courses),** then it probably makes sense to use *GLO-BUS* in one course (again probably the senior-level course) and *BSG* in the other course (again the MBA course).

However, adopters have used both *GLO-BUS* and *The Business Strategy Game* for senior and MBA courses—with apparent success at both levels. We firmly believe you can have a successful experience with either simulation in either senior or MBA courses.

**What Decision Schedule to Use.** We suggest that you consider one of the three following types of decision schedules:

- **One decision weekly throughout the term (with a total of 1 or 2 practice decisions and 7-10 regular decisions).** This decision schedule makes the simulation a standard part of the course load and spreads the work load of the simulation evenly across the whole term. This is the schedule we have used at The University of Alabama for over 30 years.

- **Two decisions weekly the last 4-5 weeks of the term (with a total of 1 or 2 practice decisions and 8 regular decisions).** The advantage of this schedule is that students will have covered a number of the chapters (ideally through Chapter 7), be familiar with many of the concepts, analytical tools, and competitive strategy options, and have had some experience in analyzing some cases. Somewhere near mid-term of the course, it can thus be assumed that students have a fairly solid foundation for beginning an exercise which will give them opportunity to use and apply all that they have learned and will learn in the course.

- **Daily decisions the last two weeks of the term (which is an ideal schedule for concluding the course and perhaps using the simulation as a final exam for the course).** A variation of this schedule is to have decisions twice daily for the last week of the term. However, you should always have at least a 3-hour interval between decision to give students ample time to review the industry and company reports and develop their strategy and decisions for the next year.

In setting up a decision schedule for the simulation at the Web site, you will also need to decide whether to require completion of Quiz 1 and Quiz 2, what deadlines to establish for completion of the quizzes (very highly recommended), whether to require completion of one or two strategic plans (at least one is highly recommended), what deadlines to establish for completion of any strategic plans you require, and whether to require completion of the peer evaluation (very highly recommended).

However, you have complete freedom to set up any decision schedule that you wish—and further to change the decision schedule at any time for any reason.
Section 3  Organizing Your Course, Deciding What the Workload Should Be, and Settling on Specific Assignments

How Much Should the Simulation Count in the Course Grade? Whether students take the simulation exercise seriously hinges in large part on whether you make performance on the simulation count enough in the overall course grade to get their attention. As a general rule, we recommend having performance on the simulation count at least 20% of the overall course grade and probably no more than 40% of the total grade. If it counts less than 20%, then student effort is weakened to an undesirable extent and some of the learning potential slips through the cracks. If it counts more than 40%, then the game may take something away from the emphasis you want to give to other aspects of the course.

However, we have growing numbers of users who are making the simulation the dominant centerpiece of the course (particularly in online and distance learning courses where case analysis is difficult to use effectively). When BSG functions as the primary part of the course (aside from the text chapters), then counting the simulation as 50-60% (or more) of the final grade is reasonable, given that you can use the quizzes, one or two 3-year strategic plan assignments, and perhaps an end-of-simulation presentation to an invited panel of 3 or 4 persons (who act as a company board of directors) as a substitute for assigning students a larger number of cases to analyze.

A related grading issue is how much each of the various assignments within The Business Strategy Game should be weighted. You have full control over these weights and can change them at your pleasure by entering different weights at the top of the columns of your online “Individual Grade Book.” A table of suggested weights is presented below:

<table>
<thead>
<tr>
<th>Performance Measures</th>
<th>Option 1</th>
<th>Option 2</th>
<th>Option 3</th>
<th>Option 4</th>
<th>Option 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall company performance on the 5 scoring measures</td>
<td>85.0%</td>
<td>80.0%</td>
<td>75.0%</td>
<td>75.0%</td>
<td>70.0%</td>
</tr>
<tr>
<td>Quiz 1 (which is relatively easy and only tests whether they have read the Participant’s Guide)</td>
<td>2.5%</td>
<td>3.0%</td>
<td>2.5%</td>
<td>2.5%</td>
<td>2.5%</td>
</tr>
<tr>
<td>Quiz 2 (harder questions covering important elements of the simulation and testing understanding of the numbers)</td>
<td>7.5%</td>
<td>7.0%</td>
<td>4.0%</td>
<td>5.0%</td>
<td>5.0%</td>
</tr>
<tr>
<td>Performance on strategic plan #1</td>
<td>N.R.</td>
<td>5.0%</td>
<td>3.5%</td>
<td>2.5%</td>
<td>2.5%</td>
</tr>
<tr>
<td>Performance on strategic plan #2</td>
<td>N.R.</td>
<td>N.R.</td>
<td>N.R.</td>
<td>5.0%</td>
<td>5.0%</td>
</tr>
<tr>
<td>Company presentation</td>
<td>N.R.</td>
<td>N.R.</td>
<td>10.0%</td>
<td>5.0%</td>
<td>7.5%</td>
</tr>
<tr>
<td>Peer evaluations done by co-managers</td>
<td>5.0%</td>
<td>5.0%</td>
<td>5.0%</td>
<td>5.0%</td>
<td>7.5%</td>
</tr>
<tr>
<td></td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

N.R. = not a required assignment

We suggest caution in placing less than a 70% weight on overall company performance, since lower weights weaken student incentive to be diligent in making decisions, doing the requisite analysis and strategic thinking, and going all out to try to boost their company’s performance.

We believe it makes sense to place a significantly higher weight on Quiz 2 as opposed to Quiz 1, because Quiz 2 is harder and tests individual understanding of important topics.

We also think it is best to weight a second strategic plan higher than the first plan because (1) students are more knowledgeable about how to do a good plan the second time around, (2) they have more experience in appraising the impact of changing market conditions, and (3) they should now be seasoned veterans in setting performance targets and trying to meet or beat them.
Using the “Exercises for Simulation Participants” at the End of Each Chapter. One of the biggest teaching/learning benefits of using a strategy simulation like BSG or GLO-BUS in your course is the array of opportunities it presents for class members to immediately utilize the concepts and analytical tools covered in the text chapters in running their simulation company. There are extensive and tight ties between the issues/challenges that company co-managers face in running their company and the content of the 12 chapters in the 17th Edition.

To provide a powerful means for you to tie the chapter content to the simulation exercise, we created a set of “Exercises for Simulation Participants” that appear at the end of each chapter. You can use these exercises to accomplish three things:

1. Prod class members in their role as company co-managers to do some quality strategic thinking about their company’s situation and the industry circumstances in which their company is operating.

2. Point each company’s management team directly to ways of using specific concepts and tools of strategic analysis to improve their decision-making and to improve their company’s performance.

3. Speed the process whereby your students bridge the gap between theory and practice—the faster and more completely that class members come to recognize the practical managerial value of strategic concepts and analytical tools covered in the text chapters the better.

It is, of course, entirely optional whether to make extensive or selective use of these exercises (or ignore them altogether). In our strategic management classes, we have found the exercises to be particularly productive in steering class members to do a more insightful job of assessing industry and competitive conditions, evaluating their company’s competitiveness, and otherwise being wiser and more analytical in managing their simulation company. We recommend that you give serious consideration to using at least some of these exercises because they will stimulate the thinking and analysis of company-co-managers in a very positive way and because they will “force” company co-managers to wrestle with things that should contribute to better decision-making and company performance.

Some of the questions/exercises can be posed to the class as a whole for open discussion and debate (perhaps as vehicles for concluding your lectures on the chapter material). But a substantial number of the exercises are best used for written assignments because the answers involve competitively sensitive analysis and thinking that company co-managers will not want to share with other class members who are managing rival companies. As a general rule, class members should be asked to prepare their answers to the italicized questions on a team basis rather than individually; having company co-managers collaborate in preparing their answers is an effective means of building consensus among company co-managers.

Other “Getting Started” Considerations. Enumerated below are our recommendations concerning the team size, number of companies, number of decisions, use of quizzes, use of the 3-year strategic plan feature, scoring, and peer evaluation requirements—all of which are specified as part of the “industry start-up” process and specifying a decision schedule:

1. **Try to assign teams of 2, 3, or 4 co-managers per company.** Two- or 3-person teams are optimum in an MBA class; 3-person teams are probably the optimum size in an undergraduate class, with 4-person teams being a very acceptable second option. The pros and cons of various team sizes are discussed at length in Section 2 of this manual.

The software for both simulations is programmed for a maximum of 12 companies in a single industry. If your class size is above 36 and thus too big to have 12 companies with 3 co-managers each, we suggest that you consider dividing the class into 2 industries so as to keep from having a large number of 4-5 person teams. With automated processing, it is really no bigger administrative burden to set up your class with 2 or more industries than it is to have the whole class in a single industry.
If you have other group activities in your class, then you should consider having students play the simulation in the same group, as long as the size of the group is 5 or fewer persons. If your other group activity involves group sizes of 6 or larger then you can divide each into two teams for the purpose of playing the simulation.

If some teams end up with only two co-managers because one or more of their co-managers drop the course, then we suggest giving the two-person team to option to continue on their own—particularly if the simulation is well underway and the co-managers are working well together. However, there are options in both simulations to switch company managers to different teams and eliminate a company from the industry, whenever you determine that is a good option.

2. **Avoid having fewer the four companies per industry if at all possible.** If you have a small class, we recommend having no fewer than 4 company teams—two-person teams for a 4-company industry will work better than fewer companies and more players per team.

3. **Select a decision schedule that is a good fit with other class assignments.** As indicated earlier, any of three decision schedules can be employed successfully. The simulations are programmed for a maximum of 2 practice decisions and 10 regular decisions.

4. **Schedule at least one, preferably two, practice decisions.** We urge scheduling 2 practice decisions (if at all possible) and 1 practice decision for sure. Practice decisions give students a chance to get comfortable with the software and to conduct “risk-free experiments” in trying out certain strategies and options. Two practice decisions are plenty to prepare your class for “the real thing,” and students can definitely do well with just 1 practice decision if the time you have to allocate to the simulation is constrained.

5. **Try to build a minimum of 6 regular decisions into your decision schedule.** This will give players some time to put a strategy in place, tweak it (or make wholesale changes), and operate the company for the “long-run.” However, 8 to 10 regular decisions is significantly better in terms of giving players enough time to really see what they can do with their company and to experience the full effects of having to adjust their strategies to changing market and competitive conditions.

6. **Consider using the default 20% weighting on each of the performance measures.** There are 5 scoring variables: earnings per share, return on stockholders’ equity (ROE), stock price appreciation, credit rating, and corporate/brand image. While we believe a 20% weight for each of the five variables works exceptionally well, you have complete freedom to set whatever weights you prefer, including assigning a 0% weight to one or more measures and eliminating them from the scoring algorithm. If you strongly believe that some of the 5 variables should carry a higher weight, then our advice is to up them to 25%-30% and cut others back to 10%-15%.

7. **Utilize both scoring standards in determining the company performance scores.** GLO-BUS and The Business Strategy Game employ two standards in scoring company performance: the “Investor Expectations” Standard and the “Best-in-Industry” Standard (these are explained in Section 2 of this manual). We suggest using the default 50%-50% weighting on these two standards in designating how the company performance scores should be weighted, but you can change the weights if you wish. (Other alternatives include 67%-33% or 33%-67% or 75%-25% or 25%-75%.) Of course, if you want to use just one of the standards, you can place a weight of 100% on that standard and a 0% weight on the other one. The IM for the two simulations contains a full explanation of the scoring standards and provides instructions for changing the default weights.

8. **Make full use of the two built-in quizzes.** We strongly urge requiring students to complete the quizzes and then counting their scores on these quizzes as part of the final simulation grade. We developed these quizzes to provide you with feedback on each individual participant’s grasp of the simulation. Both quizzes are open-book, and really are aimed at pushing students to learn what is going on rather than “testing” them.

We suggest putting a 5% weight on Quiz 1 and a 7.5% weight on Quiz 2 in having the software calculate overall performance scores for each participant. Keep in mind that both quizzes are, in effect, “open book.”
Quiz 1, which covers the Player’s Guide, is relatively easy since students the open-book nature of the quiz allows students to look up the answers they don’t know right off. Students can easily score 80 or higher on Quiz 1 if they have read the Guide and refer to it during the course of taking the quiz. Grades of 90 and higher on Quiz 1 should be common. Students who score poorly on Quiz 1 (below 75) simply have not put enough effort into reading the Guide and understanding what the simulation is all about. We urge setting the deadline for this quiz to correspond to the deadline for the first practice decision so as to spur students to read and understand the Participant’s Guide at an early stage in the simulation exercise.

Quiz 2 is more difficult than Quiz 1 and merits a higher percentage in the grade calculation. Quiz 2 consists mostly of questions that require students to make calculations or otherwise indicate their command of where the numbers in the company reports come from—it has a time limit of 90 minutes (versus 45 minutes for Quiz 1). All of the quiz questions tell the students on which Help/More Info screens the answers can be found; all of the formulas for calculating the various financial ratios are contained on the Financial Ratios summary link on each student’s Corporate Lobby screen (6-8 of the questions on Quiz 2 involve financial calculations). So students can make a pretty decent score (80 or higher) on Quiz 2 by using printouts of the Help/More Info screens to help them determine the correct answers for the 20 multiple choice question comprising Quiz 2.

We strongly suggest setting the deadline for completing Quiz 2 to correspond to the deadline for the decision for Years 9 or 10 for GLO-BUS and Years 13 or 14 for BSG. By this point in either simulation, we think students ought to have a good grasp of what is going on, what the numbers in the company reports mean, and how they are calculated.

9. Give strong consideration to having students do at least one 3-year strategic plan during the course of the exercise. Both simulations have an optional 3-year strategic plan module. The 3-year strategic plan feature calls for students to (1) articulate a strategic vision for their company (in a couple of sentences), (2) set performance targets for EPS, ROE, stock price appreciation, credit rating, and image rating for each of the next three years, (3) state the competitive strategy the company will pursue, (4) cite data showing that the chosen strategy is either currently on track or will require substantial internal changes, and (5) develop a projected income statement covering the next three years.

Each company’s strategic plan is automatically graded based on the extent to which the company meets or beats its performance targets (this is explained at greater length in Section 2 of this manual). The grade on the strategic plan is automatically recorded in your online grade book and can be used in calculating a final simulation score for each company.

For more details, see Section 2 above or the Instructor’s Guides for the simulations.

10. At the end of the simulation, we strongly urge that your decision schedule include a requirement that students do peer evaluations of their co-managers and also do a self-evaluation (using the same form). Peer evaluations provide very valuable information about how well a company’s management team functioned from the perspective of the co-managers—attendance at meeting, teamwork, contribution of ideas and suggestion, leadership, and so on. The responses to the peer evaluation are automatically scored and recorded in your online grade book. Your have the ability to click on any of the peer evaluation scores for any co-manager and review the entire peer evaluation. When students know that you will review the peer evaluations (only the low scores really need to be inspected individually), then you have a powerful tool for exposing “free riders” and students who have not carried their fair share of the workload. We suggest having the deadline for completing the peer evaluations correspond to the deadline for the last decision but you can set a later deadline if you wish—while students can review the content of the peer evaluation at any time, students are not allowed to complete the peer evaluation until the deadline approaches.

Generally, a big percentage of company co-managers will earn scores of 85 or better on the peer evaluations, signifying that their “effort index” and participation has been quite satisfactory to even superb (in the case of scores in the high-90s. Scores below 80 should usually raise a red flag and merit inspection to see discover the causes of the low ratings.
We urge that you make it clear to the class that the peer evaluations are “confidential” reports to be seen only by you and that you will exercise your judgment as to just how much they will count in assigning grades on the simulation. Making the “threat” of a bad peer evaluation a part of the simulation grade helps reduce the likelihood that weak students will slack off on their effort and let their co-managers assume full responsibility for company operations and thus make the bulk of their grade for them. In our classes, we tend to reduce the grades of participants who receive very low peer evaluations (sometimes by a full letter grade or more), since we believe it is inherently unfair and unethical for low contributors or absentee co-managers to receive a grade that their co-managers agree they really did not earn or deserve. But, obviously, you have to use discretion and judgment in how to treat peer evaluations—one can’t always be entirely sure that students are “telling the truth” on the evaluations or that their judgments are completely honest and fair. Many times, of course, students “overrate” the performance and contributions of their colleagues, so don’t be surprised if some of the peer evaluation scores are higher than they probably should be. The potential for the peer evaluations scores to be less than trustworthy in the case of some students is one reason why you may not want to include them in the grade calculations; certainly, if you tell students that the peer evaluations have some percentage weight, then the chances that co-managers will strike an agreement to give each other highly positive evaluations are substantially enhanced. That is why in our classes, we are deliberately vague about what we do with the evaluations, except to say we will definitely look them over and that everyone is expected to complete them in a professional and honest manner.

**Forming the Company Management Teams for the Simulation.** We have two approaches to offer for your consideration in assigning students to co-manage the companies. One is to let those students who want to form their own management teams do so and then assign the remaining students to companies on the basis of major (we always form teams with students of different majors, to the extent possible). This procedure seems to satisfy all concerned. Some students always prefer to choose their own teammates — so they are pleased with the two-option procedure. And those students who, for whatever reason, prefer “the luck of the draw” are nearly always pleased with the impartiality of teaming up people with different majors.

The second approach is to assign all students to teams, trying to diversify teams on the basis of both major and cultural diversity. **Assigning people to teams has the highly desirable advantage of establishing a business relationship between the team members rather than allowing teams to be formed on the basis of prior friendship or common major or prearranged liaisons with a known-to-be-bright student.** Business relationships among students with differing majors and cultural backgrounds has, in our experience over the years, often proven to be the superior basis for team formation compared to the practice of giving students the freedom to form teams based on whatever criteria they choose to use. But, on the other hand, we’ve found the first approach tends to be most popular with students.

**Tips on Conducting the Simulation.** Once the team sizes and decision schedule have been decided and the simulation has been launched, you may want to consider the following:

- Use the PowerPoint slides that we have created (see the link in the Instructor Center) to introduce the simulation to your class and explain some of the mechanics.

- Urge students to read the list of recommended decision procedures that is provided on the link on their company’s “Corporate Lobby” page. This list provides students with a useful guide in using all the available industry and company reports and a suggested routine for preparing each year’s decisions.

- Emphasize to the class that it is wise to be very wary of trying something that is imprudent or highly risky or un-businesslike (things that would get a manager fired in a real company). In our experience, overzealous students who resort to trying to “game the system” almost always shoot themselves in the foot. They’ll get more out of participating in a simulation when they take on the role of a business professional who is trying to achieve the best possible company performance using managerially prudent and responsible business approaches. Little of value will come from students approaching the simulation exercise like a daring adventurer out to win some variant of a videogame by testing the limits...
of the simulation and using whatever un-businesslike and unprofessional means they can get by with. When class members know you will hold them accountable for bad or foolish decisions, they are less likely to be a “loose cannon” in running their companies and will take things more seriously.

- As previously discussed, use the “Exercises for Simulation Participants” that appear at the end of each chapter in the 17th Edition (and that can also be accessed via a link in your Instructor Center for the simulation) to help connect issues/challenges that company co-managers face in running their company to the content of the 12 chapters. Some of these exercises are suitable for open class discussion (immediately during or following your lectures on the chapters) and some are best used for team assignments, with the answers provided confidentially to the instructor in a brief report (because the answers involve competitively sensitive analysis and thinking on the part of each company team that they will definitely not want to share with class members managing rival companies).

- Stress that at the end of the simulation, all company managers will be asked to complete comprehensive peer evaluations of their co-managers, as well as an evaluation of their own performance. (Students can see the content of the 12-question peer evaluation form by clicking on the Peer Evaluations link in their “Corporate Lobby” but they are not given access to completing the form until the deadline for the next-to-last decision has passed. Hence, it is no secret what they will be rated on.) Peer evaluations will have the effect of greatly reducing “free-riding” or “coasting on the coattails” of more industrious co-managers if you emphasize to the class early on that the results of the peer evaluations will be taken seriously and that poor evaluations and absences from team meetings will negatively impact an individual’s grade on the simulation.

In the event that you want to do an “interim” or “mid-course” peer evaluation after the first 3-5 decisions as a check on how well things are going, you can ask students to print out a copy of the peer evaluation form, fill it in, and submit it to you. Alternatively, you can print out a blank peer evaluation form, make copies, and pass them out in class. You’ll find it pretty simple to skim through the evaluations to spot any problems with low performers. It is generally wise to call them in for a consultation and counsel them on the importance of being a fully-participating contributor. Usually, this will suffice to alter their behavior and jack up their participation and contribution.

- Instructors that want to take a more hands-on approach to administering the simulation may find it worthwhile to spend about 10 minutes of class time “debriefing” industry members on particularly interesting outcomes and results, to comment on what you see happening in the industry, to urge them to make note of the wide differences in company costs that you see in the benchmarking data, and to connect events in the simulation to your lectures on the chapters or to similar situations in some of the assigned cases you’ve discussed. You can hold these debriefings on a regular basis (following each round of decisions and results) or just hold them occasionally when there’s something of significance you want to talk about. You’ll find information for these debriefings in the Industry reports and in the special Administrative Reports that you can view or print out after each decision. Most of the information in the Administrative Report is not provided to players and you’ll find it to be a quick and convenience source of which companies are doing what and which companies have operating costs that are out-of-line and in need of attention.

- Don’t be overly concerned if one or more company teams do poorly on the first one or even two decisions—and you should definitely convey to teams that might be distressed with their initial results that is absolutely possible to turn things around and come out as a market leader by the end of the simulation. Sometimes it just takes a while for a company’s strategy to begin to bear fruit or the chemistry on the team to jell; sometimes, the initial strategy is ill-conceived or is thwarted by the strategies of rival firms and thus has to be adjusted. In our experience, the companies that are the leaders after the first one or two decisions seldom end up on top. Just as who is ahead after one or two innings of a 9-inning baseball game may not end up winning the ball game, so also is it in a competition-based simulation.

Naturally, of course, the co-managers of companies who fare poorly will be concerned and should be counseled to review their strategy and decisions for ways to improve. You should tell concerned co-managers of low-performing companies that much of the information provided in the various reports is
“diagnostic” (particularly the Competitive Intelligence Reports) and points directly to things that are in need of attention. In our experience, there are two primary reasons why companies perform poorly:

- Company co-managers have a poor grasp of the contents of the Player’s Guide and/or have not spent time reading the Help screens (which provide substantial guidance in how to approach strategizing and decision-making.

- Company co-managers are not paying nearly enough attention to studying and digging the information in all the reports and diagnosing their company’s situation. When they are directed to really probe this information and use it, then their company usually begins to perform better. You’ll find there is plenty of information provided in the reports for students to identify “what went wrong”, where their costs are out-of-line with rivals, and what they should do to boost sales and market share.

Company managers who conscientiously look at the numbers will have little trouble spotting avenues for improving their company’s performance—each page of the Competitive Intelligence Reports provides a list of competitive strengths and competitive weaknesses in each of the four geographic regions. Determine if company co-managers have grasped the significance of the information in the Competitive Intelligence Reports and really dug into the numbers—if not, this is the root of their problem. Urge that they pay very special attention to the numbers in these reports, read the Help screens for these reports, and take actions to remedy their company’s competitive weaknesses.

Sometimes, bad results turn out to be a positive catalyst for co-managers, causing them to really buckle down, dig into the numbers, and get serious about the effort they are putting into the simulation. Students can learn every bit as much from their mistakes and from efforts to turn their company around as from enjoying success decision round after decision round.

As a general rule, we think that companies with an overall performance score of 90 or above should get an A. Companies with an overall performance score of 80-89 should get a B (or better if there are no companies with scores of 90 or more). Companies with an overall performance score of 70-79 above should get a C (or better depending on how many teams have higher scores). You may find it desirable to scale the scores if competition turns out to be so fierce or cutthroat that companies in the industry can’t earn good profits and meet investors’ performance expectations. In most of our classes, we end up scaling the performance scores of companies with scores below 70-75, but it is rare for no company to end up with a score above 90 and thus clearly earn an A without the need for putting much of a scale on the grades on the upper end.

Bear in mind that the scoring method we use does not in any way require that some companies receive low scores. Scores are based entirely on (1) whether companies achieve the benchmark performances that investors expect for EPS, ROE, credit rating, stock price appreciation, and image and (2) whether the race to be the market leader is very close from the first place company to the last place company or whether there is quite a wide disparity in the caliber of performances (with the bottom-performing companies turning in truly bad results). If one or more companies have truly low performance scores relative to the other companies, we leave it up to you to decide what sort of scale to apply and thus how much to raise their grade. You’ll find that there’s plenty of information provided to you in your online electronic grade book to decide what grades to assign. You can either use the ones calculated for you (based on the weights you have specified, which can be changed whenever you wish by merely inputting different weights) or else scale the overall performance scores to your liking.

Dealing with Disagreements among Co-Managers and “Non-Contributors.” As with any team assignment, situations will arise where a team member does not carry his or her share of the workload, causing other team members to complain or otherwise voice displeasure. We recommend handling this situation in several ways. Our first recommendation is always to urge the hard-working team members to have a heart-to-heart talk with the person who is slacking off; we also offer to talk with the low-contributing student if the other team members think that would be helpful. A second approach to dealing with complaints about weak contributors is to remind the low-contributing student (or the class as a whole) that there will be peer evaluations at the end of the course and that poor peer evaluations are likely to have an adverse and perhaps severe effect on the grade assigned. If an alleged low-performer’s contribution still does not improve, you may have to read them the riot
act, threaten to drop them from the simulation with a failing grade, or (if it seems appropriate or practical) you may consider assigning the low-performer to another team (with their consent).

On occasions, company co-managers get into such serious disagreements or have disruptive personality conflicts that it makes sense to move one or more team members to a different team. While moving a person from one company team to another should be done sparingly, it does give you a sometimes workable out for dealing with unusually severe problems among company co-managers.

Moving students to a different team is quickly accomplished if you are using either GLO-BUS or The Business Strategy Game; all you have to do is select the “Move/Delete Company Co-Managers” option on the Administrative Menu. But you should probably first consult the co-managers of the company to which you want to move the person and secure their approval to take on a new member.

The Business Strategy Game also has an “Add a Company” menu feature. This option (which is available if you have less than the maximum 12 teams in an industry) allows you to assign disgruntled or low performers as co-managers to run a newly created company as they see fit. This may, indeed, be the best solution for all concerned.

Suggestions for Using Outside Readings

It is very much in order, especially in an MBA course, to ask students to do a modest amount of reading in the current literature to supplement and elaborate upon the points made in the text and, in addition, to provide them with some exposure to the literature of strategic management. Instructors who like to expand the scope and depth of their course with a sampling of journal articles and readings from the strategic management literature should take a look at the list of 20 readings that we have included in the 17th edition of Crafting and Executing Strategy: Text and Readings.

We do not recommend the use of outside readings in the senior-level strategy course (except, perhaps, in an “honors” section)—there is simply too much else to cover that merits higher priority.

In addition to formally assigned readings, we urge our students to get into the habit of regularly reading Business Week, Fortune, Forbes, The Wall Street Journal, and the Harvard Business Review—and to do so not only while they are taking our strategic management course but also after they graduate. A regular perusal of these periodicals is part and parcel of keeping abreast of business trends and new developments in professional management.

SUGGESTIONS FOR SEQUENCING CHAPTER COVERAGE AND CASE ASSIGNMENTS

In using Crafting and Executing Strategy: The Quest for Competitive Advantage, two basic sequencing approaches are possible:

(1) Spend the first several weeks covering the 12 chapters of text material (and outside readings, if any), then spend the remainder of the course on cases.

or

(2) Synthesize coverage of the text material, readings (if any), and the cases.

In our course we’ve done it both ways successfully but our strong preference is for the latter, so as to introduce some variety into the assignments from class period to class period. We have organized the text chapters and the cases to make it easy to integrate the sequencing. For example, the primary issues in the 17 cases in Section A—Crafting Strategy in Single Business Companies call upon students to make heavy use of the tools and concepts in Chapters 1 through 7. The 2 cases in Section B—Crafting Strategy in Diversified Companies require application of material in Chapter 8. The 5 cases in Section C—Executing Strategy deal mainly with the material covered in Chapters 10 through 12. The 2 ethics and social responsibility cases in Section D make a fitting companion to your coverage of Chapter 9.
Chapter 9 and the 2 ethics/social responsibility cases can form the basis for a “strategy-ethics-social responsibility” module that is taught (1) as a separate module following either the Section A cases or the Section B cases or (2) at the end of the course. Alternatively, the stand-alone nature of Chapter 9 allows you to position the coverage of strategy/ethics/social responsibility most anywhere you wish. However, since there’s substantial material on values and ethics in Chapter 12, as well as in Chapter 9 (and to a lesser extent in Chapter 1), there’s some merit in assigning the cases in Section D at the end of the course (or at least after all of the chapters have been covered.)

In Section 4 that follows, you find 11 various sample schedules of class activities that show recommended ways to sequence your coverage of the chapters and cases.

Making Use of the Videos Accompanying the Text Chapters

There is a set of videos that accompany the text chapters. The videos involve interviews with corporate executives, and the interview content pertains to topics covered in the chapters. You may wish to show some of the videos during the course of your lectures on the chapters. All of the videos are on a DVD that accompanies the Instructor Resource package—you can preview them at your leisure. Table 1 below provides you with some information on the chapter videos.

Table 1  List of Videos Accompanying the Chapters in the 17th Edition

<table>
<thead>
<tr>
<th>Chapter</th>
<th>Video Title</th>
<th>Person Interviewed on the Video</th>
<th>Video Length (in minutes)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Strategy Should Continuously Evolve</td>
<td>Stuart Grief, Textron</td>
<td>4:10</td>
</tr>
<tr>
<td>2</td>
<td>Be Clear What the Aim Is</td>
<td>Sir Gerry Robinson, Allied Domecq</td>
<td>3:36</td>
</tr>
<tr>
<td>3</td>
<td>You Can’t Predict the Future, But You Can Plan For It</td>
<td>Erroll Davis, Jr., Alliant Energy Corporation</td>
<td>5:25</td>
</tr>
<tr>
<td>4</td>
<td>Learn When To Say No To New Business Opportunities</td>
<td>Karen Kerrigan, Small Business &amp; Entrepreneurship Council</td>
<td>4:26</td>
</tr>
<tr>
<td>5</td>
<td>Smart Cost Reduction</td>
<td>Paul Skinner, Rio Tinto</td>
<td>5:09</td>
</tr>
<tr>
<td>6</td>
<td>Relationships, Not Partnerships</td>
<td>Phil Smith, Cisco Systems</td>
<td>4:18</td>
</tr>
<tr>
<td>7</td>
<td>Integrating Global Business at a Local Level</td>
<td>E. Neville Isdell, The Coca-Cola Company</td>
<td>3:10</td>
</tr>
<tr>
<td>8</td>
<td>Aligning Strategies Across Multiple Business Units</td>
<td>Stuart Grief, Textron</td>
<td>5:48</td>
</tr>
<tr>
<td>9</td>
<td>Beyond Business as Usual</td>
<td>Professor Lynda Gratton, London Business School</td>
<td>4:58</td>
</tr>
<tr>
<td>10</td>
<td>Strategy Doesn’t Compensate for Poor Execution</td>
<td>Ivan Seidenberg, Verizon</td>
<td>3:33</td>
</tr>
<tr>
<td>11</td>
<td>The Pitfalls of Individual Incentive Plans</td>
<td>Professor Edward Lawler, University of Southern California</td>
<td>4:22</td>
</tr>
<tr>
<td>12</td>
<td>Dealing with Opposition to Culture Change</td>
<td>John Roberts, United Utilities</td>
<td>2:25</td>
</tr>
</tbody>
</table>

Making Use of the Guide to Case Analysis

Generally speaking, before initiating discussion of the cases, you should encourage students to read the “Guide to Case Analysis” posted in the “Student Edition” section of the text Web site (www.mhhe.com/thompson). Having students read the Guide is especially important when many of the class members are not familiar with the case method and with how to prepare a case for class discussion or for written analysis. Most students need explicit direction in the mechanics of coming to class adequately prepared for class discussion of an assigned case—otherwise, they are likely to do no more than read the case and respond to your questions with off-the-cuff opinions. The hints and pointers in the Guide to Case Analysis should help students get off to a better start and orient them to the traditional analytical sequence of (1) identify, (2) evaluate, and (3) recommend.
In explaining how you plan to handle class discussion of the cases, you can easily highlight those points discussed in the Guide to Case Analysis which best reflect your own thinking and preferences. And you can do the same with regard to the suggestions for preparing a written case analysis and doing an oral team presentation.

**The Table of Financial Ratios.** *There is a summary table in both Chapter 4 (Table 4.1) and in the Guide to Case Analysis that presents and explains the array of standard financial ratios that come into play in sizing up a company’s financial situation.* We suggest calling this table to the attention of students so they can utilize it in analyzing the financial statements in the cases.

A big majority of students will likely make extensive use of the Financial Ratio table in calculating and properly interpreting financial and operating ratios appropriate for assigned cases.

**Doing Follow-Up Research on Companies That Are Featured in the Cases.** The Guide to Case Analysis contains a section on how to use the Internet and various online services to (1) do further research on an industry or company, (2) obtain a company’s latest financial results, and (3) get updates on what has happened since the case was written. This is an especially valuable section if you like for students, as part of an oral case presentation or written case assignment, to gather further information about what has transpired at the company since the case was researched.

Most company websites, especially those of companies whose shares are publicly-held, contain extensive financial information and often have pages relating to mission statements, core values, codes of ethics, strategy, and culture. It is very easy for students to research the latest developments at a company by perusing its press releases and by using Google or other search engines to locate the latest articles written about the company.

**How Many Cases to Assign**

How many cases to use varies with whether you use a simulation game, how much class time you wish to spend on the text chapters, whether you like to assign additional readings from either a readings supplement or from library resources, how many times your class meets per week, and whether the course runs for a quarter, a semester, or two quarters.

Generally speaking, we recommend covering 10 to 15 cases in a semester-long course meeting twice weekly (25 or so class meetings). In a one-quarter course you may find it more comfortable to cover only 6-10 cases in a class meeting twice weekly for 75 minutes.

Aside from the number and length of the class meetings each term, the “right” number of cases to try to cover is very much a function of your choices about using a simulation game and how much (if any) time you opt to spend on the simulation in class, how you decide to handle supplemental readings, the amount of class time you want to spend covering the basic concepts and analytical tools (the material in Chapters 1-12), and whether you decide to spend more than one class period covering one or two of the longer/issue-rich cases.

**Deciding How to Sequence the Case Assignments**

In selecting what sequence in which to assign the cases, we suggest at least a rough adherence to the order in which the cases appear in the book—particularly the first time you use the book. In sequencing the cases under each topic heading, we have tried to follow some logical order based on central teaching points, key issues, analytical complexity, and overall pedagogical purpose.

Our grouping of the cases into Sections A, B, C, and D implies, of course, that the central thrust of the case deals with the indicated topics. Although our groupings are accurate (we think!), it is also true that several of the cases involve a sufficiently broad cross-section of strategic management problems and issues that they are suitable for use at several different places in the course.

In Section 4 of this IM are 5 sample course schedules that provide specific suggestions for sequencing your case assignments over a 15-week term. Section 4 also provides 3 sample daily schedules for a 10-week term and
three sample daily class schedules for a 5-week summer. In addition, each case teaching note contains a section on “Suggestions for Using the Case” that provides further details and guidance on where a particular case fits and the central teaching points it contains. But to simplify things a bit in choosing the cases and sequencing that might work for you and to further supplement the Table 1 grid showing the strategic issues that are prominent in each case, we have provided some groupings below that you may find helpful.

Cases which make especially good lead-off cases for a Section A, B, C, or D set of case assignments and/or which are easier to analyze:

<table>
<thead>
<tr>
<th>Section A Lead-Off Cases</th>
<th>Section C Lead-Off Cases</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Whole Foods Market in 2008</td>
<td>• Robin Hood</td>
</tr>
<tr>
<td>• Costco Wholesale—Mission Business Model, Strategy (has accompanying video)</td>
<td>• Dilemma at Devil’s Den</td>
</tr>
<tr>
<td>• JetBlue Airways (has accompanying video)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Section B Lead-Off Cases</th>
<th>Section D Lead-Off Cases</th>
</tr>
</thead>
<tbody>
<tr>
<td>• PepsiCo’s Diversification Strategy in 2008</td>
<td>• E &amp; J Gallo</td>
</tr>
</tbody>
</table>

Cases which are good follow-ons to “lead-off” cases, highly suitable for the first-half of a Section A, B, C, or D set of case assignments, and only moderately difficult for students to analyze:

<table>
<thead>
<tr>
<th>Section A Follow-On Cases</th>
<th>Section B Follow-On Cases</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Competition in the Golf Equipment Industry in 2008</td>
<td>• Adidas in 2008</td>
</tr>
<tr>
<td>• Competition in the Movie Rental Industry in 2008 (has accompanying video)</td>
<td></td>
</tr>
<tr>
<td>• Dell, Inc. in 2008 (has accompanying video)</td>
<td></td>
</tr>
<tr>
<td>• Panera Bread Company (has accompanying video)</td>
<td></td>
</tr>
<tr>
<td>• Competition in Video Game Consoles (has accompanying video)</td>
<td></td>
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<tr>
<td>• Apple, Inc. in 2008</td>
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<tr>
<td>• Nintendo’s Strategy for the Wii</td>
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<tr>
<td>• Corona Beer</td>
<td></td>
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<tr>
<td>• Rogers’ Chocolates</td>
<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Section C Follow-On Cases</th>
<th>Section D Follow-On Case</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Southwest Airlines in 2008 (has accompanying video)</td>
<td></td>
</tr>
<tr>
<td>• Detecting Unethical Practices at Supplier Factories: The Monitoring and Remediation Challenges</td>
<td></td>
</tr>
</tbody>
</table>

Cases which are most suitable for the second-half of a Section A, B, C or D set of case assignments because of their comprehensive nature and somewhat greater analytical requirements:

<table>
<thead>
<tr>
<th>Section A Comprehensive Cases</th>
<th>Section B Comprehensive Cases</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Dell, Inc. in 2008 (has accompanying video)</td>
<td>• Adidas in 2008</td>
</tr>
<tr>
<td>• Nucor Corporation: Competing Against Low-Cost Foreign Imports</td>
<td></td>
</tr>
<tr>
<td>• Google’s Strategy in 2008 (has accompanying video)</td>
<td></td>
</tr>
<tr>
<td>• The Challenges Facing eBay in 2008</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Section C Comprehensive Cases</th>
<th>Section D Comprehensive Cases</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Lowlaw Companies Limited: Preparing for Wal-Mart Supercenters</td>
<td>• Wal-Mart Stores, Inc. in 2008 (has accompanying video)</td>
</tr>
<tr>
<td>• Research in Motion: Managing Explosive Growth</td>
<td>• Shangri-La Hotels</td>
</tr>
</tbody>
</table>

Table 2 profiles the topics and issues that are contained in the 26 cases in this edition. The grid in Table 2 and sample daily class schedules in Section 4 are intended to help you make wise choices about how to position coverage of the chapters and sequence the case assignments in your course. Each case teaching note also contains a section on “Suggestions for Using the Case” that provides ideas on case sequencing and case use.
<table>
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</thead>
<tbody>
<tr>
<td>Case 1</td>
<td>Whole Foods Market in 2008—Vision, Core Values, and Strategy</td>
<td>N</td>
<td>M</td>
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<tr>
<td>Case 2</td>
<td>Costco Wholesale Corp. in 2008—Mission, Business Model, and Strategy</td>
<td>Y</td>
<td>L</td>
<td>X</td>
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<tr>
<td>Case 3</td>
<td>JetBlue Airways: A Cadre of New Managers Takes Control</td>
<td>Y</td>
<td>L</td>
<td>X</td>
<td>X</td>
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<tr>
<td>Case 4</td>
<td>Competition in the Golf Equipment Industry in 2008</td>
<td>N</td>
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<tr>
<td>Case 5</td>
<td>Competition in the Movie Rental Industry in 2008: Netflix and Blockbuster Battle for Market Leadership</td>
<td>Y</td>
<td>L</td>
<td>X</td>
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<tr>
<td>Case 6</td>
<td>Dell, Inc. in 2008—Can It Overtake Hewlett-Packard as the Worldwide Leader in Personal Computers?</td>
<td>Y</td>
<td>L</td>
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<tr>
<td>Case 7</td>
<td>Apple, Inc. in 2008</td>
<td>N</td>
<td>L</td>
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<tr>
<td>Case 8</td>
<td>Panera Bread Company</td>
<td>Y</td>
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<tr>
<td>Case 9</td>
<td>Rogers’ Chocolates</td>
<td>N</td>
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<td>Case 10</td>
<td>Nucor Corp.—Competing Against Low Cost Foreign Imports</td>
<td>N</td>
<td>L</td>
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<tr>
<td>Case 12</td>
<td>Nintendo’s Strategy for the Wii—Good Enough to Beat Xbox 360 and PlayStation 3?</td>
<td>N</td>
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<tr>
<td>Case 13</td>
<td>Corona Beer</td>
<td>N</td>
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<tr>
<td>Case 14</td>
<td>Google’s Strategy in 2008</td>
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<tr>
<td>Case 16</td>
<td>Loblaw Companies Limited: Preparing for Wal-Mart Supercenters</td>
<td>N</td>
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<tr>
<td>Case 17</td>
<td>Research in Motion: Managing Explosive Growth</td>
<td>N</td>
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<tr>
<td>Case 18</td>
<td>Adidas in 2008: Has Corporate Restructuring Increased Shareholder Value?</td>
<td>N</td>
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<tr>
<td>Case 19</td>
<td>PepsiCo’s Diversification Strategy in 2008</td>
<td>N</td>
<td>L</td>
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<tr>
<td>Case 20</td>
<td>Robin Hood</td>
<td>N</td>
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<td>X</td>
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<tr>
<td>Case 21</td>
<td>Dilemma at Devil’s Den</td>
<td>N</td>
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<tr>
<td>Case 22</td>
<td>Wal-Mart Stores, Inc. in 2008—Management’s Initiatives to Transform the Company and Curtail Wal-Mart Bashing</td>
<td>Y</td>
<td>L</td>
<td>X</td>
<td>X</td>
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<tr>
<td>Case 23</td>
<td>Southwest Airlines in 2008: Culture, Values, and Operating Practices</td>
<td>Y</td>
<td>L</td>
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<tr>
<td>Case 24</td>
<td>Shangri-La Hotels</td>
<td>N</td>
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<tr>
<td>Case 25</td>
<td>E &amp; J Gallo</td>
<td>N</td>
<td>L</td>
<td>X</td>
<td>X</td>
<td>X</td>
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<tr>
<td>Case 26</td>
<td>Detecting Unethical Practices at Supplier Factories: The Monitoring and Remediation Challenges</td>
<td>N</td>
<td>X</td>
<td>X</td>
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</table>
CASES WITH ACCOMPANYING VIDEOS

Nine of the cases in this 17th edition have accompanying videos which may want to consider showing during the course of the case discussions. Table 3 below provides some information on the case videos:

Table 3  List of Videos Accompanying the Cases in the 17th Edition

<table>
<thead>
<tr>
<th>Case Number</th>
<th>Case Title</th>
<th>Video Title</th>
<th>Video Length (in minutes)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>Costco Wholesale Corp. in 2008—Mission, Business Model, and Strategy</td>
<td>Costco Vs. Sam’s Club: Big Warehouses, Big Savings</td>
<td>4:19</td>
</tr>
<tr>
<td>5</td>
<td>Competition in the Movie Rental Industry in 2008: Netflix and Blockbuster Battle for Market Leadership</td>
<td>Movie Night Done Right: Is It Better to Join One of Those DVD Mail Clubs or Just Rent One On Demand?</td>
<td>4:50</td>
</tr>
<tr>
<td>6</td>
<td>Dell, Inc. in 2008—Can It Overtake Hewlett-Packard as the Worldwide Leader in Personal Computers?</td>
<td>How Strategy Evolves in a Large Organization; Interview with Michael Dell</td>
<td>5:38</td>
</tr>
<tr>
<td>8</td>
<td>Panera Bread Company</td>
<td>Panera Bread Company</td>
<td>9:54</td>
</tr>
<tr>
<td>11</td>
<td>Competition in Video Game Consoles: The State of the Battle for Supremacy in 2008</td>
<td>Game Changer: Senior Citizens are Playing Video Games in Increasing Numbers</td>
<td>2:48</td>
</tr>
<tr>
<td>14</td>
<td>Google’s Strategy in 2008</td>
<td>Google CEO Eric Schmidt Interview with McKinsey Quarterly</td>
<td>20.00</td>
</tr>
<tr>
<td>22</td>
<td>Wal-Mart Stores, Inc. in 2008—Management’s Initiatives to Transform the Company and Curtail Wal-Mart Bashing</td>
<td>CVS vs. Wal-Mart: Chains Cut Generic Drug Cost</td>
<td>1.29</td>
</tr>
<tr>
<td>23</td>
<td>Southwest Airlines in 2008: Culture, Values, and Operating Practices</td>
<td>Southwest CEO: Get to Know Gary Kelly</td>
<td>3:40</td>
</tr>
</tbody>
</table>

SUGGESTED CASES FOR ORAL TEAM PRESENTATIONS

There is great merit in selecting several cases for use as oral presentations by teams or groups of students. Group sizes can range from two to as many as four or five, with the time allocated for presentation ranging from about 30 minutes per group to the whole class period. We like to assign oral team presentations of cases because such assignments drill students in organizing the work and tasks of several people into a team effort, presenting their ideas, preparing professional caliber PowerPoint slides, and defending their ideas in a Q&A session—all skills that most students will be called on to display in future job assignments.

In our course, we like to have teams of 3-4 persons (usually composed of the same students who are playing the simulation exercise together) and presentations that last 15 to 20 minutes, followed by a 10-minute question and answer session (where class members have responsibility for asking all the questions and can be graded on the caliber of their question for class participation purposes). With this format, two or three teams can be assigned the same case and give their presentations of the case on the same day. This adds a useful bit of competition to the process and also serves to illustrate the different perspectives, analysis, and recommendations that can flow from wrestling with the same case situation (amazingly enough, 3 presentations of the same case tend to be strikingly different).

Cases which are particularly well suited for oral team presentations include:

- Whole Foods Market in 2008—Vision, Core Values, and Strategy
- Costco Wholesale: Mission, Business Model, Strategy
- JetBlue Airways: A Cadre of New Managers Takes Control
- Competition in the Movie Rental Industry in 2008: Netflix and Blockbuster Battle for Market Leadership
- Dell, Inc. in 2008—Can It Overtake Hewlett-Packard as the Worldwide Leader in Personal Computers?
- Apple, Inc. in 2008
- Panera Bread Company
- Rogers’ Chocolates
- Nucor Corp.—Competing Against Low-Cost Foreign Imports
- Nintendo’s Strategy for the Wii—Good Enough to Beat Xbox 360 and PlayStation 3?
- Corona Beer
- Google’s Strategy in 2008
- The Challenges Facing eBay in 2008—Time for Changes in Strategy?
- Loblaw Companies Limited: Preparing for Wal-Mart Supercenters
- Research in Motion: Managing Explosive Growth
- Adidas in 2008: Has Corporate Restructuring Increased Shareholder Value?
- PepsiCo’s Diversification Strategy in 2008
- Dilemma at Devil’s Den
- Wal-Mart Stores, Inc. in 2008—Management’s Initiatives to Transform the Company and Curtail Wal-Mart Bashing
- Southwest Airlines in 2008: Culture, Values, and Operating Practices.
- Shangri-La Hotels
- E & J Gallo
- Detecting Unethical Practices at Supplier Factories: The Monitoring and Remediation Challenges

**CASES SUITABLE FOR FOLLOW-ON RESEARCH ON THE INTERNET**

If you are inclined to have students do further research on companies and update what’s happened since the case was researched, the following cases are especially good choices:

- Whole Foods Market in 2008—Vision, Core Values, and Strategy
- Costco Wholesale: Mission, Business Model, Strategy
- JetBlue Airways: A Cadre of New Managers Takes Control
- Competition in the Movie Rental Industry in 2008: Netflix and Blockbuster Battle for Market Leadership
- Dell, Inc. in 2008—Can It Overtake Hewlett-Packard as the Worldwide Leader in Personal Computers?
- Apple, Inc. in 2008
- Panera Bread Company
- Nucor Corp.—Competing Against Low-Cost Foreign Imports
- Nintendo’s Strategy for the Wii—Good Enough to Beat Xbox 360 and PlayStation 3?
- Corona Beer
- Google’s Strategy in 2008
The Challenges Facing eBay in 2008—Time for Changes in Strategy?
The Loblaw Companies Limited: Preparing for Wal-Mart Supercenters
Research in Motion: Managing Explosive Growth
Adidas in 2008: Has Corporate Restructuring Increased Shareholder Value?
PepsiCo’s Diversification Strategy in 2008
Wal-Mart Stores, Inc. in 2008—Management’s Initiatives to Transform the Company and Curtail Wal-Mart Bashing
Southwest Airlines in 2008: Culture, Values, and Operating Practices.
Shangri-La Hotels
E&J Gallo
Detecting Unethical Practices at Supplier Factories: The Monitoring and Remediation Challenges

THE MERITS OF PROVIDING STUDENTS WITH STUDY QUESTIONS FOR ASSIGNED CASES

In assigning cases for either oral discussion or written analysis, we’ve found it advisable to provide students with a set of assignment questions.

Assignment questions direct students toward what to be alert for in the case, push them to do the kind of strategic thinking and analysis that is required, and let them know what things you intend to bring up in leading class discussion of the case. Making it crystal clear that students are absolutely expected to prepare substantive answers to each of the assignment questions is pretty much essential if you want students to speak with authority and make meaningful comments on the questions you pose. Otherwise, your class discussions are likely to involve a lot of shooting-from-the-hip, instant analysis, and uninformed opinion on the part of students, none of which does much in the way of building their analytical skills or teaching them to probe deeply into the decision-making issues posed in the case. Without assignment questions to guide their thinking and analysis, too many students tend merely to read the case and come to class without having done any thoughtful analysis and evaluation—a condition which lowers the overall caliber and value of the case discussion.

But when the instructor insists on conscientious preparation of answers to study questions, then one or two of the assigned questions can be used as the basis for launching discussion of the case and getting the class started on a positive note. Sometimes, particularly for more complex cases, it is good to assign specific study questions to specific groups of students prior to the day of class and ask them to come prepared to present their analysis to the rest of the class.

To facilitate your providing class members with study questions for the assigned cases, we have created a PDF file of Assignment Questions for each case and posted the files for all 26 cases at the “Student Edition” section of the text Web site (www.mhhe.com/thompson). The assignment questions for each case are identical to the suggested assignment questions that are part of our teaching note for each of the 26 cases in this edition (the teaching notes are in Section 7 of the IM). Having students use the assignment questions posted at the Student Edition of the text Web site eliminates the need for you to go to the trouble of providing your class with assignment questions for the cases in your syllabus (if you are so inclined, you can single out specific questions for students to concentrate on, should you wish to focus the class discussion on particular areas). Naturally, of course, you can provide class members with your own set of preferred study questions for each case and have them ignore the ones that are posted altogether.
WRITTEN CASE ASSIGNMENTS

It is our practice during the term to assign two, sometimes three, written reports on assigned cases. Written reports are a valuable requirement from several perspectives. They give students a formal workout in

- diagnosing a company’s situation,
- sizing up what problems/issues need to be addressed,
- deciding what analysis to conduct to probe the identified problems and issues,
- making use of the appropriate core concepts and analytical tools in the text chapters to thoroughly describe the ins and outs of the company’s situation,
- evaluating the pros and cons of various action alternatives,
- setting forth a practical, workable set of action recommendations (that are within the financial means and resource capabilities), and
- putting their thoughts in writing—and doing so in a persuasive, professional manner.

Moreover, a written report gives students valuable practice in (a) preparing charts, graphs, and other visuals, (b) organizing their thoughts, and (c) communicating their analysis and conclusions in a manner suitable for top management. And, finally, written reports provide feedback to students on how well they are doing and to the instructor on how well the class is progressing.

To accomplish these objectives, you can choose among three different types of written case analyses:

1. **Short reports of about 500 words.** These reports are prepared in response to a specific question and do not require a broad-ranging analysis and set of recommendations. Generally, we ask such questions as: What is the firm’s strategy? What actions would you recommend management take to deal with its problem of . . .? Does the company need to change its organization structure to accommodate its change in strategy? Is this an attractive industry to be in? What is your appraisal of competitive conditions? What issues do you think management needs to be worried about most? Short reports can be assigned for almost any case. The primary value of short assignments is in preparing students to do a better job on longer, more comprehensive written analyses.

2. **Comprehensive reports of about 1,000 - 2,000 words (3-6 pages) plus exhibits.** These reports require that students go through the entire process of identifying (or diagnosing), evaluating, and recommending. We stress to students that their reports should deal with all of the major problems and issues raised in the case. Normally, we insist that these analyses be prepared as “reports to management” rather than as the commentary of a student analyst to the instructor. We think it is important for students to assume the posture of a professional manager writing to an audience of other practicing managers. On occasions we like to focus the entire assignment on “what to do and why.” Making students center their report on a set of well-supported recommendations to management has the advantage of involving them more directly in the case situation and keeping the student’s analysis action-oriented.

3. **In-class written analyses.** It is often useful to require students to do an in-class written analysis of either a case which has been discussed earlier (in part or in whole) or a case that is completely new. Because of the time constraints, it is obviously imperative here to select a case that can be read and analyzed in the allotted time. It is a matter of preference whether students are given a narrowly-focused question to answer or a broad-ranging analysis to conduct. The amount of time available for the exam (as well as the length and complexity of the chosen case) should determine which approach is taken. We use an in-class written case as a final examination and schedule it over a four-hour period. We have opted for closed-book instead of open-book exams; the only aid students can use is a calculator to expedite calculations and financial analysis. As an alternative to giving students a sight-unseen case for in-class analysis, you can assign the case to be read and studied beforehand and use the whole class-time for answering questions posed by the instructor. This technique works quite well when the class time available for examination is only 50 to 75 minutes, but it has the disadvantage of not testing the student’s abilities independent of opportunities to consult with others.
In our course, we insist that written case analyses be prepared in a professional manner. By this we mean that papers should be concise, incisive, and literate and include appropriate supporting tables, charts, and exhibits. *Summarizing and rehashing facts stated in the case is highly discouraged (and usually penalized)—except where factual restatement is an integral part of the analysis and evaluation and is done to support conclusions about the company’s situation.* We find that if we insist upon a quality effort from students (with severe grade consequence for poorly-done papers—poor from an analytical perspective or from the standpoint of grammar, spelling, and writing style), then students are more likely to prepare their written cases in a manner that reflects serious analytical effort and professionalism. It is our policy to automatically reduce the grade by one letter if a paper is sloppily and incompetently written; students have to understand that a badly written report reflects badly on their skills and credentials and simply cannot be tolerated at this point in their academic careers.

To avoid chronic problems with late cases, it is our policy to reduce the grade on each late paper by two letters; thus the maximum grade on a late paper is a C (and that only if the paper would otherwise be an A paper). We feel such a policy is entirely justified because it is not a great achievement for students to attend the class discussion of the assigned case, take copious notes, and then hand in a paper which does little more than summarize the class discussion. The latter tactics subvert the pedagogical value of written cases and cannot be tolerated. Our automatic two-letter grade penalty on late papers has worked well in discouraging overdue reports, and you may wish to experiment with it if you are plagued with late papers.

**Cases in this edition which we feel are especially appropriate for written case assignments include the following:**

- Whole Foods Market in 2008—Vision, Core Values, and Strategy
- Costco Wholesale: Mission, Business Model, Strategy
- JetBlue Airways: A Cadre of New Managers Takes Control
- Competition in the Movie Rental Industry in 2008: Netflix and Blockbuster Battle for Market Leadership
- Dell, Inc. in 2008—Can It Overtake Hewlett-Packard as the Worldwide Leader in Personal Computers?
- Apple, Inc. in 2008
- Panera Bread Company
- Rogers’ Chocolates
- Nucor Corp.—Competing Against Low-Cost Foreign Imports
- Nintendo’s Strategy for the Wii—Good Enough to Beat Xbox 360 and PlayStation 3?
- Corona Beer
- Google’s Strategy in 2008
- The Challenges Facing eBay in 2008—Time for Changes in Strategy?
- Loblaw Companies Limited: Preparing for Wal-Mart Supercenters
- Research in Motion: Managing Explosive Growth
- Adidas in 2008: Has Corporate Restructuring Increased Shareholder Value?
- PepsiCo’s Diversification Strategy in 2008
- Dilemma at Devil’s Den
- Wal-Mart Stores, Inc. in 2008—Management’s Initiatives to Transform the Company and Curtail Wal-Mart Bashing
- Southwest Airlines in 2008: Culture, Values, and Operating Practices.
- Shangri-La Hotels
- E & J Gallo

Suggested written case assignments for these and other cases are provided in the teaching notes for the cases.
SUGGESTIONS FOR LEADING A CASE DISCUSSION

In the event you want some suggestions on how to lead a case discussion, we highly recommend the following sources:

1. V. Kasturi Rangan, “Choreographing a Case Class,” available from Harvard Business School Publishing (can be downloaded free at [www.hbsp.harvard.edu](http://www.hbsp.harvard.edu)).


3. Charles I. Gragg, “Because Wisdom Can’t Be Told,” available from Harvard Business School Publishing (the product number is 9-451-005; it can be ordered by calling 800-545-7685, or faxing 617-495-6985, or going to www.hbsp.harvard.edu). Gragg’s presentation is a classic and is very worthwhile reading.


Sample Syllabi and Daily Course Schedules
This section contains:

1. Two sample course syllabi—The two sample course syllabi are ones that we have used in our own senior-level strategic management courses at The University of Alabama and The University of South Alabama.

2. A comprehensive set of suggested daily class schedules:
   - 5 alternative suggested daily schedules for 15-week (or semester-length) terms, including sample schedules for classes meeting 2 times weekly and 1 time weekly, with and without use of a simulation exercise such as *The Business Strategy Game* or *GLO-BUS*.
   - 3 sample daily schedules for 10-week (or quarter-length) terms, including suggested schedules for classes meeting 2 times weekly and 1 time weekly, with and without use of a simulation exercise such as *The Business Strategy Game* or *GLO-BUS*.
   - 3 sample daily course schedules for 5-week terms.

Should your course involve more or less class meetings than indicated on our sample schedules, you can (1) add or delete case assignments as needed or (2) devote more/less class time to covering the 12 chapters of text or (3) schedule more class meetings in the computer lab (in the event you opt to use a strategy simulation).

Having the class meet in the computer lab gives you a great opportunity to personally observe the dynamics of how different companies go about the task of strategizing and making decisions).

If you are inexperienced in teaching first-level strategy courses for seniors and MBA students, we think you will find the contents of the sample syllabi and daily course schedules helpful in developing a syllabus and daily class schedule for your own course that you are comfortable with.
COURSE SYLLABUS (SAMPLE 1)

Course Description

Unlike other business courses that concentrate narrowly on a particular function or piece of the business—accounting, finance, marketing, production, human resources, or information systems, strategic management is a big picture course. It cuts across the whole spectrum of business and management. The center of attention is the total enterprise—the industry and competitive environment in which it operates, its long-term direction and strategy, its resources and competitive capabilities, and its prospects for success.

Throughout the course, the spotlight will be trained on the foremost issue in running a business enterprise: “What must managers do, and do well, to make the company a winner in the game of business?” The answer that emerges, and which becomes the theme of the course, is that good strategy-making and good strategy-execution are the key ingredients of company success and the most reliable signs of good management. The mission of the course is to explore why good strategic management leads to good business performance, to present the basic concepts and tools of strategic analysis, and to drill you in the methods of crafting a well-conceived strategy and executing it competently.

You’ll be called on to probe, question, and evaluate all aspects of a company’s external and internal situation. You’ll grapple with sizing up a company’s standing in the marketplace and its ability to go head-to-head with rivals, learn to tell the difference between winning strategies and mediocre strategies, and become more skilled in spotting ways to improve a company’s strategy or its execution.

In the midst of all this, another purpose is accomplished: to help you synthesize what you have learned in prior business courses. Dealing with the grand sweep of how to manage all the pieces of a business makes strategic management an integrative, capstone course in which you reach back to use concepts and techniques covered in previous courses. For perhaps the first time you’ll see how the various pieces of the business puzzle fit together and why the different parts of a business need to be managed in strategic harmony for the organization to operate in winning fashion.

The Next Weeks Will Be Exciting, Fun, Challenging, and Filled with Learning Opportunities.

No matter what your major is, the content of this course has all the ingredients to be the best course you’ve taken—best in the sense of learning a lot about business, holding your interest from beginning to end, and enhancing your powers of business judgment. As you tackle the subject matter, ponder Ralph Waldo Emerson’s observation, “Commerce is a game of skill which many people play, but which few play well.” The overriding intent of the course is to help you become a more savvy player and better prepare you for a successful business career. We sincerely hope this course will prove to be instrumental in making you “competitively superior”, successful in your career, and much wiser about the secrets of first-rate management.

Required Texts and Materials


2. Thompson, and others, The Business Strategy Game or GLO-BUS: Developing Winning Competitive Strategies (register to participate at www.bsg-online.com or www.glo-bus.com). To complete the registration, you will need (1) either a credit card or the Prepaid Access Code on the card that was shrink-wrapped with your copy of the text and (2) the company registration code provided by the instructor.
Section 4  Sample Syllabi and Daily Course Schedules

Course Objectives

1. To develop your capacity to think strategically about a company, its present business position, its long-term direction, its resources and competitive capabilities, the caliber of its strategy, and its opportunities for gaining sustainable competitive advantage.

2. To build your skills in conducting strategic analysis in a variety of industries and competitive situations and, especially, to provide you with a stronger understanding of the competitive challenges of a global market environment.

3. To give you hands-on experience in crafting business strategy, reasoning carefully about strategic options, using what-if analysis to evaluate action alternatives, and making sound strategic decisions.

4. To acquaint you with the managerial tasks associated with implementing and executing company strategies, drill you in the range of actions managers can take to promote competent strategy execution, and give you some confidence in being able to function effectively as part of a company’s strategy-implementing team.

5. To integrate the knowledge gained in earlier core courses in the business school curriculum, show you how the various pieces of the business puzzle fit together, and demonstrate why the different parts of a business need to be managed in strategic harmony for the organization to operate in winning fashion.

6. To heighten your awareness of how and why ethical principles, core values, and socially responsible management practices matter greatly in the conduct of a company’s business.

7. To develop your powers of managerial judgment, help you learn how to assess business risk, and improve your ability to make sound business decisions and achieve effective outcomes.

Grading Plan/Performance Evaluations

Your course grade will be based on the following components and percentage allocation:

| Performance on the BSG or GLO-BUS simulation exercise (including the quizzes, the 3-year strategic plan, and the peer evaluations) | 30% |
| Written case assignment | 15% |
| Participation in class discussion of cases | 15% |
| Exams on lectures/text materials and satisfactory completion of practice tests on assigned chapters in the text | 25% |
| Oral team presentation of assigned case | 15% |
| 100% |

The Approach to Teaching/Learning

1. Lectures by the instructor 30% of in-class hrs.

2. Practicing the tasks of managerial analysis and decision-making via use of actual case studies--analysis/discussion by whole class (students do most of the talking) 45% of in-class hrs.

3. Practicing the task of managing via the “learn-by-doing” simulation exercise. Out-of-class team meetings.

4. Exams/oral team presentations 25% of in-class hrs.
Required Participation in Class Discussions of Assigned Cases
Due to the fact that participation in class discussion of cases counts as a factor in determining your overall grade in the course, each student MUST contribute significantly to in-class analysis and discussion of the cases. Each student is expected to be an active participant in case discussions and to offer meaningful analysis and convincing arguments for the position you stake out. Your grade on class participation is something to be earned by contributing your assessments and judgments to the discussion. Merely coming to class and listening to the discussion of assigned cases is not sufficient; attendance is not participation. You should, therefore, make a conscientious effort to be sufficiently prepared to make intelligent, timely comments regarding the managerial issues raised in the cases—this entails reading the assigned cases and preparing several pages of notes to the assignment questions for the case.

The bare minimum number of assigned cases on which you are expected to display your analytical skills by speaking out and making a meaningful contribution is 6 (multiple contributions to a single case are averaged into a single grade for participating on that case). A contribution is defined as making a relevant and clearly articulated statement, either in response to a question by the instructor or in response/rebuttal to comments made by another class member. Merely saying “yes” or “no” without any elaboration or without having the full attention of the class does not count as meaningful participation. On days when there are oral team presentations, class participation is judged on the caliber of the question(s) you pose to one or more of the presenting teams.

Satisfactory contributions on 6 assigned cases will be judged as a C– (70); and good-to-excellent contributions on 6 cases will be worth a B– (80). To earn an A on class discussion typically requires contributing meaningfully on 10 to 13 cases (out of the 15 total cases that are assigned) and standing out as a class leader in the discussions of assigned cases. Satisfactory contributions on only 2 assigned cases will be judged as a 30; satisfactory contributions on just 3 cases will be judged as a 40; satisfactory contributions on 4 cases will be judged as a 50; and satisfactory contributions on 5 cases will be judged as a 60—so failure to have the minimum 6 case participations will negatively impact your grade in the course.

Special Note: In lieu of two of the required six oral contributions, you may opt to turn in a fully completed, typewritten set of answers to the assignment questions for the case. To count, these must be turned in at the end of the class period on the day the case is discussed in class and you must have been present in class that day. For completion of your written answers to the study questions to qualify as a substitute for an oral contribution, they must be completed in full and the quality of your work must be judged as the equivalent of at least a B to count as an oral participation.

Policies Regarding Class Attendance and Make-Up of Absences
Attendance at all class sessions is expected, but attendance is required on those days an assigned case is discussed in class. Absence from class on case discussion days requires make-up and should be discussed with your instructor, since roll is taken on case discussion days.

If you must miss class discussion of an assigned case, you are required to turn in answers to the assignment questions for the case. The make-up work for the missed case discussions is due no later than the following class period (except by prearranged consent of the instructor).

Failure to satisfactorily complete and hand in the “make-up” work at the next class meeting will result in a 2-point penalty deduction from your overall course average for each case discussion absence without a satisfactorily-completed written make-up (thus if your final average is an 80 and you have three unmade-up absences from case discussions, your final average will be reduced to 74).

More than one absence on case discussion and oral team presentation days, even if made up by turning in written answers to the assignment questions, will be penalized at the discretion of the instructor.
Completion of the Self-Graded Tests on Assigned Chapters

The Student Edition portion of the website for the text ([www.mhhe.com/thompson](http://www.mhhe.com/thompson)) has a menu option that contains 20-question multiple choice “tests” for each of the assigned text chapters. You are urged to conscientiously attempt and complete each of these self-scoring chapter tests in a timely manner.

The multiple choice questions that comprise these tests are indicative of the types of questions that will appear on the comprehensive chapter exam. In other words, the nature and difficulty of these 20 multiple choice questions that comprise the self-graded tests are very similar to the kinds of questions used for the comprehensive exam on the 12 chapters. Hence, if you can score well on the self-graded tests, you ought to be able to score well on the comprehensive exam.

Preparation of Written Case Assignment

The written case assignment is to be prepared on an [individual](http://www.mhhe.com/thompson) basis. It is expected that the content of your written case will reflect your thoughts and analysis rather than the work of others. The nature of the written assignment will be handed out in class about a week prior to the due date.

Suggestions regarding the preparation of written case assignments are discussed in “A Guide to Case Analysis” posted in the “Student Center” at [www.mhhe.com/thompson](http://www.mhhe.com/thompson). The criteria for grading written case presentations include:

1. Identification of key problems/strategic issues.
2. Use of appropriate analytical tools techniques, including the use of charts and tables where appropriate. You are expected to demonstrate that you can use the tools and techniques of strategic analysis presented in the chapters. Both breadth and depth of analysis will be evaluated.
3. Presenting realistic, workable, well-supported recommendations for action.
4. Use of good communication skills—failure to use good grammar, spelling, and other written communication skills will result in a full one-letter grade reduction.
5. Evidence of adequate preparation, pride of workmanship, and display of professional attitude and approach.

Written case assignments are due on the day the case is scheduled for class discussion (see the [Schedule of Class Activities](http://www.mhhe.com/thompson)) and should be turned in to your instructor at the end of the class period. **All written case assignments are to be prepared individually; group work is “out of bounds.”**

Cases turned in after the scheduled class period are eligible for a grade no higher than a C (and that only if the paper is otherwise an A or B+ paper). **No late papers will be accepted if submitted more than 2 class days past the scheduled due date** (except by prearranged consent of the instructor).

All written cases are to be typed (double-spaced) and should incorporate correct form, spelling, grammar, sentence structure, and communication skills.

Papers which, in the opinion of the instructor, employ disproportionately poor grammar and poor quality written communication skills will be assigned a grade that is a full one-letter lower than would otherwise be assigned.

Oral Team Presentations

Oral presentations consist of a 20-minute presentation followed by a 10-minute question-answer session. The nature of the presentation is indicated on the schedule of class activities. **You and your team members should assume the role of consultants employed to present your analysis and recommendations to the assigned company’s senior management—you do NOT have the option of ignoring this assigned role.**

**All team members are expected to make roughly equal contributions to the presentation,** both the formal 20-minute presentation and the 10-minute Q&A portion.

All presentations should incorporate the use of attractive, effective PowerPoint slides.
Your grade on the presentation will be based on six factors:

1. The clarity and thoroughness with which your team identifies and articulates the problems facing the company and the issues which management needs to address—12%,
2. The caliber (depth and breadth) of your team’s analysis of the company’s situation and demonstrated ability to use the concepts and tools of strategic analysis in a competent fashion—30%,
3. The breadth, depth, and practicality of your team’s recommendations, degree of detail and specificity of recommended actions, caliber of supporting arguments—20%,
4. The caliber of your PowerPoint slides—15%,
5. The degree of preparation, professionalism, energy, enthusiasm, and skills demonstrated in delivering your part of the presentation—15%, and
6. Your personal contributions to your team’s answers to the questions posed by the class—how well you defend and support your team’s analysis and recommendations during the Q&A period—8%. Every team member is expected to answer at least one question posed by the class (or else there is no individual contribution for the instructor to grade!!!!!!!).

Appropriate dress for presenters is business casual.

Time Requirements

Anyway you look at it, the workload in this course is quite heavy for the 5-week period. The time requirements are demanding and the daily activities are fast-paced (with almost no let-up during the term):

- There are 12 chapters of text material (about 400 pages) to master and be examined on. The self-graded chapter tests contain 20 questions. You should plan on taking each of these tests to gauge your command of the material and prepare yourself for comprehensive exam on the 12 chapters.
- Expect to spend 1½ to 2 hours per decision participating in GLO-BUS strategy simulation and doing all the analysis and calculations needed to win the competitive battle in the global digital camera market. A few more hours might be needed the first 2-3 decisions to grasp what the simulation is all about and how the software and website work; the 3-year strategic plan due in Year 12 will probably entail 1-2 hours. You will probably spend 25-30 hours outside of class working with your co-managers on the GLO-BUS exercise.
- Expect to spend 1 1/2 to 3 hours preparing a case for class discussion (you will need 2-3 pages of notes/answers to the study questions in front of you each day to sparkle and shine in the class discussions!). Trying to wing it by just quickly reading through an assigned case prior to class is ill-advised!
- Expect to spend 10 to 15 hours preparing for the oral team presentation.

It all adds up to a bunch of hours (probably more than for most other courses) and will constitute a very strenuous workout. You will have to dedicate a considerable amount of your time during the term to this course.

But don’t let the hours/time requirements intimidate you. All of the assignments that comprise the course aim at (a) improving your grasp of important tools and concepts, (b) enhancing your ability to use and apply them correctly, and (c) sharpening your business decision-making judgment. The course has been deliberately designed to push you to do your best under pressure and to be very real-world in terms of what you learn and what you can take with you of practical value as you launch your business career. In a very real way, the entire course is your “final exam” for business school and for being cleared to become a “licensed practitioner of business.”

Electronic Mail

The primary method of communication with the class outside of our classroom time will be through electronic mail. It is your responsibility to stay current with the messages delivered to your C&BA account. Communications regarding the simulation will typically occur within the simulation’s e-mail messaging system. Also, PowerPoint slides for the 12 text chapters will be posted in the course folder for you to access at your convenience.
COURSE SYLLABUS (SAMPLE 2)

Required Texts and Materials


2. Thompson, et al., The Business Strategy Game or GLO-BUS: Developing Winning Competitive Strategies (register to participate at www.bsg-online.com or www.glo-bus.com). To complete the registration, you will need (1) either a credit card or the Prepaid Access Code on the card that was shrink-wrapped with your copy of the text and (2) the company registration code provided by the instructor.

Course Description

MGT 485 is intended to be a challenging and exciting capstone course for the undergraduate business school curriculum. It is first and foremost a course about “strategy” and about “managing for success.” The course centers upon the theme that a company achieves sustained success if and only if its managers (1) formulate an astute “game plan” and (2) implement and execute the game plan with some proficiency. We shall try to “prove” how and why doing a good job of strategy formulation and strategy implementation nearly always produces good business performance.

In studying the tasks of strategic management we shall also tackle another important function: That of trying to integrate much of the knowledge you have gained in the core business curriculum. MGT 485 is a “big picture” course, a trait that makes it a truly different kind of course from other College of Business courses. Virtually all of the other required and elective courses you have taken were concerned with a specific functional area (production, marketing, finance, accounting) and/or a well-defined body of knowledge (economics, statistics, legal environment). More than a few of your previous courses have been highly structured and related closely to a well-developed body of theory. Some provided quantitative techniques for you to sink your teeth into and to master. Others related to information and to specific skills the faculty believes you needed to acquire. This course shares few of these traits. The problems and issues of strategy formulation and implementation cover the whole spectrum of business and management. Strategic management requires dealing with many variables and situational factors at once. Weighing the pros and cons of strategy entails a total enterprise perspective and a talent for judging just how all of the relevant factors add up to shape what actions need to be taken.

The Mitchell College of Business at USA (as well as at all other good business schools) have seen fit to require you to take this course in order to drive home what the role and tasks of the strategy manager are, to introduce you to what strategy means, to lead you through the in and outs of formulating and implementing a strategic plan, to teach you to use the tools and techniques of situation analysis, and to give you practice in making strategic decisions. Our objective is to sharpen your abilities to “think strategically” and to weigh things from the perspective of the total enterprise operating in an increasingly global market environment. Accomplishing this objective means giving you an appreciation for the importance of building a competitive advantage. It means drilling you thoroughly in the tools of strategy analysis and exercising you in the managerial task of sizing up a company’s strategic position. It means systematically exposing you to the rigor of industry and competitive analysis, to the ingredients of an attractive strategic plan, and to the varied administrative tasks associated with implementing and executing the chosen strategy as well as circumstances permit. And it means instilling a strong sense of ethical principles and values into the process and tasks of managing.

The course content is all but guaranteed to keep your interest and attention. In our minds, the glamour and the grand sweep of “strategizing” and managing an enterprise down the road of success make the course go and make it fun to teach. We sincerely hope this course will be the very best course you have ever had--that it will be instrumental in making you: (1) “competitively superior” (in comparison to graduates from “other business schools”), (2) successful in your career, and (3) much wiser about the secrets of first-rate management.
Course Objectives

1. To develop your capacity to think strategically about a company, its business position, and how it can gain sustainable competitive advantage. (This objective will be measured by your performance on your written case analyses.)

2. To give hands-on experience individually and in group settings in crafting business strategy, reasoning carefully about strategic options, using what-if analysis to evaluate action alternatives, and initiating the changes necessary to keep the strategy responsive to newly emerging market conditions. (This objective will be measured by your team’s performance in the Business Strategy Game business simulation.)

3. To integrate the knowledge gained in earlier Mitchell College of Business courses. (This objective will be measured by your performance on your written case analyses.)

4. To make the student more conscious of the importance of ethical principles, personal and company values, and socially responsible management practices. (This objective will be measured by your performance on case analyses concerning ethical issues and social responsibility.)

5. To enhance each student’s written and oral business communication skills. (This objective will be assessed by your performance on your written assignments and oral presentations.)

Course Requirements

Your course grade will be based on the following components.

<table>
<thead>
<tr>
<th>Component</th>
<th>Percentage</th>
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</thead>
<tbody>
<tr>
<td>Participation in case discussions</td>
<td>15%</td>
</tr>
<tr>
<td>Written case analyses (2)</td>
<td>30% (15% each)</td>
</tr>
<tr>
<td>Exam 1 (Chapters 1-7)</td>
<td>10%</td>
</tr>
<tr>
<td>Exam 2 (Chapters 8-12)</td>
<td>10%</td>
</tr>
<tr>
<td>Team performance on The Business Strategy Game</td>
<td>25%</td>
</tr>
<tr>
<td>BSG Group Presentation/Written Exec. Summary</td>
<td>10%</td>
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<tr>
<td><strong>TOTAL</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

The instructor reserves the right to modify/change course requirements as circumstances dictate. For example, the instructor may wish to change the number and frequency of exams or other assignments if unexpected changes in the class schedule occur. If such a modification is needed, you will be notified by e-mail or through the course Web site.

Policies Regarding Exams and Participation in Case Discussions

Examination Policy

You are expected to take the examinations when scheduled. All make-up exams are scheduled for the date of the final and immediately upon the completion of the final exam.

Class Participation

Due to the fact that participation in class discussion of cases counts 10% of your grade, each student must contribute significantly to in-class analysis of the cases. Each student is expected to be an active participant and to make meaningful comments on cases being discussed. Your grade on class participation is something to be earned via consistent, daily contribution to class discussions. You should, therefore, make a conscientious effort to attend class discussions of cases and to be sufficiently prepared to contribute to the case discussions.
The best approach to preparing for class discussions is to complete the assignment questions in the case. Merely coming to class is not sufficient; attendance is not participation. The bare minimum number of times you are expected to display your analytical skills by speaking out is 5 times during the semester, which will be judged as no better than a low C. Students who are absent from 5 or more class periods should expect a failing grade for participation.

Your written answers to the case discussion questions may be collected at the end of the case discussion. In order to earn maximum participation credit for a case, your written analysis must be completed, including a financial analysis of the financial data presented in the case.

**Guidelines For Written Case Analyses**

The written case assignment is to be prepared on an individual basis. It is expected that the content of your written case reflects your thoughts and analysis rather than the work of others. The nature of the written assignment will be announced a week before the written case is due.

Examples of cases receiving high marks from prior semesters are available for review in the document sharing section of the course website.

The criteria for grading written case presentations include:

1. Evidence of ability to size-up the organization’s situation and to identify key problems/issues.
2. Use of appropriate analytical techniques, sound logic, and well-supported arguments in evaluating the organization’s present condition and future prospects.
3. Evidence of ability to formulate realistic and workable recommendations for action.
4. Thoroughness -- both (a) scope and coverage and (b) depth of analysis.
5. Evidence of ability to use good communication skills (including the use of charts, tables, graphs, and figures).
6. Evidence of adequate preparation, pride of workmanship, and display of professional attitude and approach.

Papers which, in the opinion of the instructor, employ disproportionately poor grammar and poor quality written communication skills will receive up to a two letter grade reduction; such papers may be resubmitted after a session in the writing skills lab for an improvement in the initial grade assigned to the paper.

Written case assignments are due on the day the case is scheduled for class discussion (see the Schedule of Activities) and should be turned in to your professor at the end of the class period. **An electronic file of each written case must be uploaded to www.turnitin.com before class begins.** Assignments submitted to turnitin.com will be included as source documents in a restricted access database solely for the purpose of detecting possible plagiarism in such documents. As part of this process, you may be required to submit electronic as well as hard copies of your writing. By taking this course, you agree that all assignments may be subject to some form of originality review. A paper not submitted according to procedures and format set by the teacher will not be accepted.

All written case assignments are to be prepared individually: group work is “out of bounds.” If two students submit the same written assignment both will receive zeros for the assignment.

Papers submitted after the class is adjourned will receive a grade no higher than C.
**Academic Misconduct**

Plagiarism is the use of another’s written work without giving the original author credit for his/her work. Those who directly quote from another source without putting the quote in quotation marks and citing the original work using MLA standards are guilty of academic dishonesty. Plagiarism is prohibited by the University of South Alabama under its Academic Misconduct Policy. The policy provides for penalties up to and including dismissal from the University.

**Participating in The Business Strategy Game Simulation**

**Peer Evaluations** – All students will be required to rate the performance of their *The Business Strategy Game* team members along with their own performance in the *The Business Strategy Game* simulation. Students’ grades for their performance in the simulation may be lowered by as much as two letter grades if other team members universally rate a student’s knowledge of the mechanics of the simulation and contribution to team success as “poor.”

**Terminating a member of your management team** – Team members are subject to dismissal from the team if they are unwilling to master the material presented in *The Business Strategy Game Players’ Guide* or are unwilling to attend team meetings or otherwise participate in the simulation.

**Guidelines for The Business Strategy Game Presentation and Executive Summary**

Upon the completion of the simulation your team will be required to prepare a presentation to brief investors on the company’s performance during the period of time covered by its most recent 3-year plan. This review should consist of charts showing the following:

- Trends in the company’s annual total revenues
- Trends in the company’s annual earnings per share (EPS)
- Trends in the company’s annual return on equity investment (ROE)
- Trends in the company’s annual credit rating
- Trends in the company’s year-end stock price
- Trends in the company’s annual image rating
- Trends in global unit sales (both branded and private-label footwear)
- Trends in the company’s global market share

Additional slides expected in your presentation include:

- A slide describing your strategic vision for the company.
- A slide that shows what performance targets for EPS, ROE, credit rating, and image rating you and your co-managers would set for each of the next two years (assuming the simulation were to continue). You may also want to include global market share and/or stock price targets as well.
- A slide that sets forth your company’s competitive strategy in branded footwear in some detail and how that strategy has evolved over the years you have managed the company. You may need to have more than one slide here if your company’s strategy in branded footwear varies markedly from geographic region to geographic region or if your strategy for branded sales to retailers differs in important ways from your strategy for Internet sales.
• A slide that sets forth your company’s competitive strategy in private-label in some detail and how that strategy has evolved over the years. Again, more than one slide may be needed if your company’s strategy in private-label footwear varies markedly from one geographic region to another.

• A slide showing your company’s production strategy and work force compensation strategy

• A slide describing your company’s finance strategy (as concerns dividends, use of debt versus equity, stock issues/repurchases, actions to achieve/maintain a strong credit rating, etc.) You should clearly describe your company’s dividend policy during the period you have managed the company. Here, you should also set forth what sort of dividend increases, if any, you would likely consider paying out in the next two upcoming years (given the EPS targets you have established).

• A slide showing (1) those companies you consider to be your strongest/closest competitors in branded footwear as of the last year or two of the simulation and (2) those companies that are your strongest/closest competitors in the private-label segment of the marketplace.

• One or more slides detailing the actions you would take to out-compete these close rivals in the next two years (assuming the simulation continues for several more years). Since the actions may differ as between branded and private-label footwear, you may well need 2 slides here.

• A set of slides detailing the “lessons learned” about crafting a winning strategy and about what the managers of a company should or should not do for a company to be financially and competitively successful in a head-to-head battle against shrewdly-managed rival companies.

The criteria for grading the company presentation include:

1. Inclusion of above referenced expected slides.

2. Introduction of team members, smooth transitions between speakers, an introduction previewing the topics to be covered in the presentation and ending with a summary review of the major points.

3. Presentations that are completed within the allotted time limits.

4. Clear and articulate speech from each presenter.

5. Conversational style of presentation that does not substantially rely on notes written on cards or papers.

6. Evidence of adequate preparation, pride of workmanship, and display of professional attitude and approach.

Appropriate dress for presenters is business casual.

Your presentation should be accompanied by a 2-3 page executive summary of “lessons learned” about crafting a winning strategy in a competitive marketplace. The executive summary is due at the time of the presentation and should be turned in to your professor before the presentation begins. You should also submit a copy of your PowerPoint presentation at the beginning of the class period.

An electronic file of the executive summary must be uploaded to www.turnitin.com before class begins. It is not necessary to upload your PowerPoint presentation. Assignments submitted to turnitin.com will be included as source documents in a restricted access database solely for the purpose of detecting possible plagiarism in such documents. As part of this process, you may be required to submit electronic as well as hard copies of your writing. By taking this course, you agree that all assignments may be subject to some form of originality review. A paper not submitted according to procedures and format set by the teacher will not be accepted.

Executive summaries which, in the opinion of the instructor, employ disproportionately poor grammar and poor quality written communication skills will receive up to a two letter grade reduction; such papers may be resubmitted after a session in the writing skills lab for an improvement in the initial grade assigned to the paper.

Executive summaries submitted after the class is adjourned will receive a grade no higher than C.
Time Requirements

Anyway you look at it the workload in this course is heavy. The time requirements are big (this part of the local folklore about the course is very accurate!).

- Expect to spend 2 hours for each game decision and doing all the analysis and calculations needed to win the competitive battle. A few more hours will be needed for the first decisions to get over the start-up hump.

- Expect to spend 2 to 4 hours preparing a case for class discussion (you will need 2-3 pages of notes/answers to the assignment questions in front of you each day to sparkle and shine in the class discussions!). Trying to wing it is ill-advised!

- Expect to spend 8 to 15 hours (this varies according to your own personal efficiency and skills) preparing a written case.

- Then there are 12 chapters of text material (about 400 pages) to master.

But don’t let the hours/time intimidate you. We sincerely believe the workout will be well worth it in terms of what you learn that you can take with you out into the real world. You will find very little busy work involved; we have earnestly strived to make each assignment productive and worthwhile. (If you find that we have “screwed up,” tell us on the course evaluations at the end and we’ll fix it next time around!)
### CLASS SCHEDULE FOR A 15-WEEK (OR SEMESTER-LENGTH) COURSE (SAMPLE 1)

30 class meetings of 75 minutes

Includes 9 case assignments (some of which entail oral team presentations) and weekly BSG or GLO-BUS decision rounds throughout the term

<table>
<thead>
<tr>
<th>Class</th>
<th>Assignment/Activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Orientation and course preview; coverage of course syllabus</td>
</tr>
<tr>
<td>2</td>
<td>Lecture/discussion of Chapter 1</td>
</tr>
<tr>
<td>3</td>
<td>Introduction to <em>The Business Strategy Game</em> using the PowerPoint slides provided; assign class members to company teams; provide company co-managers with company registration codes (required in order for class members to register at <a href="http://www.bsg-online.com">www.bsg-online.com</a>). Ask all class members to read <em>The Business Strategy Game</em> Player’s Guide by the next class meeting</td>
</tr>
<tr>
<td>4</td>
<td>Lecture/discussion of Chapter 2; remind class members that they should be meeting with their company co-managers to work on the decisions for the first BSG practice round</td>
</tr>
<tr>
<td>5</td>
<td>Class meets in computer lab so that company co-managers can work on preparing their decisions for the first BSG practice round; <strong>decision entries for the first <em>The Business Strategy Game</em> practice round due at 11:59 p.m. today; also the deadline for completing Quiz 1 covering <em>The Business Strategy Game</em> Player’s Guide is today at 11:59 p.m.</strong></td>
</tr>
<tr>
<td>6</td>
<td>Lecture/discussion of Chapter 3 Optional 30-minute debriefing on the results of first BSG practice decision; instructor leads a class discussion of the information presented in the Footwear Industry Report and the Competitive Intelligence Reports for the first practice round—all class members should bring a copy of these reports to class (or the instructor can provide copies to all class members). The purpose of this debriefing is to make sure that all class members have a good grasp of all the information being provided to them after each decision round is completed (but it should be totally up to each team of co-managers to review the information, digest the meaning of all the numbers and statistics provided, and decide what, if any, actions to take in the next decision round based on this information about the outcomes).</td>
</tr>
<tr>
<td>7</td>
<td>Lecture/discussion of Chapter 4; <strong>deadline for completing decision entries for the second BSG practice round is 11:59 p.m. today</strong></td>
</tr>
<tr>
<td>8</td>
<td>Lecture/discussion of Chapter 5 Optional 30-minute debriefing on the results of second BSG practice decision; instructor leads a class discussion of the information presented in the Footwear Industry Report and the Competitive Intelligence Reports for the second practice round—all class members should bring a copy of these reports to class (or the instructor can provide copies to all class members). Now is a good time to strongly encourage all class members to get in the habit of carefully and thoroughly reviewing the information in each year’s Footwear Industry Report, Competitive Intelligence Reports and Company Operations Reports—otherwise, company co-managers lack knowledge of market conditions and their company’s competitiveness vis-à-vis rivals heading into the next decision round (flying blind in a fiercely competitive marketplace is a ticket for disastrous company performance).</td>
</tr>
<tr>
<td>9</td>
<td>Class meets in computer lab so that company co-managers can work on preparing their decisions for the first regular or scored BSG decision round; <strong>deadline for completing Year 11 decision entries for <em>The Business Strategy Game</em> is 11:59 p.m. today.</strong></td>
</tr>
<tr>
<td>10</td>
<td>Lecture/discussion of Chapter 6; Optional 15-minute debriefing on the results of BSG Year 11 decision round.</td>
</tr>
<tr>
<td>11</td>
<td>Class discussion of Whole Foods Market in 2008 case or Costco Wholesale Corp. in 2008 (has accompanying video); <strong>deadline for completing BSG Year 12 decision entries is 11:59 p.m. today.</strong></td>
</tr>
<tr>
<td>Lecture/discussion of Chapter 7</td>
<td>Optional 15-minute debriefing on the results of Year 12 decision round.</td>
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<tr>
<td>Lecture/discussion of Chapter 8</td>
<td>deadline for completing BSG Year 15 decision entries is 11:59 p.m. today.</td>
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<tr>
<td>Lecture/discussion of Chapter 9</td>
<td>Optional debriefing on the results of the Year 15 decision round and a quick review of how well company teams did in meeting the Year 14 and 15 performance targets set forth in their 3-year strategic plan for Years 14-15-16 (this data is contained in the instructor’s online grade book). Co-managers should be challenged to consider what they will need to do to get company performance back on track for Year 16, if performance in Years 14 and/or 15 was sub-par.</td>
</tr>
<tr>
<td>Lecture/discussion of Chapter 11; deadline for completing both the Strategic Plan for Years 17-18-19 and Year 17 BSG decision entries is 11:59 p.m. today.</td>
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<tr>
<td>Lecture/discussion of Chapter 12</td>
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<tr>
<td>Lecture/discussion of Chapter 13</td>
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<tr>
<td>Class discussion of Competition in the Golf Equipment Industry or Competition in the Movie Rental Industry (has accompanying video); deadline for completing BSG Year 13 decision entries is 11:59 p.m. today; also the deadline for completing online Quiz 2 (covering understanding of company operations) is today at 11:59 p.m.</td>
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</tr>
<tr>
<td>Class meets in computer lab so that company co-managers can work on preparing their 3-Year Strategic Plan for Years 14-15-16 for their BSG company and/or their strategy and decision entries for BSG Year 14.</td>
<td></td>
</tr>
<tr>
<td>Oral team presentation of Jet Blue Airways (has accompanying video) or Panera Bread (has accompanying video) or Dell in 2008 (has accompanying video) or Nucor Corp.; deadline for completing both the Strategic Plan for Years 14-15-16 and Year 14 decision entries is 11:59 p.m. today.</td>
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<tr>
<td>Oral team presentation of Adidas in 2008 or PepsiCo’s Diversification Strategy in 2008; deadline for completing Year 16 BSG decision entries is 11:59 p.m. today.</td>
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<tr>
<td>Examination covering Chapters 1-7</td>
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<tr>
<td>Class meets in computer lab so that company co-managers can work on preparing their company’s 3-Year Strategic Plan for Years 17-18-19</td>
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<tr>
<td>Lecture/discussion of Chapter 10</td>
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<tr>
<td>Lecture/discussion of Chapter 11</td>
<td></td>
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<tr>
<td>Class discussion of Robin Hood or Dilemma at Devil’s Den; deadline for completing Year 18 BSG decision entries is 11:59 p.m. today.</td>
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<tr>
<td>Examination over Chapters 7-12</td>
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<tr>
<td>Oral team presentation of Apple or Nintendo or eBay or Google (has accompanying video) cases; deadline for completing Year 19 BSG decision entries is 11:59 p.m. today.</td>
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<tr>
<td>Oral team presentation of Corona Beer or Loblaw or Research in Motion cases</td>
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<tr>
<td>Class discussion (or oral team presentation) of Wal-Mart Stores in 2008 (has accompanying video) or Southwest Airlines (has accompanying video) or Shangri-La Hotels; deadline for completing Year 20 BSG decision entries is 11:59 p.m. today.</td>
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<tr>
<td>Class discussion (or oral team presentation) of E&amp;J Gallo case or Detecting Unethical Practices at Supplier Factories</td>
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<tr>
<td>End-of-simulation BSG company presentations (and 5 to 10-minute Q&amp;A sessions for each presentation if time permits) All company co-managers should have competed their peer evaluations by the beginning of class today.</td>
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<tr>
<td>Examination over Chapters 7-12</td>
<td></td>
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<tr>
<td>Lecture/discussion of Chapter 12</td>
<td></td>
</tr>
<tr>
<td>Class discussion (or oral team presentation) of Wal-Mart Stores in 2008 (has accompanying video) or Southwest Airlines (has accompanying video) or Shangri-La Hotels; deadline for completing Year 20 BSG decision entries is 11:59 p.m. today.</td>
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<tr>
<td>Class discussion (or oral team presentation) of E&amp;J Gallo case or Detecting Unethical Practices at Supplier Factories</td>
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<tr>
<td>In-class written case analysis</td>
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CLASS SCHEDULE FOR A 15-WEEK (OR SEMESTER-LENGTH) COURSE  
(SAMPLE 2)

30 class meetings of 75 minutes

Includes 12 case assignments and *bi-weekly BSG or GLO-BUS* decision rounds during the second half of course

<table>
<thead>
<tr>
<th>Class</th>
<th>Assignment/Activity</th>
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<tbody>
<tr>
<td>1</td>
<td>Orientation and course preview; lecture on Chapter 1</td>
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<tr>
<td>2</td>
<td>Lecture on Chapter 2</td>
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<td>3</td>
<td>Lecture on Chapter 3</td>
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<td>4</td>
<td>Lecture on Chapter 4</td>
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<td>5</td>
<td>Lecture on Chapter 5</td>
</tr>
<tr>
<td>6</td>
<td>Class discussion of Whole Foods Market or Costco Wholesale (has accompanying video) or JetBlue Airways (has accompanying video)</td>
</tr>
<tr>
<td>7</td>
<td>Lecture on Chapter 6</td>
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<tr>
<td>8</td>
<td>Class discussion of Competition in Golf Equipment or Competition in Movie Rental Industry (has accompanying video) or Dell in 2008 (has accompanying video) or Rogers’ Chocolates</td>
</tr>
<tr>
<td>9</td>
<td>Lecture on Chapter 7</td>
</tr>
<tr>
<td>10</td>
<td>Exam over Chapters 1-7</td>
</tr>
<tr>
<td>11</td>
<td>Lecture on Chapter 8</td>
</tr>
<tr>
<td>12</td>
<td>Lecture on Chapter 9</td>
</tr>
<tr>
<td>13</td>
<td>Class discussion (or oral team presentations) of Nucor Corp. or Competition in Video Games or The Challenges Facing eBay or Panera Bread (has accompanying video)</td>
</tr>
<tr>
<td>14</td>
<td>Class discussion (or oral team presentations) of Nintendo or Google’s Strategy in 2008 (has accompanying video) or Loblaw or Research in Motion</td>
</tr>
<tr>
<td>15</td>
<td>Introduction to The Business Strategy Game using the PowerPoint slides provided; assign class members to company teams; provide company co-managers with company registration codes (required in order for class members to register at <a href="http://www.bsg-online.com">www.bsg-online.com</a>). Ask all class members to read the BSG Player’s Guide by the next class meeting.</td>
</tr>
<tr>
<td>16</td>
<td>Lecture on Chapter 10; remind class members that they should be meeting with their company co-managers to work on the decisions for the first BSG practice round</td>
</tr>
<tr>
<td>17</td>
<td>Class meets in the computer lab to allow company co-managers to work on their decisions for the first practice round (or to take online Quiz 1 covering the BSG Player’s Guide)</td>
</tr>
<tr>
<td>18</td>
<td>Lecture on Chapter 11; <strong>deadline for completing both the decision entries for the first BSG practice round and online Quiz 1 (covering the contents of the BSG Player’s Guide) is 11:59 p.m. today.</strong></td>
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<tr>
<th>Date</th>
<th>Activity</th>
</tr>
</thead>
</table>
| 19   | Lecture on Chapter 12  
Optional 30-minute debriefing on the results of the first practice BSG decision— instructor leads a class discussion of the information presented in the Footwear Industry Report and the Competitive Intelligence Reports showing practice round outcomes. All class members should bring a copy of these reports to class (or the instructor can provide copies to all class members). The purpose of this debriefing is to make sure that all class members have a good grasp of all the information being provided to them after each decision round is completed but it should be totally up to each team of co-managers to review the information, digest the meaning of all the numbers and statistics provided, and decide what, if any, actions to take in the next decision round based on this information about the outcomes).  
Optional Q & A session regarding simulation mechanics and results of first practice decision.  
**Deadline for completing the second BSG practice decision round is 11:59 p.m. today.** |
| 20   | Class discussion (or oral team presentations) of Adidas in 2008 or PepsiCo’s Diversification Strategy  
Optional 20-minute debriefing on the results of the second practice decision— instructor leads a class discussion of the information presented in the Footwear Industry Report and the Competitive Intelligence Reports showing practice decision outcomes. All class members should bring a copy of these reports to class (or the instructor can provide copies to all class members). Now is a good time to strongly encourage all class members to get in the habit of carefully and thoroughly reviewing the information in each year’s Footwear Industry Report, Competitive Intelligence Reports and Company Operations Reports— otherwise, company co-managers lack knowledge of market conditions and their company’s competitiveness vis-à-vis rivals heading into the next decision round (flying blind in a fiercely competitive marketplace is a ticket for disastrous company performance).  |
| 21   | Class meets in computer lab so that company co-managers can work on their strategy and decisions for the Year 11 BSG decision round; **deadline for completing Year 11 BSG decision entries is 11:59 p.m. today**.  |
| 22   | Class discussion of Robin Hood or Dilemma at Devil’s Den; **deadline for completing the Year 12 BSG decision entries is 11:59 p.m. today.**  |
| 23   | Exam covering Chapters 8-12  |
| 24   | Class discussion (or oral team presentations) of Wal-Mart (has accompanying video) or Southwest Airlines (has accompanying video); **deadline for completing both the Year 13 BSG decision entries and online Quiz 2 (covering understanding of company operations) is 11:59 p.m. today.**  |
| 25   | Oral team presentation of Panera Bread (has accompanying video) or Apple Inc.; **deadline for completing the Year 14 BSG decision entries is 11:59 p.m. today.**  |
| 26   | Oral team presentation of Corona Beer or Nintendo or Rogers’ Chocolates; **deadline for completing Year 15 BSG decision entries is 11:59 p.m. today.**  |
| 27   | Oral team presentation of Shangri-La Hotels or Nucor or Research in Motion; **deadline for completing Year 16 BSG decision entries is 11:59 p.m. today.**  |
| 28   | Class discussion of case on Detecting Unethical Practices at Supplier Factories; **deadline for completing Year 17 BSG decision entries is 11:59 p.m. today.**  |
| 29   | Oral team presentation of E&J Gallo or Jet Blue Airways (has accompanying video) or Loblaw or Google’s Strategy in 2008 (has accompanying video); **deadline for completing Year 18 BSG decision entries and the peer evaluations of all co-managers is 11:59 p.m. today.**  |
| 30   | End-of-simulation BSG company presentations (with brief Q&A session if time permits)  
Course wrap-up; assessment of Business Strategy Game simulation and lessons learned. Instructor may wish to share some of the class-wide averages for the 9 measures in the Learning Assurance Report.  |
| Final Exam | In-class written case analysis |
CLASS SCHEDULE FOR A 15-WEEK (OR SEMESTER-LENGTH) COURSE (SAMPLE 3)

One class meeting of ~3-hours each week for 15 weeks

Includes 6 case assignments or oral team presentations and weekly BSG or GLO-BUS decision rounds throughout the term

<table>
<thead>
<tr>
<th>Week</th>
<th>Assignment/Activity</th>
</tr>
</thead>
</table>
| 1    | Lecture on Chapter 1 Introduction to GLO-BUS  
Explanation of GLO-BUS simulation using PowerPoint slides provided in Instructor Center; assign class members to teams; provide company co-managers with company registration codes (required in order for class members to register for the GLO-BUS simulation at www.glo-bus.com); ask all class members to read the Participant’s Guide prior to next class meeting |
| 2    | Lecture/discussion of Chapter 2 and instructor-selected chapter-end exercises (including those exercises for simulation participants, but avoid open discussions where company co-managers are asked to reveal competitive sensitive aspects about their company to their rivals)  
Optional Q & A session regarding simulation mechanics  
Balance of class is devoted to a simulation workshop where company co-managers meet in teams in the computer lab to prepare their strategy and decisions for the first practice round; if needed, company co-managers meet outside of class to complete their decision-making for the first practice round. [Alternatively, the simulation may be held in the regular classroom if the classroom has sufficient PCs or if each company team has a laptop and access to an Internet connection.]

**Deadline for completing decision entries for the first GLO-BUS practice round is 11 p.m. on the day before weekly class meeting #3. Deadline for completing online Quiz 1 (covering the contents of the Participant’s Guide) corresponds to the same 11 p.m. deadline for completing the decisions for the first practice round.** |
| 3    | Lecture/discussion of Chapter 3 and instructor-selected chapter-end exercises (including those exercises for simulation participants, but it is wise to avoid open discussions that call upon company co-managers to reveal competitive sensitive aspects about their company to their rivals)  
Optional debriefing on the results of the first GLO-BUS practice round—instructor leads a class discussion of the information presented in the GLO-BUS Statistical Review and the Competitive Intelligence Reports showing the outcomes for practice round 1. All class members should bring a copy of these reports to class (or the instructor can provide copies to all class members). The purpose for this debriefing is to make sure that all class members have a good grasp of all the information being provided to them after each decision round is completed (but it should be totally up to each team of co-managers to review the information, digest the meaning of all the numbers and statistics provided, and decide what, if any, actions to take in the next decision round based on this information about the outcomes)  
Optional Q & A session regarding simulation mechanics and results of first practice decision.  
Remainder of class is devoted to a simulation workshop where company co-managers meet in teams to prepare their strategy and decisions for the second GLO-BUS practice round; if and when needed, company co-managers meet outside of class to complete their decision-making for GLO-BUS practice round two.  
**Deadline for completing decision entries for the second practice round is 11 p.m. on the day before weekly class meeting #4.** |
|   | Lecture/discussion of Chapter 4 and instructor-selected chapter-end exercises (including those exercises for simulation participants, but be careful to skirt discussions where company co-managers are asked to reveal competitive sensitive aspects about their company to their rivals)  
Optional debriefing on the results of the second GLO-BUS practice round—instructor leads a class discussion of the information presented in the GLO-BUS Statistical Review and the Competitive Intelligence Reports showing the second practice round results. All class members should bring a copy of these reports to class. Now is a good time to strongly encourage all class members to get in the habit of carefully and thoroughly reviewing the information in each year’s GLO-BUS Statistical Review, Competitive Intelligence Reports and Company Operations Reports—otherwise, company co-managers lack knowledge of market conditions and their company’s competitiveness vis-à-vis rivals heading into the next decision round (flying blind in a fiercely competitive marketplace is a ticket for disastrous company performance).  
Short Q & A session regarding the results of the second practice round.  
Data is reset back to Year 5 immediately prior to the beginning of class #4, so that GLO-BUS company co-managers will be able to work on the Year 6 decision round during the class period.  
Remainder of class is devoted to a simulation workshop where company co-managers convene in their respective teams to prepare their strategy and decisions for the Year 6 GLO-BUS decision round (the first regular or scored set of company decisions); company co-managers meet outside of class as may be needed to complete their decision-making for Year 6.  
Deadline for completing GLO-BUS Year 6 decision entries is 11 p.m. on the day before weekly class meeting #5. |
|---|---|
|   | Lecture/discussion of Chapter 5 and instructor-selected chapter-end exercises (including those exercises for simulation participants, but avoid open discussions where company co-managers are asked to reveal competitive sensitive aspects about their company to their rivals)  
Ask each company to come to class having prepared a 2-3 sentence mission statement or strategic vision for their GLO-BUS company, together with a set of performance targets for the Year 7 decision round. Review/discuss these with each individual company as a way of checking whether they have agreed on a long-term direction for their company and set performance targets (but it is unwise for each company to be required to share this competitively sensitive information with class members who are managing rival companies).  
Optional debriefing on the results of the Year 6 GLO-BUS decision round—instructor leads a class discussion of the information presented in the Year 6 GLO-BUS Statistical Review and the Competitive Intelligence Reports showing the Year 6 outcomes. All class members should bring a copy of these reports to class—standard procedure for all debriefings).  
Remainder of class is devoted to a simulation workshop where company co-managers convene in teams to prepare their strategy and decisions for the Year 7 decision round; company co-managers meet outside of class as may be needed to complete their decision-making for GLO-BUS Year 7.  
Deadline for completing Year 7 GLO-BUS decision entries is 11 p.m. on the day before weekly class meeting #6. |
|   | Lecture/discussion of Chapter 6 and 7 and instructor-selected chapter-end exercises (including those exercises for simulation participants)  
Optional debriefing on the results of the Year 7 GLO-BUS decision round.  
Remainder of class is devoted to a simulation workshop where company co-managers convene in teams to prepare their strategy and decisions for GLO-BUS Year 8; company co-managers meet outside of class as may be needed to complete their decision-making for GLO-BUS Year 8.  
Deadline for completing both Year 8 GLO-BUS decision entries and online Quiz 2 (covering understanding of company operations) is 11 p.m. on the day before weekly class meeting #7. |
<table>
<thead>
<tr>
<th>Week</th>
<th>Activity</th>
</tr>
</thead>
</table>
| 7    | Exam over Chapters 1-7  
Optional debriefing on the results of the Year 8 GLO-BUS decision round.  
Remainder of class is devoted to a simulation workshop where company co-managers convene (either in the computer lab or around Internet-accessible PCs/laptops in the regular classroom) to prepare 3-Year Strategic Plan #1 covering Years 9-10-11; company co-managers meet outside of class to complete their decision-making for Year 9.  
Deadline for completing both Strategic Plan #1 and Year 9 decision entries is 11 p.m. on the day before weekly class meeting #8. |
| 8    | Lecture/discussion of Chapter 8 and instructor-selected chapter-end exercises (including those exercises for simulation participants)  
Optional debriefing on the results of the Year 9 GLO-BUS decision round and a quick review of how well company teams did in meeting the Year 9 performance targets set forth in their 3-year strategic plan for Years 9-10-11. Co-managers should be asked to consider what will need to be done to get back on track for Year 10, if performance in Year 9 was sub-par.—instructor leads a class discussion of the information presented in the Year 9 GLO-BUS Statistical Review and the Competitive Intelligence Reports. All class members should bring a copy of these reports to class.  
Remainder of class is devoted to a simulation workshop where company co-managers convene in teams to prepare their strategy and decisions for GLO-BUS Year 10; company co-managers meet outside of class as may be needed to complete their decision-making for GLO-BUS Year 10.  
Deadline for completing Year 10 GLO-BUS decision entries is 11 p.m. on the day before weekly class meeting #9. |
| 9    | Lecture/discussion of Chapter 9 and instructor-selected chapter-end exercises (including those exercises for simulation participants)  
Optional debriefing on the results of the Year 10 decision round and a quick review of how well company teams did in meeting the Year 9 and Year 10 performance targets set forth in their 3-year strategic plan for Years 9-10-11. Co-managers should be asked to consider what will need to be done to get back on track for Year 11, if performance in Years 9 and/or 10 was sub-par.  
Remainder of class is devoted to a simulation workshop where company co-managers convene in teams to prepare their strategy and decisions for the Year 11 GLO-BUS decision round; company co-managers meet outside of class as may be needed to complete their decision-making for GLO-BUS Year 11.  
Deadline for completing Year 11 GLO-BUS decision entries is 11 p.m. the day before weekly class meeting #10. |
| 10   | Lecture/discussion of Chapters 10, 11, and 12 and instructor-selected chapter-end exercises  
Optional short debriefing on the results of the Year 11 GLO-BUS decision round; instructor briefly discusses company performances on the first 3-year strategic plan (this information is in the instructor’s online grade book) and asks class members for ideas and suggestions on how company co-managers can improve on setting and meeting (or beating) the performance targets they set for each year of the second 3-year strategic plan.  
Remainder of class is devoted to a simulation workshop where the class convenes in the computer lab (or around Internet-accessible laptops of company managers) to allow company co-managers to work on 3-Year Strategic Plan #2 covering Years 12-13-14; company co-managers meet outside of class to complete their decision-making for GLO-BUS Year 12.  
Deadline for completing both Strategic Plan #2 and Year 12 GLO-BUS decision entries is 11 p.m. on the day before weekly class meeting #11. |

continued
<table>
<thead>
<tr>
<th>Week</th>
<th>Oral Team Presentations</th>
<th>Optional Debriefing</th>
<th>Simulation Workshop</th>
<th>Decision Deadline</th>
<th>Summary of Lessons Learned</th>
</tr>
</thead>
<tbody>
<tr>
<td>11</td>
<td>Dell in 2008 or Panera Bread</td>
<td>Results of Year 12</td>
<td>Prepare strategy for Year 13</td>
<td>11 p.m. on the day before meeting #12</td>
<td>End-of-simulation company presentations</td>
</tr>
<tr>
<td>12</td>
<td>JetBlue Airways or Loblaw or Research in Motion</td>
<td>Results of Year 13</td>
<td>Prepare strategy for Year 14</td>
<td>11 p.m. two days before meeting #14</td>
<td>End-of-simulation company presentations</td>
</tr>
<tr>
<td>13</td>
<td>Apple or Nucor cases</td>
<td>Results of Year 14</td>
<td>Prepare strategy for Year 15</td>
<td>11 p.m.</td>
<td>End-of-simulation company presentations</td>
</tr>
<tr>
<td>14</td>
<td>eBay or Google or Nintendo cases</td>
<td>Complete Year 15</td>
<td>End-of-simulation company presentations</td>
<td></td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>Adidas in 2008 or PepsiCo’s Diversification Strategy or Shangri-La Hotels</td>
<td>Complete Year 16</td>
<td>End-of-simulation company presentations</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Final Exam: In-class written case analysis</td>
</tr>
</tbody>
</table>
# CLASS SCHEDULE FOR A 15-WEEK (OR SEMESTER-LENGTH) COURSE
(SAMPLE 4)

30 class meetings of 75 minutes

No use of a simulation; 6 case assignments or oral team presentations

<table>
<thead>
<tr>
<th>Day</th>
<th>Assignment/Activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Orientation and course preview; lecture on Chapter 1</td>
</tr>
<tr>
<td>2</td>
<td>Lecture/discussion of Chapter 2 and instructor-selected chapter-end exercises or Illustration Capsules</td>
</tr>
<tr>
<td>3</td>
<td>Lecture/discussion of Chapter 3 and instructor-selected chapter-end exercises or Illustration Capsules; coverage of key points in &quot;Guide to Case Analysis&quot; (available to class members in the Student Center at <a href="http://www.mhhe.com/thompson">www.mhhe.com/thompson</a>)</td>
</tr>
<tr>
<td>4</td>
<td>Class discussion Whole Foods Market or Costco Wholesale (has accompanying video) or JetBlue Airways (has accompanying video)</td>
</tr>
<tr>
<td>5</td>
<td>Lecture/discussion of Chapter 3 and instructor-selected chapter-end exercises or Illustration Capsules</td>
</tr>
<tr>
<td>6</td>
<td>Lecture/discussion of Chapter 4 and instructor-selected chapter-end exercises or Illustration Capsules</td>
</tr>
<tr>
<td>7</td>
<td>Class discussion of Competition in the Golf Equipment Industry or Competition in the Movie Rental Industry (has accompanying video)</td>
</tr>
<tr>
<td>8</td>
<td>Lecture/discussion of Chapter 5 and instructor-selected chapter-end exercises or Illustration Capsules</td>
</tr>
<tr>
<td>9</td>
<td>Lecture/discussion of Chapter 6 and instructor-selected chapter-end exercises or Illustration Capsules</td>
</tr>
<tr>
<td>10</td>
<td>Class discussion of Dell in 2008 (has accompanying video) or Apple or Nucor cases</td>
</tr>
<tr>
<td>11</td>
<td>Lecture/discussion of Chapter 7 and instructor-selected chapter-end exercises or Illustration Capsules</td>
</tr>
<tr>
<td>12</td>
<td>Class discussion of Rogers’ Chocolates or Panera Bread (has accompanying video)</td>
</tr>
<tr>
<td>13</td>
<td>Examination, Chapters 1-7</td>
</tr>
<tr>
<td>14</td>
<td>Class discussion of Competition in Video Game Consoles (has accompanying video)</td>
</tr>
<tr>
<td>15</td>
<td>Class discussion (or oral team presentation) of Nintendo case</td>
</tr>
<tr>
<td>16</td>
<td>Class discussion (or oral team presentation) of Corona Beer or Loblaw or Research in Motion</td>
</tr>
<tr>
<td>17</td>
<td>Class discussion (or oral team presentation) of Google (has accompanying video) or eBay case</td>
</tr>
<tr>
<td>18</td>
<td>Lecture/discussion of Chapter 8 and instructor-selected chapter-end exercises or Illustration Capsules</td>
</tr>
<tr>
<td>19</td>
<td>Class discussion of Adidas in 2008</td>
</tr>
<tr>
<td>20</td>
<td>Class discussion (or oral team presentation) of PepsiCo’s Diversification Strategy</td>
</tr>
<tr>
<td>21</td>
<td>Lecture/discussion of Chapter 9 and instructor-selected chapter-end exercises or Illustration Capsules</td>
</tr>
<tr>
<td>22</td>
<td>Lecture/discussion of Chapter 10 and instructor-selected chapter-end exercises or Illustration Capsules</td>
</tr>
<tr>
<td>23</td>
<td>Lecture/discussion of Chapter 11 and instructor-selected chapter-end exercises or Illustration Capsules</td>
</tr>
<tr>
<td>24</td>
<td>Lecture/discussion of Chapter 12 and instructor-selected chapter-end exercises or Illustration Capsules</td>
</tr>
<tr>
<td>25</td>
<td>Class discussion of Robin Hood or Dilemma at Devil’s Den</td>
</tr>
<tr>
<td>26</td>
<td>Class discussion of Wal-Mart (has accompanying video) or Southwest Airlines (has accompanying video)</td>
</tr>
<tr>
<td>27</td>
<td>Examination, Chapters 8-12</td>
</tr>
<tr>
<td>28</td>
<td>Class discussion of Detecting Unethical Practices at Supplier Factories</td>
</tr>
<tr>
<td>29</td>
<td>Class discussion (or oral team presentation) of E&amp;J Gallo case</td>
</tr>
<tr>
<td>30</td>
<td>Course wrap-up</td>
</tr>
<tr>
<td>Final Exam</td>
<td>In-class written case</td>
</tr>
</tbody>
</table>
### CLASS SCHEDULE FOR A 15-WEEK (OR SEMESTER-LENGTH) COURSE (SAMPLE 5)

1 class meeting of ~ 3 hours per week

No use of a simulation; 12 case assignments or oral team presentations

<table>
<thead>
<tr>
<th>Week</th>
<th>Assignment/Activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Course preview and lecture on Chapter 1</td>
</tr>
<tr>
<td>2</td>
<td>Lecture/discussion of Chapter 2 and instructor-selected chapter-end exercises and Illustration Capsules</td>
</tr>
</tbody>
</table>
| 3    | Lecture/discussion of Chapter 3 and instructor-selected chapter-end exercises  
Class discussion of Whole Foods Market or Costco Wholesale in 2008 (has accompanying video) |
| 4    | Lecture/discussion of Chapter 4 and instructor-selected chapter-end exercises  
Class discussion of Competition in the Golf Equipment Industry or Competition in the Movie Rental Industry (has accompanying video) |
| 5    | Lecture/discussion of Chapter 5 and instructor-selected chapter-end exercises  
Class discussion of Dell in 2008 (has accompanying video) or JetBlue Airways (has accompanying video) or Panera Bread (has accompanying video) |
| 6    | Lecture/discussion of Chapter 6 and instructor-selected chapter-end exercises  
Class discussion of Rogers’ Chocolates or Nucor or Corona Beer |
| 7    | Lecture/discussion of Chapter 7 and instructor-selected chapter-end exercises  
Oral team presentations of eBay or Google (has accompanying video) cases |
| 8    | Class discussion of Competition in Video Game Consoles (has accompanying video)  
Oral team presentations of Nintendo case |
| 9    | Lecture on Chapter 8  
Exam over Chapters 1-7 |
| 10   | Lecture/discussion of Chapter 9 and instructor-selected chapter-end exercises  
Class discussion of Detecting Unethical Practices at Supplier Factories |
| 11   | Lecture/discussion of Chapter 10 and instructor-selected chapter-end exercises  
Class discussion of Dilemma at Devil’s Den |
| 12   | Lecture/discussion of Chapter 11 and instructor-selected chapter-end exercises  
Class discussion of Wal-Mart (has accompanying video) or Southwest Airlines (has accompanying video) |
| 13   | Lecture/discussion of Chapter 12 and instructor-selected chapter-end exercises  
Oral team presentations of Shangri-La Hotels |
| 14   | Oral team presentations of Corona Beer or Loblaw or Research in Motion or E&J Gallo cases |
| 15   | In-class written case or Exam over Chapters 8-12  
Course wrap-up |
|     | Final Exam  
Questions relating to Chapters 8-12 or in-class written case analysis |
### CLASS SCHEDULE FOR A 10-WEEK (OR QUARTER-LENGTH) COURSE (SAMPLE 1)

2 class meetings per week

Includes assignment of 4 cases for oral team presentations and weekly BSG or GLO-BUS decision rounds throughout the term

<table>
<thead>
<tr>
<th>Day</th>
<th>Assignment/Activity</th>
</tr>
</thead>
</table>
| 1   | Orientation and course preview  
Explanation of GLO-BUS simulation using PowerPoint slides provided in Instructor Center; assign class members to teams; provide company co-managers with company registration codes (required in order for class members to register for the simulation at [www.glo-bus.com](http://www.glo-bus.com)); ask all class members to read the Player’s Guide prior to next class meeting |
| 2   | Lecture on Chapter 1; remind all company co-managers to begin meeting with company co-managers to work on first practice decision |
| 3   | Class meets in computer lab so that company co-managers can work on their strategy and decisions for the practice round; **deadline for completing GLO-BUS practice decision entries and online Quiz 1 (covering the contents of the GLO-BUS Participant’s Guide) is today at 11:59 p.m.** |
| 4   | Lecture/discussion of Chapter 2 and selected chapter-end exercises (including those exercises for simulation participants, but avoid open discussions that call upon company co-managers to reveal competitive sensitive aspects about their company to their rivals)  
Optional 30-minute debriefing on the results of practice round—Instructor leads a class discussion of the information presented in the GLO-BUS Statistical Review and the Competitive Intelligence Reports showing practice round outcomes. All class members should bring a copy of these reports to class (or the instructor can provide copies to all class members). The purpose of this debriefing is to make sure that all class members have a good grasp of all the information being provided to them after each decision round is completed (but it should be totally up to each team of co-managers to review the information, digest the meaning of all the numbers and statistics provided, and decide what, if any, actions to take in the next decision round based on this information about the outcomes). |
| 5   | Class meets in computer lab so that company co-managers can work on their strategy and decisions for the Year 6 GLO-BUS decision round (the first regular or scored set of decisions); **deadline for completing GLO-BUS Year 6 decision entries is today at 11:59 p.m.** |
| 6   | Lecture/discussion of Chapter 3 and selected chapter-end exercises (including those exercises for simulation participants, but be careful to skirt open discussions that call upon company co-managers to reveal competitive sensitive aspects about their company to their rivals)  
Optional 15-minute debriefing on the results of Year 6 decision round—Instructor leads a class discussion of the information presented in the Year 6 GLO-BUS Statistical Review and the Competitive Intelligence Reports showing Year 6 outcomes. All class members should bring a copy of these reports to class (or the instructor can provide copies to all class members). Now is a good time to strongly encourage all class members to get in the habit of carefully and thoroughly reviewing the information in each year’s GLO-BUS Statistical Review, Competitive Intelligence Reports and Company Operations Reports—otherwise, company co-managers lack knowledge of market conditions and their company’s competitiveness vis-à-vis rivals heading into the next decision round (flying blind in a fiercely competitive marketplace is a ticket for disastrous company performance). |
| 7   | Lecture/discussion of Chapter 4 and selected chapter-end exercises (including those exercises for simulation participants, but be careful to skirt open discussions that call upon company co-managers to reveal competitive sensitive aspects about their company to their rivals); **deadline for completing GLO-BUS Year 7 decision entries is today at 11:59 p.m.** |

*continued*
<table>
<thead>
<tr>
<th>8</th>
<th>Lecture/discussion of Chapter 5 and selected chapter-end exercises (including those exercises for simulation participants, but be careful to skirt open discussions that call upon company co-managers to reveal competitive sensitive aspects about their company to their rivals)</th>
</tr>
</thead>
<tbody>
<tr>
<td>9</td>
<td>Lecture/discussion of Chapter 6 and selected chapter-end exercises (including those exercises for simulation participants, but be careful to skirt open discussions that call upon company co-managers to reveal competitive sensitive aspects about their company to their rivals); <strong>deadline for completing both GLO-BUS Year 8 decision entries and online Quiz 2 (covering understanding of company operations) is today at 11:59 p.m.</strong></td>
</tr>
<tr>
<td>10</td>
<td>Lecture/discussion of Chapter 7 and selected chapter-end exercises (including those exercises for simulation participants, but be careful to skirt open discussions that call upon company co-managers to reveal competitive sensitive aspects about their company to their rivals)</td>
</tr>
<tr>
<td>11</td>
<td>Examination over Chapters 1-7; <strong>deadline for completing GLO-BUS Year 9 decision entries is today at 11:59 p.m.</strong></td>
</tr>
<tr>
<td>12</td>
<td>Lecture/discussion of Chapter 8 and selected chapter-end exercises</td>
</tr>
<tr>
<td>13</td>
<td>Lecture/discussion of Chapter 9 and selected chapter-end exercises (including those exercises for simulation participants, but be careful to skirt open discussions that call upon company co-managers to reveal competitive sensitive aspects about their company to their rivals); <strong>deadline for completing GLO-BUS Year 10 decision entries is today at 11:59 p.m.</strong></td>
</tr>
<tr>
<td>14</td>
<td>Lecture/discussion of Chapter 10 and selected chapter-end exercises</td>
</tr>
<tr>
<td>15</td>
<td>Lecture/discussion of Chapter 11 and selected chapter-end exercises; <strong>deadline for completing GLO-BUS Year 11 decision round is today at 11:59 p.m.</strong></td>
</tr>
<tr>
<td>16</td>
<td>Lecture/discussion of Chapter 12 and selected chapter-end exercises (including those exercises for simulation participants, but be careful to skirt open discussions that call upon company co-managers to reveal competitive sensitive aspects about their company to their rivals)</td>
</tr>
<tr>
<td>17</td>
<td>Oral team presentations of JetBlue Airways (has accompanying video) or Dell in 2008 (has accompanying video) or Apple in 2008; <strong>deadline for completing GLO-BUS Year 12 decision entries is today at 11:59 p.m.</strong></td>
</tr>
<tr>
<td>18</td>
<td>Oral team presentations of Panera Bread (has accompanying video) or Nucor or Nintendo or Rogers’ Chocolates</td>
</tr>
<tr>
<td>19</td>
<td>Oral team presentations of Google (has accompanying video) or eBay or Research in Motion or Loblaw</td>
</tr>
<tr>
<td>20</td>
<td>Oral team presentations of Adidas in 2008 or PepsiCo’s Diversification Strategy or Shangri-La Hotels or E&amp;J Gallo; course wrap-up</td>
</tr>
</tbody>
</table>

**Final Exam**

Chapters 8-12
# CLASS SCHEDULE FOR A 10-WEEK (OR QUARTER-LENGTH) COURSE (SAMPLE 2)

1 class meeting weekly of ~3 hours

Includes assignment of 4 cases for oral team presentations
and weekly BSG or GLO-BUS decision rounds throughout the term

<table>
<thead>
<tr>
<th>Week</th>
<th>Assignment/Activity</th>
</tr>
</thead>
</table>
| 1    | Orientation and course preview  
Introduction to *GLO-BUS* using the PowerPoint slides provided; assign class members to company teams; provide company co-managers with company registration codes (required in order for class members to register at [www.glo-bus.com](http://www.glo-bus.com)). Ask all class members to read the *GLO-BUS* Participant’s Guide and have the co-managers of each company team complete their decision entries for the first *GLO-BUS* practice round three hours prior to the upcoming class meeting. Also have all company co-managers complete online Quiz 1 covering the *GLO-BUS* Participant’s Guide three hours prior to the upcoming class meeting.  
Remainder of class period: Lecture on Chapter 1 |
| 2    | Lecture/discussion of Chapter 2 and instructor-selected chapter-end exercises (including those exercises for simulation participants, but avoid open discussions where company co-managers are asked to reveal competitive sensitive aspects about their company to their rivals)  
Optional 45-minute debriefing on the results of the practice decision—instructor leads a class discussion of the information presented in the *GLO-BUS* Statistical Review and the Competitive Intelligence Reports showing practice decision outcomes. All class members should bring a copy of these reports to class (or the instructor can provide copies to all class members). The purpose of this debriefing is to make sure that all class members have a good grasp of all the information being provided to them after each decision round is completed (but it should be totally up to each team of co-managers to review the information, digest the meaning of all the numbers and statistics provided, and decide what, if any, actions to take in the next decision round based on this information about the outcomes).  
Optional Q & A session regarding simulation mechanics and results of first *GLO-BUS* practice decision.  
Remainder of class period: Each team of company co-managers meets as a group (in computer lab or in classroom if each team has access to a PC/laptop and an Internet connection) to work on their strategy and decisions for Year 6. Company co-managers will usually need to meet outside of class to complete their decision-making for Year 6. **Deadline for completing Year 6 *GLO-BUS* decision entries is 11:59 p.m. the evening before the next class meeting.** |
| 3    | Lecture/discussion of Chapter 3 and instructor-selected chapter-end exercises (including those exercises for simulation participants, but avoid open discussions where company co-managers are asked to reveal competitive sensitive aspects about their company to their rivals)  
Optional 30-minute debriefing on the results of the Year 6 decision round—instructor lead a class discussion of the information presented in the Year 6 *GLO-BUS* Statistical Review and the Competitive Intelligence Reports showing Year 6 outcomes. All class members should bring a copy of these reports to class (or the instructor can provide copies to all class members). Now is a good time to strongly encourage all class members to get in the habit of carefully and thoroughly reviewing the information in each year’s *GLO-BUS* Statistical Review, Competitive Intelligence Reports and Company Operations Reports—otherwise, company co-managers lack knowledge of market conditions and their company’s competitiveness vis-à-vis rivals heading into the next decision round (flying blind in a fiercely competitive marketplace is a ticket for disastrous company performance).  
Remainder of class period: Each team of company co-managers meets as a group (in computer lab or in classroom if each team has access to a PC/laptop and an Internet connection) to work on their strategy and decisions for Year 7. Company co-managers will generally need to meet outside of class to complete their decision-making for Year 7. **Deadline for completing Year 7 *GLO-BUS* decision entries is 11:59 p.m. the evening before the next class meeting.** |
<table>
<thead>
<tr>
<th>Lecture/discussion of Chapter 4 and instructor-selected chapter-end exercises (including those exercises for simulation participants, but avoid open discussions where company co-managers are asked to reveal competitive sensitive aspects about their company to their rivals)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Optional 20-minute debriefing on the results of the Year 7 decision round—instructor leads a class discussion of the information presented in the Year 7 GLO-BUS Statistical Review and the Competitive Intelligence Reports showing Year 7 outcomes. All class members should bring a copy of these reports to class (or the instructor can provide copies to all class members).</td>
</tr>
<tr>
<td>Remainder of class period: Each team of company co-managers meets as a group (in computer lab or in classroom if each team has access to a PC/laptop and an Internet connection) to work on their strategy and decisions for Year 8. Company co-managers will generally need to meet outside of class to complete their decision-making for Year 8. <strong>Deadline for completing both Year 8 GLO-BUS decision entries and online Quiz 2 (covering understanding of company operations) is 11:59 p.m. the evening before the next class meeting.</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Lecture/discussion of Chapter 5 and instructor-selected chapter-end exercises (including those exercises for simulation participants, but avoid open discussions where company co-managers are asked to reveal competitive sensitive aspects about their company to their rivals)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oral team presentations of Panera Bread (has accompanying video) or Dell in 2008 (has accompanying video) or Apple cases</td>
</tr>
<tr>
<td>Company co-managers meet outside of class to complete their decision-making for GLO-BUS Year 9. <strong>Deadline for completing Year 9 GLO-BUS decision entries is 11:59 p.m. the evening before the next class meeting.</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Lecture/discussion of Chapter 6, Chapter 7, and instructor-selected chapter-end exercises (including those exercises for simulation participants, but avoid open discussions where company co-managers are asked to reveal competitive sensitive aspects about their company to their rivals)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Remainder of class: Company co-managers meet (in computer lab or around PCs/laptops in classroom to work on preparing a 3-Year Strategic Plan for Years 10-11-12. Company co-managers will generally need to meet outside of class to complete the 3-year strategic plan and their strategy/decisions for Year 10. <strong>Deadline for completing both the Year 10 GLO-BUS decision entries and the strategic plan for Years 10-11-12 is 11:59 p.m. the evening before the next class meeting.</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Lecture/discussion of Chapter 8 and instructor-selected chapter-end exercises (including those exercises for simulation participants, but avoid open discussions where company co-managers are asked to reveal competitive sensitive aspects about their company to their rivals)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oral team presentations of eBay or Google (has accompanying video) or Corona Beer or Nucor or Rogers’ Chocolates cases</td>
</tr>
<tr>
<td>Company co-managers meet outside of class to complete their decision-making for Year 11. <strong>Deadline for completing Year 11 GLO-BUS decision entries is 11:59 p.m. the evening before the next class meeting.</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Lecture/discussion of Chapter 9 and instructor-selected chapter-end exercises (including those exercises for simulation participants, but avoid open discussions where company co-managers are asked to reveal competitive sensitive aspects about their company to their rivals)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oral team presentations of Adidas in 2008 or PepsiCo’s Diversification Strategy</td>
</tr>
<tr>
<td>Company co-managers meet outside of class to complete their decision-making for Year 12. <strong>Deadline for completing Year 12 GLO-BUS decision entries is 11:59 p.m. the evening before the next class meeting.</strong></td>
</tr>
</tbody>
</table>

*continued*
<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Section 4</strong></td>
<td>Sample Syllabi and Daily Course Schedules</td>
</tr>
</tbody>
</table>
| **9** | Lecture/discussion of Chapter 10, 11, and 12 and instructor-selected chapter-end exercises (including those exercises for simulation participants, but avoid open discussions where company co-managers are asked to reveal competitive sensitive aspects about their company to their rivals)  
Oral team presentations of Wal-Mart (has accompanying video) or Southwest (has accompanying video) or Shangri-La Hotels or E&J Gallo cases  
Discussion of requirements for preparing end-of-simulation company presentations.  
Company co-managers meet outside of class to complete their decision-making for *GLO-BUS* Year 13. **Deadline for completing the Year 13 *GLO-BUS* decision round is 11:59 p.m. two evenings before the next class meeting (having the deadline 1-day earlier will give class members more time to prepare the PowerPoint slides for their company presentations at class meeting 10).** |
| **10** | End-of simulation *GLO-BUS* company presentations (with 5-10 minute Q&A sessions for each presentation if time permits).  
Instructor may wish to share some of the class-wide averages for the 9 measures in the Learning Assurance Report.  
**All *GLO-BUS* company co-managers should have completed the peer evaluations by the beginning of today’s class period.** |
| **Final Exam** | Exam on Chapters 1-12 |
CLASS SCHEDULE FOR A 10-WEEK
(OR QUARTER-LENGTH)
COURSE (SAMPLE 3)

2 class meetings per week

No use of simulation; Includes class discussion of 3 cases
and assignment of 5 cases for oral team presentations

<table>
<thead>
<tr>
<th>Week</th>
<th>Assignment/Activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Orientation and course preview; lecture on Chapter 1</td>
</tr>
<tr>
<td>2</td>
<td>Lecture/discussion of Chapter 2 and instructor-selected chapter-end exercises; coverage of key points in “Guide to Case Analysis” (available to students in the Student center at <a href="http://www.mhhe.com/thompson">www.mhhe.com/thompson</a>.</td>
</tr>
<tr>
<td>3</td>
<td>Class discussion of Whole Foods Market or Costco Wholesale in 2008 (has accompanying video)</td>
</tr>
<tr>
<td>4</td>
<td>Lecture/discussion of Chapter 3 and instructor-selected chapter-end exercises</td>
</tr>
<tr>
<td>5</td>
<td>Class discussion of Competition in the Golf Equipment Industry or Competition in the Movie Rental Industry (has accompanying video)</td>
</tr>
<tr>
<td>6</td>
<td>Lecture/discussion of Chapter 4 and instructor-selected chapter-end exercises</td>
</tr>
<tr>
<td>7</td>
<td>Lecture/discussion of Chapter 5 and instructor-selected chapter-end exercises</td>
</tr>
<tr>
<td>8</td>
<td>Lecture/discussion of Chapter 6 and instructor-selected chapter-end exercises</td>
</tr>
<tr>
<td>9</td>
<td>Lecture/discussion of Chapter 7 and instructor-selected chapter-end exercises</td>
</tr>
<tr>
<td>10</td>
<td>Exam on Chapters 1-7</td>
</tr>
<tr>
<td>11</td>
<td>Lecture/discussion of Chapter 8 and instructor-selected chapter-end exercises</td>
</tr>
<tr>
<td>12</td>
<td>Lecture/discussion of Chapter 9; class discussion of Detecting Unethical Practices at Supplier Factories</td>
</tr>
<tr>
<td>13</td>
<td>Lecture/discussion of Chapter 10 and instructor-selected chapter-end exercises</td>
</tr>
<tr>
<td>14</td>
<td>Lecture/discussion of Chapter 11 and instructor-selected chapter-end exercises</td>
</tr>
<tr>
<td>15</td>
<td>Lecture/discussion of Chapter 12 and instructor-selected chapter-end exercises</td>
</tr>
<tr>
<td>16</td>
<td>Oral team presentations on eBay or Google (has accompanying video) or Nucor</td>
</tr>
<tr>
<td>17</td>
<td>Oral team presentations on Rogers Chocolates or Panera Bread (has accompanying video)</td>
</tr>
<tr>
<td>18</td>
<td>Oral team presentations on Whole Foods or JetBlue (has accompanying video) or Dell in 2008 (has accompanying video)</td>
</tr>
<tr>
<td>19</td>
<td>Oral team presentations on Corona Beer or Loblaw or Research in Motion</td>
</tr>
<tr>
<td>20</td>
<td>Oral team presentations on Adidas or PepsiCo or Shangri-La Hotels or E&amp;J Gallo</td>
</tr>
<tr>
<td>Final Exam</td>
<td>Chapters 8-12</td>
</tr>
</tbody>
</table>
CLASS SCHEDULE FOR A 5-WEEK COURSE  
(SAMPLE 1) 

Includes assignment of 4 cases for oral team presentations 
and biweekly BSG or GLO-BUS decision rounds throughout the term

<table>
<thead>
<tr>
<th>Class</th>
<th>Assignment/Activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Orientation and course preview</td>
</tr>
<tr>
<td></td>
<td>Introduction to GLO-BUS using the PowerPoint slides provided; assign class members to company teams; provide company co-managers with company registration codes (required in order for class members to register at <a href="http://www.glo-bus.com">www.glo-bus.com</a>). Ask all class members to read the GLO-BUS Participant’s Guide and have the co-managers of each company team complete their decision entries for the first GLO-BUS practice round three hours prior to the upcoming class meeting. Also have all company co-managers complete online Quiz 1 covering the GLO-BUS Participant’s Guide three hours prior to the upcoming class meeting.</td>
</tr>
<tr>
<td></td>
<td>Remainder of class period: Lecture on Chapter 1</td>
</tr>
<tr>
<td>2</td>
<td>Lecture/discussion of Chapter 2 and instructor-selected chapter-end exercises (including those exercises for simulation participants, but avoid open discussions where company co-managers are asked to reveal competitive sensitive aspects about their company to their rivals)</td>
</tr>
<tr>
<td></td>
<td>Optional 45-minute debriefing on the results of the practice decision—instructor leads a class discussion of the information presented in the GLO-BUS Statistical Review and the Competitive Intelligence Reports showing practice decision outcomes. All class members should bring a copy of these reports to class (or the instructor can provide copies to all class members). The purpose of this debriefing is to make sure that all class members have a good grasp of all the information being provided to them after each decision round is completed (but it should be totally up to each team of co-managers to review the information, digest the meaning of all the numbers and statistics provided, and decide what, if any, actions to take in the next decision round based on this information about the outcomes).</td>
</tr>
<tr>
<td></td>
<td>Optional Q &amp; A session regarding simulation mechanics and results of first GLO-BUS practice decision.</td>
</tr>
<tr>
<td></td>
<td>Remainder of class period: Each team of company co-managers meets as a group (in computer lab or in classroom if each team has access to a PC/laptop and an Internet connection) to work on their strategy and decisions for Year 6. Company co-managers will usually need to meet outside of class to complete their decision-making for Year 6. Deadline for completing Year 6 GLO-BUS decision entries is 11:59 p.m. the evening before the next class meeting.</td>
</tr>
<tr>
<td>3</td>
<td>Lecture/discussion of Chapter 3 and instructor-selected chapter-end exercises (including those exercises for simulation participants, but avoid open discussions where company co-managers are asked to reveal competitive sensitive aspects about their company to their rivals)</td>
</tr>
<tr>
<td></td>
<td>Optional 30-minute debriefing on the results of the Year 6 decision round—instructor lead a class discussion of the information presented in the Year 6 GLO-BUS Statistical Review and the Competitive Intelligence Reports showing Year 6 outcomes. All class members should bring a copy of these reports to class (or the instructor can provide copies to all class members). Now is a good time to strongly encourage all class members to get in the habit of carefully and thoroughly reviewing the information in each year’s GLO-BUS Statistical Review. Competitive Intelligence Reports and Company Operations Reports—otherwise, company co-managers lack knowledge of market conditions and their company’s competitiveness vis-à-vis rivals heading into the next decision round (flying blind in a fiercely competitive marketplace is a ticket for disastrous company performance).</td>
</tr>
<tr>
<td></td>
<td>Remainder of class period: Each team of company co-managers meets as a group (in computer lab or in classroom if each team has access to a PC/laptop and an Internet connection) to work on their strategy and decisions for Year 7. Company co-managers will generally need to meet outside of class to complete their decision-making for Year 7. Deadline for completing Year 7 GLO-BUS decision entries is 11:59 p.m. the evening before the next class meeting.</td>
</tr>
</tbody>
</table>

continued
<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
</table>
| **4** | Lecture/discussion of Chapter 4 and instructor-selected chapter-end exercises (including those exercises for simulation participants, but avoid open discussions where company co-managers are asked to reveal competitive sensitive aspects about their company to their rivals)  
Optional 20-minute debriefing on the results of the Year 7 decision round—instructor leads a class discussion of the information presented in the Year 7 *GLO-BUS* Statistical Review and the Competitive Intelligence Reports showing Year 7 outcomes. All class members should bring a copy of these reports to class (or the instructor can provide copies to all class members).  
Remainder of class period: Each team of company co-managers meets as a group (in computer lab or in classroom if each team has access to a PC/laptop and an Internet connection) to work on their strategy and decisions for Year 8. Company co-managers will generally need to meet outside of class to complete their decision-making for Year 8. **Deadline for completing both the Year 8 *GLO-BUS* decision entries and online Quiz 2 (covering understanding of company operations) is 11:59 p.m. the evening before the next class meeting.** |
| **5** | Lecture/discussion of Chapter 5 and instructor-selected chapter-end exercises (including those exercises for simulation participants, but avoid open discussions where company co-managers are asked to reveal competitive sensitive aspects about their company to their rivals)  
Oral team presentations of JetBlue Airways (has accompanying video) or Panera Bread (has accompanying video) or Nucor or Apple in 2008 or Dell in 2008 (has accompanying video)  
Company co-managers meet outside of class to complete their decision-making for *GLO-BUS* Year 9. **Deadline for completing Year 9 *GLO-BUS* decision entries is 11:59 p.m. the evening before the next class meeting.** |
| **6** | Lecture/discussion of Chapter 6, Chapter 7, and instructor-selected chapter-end exercises (including those exercises for simulation participants, but avoid open discussions where company co-managers are asked to reveal competitive sensitive aspects about their company to their rivals)  
Remainder of class: Company co-managers meet in computer lab or around PCs/laptops in classroom to work on preparing a 3-Year Strategic Plan for Years 10-11-12. Company co-managers will generally need to meet outside of class to complete the 3-year strategic plan and their strategy/decisions for Year 10. **Deadline for completing both the Year 10 *GLO-BUS* decision entries and the strategic plan for Years 10-11-12 is 11:59 p.m. the evening before the next class meeting.** |
| **7** | Lecture/discussion of Chapter 9  
Oral team Presentations of eBay or Google (has accompanying video) or Rogers’ Chocolates cases or class discussion of Detecting Unethical Practices in Supplier Factories case  
Company co-managers meet outside of class to complete their decision-making for Year 11. **Deadline for completing Year 11 *GLO-BUS* decision entries is 11:59 p.m. the evening before the next class meeting.** |
| **8** | Lecture/discussion of Chapters 10, 11, and 12  
Company co-managers meet outside of class to complete their decision-making for *GLO-BUS* Year 12. **Deadline for completing Year 12 *GLO-BUS* decision entries is 11:59 p.m. the evening before the next class meeting.** |
| **9** | Oral team presentations of Corona Beer or Loblaw or Research in Motion or Nintendo cases  
Company co-managers meet outside of class to complete their decision-making for *GLO-BUS* Year 13. **Deadline for completing Year 13 *GLO-BUS* decision entries is 11:59 p.m. the evening before the next class meeting.** |
| **10** | Oral team presentations of Wal-Mart (has accompanying video) or Southwest Airlines (has accompanying video) or Shangri-La Hotels or E&J Gallo cases  
**All *GLO-BUS* company co-managers should have completed the peer evaluations by the beginning of today’s class period.** |

**Final Exam**  
Exam on Chapters 1-7, 9-12
CLASS SCHEDULE FOR A 5-WEEK COURSE  
(SAMPLE 2)

Daily class meetings of 75-90 minutes

Includes assignment of 3 cases for class discussion, 4 cases for oral team presentations, and weekly BSG or GLO-BUS decision rounds throughout the term

<table>
<thead>
<tr>
<th>Day</th>
<th>Assignment/Activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Orientation and course preview</td>
</tr>
<tr>
<td></td>
<td>Introduction to <em>The Business Strategy Game</em> using the PowerPoint slides provided; assign class members to company teams; provide company co-managers with company registration codes (required in order for class members to register at <a href="http://www.bsg-online.com">www.bsg-online.com</a>). Ask all class members to read the BSG Player's Guide prior to the next class meeting.</td>
</tr>
<tr>
<td></td>
<td>Remainder of class period: Lecture on Chapter 1</td>
</tr>
<tr>
<td>2</td>
<td>Lecture on Chapter 2; remind class members that they should be meeting with their company co-managers to work on the decisions for the upcoming first practice round for <em>The Business Strategy Game</em> simulation.</td>
</tr>
<tr>
<td>3</td>
<td>Lecture on Chapter 3; remind class members that they should be meeting with their company co-managers to work on the decisions for the upcoming first practice round for <em>The Business Strategy Game</em> simulation</td>
</tr>
<tr>
<td>4</td>
<td>Lecture on Chapter 4. <strong>Deadline for completing both decision entries for the first BSG practice round and online Quiz 1 (covering the contents of the Player’s Guide) is 11:59 p.m. tonight.</strong></td>
</tr>
<tr>
<td>5</td>
<td>Lecture on Chapter 5</td>
</tr>
<tr>
<td></td>
<td>Optional 25-minute debriefing on the results of the practice decision— instructor leads a class discussion of the information presented in the Footwear Industry Report and the Competitive Intelligence Reports showing practice decision outcomes. All class members should bring a copy of these reports to class (or the instructor can provide copies to all class members). The purpose of this debriefing is to make sure that all class members have a good grasp of all the information being provided to them after each decision round is completed (but it should be totally up to each team of co-managers to review the information, digest the meaning of all the numbers and statistics provided, and decide what, if any, actions to take in the next decision round based on this information about the outcomes).</td>
</tr>
<tr>
<td></td>
<td>Optional Q &amp; A session regarding simulation mechanics and results of first BSG practice decision.</td>
</tr>
<tr>
<td>6</td>
<td>Class meets in computer lab so that company co-managers can work on their strategy and decisions for the Year 11 BSG decision round; <strong>deadline for completing Year 11 BSG decision entries is 11:59 p.m. tonight.</strong></td>
</tr>
<tr>
<td>7</td>
<td>Lecture on Chapter 6</td>
</tr>
<tr>
<td></td>
<td>Optional 20-minute debriefing on the results of the Year 11 BSG decision round—instructor leads a class discussion of the information presented in the Year 11 Footwear Industry Report and the Competitive Intelligence Reports showing Year 11 decision outcomes. All class members should bring a copy of these reports to class (or the instructor can provide copies to all class members). Now is a good time to strongly encourage all class members to get in the habit of carefully and thoroughly reviewing the information in each year’s Footwear Industry Report, Competitive Intelligence Reports and Company Operations Reports—otherwise, company co-managers lack knowledge of market conditions and their company’s competitiveness vis-à-vis rivals heading into the next decision round (flying blind in a fiercely competitive marketplace is a ticket for disastrous company performance).</td>
</tr>
<tr>
<td>8</td>
<td>Class discussion (or oral team presentation) of Whole Foods Market or Costco Wholesale (has accompanying video) or Competition in the Movie Rental Industry (has accompanying video)</td>
</tr>
<tr>
<td>9</td>
<td>Lecture on Chapter 7; <strong>deadline for completing Year 12 BSG decision entries is 11:59 p.m. tonight.</strong></td>
</tr>
<tr>
<td>10</td>
<td>Exam covering Chapters 1-7</td>
</tr>
</tbody>
</table>

continued
<table>
<thead>
<tr>
<th>Day</th>
<th>Activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>11</td>
<td>Class meets in computer lab so that company co-managers can work on their strategy and decisions for the Year 13 decision round; deadline for completing both Year 13 BSG decision entries and online Quiz 2 (covering understanding of company operations) is 11:59 p.m. today.</td>
</tr>
<tr>
<td>12</td>
<td>Lecture on Chapter 8; optional 10-minute debriefing on the results of the Year 13 decision round—instructor leads a class discussion of the information presented in the Year 13 Footwear Industry Report and the Competitive Intelligence Reports showing Year 13 decision outcomes. All class members should bring a copy of these reports to class (or the instructor can provide copies to all class members).</td>
</tr>
<tr>
<td>13</td>
<td>Class discussion (or oral team presentation) of Adidas in 2008 or PepsiCo’s Diversification Strategy</td>
</tr>
<tr>
<td>14</td>
<td>Lecture on Chapter 9; <strong>deadline for completing Year 14 BSG decision entries is 11:59 p.m. today.</strong></td>
</tr>
<tr>
<td>15</td>
<td>Lecture on Chapter 10</td>
</tr>
<tr>
<td>16</td>
<td>Lecture on Chapter 11; <strong>deadline for completing Year 15 BSG decision entries is 11:59 p.m. today.</strong></td>
</tr>
<tr>
<td>17</td>
<td>Class meets in computer lab so that company co-managers can work on their 3-year strategic plan for Years 16-17-18</td>
</tr>
<tr>
<td>18</td>
<td>Class meets in computer lab so that company co-managers can work on their 3-year strategic plan for Years 16-17-18 and their strategy and decisions for Year 16</td>
</tr>
<tr>
<td>19</td>
<td>Lecture on Chapter 12; <strong>deadline for completing both Year 16 BSG decision entries and the 3-year strategic plan for Years 16-17-18 is 11:59 p.m. today.</strong></td>
</tr>
<tr>
<td>20</td>
<td>Oral team presentations of Dell in 2008 (has accompanying video) or Panera Bread (has accompanying video) or Nucor Corp</td>
</tr>
<tr>
<td>21</td>
<td>Class discussion of Robin Hood or Dilemma at Devil’s Den; <strong>deadline for completing Year 17 BSG decision entries is 11:59 p.m. today.</strong></td>
</tr>
<tr>
<td>22</td>
<td>Oral team presentations of Apple in 2008 or Rogers’ Chocolates or eBay</td>
</tr>
<tr>
<td>23</td>
<td>Oral team presentations of JetBlue Airways (has accompanying video) or Google (has accompanying video) or Loblaw or Corona Beer</td>
</tr>
<tr>
<td>24</td>
<td>Oral team presentations of Shangri-La Hotels or E&amp;J Gallo <strong>Deadline for completing Year 18 BSG decision entries is 11:59 p.m. today.</strong> Discussion of requirements for preparing end-of-simulation company presentations.</td>
</tr>
<tr>
<td>25</td>
<td>End-of simulation company presentations (with brief Q&amp;A session for each presentation if time permits) Course wrap-up by instructor; assessment of learning and benefits of BSG simulation exercise. Instructor may wish to share some of the class-wide averages for the 8 measures in the Learning Assurance Report. <strong>All BSG company co-managers should have completed the peer evaluations by the beginning of today’s class period.</strong></td>
</tr>
</tbody>
</table>

| Final Exam | Exam on Chapters 8-12 |
CLASS SCHEDULE FOR A 5-WEEK COURSE
(SAMPLE 3)

Daily class meetings of 75-90 minutes

No use of simulation; Includes class discussion of 3 cases
and assignment of 5 cases for oral team presentations

<table>
<thead>
<tr>
<th>Week</th>
<th>Assignment/Activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Orientation and course preview: lecture on Chapter 1</td>
</tr>
<tr>
<td>2</td>
<td>Lecture/discussion of Chapter 2 and instructor-selected chapter-end exercises; coverage of key points in &quot;Guide to Case Analysis&quot; (available to students in the Student center at <a href="http://www.mhhe.com/thompson">www.mhhe.com/thompson</a>)</td>
</tr>
<tr>
<td>3</td>
<td>Class discussion of Whole Foods Market or Costco Wholesale in 2008 (has accompanying video)</td>
</tr>
<tr>
<td>4</td>
<td>Lecture/discussion of Chapter 3 and instructor-selected chapter-end exercises</td>
</tr>
<tr>
<td>5</td>
<td>Class discussion of Competition in the Golf Equipment Industry or Competition in the Movie Rental Industry (has accompanying video)</td>
</tr>
<tr>
<td>6</td>
<td>Lecture/discussion of Chapter 4 and instructor-selected chapter-end exercises</td>
</tr>
<tr>
<td>7</td>
<td>Lecture/discussion of Chapter 5 and instructor-selected chapter-end exercises</td>
</tr>
<tr>
<td>8</td>
<td>Class discussion of Dell in 2008 (has accompanying video) or Panera Bread (has accompanying video) or JetBlue Airways (has accompanying video)</td>
</tr>
<tr>
<td>9</td>
<td>Lecture/discussion of Chapter 6 and instructor-selected chapter-end exercises</td>
</tr>
<tr>
<td>10</td>
<td>Lecture/discussion of Chapter 7 and instructor-selected chapter-end exercises</td>
</tr>
<tr>
<td>11</td>
<td>Exam on Chapters 1-7</td>
</tr>
<tr>
<td>12</td>
<td>Class discussion of Competition in the Video Game Industry (has accompanying video)</td>
</tr>
<tr>
<td>13</td>
<td>Oral team presentations of Nintendo case</td>
</tr>
<tr>
<td>14</td>
<td>Lecture/discussion of Chapter 8 and instructor-selected chapter-end exercises</td>
</tr>
<tr>
<td>15</td>
<td>Lecture/discussion of Chapter 9</td>
</tr>
<tr>
<td>16</td>
<td>Class discussion of Detecting Unethical Practices at Supplier Factories</td>
</tr>
<tr>
<td>17</td>
<td>Lecture/discussion of Chapter 10 and instructor-selected chapter-end exercises</td>
</tr>
<tr>
<td>18</td>
<td>Lecture/discussion of Chapter 11 and instructor-selected chapter-end exercises</td>
</tr>
<tr>
<td>19</td>
<td>Lecture/discussion of Chapter 12 and instructor-selected chapter-end exercises</td>
</tr>
<tr>
<td>20</td>
<td>Oral team presentations on Rogers Chocolates or Nucor Corp</td>
</tr>
<tr>
<td>21</td>
<td>Exam, Chapters 8-12</td>
</tr>
<tr>
<td>22</td>
<td>Oral team presentations on eBay or Google (has accompanying video)</td>
</tr>
<tr>
<td>23</td>
<td>Oral team presentations on Corona Beer or Loblaw or Research in Motion</td>
</tr>
<tr>
<td>24</td>
<td>Oral team presentations on Adidas or PepsiCo</td>
</tr>
<tr>
<td>25</td>
<td>Oral team presentations on Shangri-La Hotels or E&amp;J Gallo</td>
</tr>
<tr>
<td>Final Exam</td>
<td>in-class written case analysis</td>
</tr>
</tbody>
</table>
section 5

Test Bank
for Chapters 1-12
Using the 17e Test Bank to Support College Assessment of Program Learning Objectives

The items in the 17th Edition Test Bank can be used to assess student knowledge of course concepts and to assess student knowledge of college program objectives. Each question in the 17e Test Bank includes tagging information that allows you to select items by chapter learning objective or by knowledge areas included in AACSB Assurance of Learning Standards and/or Bloom’s Taxonomy.

The following key should be used to sort test bank items by AACSB general and management-specific knowledge areas.

<table>
<thead>
<tr>
<th>Test Bank Code</th>
<th>AACSB Knowledge Area</th>
</tr>
</thead>
<tbody>
<tr>
<td>AACSB: Ethics/Legal Responsibilities</td>
<td>Ethical understanding and reasoning abilities/Ethical and legal responsibilities in organizations and society.</td>
</tr>
<tr>
<td>AACSB: Financial</td>
<td>Financial theories, analysis, reporting, and markets.</td>
</tr>
<tr>
<td>AACSB: Value Creation</td>
<td>Creation of value through the integrated production and distribution of goods, services, and information.</td>
</tr>
<tr>
<td>AACSB: Group/Individual Dynamics</td>
<td>Group and individual dynamics in organizations.</td>
</tr>
<tr>
<td>AACSB: Technology Influence</td>
<td>Information technologies as they influence the structure and processes of organizations and economies, and as they influence the roles and techniques of management.</td>
</tr>
<tr>
<td>Domestic/Global Economic Environments</td>
<td>Domestic and global economic environments of organizations.</td>
</tr>
</tbody>
</table>

The test bank tagging for behavioral categories related to learning included in Bloom’s Taxonomy (1956) is based on the following codes:

<table>
<thead>
<tr>
<th>Test Bank Code</th>
<th>Bloom’s Taxonomy Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxonomy: Knowledge</td>
<td>Recall or define information</td>
</tr>
<tr>
<td>Taxonomy: Comprehension</td>
<td>Describe, discuss or explain concepts</td>
</tr>
<tr>
<td>Taxonomy: Application</td>
<td>Solve problems and apply concepts</td>
</tr>
<tr>
<td>Taxonomy: Analysis</td>
<td>Critical examination of information</td>
</tr>
</tbody>
</table>
What Is Strategy and Why Is It Important?

Multiple Choice Questions

What Do We Mean By “Strategy?”

1. Which of the following is not one of the central questions in evaluating a company’s business prospects?

A) What is the company’s present situation?
B) What are the key product or service attributes demanded by consumers?
C) Where does the company need to go from here?
D) How should it get there?
E) All of the above are pertinent in evaluating a company’s business prospects.

Answer: B  Page: 5  Learning Objective: 1  Difficulty: Easy  Taxonomy: Knowledge
AACSB: Value Creation

2. A company’s strategy concerns

A) its market focus and plans for offering a more appealing product than rivals.
B) how it plans to make money in its chosen business.
C) management’s action plan for running the business and conducting operations—its commitment to pursue a particular set of actions in growing the business, staking out a market position, attracting and pleasing customers, competing successfully, conducting operations, and achieving targeted objectives.
D) the long-term direction that management believes the company should pursue.
E) whether it is employing an aggressive offense to gain market share or a conservative defense to protect its market position.

Answer: C  Page: 6  Learning Objective: 1  Difficulty: Medium  Taxonomy: Knowledge
AACSB: Value Creation

3. A company’s strategy consists of

A) the competitive moves and business approaches that managers are employing to grow the business, stake out a market position, attract and please customers, compete successfully, conduct operations, and achieve targeted objectives.
B) the plans it has to outcompete rivals and establish a sustainable competitive advantage.
C) the offensive moves it is employing to make its product offering more distinctive and appealing to buyers.
D) the actions it is taking to develop a more appealing business model than rivals.
E) its strategic vision, its strategic objectives, and its strategic intent.

Answer: A  Page: 6  Learning Objective: 1  Difficulty: Medium  Taxonomy: Knowledge
AACSB: Value Creation
4. The competitive moves and business approaches a company’s management is using to grow the business, stake out a market position, attract and please customers, compete successfully, conduct operations, and achieve organizational objectives is referred to as its
   A) strategy.
   B) mission statement.
   C) strategic intent.
   D) business model.
   E) strategic vision.

   **Answer:** A  Page: 6  Learning Objective: 1  Difficulty: Easy  Taxonomy: Knowledge
   AACSB: Value Creation

5. In crafting a strategy, management is in effect saying
   A) “this is who we are and where we are headed.”
   B) “this is our model for making money in our particular line of business.”
   C) “we intend to launch these new moves to outcompete our rivals.”
   D) “among all the many different business approaches and ways of competing we could have chosen, we have decided to employ this particular combination of competitive and operating approaches in moving the company in the intended direction, strengthening its market position and competitiveness, and boosting performance.”
   E) “this is our vision of what our business will be like, what products/services we will sell, and who our customers will be in the years to come.”

   **Answer:** D  Page: 6  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

6. A company’s strategy is most accurately defined as
   A) management’s approaches to building revenues, controlling costs and generating an attractive profit.
   B) the choices management has made regarding what financial plan to pursue
   C) management’s concept of “who we are, what we do, and where we are headed.”
   D) the business model that a company’s board of directors has approved for outcompeting rivals and making the company profitable.
   E) management’s commitment to pursue a particular set of actions in growing the business, attracting and pleasing customers, competing successfully, conducting operations, and improving the company’s financial and market performance.

   **Answer:** E  Page: 6  Learning Objective: 1  Difficulty: Easy  Taxonomy: Knowledge
   AACSB: Value Creation

7. Which of the following is **not** something a company’s strategy is concerned with?
   A) Management’s choices about how to attract and please customers
   B) How quickly and closely to copy the strategies being used by successful rival companies
   C) Management’s choices about how to grow the business
   D) Management’s choices about how to compete successfully
   E) Management’s action plan for conducting operations and improving the company’s financial and market performance

   **Answer:** B  Page: 6  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation
8. Which of the following is not a primary focus of a company’s strategy?
   A) How to attract and please customers
   B) How each functional piece of the business will be operated
   C) How to achieve above-average gains in the company’s stock price and thereby meet or beat shareholder expectations
   D) How to compete successfully
   E) How to grow the business

   Answer: C   Page: 6   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

9. In crafting a company’s strategy,
   A) management’s biggest challenge is how closely to mimic the strategies of successful companies in the industry.
   B) managers have comparatively little freedom in choosing the hows of strategy.
   C) managers are wise not to decide on concrete courses of action in order to preserve maximum strategic flexibility.
   D) managers need to come up with some distinctive “aha” element to the strategy that draws in customers and produces a competitive edge over rivals.
   E) managers are well-advised to be risk-averse and develop a “conservative” strategy—“dare-to-be-different” strategies rarely are successful.

   Answer: D   Page: 6   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

10. A company’s strategy stands a better chance of succeeding when
    A) it is developed through a collaborative process involving managers from all levels of the organization.
    B) managers employ conservative strategic moves.
    C) it is predicated on competitive moves aimed at appealing to buyers in ways that set the company apart from rivals.
    D) managers copy the strategic moves of successful companies in its industry.
    E) managers focus on meeting or beating shareholder expectations

    Answer: C   Page: 7   Learning Objective: 1   Difficulty: Easy   Taxonomy: Comprehension
    AACSB: Value Creation

**Strategy and the Quest for Competitive Advantage**

11. The heart and soul of a company’s strategy-making effort
    A) is figuring out how to become the industry’s low-cost provider.
    B) is figuring out how to maximize the profits and shareholder value.
    C) concerns how to improve the efficiency of its business model.
    D) deals with how management plans to maximize profits while, at the same time, operating in a socially responsible manner that keeps the company’s prices as low as possible.
    E) involves coming up with moves and actions that produce a durable competitive edge over rivals.

    Answer: E   Page: 7   Learning Objective: 1   Difficulty: Easy   Taxonomy: Comprehension
    AACSB: Value Creation
12. A company’s strategy and its quest for competitive advantage are tightly connected because
   A) without a competitive advantage a company cannot become the industry leader.
   B) without a competitive advantage a company cannot have a profitable business model.
   C) crafting a strategy that yields a competitive advantage over rivals is a company’s most reliable means
       of achieving above-average profitability and financial performance.
   D) a competitive advantage is what enables a company to achieve its strategic objectives.
   E) how a company goes about trying to please customers and outcompete rivals is what enables senior
       managers choose an appropriate strategic vision for the company.

   **Answer:** C   Page: 9   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

13. A company achieves sustainable competitive advantage when
   A) an attractive number of buyers have a lasting preference for its products or services as compared to the
       offerings of competitors.
   B) it has a profitable business model.
   C) it is able to maximize shareholder wealth.
   D) it is consistently able to achieve both its strategic and financial objectives.
   E) its strategy and its business model are well-matched and in sync.

   **Answer:** A   Page: 7   Learning Objective: 1   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

14. A creative, distinctive strategy that sets a company apart from rivals and that gives it a sustainable competitive
    advantage
   A) is a reliable indicator that the company has a profitable business model.
   B) is every company’s strategic vision.
   C) is a company’s most reliable ticket to above-average profitability—indeed, the tight connection between
       competitive advantage and profitability means that the quest for sustainable competitive advantage
       always ranks center stage in crafting a strategy.
   D) signals that the company has a bold, ambitious strategic intent that places the achievement of strategic
       objectives ahead of the achievement of financial objectives.
   E) is the best indicator that the company’s strategy and business model are well-matched and properly
       synchronized.

   **Answer:** C   Page: 7, 9   Learning Objective: 1   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

15. What separates a powerful strategy from a run-of-the-mill or ineffective one is
   A) the ability of the strategy to keep the company profitable.
   B) the proven ability of the strategy to generate maximum profits.
   C) the speed with which it helps the company achieve its strategic vision.
   D) management’s ability to forge a series of moves, both in the marketplace and internally, that sets the
       company apart from rivals, tilts the playing field in the company’s favor, and produces sustainable
       competitive advantage over rivals.
   E) whether it allows the company to maximize shareholder value in the shortest possible time.

   **Answer:** D   Page: 9   Learning Objective: 1   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation
16. Which of the following is a frequently used strategic approach to setting a company apart from rivals and achieving a sustainable competitive advantage?

A) Striving to be the industry’s low-cost provider, thereby aiming for a cost-based competitive advantage
B) Outcompeting rivals on the basis of such differentiating features as higher quality, wider product selection, added performance, better service, more attractive styling, technological superiority, or unusually good value for the money
C) Developing expertise and resource strengths that give the company competitive capabilities that rivals can’t easily imitate or trump with capabilities of their own
D) Focusing on a narrow market niche and winning a competitive edge by doing a better job than rivals of serving the special needs and tastes of buyers comprising the niche
E) All of these

**Answer:** E  Page: 7, 9  Learning Objective: 2  Difficulty: Easy  Taxonomy: Knowledge
AACSB: Value Creation

17. Which of the following is not a frequently used strategic approach to setting a company apart from rivals and achieving a sustainable competitive advantage?

A) Striving to be the industry’s low-cost provider, thereby aiming for a cost-based competitive advantage
B) Outcompeting rivals on the basis of such differentiating features as higher quality, wider product selection, added performance, better service, more attractive styling, technological superiority, or unusually good value for the money
C) Striving to be more profitable than rivals and aiming for a competitive edge based on bigger profit margins
D) Focusing on a narrow market niche and winning a competitive edge by doing a better job than rivals of satisfying the needs and tastes of buyers comprising the niche
E) Developing expertise and resource strengths that give the company competitive capabilities that rivals can’t easily imitate or trump with capabilities of their own

**Answer:** C  Page: 7, 9  Learning Objective: 2  Difficulty: Medium  Taxonomy: Knowledge
AACSB: Value Creation

18. One of the keys to successful strategy-making is

A) to come up with one or more strategy elements that act as a magnet to draw customers and yield a lasting competitive edge.
B) to aggressively pursue all of the growth opportunities the company can identify.
C) to develop a product/service with more innovative performance features than what rivals are offering and to provide customers with better after-the-sale service.
D) to come up with a business model that enables a company to earn bigger profits per unit sold than rivals.
E) to charge a lower price than rivals and thereby win sales and market share away from rivals.

**Answer:** A  Page: 9  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation
Identifying a Company’s Strategy

19. Which of the following is not something to look for in identifying a company’s strategy?
   A) Actions to respond to changing market conditions or other external factors
   B) Management actions to revise the company’s financial and strategic performance targets
   C) Actions to strengthen competitive capabilities and correct competitive weaknesses
   D) Actions to capture emerging market opportunities and defend against external threats to the company’s business prospects
   E) Actions to gain sales and market share via lower prices, more performance features, more appealing design, or other such actions.

   **Answer:** B   Page: 10   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

20. Which of the following is something to look for in identifying a company’s strategy?
   A) Actions to gain sales and market share
   B) Actions to strengthen marketing standing and competitiveness by merging with or acquiring rival companies
   C) Actions to enter new geographic or product markets or exit existing ones
   D) Actions and approaches used in managing R&D, production, sales and marketing, finance, and other key activities
   E) All of above are pertinent in identifying a company’s strategy.

   **Answer:** E   Page: 10   Learning Objective: 1   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

Why a Company's Strategy Evolves Over Time

21. A company’s strategy evolves over time as a consequence of
   A) the need to keep strategy in step with changing market conditions and changing customer needs and expectations.
   B) the proactive efforts of company managers to fine-tune and improve one or more pieces of the strategy.
   C) the need to abandon some strategy features that are no longer working well.
   D) the need to respond to the newly-initiated actions and competitive moves of rival firms.
   E) All of these.

   **Answer:** E   Page: 11   Learning Objective: 3   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

22. Which of the following is not one of the basic reasons that a company’s strategy evolves over time?
   A) The need on the part of company managers to initiate fresh strategic actions that boost employee commitment and create a results-oriented culture.
   B) The proactive efforts of company managers to fine-tune and improve one or more pieces of the strategy.
   C) An ongoing need to abandon those strategy features that are no longer working well.
   D) The need to respond to the actions and competitive moves of rival firms.
   E) The need to keep strategy in step with changing market conditions and changing customer needs and expectations.

   **Answer:** A   Page: 11   Learning Objective: 3   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation
23. Changing circumstances and ongoing managerial efforts to improve the strategy
   A) account for why a company’s strategy evolves over time.
   B) explain why a company’s strategic vision undergoes almost constant change.
   C) make it very difficult for a company to have concrete strategic objectives.
   D) make it very hard to know what a company’s strategy really is.
   E) All of the above.

   Answer: A   Page: 11   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

24. A company’s strategy is a “work in progress” and evolves over time because of
   A) the importance of developing a fresh strategic plan every year (which also has the benefit of keeping
      employees from becoming bored with executing the same strategy year after year).
   B) the ongoing need to imitate the new strategic moves of the industry leaders.
   C) the need to make regular adjustments in the company’s strategic vision.
   D) the ongoing need of company managers to react and respond to changing market and competitive
      conditions.
   E) the frequent need to modify key elements of the company’s business model.

   Answer: D   Page: 11   Learning Objective: 3   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

**A Company’s Strategy Is Partly Proactive and Partly Reactive**

25. It is normal for a company’s strategy to end up being
   A) a blend of offensive actions on the part of managers to improve the company’s profitability and
      defensive moves to counteract changing market conditions.
   B) a combination of conservative moves to protect the company’s market share and somewhat more risky
      initiatives to set the company’s product offering apart from rivals.
   C) a close imitation of the strategy employed by the recognized industry leader.
   D) a blend of proactive actions to improve the company’s competitiveness and financial performance and
      as-needed reactions to unanticipated developments and fresh market conditions.
   E) more a product of clever entrepreneurship than of efforts to clearly set a company’s product/service
      offering apart from the offerings of rivals.

   Answer: D   Page: 11-12   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

26. Crafting a strategy involves
   A) trying to imitate as much of the market leader’s strategy as possible so as not to end up at a competitive
      disadvantage.
   B) developing a 5-year strategic plan and then fine-tuning it during the remainder of the plan period; big
      changes in strategy are thus made only once every 5 years.
   C) stitching together a proactive/intended strategy and then adapting first one piece and then another as
      circumstances surrounding the company’s situation change or better options emerge.
   D) doing everything possible (in the way of price, quality, service, warranties, advertising, and so on)
      to make sure the company’s product/service is very clearly differentiated from the product/service
      offerings of rivals.
   E) All of these accurately characterize the managerial process of crafting a company’s strategy.

   Answer: C   Page: 12   Learning Objective: 3   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation
27. Which of the following statements about a company’s strategy is true?
   A) A company’s strategy is mostly hidden to outside view and is deliberately kept under wraps by top-level managers (so as to catch rival companies by surprise when the strategy is launched).
   B) A company’s strategy is typically planned well in advance and usually deviates little from the planned set of actions and business approaches because of the risks of making on-the-spot changes.
   C) A company’s strategy generally changes very little over time unless a newly-appointed CEO decides to take the company in a new direction with a new strategy.
   D) A company’s strategy is typically a blend of proactive and reactive strategy elements.
   E) A company’s strategy is developed mostly on the fly because of the constant efforts of managers to come up with fresh moves to keep the company’s product offering clearly different and set apart from the product offerings of rival companies.

   **Answer:** D  Page: 12  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension  
   AACSB: Value Creation

28. A company’s strategy evolves from one version to the next because of
   A) changing management conclusions about which of several appealing strategy alternatives is actually best.
   B) the proactive efforts of company managers to improve this or that aspect of the strategy, a need to respond to changing customer requirements and expectations, and a need to react to fresh strategic maneuvers on the part of rival firms.
   C) ongoing turnover in the managerial and executive ranks (new managers often decide to shift to a different strategy).
   D) pressures from shareholders to boost profit margins and pay higher dividends.
   E) the importance of keeping the company’s business model fresh and up-to-date.

   **Answer:** B  Page: 12  Learning Objective: 3  Difficulty: Easy  Taxonomy: Comprehension  
   AACSB: Value Creation

29. Which one of the following does not account for why a company’s strategy evolves from one version to another?
   A) A desire on the part of company managers to develop new strategy elements on the fly
   B) The need to abandon some strategy elements that are no longer working well
   C) A need to respond to changing customer requirements and expectations
   D) A need to react to fresh strategic maneuvers on the part of rival firms
   E) The proactive efforts of company managers to improve this or that aspect of the strategy

   **Answer:** A  Page: 12  Learning Objective: 3  Difficulty: Easy  Taxonomy: Comprehension  
   AACSB: Value Creation

30. In the course of crafting a strategy, it is common for management to
   A) decide to abandon certain strategy elements that have grown stale or become obsolete.
   B) modify the current strategy when market and competitive conditions take an unexpected turn or some aspects of the company’s strategy hit a stone wall.
   C) modify the current strategy in response to the fresh strategic maneuvers of rival firms.
   D) take proactive actions to improve this or that piece of the strategy.
   E) All of these.

   **Answer:** E  Page: 12  Learning Objective: 3  Difficulty: Easy  Taxonomy: Comprehension  
   AACSB: Value Creation
31. In choosing among strategy alternatives, company managers
A) should recognize that they are duty-bound to make as much money for shareholders as possible and that any and all strategic actions that are legal are entirely permissible and defensible in pursuit of this duty.
B) have no compelling duty to craft a strategy whose elements are considered ethical—their only real duty is to craft a strategy that is calculated to yield a sustainable competitive advantage.
C) are well-advised to go beyond merely keeping a company’s strategic actions within the bounds of what is legal and consider whether the various pieces of the company’s strategy are compatible with ethical standards of “right” and “wrong” and duty—what a company should and should not do.
D) should take the position that any strategy that is legal can be defended as appropriate and well within the company’s right to pursue—any notion that managers should have a moral conscience in making strategic choices is totally inappropriate in business situations.
E) should recognize that outsiders have no right to pressure a company to observe so-called moral and ethical standards—there is no validity to the notion that a company’s strategy should pass any so-called test of moral scrutiny.

Answer: C   Page: 13   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

32. A company’s strategy can be considered “ethical”
A) if each element of its strategy is “legal.”
B) if it does not entail actions or behaviors that cross the moral line from “can do” to “should not do” (because such actions are unsavory, unconscionable, injurious to others, or unnecessarily harmful to the environment) and if it allows management to fulfill its ethical duties to all stakeholders (shareholders, employees, customers, suppliers, the communities in which it operates, and society at large).
C) if its actions and behaviors fall within the bounds of “fair competition.”
D) so long as leading religious authorities find nothing “morally wrong” in the company’s actions.
E) so long as the company’s strategic actions do not injure the business of rival firms or the well-being of customers.

Answer: B   Page: 13   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

33. A company’s strategy can be considered “ethical”
A) if it does not entail actions or behaviors that cross the moral line from “can do” to “should not do” (because such actions are unsavory, unconscionable, injurious to others, or unnecessarily harmful to the environment).
B) provided it keeps its prices as low as possible and its product quality as high as possible.
C) provided its actions and behaviors contribute positively to the well-being of society as a whole.
D) as long as its actions and maneuvers in the marketplace positively affect the well-being of customers.
E) so long as none of the company’s strategic actions adversely affect the business of rival firms.

Answer: A   Page: 13   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities
34. Which of the following actions would not typically be employed by senior executives with strong ethical convictions?
   A) Placing organizational checks and balances in place to monitor employee behaviors
   B) Clearly indicating all company personnel are expected to act with integrity
   C) Forbidding the pursuit of ethically questionable business opportunities
   D) Ensuring each element of the company’s strategy complies only with legal standards
   E) Providing guidance to employees regarding gray areas related to ethical behaviors

   **Answer:** D  Page: 13  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Ethics/Legal Responsibilities

35. A company’s strategy can be considered “unethical” or shady
   A) if any of its actions constitute “unfair competition.”
   B) if the company engages in actions or behaviors that are contrary to the general public interest.
   C) if the company’s actions/behaviors are harmful to its stakeholders—customers, employees, shareholders, suppliers, and the communities in which the company operates.
   D) if it entails actions or behaviors that cross the moral line from “can do” to “should not do” (because such actions are “unsavory” or unconscionable or unnecessarily harmful to the environment).
   E) All of the above call the company’s actions/behaviors into question from an ethical standpoint.

   **Answer:** E  Page: 13-14  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Ethics/Legal Responsibilities

36. A company whose strategy has shady or unethical elements
   A) stands a good chance that its unethical behavior will go undetected and unnoticed.
   B) is automatically barred by the Securities and Exchange Commission from filing annual reports and having its stock publicly traded.
   C) risks being temporarily embarrassed if its actions are discovered and publicized by the media—but as long as this risk is tolerable, company managers are well advised to pursue whatever unethical or unsavory actions they believe the company can get away with (especially if such actions enhance company profitability and financial performance).
   D) puts the reputation of the company and its top executives at risk and may even jeopardize the company’s long-term well-being and survival, especially if it is required to pay out considerable sums of money to settle punitive lawsuits and compensate customers, employees, shareholders, suppliers, rival companies and any others for the injuries they have suffered.
   E) risks only being required to “cease and desist” if governmental authorities determine that its strategic actions constitute “unfair competition.”

   **Answer:** D  Page: 13-14  Learning Objective: 1  Difficulty: Hard  Taxonomy: Application
   AACSB: Ethics/Legal Responsibilities

37. In endeavoring to craft an ethical strategy, company managers
   A) need only take care to ensure that each piece of the strategy entails actions and behaviors that are within the letter and spirit of the law.
   B) have to go beyond what strategic actions and behaviors are legal and address whether all the various elements of the company’s strategy can pass the test of moral scrutiny.
   C) are well advised to have the company’s board of directors review the strategy and “certify” whether each element of the company’s strategy is ethical or not.
   D) are well advised to implement managerial training sessions that help define what strategic actions are ethical (and which will be pursued) and which are unethical (and will not be tolerated).
   E) have to back off aggressive efforts to maximize profits (many strategic actions to maximize profits cross over the line to unsavory or shady—or, at least, are borderline unethical).

   **Answer:** B  Page: 13  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Ethics/Legal Responsibilities
The Relationship between a Company's Strategy and Its Business Model

38. A company’s business model
A) concerns the actions and business approaches that will be used to grow the business, conduct operations, please customers, and compete successfully.
B) is management’s storyline for how it will generate revenues ample to cover costs and produce a profit—absent the ability to deliver good profitability, the strategy is not viable and the survival of the business is in doubt.
C) concerns what combination of moves in the marketplace it plans to make to outcompete rivals.
D) deals with how it can simultaneously maximize profits and operate in a socially responsible manner that keeps its prices as low as possible.
E) concerns how management plans to pursue strategic objectives, given the larger imperative of meeting or beating its financial performance targets.

Answer: B   Page: 14   Learning Objective: 4   Difficulty: Medium   Taxonomy: Knowledge
AACSB: Value Creation

39. A company’s business model
A) zeros in on how and why the business will generate revenues sufficient to cover costs and produce attractive profits and return on investment.
B) is management’s storyline for how the strategy will result in achieving the targeted strategic objectives.
C) details the ethical and socially responsible nature of the company’s strategy.
D) explains how it intends to achieve high profit margins.
E) sets forth the actions and approaches that it will employ to achieve market leadership.

Answer: A   Page: 14   Learning Objective: 4   Difficulty: Medium   Taxonomy: Knowledge
AACSB: Value Creation

40. A company’s business model
A) sets forth management’s game plan for maximizing profits for shareholders.
B) details exactly how management’s strategy will result in the achievement of the company’s strategic intent.
C) explains how it will achieve high profit margins while at the same time charging relatively low prices to customers.
D) sets forth the key components of the enterprise’s business approach, indicates how revenues will be generated, and makes a case for why the strategy can deliver value to customers in a profitable manner.
E) sets forth management’s long term action plan for achieving market leadership.

Answer: D   Page: 14   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

41. Management’s storyline for how and why the company’s business approaches will generate revenues sufficient to cover costs and produce attractive profits and returns on investment
A) describes what is meant by a company’s strategy.
B) best describes what is meant by a company’s business model.
C) accounts for why a company’s financial objectives are at the stated level.
D) portrays the essence of a company’s business purpose or mission.
E) is what is meant by the term strategic intent.

Answer: B   Page: 14   Learning Objective: 4   Difficulty: Easy   Taxonomy: Knowledge
AACSB: Value Creation
42. The difference between a company’s strategy and a company’s business model is that
   A) a company’s strategy is management’s game plan for achieving strategic objectives while its business model is management’s game plan for achieving financial objectives.
   B) the strategy concerns how to compete successfully and the business model concerns how to operate efficiently.
   C) a company’s strategy is management’s game plan for realizing the strategic vision whereas a company’s business model is the game plan for accomplishing the business purpose or mission.
   D) strategy relates broadly to a company’s competitive moves and business approaches (which may or may not lead to profitability) while its business model relates to whether the revenues and costs flowing from the strategy demonstrate that the business is viable from the standpoint of being able to earn satisfactory profits and returns on investment.
   E) a company’s strategy concerns how to please customers while its business model concerns how to please shareholders.

   Answer: D   Page: 14   Learning Objective: 4   Difficulty: Hard   Taxonomy: Comprehension
   AACSB: Value Creation

What Makes a Strategy a Winner?

43. A winning strategy is one that
   A) builds strategic fit, is socially responsible, and maximizes shareholder wealth.
   B) is highly profitable and boosts the company’s market share.
   C) fits the company’s internal and external situation, builds sustainable competitive advantage, and improves company performance.
   D) results in a company becoming the dominant industry leader.
   E) can pass the ethical standards test, the strategic intent test, and the profitability test.

   Answer: C   Page: 15   Learning Objective: 5   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation

44. A winning strategy is one that
   A) results in a company becoming the dominant market leader.
   B) produces exceptionally high levels of customer satisfaction and is both ethical and highly profitable.
   C) fits the company’s internal and external situations, builds sustainable competitive advantage, and improves company performance.
   D) is ethical, socially responsible, and profitable.
   E) builds shareholder value, passes the completeness test, and passes the customer satisfaction test.

   Answer: C   Page: 15   Learning Objective: 5   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation

45. Which one of the following questions can be used to test the merits of one strategy over another and distinguish a winning strategy from a mediocre or losing strategy?
   A) How good is the company’s business model?
   B) Is the company a technology leader?
   C) Does the company have low prices in comparison to rivals?
   D) Is the company putting too little emphasis on behaving in an ethical and socially responsible manner?
   E) How well does the strategy fit the company’s situation?

   Answer: E   Page: 15   Learning Objective: 5   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation
46. Which of the following questions ought to be used to test the merits of one strategy over another and distinguish a winning strategy from a mediocre or losing strategy?
A) Is the company’s strategy ethical and socially responsible and does it put enough emphasis on good product quality and good customer service?
B) Is the company putting too little emphasis on growth and profitability and too much emphasis on behaving in an ethical and socially responsible manner?
C) Is the strategy resulting in the development of additional competitive capabilities?
D) Is the strategy helping the company achieve a sustainable competitive advantage and is it resulting in better company performance?
E) Does the strategy strike a good balance between maximizing shareholder wealth and maximizing customer satisfaction?

**Answer:** D  Page: 15  Learning Objective: 5  Difficulty: Medium  Taxonomy: Comprehension  
AACSBS: Value Creation

**Why Are Crafting and Executing Strategy Important?**

47. Crafting and executing strategy are top-priority managerial tasks because
A) working their way through the tasks of crafting and executing strategy helps top executives create tight fits between a company’s strategic vision and business model.
B) all company personnel, and especially senior executives, need to know the answer to “who are we, what do we do, and where are we headed?”
C) there is a compelling need for managers to proactively shape how the company’s business will be conducted and because a strategy-focused enterprise is more likely to be a stronger bottom-line performer than a company whose management views strategy as secondary and puts its priorities elsewhere.
D) without clear guidance as to what the company’s business model and strategic intent are, managerial decision-making is likely to be rudderless.
E) how well executives perform these tasks are the key determinants of executive compensation.

**Answer:** C  Page: 17  Learning Objective: 6  Difficulty: Easy  Taxonomy: Comprehension  
AACSBS: Value Creation

48. Crafting and executing strategy are top-priority managerial tasks because
A) they are necessary ingredients of a sound business model.
B) good strategy coupled with good strategy execution greatly raises the chances that a company will be a standout performer in the marketplace.
C) the management skills of top executives are sharpened as they work their way through the strategy-making/strategy-executing process.
D) doing these tasks helps executives develop an appropriate strategic vision, strategic intent, and set of strategic objectives.
E) of the contribution they make to maximizing value for shareholders.

**Answer:** B  Page: 17  Learning Objective: 6  Difficulty: Medium  Taxonomy: Comprehension  
AACSBS: Value Creation
Good Strategy + Good Execution = Good Management

49. Good strategy combined with good strategy execution
   A) offers a surefire guarantee for avoiding periods of weak financial performance.
   B) are the two best signs that a company is a true industry leader.
   C) are more important management functions than forming a strategic vision and setting objectives.
   D) are the most trustworthy signs of good management.
   E) signal that a company has a superior business model.

   **Answer:** D   Page: 17   Learning Objective: 6   Difficulty: Easy   Taxonomy: Knowledge
   AACSB: Value Creation

50. The most trustworthy signs of a well-managed company are
   A) the eagerness with which executives set stretch financial and strategic objectives and develop an
      ambitious strategic vision.
   B) aggressive pursuit of new opportunities and a willingness to change the company’s business model
      whenever circumstances warrant.
   C) good strategy-making combined with good strategy execution.
   D) a visionary mission statement and a willingness to pursue offensive strategies rather than defensive
      strategies.
   E) a profitable business model and a balanced scorecard approach to measuring the company’s
      performance.

   **Answer:** C   Page: 17   Learning Objective: 6   Difficulty: Easy   Taxonomy: Knowledge
   AACSB: Value Creation

51. Excellent execution of an excellent strategy is
   A) the best test of managerial excellence and the best recipe for making a company a standout
      performer.
   B) a solid indication that managers are maximizing profits and looking out for the best interests of
      shareholders.
   C) the best test of whether a company is a “true” industry leader.
   D) the best evidence that managers have a winning business model.
   E) the best test of whether a company enjoys sustainable competitive advantage.

   **Answer:** A   Page: 17   Learning Objective: 6   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

**Short Answer Questions**

52. Briefly define each of the following terms:
   a. Strategy
   b. Sustainable competitive advantage
   c. Business model

   **Pages:** 6, 7, 14   Learning Objectives: 1, 4   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation
53. Identify and briefly describe the four most frequently used strategic approaches to achieving a sustainable competitive advantage. Provide examples.

**Pages:** 7, 9  Learning Objective: 2  Difficulty: Medium  Taxonomy: Knowledge  AACSB: Value Creation

54. What is the connection between a company’s strategy and its quest for sustainable competitive advantage?

**Page:** 9  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension  AACSB: Value Creation

55. Should a company’s strategy be tightly connected to its quest for competitive advantage? Why or why not? What difference does it make whether a company has a sustainable competitive advantage or not?

**Page:** 9  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension  AACSB: Value Creation

56. List five things to look for in identifying the components of an organization’s strategy.

**Page:** 10  Learning Objective: 1  Difficulty: Medium  Taxonomy: Knowledge  AACSB: Value Creation

57. Why does a company’s strategy tend to evolve over time?

**Page:** 11  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension  AACSB: Value Creation

58. Why is a company’s strategy partly proactive and partly reactive?

**Page:** 11-12  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension  AACSB: Value Creation

59. Is it more accurate to think of strategy as being “proactive” or as being “reactive?” Why?

**Page:** 11-12  Learning Objective: 3  Difficulty: Medium  Taxonomy: Application  AACSB: Value Creation

60. Explain why a company’s strategy cannot be completely planned out in advance and why crafting a company’s strategy cannot be a one-time, once-and-for-all managerial exercise. Identify at least 3 factors that account for why company strategies evolve.

**Page:** 11-12  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension  AACSB: Value Creation

61. What determines whether a company’s strategy is “ethical?” Why should a company care where its strategy can pass the test of moral scrutiny so long as each of its strategic actions fall within the bounds of what is considered legal?

**Page:** 13  Learning Objective: 1  Difficulty: Hard  Taxonomy: Application  AACSB: Ethics/Legal Responsibilities
62. If a company’s strategic actions are legal, then its strategy qualifies as ethical. True or false? Give examples to support your answer.

Page: 13-14 Learning Objective: 1 Difficulty: Medium Taxonomy: Comprehension AACSB: Ethics/Legal Responsibilities

63. Explain the difference between a company’s business model and a company’s strategy.

Page: 14 Learning Objective: 4 Difficulty: Hard Taxonomy: Comprehension AACSB: Value Creation

64. What are the three criteria for determining whether a company has a winning strategy?

Page: 15 Learning Objective: 5 Difficulty: Medium Taxonomy: Knowledge AACSB: Value Creation

65. How can one tell a winning strategy from a strategy that is mediocre or a loser?

Page: 15 Value Creation Learning Objective: 5 Difficulty: Medium Taxonomy: Comprehension AACSB: AACSB: Value Creation

66. Why is sustainable competitive advantage so important to a winning business strategy?

Page: 15 Learning Objective: 5 Difficulty: Medium Taxonomy: Comprehension AACSB: Value Creation

67. Why is it appropriate to argue that good strategy-making combined with good strategy execution are valid signs of good management?

Page: 17 Learning Objective: 6 Difficulty: Medium Taxonomy: Comprehension AACSB: Value Creation

68. Powerful execution of a powerful strategy is a proven recipe for winning in the marketplace. True or false? Explain your answer.

Page: 17 Learning Objective: 6 Difficulty: Medium Taxonomy: Comprehension AACSB: Value Creation

69. Good strategy + good strategy execution = good management. True or false? Justify and explain your answer.

Page: 17 Learning Objective: 6 Difficulty: Medium Taxonomy: Comprehension AACSB: Value Creation
Multiple Choice Questions


1. Which one of the following is not one of the five basic tasks of the strategy-making, strategy-executing process?
   A) Forming a strategic vision of where the company needs to head and what its future business make-up will be
   B) Setting objectives to convert the strategic vision into specific strategic and financial performance outcomes for the company to achieve
   C) Crafting a strategy to achieve the objectives and get the company where it wants to go
   D) Developing a profitable business model
   E) Implementing and executing the chosen strategy efficiently and effectively

   **Answer:** D   Page: 24   Learning Objective: 1   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

2. Which of the following is an integral part of the managerial process of crafting and executing strategy?
   A) Developing a proven business model
   B) Deciding how much of the company’s resources to employ in the pursuit of sustainable competitive advantage
   C) Setting objectives and using them as yardsticks for measuring the company’s performance and progress
   D) Communicating the company’s values and code of conduct to all employees
   E) Deciding on the company’s strategic intent

   **Answer:** C   Page: 24   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

3. Which of the following are integral parts of the managerial process of crafting and executing strategy?
   A) Developing a strategic vision, setting objectives, and crafting a strategy
   B) Developing a proven business model, deciding on the company’s strategic intent, and crafting a strategy
   C) Setting objectives, crafting a strategy, implementing and executing the chosen strategy, and deciding how much of the company’s resources to employ in the pursuit of sustainable competitive advantage
   D) Coming up with a statement of the company’s mission and purpose, setting objectives, choosing what business approaches to employ, selecting a business model, and monitoring developments
   E) Deciding on the company’s strategic intent, setting financial objectives, crafting a strategy, and choosing what business approaches and operating practices to employ

   **Answer:** A   Page: 24   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
4. The strategy-making, strategy-executing process
   A) is usually delegated to members of a company’s board of directors so as not to infringe on the time of busy executives.
   B) includes establishing a company’s mission, developing a business model aimed at making the company an industry leader, and crafting a strategy to implement and execute the business model.
   C) embraces the tasks of developing a strategic vision, setting objectives, crafting a strategy, implementing and executing the strategy, and then monitoring developments and initiating corrective adjustments in light of experience, changing conditions, and new opportunities.
   D) is principally concerned with sizing up an organization’s internal and external situation, so as to be prepared for the challenge of developing a sound business model.
   E) is primarily the responsibility of top executives and the board of directors; very few managers below this level are involved.

   Answer: C   Page: 24   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension   AACSB: Value Creation

Phase 1: Developing a Strategic Vision

5. A company’s strategic vision concerns
   A) “who we are and what we do.”
   B) why the company does certain things in trying to please its customers.
   C) management’s storyline of how it intends to make a profit with the chosen strategy.
   D) a company’s directional path and future product-market-customer-technology focus.
   E) what future actions the enterprise will likely undertake to outmaneuver rivals and achieve a sustainable competitive advantage.

   Answer: D   Page: 24-25   Learning Objective: 1   Difficulty: Easy   Taxonomy: Knowledge   AACSB: Value Creation

6. A company’s strategic vision
   A) is management’s story line for how it plans to implement and execute a profitable business model.
   B) sets forth what business the company is presently in and why it uses particular operating practices in trying to please customers.
   C) delineates management’s aspirations for the business, providing a panoramic view of “where we are going” and a convincing rationale for why this makes good business sense.
   D) defines “who we are and what we do.”
   E) spells out a company’s strategic intent, its strategic and financial objectives, and the business approaches and operating practices that will underpin its efforts to achieve sustainable competitive advantage.

   Answer: C   Page: 25   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension   AACSB: Value Creation

7. Developing a strategic vision for a company entails
   A) prescribing a strategic direction for the company to pursue and a rationale for why this strategic path makes good business sense.
   B) describing its business model and the kind of value that it is trying to deliver to customers.
   C) putting together a story line of why the business will be a moneymaker.
   D) describing “who we are and what we do.”
   E) coming up with a long-term plan for outcompeting rivals and achieving a competitive advantage.

   Answer: A   Page: 25   Learning Objective: 1   Difficulty: Easy   Taxonomy: Comprehension   AACSB: Value Creation
8. The managerial task of developing a strategic vision for a company
   A) concerns deciding what approach the company should take to implement and execute its business model.
   B) entails coming up with a fairly specific answer to “who are we, what do we do, and why are we here?”
   C) is chiefly concerned with addressing what a company needs to do to successfully outcompete rivals in the marketplace.
   D) involves deciding upon what strategic course a company should pursue in preparing for the future and why this directional path makes good business sense.
   E) entails coming up with a persuasive storyline of how the company intends to make money.

   **Answer:** D  Page: 25  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

9. Which one of the following is not an accurate attribute of an organization’s strategic vision?
   A) Providing a panoramic view of “where we are going”
   B) Outlining how the company intends to implement and execute its business model
   C) Pointing an organization in a particular direction and charting a strategic path for it to follow
   D) Helping mold an organization’s character and identity
   E) Describing the company’s future product-market-customer-technology focus

   **Answer:** B  Page: 25  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

10. Management’s strategic vision for an organization
    A) charts a strategic course for the organization (“where we are going”) and provides a rationale for why this directional path makes good sense.
    B) describes in fairly specific terms the organization’s strategic intent, strategic objectives, and strategy.
    C) spells out how the company will become a big moneymaker and boost shareholder value.
    D) addresses the critical issue of “why our business model needs to change and how we plan to change it.”
    E) spells out the organization’s strategic intent and the actions and moves that will be undertaken to achieve it.

    **Answer:** A  Page: 25  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
    AACSB: Value Creation

11. What a company’s top executives are saying about where the company is headed and about what the company’s future product-customer-market-technology will be
    A) indicates what kind of business model the company is going to have in the future.
    B) constitutes their strategic vision for the company.
    C) signals what the firm’s strategy will be.
    D) serves to define the company’s mission.
    E) indicates what the company’s long-term strategic plan is.

    **Answer:** B  Page: 25  Learning Objective: 1  Difficulty: Easy  Taxonomy: Comprehension
    AACSB: Value Creation
12. One of the important benefits of a well-conceived and well-stated strategic vision is to
   A) clearly delineate how the company’s business model will be implemented and executed.
   B) clearly communicate management’s aspirations for the company to stakeholders and help steer the
      energies of company personnel in a common direction.
   C) set forth the firm’s strategic objectives in clear and fairly precise terms.
   D) help create a “balanced scorecard” approach to objective-setting and not stretch the company’s
      resources too thin across different products, technologies, and geographic markets.
   E) indicate what kind of sustainable competitive advantage the company will try to create in the course of
      becoming the industry leader.

   **Answer:** B   Page: 25   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

13. The defining characteristic of a well-conceived strategic vision is
   A) what it says about the company’s future strategic course—“the direction we are headed and what our
      future product-market-customer-technology focus will be.”
   B) that it not stretch the company’s resources too thin across different products, technologies, and
      geographic markets.
   C) clarity and specificity about “who we are, what we do, and why we are here.”
   D) that it be flexible and in the mainstream.
   E) that it be within the realm of what the company can reasonably expect to achieve within 2-4 years.

   **Answer:** A   Page: 25   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

14. Which one of the following questions is not pertinent to company managers in thinking strategically about
    their company’s directional path and developing a strategic vision?
   A) Is the outlook for the company promising if it continues with its present product-market-technology-
      customer focus?
   B) Are changing market and competitive conditions acting to enhance or weaken the company’s
      prospects?
   C) What business approaches and operating practices should we consider in trying to implement and
      execute our business model?
   D) What are our ambitions for the company—what industry standing do we want the company to have?
   E) What, if any, new customer groups and/or geographic markets should the company get in position to
      serve?

   **Answer:** C   Page: 25   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

15. Which one of the following questions is not something that company managers should consider in choosing
    to pursue one strategic course or directional path versus another?
   A) Are changing market and competitive conditions acting to enhance or weaken the company’s business
      outlook?
   B) Is the company stretching its resources too thinly by trying to compete in too many markets or segments,
      some of which are unprofitable?
   C) Will our present business generate sufficient growth and profitability in the years ahead to please
      shareholders?
   D) What emerging market opportunities should the company pursue and which ones should not be
      pursued?
   E) Do we have a better business model than key rivals?

   **Answer:** E   Page: 25   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
16. Which of the following are characteristics of an effectively-worded strategic vision statement?
   A) Balanced, responsible, and rational
   B) Challenging, competitive, and “set in concrete”
   C) Graphic, directional, and focused
   D) Realistic, customer-focused, and market-driven
   E) Achievable, profitable, and ethical

   **Answer:** C   Page: 26   Learning Objective: 1   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation

17. Which one of the following is **not** a characteristic of an effectively-worded strategic vision statement?
   A) Directional (is forward-looking, describes the strategic course that management has charted and the kinds of product-market-customer-technology changes that will help the company prepare for the future)
   B) Easy to communicate (is explainable in 10-15 minutes, can be reduced to a memorable slogan)
   C) Graphic (paints a picture of the kind of company management is trying to create and the market position(s) the company is striving to stake out)
   D) Consensus-driven (commits the company to a “mainstream” directional path that most all stakeholders will enthusiastically support)
   E) Focused (is specific enough to provide guidance to managers in making decisions and allocating resources)

   **Answer:** D   Page: 26   Learning Objective: 1   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation

18. Which of the following is **not** a common shortcoming of company vision statements?
   A) Vague or incomplete—short on specifics
   B) Too narrow—doesn’t leave enough room for future growth
   C) Bland or uninspiring
   D) Not distinctive—could apply to most any company (or at least several others in the same industry)
   E) Too reliant on superlatives (best, most successful, recognized leader, global or worldwide leader, first choice of customers)

   **Answer:** B   Page: 26   Learning Objective: 1   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation

19. Which of the following are common shortcomings of company vision statements?
   A) Too specific, too inflexible, and can’t be achieved in 5 years
   B) Unrealistic, unconventional, and un-businesslike
   C) Too broad, vague or incomplete, bland/uninspiring, not distinctive, and too reliant on superlatives
   D) Too broad, too narrow, and too risky
   E) Not customer-driven, out-of-step with emerging technological trends, and too ambitious

   **Answer:** C   Page: 26   Learning Objective: 1   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation
How a Strategic Vision Differs from a Mission Statement

20. A company’s mission statement typically addresses which of the following questions?
   A) “Who are we and what do we do?”
   B) “What objectives and level of performance do we want to achieve?”
   C) “Where are we going and what should our strategy be?”
   D) “What approach should we take to achieve sustainable competitive advantage?”
   E) “What business model should we employ to achieve our objectives and our vision?”

   **Answer:** A Page: 28   Learning Objective: 1   Difficulty: Easy   Taxonomy: Knowledge
   AACSB: Value Creation

21. The difference between the concept of a company mission statement and the concept of a strategic vision is that
   A) a mission concerns what to do to achieve short-run objectives and a strategic vision concerns what to do to achieve long-run performance targets.
   B) the mission is to make a profit, whereas a strategic vision concerns what business model to employ in striving to make a profit.
   C) a mission statement deals with what to accomplish on behalf of shareholders and a strategic vision concerns what to accomplish on behalf of customers.
   D) a mission statement typically concerns a company’s present business scope (“who we are and what we do”) whereas the principal concern of a strategic vision is the company’s long term direction and future product-market-customer-technology focus.
   E) a mission statement deals with “where we are headed” whereas a strategic vision provides the critical answer to “how will we get there?”

   **Answer:** D Page: 28   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

22. The difference between a company’s mission statement and the concept of a strategic vision is that
   A) the mission explains why it is essential to make a profit, whereas the strategic vision explains how the company will be a moneymaker.
   B) a mission statement typically concerns a company’s present business scope and purpose whereas a strategic vision sets forth “where we are going and why.”
   C) a mission deals with how to please customers whereas a strategic vision deals with how to please shareholders.
   D) a mission statement deals with “where we are headed” whereas a strategic vision provides the critical answer to “how will we get there?”
   E) a mission statement addresses “how we are trying to make a profit today” while a strategic vision concerns “how will we make money in the markets of tomorrow?”

   **Answer:** B Page: 28   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
Linking the Vision/Mission with Company Values

23. A company's values concern
   A) whether and to what extent it intends to operate in an ethical and socially responsible manner.
   B) how aggressively it will seek to maximize profits and enforce high ethical standards.
   C) the beliefs and operating principles built into the company’s “balanced scorecard” for measuring performance.
   D) the beliefs, traits, and behavioral norms that company personnel are expected to display in conducting the company’s business and pursuing its strategic vision and strategy.
   E) the beliefs, principles, and ethical standards that are incorporated into the company’s strategic intent and business model.

**Answer:** D  Page: 29  Learning Objective: 1  Difficulty: Medium  Taxonomy: Knowledge
AACSB: Ethics/Legal Responsibilities

24. A company’s values relate to such things as
   A) how it will balance its pursuit of financial objectives against the pursuit of its strategic objectives.
   B) how it will balance the pursuit of its business purpose/mission against the pursuit of its strategic vision.
   C) fair treatment, integrity, ethical behavior, innovativeness, teamwork, top-notch quality, superior customer service, social responsibility, and community citizenship.
   D) whether it will emphasize stock price appreciation or higher dividend payments to shareholders, and whether it will put more emphasis on the achievement of short-term performance targets or long-range performance targets.
   E) All of the above.

**Answer:** C  Page: 29  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

25. Company managers connect values to the chosen strategic vision by
   A) combining the company’s values and mission/business purpose into a single statement.
   B) using a values-based balanced scorecard to measure the company’s progress in achieving the vision.
   C) making achievement of the values a prominent part of the company’s strategic objectives.
   D) making it clear that company personnel are expected to live up to the values in conducting the company’s business and pursuing its strategic vision.
   E) making adherence to the company’s values the centerpiece of the company’s strategy.

**Answer:** D  Page: 30  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

Communicating the Strategic Vision

26. Top management efforts to communicate the strategic vision to company personnel
   A) ought to be done in writing rather than orally so as to leave no room for company personnel to misinterpret what the strategic vision really is.
   B) should be done in language that inspires and motivates company personnel to unite behind executive efforts to get the company moving in the intended direction.
   C) tends to be more effective when top management avoids trying to capture the essence of the strategic vision in a catchy slogan.
   D) is most efficiently and effectively done by posting the strategic vision prominently on the company’s Web site and encouraging employees to read it.
   E) should be attempted only after management has explained the company’s strategic intent, strategy, and business model to company personnel.

**Answer:** B  Page: 30  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation
27. Effectively communicating the strategic vision down the line to lower-level managers and employees has
the value of
A) inspiring company personnel to unite behind managerial efforts to get the company moving in the
intended direction.
B) helping company personnel understand why “making a profit” is so important.
C) making it easier for top executives to set stretch objectives.
D) helping lower-level managers and employees better understand the company’s business model.
E) All of these.

Answer: A  Page: 30  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

28. Perhaps the most important benefit of a vivid, engaging, and convincing strategic vision is
A) helping gain managerial consensus on what resources must be developed to successfully achieve
strategic objectives.
B) uniting company personnel behind managerial efforts to get the company moving in the intended
direction.
C) helping justify the company’s mission of making a profit.
D) helping company personnel understand the logic of the company’s business model.
E) keeping company personnel well-informed.

Answer: B  Page: 30  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

29. The task of effectively communicating the strategic vision is made easier by
A) having a simple strategy that is easy for company personnel to understand.
B) combining the strategic vision and the company’s values statement into a single document.
C) capturing the essence of the vision in a catchy slogan or brief phrase and then using it repeatedly as a
reminder of “where we are going and why.”
D) waiting until the company achieves its mission to tell company personnel about the strategic vision.
E) combining the strategic vision and the mission statement into a single statement of overall business
purpose.

Answer: C  Page: 31-32  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

When External Change Calls for a New Strategic Direction

30. When there’s an order of magnitude change in a company’s environment that dramatically alters its prospects
and mandates radical revision of its strategic course, the company is said to have encountered
A) an opportunity to pursue a new strategic vision.
B) a strategic inflection point.
C) a strategic roadblock.
D) a new strategic opportunity.
E) a fork in the road that gives the company an opening to change to a different business model.

Answer: B  Page: 32  Learning Objective: 1  Difficulty: Medium  Taxonomy: Knowledge
AACSB: Value Creation
Breaking Down Resistance to a New Strategic Vision

31. Breaking down resistance to a new strategic vision typically requires that top management
   A) institute a balanced scorecard approach to measuring company performance, with the “balance”
   including a mixture of both old and new performance measures.
   B) keep company personnel well-informed about forthcoming changes in the company’s strategy.
   C) frequently reiterate the basis for the new direction at company gatherings, address employee concerns
   and fears head-on, and provide updates and progress reports as events unfold.
   D) move promptly to update the company’s business model and hold meetings with company personnel
   to explain the merits of the new business model.
   E) raise wages and salaries to win the support of company personnel for the company’s new direction.

   Answer: C   Page: 32   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

The Payoffs of a Clear Vision Statement

32. The payoffs of a clear vision statement do not include
   A) reducing the risks of rudderless decision-making.
   B) helping the organization prepare for the future.
   C) greater ability to avoid strategic inflection points.
   D) helping to crystallize top management’s own view about the firm’s long-term direction.
   E) providing a tool for winning the support of organizational members for internal changes that will help
   make the vision a reality.

   Answer: C   Page: 33   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

Phase 2: Setting Objectives

33. The managerial purpose of setting objectives includes
   A) converting the strategic vision into specific performance targets—results and outcomes the organization
   wants to achieve.
   B) using the objectives as yardsticks for tracking the company’s progress and performance.
   C) challenging and helping stretch the organization to perform at its full potential and deliver the best
   possible results.
   D) pushing company personnel to be more inventive and to exhibit more urgency in improving the
   company’s financial performance and business position.
   E) All of these.

   Answer: E   Page: 33   Learning Objective: 2   Difficulty: Easy   Taxonomy: Knowledge
   AACSB: Value Creation

The Imperative of Setting Stretch Objectives

34. A set of “stretch” financial and strategic objectives
   A) pushes the company closer to true profit maximization.
   B) helps create a “balanced scorecard” for judging company performance.
   C) helps convert the mission statement into meaningful company values.
   D) challenges company personnel to execute the strategy with greater proficiency.
   E) is an effective tool for avoiding ho-hum results.

   Answer: E   Page: 33   Learning Objective: 2   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation
35. Which one of the following is not an advantage of setting “stretch” objectives?
   A) Helping to avoid ho-hum results
   B) Pushing company personnel to be more inventive and innovative
   C) Helping clarify the company’s strategic vision and strategic intent
   D) Helping a company be more focused and intentional in its actions
   E) Spurring exceptional performance and helping build a firewall against contentment with modest performance gains

   Answer: C   Page: 33   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

**What Kinds of Objectives to Set—the Need for a Balanced Scorecard**

36. A company needs financial objectives
   A) to spur company personnel to help the company overtake key competitors on such important measures as net profit margins and return on investment.
   B) because adequate profitability and financial strength is critical to effective pursuit of its strategic vision, as well as to its long-term health and ultimate survival.
   C) to indicate to employees whether the emphasis should be on earnings per share or return on investment or return on assets or positive cash flow.
   D) to convince shareholders that top management is acting in their interests.
   E) to counterbalance its pursuit of strategic objectives and have a balanced scorecard for judging the caliber of its overall performance.

   Answer: B   Page: 34   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

37. Which of the following is the best example of a well-stated financial objective?
   A) Increase earnings per share by 15% annually.
   B) Gradually boost market share from 10% to 15% over the next several years.
   C) Achieve lower costs than any other industry competitor.
   D) Boost revenues by a percentage greater than the industry average.
   E) Maximize total company profits and return on investment.

   Answer: A   Page: 34   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

38. Which of the following is the best example of a well-stated strategic objective?
   A) Increase revenues by more than the industry average.
   B) Be among the top 5 five companies in the industry on customer service.
   C) Overtake key competitors on product quality within three years.
   D) Improve manufacturing performance by 5% within 12 months.
   E) Obtain 150 new customers during the current fiscal year.

   Answer: C   Page: 34   Learning Objective: 2   Difficulty: Hard   Taxonomy: Comprehension
   AACSB: Value Creation
39. Strategic objectives
   A) are more essential in achieving a company’s strategic vision than are financial objectives.
   B) relate to strengthening a company’s overall business and competitive position.
   C) are more difficult to achieve and harder to measure than financial objectives.
   D) are generally less important than financial objectives.
   E) help managers track an organization’s true progress better than do financial objectives.

   **Answer:** B   Page: 34   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

40. A balanced scorecard for measuring company performance
   A) entails putting equal emphasis on financial and strategic objectives.
   B) entails putting balanced emphasis on profit and non-profit objectives.
   C) prevents the drive for achieving financial objectives from overwhelming the pursuit of strategic objectives.
   D) prevents the drive for achieving strategic objectives from overwhelming the pursuit of financial objectives.
   E) entails creating a set of objectives that is “balanced” in the sense of including both financial and strategic objectives.

   **Answer:** E   Page: 34-35   Learning Objective: 2   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation

41. A “balanced scorecard” that includes both strategic and financial performance targets is a conceptually strong approach for judging a company’s overall performance because
   A) it assists managers in putting roughly equal emphasis on short-term and long-term performance targets.
   B) it entails putting equal emphasis on good strategy execution and good business model execution.
   C) a balanced scorecard approach pushes managers to avoid setting objectives that reflect the results of past decisions and organizational activities.
   D) financial performance measures are lagging indicators that reflect the results of past decisions and organizational activities whereas strategic performance measures are leading indicators of a company’s future financial performance.
   E) it forces managers to put equal emphasis on financial and strategic objectives.

   **Answer:** D   Page: 34   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

42. Perhaps the most reliable way for a company to improve its financial performance over time is to
   A) put 100% emphasis on the achievement of its short-term and long-term financial objectives.
   B) recognize that the achievement of strategic objectives fosters better long-term financial performance.
   C) substitute financial intent for strategic intent and judiciously concentrate on the mission of making a profit.
   D) not allocate any resources to the achievement of strategic objectives until it is very clear that the company can meet or beat its stretch financial performance targets.
   E) avoid use of the “balanced scorecard” philosophy since achievement of financial performance targets is obviously more important than achievement of strategic performance targets.

   **Answer:** B   Page: 34-35   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
43. A company that pursues and achieves strategic objectives
   A) is likely to weaken the achievement of its short-term and long-term financial objectives.
   B) believes that the company’s financial performance is not as important as it really is.
   C) is generally not strongly focused on its true mission of making a profit.
   D) is frequently in a better position to improve its future financial performance because of the increased competitiveness that flows from the achievement of strategic objectives.
   E) is likely to be a weak financial performer because diverting resources to the pursuit of strategic objectives takes away from the achievement of financial performance targets.

   Answer: D   Page: 34-35   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

**Strategic Intent: Relentless Pursuit of an Ambitious Long-Term Strategic Objective**

44. A company exhibits strategic intent when
   A) it adopts a strategic plan.
   B) it relentlessly pursues an ambitious strategic objective, concentrating the full force of its resources and competitive actions on achieving that objective.
   C) senior executives pursue their strategic vision.
   D) top management establishes a comprehensive set of strategic objectives.
   E) it pursues a particular competitive advantage.

   Answer: B   Page: 36   Learning Objective: 2   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation

45. Strategic intent refers to a situation where a company
   A) commits to using a particular business model to make money.
   B) decides to adopt a particular strategy.
   C) relentlessly pursues an ambitious strategic objective, concentrating the full force of its resources and competitive actions on achieving that objective.
   D) commits to pursuing stretch strategic objectives.
   E) changes its long-term direction and decides to pursue a newly-adopted strategic vision.

   Answer: C   Page: 36   Learning Objective: 2   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation

46. A company with strategic intent
   A) is one that is going all-out to overcome the challenges of having encountered a strategic inflection point.
   B) is one that is putting much more emphasis on achieving its strategic objectives than its financial objectives.
   C) is one that has good alignment between its strategic objectives and its strategy.
   D) usually has an aggressive strategy and plan for growing its business.
   E) usually has an exceptionally bold and grandiose long-term objective—like becoming the dominant global market leader—and an unshakable commitment to concentrating its full resources and strategy on achieving that objective.

   Answer: E   Page: 36   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
The Need for Objectives at All Organizational Levels

47. Company objectives
   A) are needed only in those areas directly related to a company’s short-term and long-term profitability.
   B) need to be broken down into performance targets for each of its separate businesses, product lines, functional departments, and individual work units.
   C) play the important role of establishing the direction in which it needs to be headed.
   D) are important because they help guide managers in deciding what the company’s strategic intent should be.
   E) should be set in a manner that does not conflict with the performance targets of lower-level organizational units.

   **Answer:** B
   Page: 36
   Learning Objective: 2
   Difficulty: Medium
   Taxonomy: Comprehension
   AACSB: Value Creation

48. A company needs performance targets or objectives
   A) to help guide managers in deciding what strategic path to take in the event that a strategic inflection point is encountered.
   B) because they give the company clear-cut strategic intent.
   C) in order to unify the company’s strategic vision and business model.
   D) for its operations as a whole and also for each of its separate businesses, product lines, functional departments, and individual work units.
   E) in order to prevent lower-level organizational units from establishing their own objectives.

   **Answer:** D
   Page: 36
   Learning Objective: 2
   Difficulty: Medium
   Taxonomy: Comprehension
   AACSB: Value Creation

Phase 3: Crafting a Strategy

49. The task of stitching together a strategy
   A) entails addressing a series of hows: how to grow the business, how to please customers, how to outcompete rivals, how to respond to changing market conditions, and how to achieve strategic and financial objectives.
   B) is primarily an exercise in deciding which of several freshly-emerging market opportunities to pursue.
   C) is mainly an exercise that should be dictated by what is comfortable to management from a risk perspective and what is acceptable in terms of capital requirements.
   D) requires trying to copy the strategies of industry leaders as closely as possible.
   E) is mainly an exercise in good planning.

   **Answer:** A
   Page: 37
   Learning Objective: 3
   Difficulty: Medium
   Taxonomy: Knowledge
   AACSB: Value Creation

50. Masterful strategies come from
   A) successful managerial efforts to develop a sound strategic vision.
   B) doing a very thorough job of strategic planning.
   C) involving as many company personnel as possible in the strategy-making process.
   D) crafting a strategy that mimics the best parts of the strategies of the industry leaders.
   E) doing things differently from competitors where it counts—out-innovating them, being more efficient, adapting faster—rather than running with the herd.

   **Answer:** E
   Page: 37
   Learning Objective: 3
   Difficulty: Medium
   Taxonomy: Knowledge
   AACSB: Value Creation
Strategy Making Involves Managers at All Organizational Levels

51. Strategy-making is
   A) primarily the responsibility of key executives rather than a task for a company’s entire management team.
   B) more of a collaborative group effort that involves all managers and sometimes key employees, as opposed to being the function and responsibility of a few high-level executives.
   C) first and foremost the function and responsibility of a company’s strategic planning staff.
   D) first and foremost the function and responsibility of a company’s board of directors.
   E) first and foremost the function of a company’s chief executive officer—who formulates strategic initiatives and submits them to the board of directors for approval.

   Answer: B   Page: 37-38   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

52. Which of the following is not an accurate description of the task of crafting a company’s strategy?
   A) In most companies, crafting strategy is a team effort, involving managers and often key employees at many organization levels.
   B) Ultimate responsibility for leading the strategy-making task rests with the chief executive officer.
   C) The task of crafting strategy is best done by a company’s chief strategic planning officer, who should report directly to the company’s CEO and board of directors.
   D) It is the responsibility and duty of a company’s board of directors to ensure that new strategy proposals can be defended as superior to alternatives and, ultimately, to approve or disapprove of the strategy formulated and proposed by the company’s management.
   E) In most of today’s companies, every company manager has a strategy-making role, ranging from major to minor, for his/her area of responsibility.

   Answer: C   Page: 37-38   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

53. Managerial jobs with strategy-making responsibility
   A) extend throughout the managerial ranks and exist in every part of a company–business units, operating divisions, functional departments, manufacturing plants, and sales districts.
   B) are primarily located in the strategic planning departments of large corporations.
   C) are relatively rare because most strategy-making is done by the members of a company’s board of directors.
   D) seldom exist within a functional department (e.g., marketing and sales) or in an operating unit (a plant or a district office) because these levels of the organization structure are well below the level where strategic decisions are typically made.
   E) are found only at the vice-president level and above in most companies.

   Answer: A   Page: 38   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
54. Which of the following most accurately describes the task of crafting a company’s strategy?
   A) In most companies, strategy-making is the exclusive province of top management—owner-entrepreneurs, CEOs, and other very senior executives.
   B) The more a company’s operations cut across different products, industries, and geographical areas, the more that headquarters executives have little option but to delegate considerable strategy-making authority to down-the-line managers in charge of particular subsidiaries, product lines, geographic sales offices, and plants.
   C) A company’s board of directors generally takes the lead role in crafting a company’s strategy.
   D) In most of today’s companies, the lead strategy-making role is being assumed by an elite group of corporate intrapreneurs.
   E) Masterful strategies are nearly always the product of brilliant corporate intrapreneurs.

**Answer:** B   Page: 38   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
AACSFB: Value Creation

### A Company’s Strategy-Making Hierarchy

55. A company’s overall strategy
   A) determines whether its strategic intent is proactive or reactive.
   B) is subject to being changed much less frequently than either its objectives or its mission statement and thus serves as the base of its strategy-making pyramid.
   C) should be based on a flexible strategic vision and strategic intent.
   D) is customarily reviewed and approved level-by-level by the company board of directors.
   E) is really a collection of strategic initiatives and actions devised by managers and key employees up and down the whole organizational hierarchy.

**Answer:** E   Page: 38-39   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
AACSFB: Value Creation

56. In a diversified company, the strategy-making hierarchy consists of
   A) corporate strategy and a group of business strategies (one for each line of business the corporation has diversified into).
   B) corporate or managerial strategy, a set of business strategies, and divisional strategies within each business.
   C) business strategies, functional strategies, and operating strategies.
   D) corporate strategy, business strategies, functional strategies, and operating strategies.
   E) its diversification strategy, its line of business strategies, and its operating strategies.

**Answer:** D   Page: 39   Learning Objective: 4   Difficulty: Medium   Taxonomy: Knowledge
AACSFB: Value Creation

57. Corporate strategy for a diversified or multi-business enterprise
   A) is orchestrated by senior corporate executives and focuses on how to create a competitive advantage in each specific line-of-business the total enterprise is in.
   B) concerns how best to allocate resources across the departments of each line of business the company is in.
   C) is orchestrated by senior corporate executives and centers around the kinds of initiatives the company uses to establish business positions in different industries and efforts to boost the combined performance of the businesses the company has diversified into.
   D) deals chiefly with what the strategic intent of each of its business units should be.
   E) involves how functional strategies should be aligned with business strategies in each of the various lines of business the company is in.

**Answer:** C   Page: 39-40   Learning Objective: 4   Difficulty: Hard   Taxonomy: Knowledge
AACSFB: Value Creation
58. Business strategy concerns
   A) the actions and approaches crafted by management to produce successful performance in one specific line of business.
   B) what set of businesses to be in and why.
   C) selecting a business model to use in pursuing business objectives.
   D) selecting a set of stretch financial and strategic objectives for a particular line of business.
   E) choosing the most appropriate strategic intent for a specific line of business.

   Answer: A   Page: 39-40   Learning Objective: 3   Difficulty: Easy   Taxonomy: Knowledge
   AACSB: Value Creation

59. Business strategy, as distinct from corporate strategy, is chiefly concerned with
   A) deciding what new businesses to enter, which existing businesses to get of, and which existing business to remain in.
   B) forging actions and approaches to compete successfully in a particular line of business.
   C) making sure the strategic intent of a particular business is in step with the company’s overall strategic intent and strategy.
   D) coordinating the competitive approaches of a company’s different business units.
   E) what business model to employ in each of the company’s different businesses.

   Answer: B   Page: 39-40   Learning Objective: 3   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation

60. Functional strategies
   A) concern the actions, approaches, and practices to be employed in managing particular functions or business processes or key activities within a business.
   B) specify what actions a company should take to resolve specific strategic issues and problems.
   C) are normally crafted by operating-level managers.
   D) are concerned with how to unify the firm’s several different operating strategies into a cohesive whole.
   E) are normally crafted by the company’s CEO and other senior executives.

   Answer: A   Page: 39-40   Learning Objective: 3   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation

61. The primary role of a functional strategy is to
   A) unify the company’s various operating-level strategies.
   B) specify how to build and strengthen the skills, expertise, and competencies needed to execute operating-level strategies successfully.
   C) support and add power to the corporate-level strategy.
   D) create compatible degrees of strategic intent among a company’s different business functions.
   E) support the overall business strategy and competitive approach.

   Answer: E   Page: 39-40   Learning Objective: 3   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation
62. Operating strategies concern
A) what the firm’s operating departments are doing and plan to do to unify the company’s functional and business strategies.
B) the specific plans for building competitive advantage in each major department and operating unit.
C) the relatively narrow strategic initiatives for managing key operating units within a business (plants, distribution centers, geographic units) and for performing strategically significant operating tasks (maintenance, shipping, inventory control, purchasing, advertising) in ways that support functional strategies and the overall business strategy.
D) how best to carry out the company’s corporate strategy.
E) how best to implement and execute the company’s different business-level strategies.

Answer: C  Page: 39-40  Learning Objective: 3  Difficulty: Medium  Taxonomy: Knowledge
AACSB: Value Creation

63. In a single-business company, the strategy-making hierarchy consists of
A) business strategy, divisional strategies, and departmental strategies.
B) business strategy, functional strategies, and operating strategies.
C) business strategy and operating strategy.
D) managerial strategy, business strategy, and divisional strategies.
E) corporate strategy, divisional strategies, and departmental strategies.

Answer: B  Page: 40-41  Learning Objective: 3  Difficulty: Medium  Taxonomy: Knowledge
AACSB: Value Creation

**A Strategic Vision + Objectives + Strategy = A Strategic Plan**

64. A company’s strategic plan consists of
A) its objectives and its strategy for achieving them.
B) a vision of where it is headed, a set of performance targets, and a strategy to achieve them.
C) its strategy and management’s specific, detailed plans for implementing it.
D) a company’s strategic vision, strategic objectives, strategic intent, and strategy.
E) a strategic vision, a strategy, and a business model.

Answer: B  Page: 41  Learning Objective: 3  Difficulty: Easy  Taxonomy: Knowledge
AACSB: Value Creation

**Phase 4: Implementing and Executing the Strategy**

65. Which of the following is *not* among the principal managerial tasks associated with managing the strategy execution process?
A) Ensuring that policies and procedures facilitate rather than impede effective execution
B) Creating a company culture and work climate conducive to successful strategy implementation and execution
C) Surveying employees on how they think costs can be reduced and how employee morale and job satisfaction can be improved
D) Exerting the internal leadership needed to drive implementation forward and keep improving on how the strategy is being executed
E) Tying rewards and incentives directly to the achievement of performance objectives and good strategy execution

Answer: C  Page: 41-42  Learning Objective: 5  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation
Phase 5: Evaluating Performance and Initiating Corrective Adjustments

66. Management is obligated to monitor new external developments, evaluate the company’s progress, and make corrective adjustments in order to
A) determine whether the company has a balanced scorecard for judging its performance.
B) stay on track in achieving the company’s mission and strategic vision.
C) keep the company’s board of directors well-informed about the company’s future outlook.
D) determine whether the company’s business model is well matched to changing market and competitive circumstances.
E) decide whether to continue or change the company’s strategic vision, objectives, strategy and/or strategy execution methods.

Answer: E   Page: 43   Learning Objective: 6   Difficulty: Easy   Taxonomy: Comprehension
AACSB: Value Creation

Leading the Strategic Management Process

67. Leading the drive for good strategy execution and operating excellence calls upon managers to
A) be very personable, an effective communicator, and skilled in the empowerment of company personnel.
B) practice MBWA, ensure the company has a good strategic plan, put constructive pressure on the organization to achieve good results, push for the development of stronger core competencies and competitive capabilities, display ethical integrity, and lead social responsibility initiatives.
C) delegate little to subordinates and, instead, personally exert a strong, highly visible influence on the company’s approaches to strategy execution.
D) be creative in establishing policies and procedures that will facilitate high standards of operating excellence.
E) be charismatic, a decisive decision-maker, and make inspiring speeches at company events.

Answer: B   Page: 44   Learning Objective: 7   Difficulty: Easy   Taxonomy: Comprehension
AACSB: Value Creation

68. Which of the following is most integral to the task of leading the drive for good strategy execution and operating excellence?
A) Pushing lower-level managers and supervisors to practice MBWA
B) Being a good motivator and a decisive decision-maker
C) Staying on top of how well things are going, making sure the company has a good strategic plan, putting constructive pressure on the organization to achieve good results, displaying ethical integrity, leading social responsibility initiatives, and pushing corrective actions to improve strategy execution and achieve the targeted results
D) Practicing enlightened empowerment of employees and using a decentralized approach to decision-making
E) Being good at designing a strategy-supportive reward structure

Answer: C   Page: 44   Learning Objective: 7   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation
69. Which of the following is not one of the important leadership roles that managers have to play in pushing for good strategy execution and operating excellence?
A) Weeding out managers who are consistently in the ranks of the lowest performers (the bottom 10%) and who are not enthusiastic about the strategy or how it is being executed
B) Displaying ethical integrity and leading social responsibility initiatives
C) Putting constructive pressure on the organization to achieve good results and operating excellence
D) Pushing corrective actions to improve strategy execution and achieve the targeted results
E) Staying on top of what is happening, closely monitoring progress, ferreting out issues, and learning what obstacles lay in the path of good strategy execution

Answer: A Page: 44 Learning Objective: 7 Difficulty: Medium Taxonomy: Comprehension
AACSBB: Value Creation

Staying on Top of How Well Things Are Going

70. MBWA refers to
A) modifying businesses with action.
B) making budgets without accountants.
C) the managerial practice of making regular visits to field operations, talking with many different people at many different levels, and learning first-hand how well things are going.
D) modifying behavior without anxiety.
E) managing businesses with authority.

Answer: C Page: 44 Learning Objective: 7 Difficulty: Medium Taxonomy: Comprehension
AACSBB: Value Creation

71. The purpose of managing by walking around is to
A) learn more about company operations and see how activities are really being done.
B) gather information and opinions about what is happening from diverse sources and learn firsthand how well the strategy execution process is proceeding.
C) give employees a chance to make suggestions for improvement.
D) gather information about what strategy to follow and to learn what competitors are doing.
E) be visible and accessible to employees.

Answer: B Page: 44 Learning Objective: 7 Difficulty: Medium Taxonomy: Comprehension
AACSBB: Value Creation

Making Sure a Company Has a Good Strategic Plan

72. Which of the following is most integral to the responsibility of top executives to ensure a company has a sound, cohesive strategic plan?
A) Requiring operating excellence as the company’s primary core value.
B) Delegating the responsibility of setting objectives and formulating the details of strategy to key midlevel and frontline managers
C) Gathering information about what key rivals are doing and then developing a strategic plan based on this data
D) Effectively communicating the company’s vision, objectives, and key strategy components to key personnel and exercising due diligence in reviewing lower-level strategies for consistency and support of higher-level strategies
E) Addressing conflicts among midlevel and frontline managers in their development of the company’s vision, mission, objectives, and key strategy components

Answer: D Page: 45 Learning Objective: 7 Difficulty: Medium Taxonomy: Comprehension
AACSBB: Value Creation
73. Which one of the following is not a key approach to promote innovative ideas in the strategy-making process?
   A) Using various types of ad hoc organizational forms to support ideas and experimentation
   B) Taking special pains to foster, nourish, and support people who want to explore adding new or improved products
   C) Monitoring conflicts that arise in the allocation of financial resources to new business ventures
   D) Ensuring rewards for successful champions are large and visible
   E) Encouraging individuals and groups to brainstorm proposals for new business ventures

   \[\text{Answer: C} \quad \text{Page: 44} \quad \text{Learning Objective: 7} \quad \text{Difficulty: Hard} \quad \text{Taxonomy: Comprehension} \quad \text{AACSB: Value Creation}\]

**Putting Constructive Pressure on Organizational Units to Achieve Good Results and Operating Excellence**

74. Successfully leading the effort to instill a results-oriented work climate and put constructive pressure on the organization to achieve good results
   A) entails such actions as promoting a culture of innovation and high performance, emphasizing individual initiative and creativity, and respecting the contribution of individuals and groups.
   B) hinges on the extent to which top management emphasizes a positive rather than a negative reward system.
   C) requires that top executives make operating excellence the company’s only core value.
   D) calls for top executives to stress the adoption of best practices and push for continuous product innovation.
   E) hinges on the degree to which lower-level managers and supervisors are good practitioners of MBWA.

   \[\text{Answer: A} \quad \text{Page: 47} \quad \text{Learning Objective: 7} \quad \text{Difficulty: Medium} \quad \text{Taxonomy: Comprehension} \quad \text{AACSB: Value Creation}\]

75. Which of the following is not a managerial action calculated to promote an organizational climate where good strategy execution and operating excellence can blossom and thrive?
   A) Promoting a culture of innovation and high performance
   B) Keeping the reward system positive and striving to eliminate tension, fear, job insecurity, stress, and anxiety from the work environment
   C) Respecting the contributions of both individuals and groups
   D) Emphasizing individual initiative and creativity
   E) Using people-management practices to win the emotional commitment of company personnel, inspiring them to do their best

   \[\text{Answer: B} \quad \text{Page: 47} \quad \text{Learning Objective: 7} \quad \text{Difficulty: Medium} \quad \text{Taxonomy: Comprehension} \quad \text{AACSB: Value Creation}\]
Pushing Corrective Actions to Improve Both the Company’s Strategy and How Well It Is Being Executed

76. The leadership challenges that top executives face in making corrective adjustments when things are not going well include
A) knowing when to replace poorly performing subordinates and when to do a better job of coaching them to do the right things.
B) being able to discern whether to promote better achievement of strategic performance targets or whether to promote better achievement of financial performance targets.
C) deciding when adjustments are needed and what adjustments to make.
D) having the analytical skills to separate the problems due to a bad strategy from the problems due to bad strategy execution.
E) deciding whether the company would be better off making adjustments that curtail the achievement of strategic objectives or that curtail the achievement of financial objectives.

Answer: C  Page: 47  Learning Objective: 7  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

77. The task of top executives in making corrective adjustments includes
A) knowing when to continue with the present corporate culture and when to shift to a different and better corporate culture.
B) deciding when adjustments are needed and what adjustments to make.
C) being good at figuring out whether to arrive at decisions quickly or slowly in choosing among the various alternative adjustments.
D) deciding whether to try to fix the problems of poor strategy execution or simply shift to a strategy that is easier to execute correctly.
E) deciding how to identify the problems that need fixing.

Answer: B  Page: 47  Learning Objective: 7  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

Leading the Development of Better Competencies and Capabilities

78. Strengthening a company’s competencies and competitive capabilities
A) often requires proactive leadership by top executives because they are in the best organizational position to spot opportunities to leverage existing competencies and competitive capabilities.
B) is an exercise best orchestrated by senior managers who have the clout to enforce the necessary networking and cooperation among individuals, groups, departments, and external allies.
C) often requires top executive action because senior managers are in the best position to anticipate changes in customer requirements and market conditions and see the potential of new competencies and capabilities.
D) is often a top management function because proactively building new competencies and capabilities ahead of rivals to gain a competitive edge is strategic leadership of the best kind.
E) All of the above.

Answer: E  Page: 48  Learning Objective: 7  Difficulty: Easy  Taxonomy: Comprehension
AACSB: Value Creation
Chapter 2  Leading the Process of Crafting and Executing Strategy

79. Which of the following statements about leading the development of better competencies and capabilities is false?

A) Top executives are the ones who craft the strategy, and thus they are the ones responsible for strengthening this or that competence or capability to keep the strategy successful.

B) Senior managers are more likely to appreciate the strategy-implementing/strategy-executing significance of stronger competences and competitive capabilities, and they have the clout to enforce the necessary cooperation among individuals, groups, departments, and external allies.

C) Effective strategy leaders try to anticipate changes in customer/market requirements and proactively build new competencies and capabilities that offer a competitive edge over rivals.

D) Executives who move proactively to build new competencies and capabilities ahead of rivals to gain a competitive edge are demonstrating strategic leadership of the best kind.

E) Senior managers are in the best position to see the need and potential of new competencies and capabilities and then play a lead role in the capability-building, resource-strengthening process.

Answer: A  Page: 48  Learning Objective: 7  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

Displaying Ethical Integrity and Undertaking Social Responsibility Initiatives

80. Leading the effort to operate a company in an ethically-principled fashion involves the CEO and other senior executives

A) setting an excellent example in their own ethical behavior and demonstrating integrity in their actions and decisions.

B) taking an uncompromising stand on expecting all company personnel to conduct themselves in an ethical fashion at all times.

C) declaring unequivocal support of the company’s ethics code.

D) reprimanding those who are lax in monitoring and enforcing ethics compliance.

E) All of these.

Answer: E  Page: 48  Learning Objective: 7  Difficulty: Easy  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

81. Which of the following is not a part of top management’s job (especially the CEO) in leading the effort to operate the company’s business in an ethically-principled fashion?

A) Setting an excellent example in their own ethical behavior and demonstrating character and integrity in their actions and decisions

B) Personally writing the company’s code of ethics—this ensures that they will walk the talk and be committed to upholding the ethical standards they have prescribed

C) Being willing to reprimand those who are lax in monitoring and enforcing ethics compliance

D) Visibly and frequently declaring unequivocal support of the company’s ethics code

E) Taking an uncompromising stand on expecting all company personnel to conduct themselves in an ethical fashion at all times

Answer: B  Page: 48  Learning Objective: 7  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities
82. What separates companies that make a sincere effort to carry their weight in being good corporate citizens from companies that are content to do only what is legally required of them
A) are shareholders who insist that senior executives practice corporate citizenship and social responsibility.
B) is a strong board of directors that is committed to avoiding the potential for unfavorable media exposure and scandal that occurs when a company steps out of bounds and gets caught.
C) are company leaders who believe that just making a profit is not good enough and that judging the company’s performance must include social and environmental metrics as well as financial and strategic metrics.
D) is pressure from customers who want and expect the companies they do business with to be honorable and socially responsible in their actions.
E) is pressure from employees—employees want to be proud of the company they work for and proud of the way it behaves.

Answer: C  Page: 49  Learning Objective: 7  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

Corporate Governance: The Role of the Board of Directors in the Strategy-Making, Strategy-Executing Process

83. The primary roles/obligations of a company’s board of directors in the strategy-making, strategy-executing process include
A) playing the lead role in forming the company’s strategy and then directly supervising the efforts and actions of senior executives in implementing and executing the strategy.
B) providing guidance and counsel to the CEO in carrying out his/her duties as chief strategist and chief strategy implementer.
C) overseeing the company’s direction, strategy and business approaches and evaluating the caliber of senior executives’ strategy-making and strategy-executing skills.
D) working closely with the CEO, senior executives, and the strategic planning staff to develop a strategic plan for the company and then overseeing how well the CEO and senior executives carry out the board’s directives in implementing and executing the strategic plan.
E) reviewing and approving the company’s business model and also reviewing and approving the proposals and recommendations of the CEO as to how to execute the business model.

Answer: C  Page: 49  Learning Objective: 8  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

84. The obligations of an investor-owned company’s board of directors in the strategy-making, strategy-executing process include
A) coming up with compelling strategy proposals of their own to debate against those put forward by top management.
B) overseeing the company’s financial accounting and financial reporting practices and evaluating the caliber of senior executives’ strategy-making/strategy-executing skills.
C) taking the lead in developing the company’s business model and strategic vision.
D) taking the lead in formulating the company’s strategic plan but then delegating the task of implementing and executing the strategic plan to the company’s CEO and other senior executives.
E) approving the company’s operating strategies, functional-area strategies, business strategy, and overall corporate strategy.

Answer: B  Page: 49-50  Learning Objective: 8  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation
85. Which one of the following is not among the chief duties/responsibilities of a company’s board of directors insofar as the strategy-making, strategy-executing process is concerned?

A) Hiring and firing senior-level executives and working with the company’s chief strategic planning officer to improve the company’s strategy when performance comes up short of expectations

B) Being inquiring critics and exercising strong oversight over the company’s direction, strategy, and business approaches

C) Evaluating the caliber of senior executives’ strategy-making/strategy-executing skills

D) Instituting a compensation plan for top executives that rewards them for actions and results that serve stakeholders’ interests, most especially those of shareholders

E) Overseeing the company’s financial accounting and financial reporting practices

Answer: A   Page: 49-50   Learning Objective: 8   Difficulty: Medium   Taxonomy: Comprehension   AACSB: Value Creation

Short Answer Questions

86. What are the five phases of the strategy-making, strategy-executing process and what does each one involve?

Page: 24   Learning Objective: 1   Difficulty: Medium   Taxonomy: Knowledge   AACSB: Value Creation

87. Define and briefly explain what is meant by each of the following terms:

a) strategic vision
b) strategic inflection point
c) stretch objectives
d) strategic objective
e) balanced scorecard
f) strategic intent
g) strategic plan

Page: 25, 32, 33-34, 34-35, 36, 41   Learning Objective: 1, 2, 3   Difficulty: Hard   Taxonomy: Knowledge   AACSB: Value Creation

88. A well-conceived strategic vision helps prepare a company for the future. True or false? Explain and justify your answer.

Page: 25   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension   AACSB: Value Creation

89. Explain why an organization needs a strategic vision. What purpose does a strategic vision serve?

Page: 25-26   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension   AACSB: Value Creation

90. What is the managerial value of a good strategic vision?

Page: 25-26   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension   AACSB: Value Creation
91. What is the difference between a mission statement and a strategic vision?

92. Which is more important—a company’s mission statement or its strategic vision? Explain.

93. How can one tell if a company has an ethical strategy?

94. Identify the key characteristics of a well-stated organizational objective.

95. What is meant by the term “stretch objectives?” Is it important that companies establish stretch objectives? Why or why not?

96. Why does an organization need both financial and strategic objectives?

97. Explain the difference between financial objectives and strategic objectives. Give examples of each.

98. What are the qualities of a “well-stated” objective? Give an example of a well-stated financial objective and a well-stated strategic objective.

99. The achievement of financial objectives tends to be a lagging indicator of a company’s performance while the achievement of strategic objectives tends to be a leading indicator of a company’s future financial performance. True or false? Support and explain your answer.
100. What is the meaning of the term “balanced scorecard?” What are the merits of using a balanced scorecard in judging a company’s performance?

Page: 34-35   Learning Objective: 2   Difficulty: Medium   Taxonomy: Knowledge
AACSB: Value Creation

101. Which is more important to a company’s future financial performance: the achievement of strategic objectives or the achievement financial objectives? Why?

Page: 34-35   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

102. Who is responsible for actually performing the five phases of the strategy-making, strategy-executing process?

Page: 37-38   Learning Objective: 3   Difficulty: Easy   Taxonomy: Comprehension AACS: Value Creation

103. What is the role and responsibility of a company’s CEO in the strategy-making, strategy-executing process?

Page: 37-38, 44   Learning Objective: 3, 7   Difficulty: Easy   Taxonomy: Comprehension AACS: Value Creation

104. The task of crafting a company’s strategy is typically a job for the company’s whole management team, not just a small group of senior executives. True or false? Explain and support your answer.


105. Explain why a company’s strategy is really a collection of strategies.


106. What is the strategy-making hierarchy for a diversified company? How does it differ from the strategy-making hierarchy for a single business company?

Page: 39-41   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension AACS: Value Creation

107. A company’s strategy is really a collection of layered strategies. True or false? Discuss and explain.

108. Discuss the meaning of each of the following levels of strategy and indicate what level of management tends to take lead responsibility for crafting the strategy at each of the four levels:
   a) corporate strategy
   b) business strategy
   c) functional area strategy
   d) operating strategy

Page: 39-40  Learning Objective: 3  Difficulty: Hard  Taxonomy: Knowledge
AACSB: Value Creation

109. An organization’s strategic plan consists of the actions which management plans to take in the near future. True or false? Explain and justify your answer.

Page: 41  Learning Objective: 3  Difficulty: Medium  Taxonomy: Knowledge
AACSB: Value Creation

110. Identify four actions that top executives can take to help instill a spirit of high achievement into the corporate culture and mobilize organizational energy behind the drive for good strategy execution and operating excellence.

Page: 44  Learning Objective: 7  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

111. Identify four actions that are key elements of leading the strategy execution process.

Page: 44  Learning Objective: 7  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

112. What is MBWA and why is it important?

Page: 44  Learning Objective: 7  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

113. Identify three actions top management can take to promote innovation and new ideas in the strategymaking process.

Page: 46  Learning Objective: 7  Difficulty: Medium  Taxonomy: Knowledge
AACSB: Value Creation

114. What are the three main things a CEO and those around the CEO should do in leading the effort to operate the company’s business in an ethically principled fashion?

Page: 48  Learning Objective: 7  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

115. Identify three actions that senior managers need to take if they are really serious about enforcing ethical behavior.

Page: 48  Learning Objective: 7  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities
116. The strength of a CEO’s commitment ultimately determines whether a company will genuinely strive to operate in an ethically-principled manner. True or false? Justify your answer.

Page: 48  Learning Objective: 7  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

117. What indicates a company is making a sincere effort to carry its weight in being a good corporate citizen are actions to do what is legally required of them and company leaders who believe strongly that making a profit is the most socially responsible thing a company can do. True or false? Justify your answer.

Page: 48-49  Learning Objective: 7  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

118. Socially-conscious strategy leaders who believe that making a profit is not enough have to insist that social and environmental metrics be made co-equal with financial and strategic objectives in evaluating company performance. True or false? Explain.

Page: 49  Learning Objective: 7  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

119. What are the roles/obligations of a company’s board of directors in the strategy-making, strategy-executing process?

Page: 49-50  Learning Objective: 8  Difficulty: Easy  Taxonomy: Comprehension
AACSB: Value Creation

120. Identify and briefly discuss at least three obligations of a company’s board of directors in corporate governance and the strategy-making, strategy-executing process.

Page: 49-50  Learning Objective: 8  Difficulty: Hard  Taxonomy: Knowledge
AACSB: Value Creation
Multiple Choice Questions

The Strategically Relevant Components of a Company's External Environment

1. A company’s “macroenvironment” refers to
   A) the industry and competitive arena in which the company operates.
   B) general economic conditions plus the factors driving change in the markets where a company operates.
   C) all the relevant forces and factors outside a company’s boundaries—general economic conditions, population demographics, societal values and lifestyles, technological factors, governmental legislation and regulation, and closer to home, the industry and competitive arena in which it operates.
   D) the competitive market environment that exists between a company and its competitors.
   E) the dominant economic features of a company’s industry.

   Answer: C   Page: 56-57   Learning Objective: 1   Difficulty: Easy   Taxonomy: Knowledge
   AACSB: Domestic/Global Economic Environments

2. Which one of the following is not part of a company’s macroenvironment?
   A) Conditions in the economy at large
   B) Population demographics and societal values and lifestyles
   C) Technological factors and governmental regulations and legislation
   D) The industry and competitive environment arena in which the company operates
   E) The company’s resource strengths, resource weaknesses, and competitive capabilities

   Answer: E   Page: 56-57   Learning Objective: 1   Difficulty: Easy   Taxonomy: Knowledge
   AACSB: Domestic/Global Economic Environments

Thinking Strategically about a Company's Industry and Competitive Environment

3. Which of the following is not a major question to ask in thinking strategically about industry and competitive conditions in a given industry?
   A) How many companies in the industry have good track records for revenue growth and profitability?
   B) What strategic moves are rivals likely to make next?
   C) What are the key factors for future competitive success?
   D) Does the outlook for the industry present the company with sufficiently attractive prospects for profitability?
   E) What forces are driving changes in the industry, and what impact will these changes have on competitive intensity and industry profitability?

   Answer: A   Page: 58   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Domestic/Global Economic Environments
4. Thinking strategically about industry and competitive conditions in a given industry involves evaluating such considerations as
   A) the forces driving change in the industry.
   B) the dominant economic features of the industry in which the company operates.
   C) the kinds of competitive forces industry members are facing and the strength of each competitive force.
   D) the key factors influencing future competitive success in the industry.
   E) All of the above.

   **Answer:** E  Page: 58  Learning Objective: 1  Difficulty: Easy  Taxonomy: Comprehension
   AACSB: Domestic/Global Economic Environments

**Question 1: What Are the Industry's Dominant Economic Features?**

5. Which of the following is **not** a factor to consider in identifying an industry’s dominant economic features?
   A) Market size and growth rate
   B) The extent of backward and forward integration and buyer needs and requirements
   C) Whether the products or services of rival firms are becoming more or less differentiated
   D) Strength of driving forces and competitive forces
   E) The pace of technological change, scale economies and experience curve effects, and product innovation

   **Answer:** D  Page: 59  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Domestic/Global Economic Environments

6. Which of the following is **not** a relevant consideration in identifying an industry’s dominant economic features?
   A) Market size and growth rate, the geographic scope of competitive rivalry, and demand-supply conditions
   B) The extent to which economies of scale and learning/experience curve effects are present
   C) How many strategic groups the industry has and which ones are most profitable and least profitable
   D) The number and sizes of buyers, the number of rivals, and the pace of product innovation
   E) The prevalence of vertical integration and the pace of technological change

   **Answer:** C  Page: 59  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Domestic/Global Economic Environments

**Question 2: How Strong Are Competitive Forces?**

7. The state of competition in an industry is a function of
   A) the competitive pressures associated with the market maneuvering and jockeying for buyer patronage that goes on among rival firms in the industry.
   B) competitive pressures coming from the attempts of companies in other industries attempting to win buyers over to their substitute products.
   C) competitive pressures associated with the threat of new entrants into the marketplace.
   D) competitive pressures associated with the bargaining power of suppliers and customers.
   E) All of these.

   **Answer:** E  Page: 60  Learning Objective: 2  Difficulty: Easy  Taxonomy: Comprehension
   AACSB: Value Creation
8. The nature and strength of the competitive forces that prevail in an industry are generally a joint product of
   A) the pressures induced by the market maneuvering and jockeying for buyer patronage that goes on among rival sellers in the industry.
   B) the threat that firms outside the industry will decide to enter the market.
   C) the attempts of companies in other industries to win buyers over to their own substitute products.
   D) competitive pressures stemming from the bargaining power of both suppliers and buyers.
   E) All of these.

   Answer: E   Page: 60-61   Learning Objective: 2   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

9. Which of the following is not one of the five typical sources of competitive pressures?
   A) The power and influence of industry driving forces
   B) The bargaining power of suppliers and seller-supplier collaboration
   C) The threat of new entrants into the market
   D) The attempts of companies in other industries to win customers over to their own substitute products
   E) The market maneuvering and jockeying for buyer patronage that goes on among rival sellers in the industry

   Answer: A   Page: 60-61   Learning Objective: 2   Difficulty: Easy   Taxonomy: Knowledge
   AACSB: Value Creation

10. The most powerful of the five competitive forces is usually
    A) the competitive pressures that stem from the ready availability of attractively-priced substitute products.
    B) the competitive pressures associated with the market maneuvering and jockeying for buyer patronage that goes on among rival sellers in the industry.
    C) the benefits that emerge from close collaboration with suppliers and the competitive pressures that such collaboration creates.
    D) the competitive pressures associated with the potential entry of new competitors.
    E) the bargaining power and leverage that large customers are able to exercise.

    Answer: B   Page: 61   Learning Objective: 2   Difficulty: Easy   Taxonomy: Knowledge
    AACSB: Value Creation

11. Typically, the weakest of the five competitive forces in an industry is/are:
    A) the threat posed by potential new entrants.
    B) the bargaining power and leverage that suppliers are able to exercise.
    C) the competitive pressures that stem from the ready availability of attractively-priced substitute products.
    D) the bargaining power and leverage that buyers are able to exercise.
    E) None of the above is typically weakest.

    Answer: E   Page: 60-61   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
    AACSB: Value Creation
12. Using the five-forces model of competition to determine what competition is like in a given industry involves
A) building the picture of competition in three steps: (1) identifying the specific competitive pressures associated with each of the five competitive forces; (2) evaluating how strong the pressures comprising each competitive force are; and (3) determining whether the collective impact of all five competitive forces is conducive to earning attractive profits.
B) building the picture of competition in two steps: (1) determining which rival has the biggest competitive advantage and (2) assessing whether the competitive advantages possessed by various industry members allow most industry members to earn above-average profits.
C) evaluating whether competition is being intensified or weakened by the industry’s driving forces and key success factors.
D) assessing whether the collective impact of all five forces is weak enough to allow industry members to go on the offensive or use a defensive strategy to insulate against fierce competitive pressures.
E) gauging the overall strength of competition based on how many industry rivals are operating with a competitive advantage and how many are operating at a competitive disadvantage.

Answer: A   Page: 60   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

**Competitive Pressures Created by the Rivalry Among Competing Sellers**

13. What makes the marketplace a competitive battlefield is
A) the race of industry members to build strong defenses against the industry’s driving forces.
B) the constant jockeying of industry members to strengthen their standing with buyers and win a competitive edge over rivals.
C) the ongoing race among rival sellers to have the highest quality product.
D) the ongoing efforts of industry members to introduce new and improved products/services at a faster rate than their rivals.
E) the ongoing race among rivals to achieve the fastest rate of growth in revenues and profits.

Answer: B   Page: 61   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

14. Competitive jockeying and market maneuvering among industry rivals
A) determines whether the industry’s strategic group map will be static or dynamic.
B) centers around collaborative efforts to overcome the bargaining power of powerful suppliers and powerful buyers.
C) is usually an industry’s strongest driving force.
D) is usually one of the two or three weakest competitive forces because of the close familiarity that rivals have for one another’s likely next moves.
E) is ever-changing as fresh offensive and defensive moves are initiated and as rivals emphasize first one mix of competitive weapons and tactics and then another.

Answer: E   Page: 62   Learning Objective: 2   Difficulty: Easy   Taxonomy: Comprehension
AACSB: Value Creation
15. Factors that cause the rivalry among competing sellers to be weak include
   A) low buyer switching costs and rival sellers that are relatively equal in size and capability.
   B) rapid growth in buyer demand and high buyer switching costs.
   C) few industry rivals that any one company’s actions can easily be anticipated and countered by its rivals.
   D) low barriers to entry and weakly differentiated products among rival sellers.
   E) slow growth in buyer demand and strongly differentiated products.

   **Answer:** B   Page: 63   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

16. Which one of the following does *not* cause the rivalry among competing sellers to be weak?
   A) High buyer switching costs
   B) Rapid growth in buyer demand
   C) Industry conditions that tempt rivals to use price cuts or other competitive weapons to boost unit sales
   D) Low barriers to entry
   E) Strongly differentiated products among rival sellers

   **Answer:** D   Page: 63   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

17. Factors that tend to result in weak rivalry among competing sellers include
   A) low buyer switching costs and low barriers to entry.
   B) rapid growth in buyer demand, high buyer costs to switch brands, and so many industry rivals that any one company’s actions have little impact on rivals’ businesses.
   C) weakly differentiated products among rival sellers.
   D) rivals that are quite diverse in terms of their strategies, objectives, and countries of origin.
   E) conditions where outsiders have recently acquired weak competitors and are trying to turn them into major contenders.

   **Answer:** B   Page: 63   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

18. The rivalry among competing sellers tends to be less intense when
   A) industry conditions tempt competitors to use price cuts or other competitive weapons to boost unit sales.
   B) buyer demand is weak and many sellers have excess capacity and/or inventory.
   C) industry rivals are not particularly aggressive or active in making fresh moves to improve their market standing and business performance.
   D) rivals have diverse strategies and objectives and are located in different countries.
   E) rival sellers have weakly differentiated products.

   **Answer:** C   Page: 63   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
19. Rivalry among competing sellers is generally more intense when
   A) there are relatively few industry key success factors and rivals have highly differentiated products.
   B) the industry’s driving forces are strong and rivals have strongly differentiated products.
   C) barriers to entry are moderately high and the pool of likely entry candidates is small.
   D) rivals are active in making fresh moves to lower prices, introduce new products, increase promotional
       efforts and advertising, and otherwise gain sales and market share.
   E) barriers to entry are high and buyer switching costs are high.

   **Answer:** D  Page: 62-63  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

20. Rivalry among competing sellers grows in intensity when
   A) rivals’ products/services are sold at widely varying prices and there are only 2-4 rivals.
   B) rivals have highly differentiated products and buyer demand is growing rapidly.
   C) there are so many industry rivals that the impact of any one company’s actions is spread thinly across
       all industry members.
   D) the products/services of rivals are strongly differentiated and buyers have high switching costs.
   E) buyer demand is growing slowly and the industry is composed of 6 to 10 competitors that are fairly
       equal in size and competitive capability.

   **Answer:** E  Page: 63  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

21. The rivalry among competing firms tends to be more intense
   A) when demand for the product is growing slowly, buyers have low switching costs, and the actions of
       any one company to attract more customers and boost market share have strong direct impact on their
       rivals.
   B) when the products/services of rival sellers are strongly differentiated and buyer demand is strong.
   C) when rivals are relatively content with their current market position.
   D) when there are so many industry rivals that the impact of any one company’s actions is spread thinly
       across all industry members.
   E) the smaller the number of firms in the industry and the more unequal their market shares.

   **Answer:** A  Page: 63  Learning Objective: 2  Difficulty: Hard  Taxonomy: Comprehension
   AACSB: Value Creation

22. Which of the following is not among the factors that affect whether competitive rivalry among participating
    firms is strong, moderate, or weak?
   A) Whether the products of rival sellers are strongly or weakly differentiated
   B) Whether demand for the industry’s product is growing rapidly or slowly
   C) The degree to which rivals are satisfied with their current market position
   D) Whether industry driving forces are strong or weak
   E) Whether industry conditions tempt competitors to use price cuts or other competitive weapons to boost
       unit sales and whether one or two rivals have particularly powerful strategies

   **Answer:** D  Page: 63  Learning Objective: 2  Difficulty: Hard  Taxonomy: Comprehension
   AACSB: Value Creation
23. Rivalry among competing sellers tends to be more intense when
A) competitors are very unequal in size and capability, such that small competitors must really scramble to even survive.
B) buyer switching costs are high and market demand is growing rapidly.
C) several competitors are under pressure to improve their market share or profitability and launch fresh strategic initiatives to attract more buyers and bolster their business position.
D) the products of rival sellers are strongly differentiated.
E) there are fewer than 5 competitors and their products are strongly differentiated.

Answer: C   Page: 63   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

24. The competitive force of rival firms’ jockeying for better market positions, higher sales and market shares, and competitive advantage
A) is stronger when firms strive to be low-cost producers than when they use differentiation and focus strategies.
B) is typically a weaker competitive force than is the threat of entry of new rivals.
C) is largely unaffected by whether industry conditions tempt rivals to use price cuts or other competitive weapons to boost unit sales.
D) tends to intensify when strong companies outside the industry acquire weak firms in the industry and launch aggressive, well-funded moves to transform the acquired companies into strong market contenders.
E) is weaker when more firms have weakly differentiated products, buyer demand is growing slowly, and buyers have moderate switching costs.

Answer: D   Page: 65   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

25. In analyzing the strength of competition among rival firms, an important consideration is
A) the potential for buyers to exercise strong bargaining power.
B) the diversity of competitors in terms of visions, strategic intents, objectives, strategies, resources and countries of origin.
C) the number of firms pursuing differentiation strategies versus the number pursuing low-cost leadership strategies and focus strategies.
D) the extent to which some rivals have more than two competitively valuable competencies or capabilities.
E) whether the industry is characterized by a strong learning/experience curve and whether the industry is composed of many or few strategic groups.

Answer: B   Page: 65   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

26. The intensity of rivalry among competing sellers does not depend on whether
A) the industry has more than two strong driving forces and whether the industry has more than 2 strategic groups.
B) competitors are diverse in terms of visions, strategic intents, objectives, strategies, resources and countries of origin.
C) strong companies outside the industry have acquired weak firms in the industry and are launching aggressive moves to transform the acquired companies into strong market contenders.
D) one or two rivals have particularly powerful and successful strategies.
E) industry conditions tempt industry members to use price cuts or other competitive weapons to boost unit sales.

Answer: A   Page: 65   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation
27. In which one of the following instances is rivalry among competing sellers not more intense?
   A) When certain competitors are dissatisfied with their market position and make moves to bolster their standing
   B) When strong companies outside the industry acquire weak firms in the industry and launch aggressive moves to transform their newly-acquired competitors into stronger market contenders
   C) When competitors are fairly equal in size and capability
   D) When the products of rivals are weakly differentiated, buyer switching costs are low, and market demand is growing slowly
   E) When there are vast numbers of small rivals so the impact of any one company’s actions is spread thinly across all industry members

   **Answer:** E  Page: 65  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

**Competitive Pressures Associated with the Threat of New Entrants**

28. Which of the following is generally not considered as a barrier to entry?
   A) Rapid market growth
   B) Sizable capital requirements and an array of regulatory requirements
   C) Strong buyer loyalty to existing brands
   D) Sizable economies of scale in production
   E) Difficulties in gaining access to technological know-how

   **Answer:** A  Page: 66-68  Learning Objective: 2  Difficulty: Easy  Taxonomy: Comprehension
   AACSB: Value Creation

29. Potential entrants are more likely to be deterred from actually entering an industry when
   A) incumbent firms have previously been aggressive in defending their market positions against entry.
   B) incumbent firms are complacent.
   C) buyers are not particularly price sensitive and the industry already contains a dozen or more rivals.
   D) the relative cost positions of incumbent firms are about the same, such that no one incumbent has a meaningful cost advantage.
   E) buyer switching costs are moderately low because of strong product differentiation among incumbent firms.

   **Answer:** A  Page: 67-68  Learning Objective: 2  Difficulty: Hard  Taxonomy: Comprehension
   AACSB: Value Creation

30. Competitive pressures associated with the threat of entry are greater when
   A) incumbent firms are unable or unwilling to strongly contest the entry of newcomers.
   B) newcomers can expect to earn attractive profits and a number of outsiders have the expertise and resources to hurdle whatever entry barriers exist.
   C) entry barriers are relatively low and buyer demand for the product is growing fairly rapidly.
   D) existing industry members are looking to expand their market reach by entering product segments or geographic areas where they currently do not have a presence.
   E) All of these conditions heighten the competitive pressures associated with fresh entry into the industry.

   **Answer:** E  Page: 67  Learning Objective: 2  Difficulty: Easy  Taxonomy: Comprehension
   AACSB: Value Creation
31. Which one of the following does not intensify the competitive pressures associated with the threat of entry?
A) When incumbent firms are unable or unwilling to launch competitive initiatives to strongly contest the entry of newcomers
B) When industry members are struggling to earn good profits
C) When entry barriers are relatively low and buyer demand for the product is growing fairly rapidly
D) When existing industry members are looking to expand their market reach by entering product segments or geographic areas where they currently do not have a presence
E) When newcomers can expect to earn attractive profits and a number of outsiders have the expertise and resources to hurdle whatever entry barriers exist

*Answer:* B  Page: 67  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension

32. Which one of the following increases the competitive pressures associated with the threat of entry?
A) When incumbent firms are likely to launch competitive initiatives to strongly contest the entry of newcomers
B) When buyers have a high degree of loyalty to the brands and product offerings of existing industry members
C) When buyer demand for the product is growing fairly slowly
D) When few outsiders have the expertise and resources to hurdle whatever entry barriers exist
E) When newcomers can expect to earn attractive profits

*Answer:* E  Page: 67  Learning Objective: 2  Difficulty: Easy  Taxonomy: Comprehension

33. The competitive threat that outsiders will enter a market is weaker when
A) financially strong industry members send strong signals that they will launch strategic initiatives to combat the entry of newcomers.
B) the industry is characterized by the lack of sizable scale economies and learning/experience curve effects.
C) the industry’s market growth is rapid.
D) there are more than 2 entry barriers.
E) buyers have little loyalty to the brands and product offerings of existing industry members.

*Answer:* A  Page: 67  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension

34. Competitive pressures stemming from the threat of entry are weaker when
A) there are fewer than 20 potential entry candidates and more than 10 firms already in the industry.
B) there are more than 3 entry barriers.
C) the industry outlook is risky or uncertain.
D) incumbent firms have little ability to leverage distributors, dealers, and/or retailers to retain their business.
E) the nature of the industry entails few scale economies.

*Answer:* C  Page: 67  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension

AASCB: Value Creation
35. The best test of whether potential entry is a strong or weak competitive force is
   A) the strength of buyer loyalty to existing brands.
   B) whether the industry’s driving forces make it harder or easier for new entrants to be successful.
   C) whether the strategies of industry members are well-matched to the industry’s key success factors.
   D) whether there are any vacant spaces on the industry’s strategic group map.
   E) to ask if the industry’s growth and profit prospects are strongly attractive to potential entry candidates.

   Answer: E   Page: 69   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

**Competitive Pressures from the Sellers of Substitute Products**

36. Which of the following is *not* a good example of a substitute product that triggers stronger competitive pressures?
   A) A salad as a substitute for French fries
   B) Wireless phones as a substitute for wired telephones
   C) Coca-Cola as a substitute for Pepsi
   D) Snowboards as a substitute for snow skis
   E) Video-on-demand services from a cable TV company as a substitute for going to the movies

   Answer: C   Page: 69   Learning Objective: 2   Difficulty: Medium   Taxonomy: Application
   AACSB: Value Creation

37. The competitive pressures from substitute products tend to be stronger when
   A) buyers are relatively comfortable with using substitutes and the costs to buyers of switching over to the substitutes are low.
   B) there are more than 10 sellers of substitute products.
   C) the quality and performance of the substitutes is well above what buyers need to meet their requirements.
   D) buyers have high psychic costs in severing existing brand relationships and establishing new ones.
   E) demand for the industry’s product is not very price sensitive.

   Answer: A   Page: 71   Learning Objective: 2   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

38. In which of the following instances are industry members *not* subject to stronger competitive pressures from substitute products?
   A) The costs to buyers of switching over to the substitutes are low.
   B) Buyers are dubious about using substitutes.
   C) The quality and performance of the substitutes is well matched to what buyers need to meet their requirements.
   D) Buyer brand loyalty is weak.
   E) Substitutes are readily available at competitive prices.

   Answer: B   Page: 71   Learning Objective: 2   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation
39. Industry rivals tend to experience weak competitive pressures from substitute products when
A) the available substitute products are weakly differentiated from one another.
B) the buyers of the industry’s products are few in number and they have substantial amounts of leverage with sellers.
C) rival sellers experience strong bargaining power from both suppliers and influential customers.
D) buyers incur high costs in switching to substitutes and substitutes are higher priced relative to the performance they deliver.
E) the producers of substitute products are all pursuing strategies to strongly differentiate their products on the basis of quality and product performance.

**Answer:** D  Page: 71  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation

40. Just how strong the competitive pressures are from substitute products depends on
A) whether the available substitutes are strongly or weakly differentiated and whether buyers make purchases frequently or infrequently.
B) whether attractively priced substitutes are readily available and the ease with which buyers can switch to substitutes.
C) whether the available substitutes are products or services.
D) whether the producers of substitutes have ample budgets for new product R&D.
E) the speed with which buyer needs and expectations are changing.

**Answer:** B  Page: 71  Learning Objective: 2  Difficulty: Easy  Taxonomy: Comprehension  
AACSB: Value Creation

**Competitive Pressures Stemming from Supplier Bargaining Power and Supplier-Seller Collaboration**

41. Whether supplier-seller relationships in an industry represent a strong or weak source of competitive pressure is a function of
A) whether the profits of suppliers are relatively high or low.
B) the number of suppliers that each seller/industry member purchases from on average.
C) how aggressively rival industry members are trying to differentiate their products.
D) whether suppliers can exercise sufficient bargaining power to influence the terms and conditions of supply in their favor and the extent of seller-supplier collaboration in the industry.
E) whether the prices of the items being furnished by the suppliers are rising or falling.

**Answer:** D  Page: 70-72  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation

42. The strength of competitive pressures that suppliers can exert on industry members is mainly a function of
A) whether needed inputs are in short supply or whether ample supplies are readily available from several different suppliers.
B) whether suppliers self-manufacture what they supply or source their items from other manufacturers.
C) the industry’s position in the growth cycle.
D) whether technological change in the businesses of suppliers is rapid or slow.
E) whether the needs and expectations of buyers of the industry product are changing slowly or rapidly.

**Answer:** A  Page: 72  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation
43. The bargaining leverage of suppliers is greater when
   A) there are no good substitutes for the items being furnished by the suppliers and the number of suppliers
      is relatively small.
   B) industry members incur low costs in switching their purchases from one supplier to another.
   C) industry members purchase in large quantities and thus are important customers of the suppliers.
   D) there is extensive seller-supplier collaboration.
   E) the supplier industry is composed of a large number of relatively small suppliers.

   Answer: A   Page: 72-74  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

44. In which one of the following instances are the competitive pressures that industry members experience in
   their dealings with suppliers not weakened?
   A) When industry members pose a credible threat of backward integration into the business of suppliers
   B) When the cost of switching from one supplier to another is low
   C) When the buying firms purchase in large quantities and thus are important customers of the suppliers
   D) When the item being supplied is a commodity
   E) When the items purchased from suppliers are in short supply

   Answer: E   Page: 74  Learning Objective: 2  Difficulty: Easy  Taxonomy: Comprehension
   AACSB: Value Creation

45. Supplier bargaining power is weaker when
   A) good substitute inputs exist or new ones emerge.
   B) the cost of switching from one supplier to another is high.
   C) suppliers furnish a critical part or component.
   D) buying firms are looking for suppliers with good just-in-time supply capabilities.
   E) a few large suppliers are the primary sources of a particular item.

   Answer: A   Page: 74  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

46. Which one of the following is not a factor that affects the strength of supplier bargaining power?
   A) Whether needed inputs are in ample supply and are readily available from several different suppliers
   B) Whether industry members are a strong threat to integrate backward into the business of suppliers and
      self-manufacture their own requirements
   C) Whether industry members are struggling to make good profits because of slow-growing market
      demand
   D) Whether the costs of industry members to switch their purchases to alternative suppliers are high or
      low
   E) Whether the item being supplied is a commodity or is highly differentiated from supplier to supplier

   Answer: C   Page: 74  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

47. Which one of the following is not a factor in causing supplier bargaining power to be relatively strong?
   A) The inputs needed from suppliers are in short supply.
   B) Suppliers are a strong threat to integrate forward into the business of industry members.
   C) The input being supplied is a commodity.
   D) The input being supplied significantly enhances the quality or performance of the products of industry
      members.
   E) There are only a few suppliers of the input.

   Answer: C   Page: 74  Learning Objective: 2  Difficulty: Easy  Taxonomy: Comprehension
   AACSB: Value Creation
48. When one or more industry members have unusually effective and mutually advantageous partnerships with their suppliers,
   A) it is rare for such partnerships to have much competitive impact on those industry members not having such partnerships.
   B) one unfortunate outcome is that it tends to give the supply partners much enhanced bargaining power in their dealings with these industry members.
   C) there is a strong likelihood such partnerships will put increased competitive pressure on those industry members who lack productive collaborative relationships with their suppliers.
   D) there is a high likelihood of such partnerships reducing competitive pressures on all industry members, provided technological change in the suppliers’ business is rapid and the item being supplied is a commodity.
   E) the usual result is to reduce competitive pressures on all industry members, provided the costs of the items furnished by supply chain partners amount to 50% or more of total cost.

Answer: C  Page: 73  Learning Objective: 2  Difficulty: Hard  Taxonomy: Application
AACSBB: Value Creation

49. Which one of the following is not a reason why industry members are often motivated to enter into collaborative partnerships with key suppliers?
   A) To reduce the costs of switching suppliers
   B) To speed the availability of next-generation components
   C) To enhance the quality of parts and components being supplied and reduce defect rates
   D) To squeeze out important cost savings for both themselves and their suppliers
   E) To reduce inventory and logistics costs

Answer: A  Page: 73  Learning Objective: 2  Difficulty: Easy  Taxonomy: Comprehension
AACSBB: Value Creation

**Competitive Pressures Stemming from Buyer Bargaining Power and Seller-Buyer Collaboration**

50. Whether buyer-seller relationships in an industry represent a strong or weak source of competitive pressure is a function of
   A) the speed with which general economic conditions and interest rates are changing.
   B) the extent to which buyers can exercise enough bargaining power to influence the conditions of sale in their favor and whether strategic partnerships between certain industry members can adversely affect other industry members
   C) how many buyers purchase all of their requirements from a single seller versus how many purchase from several sellers.
   D) the number of buyers versus the number of sellers.
   E) whether industry members are spending more or less on advertising.

Answer: B  Page: 74-75  Learning Objective: 2  Difficulty: Easy  Taxonomy: Comprehension
AACSBB: Value Creation

51. Whether buyer bargaining power poses a strong or weak source of competitive pressure on industry members depends in part on
   A) whether most buyers possess roughly equal or varying degrees of bargaining power and leverage.
   B) how many buyers are engaged in collaborative partnerships with sellers.
   C) whether entry barriers are high or low and the size of the pool of likely entry candidates.
   D) whether the overall quality of the items being furnished by industry members is rising or falling.
   E) whether demand-supply conditions represent a buyer’s market or a seller’s market.

Answer: E  Page: 75  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
AACSBB: Value Creation
52. Which of the following is not a factor that causes buyer bargaining power to be stronger?
A) Some buyers are a threat to integrate backward into the business of sellers and become an important competitor.
B) The industry is composed of a few large sellers and the customer group consists of numerous buyers that purchase in fairly small quantities.
C) Buyers have considerable discretion over whether and when they purchase the product.
D) Buyers purchase the item frequently and are well-informed about sellers’ products, prices, and costs.
E) The costs incurred by buyers in switching to competing brands or to substitute products are relatively low.

Answer: B Page: 75-76 Learning Objective: 2 Difficulty: Easy Taxonomy: Comprehension
AACSB: Value Creation

53. Which of the following factors does not affect whether buyer bargaining power and seller-buyer collaboration are an important source of competitive pressure in an industry?
A) Whether winning the business of certain customers offers a seller important market exposure or prestige
B) The extent and importance of collaborative partnerships and alliances between particular sellers and buyers
C) Whether buyers pose a major threat to integrate backward into the product market of sellers
D) Whether sellers’ products are weakly differentiated, making it easy and inexpensive for buyers to switch to competing brands
E) Whether buyers have a strong preference for products of superior quality or just average quality

Answer: E Page: 75-77 Learning Objective: 2 Difficulty: Medium Taxonomy: Comprehension
AACSB: Value Creation

54. Which of the following factors is not a relevant consideration in determining the strength of buyer bargaining power?
A) Whether winning the business of prestigious customers gives a seller important market exposure and heightens its brand name
B) Whether the seller is a manufacturer or a wholesaler/distributor
C) Whether buyers pose a major threat to integrate backward into the product market of sellers
D) Whether sellers’ products are weakly differentiated, making it easy for buyers to switch to competing brands
E) Whether collaborative partnerships and alliances between particular sellers and buyers put rivals lacking such collaborative relationships at a competitive disadvantage

Answer: B Page: 75-77 Learning Objective: 2 Difficulty: Medium Taxonomy: Comprehension
AACSB: Value Creation

55. Collaborative relationships between particular sellers and buyers in an industry can represent a source of strong competitive pressure when
A) virtually all buyers have strong brand attachments and are highly brand loyal.
B) demand for the product is growing rapidly.
C) one or more rival sellers form mutually advantageous partnerships with important or prestigious buyers such that rivals lacking such partnerships are placed at a competitive disadvantage.
D) sellers are racing to add the latest and greatest performance features so as to attract the patronage of important or prestigious buyers.
E) buyers are very quality conscious.

Answer: C Page: 76-77 Learning Objective: 2 Difficulty: Medium Taxonomy: Comprehension
AACSB: Value Creation
56. In which of the following circumstances are competitive pressures associated with the bargaining power of buyers not relatively strong?
A) When buyer demand is growing rapidly
B) When buyers are relatively well informed about sellers’ products, prices, and costs
C) When buyers pose a major threat to integrate backward into the product market of sellers
D) When sellers’ products are weakly differentiated, making it easy for buyers to switch to competing brands
E) When buyers have considerable discretion over whether and when they purchase the product

Answer: A   Page: 77   Learning Objective: 2   Difficulty: Easy   Taxonomy: Comprehension
AACSB: Value Creation

57. Competitive pressures stemming from buyer bargaining power tend to be weaker when
A) the number of buyers is small, such that each customer’s business tends to be particularly important to a seller.
B) buyer demand is growing slowly or maybe even declining.
C) the costs incurred by buyers in switching to competing brands or to substitute products are relatively high.
D) buyers purchase the item frequently and are well-informed about sellers’ products, prices, and costs.
E) the buyer group consists of a few large buyers and the seller group consists of numerous small firms.

Answer: C   Page: 77   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

58. Which of the following conditions acts to weaken buyer bargaining power?
A) When buyers are unlikely to integrate backward into the business of sellers
B) When buyers purchase the item frequently and are well-informed about sellers’ products, prices, and costs.
C) When the costs incurred by buyers in switching to competing brands or to substitute products are relatively low.
D) When the products of rival sellers are weakly differentiated and buyers have considerable discretion over whether and when they purchase the product.
E) When buyers are few in number and/or often purchase in large quantities.

Answer: A   Page: 77   Learning Objective: 2   Difficulty: Easy   Taxonomy: Comprehension
AACSB: Value Creation

59. Buyers are in position to exert strong bargaining power in dealing with sellers when
A) their costs to switch to competing brands or to substitute products are relatively high.
B) a particular seller’s product delivers quality or performance that is very important to the buyer and is not matched by other brands.
C) they buy the product infrequently or in small quantities and are not particularly well-informed about sellers’ products, prices, and costs.
D) buyer demand is growing rapidly.
E) the number of buyers is small or when a customer is particularly important to a seller.

Answer: E   Page: 77   Learning Objective: 2   Difficulty: Easy   Taxonomy: Comprehension
AACSB: Value Creation
60. Which of the following factors is not a relevant consideration in judging whether buyer bargaining power is relatively strong or relatively weak?

A) Whether certain customers offer sellers important market exposure or prestige
B) Whether customers are relatively well informed about sellers’ products, prices, and costs
C) Whether buyer needs and expectations are changing rapidly or slowly
D) Whether sellers’ products are highly differentiated, making it troublesome or costly for buyers to switch to competing brands or to substitute products
E) Whether sellers pose little threat of forward integration into the product market of their customers and whether buyers pose a major threat to integrate backward into the product market of sellers

**Answer:** C  Page: 77  Learning Objective: 2  Difficulty: Easy  Taxonomy: Comprehension  
AACSB: Value Creation

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**Is the Collective Strength of the Five Competitive Forces Conducive to Good Profitability?**

61. A competitive environment where there is weak to moderate rivalry among sellers, high entry barriers, weak competition from substitute products, and little bargaining leverage on the part of both suppliers and customers

A) lacks powerful driving forces.
B) gives each industry competitor the best potential for building sustainable competitive advantage over rival firms.
C) makes it hard for industry members to compete successfully unless they can strongly differentiate their products.
D) is conducive to industry members earning attractive profits.
E) requires that industry members have low costs in order to be competitively successful.

**Answer:** D  Page: 78  Learning Objective: 2  Difficulty: Easy  Taxonomy: Comprehension  
AACSB: Value Creation

62. A competitive environment where there is strong rivalry among sellers, low entry barriers, strong competition from substitute products, and considerable bargaining leverage on the part of both suppliers and customers

A) is competitively unattractive from the standpoint of earning good profits.
B) offers little ability to build a sustainable competitive advantage.
C) is highly conducive to achieving strong product differentiation and high customer loyalty to the company’s brand.
D) offers moderate to good prospects for making a reasonable profit and building a sustainable competitive advantage.
E) requires that industry members have a strongly differentiated product offering in order to be profitable.

**Answer:** A  Page: 78  Learning Objective: 2  Difficulty: Easy  Taxonomy: Comprehension  
AACSB: Value Creation

63. As a rule, the stronger the collective impact of competitive pressures associated with the five competitive forces,

A) the stronger are the industry’s driving forces.
B) the lower the combined profitability of industry members.
C) the fewer companies that can achieve a competitive advantage via anything other than being the industry’s low-cost leader.
D) the larger the number of competitive advantage opportunities for industry members.
E) the greater the number of industry key success factors.

**Answer:** B  Page: 78  Learning Objective: 2  Difficulty: Easy  Taxonomy: Comprehension  
AACSB: Value Creation
**Question 3: What Forces Are Driving Industry Change and What Impacts Will They Have?**

64. The “driving forces” in an industry
   A) are usually triggered by changing technology or stronger learning/experience curve effects.
   B) usually are spawned by growing demand for the product, the outbreak of price-cutting, and big reductions in entry barriers.
   C) are major underlying causes of changing industry and competitive conditions and have the biggest influences in reshaping the industry landscape and altering competitive conditions.
   D) appear when an industry begins to mature but seldom present during early stages of the industry lifecycle.
   E) are usually triggered by shifting buyer needs and expectations or by the appearance of new substitute products.

   **Answer:** C Page: 79 Learning Objective: 1 Difficulty: Easy Taxonomy: Knowledge
   AACSB: Value Creation

65. Industry conditions change
   A) because of such powerful driving forces as swings in buyer demand, changing interest rates, ups and downs in the economy, and higher/lower entry barriers.
   B) because of newly-emerging industry threats and industry opportunities that alter the composition of the industry’s strategic groups.
   C) because new industry key success factors emerge.
   D) because important forces create pressures or incentives for industry participants (competitors, customers, suppliers) to alter their actions.
   E) chiefly because of changes in the barriers to entry and the degree of competition from substitute products.

   **Answer:** D Page: 79 Learning Objective: 1 Difficulty: Easy Taxonomy: Comprehension
   AACSB: Value Creation

66. The task of driving forces analysis is to
   A) develop a comprehensive list of all the potential causes of changing industry conditions.
   B) predict which new driving forces will emerge next.
   C) determine which of the five competitive forces is the biggest driver of industry change.
   D) identify the driving forces, assess whether their impact will make the industry more or less attractive, and determine what strategy changes are needed to prepare for the impacts of the driving forces.
   E) learn what the industry key success factors are and how they might change in the future.

   **Answer:** D Page: 79 Learning Objective: 1 Difficulty: Medium Taxonomy: Comprehension
   AACSB: Value Creation

67. Driving forces analysis
   A) involves identifying the driving forces, assessing whether their impact will make the industry more or less attractive, and determining what strategy changes a company may need to make to prepare for the impacts of the driving forces.
   B) identifies which strategic group is the most powerful.
   C) helps managers identify which industry member is likely to become (or remain) industry leader and why.
   D) helps managers identify which key success factors are most likely to help their company gain a competitive advantage.
   E) helps managers identify which of the five competitive forces will be the strongest driver of industry change.

   **Answer:** A Page: 79 Learning Objective: 1 Difficulty: Easy Taxonomy: Comprehension
   AACSB: Value Creation
Chapter 3  Evaluating a Company’s External Environment

Identifying an Industry’s Driving Forces

68. Which of the following is not generally a “driving force” capable of producing fundamental changes in industry and competitive conditions?
A) Changes in the long-term industry growth rate
B) Increasing globalization of the industry
C) Product innovation and technological change
D) Ups and downs in the economy and in interest rates
E) New government regulations or significant changes in government policy toward the industry

Answer: D  Page: 80  Learning Objective: 1  Difficulty: Medium  Taxonomy: Knowledge
AACSB: Value Creation

69. Which of the following are most unlikely to qualify as driving forces?
A) Changes in the long-term industry growth rate, the entry or exit of major firms, and changes in cost and efficiency
B) Increasing globalization of the industry and product innovation
C) New Internet technology applications, new government regulations, and significant changes in government policy toward the industry
D) Mounting competition from substitutes and increasing efforts to collaborate with suppliers via strategic alliances
E) Marketing innovations and changes in who buys the industry’s product and how they use it

Answer: D  Page: 80  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
AACSB: 3  Value Creation

70. Which of the following do not qualify as potential driving forces capable of inducing fundamental changes in industry and competitive conditions?
A) Changes in who buys the product and how they use it and changes in the long-term industry growth rate
B) Entry or exit of major firms, product innovation, and marketing innovation
C) Increases in the economic power and bargaining leverage of customers and suppliers, growing supplier-seller collaboration, and growing buyer-seller collaboration
D) Growing buyer preferences for differentiated products instead of mostly standardized or identical products
E) Changes in economies of scale and experience curve effects brought on by changes in manufacturing technology and new Internet capabilities

Answer: C  Page: 80  Learning Objective: 1  Difficulty: Hard  Taxonomy: Knowledge
AACSB: Value Creation

71. Which of the following is most likely to qualify as a driving force?
A) Increases in price-cutting by rival sellers and the launch of major new advertising campaigns by one or more rivals
B) Wildly successful introduction of innovative new products by one or more industry rivals that force other rivals to respond quickly or lose a major share of their customers to the innovating rival(s)
C) An increase in the prices of substitute products
D) Decisions on the part the industry’s three biggest competitors not to pursue a strategy of striving to be the industry’s low-cost leader
E) Decisions by one or more outsiders not to attempt to enter the industry

Answer: B  Page: 80 & 82  Learning Objective: 1  Difficulty: Medium  Taxonomy: Application
AACSB: Value Creation
72. Which one of the following is not a common type of driving force?
A) Reductions in uncertainty and business risk
B) Changing societal concerns, attitudes, and lifestyles
C) Diffusion of technical know-how across more companies and more countries
D) Increasing efforts on the part of industry members to collaborate closely with their suppliers
E) Technological change and manufacturing process innovation

**Answer:** D  Page: 80  Learning Objective: 1  Difficulty: Easy  Taxonomy: Knowledge
AACSB: Value Creation

73. Increasing globalization of the industry can be a driving force because
A) the products of foreign competitors are nearly always cheaper or of better quality than those of domestic companies.
B) foreign producers typically have lower costs, greater technological expertise, and more product innovation capabilities than domestic firms.
C) it tends to increase rivalry among industry members and often shifts the pattern of competition among an industry’s major players, favoring some and disadvantaging others.
D) it results in companies having fewer competitors and a strategic group map with fewer circles.
E) market growth rates go up, product innovation speeds up, and new firms are likely to enter the industry.

**Answer:** C  Page: 80-81  Learning Objective: 1  Difficulty: Medium  Taxonomy: Application
AACSB: Value Creation

### Assessing the Impact of the Driving Forces

74. Driving forces analysis helps managers identify whether
A) the combined impacts of the driving forces will act to increase/decrease market demand, increase/decrease competition, and raise/lower industry profitability in the years ahead.
B) it will become more or less important to aim the company’s strategy at being the industry’s low-cost producer.
C) the driving forces will have a bigger impact on company profitability than competitive forces.
D) the industry is likely to become more or less vertically integrated and why.
E) competitive advantages are likely to grow or diminish in importance.

**Answer:** A  Page: 85  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

75. An industry’s driving forces
A) are generally determined by the sizes of strategic groups and the power of rival firms’ competitive strategies.
B) generally act in ways which will strengthen or weaken market demand, competition, and industry profitability in future years.
C) frequently cause a reduction in the bargaining power of buyers.
D) are normally triggered by ups and downs in the economy, higher or lower interest rates, or important new strategic alliances.
E) can be triggered by such factors as growing competitive pressures from substitute products, and the efforts of rival firms to employ new or different offensive strategies.

**Answer:** B  Page: 85  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation
Chapter 3  Evaluating a Company’s External Environment

76. In analyzing driving forces, the strategist’s role is to
A) identify the driving forces and evaluate their impact on (1) demand for the industry’s product, (2) the intensity of competition, and (3) industry profitability.
B) predict future marketing innovations and how fast the industry is likely to globalize.
C) evaluate what stage of the life cycle the industry is in and when it is likely to move to the next stage.
D) determine who is likely to exit the industry and what changes can be expected in the industry’s strategic group map.
E) forecast fluctuations in product demand and how buyer needs will most likely change.

Answer: A   Page: 85   Learning Objective: 1   Difficulty: Easy   Taxonomy: Comprehension
AACSB: Value Creation

77. Which one of the following is not an integral part of driving forces analysis?
A) Identifying the specific factors causing fundamental changes in industry conditions and/or the industry's competitive structure
B) Determining whether the driving forces are acting to cause one or more industry rivals to shift to a different strategic group
C) Determining whether the driving forces are acting to strengthen or weaken market demand
D) Determining whether the driving forces are acting to make competition more or less intense
E) Determining whether the driving forces are acting to raise or lower industry profitability

Answer: B   Page: 85   Learning Objective: 1   Difficulty: Medium   Taxonomy: Knowledge
AACSB: Value Creation


78. A strategic group
A) consists of those industry members that are growing at about the same rate and have similar product line breadth.
B) includes all rival firms having comparable profitability.
C) is a cluster of industry rivals that have similar competitive approaches and market positions.
D) consists of those firms whose market shares are about the same size.
E) is made up of those firms having comparable profit margins.

Answer: C   Page: 86   Learning Objective: 1   Difficulty: Easy   Taxonomy: Knowledge
AACSB: Value Creation

79. A strategic group consists of those firms in an industry that
A) are subject to the same driving forces.
B) are placing about the same emphasis on each distribution channel.
C) use the same key success factors to differentiate their products.
D) employ similar competitive approaches and occupy similar positions in the market.
E) have similar size market shares.

Answer: D   Page: 86   Learning Objective: 1   Difficulty: Easy   Taxonomy: Knowledge
AACSB: Value Creation
80. Strategic group mapping is a technique for displaying
   A) how many rivals are pursuing each type of strategy.
   B) which companies have the biggest market share and who the industry leader really is.
   C) the different market or competitive positions that rival firms occupy in an industry and identifying each rival’s closest competitors.
   D) which companies have the highest degrees of brand loyalty.
   E) which companies have failing business models.

   **Answer:** C   Page: 86   Learning Objective: 1   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation

81. Which one of the following pairs of variables is *least* likely to be useful in drawing a strategic group map?
   A) Geographic coverage and degree of vertical integration
   B) Brand name reputation and distribution channel emphasis
   C) Product quality and product line breadth
   D) Level of profitability and size of market share
   E) Price/quality range and whether the company’s product appeals to many or few types of buyers

   **Answer:** D   Page: 87   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

82. The concept of strategic groups is relevant to industry and competitive analysis because
   A) firms in the same strategic groups are rarely close competitors—a firm’s closest competitors are usually in distant strategic groups.
   B) strategic group maps help identify each company’s market position and its closest competitors.
   C) competition grows in intensity as the number and diversity of the strategic groups in an industry increases.
   D) the profit potential of firms in the same strategic group is usually very similar.
   E) competitive pressures tend to be weaker within strategic groups than across strategic groups.

   **Answer:** B   Page: 87-88   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

83. In mapping strategic groups
   A) one strategic variable and one financial variable should be used as axes for the map.
   B) it is important for the variables used as axes to be highly correlated.
   C) the best variables to use as axes for the map are those that differentiate how rivals have positioned themselves in the marketplace.
   D) it is important to use price as the variable for the vertical axis.
   E) the primary objective is to determine which strategic groups are profitable and which are not.

   **Answer:** C   Page: 87   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

84. Which of the following is *not* an appropriate guideline for developing a strategic group map for a given industry?
   A) The variables chosen as axes for the map should indicate big differences in how rivals have positioned themselves to compete in the marketplace.
   B) The variables chosen as axes for the map can be either quantitative or qualitative.
   C) The variables chosen as axes for the map should be highly correlated.
   D) Several maps should be drawn if more than one pair of variables help illuminate differences in the competitive positioning of industry members.
   E) The sizes of the circles on the map should be drawn proportional to the combined sales of the firms in each strategic group.

   **Answer:** C   Page: 87   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
What Can Be Learned from Strategic Group Maps?

85. With the aid of a strategic group map, one can
   A) readily identify the entry and exit barriers for each strategic group.
   B) pinpoint precisely which firms are in profitable strategic groups and which are not.
   C) identify which competitive forces are strong and which are weak.
   D) measure accurately whether across-group rivalry is stronger than within-group rivalry or vice versa.
   E) often learn to what extent industry driving forces and competitive pressures favor some companies or groups and hurt others.

   Answer: E  Page: 88-89  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

86. One of the things that can be gleaned from a strategic group map of industry rivals is
   A) which rivals have been in business longer and thus have greater access to experience curve effects.
   B) which rivals have newer manufacturing facilities.
   C) which strategic groups have the highest profit margins and the highest customer switching costs.
   D) whether profit prospects vary among strategic groups due to strengths and weaknesses in their respective market positions on the map (perhaps because competitive pressures are acting to favor some strategic groups and to disadvantage other groups).
   E) which strategic groups are currently viewed as the most prestigious by customers and which companies are being shunned by customers because of high prices and relatively low product quality.

   Answer: D  Page: 88-89  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

Question 5: What Strategic Moves Are Rivals Likely to Make Next?

87. The payoff of good scouting reports on rivals is improved ability to
   A) anticipate what moves rivals are likely to make next, thereby providing a valuable assist in outmaneuvering them in the marketplace.
   B) determine which rivals are in the best strategic group.
   C) figure out how many key success factors a rival has.
   D) determine whether a rival is gaining or losing market share.
   E) determine whether a rival has the best strategy and is the industry leader.

   Answer: A  Page: 90  Learning Objective: 1  Difficulty: Easy  Taxonomy: Comprehension
   AACSB: Value Creation

88. Having good competitive intelligence about rivals’ strategies and moves to improve their situation is important because
   A) it identifies who the industry’s current market share leaders are.
   B) it helps a company to anticipate what moves rivals are likely to make next and to craft its own strategic moves with some confidence about what market maneuvers to expect from its rivals.
   C) good scouting reports help identify which rival is in which strategic group.
   D) it enables company managers to determine which rival has the worst strategy and how to avoid making the same strategy mistakes.
   E) it enables more accurate predictions about how long it will take a particular rival to copy most of what the strategy leader is doing.

   Answer: B  Page: 90  Learning Objective: 1  Difficulty: Easy  Taxonomy: Comprehension
   AACSB: Value Creation
Identifying Competitors' Strategies and Resource Strengths and Weaknesses

89. Good competitive intelligence about the strategies and competitive strengths and weaknesses of rival companies helps management determine
   A) which competitor has the best strategy and which competitors have flawed or weak strategies.
   B) which rivals are poised to gain market share and which seem destined to lose market share.
   C) which rivals are likely to rank among the industry leaders on the road ahead.
   D) which rivals are likely to initiate what kinds of fresh strategic moves and why.
   E) All of these.

   **Answer:** E  Page: 90-91  Learning Objective: 1  Difficulty: Easy  Taxonomy: Comprehension
   AACSB: Value Creation

Predicting Rivals' Next Moves

90. In seeking to predict the next moves of close or key rivals, it is useful to consider such questions as:
   A) Which rivals badly need to increase their unit sales and market share and what new offensive initiatives are they likely to employ?
   B) Which rivals are poised to gain market share and which seem destined to lose market share?
   C) Which rivals are good candidates to be acquired?
   D) Which rivals are likely to enter new geographic markets or expand their product offerings (so as to enter new market segments where they currently do not have a presence)?
   E) All of these.

   **Answer:** E  Page: 91  Learning Objective: 1  Difficulty: Easy  Taxonomy: Comprehension
   AACSB: Value Creation

Question 6: What Are the Key Factors for Future Competitive Success?

91. The key success factors in an industry
   A) are those competitive aspects that most affect industry members’ abilities to prosper in the marketplace—specific strategy elements, product attributes, competencies, competitive capabilities, and market achievements that spell the difference between being a strong competitor and a weak competitor.
   B) are determined by the industry’s driving forces.
   C) hinge on how many different strategic groups the industry has.
   D) depend on how many rivals are trying to move from one strategic group to another.
   E) are a function of such considerations as how many firms are in the industry, how many have market shares above 5%, and whether the business models being used are similar or diverse.

   **Answer:** A  Page: 92  Learning Objective: 1  Difficulty: Medium  Taxonomy: Knowledge
   AACSB: Value Creation
92. An industry’s key success factors
   A) are a function of market share, entry barriers, economies of scale, degree of vertical integration, and industry profitability.
   B) vary according to whether an industry has high or low long-term attractiveness.
   C) can be determined from an analysis of an industry’s dominant economic characteristics, what competition is like, the impacts of the driving forces, the comparative market positions of industry members, and the likely next moves of industry rivals.
   D) can be determined from studying the “winning” strategies of the industry leaders and ruling out as potential key success factors the strategy elements of those firms considered to have “losing” strategies.
   E) depend on the relative competitive strengths of the industry leaders and how vulnerable they are to competitive attack.

   Answer: C   Page: 92-93   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

93. In identifying an industry’s key success factors, strategists should
   A) try to single out all factors which play a major role in shaping whether buyer demand grows rapidly or slowly.
   B) consider on what basis customers choose between competing brands, what resources and competitive capabilities firms need to be competitively successful, and what shortcomings are almost certain to put a company at a significant competitive disadvantage.
   C) consider whether the number of strategic groups is increasing or decreasing and whether the five competitive forces are powerful or relatively weak.
   D) consider what it will take to overtake the company with the industry’s overall best strategy.
   E) focus their attention on what it will take to capitalize on impacts of the industry’s driving forces.

   Answer: B   Page: 94   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

94. Which of the following is not a good example of a marketing-related key success factor?
   A) Product R & D capabilities and expertise in product design
   B) A well-known and well-respected brand name
   C) Breadth of product line and product selection
   D) Clever advertising
   E) Courteous, personalized customer service

   Answer: A   Page: 93   Learning Objective: 1   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

95. Which of the following is a good example of a manufacturing-related key success factor?
   A) Global distribution capabilities
   B) High labor productivity (especially if the production process has high labor content)
   C) Low distribution costs
   D) Accurate filling of buyer orders
   E) Short delivery time capability

   Answer: B   Page: 93   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
Question 7: Does the Outlook for the Industry Offer the Company a Good Opportunity to Earn Attractive Profits?

96. Which of the following is particularly pertinent in evaluating whether an industry presents a sufficiently attractive business opportunity?
A) The industry’s growth potential, whether competition appears destined to become stronger or weaker, and whether the industry’s overall profit prospects are above average, average, or below average
B) An assessment of which firms in the industry have the best and worst competitive strategies, whether the number of strategic groups in the industry is increasing or decreasing, and whether economies of scale and experience curve effects are a key success factor
C) Whether there are more than 5 key success factors and more than 5 barriers to entry
D) Constructing a strategic group map and assessing the attractiveness of the competitive position of each strategic group
E) Whether the market leaders enjoy competitive advantages and how hard it is to develop a strongly differentiated product

**Answer:** A   Page: 94-95   Learning Objective: 3 & 4   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

97. Evaluating whether an industry presents a sufficiently attractive business opportunity usually does not involve a consideration of which of the following factors?
A) The industry’s growth potential, whether competitive pressures will likely grow stronger or weaker, and whether the industry’s future profit prospects are above average, average, or below average
B) An assessment of the degrees of business risk and uncertainty in the industry’s future
C) Whether the industry’s future profitability will be favorably or unfavorably affected by the prevailing driving forces
D) The severity of the problems confronting the industry as a whole
E) Whether the industry’s product is strongly or weakly differentiated

**Answer:** E   Page: 94-95   Learning Objective: 3 & 4   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

98. Evaluating whether an industry’s environment presents a company with a sufficiently attractive business opportunity involves
A) sizing up overall industry and competitive conditions to determine whether the industry’s overall profit prospects are above average, average, or below average.
B) determining which firms in the industry have a competitive advantage and how they got their advantage.
C) determining the overall strength of the five competitive forces.
D) constructing a strategic group map and assessing the attractiveness of the competitive position of each strategic group to determine the overall attractiveness of all the strategic groups.
E) using value chain analysis to determine the relative cost positions of rival firms and to learn who the industry’s low-cost producer is.

**Answer:** A   Page: 95   Learning Objective: 3 & 4   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation
Short Answer Questions

99. What are the seven key questions which form the framework of thinking strategically about a company’s industry and competitive environment?

   Page: 58   Learning Objective: 1   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Domestic/Global Economic Environments

100. Draw the five-forces model of competition and briefly describe the relevance of each of the five forces in determining the overall strength of competitive pressures a company faces. Which of the five competitive forces is typically the strongest?

   Page: 61, 61-78   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation:

101. What are the five competitive forces that comprise the five-forces model of competition?

   Page: 61   Learning Objective: 2   Difficulty: Easy   Taxonomy: Knowledge   AACSB: Value Creation

102. Competitive markets are economic battlefields. True or false? Explain.

   Page: 61-62   Learning Objective: 2   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

103. Identify and briefly explain any four of the factors that influence the strength or intensity of competitive rivalry among an industry’s member firms.

   Page: 62-65   Learning Objective: 2   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation

104. Identify five factors that tend to intensify competitive rivalry among an industry’s member firms.

   Page: 62-65   Learning Objective: 2   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation

105. Identify five factors that tend to weaken the intensity of competitive rivalry among an industry’s member firms.

   Page: 63   Learning Objective: 2   Difficulty: Medium   Taxonomy: Knowledge   AACSB: Value Creation

106. Identify and briefly describe five common barriers to entering an industry.

   Page: 66-68   Learning Objective: 2   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation

107. Identify and briefly explain any three factors that intensify competitive pressures stemming from the threat that new firms will enter the industry.

   Page: 67   Learning Objective: 2   Difficulty: Medium   Taxonomy: Knowledge   AACSB: Value Creation
108. Identify three conditions that tend to make potential entry a strong competitive force.

Page: 67  Learning Objective: 2  Difficulty: Medium  Taxonomy: Knowledge  AACSB: Value Creation

109. Identify and briefly explain any three factors that weaken the competitive pressures stemming from the threat that new firms will enter the industry.

Page: 67  Learning Objective: 2  Difficulty: Medium  Taxonomy: Knowledge  AACSB: Value Creation

110. Identify and briefly explain any two of the factors that influence the strength of competition from substitute products.

Page: 71  Learning Objective: 2  Difficulty: Medium  Taxonomy: Knowledge  AACSB: Value Creation

111. Identify and briefly explain any three of the factors that influence the bargaining strength and leverage of suppliers.

Page: 72-73  Learning Objective: 2  Difficulty: Medium  Taxonomy: Knowledge  AACSB: Value Creation

112. Explain the meaning and significance of each of the following:
   a.) bargaining power of suppliers
   b.) driving forces
   c.) strategic group mapping
   d.) key success factors

Page: 74, 79 – 80, 86 – 87, 92-93  Learning Objective: 1 & 2,  Difficulty: Medium
Taxonomy: Knowledge  AACSB: Value Creation

113. Identify and briefly explain any three factors that lead to strong bargaining power on the part of suppliers.

Page: 74  Learning Objective: 2  Difficulty: Medium  Taxonomy: Knowledge  AACSB: Value Creation

114. Identify and briefly explain any three factors that lead to weak bargaining power on the part of suppliers.

Page: 74  Learning Objective: 2  Difficulty: Medium  Taxonomy: Knowledge  AACSB: Value Creation

115. Explain why low switching costs and weakly differentiated products tend to give buyers a high degree of bargaining power.

Page: 75  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation

116. Not all buyers of an industry’s product are likely to possess the same degree of bargaining power or leverage over the terms and conditions under which they purchase the product. True or false? Explain.

Page: 75-76  Learning Objective: 2  Difficulty: Medium  Taxonomy: Knowledge  AACSB: Value Creation
117. Identify and briefly discuss any three of the factors that influence the bargaining strength and leverage of buyers.

**Page:** 75-77  Learning Objective: 2  Difficulty: Medium  Taxonomy: Knowledge  
AACSB: Value Creation

118. Identify and briefly explain any three factors that lead to strong bargaining power on the part of buyers.

**Page:** 77  Learning Objective: 2  Difficulty: Medium  Taxonomy: Knowledge  
AACSB: Value Creation

119. Identify and briefly explain any three factors that lead to weak bargaining power on the part of buyers.

**Page:** 77  Learning Objective: 2  Difficulty: Medium  Taxonomy: Knowledge  
AACSB: Value Creation

120. In doing driving forces analysis, is it sufficient to simply identify the driving forces that are operating to alter industry and competitive conditions? Why or why not? If not, then explain what else is required for a complete driving forces assessment.

**Page:** 79, 85  Learning Objective: 1  Difficulty: Hard  Taxonomy: Comprehension  
AACSB: Value Creation

121. Identify at least five common driving forces and briefly explain how each one can produce important changes in industry and competitive conditions.

**Page:** 80-84  Learning Objective: 1  Difficulty: Medium  Taxonomy: Knowledge  
AACSB: Value Creation

122. Identify at least three benefits of constructing a strategic group map.

**Page:** 87-89  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation

123. What is the analytical value of studying competitors and trying to predict what moves rivals will make next?

**Page:** 90-91  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation

124. What is the strategy-making value of identifying an industry’s key success factors?

**Page:** 92  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation

125. Identify four factors that affect whether an industry does or does not present a company with a good business opportunity?

**Page:** 93  Learning Objective: 1  Difficulty: Hard  Taxonomy: Knowledge  
AACSB: Value Creation

126. Can an industry be attractive to one company and unattractive to another company? Why or why not?

**Page:** 94-95  Learning Objective: 3 & 4  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation
Multiple Choice Questions

The Key Questions in Analyzing a Company’s Resources and Competitive Position

1. Which of the following is not one of the five questions that comprise the task of evaluating a company’s resources and competitive position?
   A) What are the company’s most profitable geographic market segments?
   B) How well is the company’s present strategy working?
   C) Are the company’s prices and costs competitive?
   D) Is the company competitively stronger or weaker than key rivals?
   E) What strategic issues and problems merit front-burner management attention?

   **Answer:** A  Page: 101  Learning Objective: 1  Difficulty: Easy  Taxonomy: Knowledge
   AACSB: Value Creation

2. Which of the following is not a component of evaluating a company’s resources and competitive position?
   A) Evaluating how well the present strategy is working
   B) Scanning the environment to determine a company’s best and most profitable customers
   C) Assessing whether the company’s costs and prices are competitive
   D) Evaluating whether the company is competitively stronger or weaker than key rivals
   E) Pinpointing what strategic issues and problems merit front-burner management attention

   **Answer:** B  Page: 101  Learning Objective: 1  Difficulty: Easy  Taxonomy: Knowledge
   AACSB: Value Creation

3. The spotlight in analyzing a company’s resources, internal circumstances, and competitiveness includes such questions/concerns as
   A) whether the company’s present strategy is better than the strategies of its closest rivals based on such performance measures as earnings per share, ROE, dividend payout ratio, and average annual increase in the common stock price.
   B) whether the company’s key success factors are more dominant than the key success factors of close rivals.
   C) whether the company has the industry’s most efficient and effective value chain.
   D) what are the company’s resource strengths and weaknesses and its external opportunities and threats.
   E) what new acquisitions the company would be well advised to make in order to strengthen its financial performance and overall balance sheet position.

   **Answer:** D  Page: 101  Learning Objective: 1  Difficulty: Easy  Taxonomy: Knowledge
   AACSB: Value Creation
**Question 1: How Well Is the Company’s Present Strategy Working?**

4. Which of the following is *not* pertinent in identifying a company’s present strategy?
   A) The key functional strategies (R&D, supply chain management, production, sales and marketing, HR, and finance) a company is employing
   B) Management’s planned, proactive moves to outcompete rivals (via better product design, improved quality or service, wider product lines, and so on)
   C) The company’s mission, strategic objectives, and financial objectives
   D) Moves to respond and react to changing conditions in the macro-environment and in industry and competitive conditions
   E) The strategic role of its collaborative partnerships and strategic alliances with others

   **Answer:** C   Page: 102   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

5. One important indicator of how well a company’s present strategy is working is whether
   A) it has more core competencies than close rivals.
   B) its strategy is built around at least two of the industry’s key success factors.
   C) the company is achieving its financial and strategic objectives and whether it is an above-average industry performer.
   D) it is customarily a first-mover in introducing new or improved products (a good sign) or a late-mover (a bad sign).
   E) it is subject to weaker competitive forces and pressures than close rivals (a good sign) or stronger competitive forces and pressures (a bad sign).

   **Answer:** C   Page: 103   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

6. The best quantitative evidence of whether a company’s present strategy is working well is
   A) whether the company has more competitive assets than it does competitive liabilities.
   B) whether the company is in the industry’s best strategic group.
   C) the caliber of results the strategy is producing, specifically whether the company is achieving its financial and strategic objectives and whether it is an above-average industry performer.
   D) whether the company has a shorter value chain than close rivals.
   E) whether the company is in the Fortune 500.

   **Answer:** C   Page: 103   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

7. Which one of the following is *not* a reliable measure of how well a company’s current strategy is working?
   A) Whether the company’s sales are growing faster, slower, or about the same pace as the industry as a whole, thus resulting in a rising, falling, or stable market share
   B) Whether it has a larger number of competitive assets than competitive liabilities and whether it has a superior quality product
   C) The firm’s image and reputation with its customers
   D) Whether its profit margins are rising or falling and how large its margins are relative to those of its rivals
   E) How well the firm stacks up against rivals on technology, product innovation, customer service, product quality, price, speed in getting newly developed products to market, and other relevant factors on which buyers base their choice of which brand to purchase

   **Answer:** B   Page: 103   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
8. Identifying and assessing a company’s resource strengths and weaknesses and its external opportunities and threats is called
   A) SWOT analysis.
   B) competitive asset/liability analysis.
   C) competitive positioning analysis.
   D) strategic resource assessment.
   E) company resource mapping.

   **Answer:** A   Page: 106   Learning Objective: 1   Difficulty: Easy   Taxonomy: Knowledge
   AACSB: Value Creation

9. SWOT analysis is a powerful tool for
   A) gauging whether a company has a cost competitive value chain.
   B) sizing up a company’s resource capabilities and deficiencies, its market opportunities, and the external threats to its future well-being.
   C) evaluating whether a company is in the most appropriate strategic group.
   D) determining a company’s competitive strength vis-à-vis close rivals.
   E) identifying the market segments in which a company is strongly positioned and weakly positioned.

   **Answer:** B   Page: 106   Learning Objective: 1   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

10. SWOT analysis
    A) is a way to measure whether a company’s value chain is longer or shorter than the chains of key rivals.
    B) is a tool for benchmarking whether a firm’s strategy is closely matched to industry key success factors.
    C) reveals whether a company is competitively stronger than its closest rivals.
    D) provides a good overview of whether a company’s situation is fundamentally healthy or unhealthy.
    E) identifies the reasons why a company’s strategy is or is not working very well.

   **Answer:** D   Page: 106   Learning Objective: 1   Difficulty: Easy   Taxonomy: Knowledge
   AACSB: Value Creation

11. The payoff of doing a thorough SWOT analysis is
    A) identifying whether the company’s value chain is cost effective vis-à-vis the value chains of rivals.
    B) helping strategy-makers benchmark the company’s resource strengths against industry key success factors.
    C) enabling a company to assess its overall competitive position relative to its key rivals.
    D) revealing whether a company’s market share, measures of profitability, and sales compare favorably or unfavorably vis-à-vis key competitors.
    E) assisting strategy-makers in crafting a strategy that is well-matched to the company’s resources and capabilities, its market opportunities, and the external threats to its future well-being.

   **Answer:** E   Page: 106   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
### Identifying Company Resource Strengths, Competencies, and Competitive Capabilities

12. A company resource strength can concern
   A) a skill, specialized expertise, or competitively important capability.
   B) valuable human assets and intellectual capital.
   C) an achievement or attribute that puts the company in a position of market advantage.
   D) competitively valuable alliances or cooperative ventures.
   E) All of these.
   
   **Answer:** E  Page: 106  Learning Objective: 1  Difficulty: Easy  Taxonomy: Comprehension  
   AACSB: Value Creation

13. Which of the following most accurately reflect a company’s resource strengths?
   A) Its human, physical and/or organization assets; its skills and competitive capabilities; and achievements or attributes that enhance the company’s ability to compete effectively
   B) The sizes of its unit sales, revenues, and market share vis-à-vis those of key rivals
   C) The sizes of its profit margins and return on investment vis-à-vis those of key rivals
   D) Whether it has more primary activities in its value chain than close rivals and a better overall value chain than these rivals
   E) Whether it has more core competencies than close rivals
   
   **Answer:** A  Page: 106  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension  
   AACSB: Value Creation

14. The best example of a company strength is
   A) having higher earnings per share and a higher return on shareholders’ equity investment than key rivals.
   B) being totally self-sufficient such that the company does not have to rely in any way on key suppliers, partnerships with outsiders, or strategic alliances.
   C) having proven technological expertise and ability to churn out new and improved products on a regular basis.
   D) having a larger number of competitive assets than competitive liabilities.
   E) having more built-in key success factors than rivals.
   
   **Answer:** C  Page: 106  Learning Objective: 1  Difficulty: Medium  Taxonomy: Application  
   AACSB: Value Creation

15. Which of the following is not a good example of a company strength?
   A) More intellectual capital and better e-commerce capabilities than rivals
   B) Fruitful partnerships or alliances with suppliers that reduce costs and/or enhance product quality and performance
   C) Having higher earnings per share and a higher stock price than key rivals
   D) A well-known brand name and enjoying the confidence of customers
   E) A lower-cost value chain than rivals
   
   **Answer:** C  Page: 106  Learning Objective: 1  Difficulty: Medium  Taxonomy: Application  
   AACSB: Value Creation
16. A company’s resource strengths are important because
   A) they pave the way for establishing a low-cost advantage over rivals.
   B) they represent its competitive assets and are big determinants of its competitiveness and ability to
      succeed in the marketplace.
   C) they provide extra muscle in helping lengthen the company’s value chain.
   D) they give it competitive protection against the industry’s driving forces.
   E) they provide extra organizational muscle in turning a core competence into a key success factor.

   **Answer:** B   Page: 107   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

17. A company’s resource strengths
   A) represent its core competencies.
   B) are the most important parts of the company’s value chain.
   C) signal whether it has the wherewithal to be a strong competitor in the marketplace
   D) give it excellent ability to insulate itself against the impact of the industry’s driving forces.
   E) combine to give it a distinctive competence.

   **Answer:** C   Page: 107   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

18. When a company has real proficiency in performing a *competitively important* value chain activity, it is said
    to have
   A) a distinctive competence.
   B) a core competence.
   C) a key value chain proficiency.
   D) a competitive advantage over rivals.
   E) a company competence.

   **Answer:** B   Page: 107   Learning Objective: 1   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

19. When a company is good at performing a particular internal activity, it is said to have
   A) a competitive advantage over rivals.
   B) a competitive capability.
   C) a distinctive competence.
   D) a core competence.
   E) a company competence.

   **Answer:** E   Page: 107   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
20. The difference between a company competence and a core competence is that
   A) a company competence refers to a company’s best-executed functional strategy and a core competence refers to a company’s best-executed business strategy.
   B) a company competence refers to a company’s strongest resource whereas a core competence refers to a company’s lowest-cost and most efficiently performed value chain activity.
   C) a company competence is a competitively relevant activity which a firm performs especially well relative to other internal activities, whereas a core competence is an activity that a company has learned to perform proficiently.
   D) a company competence represents real proficiency in performing an internal activity whereas a core competence is a competitively relevant activity which a firm performs better than other internal activities.
   E) a core competence usually resides in a company’s technology and physical assets whereas a company competence usually resides in a company’s human assets and intellectual capital.

Answer: D  Page: 107-108  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

21. The difference between a core competence and a distinctive competence is that
   A) a distinctive competence refers to a company’s strongest resource or competitive capability and a core competence refers to a company’s lowest-cost and most efficiently executed value-chain activity.
   B) a core competence usually resides in a company’s base of intellectual capital whereas a distinctive competence stems from the superiority of a company’s physical and tangible assets.
   C) a core competence is a competitively relevant activity which a firm performs especially well in comparison to the other activities it performs, whereas a distinctive competence is a competitively relevant activity which a firm performs especially well in comparison to other firms with which it competes.
   D) a core competence represents a resource strength whereas a distinctive competence is achieved by having more resource strengths than rival companies.
   E) a core competence usually resides in a company’s technology and physical assets whereas a distinctive competence usually resides in a company’s know-how, expertise, and intellectual capital.

Answer: C  Page: 107-108  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

22. A core competence
   A) adds to a company’s arsenal of competitive capabilities and competitive assets and is a genuine resource strength.
   B) is typically knowledge-based, residing in a company’s intellectual capital and not in its tangible physical assets on the balance sheet.
   C) is often grounded in cross-department combinations of knowledge and expertise.
   D) is a competitively relevant activity which a firm performs especially well in comparison to the other activities it performs.
   E) All of the above.

AACSB: Value Creation
23. A core competence
   A) gives a company competitive capability and is a genuine company strength and resource.
   B) typically has competitive value, the amount of which is reflected in the physical and tangible assets on
      a company’s balance sheet.
   C) usually is grounded in the technological expertise of a particular department or work group.
   D) is more difficult for rivals to copy than a distinctive competence.
   E) refers to a company’s lowest-cost and most efficiently executed value-chain activity.

   Answer: A   Page:107-108   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

24. When a company performs a particular competitively important activity truly well in comparison to its
competitors, it is said to have
   A) a company competence.
   B) a strategic resource.
   C) a distinctive competence.
   D) a core competence.
   E) a key success factor.

   Answer: C   Page: 108   Learning Objective: 1   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation

25. Which of the following does not represent a potential core competence?
   A) Skills in manufacturing a high-quality product at a low cost
   B) Know-how in creating and operating systems for cost-efficient supply chain management
   C) The capability to fill customer orders accurately and swiftly
   D) Having a wider product line than rivals
   E) The capability to speed new or next-generation products to the marketplace

   AACSB: Value Creation

26. A distinctive competence
   A) is a competitively important activity that a company performs better than its competitors.
   B) gives a company competitively valuable capability that is unmatched by rivals.
   C) is a basis for sustainable competitive advantage.
   D) can underpin and add real punch to a company’s strategy.
   E) All of the above.

   Answer: E   Page:108   Learning Objective: 1   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

27. Which one of the following is inaccurate as concerns a distinctive competence?
   A) A distinctive competence is a competitively important activity that a company performs better than its
      competitors.
   B) A distinctive competence is typically less difficult for rivals to copy than a core competence.
   C) A distinctive competence can be a basis for sustainable competitive advantage.
   D) A distinctive competence can underpin and add real punch to a company’s strategy.
   E) A distinctive competence gives a company competitively valuable capability that is unmatched by
      rivals.

   Answer: B   Page:108   Learning Objective: 1   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation
28. The competitive power of a company’s core competence or distinctive competence depends on
A) whether it helps differentiate a company’s product offering from the product offerings of rival firms.
B) how hard it is to copy and how easily it can be trumped by substitute resource strengths and competitive
capabilities of rivals.
C) whether customers are aware of the competence and view the competence positively enough to boost
the company’s brand name reputation.
D) whether the competence is one of the industry’s key success factors.
E) whether the competence is technology-based or based on superior marketing know-how.

Answer: B   Page:109   Learning Objective: 1   Difficulty: Medium   Taxonomy: Knowledge
AACSB: Value Creation

29. The competitive power of a company resource strength or competitive capability hinges on
A) how hard it is for competitors to copy.
B) whether it is rare and something rivals lack.
C) whether it is really competitively valuable and having the potential to contribute to a competitive
advantage.
D) how easily it can be trumped by the substitute resources/capabilities of rivals.
E) All of these.

Answer: E   Page:109   Learning Objective: 1   Difficulty: Easy   Taxonomy: Knowledge
AACSB: Value Creation

30. For a particular company resource/capability to have real competitive power and perhaps qualify as a basis
for competitive advantage, it should
A) be hard for competitors to copy, be rare and something rivals lack, be competitively valuable, and not
be easily trumped by substitute resource strengths possessed by rivals.
B) be something that a company does internally rather than in collaborative arrangements with
outsiders.
C) be patentable.
D) be an industry key success factor and occupy a prime position in the company’s value chain.
E) have the potential for lowering the firm’s unit costs.

Answer: A   Page:109   Learning Objective: 1   Difficulty: Easy   Taxonomy: Comprehension
AACSB: Value Creation

31. The competitive power of a company resource strength is not measured by which one of the following
tests?
A) Is the resource rare and something rivals lack?
B) Is the resource strength something that a company does internally rather than in collaborative
arrangements with outsiders?
C) Is the resource strength easily trumped by the substitute resources/capabilities of rivals?
D) Is the resource strength hard to copy?
E) Is the resource strength competitively valuable, having the potential to contribute to a competitive
advantage?

Answer: B   Page:109   Learning Objective: 1   Difficulty: Medium   Taxonomy: Knowledge
AACSB: Value Creation
32. If a company doesn’t possess stand alone resource strengths capable of contributing to competitive advantage
   A) all potential for competitive advantage is lost.
   B) it is unlikely to survive in the marketplace and should exit the industry.
   C) it may have a bundle of resources that can be leveraged to develop a distinctive competence.
   D) it is virtually blocked from using offensive strategies and must rely on defensive strategies.
   E) its best strategic option is to revamp its value chain in hopes of creating stronger competitive capabilities.

   **Answer:** C  Page: 110  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

**Competitively Valuable Resource Strengths and the Use of a Resource-Based Strategy**

33. A resource-based strategy
   A) is often based on cross-department combinations of intellectual capital and expertise.
   B) uses a company’s valuable and rare resource strengths and competitive capabilities to deliver value to customers that rivals have difficulty matching.
   C) is typically based on a stand-alone resource strength such as technological expertise.
   D) refers to a company’s most efficiently executed value-chain activity.
   E) uses industry key success factors to provide a company with a core competence that rivals cannot effectively imitate.

   **Answer:** B  Page: 110  Learning Objective: 1  Difficulty: Easy  Taxonomy: Comprehension
   AACSB: Value Creation

34. A resource-based strategy
   A) focuses on exploiting a company’s best-executed operating strategy.
   B) is based upon efficient performance of the company’s primary value chain activities.
   C) concentrates on minimizing the costs associated with the design of a product or service.
   D) deliberately develops valuable competencies and capabilities that add to a company’s competitive power in the marketplace.
   E) focuses on working with forward channel allies to develop capabilities to outmatch the capabilities of rivals.

   **Answer:** D  Page: 110  Learning Objective: 1  Difficulty: Easy  Taxonomy: Comprehension
   AACSB: Value Creation

**Identifying Company Resource Weaknesses, Missing Capabilities, and Competitive Deficiencies**

35. A company resource weakness or competitive deficiency
   A) represents a problem that needs to be turned into a strength because weaknesses prevent a firm from being a winner in the marketplace.
   B) causes the company to fall into a lower strategic group than it otherwise could compete in.
   C) prevents a company from having a distinctive competence.
   D) usually stems from having a missing link or links in the industry value chain.
   E) is something a company lacks or does poorly (in comparison to rivals) or a condition that puts it at a disadvantage in the marketplace.

   **Answer:** E  Page: 111  Learning Objective: 1  Difficulty: Easy  Taxonomy: Knowledge
   AACSB: Value Creation
36. A company’s resource weaknesses can relate to
   A) inferior or unproven skills, expertise, or intellectual capital in competitively important parts of the business.
   B) something that it lacks or does poorly (in comparison to rivals).
   C) deficiencies in competitively important physical, organizational, or intangible assets.
   D) missing or competitively inferior capabilities in key areas.
   E) All of these.

   Answer: E   Page: 111   Learning Objective: 1   Difficulty: Easy   Taxonomy: Knowledge
   AACSB: Value Creation

37. In doing SWOT analysis, which one of the following is not an example of a potential resource weakness or competitive deficiency that a company may have?
   A) Less productive R & D efforts than rivals
   B) Having a single, unified functional strategy instead of several distinct functional strategies
   C) Lack of a strong brand image and reputation (as compared to rivals)
   D) Higher overall unit costs relative to rivals
   E) Too narrow a product line relative to rivals

   Answer: B   Page:112   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

38. Sizing up a company’s overall resource strengths and weaknesses
   A) essentially involves constructing a “strategic balance sheet” where the company’s resource strengths represent competitive assets and its resource weaknesses represent competitive liabilities.
   B) is called benchmarking.
   C) is called competitive strength assessment.
   D) is focused squarely on ascertaining whether the company has more/less resource strengths than weaknesses.
   E) is called company resource mapping.

   Answer: A   Page:111   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

**Identifying a Company's External Market Opportunities**

39. The external market opportunities which are most relevant to a company are the ones that
   A) increase market share.
   B) reinforce its overall business strategy.
   C) match up well with the firm’s financial resources and competitive capabilities, offer the best growth and profitability, and present the most potential for competitive advantage.
   D) correct its internal weaknesses and resource deficiencies.
   E) help defend against the external threats to its well-being.

   Answer: C   Page: 113   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
40. The market opportunities most relevant to a particular company are those that
   A) offer the best growth and profitability.
   B) provide a strong defense against threats to the company’s profitability.
   C) hold the most potential for product innovation.
   D) provide avenues for taking market share away from close rivals.
   E) hold the most potential to reduce costs.

   **Answer:** A Page:113  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

41. Which of the following best describes the market opportunities that tend to be most relevant to a particular company?
   A) Those market opportunities that provide avenues for taking market share away from close rivals and enhance a company’s image as a leader in product innovation and product quality.
   B) Those market opportunities that offer the company a chance to raise entry barriers.
   C) Those market opportunities that help promote greater diversification of revenues and profits.
   D) Those market opportunities that match up well with the firm’s financial resources and competitive capabilities, offer the best growth and profitability, and present the most potential for competitive advantage.
   E) Those market opportunities that help correct a company’s biggest weaknesses and competitive deficiencies.

   **Answer:** D Page:113  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

42. In doing SWOT analysis and trying to identify a company’s market opportunities, which of the following is not an example of a potential market opportunity that a company may have?
   A) Serving additional customer groups or market segments
   B) Growing buyer preferences for substitutes for the industry’s product
   C) Acquiring rival firms or companies with attractive technological expertise or capabilities
   D) Expanding into new geographic markets
   E) Openings to win market share away from rivals

   **Answer:** B Page:112  Learning Objective: 1  Difficulty: Easy  Taxonomy: Knowledge
   AACSB: Value Creation

**Identifying the External Threats to a Company’s Future Profitability**

43. Which of the following is not an example of an external threat to a company’s future profitability?
   A) The lack of a distinctive competence
   B) New legislation that entails burdensome and costly government regulations
   C) Slowdowns in market growth
   D) More intense competitive pressures
   E) The introduction of restrictive trade policies in countries where the company does business

   **Answer:** A Page: 112  Learning Objective: 1  Difficulty: Easy  Taxonomy: Knowledge
   AACSB: Value Creation
44. Which of the following is not an example of an external threat to a company’s future profitability?
   A) Likely entry of potent new competitors
   B) The lack of a well-known brand name with which to attract new customers and help retain existing customers
   C) Shifts in buyer needs and tastes away from the industry’s product
   D) Costly new regulatory requirements
   E) Growing bargaining power on the part of the company’s major customers and major suppliers

   Answer: B   Page: 112   Learning Objective: 1   Difficulty: Easy   Taxonomy: Knowledge
   AACSB: Value Creation

**What Can Be Learned From a SWOT Analysis?**

45. One of the lessons of SWOT analysis is that a company’s strategy should
   A) be grounded in its resource strengths and capabilities.
   B) be aimed at those market opportunities that offer the best potential for both profitable growth and competitive advantage.
   C) seek to defend against threats to the company’s future profitability.
   D) generally not place heavy demands on areas where company resources are weak or unproven.
   E) All of these.

   Answer: E   Page: 114   Learning Objective: 1   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

46. Which one of the following is not part of conducting a SWOT analysis?
   A) Identifying a company’s resource strengths and competitive capabilities
   B) Benchmarking the company’s resource strengths and competitive capabilities against industry key success factors
   C) Identifying a company’s market opportunities
   D) Drawing conclusions about the company’s overall business situation—what is attractive and what is unattractive about the company’s circumstances?
   E) Translating the results of the analysis into actions for improving the company’s strategy and market position

   Answer: B   Page: 114   Learning Objective: 1   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation

47. The two most important parts of SWOT analysis are
   A) pinpointing the company’s competitive assets and pinpointing its competitive liabilities.
   B) identifying the company’s resource strengths and identifying the company’s best market opportunities.
   C) identifying the external threats to a company’s future profitability and pinpointing how many market opportunities it has.
   D) drawing conclusions from the SWOT listings about the company’s overall situation and translating these into strategic actions to better match the company’s strategy to its resource strengths and market opportunities, correct the important weaknesses, and defend against external threats.
   E) making accurate lists of the company’s strengths, weaknesses, opportunities, and threats and then using these lists as a basis for ascertaining how well the company’s strategy is working.

   Answer: D   Page: 114   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
48. The three steps of SWOT analysis are
A) identifying the company’s resource strengths and weaknesses and its opportunities and threats, drawing conclusions about the company’s overall situation, and translating the conclusions into strategic actions to improve the company’s strategy.
B) pinpointing the company’s competitive assets, pinpointing its competitive deficiencies, and determining whether it enjoys a competitive advantage.
C) determining whether the company has more competitive assets than competitive liabilities, determining whether the company has good market opportunities, and evaluating the seriousness of the threats to the company’s future profitability.
D) matching the company’s strategy to its resource strengths, correcting the company’s important resource weaknesses, and identifying the company’s best market opportunities.
E) benchmarking the company’s strengths and weaknesses against those of key rivals, identifying its market opportunities and the external threats it faces, and determining the company’s potential for establishing a competitive advantage over rivals.

**Answer:** A  Page: 114  Learning Objective: 1  Difficulty: Hard  Taxonomy: Knowledge
AACSB: Value Creation

49. Which one of the following is *not* something that can be gleaned from identifying a company’s resource strengths, resource weaknesses, market opportunities, and external threats?
A) How to improve a company’s strategy by using company strengths and capabilities as cornerstones for its strategy
B) Which market opportunities are best suited to a company’s strengths and capabilities
C) Which resource weaknesses and deficiencies need to be corrected so as to better enable the pursuit of important market opportunities and to better defend against certain external threats
D) How to turn a core competence into a distinctive competence
E) Whether any of the company’s resource strengths can be used to help lessen the impact of external threats

**Answer:** D  Page: 114  Learning Objective: 1  Difficulty: Easy  Taxonomy: Comprehension
AACSB: Value Creation

**Question 3: Are the Company's Prices and Costs Competitive with Those of Rivals?**

50. One of the most telling signs of whether a company’s market position is strong or precarious is
A) whether its product is strongly or weakly differentiated from rivals.
B) whether its prices and costs are competitive with those of key rivals.
C) whether it has a lower stock price than key rivals.
D) the opinions of buyers regarding which seller has the best product quality and customer service.
E) whether it is in a bigger or smaller strategic group than its closest rivals.

**Answer:** B  Page: 116  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation
51. Two analytical tools useful in determining whether a company’s prices and costs are competitive are
   A) SWOT analysis and key success factor analysis.
   B) SWOT analysis and benchmarking.
   C) value chain analysis and benchmarking.
   D) competitive position assessment and competitive strength assessment.
   E) driving forces analysis and SWOT analysis.

   **Answer:** C  Page: 116  Learning Objective: 2  Difficulty: Easy  Taxonomy: Comprehension
   AACSB: Value Creation

**The Concept of a Company Value Chain**

52. A company’s value chain identifies
   A) the steps it goes through to convert its net income into value for shareholders.
   B) the primary activities it performs in creating value for its customers and the related support activities.
   C) the series of steps it takes to get a product from the raw materials stage into the hands of end-users.
   D) the activities it performs in transforming its competencies into distinctive competencies.
   E) the competencies and competitive capabilities that underpin its efforts to create value for customers and shareholders.

   **Answer:** B  Page: 116  Learning Objective: 2  Difficulty: Medium  Taxonomy: Knowledge
   AACSB: Value Creation

53. A company’s value chain
   A) consists of the primary activities that it performs in seeking to deliver value to shareholders in the form of higher dividends and a higher stock price.
   B) depicts the internally performed activities associated with creating and enhancing the company’s competitive assets.
   C) consists of two broad categories of activities: the primary activities that create customer value and the requisite support activities that facilitate and enhance the performance of the primary activities.
   D) concerns the basic process the company goes through in performing R&D and developing new products.
   E) consists of the series of steps a company goes through to develop a new product, get it produced and into the marketplace, and then start collecting revenues and earning a profit.

   **Answer:** C  Page: 116  Learning Objective: 2  Difficulty: Medium  Taxonomy: Knowledge
   AACSB: Value Creation

54. Identifying the primary and secondary activities that comprise a company’s value chain
   A) indicates whether a company’s resource strengths will ultimately translate into greater value for shareholders.
   B) reveals whether a company’s resource strengths are well-matched to the industry’s key success factors.
   C) is a first step in understanding a company’s cost structure (since each activity in the value chain gives rise to costs).
   D) is called benchmarking.
   E) is called resource value analysis.

   **Answer:** C  Page: 117  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation
55. Activity-based cost accounting is used to
   A) determine whether the value chains of rival companies are similar or different.
   B) benchmark the costs of primary value chain activities against the costs of the support value chain
costs.
   C) determine the costs of each primary and support activity comprising a company’s value chain and
d thereby reveal the nature and make-up of a company’s internal cost structure.
   D) determine the costs of each strategic action a company initiates.
   E) None of the above accurately describes what activity-based costing is about.

   Answer: C   Page: 117   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

**Why the Value Chains of Rival Companies Often Differ**

56. The value chains of rival companies
   A) tend to be essentially the same—any differences are typically minor.
   B) can differ substantially, reflecting differences in the evolution of each company’s own particular
business, differences in strategy, and differences in the approaches being used to execute strategy.
   C) are fairly similar or fairly different, depending on how many activities are performed internally and
   D) how many are outsourced.
   E) can be either fairly similar or fairly different, depending on the extent to which each company’s primary
   and support activities are comprised of fixed cost activities and variable cost activities.
   F) are fairly similar except when rival companies have quite different product designs.

   Answer: B   Page: 117   Learning Objective: 2   Difficulty: Hard   Taxonomy: Comprehension
   AACSB: Value Creation

57. The three main areas in the value chain where significant differences in the costs of competing firms can
   occur include
   A) age of plants and equipment, number of employees, and advertising costs.
   B) operating level activities, functional area activities, and line of business activities.
   C) the nature and make-up of their own internal operations, the activities performed by suppliers, and the
activities performed by wholesale distribution and retailing allies.
   D) human resource activities (particularly labor costs), vertical integration activities, and strategic
   partnership activities.
   E) variable cost activities, fixed cost activities, and administrative activities.

   Answer: C   Page: 117-119   Learning Objective: 2   Difficulty: Hard   Taxonomy: Comprehension
   AACSB: Value Creation
The Value Chain System for an Entire Industry

58. Which one of the following provides the most accurate picture of whether a company is cost competitive with its rivals?

A) How the costs of the company’s internally performed activities (its own value chain) compare against the costs of the internally-performed activities of rival companies

B) Costs in the value chains of the company’s suppliers

C) Costs in the value chains of a company’s distributors and retail dealers forward channel allies

D) The costs of a company’s internally performed activities, costs in the value chains of both the company’s suppliers and forward channel allies, and how all these costs compare against the costs that make up the value chain systems employed by rival firms

E) Whether the company has a longer or shorter value chain than its close rivals

Answer: D Page: 119-120 Learning Objective: 2 Difficulty: Medium Taxonomy: Comprehension
AACSB: Value Creation

59. Determining whether a company’s prices and costs are competitive

A) requires looking at the costs of a company’s competitively relevant suppliers and forward channel allies (distributors/dealers).

B) requires considering the costs of a company’s internally performed activities.

C) involves the use of benchmarking the costs in a company’s value chain system (the costs of its suppliers, its internally performed activities, the costs of its distributors/dealers) against the costs of the value chain systems employed by rival firms.

D) typically involves the use of activity-based cost accounting.

E) All of these.

Answer: E Page: 119-120 Learning Objective: 2 Difficulty: Easy Taxonomy: Comprehension
AACSB: Value Creation

Activity-Based Cost Accounting to Learn the Costs of Value Chain Activities

60. Activity-based cost accounting aims at

A) making cross-company comparisons of the costs of each value chain activity.

B) dividing all company expenses into two categories: activities whose costs are variable and activities whose costs are fixed.

C) determining the costs of each activity comprising a company’s value chain by establishing expense categories for specific value chain activities and assigning costs to the activity responsible for creating the cost.

D) determining the costs of each strategic action a company initiates.

E) None of the above accurately describes what activity-based costing is about.

Answer: C Page: 121 Learning Objective: 2 Difficulty: Medium Taxonomy: Knowledge
AACSB: Value Creation
61. Activity-based costing
   A) is an accounting system that assigns a company’s expenses to whichever activity in a company’s value chain is responsible for creating the cost.
   B) involves using benchmarking techniques to develop cost estimates for the value chain activities of each major rival.
   C) is a powerful tool for identifying the different pieces of a company’s value chain and classifying them as primary activities and support activities.
   D) involves determining which value chain activities represent variable costs and which represent fixed costs.
   E) is a tool for identifying the activities that cause a company’s product to be strongly differentiated from the products of rivals.

   **Answer:** A   Page: 121   Learning Objective: 2   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation

**Benchmarking: A Tool for Assessing Whether a Company's Value Chain Activities Are Competitive**

62. Benchmarking involves
   A) comparing how different companies perform various value chain activities and then making cross-company comparisons of the costs of these activities.
   B) checking whether a company has achieved more of its financial and strategic objectives over the past five years relative to the other firms it is in direct competition with.
   C) studying whether a company’s resource strengths are more/less powerful than the resource strengths of rival companies.
   D) studying how a company’s competitive capabilities stack up against the competitive capabilities of selected companies known to have world class competitive capabilities.
   E) comparing the best practices in one industry against the best practices in another industry.

   **Answer:** A   Page: 122   Learning Objective: 2   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation

63. A much-used and potent managerial tool for determining whether a company performs particular functions or activities in a manner that represents “the best practice” when both cost and effectiveness are taken into account is
   A) competitive strength analysis.
   B) activity-based costing.
   C) resource cost mapping.
   D) SWOT analysis.
   E) benchmarking.

   **Answer:** E   Page: 122   Learning Objective: 2   Difficulty: Easy   Taxonomy: Knowledge
   AACSB: Value Creation
64. Which of the following is not one of the objectives of benchmarking?
   A) To identify the best practices in performing various value chain activities
   B) To learn how best practice companies achieve lower costs or better results in performing benchmarked activities
   C) To help construct a company value chain and identify which activities are primary and which are support activities
   D) To develop cross-company comparisons of the costs of performing specific value chain activities
   E) To take actions to improve a company’s cost competitiveness when benchmarking reveals that its costs and results of performing an activity are not as good as what other companies have achieved

   **Answer:** C   Page: 123   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

**Strategic Options for Remediying a Cost Disadvantage**

65. The options for remedying an internal cost disadvantage include
   A) investing in productivity-enhancing, cost-saving technological improvements.
   B) redesigning the product or some of its components to facilitate speedier and more economical manufacture or assembly.
   C) implementing the use of best practices, particularly for high-cost activities.
   D) eliminating some cost-producing activities from the value chain, especially low value-added activities.
   E) All of these.

   **Answer:** E   Page: 125   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

66. Which of the following is not a good option for trying to remedy high internal costs vis-à-vis rivals firms?
   A) Investing in productivity-enhancing, cost-saving technological improvements
   B) Redesigning the product or some of its components to permit more economical manufacture or assembly
   C) Implementing aggressive strategic resource mapping to permit across-the-board cost reduction
   D) Outsourcing high-cost activities to vendors or contractors who can perform them more economically
   E) Relocating high-cost activities (like manufacturing) to geographic areas (like China or Latin America or Eastern Europe) where they can be performed more cheaply

   **Answer:** C   Page: 125   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

67. A company’s strategic options for remedying cost disadvantages in internally performed value chain activities do not include
   A) revamping its value chain to eliminate or bypass some cost-producing activities (particularly low value-added activities).
   B) implementing the use of best practices, particularly for high-cost activities.
   C) investing in productivity-enhancing, cost-saving technological improvements.
   D) switching to activity-based costing.
   E) outsourcing the performance of high-cost activities to vendors that can perform them more cheaply.

   **Answer:** D   Page: 125   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
68. The options for remedying a supplier-related cost disadvantage include
   A) trying to negotiate more favorable prices with suppliers and switching to lower priced substitute
      inputs.
   B) forward vertical integration.
   C) shifting into the production of substitute products.
   D) shifting from a low-cost leadership strategy to a differentiation or focus strategy.
   E) cutting selling prices and trying to win a bigger market share.

   **Answer:** A Page: 125 Learning Objective: 2 Difficulty: Easy Taxonomy: Comprehension
   AACSB: Value Creation

69. Which of the following is not an option for remedying a supplier-related cost disadvantage?
   A) Integrate backward into the business of high-cost suppliers in an effort to reduce the costs of the items
      being purchased
   B) Negotiate more favorable prices with suppliers
   C) Collaborate closely with suppliers to identify mutual cost-saving opportunities
   D) Switch to lower priced substitute inputs.
   E) Persuade forward channel allies to implement best practices

   **Answer:** E Page: 125 Learning Objective: 2 Difficulty: Easy Taxonomy: Comprehension
   AACSB: Value Creation

70. Which of the following is not an option for remedying a cost disadvantage associated with activities
    performed by forward channel allies (wholesale distributors and retail dealers)?
   A) Shifting to a more economical distribution strategy such as putting more emphasis on cheaper distribu-
      tion channels (perhaps direct sales via the Internet) or perhaps integrating forward into company-
      owned retail outlets
   B) Trying to make up the difference by cutting costs earlier in the value chain
   C) Pressuring distributors-dealers and other forward channel allies to reduce their costs and markups so
      as to make the final price to buyers more competitive with the prices of rivals
   D) Insisting on across-the-board cost cuts in all value chain activities—those performed by suppliers,
      those performed in-house, and those performed by distributors-dealers
   E) Working closely with forward channel allies to identify win-win opportunities to reduce costs

   **Answer:** D Page: 126 Learning Objective: 2 Difficulty: Easy Taxonomy: Comprehension
   AACSB: Value Creation

**Translating Proficient Performance of Value Chain Activities into Competitive Advantage**

71. A company that does a first-rate job of managing its value chain activities relative to competitors
    A) is likely to have more distinctive competencies than rivals.
    B) stands a good chance of achieving competitive advantage by performing its value chain activities
       either more proficiently or at lower cost.
    C) is almost certainly going to have a longer and more profitable value chain.
    D) usually has strong proficiencies in activity-based costing and benchmarking.
    E) usually has the fewest primary activities and the lowest costs in the industry.

   **Answer:** B Page: 126 Learning Objective: 2 Difficulty: Medium Taxonomy: Comprehension
   AACSB: Value Creation
72. Out-managing rivals in performing value chain activities
   A) is one of the most dependable ways a company can build a competitive advantage over rivals.
   B) allows a company to avoid the impact of the five competitive forces.
   C) is one of the best ways for a company to avoid being impacted by the industry’s driving forces.
   D) allows a company to move into a higher strategic group.
   E) helps neutralize external threats to a company’s future business prospects.

   Answer: A   Page: 126   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

73. For a company to translate its performance of value chain activities into competitive advantage, it must
   A) develop core competencies and maybe a distinctive competence over rivals and that are instrumental in
      helping it deliver attractive value to customers or else be more cost efficient in how it performs value
      chain activities.
   B) have more core competencies than rivals.
   C) have at least three distinctive competencies.
   D) have competencies that allow it to produce the highest quality product in the industry.
   E) have more competitive assets than competitive liabilities.

   Answer: A   Page: 126   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

74. To build a competitive advantage by out-managing rivals in performing value chain activities, a company
   must
   A) position itself in the industry’s more favorably situated strategic group.
   B) develop resources strengths that will enable it to pursue the industry’s most attractive opportunities.
   C) develop core competencies and maybe a distinctive competence that rivals don’t have or can’t quite
      match and that are instrumental in helping it deliver attractive value to customers or else be more cost
      efficient in how it performs value chain activities such that it has a low-cost advantage.
   D) outsource most all of its value chain activities to world-class vendors and suppliers.
   E) eliminate its resource weaknesses.

   Answer: C   Page: 126   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

**Question 4: Is the Company Competitively Stronger or Weaker than Key Rivals?**

75. The value of doing competitive strength assessment is to
   A) determine how competitively powerful the company’s core competencies are.
   B) learn if the company’s market opportunities are better than those of its rivals.
   C) learn whether a company has a distinctive competence.
   D) learn how the company ranks relative to rivals on each of the important factors that determine market
      success and ascertain whether the company has a net competitive advantage or disadvantage vis-à-vis
      key rivals.
   E) determine whether a company’s resource strengths are sufficient to allow it to earn bigger profits than
      rivals.

   Answer: D   Page: 128   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
76. Doing a competitive strength assessment entails
   A) determining whether a company has a cost-effective value chain.
   B) ranking the company against major rivals on each of the important factors that determine market success and ascertaining whether the company has a net competitive advantage or disadvantage versus major rivals.
   C) identifying a company’s core competencies and distinctive competencies (if any).
   D) analyzing whether a company is well positioned to gain market share and be the industry’s profit leader.
   E) developing quantitative measures of a company’s chances for future profitability.

   **Answer:** B   Page: 128   Learning Objective: 3   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation

77. A weighted competitive strength assessment is generally analytically superior to an unweighted strength assessment because
   A) a weighted ranking identifies which competitive advantages are most powerful.
   B) an unweighted ranking doesn’t discriminate between companies with high and low market shares.
   C) it singles out which competitor has the most competitively potent core competencies.
   D) weighting each company’s overall competitive strength by its percentage share of total industry profits produces a more accurate measure of its true competitive strength.
   E) all of the various measures of competitive strength are not equally important.

   **Answer:** E   Page: 130   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

78. A weighted competitive strength analysis is conceptually stronger than an unweighted analysis because
   A) it provides a more accurate assessment of the strength of competitive forces.
   B) it eliminates the bias introduced for those firms having large market shares.
   C) the different measures of competitive strength are unlikely to be equally important.
   D) the results provide a more reliable measure of what competitive moves rivals are likely to make next.
   E) weighting each company’s overall competitive strength by the size of its market share produces a more accurate measure of its true competitive strength.

   **Answer:** C   Page: 130   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

79. In a weighted competitive strength assessment, the sum of the weights should add up to
   A) 100%.
   B) 1.0.
   C) 10.
   D) 100.
   E) None of the above.

   **Answer:** B   Page: 130   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
80. In a weighted competitive strength analysis, each strength measure is assigned a weight based on
   A) its percentage share of total industry revenues.
   B) the importance of each competitive strength measure in building a sustainable competitive
      advantage.
   C) its perceived importance in determining a company’s competitive success in the marketplace.
   D) its percentage share of total industry profits.
   E) what it takes to provide better analytical balance between the companies with high ratings and the
      companies with low ratings and thus get the sum of the weights to add up to 1.0.

   **Answer:** C  Page: 130  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

**Interpreting the Competitive Strength Assessments**

81. Calculating competitive strength ratings for a company and its rivals using the industry’s most telling
    measures of competitive strength or weakness
   A) is a way of determining which competitor has the biggest overall competitive advantage in the
      marketplace and which competitor is faced with the biggest overall competitive disadvantage.
   B) is the most reliable indicator of which industry member has the highest overall product quality.
   C) is a powerful way of revealing which competitors are in the best and worst strategic groups.
   D) is the most reliable indicator of which industry member has the lowest overall costs and is the low-cost
      leader.
   E) pinpoints which industry rivals are most insulated from the industry’s driving forces.

   **Answer:** A  Page: 130  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

82. Quantitative measures of a company’s competitive strength
   A) signal which competitor has the most distinctive competencies and which competitor has the fewest.
   B) provide useful indicators of how a company compares against key rivals, factor by factor and capability
      by capability—thus indicating whether the company has a net overall competitive advantage or
      disadvantage against each rival.
   C) reveal which competitors are in the best and worst strategic groups.
   D) show which industry rival has the best overall market opportunities and which competitor has the
      poorest market opportunities.
   E) pinpoint which industry rival is subject to the least amount of competitive pressures from the five
      competitive forces.

   **Answer:** B  Page: 130  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

83. Which one of the following is an accurate interpretation of the scores that result from doing a competitive
    strength assessment?
   A) High scores signal a strong competitive position and possession of a competitive advantage over
      companies with lower scores.
   B) High scores indicate that a company is a power-user of best practices while low scores signal minimal
      or ineffective adoption of best practices.
   C) The company with the lowest score has the lowest-cost value chain.
   D) The company with the lowest score has the strongest net competitive advantage over its rivals.
   E) High scores indicate which rivals are most vulnerable to competitive attack.

   **Answer:** A  Page: 130  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation
84. Which one of the following is not something that can be learned from doing a competitive strength assessment?
A) The factors on which a company is competitively strongest and weakest vis-à-vis key rivals
B) Whether a company should correct its weaknesses by adopting best practices and revamping the makeup of its value chain
C) Which of the rated companies is competitively strongest and what size competitive advantage it enjoys
D) Whether a company has a net competitive advantage or a net competitive disadvantage relative to key rivals (with the size of the advantage/disadvantage being indicated by the differences among the companies’ competitive strength scores)
E) Which rival company is competitively weakest and the areas where it is most vulnerable to competitive attack

**Answer:** B Page: 130-131 Learning Objective: 3 Difficulty: Medium Taxonomy: Comprehension
AACSB: Value Creation

85. Calculating competitive strength ratings for a company and comparing them against strength ratings for its key competitors helps indicate
A) which weaknesses and vulnerabilities of competitors that the company might be able to attack successfully.
B) which competitors are in profitable strategic groups and which competitors are in unprofitable strategic groups.
C) which competitors are employing offensive strategies and which competitors are employing defensive strategies.
D) which competitors are likely to make money and which are likely to lose money in the years ahead.
E) what the industry’s key success factors are.

**Answer:** A Page: 130-131 Learning Objective: 3 Difficulty: Medium Taxonomy: Comprehension
AACSB: Value Creation

**Question 5: What Strategic Issues and Problems Merit Front-Burner Management Attention?**

86. Identifying the strategic issues a company faces and compiling a “worry list” of problems and roadblocks is an important component of company situation analysis because
A) without a precise fix on what problems/issues a company confronts, managers cannot know what the industry’s key success factors are.
B) the “worry list” sets the management agenda for taking actions to improve the company’s performance and business outlook.
C) without a precise fix on what problems/roadblocks a company confronts, managers are less clear about what value chain activities to benchmark.
D) the “worry list” helps company managers clarify their thinking about how best to modify the company’s value chain.
E) these issues and obstacles must be cleared before management can focus clearly on what is the best strategy for the company to pursue.

**Answer:** B Page: 132 Learning Objective: 4 Difficulty: Easy Taxonomy: Comprehension
AACSB: Value Creation
87. Identifying the strategy-related issues and problems that company managers need to address and resolve entails
   A) drawing on what was learned from having analyzed the company’s industry and competitive environment.
   B) drawing on the evaluations of the company’s own resources, internal circumstances, and competitiveness.
   C) locking in on what challenges/obstacles/roadblocks the company has to overcome in order to be financially and competitively successful in the years ahead.
   D) developing a “worry list” of “how to…,” “whether to…,” and “what to do about….”
   E) All of the above.

   Answer: E   Page: 132   Learning Objective: 4   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

88. Identifying the strategic issues and problems that merit front-burner managerial attention
   A) is accomplished in part by using the results of analyzing the company’s external environment to help come up with a “worry list” of “how to…,” “whether to…,” and “what to do about….”
   B) helps set management’s agenda for taking actions to improve the company’s performance and business outlook.
   C) is done in part by evaluating the company’s own internal situation—its resources and competitive position—to help come up with a “worry list” of “how to…,” “whether to…,” and “what to do about….”
   D) is done in part as a basis for drawing conclusions about whether to stick with company’s present strategy or to modify it.
   E) All of the above.

   Answer: E   Page: 132   Learning Objective: 4   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

89. Which of the following is not part of the task of identifying the strategic issues and problems that merit front-burner managerial attention?
   A) Analyzing the company’s external environment
   B) Evaluating the company’s own resources and competitive position
   C) Surveying a company’s board members, managers, select employees, and key investors regarding what strategic issues they think the company faces
   D) Developing a “worry list” of “how to…,” “whether to…,” and “what to do about….”
   E) Assessing what challenges the company has to overcome in order to be financially and competitively successful in the years ahead

   Answer: E   Page: 132   Learning Objective: 4   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation
90. Which of the following is not accurate as concerns the task of identifying the strategic issues and problems that merit front-burner managerial attention?
A) It entails drawing upon the results and conclusions from analyzing the company’s external environment
B) It entails drawing on the results and conclusions from evaluating the company’s own resources and competitive position
C) It entails developing a “worry list” of “how to…,” “whether to…,” and “what to do about…..”
D) Identifying the strategic issues and problems that the company faces is the first thing that company managers need to do before starting to analyze the company’s internal and external environment.
E) Developing a list of what issues and problems that management needs to address (and to resolve) should always precede deciding upon a strategy and what actions to take to improve the company’s position and prospects.

Answer: D  Page: 132  Learning Objective: 4  Difficulty: Easy  Taxonomy: Comprehension  
AACSB: Value Creation

Short Answer Questions

91. Identify the five questions that form the framework of evaluating a company’s resources and competitive position.

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AACSB: Value Creation

92. Identify at least 5 indicators of whether a company’s present strategy is working well.

Page: 103  Learning Objective: 1  Difficulty: Medium  Taxonomy: Knowledge  
AACSB: Value Creation

93. Briefly discuss the meaning and significance of each of the following terms:
   a) SWOT analysis
   b) core competence
   c) distinctive competence
   d) company value chain
   e) strategic cost analysis
   f) industry value chain
   g) activity-based costing
   h) benchmarking
   i) a weighted competitive strength assessment

Difficulty: Hard  Taxonomy: Knowledge  
AACSB: Value Creation

94. Explain the difference between a company competence, a core competence, and a distinctive competence.

Page: 107-108  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation

95. A core competence represents a basis for competitive advantage. True or false? Explain your answer.

Page: 107-108  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation
96. A distinctive competence represents a competitively superior resource strength. True or false? Explain your answer.

Page: 108 Learning Objective: 1 Difficulty: Medium Taxonomy: Comprehension
AACSB: Value Creation

97. A distinctive competence represents a basis for competitive advantage. True or false? Explain your answer.

Page: 108 Learning Objective: 1 Difficulty: Medium Taxonomy: Comprehension
AACSB: Value Creation

98. Why do a company’s core competencies matter in crafting strategy?

Page: 108-109 Learning Objective: 1 Difficulty: Medium Taxonomy: Comprehension
AACSB: Value Creation

99. What are the four tests that should be used to measure the competitive power of a company’s resource strengths?

Page: 109 Learning Objective: 1 Difficulty: Medium Taxonomy: Comprehension
AACSB: Value Creation

100. What resource characteristics determine the power of a resource-based strategy?

Page: 110 Learning Objective: 1 Difficulty: Medium Taxonomy: Comprehension
AACSB: Value Creation

101. A company lacking a valuable stand-alone resource strength should focus on bundling several resource strengths into a core competence. True or false? Explain and support your answer.

Page: 110 Learning Objective: 1 Difficulty: Hard Taxonomy: Comprehension
AACSB: Value Creation

102. Instead of trying to match the resource strengths of rivals, what option(s) should a company consider to enhance its competitive power in the marketplace?

Page: 110 Learning Objective: 1 Difficulty: Hard Taxonomy: Comprehension
AACSB: Value Creation

103. In conducting a SWOT analysis, is it enough to simply compile lists of the company’s strengths, weaknesses, opportunities, and threats? Why or why not?

Page: 113-115 Learning Objective: 1 Difficulty: Medium Taxonomy: Comprehension
AACSB: Value Creation

104. What are the three steps of conducting a SWOT analysis?

Page: 114 Learning Objective: 1 Difficulty: Medium Taxonomy: Knowledge AACSB: Value Creation
105. The ability of a company to perform value chain activities more proficiently or more cheaply than rivals is a potential source of competitive advantage. True or false? Explain and defend your answer.

**Page:** 116-117  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation

106. Why does it matter whether a company is able to perform value chain activities more proficiently or more cheaply than rivals? Explain and support your answer.

**Page:** 116-117  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation

107. Draw a typical company value chain and briefly explain why the proficiency with which a firm performs the activities comprising its value chain matters.

**Page:** 116-118  Learning Objective: 2  Difficulty: Hard  Taxonomy: Comprehension  
AACSB: Value Creation

108. What is benchmarking and why is it a strategically important analytical tool?

**Page:** 122-123  Learning Objective: 2  Difficulty: Medium  Taxonomy: Knowledge  
AACSB: Value Creation

109. What is meant by the term “best practices?” Why does it matter whether a company utilizes “best practices” in performing the activities comprising its value chain?

**Page:** 122-123  Learning Objective: 2  Difficulty: Medium  Taxonomy: Knowledge  
AACSB: Value Creation

110. Assume a firm is at a cost disadvantage with rivals because its internal costs are higher than rivals. Identify five strategic moves that it can make to restore cost parity.

**Page:** 125  Learning Objective: 2  Difficulty: Hard  Taxonomy: Comprehension  
AACSB: Value Creation

111. Assume a firm is at a cost disadvantage with rivals because of higher supplier-related costs than key rivals. Identify three strategic moves that it can make to restore cost parity.

**Page:** 125  Learning Objective: 2  Difficulty: Hard  Taxonomy: Comprehension  
AACSB: Value Creation

112. Assume a firm is at a cost disadvantage with rivals because of higher distributor-dealer costs than rivals. Identify three strategic moves that it can make to restore cost parity.

**Page:** 126  Learning Objective: 2  Difficulty: Hard  Taxonomy: Comprehension  
AACSB: Value Creation
113. Explain why a weighted competitive strength assessment is conceptually superior to an unweighted one.

Page: 130   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

114. In determining the various strategic issues that a company needs to address, managers need to consider both the results of its analysis of the company’s external environment and the results of its evaluation of the company’s resources and competitive position. True or false? Explain and defend your answer.

Page: 131-132   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

115. Why is it important for company managers to develop a “worry list” of strategic issues and problems that they need to address and to resolve? What should they consider to develop this list?

Page: 132   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation
The Five Generic Competitive Strategies—Which One to Employ?

Multiple Choice Questions

The Concepts of Competitive Strategy and Competitive Advantage

1. A company’s competitive strategy deals with
   A) management’s game plan for competing successfully—the specific efforts to please customers, offensive and defensive moves to counter the maneuvers of rivals, the responses to current market conditions, and the initiatives undertaken to improve the company’s market position.
   B) what its strategy will be in such functional areas as R&D, production, sales and marketing, distribution, finance and accounting, and so on.
   C) its efforts to change its position on the industry’s strategic group map.
   D) its plans for entering into strategic alliances, utilizing mergers or acquisitions to strengthen its market position, outsourcing some in-house activities to outside specialists, and integrating forward or backward.
   E) its plans for overcoming the five competitive forces.

   Answer: A Page: 139 Learning Objective: 1 Difficulty: Medium Taxonomy: Knowledge
   AACSB: Value Creation

2. The objective of competitive strategy is to
   A) contend successfully with the industry’s 5 competitive forces.
   B) knock the socks off rival companies by doing a better job of satisfying buyer needs and preferences.
   C) get the company into the best strategic group and then dominate it.
   D) establish a competitively powerful value chain.
   E) grow revenues at a faster annual rate than rivals are able to grow their revenues.

   Answer: B Page: 139 Learning Objective: 1 Difficulty: Medium Taxonomy: Comprehension
   AACSB: Value Creation

3. A company achieves competitive advantage whenever
   A) it is the acknowledged market share leader.
   B) it is the industry’s acknowledged technology leader.
   C) it has greater financial resources than its rivals.
   D) it has a well-known and well-regarded brand name, prefers offensive strategies to defensive strategies, and has a strong balance sheet.
   E) it has some type of edge over rivals in attracting customers and coping with competitive forces.

   Answer: E Page: 139 Learning Objective: 1 Difficulty: Medium Taxonomy: Comprehension
   AACSB: Value Creation
4. A company can be said to have competitive advantage if
   A) it is the acknowledged leader in product quality.
   B) it has a different value chain than rivals.
   C) it has some type of edge over rivals in attracting customers and coping with competitive forces.
   D) it earns the largest profits of any firm in the industry.
   E) it has more resource strengths than weaknesses.

   **Answer:** C  Page: 139  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

5. While there are many routes to competitive advantage, they all involve
   A) building a brand name image that buyers trust.
   B) delivering superior value to buyers and building competencies and resource strengths in performing value chain activities that rivals cannot readily match.
   C) achieving lower costs than rivals and becoming the industry’s sales and market share leader.
   D) finding effective and efficient ways to strengthen the company’s competitive assets and to reduce its competitive liabilities.
   E) getting in the best strategic group and dominating it.

   **Answer:** B  Page: 139  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

**The Five Generic Competitive Strategies**

6. The biggest and most important differences among the competitive strategies of different companies boil down to
   A) how they go about building a brand name image that buyers trust and whether they are a risk-taker or risk-avoider.
   B) the different ways that companies try to cope with the five competitive forces.
   C) whether a company’s market target is broad or narrow and whether the company is pursuing a competitive advantage linked to low cost or differentiation.
   D) the kinds of actions companies take to improve their competitive assets and reduce their competitive liabilities.
   E) the relative emphasis they place on offensive versus defensive strategies.

   **Answer:** C  Page: 140  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

7. Which of the following is **not** one of the five generic types of competitive strategy?
   A) A low-cost provider strategy
   B) A broad differentiation strategy
   C) A best-cost provider strategy
   D) A focused low-cost provider strategy
   E) A market share dominator strategy

   **Answer:** E  Page: 140  Learning Objective: 1  Difficulty: Easy  Taxonomy: Knowledge
   AACSB: Value Creation
8. The generic types of competitive strategies include
   A) build market share, maintain market share, and slowly surrender market share.
   B) offensive strategies and defensive strategies.
   C) low-cost provider, broad differentiation, best-cost provider, focused low-cost, and focused
      differentiation.
   D) low-cost/low price strategies, high-quality/high price strategies, and medium quality/medium price
      strategies.
   E) price leader strategies, price follower strategies, technology leader strategies, first-mover strategies,
      offensive strategies, and defensive strategies.

   Answer: C   Page: 140   Learning Objective: 1   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation

9. Which one of the following generic types of competitive strategy is typically the best strategy for a company
   to employ?
   A) A low-cost leadership strategy
   B) A broad differentiation strategy
   C) A best-cost provider strategy
   D) A focused low-cost provider strategy
   E) There is no such thing as a “best” competitive strategy; a company’s “best” strategy is always one that
      is customized to fit both industry and competitive conditions and the company’s own resources and
      competitive capabilities.

   Answer: E   Page: 140   Learning Objective: 1   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

**Low-Cost Provider Strategies**

10. A low-cost leader’s basis for competitive advantage is
    A) lower prices than rival firms.
    B) using a low cost/low price approach to gain the biggest market share.
    C) high buyer switching costs.
    D) meaningfully lower overall costs than competitors.
    E) higher unit sales than rivals.

    Answer: D   Page: 140   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
    AACSB: Value Creation

11. How valuable a low-cost leader’s cost advantage is depends on
    A) whether it is easy or inexpensive for rivals to copy the low-cost leader’s methods or otherwise match
       its low costs.
    B) how easy it is for the low-cost leader to gain the biggest market share.
    C) the aggressiveness with which the low-cost leader pursues converting the cost advantage into the
       absolute lowest possible costs.
    D) the leader’s ability to combine the cost advantage with a reputation for good quality.
    E) the low-cost leader’s ability to be the industry leader in manufacturing innovation so as to keep
        lowering its manufacturing costs.

    Answer: A   Page: 141   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
    AACSB: Value Creation
12. A low-cost leader can translate its low-cost advantage over rivals into superior profit performance by
A) cutting its price to levels significantly below the prices of rivals.
B) either using its low-cost edge to underprice competitors and attract price sensitive buyers in large enough numbers to increase total profits or refraining from price-cutting and using the low-cost advantage to earn a bigger profit margin on each unit sold.
C) going all out to use its cost advantage to capture a dominant share of the market.
D) spending heavily on advertising to promote its cost advantage and the fact that it charges the lowest prices in the industry—its can then use this reputation for low prices to build very strong customer loyalty, gain repeat sales year after year, and earn sustained profits over the long-term.
E) outproducing rivals and thus having more units available to sell.

Answer: B  Page: 141  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

The Two Major Avenues for Achieving a Cost Advantage

13. The major avenues for achieving a cost advantage over rivals include
A) revamping the firm’s value chain to eliminate or bypass some cost-producing activities and/or outmanaging rivals in the efficiency with which value chain activities are performed.
B) having a management team that is highly skilled in cutting costs.
C) being a first-mover in adopting the latest state-of-the-art technologies, especially those relating to low-cost manufacture.
D) outsourcing high-cost activities to cost-efficient vendors.
E) paying lower wages and salaries than rivals.

Answer: A  Page: 141  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

14. To succeed with a low-cost provider strategy, company managers have to
A) pursue backward or forward integration to detour suppliers or buyers with considerable bargaining power and leverage.
B) move the performance of most all value chain activities to low-wage countries.
C) sell direct to users of their product or service and eliminate use of wholesale and retail intermediaries.
D) do two things: (1) perform value chain activities more cost-effectively than rivals and (2) be proactive in revamping the firm’s overall value chain to eliminate or bypass “nonessential” cost-producing activities.
E) outsource the biggest majority of value chain activities.

Answer: D  Page: 141  Learning Objective: 3  Difficulty: Easy  Taxonomy: Comprehension
AACSB: Value Creation

15. Achieving a cost advantage over rivals entails
A) concentrating on the primary activities portion of the value chain and outsourcing all support activities.
B) being a first-mover in pursuing backward and forward integration and controlling as much of the industry value chain as possible.
C) performing value chain activities more cost-effectively than rivals and finding ways to eliminate or bypass some cost-producing activities altogether.
D) minimizing R&D expenses and paying below-average wages and salaries to conserve on labor costs.
E) producing a standard product, redesigning the product infrequently, and having minimal advertising.

Answer: C  Page: 141  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation
16. Which of the following is not an action that a company can take to do a better job than rivals of performing value chain activities more cost-effectively?
A) Striving to capture all available economies of scale and learning/experience curve effects
B) Trying to operate facilities at full capacity
C) Adopting labor-saving operating methods
D) Improving supply chain efficiency
E) Redesigning products to eliminate features that might have market appeal, but excessively increase production costs

**Answer:** E   Page: 142-143   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

17. Which of the following is not one of the ways that a company can achieve a cost advantage by revamping its value chain?
A) Cutting out distributors and dealers by selling direct to customers
B) Replacing certain value chain activities with faster and cheaper online technology
C) Increasing production capacity and then striving hard to operate at full capacity
D) Relocating facilities so as to curb the need for shipping and handling activities
E) Streamlining operations by eliminating low value-added or unnecessary work steps and activities

**Answer:** C   Page: 144-145   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

**When a Low-Cost Provider Strategy Works Best**

18. A competitive strategy of striving to be the low-cost provider is particularly attractive when
A) buyers are not very brand-conscious.
B) most rivals are trying to be best-cost providers.
C) there are many ways to achieve product differentiation that have value to buyers.
D) buyers are large and have significant power to bargain down prices and buyers use the product in much the same ways.
E) most rivals are pursuing focused low-cost or focused differentiation strategies.

**Answer:** D   Page: 148   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

19. Being the overall low-cost provider in an industry has the attractive advantage of
A) building strong customer loyalty and locking customers into its product (because customers have such high switching costs).
B) giving the firm a very appealing brand image.
C) putting a firm in position to win the business of price sensitive customers, set the floor on market price, and still earn a profit.
D) putting the company in strong position to be more profitable than companies pursuing a differentiation strategy.
E) greatly reducing the strong bargaining power of key suppliers.

**Answer:** C   Page: 148   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation
Chapter 5  The Five Generic Competitive Strategies—Which One to Employ?

20. A competitive strategy to be the low-cost provider in an industry works well when
   A) price competition among rival sellers is especially vigorous.
   B) there are few ways to achieve product differentiation that have value to buyers.
   C) buyers incur low costs in switching their purchases from one seller/brand to another.
   D) industry newcomers use low introductory prices to attract buyers and build a customer base.
   E) All of these.

   **Answer:** E  Page: 148  Learning Objective: 2  Difficulty: Easy  Taxonomy: Comprehension
   AACSB: Value Creation

21. A competitive strategy predicated on low-cost leadership tends to work best when
   A) there are widely varying needs and preferences among the various buyers of the product or service.
   B) there are many market segments and market niches, such that it is feasible for a low-cost leader to dominate the niche where buyers want a budget-priced product.
   C) price competition is especially vigorous and the offerings of rival firms are essentially identical, standardized, commodity-like products.
   D) buyers prefer that the products/services of competing sellers have widely varying attributes and prices.
   E) buyers have high switching costs and there is considerable diversity in how buyers use the product.

   **Answer:** C  Page: 148  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

22. In which of the following circumstances is a strategy to be the industry’s overall low-cost provider not particularly well matched to the market situation?
   A) When the offerings of rival firms are essentially identical, standardized, commodity-like products
   B) When there are few ways to achieve differentiation that have value to buyers
   C) When price competition is especially vigorous
   D) When buyers have widely varying needs and special requirements and the prices of substitute products are relatively high
   E) When entry barriers are low and there is a stream of newcomers to the industry

   **Answer:** D  Page: 148  Learning Objective: 2  Difficulty: Hard  Taxonomy: Comprehension
   AACSB: Value Creation

23. A strategy to be the industry’s overall low-cost provider tends to be more appealing than a differentiation or best-cost or focus/market niche strategy when
   A) there are many ways to achieve product differentiation that buyers find appealing.
   B) buyers use the product in a variety of different ways and have high switching costs in changing from one seller’s product to another.
   C) the offerings of rival firms are essentially identical, standardized, commodity-like products.
   D) entry barriers are high and competition from substitutes is relatively weak.
   E) the market is composed of many distinct segments with varying buyer needs and expectations.

   **Answer:** C  Page: 148  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation
The Pitfalls of a Low-Cost Provider Strategy

24. Which of the following is *not* one of the pitfalls of a low-cost provider strategy?
   A) Overly aggressive price-cutting
   B) Trying to set the industry’s price ceiling
   C) Not emphasizing avenues of cost advantage that can be kept proprietary or that relegate rivals to playing catch up
   D) Becoming too fixated on cost reduction
   E) Having the basis for the firm’s cost advantage undermined by cost-saving technological breakthroughs that can be readily adopted by rival firms

   **Answer:** B  Page: 148-149  Learning Objective: 2  Difficulty: Easy  Taxonomy: Comprehension  
   AACSB: Value Creation

Broad Differentiation Strategies

25. The essence of a broad differentiation strategy is to
   A) appeal to the high end part of the market and concentrate on providing a top-of-the-line product to consumers.
   B) incorporate a greater number of differentiating features into its product/service than rivals.
   C) lower buyer switching costs.
   D) outspend rivals on advertising and promotion in order to inform and convince buyers of the value of its differentiating attributes.
   E) be unique in ways that are valuable and appealing to a wide range of buyers.

   **Answer:** E  Page: 149  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension  
   AACSB: Value Creation

26. A company attempting to be successful with a broad differentiation strategy has to
   A) study buyer needs and behavior carefully to learn what buyers consider important, what they think has value, and what they are willing to pay for.
   B) incorporate more differentiating features into its product/service than rivals.
   C) concentrate its differentiating efforts on marketing and advertising (where almost all differentiating features are created).
   D) have a widely known and highly respected brand name image.
   E) provide a top-of-the-line product and sell it at premium prices.

   **Answer:** A  Page: 149  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension  
   AACSB: Value Creation

27. Successful differentiation allows a firm to
   A) be the industry’s best-cost provider.
   B) set the industry ceiling on price.
   C) avoid being dragged into a price war with industry rivals and not be overly concerned about whether entry barriers into the industry are high or low.
   D) command a premium price for its product, and/or increase unit sales, and/or gain buyer loyalty to its brand.
   E) take sales and market share away from rivals by undercutting them on price.

   **Answer:** D  Page: 149  Learning Objective: 4  Difficulty: Easy  Taxonomy: Comprehension  
   AACSB: Value Creation
28. A company that succeeds in differentiating its product offering from those of its rivals can usually
A) avoid having to compete on the basis of simply a low price.
B) charge a price premium for its product.
C) increase unit sales.
D) gain buyer loyalty to its brand.
E) All of the above.

Answer: E  Page: 149  Learning Objective: 4  Difficulty: Easy  Taxonomy: Comprehension
AACSB: Value Creation

29. A broad differentiation strategy improves profitability when
A) it is focused on product innovation.
B) differentiating enhances product performance.
C) the differentiating features appeal to sophisticated and prestigious buyers.
D) the extra price the product commands exceeds the added costs of achieving the differentiation.
E) the differentiator charges a price that is only fractionally higher than the industry’s low-cost provider.

Answer: D  Page: 149  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

30. Whether a broad differentiation strategy ends up enhancing company profitability depends mainly on whether
A) many buyers view the product’s differentiating features as having value.
B) most buyers have similar needs and use the product in the same ways.
C) the extra price the product commands exceeds the added costs of achieving the differentiation.
D) buyer switching costs are low and customer loyalty to any one brand is low.
E) buyers are prone to shop the market for sellers having the best price.

Answer: C  Page: 149  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

Where Along the Value Chain to Create the Differentiating Attributes

31. Opportunities to differentiate a company’s product offering
A) are most reliably found in the R&D portion of the value chain.
B) are typically located in the sales and marketing portion of the value chain.
C) can exist in activities all along an industry’s value chain.
D) usually are tied to product quality and customer service.
E) are most frequently attached to a company’s manufacturing expertise and to its ability to achieve scale economies in production.

Answer: C  Page: 150  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation
The Four Best Routes to Competitive Advantage via a Broad Differentiation Strategy

32. Easy-to-copy differentiating features
   A) cannot produce sustainable competitive advantage.
   B) seldom are perceived by buyers as having much value.
   C) tend to give buyers a high degree of power in bargaining for a lower price.
   D) should never be incorporated in a company’s product offering if its differentiation strategy is to succeed.
   E) lead to vigorous price competition.

   Answer: A  Page: 150  Learning Objective: 4  Difficulty: Easy  Taxonomy: Comprehension
   AACSB: Value Creation

33. A differentiation-based competitive advantage
   A) nearly always is attached to the quality and service aspects of a company’s product offering.
   B) most usually is the result of highly effective marketing and advertising.
   C) requires developing at least one distinctive competence that buyers consider valuable.
   D) hinges on a company’s success in developing top-of-the-line product features that will command the biggest price premium in the industry.
   E) often hinges on incorporating features that (1) raise the performance of the product or (2) lower the buyer’s overall costs of using the company’s product or (3) enhance buyer satisfaction in intangible or non-economic ways or delivering value to customers on by differentiating on the basis of competencies and capabilities that rivals can’t match.

   Answer: E  Page: 151  Learning Objective: 4  Difficulty: Hard  Taxonomy: Comprehension
   AACSB: Value Creation

34. Which of the following is not one of the four basic routes to achieving a differentiation-based competitive advantage?
   A) Delivering value to customers via competencies and competitive capabilities that rivals don’t have or can’t afford to match
   B) Incorporating features that raise product performance
   C) Incorporating product attributes and user features that lower the buyer’s overall costs of using the company’s product
   D) Appealing to buyers who are sophisticated and shop hard for the best, stand-out differentiating attributes
   E) Incorporating features that enhance buyer satisfaction in intangible or non-economic ways

   Answer: D  Page: 151  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

35. Achieving a differentiation-based competitive advantage can involve
   A) incorporating product attributes and user features that lower a buyer’s overall cost of using the product.
   B) incorporating features that raise the performance a buyer gets from using the product.
   C) incorporating features that enhance buyer satisfaction in non-economic or intangible ways.
   D) delivering value to customers via competencies and competitive capabilities that rivals don’t have or can’t afford to match.
   E) All of the above are viable ways of building competitive advantage via differentiation.

   Answer: E  Page: 151  Learning Objective: 4  Difficulty: Easy  Taxonomy: Comprehension
   AACSB: Value Creation
The Importance of Perceived Value and Signaling Value

36. Perceived value and signaling value are often an important part of a successful differentiation strategy because
A) of the diversity of buyer needs and preferences.
B) buyers seldom will pay for value they don’t perceive, no matter how real the value of the differentiating extras may be.
C) most buyers are heavily influenced by clever ads that signal value.
D) differentiation is all about smoke and mirrors.
E) there are no other ways to differentiate a commodity product.

Answer: B  Page: 152  Learning Objective: 4  Difficulty: Hard  Taxonomy: Comprehension
AACSB: Value Creation

When a Differentiation Strategy Works Best

37. Broad differentiation strategies are well-suited for market circumstances where
A) there are many ways to differentiate the product or service and many buyers perceive these differences as having value.
B) most buyers have the same needs and use the product in the same ways.
C) buyers are susceptible to clever advertising.
D) barriers to entry are high and suppliers have a low degree of bargaining power.
E) price competition is especially vigorous.

Answer: A  Page: 152  Learning Objective: 2  Difficulty: Easy  Taxonomy: Comprehension
AACSB: Value Creation

38. Broad differentiation strategies generally work best in market circumstances where
A) buyer needs and preferences are too diverse to be fully satisfied by a standardized product.
B) most buyers have similar needs and use the product in the same ways.
C) the products of rivals are weakly differentiated and most competitors are resorting to clever advertising to try to set their product offerings apart.
D) buyers are price sensitive and buying switching costs are quite low.
E) the five competitive forces are strong.

Answer: A  Page: 152  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

39. A broad differentiation strategy works best in situations where
A) technological change is slow-paced and new or improved products are infrequent.
B) buyer needs and uses of the product are very similar.
C) buyers incur low costs in switching their purchases to rival brands.
D) buyers have a low degree of bargaining power and purchase the product frequently.
E) technological change is fast-paced and competition revolves around rapidly evolving product features.

Answer: E  Page: 152-153  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation
40. A broad differentiation strategy generally produces the best results in situations where
   A) buyer brand loyalty is low.
   B) buyer needs and uses of the product are diverse.
   C) new and improved products are introduced only infrequently.
   D) most rivals are pursuing a differentiation strategy and are seeking to differentiate their products on
      most of the same features and attributes.
   E) price competition is vigorous.

   Answer: B   Page: 152   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

41. In which one of the following market circumstances is a broad differentiation strategy generally
    not well-suited?
   A) When buyer needs and preferences are too diverse to be fully satisfied by a standardized product
   B) When few rivals are pursuing a similar differentiation approach
   C) When the products of rivals are weakly differentiated and most competitors are resorting to clever
      advertising to try to set their product offerings apart
   D) When there are many ways to differentiate the product or service and many buyers perceive these
      differences as having value
   E) When technological change is fast-paced and competition revolves around rapidly evolving product
      features

   Answer: C   Page: 152   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

The Pitfalls of a Differentiation Strategy

42. The pitfalls of a differentiation strategy include
   A) trying to differentiate on the basis of attributes or features that are easily copied.
   B) choosing to differentiate on the basis of attributes that buyers do not perceive as valuable or worth
      paying for.
   C) trying to charge too high a price premium for the differentiating features.
   D) being timid and not striving to open up meaningful gaps in quality or performance or service or other
      attractive differentiating attributes.
   E) All of these.

   Answer: E   Page: 153-154   Learning Objective: 2   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

43. Which of the following is not one of the pitfalls of pursuing a differentiation strategy?
   A) Trying to strongly differentiate the company’s product from those of rivals rather than be content with
      weak product differentiation
   B) Over-differentiating so that the features and attributes incorporated exceed buyer needs and
      requirements
   C) Trying to charge too high a price premium for the differentiating features
   D) Differentiating on features or attributes that rivals can easily copy
   E) Overspending on efforts to differentiate the company’s product offering

   Answer: A   Page: 153-154   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
Best-Cost Provider Strategies

44. A company achieves best-cost provider status by
   A) selling a product with the best cost at the best price.
   B) having the best cost (as compared to rivals) for each activity in the industry’s value chain.
   C) providing buyers with the best attributes at the best cost.
   D) incorporating attractive or upscale attributes into its product offering at a lower cost than rivals.
   E) doing a better job than rivals of adopting the best operating practices.

   Answer: D   Page: 154   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

45. A firm pursuing a best-cost provider strategy
   A) seeks to be the low-cost provider in the largest and fastest growing (or best) market segment.
   B) tries to have the best cost (as compared to rivals) for each activity in the industry’s value chain.
   C) tries to outcompete a low-cost provider by attracting buyers on the basis of charging the best price.
   D) seeks to deliver superior value to buyers by satisfying their expectations on key quality/service/features/performance attributes and beating their expectations on price (given what rivals are charging for much the same attributes).
   E) seeks to achieve the best costs by using the best operating practices and incorporating the best features and attributes.

   Answer: D   Page: 154   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

46. The objective of a best-cost provider strategy is to
   A) deliver superior value to buyers by satisfying their expectations on key quality/performance/features/service attributes and beating their expectations on price (given what rivals are charging for much the same attributes).
   B) offer buyers the industry’s best-performing product at the best cost and best (lowest) price in the industry.
   C) attract buyers on the basis of having the industry’s overall best-performing product at a price that is slightly below the industry-average price.
   D) outcompete rivals using low-cost provider strategies.
   E) translate its best-cost status into achieving the highest profit margins of any firm in the industry.

   Answer: A   Page: 154   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

47. The competitive objective of a best-cost provider strategy is to
   A) outmatch the resource strengths of both low-cost providers and differentiators.
   B) position the company outside the competitive arena of low-cost producers and differentiators.
   C) meet or exceed buyer expectations on key quality/performance/features/service attributes and beat their expectations on price (given what rivals are charging for much the same attributes).
   D) deliver superior value to buyers by doing such a good job of cost control that it ends up with the best cost (as compared to rivals) in performing each activity in its value chain.
   E) identify and concentrate on those differentiating features that are inexpensive to incorporate.

   Answer: C   Page: 154   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
48. The competitive advantage of a best-cost provider is
   A) having the best value chain in the industry.
   B) its brand name reputation.
   C) its capability to incorporate upscale attributes at lower costs than rivals whose products have similar
      upscale attributes.
   D) a distinctive competence in delivering top-notch quality and customer service.
   E) a distinctive competence in supply chain management.

   **Answer:** C   Page: 155   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

49. For a best-cost provider strategy to be successful, a company must have
   A) excellent marketing and sales skills in convincing buyers to pay a premium price for the attributes/
      features incorporated in its product.
   B) resource strengths and competitive capabilities that allow it to incorporate upscale attributes at lower
      costs than rivals whose products have similar upscale attributes.
   C) access to greater learning/experience curve effects and scale economies than rivals.
   D) one of the best-known and most respected brand names in the industry.
   E) a short, low-cost value chain.

   **Answer:** B   Page: 155   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

50. The target market of a best-cost provider is
   A) value-conscious buyers.
   B) brand-conscious buyers.
   C) price-sensitive buyers.
   D) middle-income buyers.
   E) young adults (in the 18-35 age group).

   **Answer:** A   Page: 155   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

**When a Best-Cost Provider Strategy Works Best is Appealing**

51. Best-cost provider strategies are appealing in those market situations where
   A) diverse buyer preferences make product differentiation the norm and where many buyers are sensitive
      to both price and value.
   B) a company is positioned between competitors who have ultra-low prices and competitors who have
      top-notch products in terms of both quality and performance.
   C) buyers are more quality-conscious than price-conscious.
   D) there are numerous buyer segments, buyer needs are diverse across these segments, only a few of the
      segments are growing rapidly, and seller’s products are strongly differentiated.
   E) buyers are more performance conscious than value conscious.

   **Answer:** A   Page: 155   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
The Big Risk of a Best-Cost Provider Strategy

52. The big danger or risk of a best-cost provider strategy is
   A) that buyers will be highly skeptical about paying a relatively low price for upscale attributes/features.
   B) not establishing strong alliances and partnerships with key suppliers.
   C) that low-cost leaders will be able to steal away some customers on the basis of a lower price and high-end differentiators will be able to steal away customers with the appeal of better product attributes.
   D) that it will be unable to achieve top-notch quality at a rock-bottom cost.
   E) becoming too highly integrated and not relying enough on outsourcing.

   Answer: C Page: 155 Learning Objective: 2 Difficulty: Medium Taxonomy: Comprehension
   AACSB: Value Creation

53. A company’s biggest vulnerability in employing a best-cost provider strategy is
   A) relying too heavily on outsourcing.
   B) getting squeezed between the strategies of firms employing low-cost provider strategies and high-end differentiation strategies.
   C) getting trapped in a price war with low-cost leaders.
   D) being timid in cutting its prices far enough below high-end differentiators to win away many of their customers.
   E) not having a sustainable distinctive competence in cost reduction.

   Answer: B Page: 155 Learning Objective: 2 Difficulty: Hard Taxonomy: Comprehension
   AACSB: Value Creation

Focused (or Market Niche) Strategies

54. Focused strategies keyed either to low-cost or differentiation are especially appropriate for situations where
   A) the market is composed of distinctly different buyer groups who have different needs or use the product in different ways.
   B) most other rival firms are using a best-cost producer strategy.
   C) buyers have strong bargaining power and entry barriers are low.
   D) most industry rivals have weakly differentiated products.
   E) most industry participants are also using focused low-cost or focused differentiation strategies.

   Answer: A Page: 156 Learning Objective: 2 Difficulty: Easy Taxonomy: Comprehension
   AACSB: Value Creation

55. What sets focused (or market niche) strategies apart from low-cost leadership and broad differentiation strategies is
   A) the extra attention paid to top-notch product performance and product quality.
   B) their concentrated attention on serving the needs of buyers in a narrow piece of the overall market.
   C) greater opportunity for competitive advantage.
   D) their suitability for market situations where most industry rivals have weakly differentiated products.
   E) their objective of delivering more value for the money.

   Answer: B Page: 156 Learning Objective: 2 Difficulty: Easy Taxonomy: Comprehension
   AACSB: Value Creation
A Focused Low-Cost Strategy

56. A focused low-cost strategy seeks to achieve competitive advantage by
A) outmatching competitors in offering niche members an absolute rock-bottom price.
B) delivering more value for the money than other competitors.
C) performing the primary value chain activities at a lower cost per unit than the industry’s low-cost leaders.
D) dominating more market niches in the industry via a lower cost and a lower price than any other rival.
E) serving buyers in the target market niche at a lower cost and lower price than rivals.

Answer: E  Page: 157  Learning Objective: 3  Difficulty: Easy  Taxonomy: Comprehension
AACSB: Value Creation

57. The chief difference between a low-cost provider strategy and a focused low-cost strategy is
A) whether the product is strongly differentiated or weakly differentiated from rivals.
B) the degree of bargaining power that buyers have.
C) the size of the buyer group that a company is trying to appeal to.
D) the type of value chain being used to achieve a low-cost competitive advantage.
E) the number of upscale attributes incorporated into the product offering.

Answer: C  Page: 157  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

58. A focused low-cost strategy can lead to attractive competitive advantage when
A) buyers are looking for the best value at the best price.
B) buyers are looking for a budget-priced product.
C) buyers are price sensitive and are attracted to brands with low switching costs.
D) demand in the target market niche is growing rapidly and a company can achieve a big enough volume to fully capture all the available scale economies.
E) a firm can lower costs significantly by limiting its customer base to a well-defined buyer segment.

Answer: E  Page: 157  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

A Focused Differentiation Strategy

59. A focused differentiation strategy aims at securing competitive advantage
A) by providing niche members with a top-of-the-line product at a premium price.
B) by catering to buyers looking for an upscale product at an attractively low price.
C) with a product offering carefully designed to appeal to the unique preferences and needs of a narrow, well-defined group of buyers.
D) by developing product attributes that no other company in the industry has.
E) by convincing a narrow, well-defined group of buyers that the company has a true world class product.

Answer: C  Page: 157  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation
60. The chief difference between a broad differentiation strategy and a focused differentiation is
   A) the size of the buyer group that a company is trying to appeal to.
   B) the degree of bargaining power that buyers have.
   C) whether the product is strongly differentiated or weakly differentiated from rivals.
   D) the type of value chain being used to achieve a differentiation-based competitive advantage.
   E) the number of upscale attributes incorporated into the product offering.

   **Answer:** A   Page: 157   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

### When a Focused Low-Cost or Focused Differentiation Strategy is Attractive

61. Which one of the following does not represent market circumstances that make a focused low-cost or focused differentiation strategy attractive?
   A) When it is costly or difficult for multi-segment competitors to put capabilities in place to meet the specialized needs of the target market niche and at the same time satisfy the expectations of their mainstream customers
   B) When the industry has many different segments and market niches, thereby allowing a focuser to pick an attractive niche suited to its resource strengths and capabilities
   C) When industry leaders do not see that having a presence in the niche is crucial to their own success
   D) When the target market niche is not overcrowded with a number of other rivals attempting to focus on the same niche
   E) When many rivals are attempting to specialize in the same segment

   **Answer:** E   Page: 158-159   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

### The Risks of a Focused Low-Cost or Focused Differentiation Strategy

62. The risks of a focused strategy based on either low-cost or differentiation include
   A) the chance that niche customers will bargain more aggressively for good deals than customers in the overall marketplace.
   B) the potential for the preferences and needs of niche members to shift over time towards many of the same product attributes and capabilities desired by buyers in the mainstream portion of the market.
   C) the potential for the segment to be highly vulnerable to economic cycles.
   D) the potential for segment growth to race beyond the production or service capabilities of incumbent firms.
   E) All of these.

   **Answer:** B   Page: 159-160   Learning Objective: 2   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation
The Contrasting Features of the Five Generic Competitive Strategies:
A Summary

63. One of the big dangers in crafting a competitive strategy is that managers, torn between the pros and cons of the various generic strategies, will opt for
A) a low-cost provider strategy because it is usually the safest, least risky competitive strategy.
B) a “stuck-in-the-middle” strategy.
C) a broad differentiation strategy because it is frequently the most profitable competitive strategy.
D) a best-cost provider because it has the biggest potential for generating the largest market share.
E) a focused low-cost or focused differentiation strategy because they are more insulated from competitive pressures.

Answer: B   Page: 160   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

64. The production emphasis of a company pursuing a broad differentiation strategy usually involves
A) a search for continuous cost reduction without sacrificing acceptable quality and essential features.
B) strong efforts to be a leader in manufacturing process innovation.
C) efforts to build-in whatever differentiating features that buyers are willing to pay for and striving for product superiority.
D) aggressive pursuit of economies of scale and experience curve effects.
E) developing a distinctive competence in zero-defect manufacturing techniques.

Answer: C   Page: 161   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

65. The marketing emphasis of a company pursuing a broad differentiation strategy usually is to
A) underprice rival brands with comparable features.
B) tout differentiating features and charge a premium price that more than covers the extra costs of differentiating features.
C) out-advertise rivals and make frequent use of discount coupons.
D) emphasize selling direct to end-users and promoting personalized customer service.
E) communicate the product’s ability to serve the customer’s every need.

Answer: B   Page: 161   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

66. The keys to sustaining a broad differentiation strategy are
A) to stress constant innovation to stay ahead of imitative rivals and to concentrate on a few differentiating features.
B) to charge a premium price that more than covers the extra costs of differentiating features and to convince customers to be brand loyal.
C) to out-innovate and out-advertise rivals.
D) to emphasize personalized customer service and to add as many differentiating features as possible.
E) to keep prices close to the average of all rivals and to spend heavily on new product R&D.

Answer: A   Page: 161   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation
Chapter 5  The Five Generic Competitive Strategies—Which One to Employ?

67. The marketing emphasis of a company pursuing a focused low-cost provider strategy usually is to
   A) tout the company’s lower prices.
   B) tout the lack of frills and extras.
   C) out-advertise rivals and make frequent use of discount coupons.
   D) communicate the attractive features of a budget-priced product offering that fits niche members’
      expectations.
   E) communicate the product’s ability to serve the customer’s every need.

   **Answer:** D   Page: 161   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

**Short Answer Questions**

67. What is the difference between competitive strategy and business strategy?

   **Page:** 39-40, 139   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

68. What are the five generic competitive strategies? Briefly describe each one and identify the type of
   competitive advantage that each strategy is aimed at achieving.

   **Page:** 140   Learning Objective: 1   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation

69. Describe the strategy of striving to be the industry’s overall low cost provider. What does a company have
to do to achieve low-cost provider status?

   **Page:** 140-141   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

70. Describe the two basic cost-reducing approaches a company can take to become a low-cost provider in its
    industry.

   **Page:** 141-145   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

71. Which one of the five generic competitive strategies is most likely to be best suited for an industry whose
    product is a commodity? Explain.

   **Page:** 148   Learning Objective: 2   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

72. What market conditions and circumstances make a low-cost provider strategy attractive? What are the
    pitfalls in pursuing a low-cost provider strategy—what can go wrong?

   **Page:** 148-149   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
73. What are the distinctive features of a broad differentiation strategy? Under what circumstances is a broad differentiation strategy appealing?

Page: 151-153  Learning Objective: 2, 4  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation

74. What are the pros and cons of a broad differentiation strategy?

Page: 152-154  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation

75. What are the distinctive features of a best-cost provider strategy? Under what circumstances is a best-cost provider strategy appealing?

Page: 154-155  Learning Objective: 1, 2  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation

76. What type of competitive advantage does a best-cost provider strategy aim at achieving? Explain what a company has to do to achieve this advantage.

Page: 154-155  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation

77. Explain how the strategic target of a low-cost provider differs from the strategic target of a best-cost provider.

Page: 155  Learning Objective: 1  Difficulty: Easy  Taxonomy: Comprehension  
AACSB: Value Creation

78. What are the distinctive features of a focused low-cost strategy? How does it differ from a low-cost leadership strategy?

Page: 157  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation

79. What are the distinctive features of a focused differentiation strategy? How is it different from a broad differentiation strategy?

Page: 157  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation

80. What is the difference between a low-cost leadership strategy and a focused low-cost strategy?

Page: 157  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation

81. How does a focused differentiation strategy differ from a broad differentiation strategy?

Page: 157  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation
82. In what market and competitive circumstances are focused low-cost and focused differentiation strategies attractive?

Page: 158-159  
Learning Objective: 2  
Difficulty: Medium  
Taxonomy: Comprehension  
AACSB: Value Creation

83. Explain how the marketing emphasis of a low-cost provider differs from the marketing emphasis of a best-cost provider.

Page: 161  
Learning Objective: 1  
Difficulty: Medium  
Taxonomy: Comprehension  
AACSB: Value Creation

84. Explain how the keys to sustaining a broad differentiation strategy differ from the keys to sustaining a best-cost producer strategy.

Page: 161  
Learning Objective: 1  
Difficulty: Hard  
Taxonomy: Comprehension  
AACSB: Value Creation

85. What are the keys to sustaining a focused low-cost strategy?

Page: 161  
Learning Objective: 1, 3  
Difficulty: Hard  
Taxonomy: Comprehension  
AACSB: Value Creation

86. One of the big dangers in crafting a competitive strategy is that managers, torn between the pros and cons of the various generic strategies, will opt for “stuck in the middle” strategies that represent compromises between lower costs and greater differentiation and between broad and narrow market appeal. True or false? Explain your answer.

Page: 160-162  
Learning Objective: 1, 2  
Difficulty: Hard  
Taxonomy: Comprehension  
AACSB: Value Creation
Multiple Choice Questions

Strategic Choices Beyond That of Choosing a Generic Competitive Strategy

1. Once a company has decided to employ a particular generic competitive strategy, then it must make such additional strategic choices as
   A) whether to enter into strategic alliances or collaborative partnerships.
   B) which value chain activities, if any, should be outsourced.
   C) whether to bolster the company’s market position via merger or acquisitions.
   D) whether to integrate forward or backward into more stages of the industry value chain.
   E) All of the above.

   Answer: E Page: 165 Learning Objective: 5 Difficulty: Easy Taxonomy: Knowledge
   AACSB: Value Creation

2. Which one of the following is not a strategic choice that a company must make to complement and supplement its choice of one of the five generic competitive strategies?
   A) Whether to enter into strategic alliances or collaborative partnerships
   B) Whether to outsource certain value chain activities
   C) Whether to employ a market share leadership strategy
   D) Whether to integrate forward or backward into more stages of the industry value chain
   E) Whether to bolster the company’s market position and competitiveness via acquisition or merger

   Answer: C Page: 165 Learning Objective: 5 Difficulty: Easy Taxonomy: Knowledge
   AACSB: Value Creation

Strategic Alliances and Partnerships

3. Strategic alliances
   A) are the cheapest means of developing new technologies and getting new products to market quickly.
   B) are collaborative arrangements where two or more companies join forces to achieve mutually beneficial strategic outcomes.
   C) are a proven means of reducing the costs of performing value chain activities.
   D) are best used to insulate a company from the impact of the five competitive forces.
   E) help insulate a firm from the adverse impacts of industry driving forces.

   Answer: B Page: 166 Learning Objective: 1 Difficulty: Medium Taxonomy: Knowledge
   AACSB: Value Creation
4. A strategic alliance
   A) is a collaborative arrangement where companies join forces to defeat mutual competitive rivals.
   B) involves two or more companies joining forces to pursue vertical integration.
   C) is a formal agreement between two or more companies in which there is strategically relevant collaboration of some sort, joint contribution of resources, shared risk, shared control, and mutual dependence.
   D) is a partnership between two companies that is typically intended to eliminate the need to engage in outsourcing.
   E) is usually a cheaper and more effective way for companies to join forces than is merger.

   Answer: C   Page: 166   Learning Objective: 1   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation

**Why and How Strategic Alliances Are Advantageous**

5. Entering into strategic alliances and collaborative partnerships can be competitively valuable because
   A) working closely with outsiders is essential in developing new technologies and new products in virtually every industry.
   B) cooperative arrangements with other companies are very helpful in racing against rivals to build a strong global presence and/or racing to seize opportunities on the frontiers of advancing technology.
   C) they represent highly effective ways to achieve low-cost leadership and capture first-mover advantages.
   D) they are a powerful way for companies to build loyalty and goodwill among customers with diverse needs and expectations.
   E) they are quite effective in helping a company transfer the risks of threatening external developments to other companies.

   Answer: B   Page: 166   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

6. Which of the following is not a factor that makes an alliance “strategic” as opposed to just a convenient business arrangement?
   A) The alliance is critical to the company’s achievement of an important objective.
   B) The alliance helps block a competitive threat.
   C) The alliance helps open up important new market opportunities.
   D) The alliance helps build, enhance, or sustain a core competence or competitive advantage.
   E) The alliance helps the company obtain additional financing on better credit terms.

   Answer: E   Page: 166   Learning Objective: 1   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

7. The best strategic alliances
   A) are highly selective, focusing on particular value chain activities and on obtaining a particular competitive benefit.
   B) are those whose purpose is to create an industry key success factor.
   C) are those which help a company move quickly from one strategic group to another.
   D) involve joining forces in R&D to develop new technologies cheaper than a company could develop the technology on its own.
   E) aim at raising an industry’s barriers to entry.

   Answer: A   Page: 168   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
8. Which one of the following is not a strategically beneficial reason why a company may enter into strategic partnerships or cooperative arrangements with key suppliers, distributors, or makers of complementary products?
   A) To improve access to new markets
   B) To expedite the development of promising new technologies or products
   C) To enable greater opportunities for employee advancement
   D) To improve supply chain efficiency
   E) To overcome disadvantages of small production volumes that limit scale economies and low production costs

   **Answer:** C   Page: 168   Learning Objective: 1   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

9. Companies racing against rivals for global market leadership need strategic alliances and collaborative partnerships with companies in foreign countries to
   A) combat the bargaining power of foreign suppliers and help defend against the competitive threat of substitute products produced by foreign rivals.
   B) help raise needed financial capital from foreign banks and use the brand names of their partners to make sales to foreign buyers.
   C) get into critical country markets quickly, gain inside knowledge about unfamiliar markets and cultures, and access valuable skills and competencies that are concentrated in particular geographic locations.
   D) help wage price wars against foreign competitors.
   E) exercise better control over efforts to revamp the global industry value chain.

   **Answer:** C   Page: 168-169   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

10. A company racing to seize opportunities on the frontiers of advancing technology often utilizes strategic alliances and collaborative partnerships to
    A) discourage rival companies from merging with or acquiring the very companies that it is partnering with.
    B) reduce overall business risk and raise entry barriers into the newly emerging industry.
    C) help master new technologies and build new expertise and competencies, establish a stronger beachhead for participating in the target industry, and open up broader opportunities in the target industry.
    D) help defeat competitors that are employing broad differentiation strategies.
    E) enhance its chances of achieving global low-cost leadership.

    **Answer:** C   Page: 169   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
    AACSB: Value Creation

**Capturing the Benefits of Strategic Alliances**

11. Which of the following is not one of the factors that affects whether a strategic alliance will be successful and realize its intended benefits?
    A) Picking a good partner
    B) Recognizing that the alliance must benefit both sides
    C) Minimizing the amount of resources that the partners commit to the alliance
    D) Ensuring that both parties live up to their commitments
    E) Structuring the decision-making process so that actions can be taken swiftly when needed

    **Answer:** C   Page: 169-170   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
    AACSB: Value Creation
Why Many Alliances are Unstable or Break Apart

12. Which of the following is not a typical reason that many alliances prove unstable or break apart?
   A) Diverging objectives and priorities
   B) An inability to work well together
   C) The emergence of more attractive technological paths
   D) Disagreement over how to divide the profits gained from joint collaboration
   E) Changing conditions that render the purpose of the alliance obsolete

   **Answer:** D   Page: 170   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

13. Experience indicates that strategic alliances
   A) are generally successful.
   B) work well in cooperatively developing new technologies and new products but seldom work well in promoting greater supply chain efficiency.
   C) work best when they are aimed at achieving a mutually beneficial competitive advantage for the allies.
   D) have a high “divorce rate.”
   E) are rarely useful in helping a company win the race for global industry leadership.

   **Answer:** D   Page: 170   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

The Strategic Dangers of Relying Heavily on Alliances and Cooperative Partnerships

14. The Achilles heel (or biggest disadvantage/pitfall) of relying heavily on alliances and cooperative strategies is
   A) that partners will not fully cooperate or share all they know, preferring instead to guard their most valuable information and protect their more valuable know-how.
   B) becoming dependent on other companies for essential expertise and capabilities.
   C) the added time and extra expenses associated with engaging in collaborative efforts.
   D) having to compromise the company’s own priorities and strategies in reaching agreements with partners.
   E) the collaborative arrangements will not live up to expectations.

   **Answer:** B   Page: 171   Learning Objective: 1   Difficulty: Hard   Taxonomy: Comprehension
   AACSB: Value Creation
**Merger and Acquisition Strategies**

15. The difference between a merger and an acquisition is that
   A) a merger involves one company purchasing the assets of another company with cash, whereas an acquisition involves a company acquiring another company by buying all of the shares of its common stock.
   B) a merger is a pooling of equals whereas an acquisition involves one company, the acquirer, purchasing and absorbing the operations of another company, the acquired.
   C) in a merger the companies retain their original names whereas in an acquisition the name of the company being acquired is changed to be the name of the acquiring company.
   D) a merger is a combination of three or more companies whereas an acquisition is a pooling of interests of just two companies.
   E) a merger involves two or more companies deciding to adopt the same strategy whereas an acquisition involves one company taking over the strategy-making function of another company.

   **Answer:** B Page: 171 Learning Objective: 2 Difficulty: Easy Taxonomy: Comprehension AACSB: Value Creation

16. Which of the following is not a typical strategic objective or benefit that drives mergers and acquisitions?
   A) To gain quick access to new technologies or other resources and capabilities.
   B) To create a more cost-efficient operation out of the combined companies.
   C) To expand a company’s geographic coverage.
   D) To facilitate a company’s shift from a broad differentiation strategy to a focused differentiation strategy.
   E) To extend a company’s business into new product categories.

   **Answer:** D Page: 171-172 Learning Objective: 2 Difficulty: Easy Taxonomy: Comprehension AACSB: Value Creation

17. Mergers and acquisitions are often driven by such strategic objectives as to
   A) expand a company’s geographic coverage or extend its business into new product categories.
   B) reduce the number of industry key success factors.
   C) reduce the number of strategic groups in the industry.
   D) facilitate a company’s shift from a low-cost leadership strategy to a focused low-cost strategy.
   E) lengthen a company’s value chain and thereby put it in better position to deliver superior value to buyers.

   **Answer:** A Page: 171-172 Learning Objective: 2 Difficulty: Easy Taxonomy: Comprehension AACSB: Value Creation

18. Merger and acquisition strategies
   A) are nearly always a superior strategic alternative to forming alliances or partnerships with these same companies.
   B) may offer considerable cost-saving opportunities and can also be beneficial in helping a company try to invent a new industry.
   C) are a particularly effective way of pursuing a blue ocean strategy and outsourcing strategies.
   D) seldom are a superior strategic alternative to forming alliances with these same companies because of the financial drain of using the company’s cash resources to accomplish the merger or acquisition.
   E) are one of the best ways for helping a company strongly differentiate its product offering and use a differentiation strategy to strengthen its market position.

   **Answer:** B Page: 171-172 Learning Objective: 2 Difficulty: Medium Taxonomy: Comprehension AACSB: Value Creation
Why Mergers and Acquisitions Fail to Produce Anticipated Results

19. Mergers and acquisitions
   A) are nearly always successful in achieving their desired purpose.
   B) frequently do not produce the hoped-for outcomes.
   C) are generally less effective than forming alliances or partnerships with these same companies.
   D) are highly risky because of the financial drain that comes from using the company’s cash resources to pay for the costs of the merger or acquisition.
   E) are usually more successful in achieving cost reductions than in expanding a company’s market opportunities.

   Answer: B  Page: 173  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

Vertical Integration Strategies: Operating Across More Stages of the Industry Value Chain

20. Vertical integration strategies
   A) extend a company’s competitive scope within the same industry by expanding its operations across more parts of the industry value chain.
   B) are one of the best strategic options for helping companies win the race for global market leadership.
   C) offer good potential to expand a company’s lineup of products and services.
   D) are particularly effective in boosting a company’s ability to expand into additional geographic markets, particularly the markets of foreign countries.
   E) are a good strategy option for helping a company to revamp its value chain and bypass low value-added activities.

   Answer: A  Page: 175  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

The Advantages of a Vertical Integration Strategy

21. The two best reasons for investing company resources in vertical integration (either forward or backward) are to
   A) expand into foreign markets and/or control more of the industry value chain.
   B) broaden the firm’s product line and/or avoid the need for outsourcing.
   C) gain a first mover advantage over rivals in revamping the industry value chain.
   D) strengthen the company’s competitive position and/or boost its profitability.
   E) achieve product differentiation and/or lengthen the company’s value chain to include more activities performed in-house and thereby gain greater ability to reduce internal operating costs.

   Answer: D  Page: 175  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation
22. For backward vertical integration into the business of suppliers to be a viable and profitable strategy, a company
   A) must first be a proficient manufacturer.
   B) must be able to achieve the same scale economies as outside suppliers and match or beat suppliers’ production efficiency with no drop-off in quality.
   C) must have excess production capacity, so that it has ample in-house ability to undertake additional production activities.
   D) needs to have a wide product line, so that it can supply parts and components for many products.
   E) should have a distinctive competence in production process technology and at least a core competence in manufacturing R&D.

   Answer: B   Page: 176   Learning Objective: 3   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

23. The strategic impetus for forward vertical integration is to
   A) gain better access to end users and better market visibility
   B) achieve the same scale economies as wholesale distributors and/or retail dealers.
   C) control price at the retail level.
   D) bypass distributors-dealers and sell direct to consumers at the company’s Web site.
   E) build a core competence in mass merchandising.

   Answer: A   Page: 176   Learning Objective: 3   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

24. Which of the following is typically the strategic impetus for forward vertical integration?
   A) Being able to control the wholesale/retail portion of the industry value chain
   B) Fewer disruptions in the delivery of the company’s products to end-users
   C) Gaining better access to end users and better market visibility
   D) Broadening the company’s product line
   E) Allowing the firm access to greater economies of scale

   Answer: C   Page: 176   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

25. A good example of vertical integration is
   A) a global public accounting firm acquiring a small local or regional public accounting firm.
   B) a large supermarket chain getting into convenience food stores.
   C) a crude oil refiner purchasing a firm engaged in drilling and exploring for oil.
   D) a hospital opening up a nursing home for the aged.
   E) a railroad company acquiring a trucking company specializing in long-haul freight.

   Answer: C   Page: 176   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

26. Which of the following is not a potential advantage of backward vertical integration?
   A) Reduced vulnerability to powerful suppliers (who may be inclined to raise prices at every opportunity)
   B) Reduced risks of disruptions in obtaining crucial components or support services
   C) Reduced costs
   D) Reduced business risk because of controlling a bigger portion of the overall industry value chain
   E) Adding to a company’s differentiation capabilities and perhaps achieving a differentiation-based competitive advantage

   Answer: D   Page: 176   Learning Objective: 3   Difficulty: Hard   Taxonomy: Comprehension
   AACSB: Value Creation
The Disadvantages of a Vertical Integration Strategy

27. Which of the following is not a strategic disadvantage of vertical integration?
   A) Vertical integration boosts a firm’s capital investment in the industry, thus increasing business risk if the industry becomes unattractive later.
   B) Vertical integration backward into parts and components manufacture can impair a company’s operating flexibility when it comes to changing out the use of certain parts and components.
   C) Vertical integration reduces the opportunity for achieving greater product differentiation.
   D) Forward or backward integration often calls for radically different skills and business capabilities than the firm possesses.
   E) Vertical integration poses all kinds of capacity-matching problems.

   Answer: C   Page: 177-178   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

Outsourcing Strategies: Narrowing the Boundaries of the Business

28. Outsourcing strategies
   A) are nearly always a more attractive strategic option than merger and acquisition strategies.
   B) carry the substantial risk of raising a company’s costs.
   C) carry the substantial risk of making a company overly dependent on its suppliers.
   D) increase a company’s risk exposure to changing technology and/or changing buyer preferences.
   E) involve farming out value chain activities presently performed in-house to outside specialists and strategic allies.

   Answer: E   Page: 178   Learning Objective: 4   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation

29. The two big drivers of outsourcing are
   A) increased ability to cut R&D expenses and increased ability to avoid the problems of strategic alliances.
   B) that outsiders can often perform certain activities better or cheaper and outsourcing allows a firm to focus its entire energies on those activities that are at the center of its expertise (its core competencies).
   C) a desire to reduce the company’s investment in fixed assets and the need to narrow the scope of the company’s in-house competencies and competitive capabilities.
   D) the ability to avoid capital investments that accompany vertical integration and a desire to reduce the company’s risk exposure to changing technology and/or changing buyer preferences.
   E) that a smaller in-house work force and a low investment in intellectual capital produce cost savings.

   Answer: B   Page: 178   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
When Outsourcing Strategies Are Advantageous

30. Outsourcing the performance of value chain activities presently performed in-house to outside vendors and suppliers makes strategic sense when
   A) an activity can be performed better or more cheaply by outside specialists.
   B) it allows a company to focus its entire energies on those activities that are at the center of its expertise (its core competencies) and that are most critical to its competitive and financial success.
   C) outsourcing won’t adversely hollow out the company’s technical know-how, competencies, or capabilities.
   D) it reduces the company’s risk exposure to changing technology and/or changing buyer preferences.
   E) All of these.

Answer: E  Page: 179-180  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

31. Which of the following is not one of the benefits of outsourcing value chain activities presently performed in-house?
   A) Streamlines company operations in ways that improve organizational flexibility and cut the time it takes to get new products into the marketplace
   B) Allows a company to concentrate on its core business, leverage its key resources, and do even better what it already does best
   C) Helps the company assemble diverse kinds of expertise speedily and efficiently
   D) Enables a company to gain better access to end users and better market visibility
   E) Improves a company’s ability to innovate

Answer: D  Page: 179-180  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

32. Relying on outsiders to perform certain value chain activities offers such strategic advantages as
   A) obtaining higher quality and/or cheaper components or services.
   B) improving the company’s ability to innovate by allying with “best-in-world” suppliers.
   C) reducing the company’s risk exposure to changing technology and/or changing buyer preferences.
   D) increasing the firm’s ability to assemble diverse kinds of expertise speedily and efficiently.
   E) All of the above.

Answer: E  Page: 179-180  Learning Objective: 4  Difficulty: Easy  Taxonomy: Comprehension
AACSB: Value Creation

33. Outsourcing strategies can offer such advantages as
   A) increasing a company’s ability to strongly differentiate its product and be successful with either a broad differentiation strategy or a focused differentiation strategy.
   B) obtaining higher quality and/or cheaper components or services, improving a company’s ability to innovate, and reducing its risk exposure.
   C) speeding a company’s entry into foreign markets.
   D) permitting greater use of strategic alliances and collaborative partnerships.
   E) giving a firm more direct control over the costs of value chain activities.

Answer: B  Page: 179-180  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation
The Big Risk of an Outsourcing Strategy

34. The big risk of employing an outsourcing strategy is
   A) causing the company to become partially integrated instead of being fully integrated.
   B) hollowing out a firm’s own capabilities and losing touch with activities and expertise that contribute fundamentally to the firm’s competitiveness and market success.
   C) hurting a company’s R&D capability.
   D) putting the company in the position of being a late mover instead of an early mover.
   E) increasing the firm’s risk exposure to both supply chain management failures and shifts in the composition of the industry value chain.

Answer: B  Page: 180  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

Business Strategy Choices for Specific Market Situations

35. Commonly encountered market conditions that must be considered when choosing among strategic options include:
   A) Rapidly growing markets.
   B) Mature, slow-growth markets.
   C) Stagnant or declining industries.
   D) Fragmented markets comprised of a large number of relatively small sellers.
   E) All of the above.

Answer: E  Page: 181  Learning Objective: 5  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

36. Which of the following are commonly encountered types of market conditions that must be considered by strategy-makers?
   A) Entrepreneurial industries, change dominant markets, and resource based industries.
   B) Hostile markets, competitive markets, oligopolies, and monopolies.
   C) Emerging markets, mature markets, fragmented markets, and turbulent markets.
   D) Low cost markets, differentiation markets, best cost markets, and focused industries.
   E) Moderately competitive industries, fiercely competitive industries, and weakly competitive industries.

Answer: C  Page: 181  Learning Objective: 5  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

Strategies for Competing in Emerging Markets

37. Which of the following is not usually a characteristic of competing in an emerging industry?
   A) There’s much speculation about how the industry will function, how fast it will grow, and how big it will get.
   B) Technological know-how is freely shared and exchanged among the early participants, with no competitive advantage attached to patents and proprietary technology.
   C) There is uncertainty regarding which of several competing technologies will win out or which product attributes will win the greatest buyer favor and drive buyer purchases.
   D) Many potential buyers expect first-generation products to be rapidly improved and delay their purchase until technology and product design mature.
   E) Entry barriers tend to be relatively low.

Answer: B  Page: 181-182  Learning Objective: 5  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation
38. Which of the following is not a typical feature of an emerging industry or a challenge that companies in emerging industries have to contend with and try to overcome?

A) How to raise sufficient capital to fund an R&D effort that will enable the company to win the race against rivals to patent the industry’s technology
B) Many potential buyers expect first-generation products to be rapidly improved and delay their purchase until technology and product design mature
C) The marketing challenge is to induce first-time purchase and overcome customer concerns about product features, performance reliability, and conflicting claims of rival firms
D) Strong learning and experience curve effects may be present, allowing significant price reductions as volume builds and costs fall
E) There are often uncertainties surrounding an emerging industry’s technology with no consensus regarding which product attributes will prove decisive in winning buyer favor

Answer: A Page: 181-182 Learning Objective: 5 Difficulty: Medium Taxonomy: Comprehension

39. To be successful in emerging industries, companies usually have to fashion a strategy that includes such strategic elements as

A) avoiding the “first mover disadvantages” associated with making early commitments to alternative technologies, wider product selection, different styling, or new distribution channels.
B) building core competencies and competitive capabilities rapidly so as to avoid having to enter into strategic alliances and partnerships and thus share the firm’s potential long-term profitability with outsiders.
C) pushing hard to perfect the technology, improve product quality, and develop additional attractive performance features.
D) charging first-time buyers a premium price (to help grow revenues quickly) and being a technological follower (so as to conserve scarce financial resources).
E) not cutting prices until buyer demand really mushrooms and being a late-mover in introducing new products (so as to avoid the costs and risks of introducing something that turns out to be a bust in the marketplace).

Answer: C Page: 182-183 Learning Objective: 5 Difficulty: Medium Taxonomy: Comprehension

40. Which one of the following is not one of the strategy elements that companies in emerging industries are likely to consider incorporating into their strategy?

A) Pursuing new customer groups, new user applications, and entry into new geographical areas (perhaps using strategic partnerships or joint ventures if financial resources are constrained)
B) Forming strategic alliances and partnerships with key suppliers and/or other companies having complementary technology or expertise
C) Pushing hard to perfect the technology, improve product quality, and develop additional attractive performance features
D) As technological uncertainty clears and a dominant technology emerges, trying to capture any first-mover advantages by adopting it quickly
E) Being aggressive in cutting prices below key rivals and establishing a reputation of being the low-price leader

Answer: E Page: 182-183 Learning Objective: 5 Difficulty: Medium Taxonomy: Comprehension
41. Young companies in fast-growing, emerging markets face such hurdles as
   A) learning to be a courageous first-mover, becoming skilled cost-cutters, and developing mass merchandising skills.
   B) managing rapid expansion, defending against competitors trying to horn in on their success, and building a strong competitive position for the long term.
   C) acquiring an intuitive feel for what buyers will like and how they will use the product.
   D) learning to conduct reliable market research, figuring out how to build scale economies, and becoming adept at product innovation.
   E) deciding which of the five generic competitive strategies to adopt, whether to be a risk-taker or risk-avoider, and what balance to strike between offensive and defensive strategies.

   Answer: B   Page: 183   Learning Objective: 5   Difficulty: Medium   Taxonomy: Comprehension 
   AACSB: Value Creation

Strategies for Competing in Rapidly Growing Markets

42. A company competing in a rapid-growth industry
   A) needs to be primarily concerned about building first-rate R&D capabilities.
   B) needs a strategy predicated on growing faster than the market average, so that it can boost its market share and improve its competitive standing vis-à-vis rivals.
   C) should put top priority on improving product quality.
   D) is well advised to employ a best-cost provider strategy.
   E) is doomed if it is not an aggressive first-mover.

   Answer: B   Page: 184   Learning Objective: 5   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

43. Which one of the following is not likely to be a suitable strategy option for companies competing in rapid-growth industries?
   A) Driving down costs per unit so as to enable price reductions that attract droves of new customers
   B) Pursuing rapid product innovation, both to set a company’s product offering apart from rivals and to incorporate attributes that appeal to growing numbers of customers
   C) Gaining access to additional distributional channels and sales outlets
   D) Vertically integrating forward and backward to enable greater control of the industry value chain
   E) Expanding the product line to add models/styles that appeal to a wider range of buyers

   Answer: D   Page: 184-185   Learning Objective: 5   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

44. Companies competing in rapid growth industries are not well-advised to consider which one of the following strategy elements in crafting their strategy?
   A) Expanding the company’s geographic coverage
   B) Gaining access to additional distributional channels and sales outlets
   C) Pushing hard to develop a distinctive competence in new technology R&D
   D) Expanding the product line to add models/styles that appeal to a wider range of buyers
   E) Driving down costs per unit so as to enable price reductions that attract droves of new customers

   Answer: C   Page: 184-185   Learning Objective: 5   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
Competing in Slow-Growth, Mature Markets

45. The transition to a slower-growth, maturing industry environment tends to result in
   A) a greater emphasis on backward vertical integration.
   B) growing buyer sophistication and more head-to-head competition for market share.
   C) rising industry profitability as rivalry tapers off and there’s less head-to-head competition for market share among rival firms.
   D) reduced risks associated with capacity additions and significantly faster rates of product innovation as sellers endeavor to rekindle buyer interest.
   E) reduced emphasis on mergers and acquisitions.

   Answer: B   Page: 185   Learning Objective: 5   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

46. In a maturing industry, slackening growth rates tend to alter the competitive environment in such ways as
   A) weakening competitive rivalry and dampening the forces of multinational or global competition.
   B) boosting industry profitability and spurring buyer excitement about the product.
   C) increasing the number of competitors and reducing the number of mergers and acquisitions among competing firms.
   D) lowering the emphasis on cost control and reducing price competition among rivals.
   E) increased buyer sophistication, more head-to-head competition for market share, increased difficulty in coming up with new product features, and sustaining buyer excitement.

   Answer: E   Page: 185-186   Learning Objective: 5   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

47. Which one of the following statements does not represent one of the typical fundamental changes in an industry as it approaches maturity?
   A) Industry profitability falls temporarily or permanently
   B) International competition increases
   C) New scale economies develop and overall costs per unit produced and sold drop significantly
   D) Increased competitive emphasis is placed on lowering costs and improving service
   E) Firms encounter growing difficulty in coming up with new product innovations and developing new uses and applications for the product

   Answer: C   Page: 185-186   Learning Objective: 5   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

48. Which one of the following strategic actions is not well-matched to dealing with the transition from rapid growth to industry maturity?
   A) Steering a middle course between low cost, differentiation, and focusing
   B) Pruning marginal products and models
   C) Improving value chain efficiency
   D) Acquiring rival companies at bargain prices
   E) Trimming costs

   Answer: A   Page: 186-187   Learning Objective: 5   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
49. In a maturing market where the rates of growth are on the decline, rival firms can often improve their competitive position in the marketplace by
A) pursuing backward and/or forward vertical integration to capture greater control over the industry value chain and shifting to standardized product offerings.
B) concentrating on adding new models and performance features, emphasizing product innovation, and spending heavily on advertising to achieve much stronger product differentiation vis-à-vis rivals.
C) shifting to focus or market niche strategies so as to concentrate exclusively on those buyers and models/styles where demand is continuing to grow at above-average rates.
D) pruning marginal products and models, improving value chain efficiency, trimming costs, acquiring rival firms at bargain prices, and building new or more flexible competitive capabilities, and expanding internationally.
E) competing aggressively on the basis of superior customer service and adding new models and styles to broaden the product offering.

Answer: D   Page: 186-187  Learning Objective: 5  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

50. The typical strategic mistakes companies can make during the transition from fairly rapid growth to industry maturity include
A) pursuing a differentiation strategy instead of a low-cost strategy; not capitalizing on economies of scale; and failing to adequately broaden the product line.
B) steering a middle course between low-cost, differentiation, and focusing; being slow to respond to stiffening competition; and overexpanding in the face of slowing growth.
C) pursuing a low-cost leadership strategy; spending too little on marketing and advertising efforts; and putting too much emphasis on new product R&D and product innovation.
D) sacrificing long-term competitive position for short-term profits; outsourcing too many value chain activities to allies and partners, and not pursuing aggressive acquisition of weaker rival firms.
E) merging with weaker rather than stronger rivals; failing to pursue product differentiation; and abandoning strategic alliances with outsiders.

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51. Which one of the following is not a strategic pitfall companies can make during the transition from fairly rapid growth to industry maturity?
A) Going overboard in outsourcing the performance of value chain activities to allies and partners
B) Steering a middle course between low-cost, differentiation, and focusing, thus leaving the firm stuck in the middle
C) Overexpanding in the face of slowing growth
D) Overspending on advertising and sales promotion efforts in a losing effort to combat the growth slowdown
E) Failing to pursue cost reduction aggressively enough

Answer: A   Page: 188-189  Learning Objective: 5  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation
Strategies for Competing in Stagnant or Declining Markets

52. Businesses competing in stagnant or declining industries must
A) make a fundamental strategic choice—whether to remain committed to the industry for the long-term despite the industry’s dim prospects or whether to pursue an end-game strategy to withdraw gradually or quickly from the market.
B) pursue vertical integration and gain greater operating control over more stages of the industry’s value chain.
C) initiate deep price cuts to rejuvenate long-term demand and expand into the markets of foreign countries, especially emerging country markets.
D) outsource as many value chain activities as possible, particularly as concerns production-related activities.
E) steer a middle course between low-cost, differentiation and focusing and adopt a best-cost producer strategy aimed squarely at being a middle-of-the-market seller.

Answer: A Page: 189 Learning Objective: 5 Difficulty: Easy Taxonomy: Comprehension AACSB: Value Creation

53. A company that decides to stick with a stagnant or declining industry
A) is doomed to have declining revenues and profits.
B) may still be successful if it aggressively expands into the markets of more and more foreign countries using a global differentiation strategy.
C) may have a promising future if it is the industry’s low-cost leader and has deep financial pockets to withstand bitter price wars and lots of industry-wide overcapacity.
D) is well-advised to revamp its value chain to achieve strong product differentiation.
E) may be able to grow and prosper if market demand decays very slowly and it has the competitive capabilities to take market share away from weaker competitors.

Answer: E Page: 189-190 Learning Objective: 5 Difficulty: Medium Taxonomy: Comprehension AACSB: Value Creation

54. Potentially promising strategy alternatives for a company that decides to stick with a declining industry, because top management is encouraged by the remaining opportunities and/or sees merit in striving for market share leadership, include
A) deemphasizing superior quality and customer service and shifting to a more standardized product offering.
B) concentrating on vertical integration to gain operating control over more stages of the industry’s value chain.
C) initiating deep price cuts to rekindle demand for the product.
D) pursuing a focused strategy aimed at the fastest-growing or slowest-decaying market segments and stressing differentiation based on quality improvement and product innovation.
E) steering a middle course between low-cost, differentiation and focusing and adopting a best-cost producer strategy aimed squarely at being a middle-of-the-market seller.

Answer: D Page: 190 Learning Objective: 5 Difficulty: Medium Taxonomy: Comprehension AACSB: Value Creation
55. An end-game strategy in a stagnant or declining industry usually involves
A) stressing differentiation based on quality improvement and product innovation.
B) either a fast-exit/sell-out quickly strategy or a slow exit strategy that involves a gradual phasing down of operations coupled with an objective of getting the most cash flow from the business.
C) pursuing a focused strategy aimed at the fastest-growing or slowest-decaying market segments.
D) becoming a lower-cost producer.
E) initiating price cuts, boosting advertising, adding new features and more models, and stressing improved customer service so as to achieve strong product differentiation.

Answer: B Page: 191 Learning Objective: 5 Difficulty: Medium Taxonomy: Comprehension
AACSBB: Value Creation

56. A slow-exit type of end-game strategy involves
A) retreating to a market niche which the firm can defend for a few years.
B) selling off assets gradually and liquidating the business.
C) a gradual phasing down of operations coupled with an objective of generating the greatest possible harvest of cash from the business for as long as possible.
D) withdrawing, one by one, from the various market segments in which the firm competes and then selling the business to the buyer offering the highest price.
E) pruning the product line down to a few select products which the firm can still market profitably for a few more years, then when they begin to decline selling out to the highest bidder.

Answer: C Page: 191 Learning Objective: 5 Difficulty: Medium Taxonomy: Comprehension
AACSBB: Value Creation

**Competing in Turbulent, Fast-Changing Markets**

57. A turbulent or fast-changing industry environment is characterized by
A) rapid entry and exit of participating firms (there’s an unusually high competitor turnover rate compared to other industries).
B) the need for industry members to change to radically different strategies several times a year (company strategies have a very short life).
C) the rapid appearance and disappearance of industry driving forces (such that the industry is in constant turmoil).
D) rapid technological change, short product life cycles, the entry of important new rivals, lots of competitive maneuvering by rivals, and fast-evolving customer requirements and expectations (all occurring in a manner that creates swirling market conditions).
E) All of these.

Answer: D Page: 191 Learning Objective: 5 Difficulty: Easy Taxonomy: Comprehension
AACSBB: Value Creation

58. The central strategy-making challenge in a turbulent market environment is
A) remaining the industry’s first-mover.
B) building stronger supply chain alliances than rivals.
C) managing change.
D) deciding when to cut prices versus when to improve product features and performance.
E) how often to change the company’s business model without impairing profitability.

Answer: C Page: 192 Learning Objective: 5 Difficulty: Easy Taxonomy: Comprehension
AACSBB: Value Creation
59. In a turbulent, fast-changing industry environment, a company’s approach to coping with rapid change should, ideally,
A) strive to compete on the basis of low-cost/low-price rather than on the basis of strong product differentiation or best-cost.
B) try to lead change with proactive strategic moves while at the same time trying to anticipate and prepare for upcoming changes and being quick to react to unexpected developments.
C) be a consistent first-mover or a consistent fast follower or a consistent slow-mover whichever best fits management’s temperaments and shareholder expectations.
D) involve pursuing a focused niche strategy aimed at the fastest-growing market segments.
E) place strong emphasis on building and strengthening the company’s long-term market position rather than worrying excessively about short-term profitability and ROE.

Answer: B   Page: 192   Learning Objective: 5   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

60. In trying to deal with a turbulent, fast-changing market, a company’s three strategic options are
A) to pursue low-cost, differentiation, or best-cost strategies.
B) to react to change, to anticipate change, and/or to try to lead change.
C) to be a first-mover, a fast follower, or a slow-mover—whichever is most expedient.
D) play offense, play defense, or utilize focus strategies to compete in those market segments where change occurs at a more leisurely pace.
E) to pursue short-term profitability, intermediate-term profitability, or long-term profitability.

Answer: B   Page: 192   Learning Objective: 5   Difficulty: Easy   Taxonomy: Comprehension
AACSB: Value Creation

61. In trying to deal with turbulent and rapid changes in the marketplace, a company
A) can either pursue profitability or market share, but not both.
B) can react to change, anticipate change, and/or try to lead change.
C) should be a first-mover, a fast follower, or a slow-mover—as may be most expedient.
D) can play offense, play defense, or utilize end-run offensives to compete in those market segments where change occurs at a more leisurely pace.
E) should be a technological leader, a product quality leader, or a customer service leader—whichever is most appealing to buyers.

Answer: B   Page: 192   Learning Objective: 5   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

62. Competitive success in fast-changing markets tends to hinge on a company’s ability to
A) be the first-mover in reacting and responding to change.
B) be more adept than rivals in employing offensive strategies of one kind or another.
C) develop a distinctive competence in anticipating change.
D) stay on the cutting-edge of technological change.
E) improvise, experiment, adapt, reinvent, and regenerate as market and competitive conditions shift rapidly and sometimes unpredictably.

Answer: E   Page: 192   Learning Objective: 5   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation
Supplementing the Chosen Competitive Strategy–Other Important Strategy Choices

63. The strategic moves and initiatives that seem to offer the best payoff in turbulent, fast-changing markets include
   A) developing quick response capability.
   B) keeping the company’s products fresh and exciting enough to stand out in the midst of all the change that is taking place.
   C) investing aggressively in R&D to stay on the leading edge of technological know-how.
   D) initiating fresh actions every few months, not just when a competitive response is needed.
   E) All of these.

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64. The types of strategic initiatives that seem to offer the best payoff in fast-changing markets include
   A) being clever at being a fast follower, doing a better job than rivals in anticipating and planning for change, and striving for a low-cost edge over rivals.
   B) having a wider product line than rivals, making sure the company’s products are strongly differentiated, and having a shorter value chain than rivals so the company has fewer activities to revamp as the market changes.
   C) investing aggressively to stay on the leading edge of technological know-how; launching fresh actions every few months; having quick-response capabilities; and keeping the company’s products fresh and exciting enough to stand out in the midst of all the change that is taking place.
   D) doing a better job than rivals of leading industry change and being a successful first mover; having sufficient internal resources and competencies so the company does not need to have many strategic partners; and outspending rivals on new product R&D.
   E) doing a better job than rivals of reacting and responding to rapid change, concentrating on a few crucial value chain activities and farming the rest out to strategic partners, and being a fast follower as opposed to a first-mover in technology.

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Competing in Fragmented Industries

65. An industry is said to be fragmented when
   A) it contains an unusually large number of different market segments and distinct buyer groups.
   B) demand for the product is scattered over many different country markets.
   C) the industry value chain is divided into 15 or more distinctly different stages.
   D) the supply side of the market is populated by hundreds, perhaps thousands of sellers, no one of which has a substantial share of total industry sales.
   E) the annual number of buyer-seller transactions is in the millions (or higher).

   Answer: D  Page: 195  Learning Objective: 5  Difficulty: Medium  Taxonomy: Knowledge
   AACSB: Value Creation

66. The standout competitive characteristic or feature of a fragmented industry is
   A) an unusually large number of different market segments and buyer groups.
   B) a market situation where demand for the product is scattered over many different country markets.
   C) an exceptionally large number of models, styles, and product varieties being produced and marketed by industry members.
   D) the demand side of the market is populated by millions of buyers, no one of which buys in large volume quantities.
   E) the absence of market leaders with king-sized market shares and widespread buyer recognition.

   Answer: E  Page: 195  Learning Objective: 5  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation
67. Which of the following does not generally account for why the supply side of an industry may be fragmented and contain thousands of companies?

A) A condition where most all competitors have, for one reason or another, chosen to pursue focus and market niche strategies
B) Low entry barriers that permit small firms to enter cheaply and quickly
C) An absence of scale economies permits small companies to compete on an equal cost footing with larger firms
D) Buyer preferences and requirements are so diverse that very large numbers of firms can easily coexist trying to accommodate differing buyer tastes, expectations, and pocketbooks
E) The scope of the geographic market for the industry’s product or service is transitioning from national to global, putting companies in more and more countries in the same competitive arena

**Answer:** A Page: 195-196 Learning Objective: 5 Difficulty: Medium Taxonomy: Comprehension AACSB: Value Creation

68. Which of the following is not usually a promising option for competing in a fragmented industry?

A) Specializing by product type or by customer type
B) Becoming a low-cost operator
C) Employing a best-cost provider strategy aimed at giving buyers more value for their money and trying to appeal to a broader customer base
D) Focusing on a limited geographic area
E) Constructing and operating “formula” facilities at many different locations

**Answer:** C Page: 197 Learning Objective: 5 Difficulty: Medium Taxonomy: Comprehension AACSB: Value Creation

69. Which of the following is usually a promising strategic option for competing in a fragmented industry?

A) Specializing by product type or by customer type
B) Becoming a low-cost operator
C) Constructing and operating “formula” facilities at many different locations
D) Focusing on a limited geographic area
E) All of the above can be promising options.

**Answer:** E Page: 197 Learning Objective: 5 Difficulty: Easy Taxonomy: Comprehension AACSB: Value Creation

70. Promising strategic options for companies competing in a fragmented industry include

A) constructing and operating customized facilities at many different locations so as to match local buyer expectations and varying market conditions.
B) becoming a best-cost provider and pursuing a multicountry strategy to achieve above-average growth.
C) specializing by product type or by customer type, becoming a low-cost operator, and focusing on a limited geographic area.
D) striving to become the industry’s low-cost leader.
E) using a broad differentiation strategy to set the company’s product offering well apart from rivals and striving to sell in an ever larger number of country markets.

**Answer:** C Page: 197 Learning Objective: 5 Difficulty: Medium Taxonomy: Comprehension AACSB: Value Creation
When Being a First-Mover Leads to Competitive Advantage

71. Being first to initiate a particular strategic move can have a high payoff when
   A) pioneering helps build up a firm’s image and reputation with buyers.
   B) first-time buyers remain strongly loyal to pioneering firms in making repeat purchases.
   C) moving first can result in a cost advantage over rivals.
   D) moving first can constitute a preemptive strike, making imitation extra hard or unlikely.
   E) All of these.

   **Answer:** E  Page: 199  Learning Objective: 6  Difficulty: Easy  Taxonomy: Comprehension
   AACSB: Value Creation

72. In which of the following instances is being a first-mover not particularly advantageous?
   A) When moving first with a preemptive strike makes imitation difficult or unlikely
   B) When first-time buyers remain strongly loyal to pioneering firms in making repeat purchases
   C) When early commitments to new technologies, types of components, or emerging distribution channels
      produce an absolute cost advantage over rivals
   D) When markets are slow to accept the innovative product offering of a first-mover and fast followers
      possess sufficient resources and marketing muscle to overtake a first mover
   E) When being a pioneer helps build a firm’s image with buyers

   **Answer:** D  Page: 199  Learning Objective: 6  Difficulty: Easy  Taxonomy: Comprehension
   AACSB: Value Creation

73. Because when to make a strategic move can be just as important as what move to make, a company’s best
    option with respect to timing is
   A) to be the first mover.
   B) to be a fast follower.
   C) to be a late mover (because it is cheaper and easier to imitate the successful moves of the leaders and
      moving late allows a company to avoid the mistakes and costs associated with trying to be a pioneer—
      first-mover disadvantages usually overwhelm first-mover advantages).
   D) to be the last-mover—playing catch-up is usually fairly easily and nearly always much cheaper than
      any other option.
   E) to carefully weigh the first-mover advantages against the first-mover disadvantages and act accordingly.

   **Answer:** E  Page: 199-202  Learning Objective: 6  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

Blue Ocean Strategy—A Powerful First-Mover Approach

74. A blue ocean strategy
   A) is an offensive attack used by a market leader to steal customers away from unsuspecting smaller rivals.
   B) involves a preemptive strike to secure an advantageous position in a fast-growing market segment.
   C) works best when a company is the industry’s low-cost leader.
   D) involves abandoning efforts to beat out competitors in existing markets and, instead, inventing a new
      industry or new market segment that renders existing competitors largely irrelevant and allows a
      company to create and capture altogether new demand.
   E) involves the use of highly creative, never-used-before strategic moves to attack the competitive
      weaknesses of rivals.

   **Answer:** D  Page: 200  Learning Objective: 6  Difficulty: Medium  Taxonomy: Knowledge
   AACSB: Value Creation
When Being a Late-Mover Can Be Advantageous

75. First-mover disadvantages (or late-mover advantage) arise when
A) the costs of pioneering are much higher than being a follower and only negligible learning/experience curve benefits accrue to the pioneer.
B) rapid market evolution gives fast-followers an opening to leapfrog the pioneer with next-generation products of their own.
C) the pioneer’s products are somewhat primitive and do not live up to buyer expectations, allowing clever followers to win disenchanted buyers with better-performing products.
D) the marketplace is skeptical about the benefits of a new technology or product being pioneered by a first-mover.
E) All of these.

Answer: E  Page: 201  Learning Objective: 6  Difficulty: Easy  Taxonomy: Comprehension  
AACSB: Value Creation

76. In which of the following cases are late-mover advantages (or first-mover disadvantages) not likely to arise?
A) When the costs of pioneering are much higher than being a follower and only negligible learning/experience benefits accrue to the pioneer
B) When the marketplace is skeptical about the benefits of a new technology or product being pioneered by a first-mover
C) When the pioneer’s products are somewhat primitive and are easily bested by late movers
D) When opportunities exist to invent a new industry or distinctive market segment that creates altogether new demand
E) When technological change is rapid and fast-following rivals find it easy to leapfrog the pioneer with next-generation products of their own

Answer: D  Page: 201  Learning Objective: 6  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation

To Be a First-Mover or Not

77. The race among rivals for industry leadership is more likely to be a marathon rather than a sprint when,
A) new industry or market segments are yet to be developed and create altogether new consumer demand.
B) fast followers find it easy to leapfrog the pioneer with even better next-generation products of their own.
C) the market depends on the development of complementary products or services that are currently not available, buyers have high switching costs, and influential rivals are in position to derail the efforts of a first-mover.
D) entry barriers are high, substitute products or services or readily available, and buyers are prone to negotiate aggressively for better terms and lower prices.
E) there are nearly always big advantages to being a slow mover rather than an early mover, especially as concerns avoiding the “mistakes” of first or early movers.

Answer: C  Page: 202  Learning Objective: 6  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation
Short Answer Questions

78. Identify and briefly explain what is meant by each of the following terms:
   a.) strategic alliance
   b.) vertical integration strategy
   c.) outsourcing strategy
   d.) a first-mover advantage
   e.) a first-mover disadvantage (or late-mover advantage)

   Page: 166, 175, 178 – 179, 199 and 201   Learning Objective: 1, 3, 4, 6   Difficulty: Hard
   Taxonomy: Knowledge   AACSB: Value Creation

79. What are the advantages of strategic alliances and collaborative partnerships with key suppliers?

   Page: 168-169   Learning Objective: 1   Difficulty: Hard   Taxonomy: Comprehension
   AACSB: Value Creation

80. What are the merits of strategic alliances and collaborative partnerships for companies racing for global market leadership? Under what circumstances do they make sense? How do they contribute to competitive advantage?

   Page: 168-169   Learning Objective: 1   Difficulty: Hard   Taxonomy: Comprehension
   AACSB: Value Creation

81. What are the merits of strategic alliances and collaborative partnerships for companies racing to seize opportunities in an industry of the future? Under what circumstances do they make sense? How do they contribute to competitive advantage?

   Page: 169   Learning Objective: 1   Difficulty: Hard   Taxonomy: Comprehension
   AACSB: Value Creation

82. Identify and briefly discuss three factors a company must consider in order to capture the benefits of engaging in strategic alliances.

   AACSB: Value Creation

83. Under what sorts of circumstances are mergers with or acquisitions of other companies a better solution than entering into partnerships or alliances with these companies? How do mergers and/or acquisitions contribute to enhancing a company’s position?

   Page: 171   Learning Objective: 2   Difficulty: Hard   Taxonomy: Comprehension
   AACSB: Value Creation

84. What are the potential strategic objectives of merger and acquisition strategies?

   Page: 171-172   Learning Objective: 2   Difficulty: Hard   Taxonomy: Comprehension
   AACSB: Value Creation

85. What are the strategic advantages of a backward vertical integration strategy?

   Page: 175-176   Learning Objective: 3   Difficulty: Hard   Taxonomy: Comprehension
   AACSB: Value Creation
86. What are the strategic disadvantages of a backward vertical integration strategy?

Page: 177-178  Learning Objective: 3  Difficulty: Hard  Taxonomy: Comprehension  
AACSB: Value Creation

87. What are the strategic advantages of a forward vertical integration strategy?

Page: 176-177  Learning Objective: 3  Difficulty: Hard  Taxonomy: Comprehension  
AACSB: Value Creation

88. What are the strategic disadvantages of a forward vertical integration strategy?

Page: 177-178  Learning Objective: 3  Difficulty: Hard  Taxonomy: Comprehension  
AACSB: Value Creation

89. What are the merits of outsourcing the performance of certain value chain activities as opposed to performing them in-house? Under what circumstances does outsourcing make good strategic sense?

Page: 179-180  Learning Objective: 4  Difficulty: Hard  Taxonomy: Comprehension  
AACSB: Value Creation

90. Identify and briefly discuss three challenges of competing in an emerging industry.

Page: 181-182  Learning Objective: 5  Difficulty: Hard  Taxonomy: Comprehension  
AACSB: Value Creation

91. Identify at least four strategic approaches or options that are well-suited for competing in an emerging industry.

Page: 182-183  Learning Objective: 5  Difficulty: Hard  Taxonomy: Comprehension  
AACSB: Value Creation

92. Identify at least two strategy elements that are well-suited for competing in rapidly growing markets.

Page: 184-185  Learning Objective: 5  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation

93. What kinds of changes in the competitive environment occur when an industry begins to mature? Identify three strategic approaches that are well-suited for this type of industry environment.

AACSB: Value Creation

94. Identify at least three ways that slowing market growth alters market conditions. Then identify two strategy elements that are well-suited for companies that are in an industry transitioning from rapid growth to industry maturity.

AACSB: Value Creation
95. Companies in a stagnant or declining industry are doomed to having declining revenues and profits. True or false? Explain your answer.

Page: 189 Learning Objective: 5 Difficulty: Medium Taxonomy: Comprehension AACSB: Value Creation

96. Identify at least two strategic approaches that are well-suited for competing in a stagnant or declining industry.

Page: 190 Learning Objective: 5 Difficulty: Medium Taxonomy: Comprehension AACSB: Value Creation

97. Regarding end-game strategies for a stagnant/declining industry, what is the difference between a fast-exit strategy and a slow-exit strategy?

Page: 191 Learning Objective: 5 Difficulty: Medium Taxonomy: Knowledge AACSB: Value Creation

98. In what kinds of industry circumstances is an end-game strategy particularly worthy of consideration?

Page: 191 Learning Objective: 5 Difficulty: Medium Taxonomy: Comprehension AACSB: Value Creation

99. Identify at least two strategy options that are well-suited for competing in a turbulent, high-velocity market environment.

Page: 193-194 Learning Objective: 5 Difficulty: Medium Taxonomy: Comprehension AACSB: Value Creation

100. Identify at least three factors that cause the supply side of an industry to be fragmented. Describe three strategy options that are suitable for competing in a fragmented industry?


101. What are the strategic advantages of being a first-mover? What are the strategic advantages of being a follower or “late mover”?

Page: 199 and 201 Learning Objective: 6 Difficulty: Hard Taxonomy: Comprehension AACSB: Value Creation

102. What is a blue ocean strategy and what is its appeal?

Page: 200 Learning Objective: 6 Difficulty: Hard Taxonomy: Knowledge AACSB: Value Creation

103. In what sorts of circumstances is it strategically advantageous to be a fast follower or “late mover” as opposed to a first-mover?

Multiple Choice Questions

Why Companies Expand into Foreign Markets

1. The reasons why a company opts to expand outside its home market include
   A) gaining access to new customers for the company’s products/services.
   B) spreading its business risk across a wider market base.
   C) achieving lower costs and enhancing the company’s competitiveness.
   D) a desire to capitalize on its core competencies and capabilities.
   E) All of these.
   **Answer:** E  Page: 208  Learning Objective: 1  Difficulty: Easy  Taxonomy: Knowledge
   AACSB: Domestic/Global Economic Environments

2. Which of the following is **not** a typical reason for companies to expand into the markets of foreign countries?
   A) To gain access to new customers
   B) To strengthen its capability to employ vertical integration strategies, especially those that involve partial integration (building positions in selected stages of the industry’s value chain
   C) To achieve lower costs and enhance the firm’s competitiveness
   D) To capitalize on company competencies and capabilities
   E) To spread business risk across a wider geographic market base
   **Answer:** B  Page: 208  Learning Objective: 1  Difficulty: Medium  Taxonomy: Knowledge
   AACSB: Domestic/Global Economic Environments

3. Which one of the following is **not** a reason why a company decides to enter foreign markets?
   A) To spread business risk across a wider geographic market base
   B) To capitalize on company competencies and capabilities
   C) To achieve lower costs and enhance the firm’s competitiveness
   D) To gain economic incentives offered by governments of developing countries wishing to expand industry and job creation
   E) To gain access to more buyers for the company’s products/services
   **Answer:** D  Page: 208  Learning Objective: 1  Difficulty: Medium  Taxonomy: Knowledge
   AACSB: Domestic/Global Economic Environments
The Difference Between Competing Internationally and Competing Globally

4. A company is said to be an international competitor when
   A) it competes in a majority of the world’s different country markets.
   B) it has operations on all of the world’s major continents.
   C) it competes in a select few foreign markets and perhaps has only modest ambitions to enter additional country markets.
   D) it employs an international strategy and competes in 50 or fewer country markets.
   E) it has 2 or more profit sanctuaries.

   **Answer:** C   Page: 208-209   Learning Objective: 1   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation

5. A company is said to be a global competitor when
   A) it competes in a majority of the world’s different country markets.
   B) it employs a global strategy.
   C) it has long range strategic intentions to compete in as many as 50 country markets.
   D) it competes in 15 or more country markets.
   E) it sells its products in 50 to 100 or more countries and is expanding its operations into additional country markets annually.

   **Answer:** E   Page: 208-209   Learning Objective: 1   Difficulty: Easy   Taxonomy: Knowledge
   AACSB: Value Creation

6. The difference between a company that competes “internationally” and a company that competes “globally” is that
   A) a global competitor operates in “many” country markets and an international competitor operates in just a “few” country markets.
   B) an international competitor competes in a select few foreign markets (and perhaps has only modest ambitions to enter additional country markets) while a global competitor has or is pursuing a market presence on most continents and is expanding its operations into additional country markets annually.
   C) an international competitor has a market presence in countries on one continent and a global competitor has a market presence in countries on most all of the world’s continents.
   D) an international competitor has a market presence in a few of the biggest country markets in the world and a global competitor has a market presence in most all of the major country markets of the world.
   E) an international competitor has an international strategy and a global competitor has a global strategy.

   **Answer:** B   Page: 208-209   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
Factors that Shape Strategy Choices in Foreign Markets

7. Which of the following is not an accurate statement as concerns competing in the markets of foreign countries?
   A) A multi-country strategy is generally superior to a global strategy.
   B) There are country-to-country differences in consumer buying habits and buyer tastes and preferences.
   C) A company must contend with fluctuating exchange rates and country-to-country variations in host government restrictions and requirements.
   D) Product designs suitable for one country are often inappropriate in another.
   E) Market growth rates vary from country to country.

   **Answer:** A Page: 209-210 Learning Objective: 2 Difficulty: Medium Taxonomy: Comprehension AACSB: Domestic/Global Economic Environments

8. Competing in the markets of foreign countries entails dealing with such factors as
   A) fluctuating exchange rates, country-to-country variations in host government restrictions and requirements, and country-to-country variations in cultural, demographic, and market conditions.
   B) important country-to-country differences in consumer buying habits and buyer tastes and preferences.
   C) whether to customize the company’s offerings in each different country market or whether to offer a mostly standardized product worldwide.
   D) the fact that product designs suitable for one country are sometimes inappropriate in another.
   E) All of these.

   **Answer:** E Page: 209-210 Learning Objective: 2 Difficulty: Easy Taxonomy: Comprehension AACSB: Domestic/Global Economic Environments

9. Competing in the markets of foreign countries generally does not involve which of the following?
   A) Country-to-country differences in consumer buying habits and buyer tastes and preferences
   B) Country-to-country variations in host government restrictions and requirements and fluctuating exchange rates
   C) Whether to customize the company’s offerings in each different country market or whether to offer a mostly standardized product worldwide
   D) In which countries to locate company operations for maximum locational advantage, given country-to-country variations in wages rates, worker productivity, energy costs, tax rates, and the like
   E) Crafting a multicountry strategy that works just as well in one country as in another and that also has the appeal of turning the world market into a mostly homogeneous market

   **Answer:** E Page: 209-210 Learning Objective: 2 Difficulty: Easy Taxonomy: Comprehension AACSB: Domestic/Global Economic Environments

10. One of the biggest strategic challenges to competing in the international arena include
   A) how to avoid the risks of shifting exchange rates.
   B) whether to charge the same price in all country markets.
   C) how many foreign firms to license to produce and distribute the company’s products.
   D) whether to offer a mostly standardized product worldwide or whether to customize the company’s offerings in each different country market to more precisely match the tastes and preferences of local buyers.
   E) whether to pursue a global strategy or an international strategy.

   **Answer:** D Page: 210 Learning Objective: 2 Difficulty: Medium Taxonomy: Comprehension AACSB: Domestic/Global Economic Environments
Gaining Competitive Advantage Based on Where Activities Are Located

11. One important concern a company has in trying to compete successfully in foreign markets is
   A) convincing shippers to keep cross-country transportation costs low enough that the company can export its goods to foreign countries cheaply.
   B) whether it will have to integrate forward into wholesale and/or retail activities in order to gain visibility for its products in foreign countries.
   C) how it can gain competitive advantage based on where it locates its various value chain activities.
   D) how to convince local government officials to reduce tariffs on the imports of its goods into their country.
   E) developing the expertise to avoid the impact of fluctuating exchange rates.

   Answer: C   Page: 210   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Domestic/Global Economic Environments

The Risks of Adverse Exchange Rate Shifts

12. A U.S. manufacturer that exports goods made at its U.S. plants for shipment to foreign markets
   A) is competitively disadvantaged when the U.S. dollar declines in value against the currencies of the countries to which it is exporting.
   B) is largely unaffected by fluctuating exchange rates; it would, however, be affected if its plants were in foreign countries.
   C) becomes more competitive in foreign markets when the U.S. dollar gains in value against the currencies of the countries to which it is exporting.
   D) becomes more competitive in foreign markets when the U.S. dollar declines in value against the currencies of the countries to which it is exporting.
   E) has no interest in whether the dollar grows stronger or weaker versus foreign currencies unless it is competing only against companies located in foreign countries.

   Answer: D   Page: 211   Learning Objective: 2   Difficulty: Hard   Taxonomy: Comprehension
   AACSB: Domestic/Global Economic Environments

13. A European manufacturer that exports goods made at its European plants to the United States
   A) is competitively disadvantaged when the euro declines in value against the U.S. dollar.
   B) is largely unaffected by fluctuating exchange rates between the euro and the U.S. dollar; it would, however, be affected if its plants were in the U.S.
   C) becomes more competitive in the U.S. market when the euro declines in value against the U.S. dollar.
   D) becomes more competitive in European markets when the euro declines in value against the U.S. dollar.
   E) has no interest in whether the euro grows stronger or weaker versus the U.S. dollar unless its chief competitors are other companies located in countries whose currency is also the euro.

   Answer: C   Page: 211   Learning Objective: 2   Difficulty: Hard   Taxonomy: Comprehension
   AACSB: Domestic/Global Economic Environments
14. A U.S. company that makes all of its goods at a plant in Brazil and then exports the Brazilian-made goods to country markets across the world
   A) is competitively disadvantaged when the U.S. dollar declines in value against the Brazilian real.
   B) is competitively advantaged when the Brazilian real declines in value against the currencies of the countries to which the Brazilian-made goods are being exported.
   C) becomes less competitive in foreign markets when the Brazilian real declines in value against the currencies of the countries to which the Brazilian-made goods are being exported.
   D) is competitively advantaged when the U.S. dollar appreciates in value against the Brazilian real.
   E) is unaffected by changes in the valuation of foreign currencies against the Brazilian real—all that matters to a U.S. company is the valuation of the U.S. dollar against the Brazilian real.

   Answer: B   Page: 211   Learning Objective: 2   Difficulty: Hard   Taxonomy: Comprehension
   AACSB: Domestic/Global Economic Environments

15. A European-based company that makes all of its goods at a plant in Brazil and then exports the Brazilian-made goods to country markets in many different parts of the world
   A) is competitively disadvantaged when the euro declines in value against the Brazilian real.
   B) is competitively disadvantaged when the Brazilian real declines in value against the currencies of the countries to which the goods are being exported.
   C) becomes less competitive in foreign markets when the Brazilian real gains in value against the currencies of the countries to which the Brazilian-made goods are being exported.
   D) is competitively advantaged when the euro appreciates in value against the Brazilian real.
   E) has no interest in whether the euro grows stronger or weaker versus the Brazilian real unless its chief competitors are other companies located in countries whose currency is also the euro.

   Answer: C   Page: 211-212   Learning Objective: 2   Difficulty: Hard   Taxonomy: Comprehension
   AACSB: Domestic/Global Economic Environments

16. One of the big risks of competing in foreign markets is
   A) the extent to which the advantages of exporting goods from a particular country can be wiped out when fluctuating exchange rates result in that country’s currency growing much weaker relative to the currencies of the countries to which the goods are being exported.
   B) whether the economies of foreign countries will continue to grow at double digit rates.
   C) the fact that some countries have lower wage rates than others.
   D) the potential for local government officials to reduce tariffs on the imports of its goods into their country.
   E) the extent to which the advantages of manufacturing goods in a particular country can be wiped out when fluctuating exchange rates result in that country’s currency growing stronger relative to the currencies of the countries where the output is being sold.

   Answer: E   Page: 212   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Domestic/Global Economic Environments
17. The advantages of manufacturing goods in a particular country and exporting them to foreign markets
   A) are largely unaffected by fluctuating exchange rates.
   B) are greatest when local distributors and dealers in that country can be convinced not to carry products
      that are made outside the country’s borders.
   C) can be wiped out when that country’s currency grows weaker relative to the currencies of the countries
      where the output is being sold.
   D) are weakened when that country’s currency grows stronger relative to the currencies of the countries
      where the output is being sold.
   E) are seriously compromised by the potential for local government officials to raise tariffs on the imports
      of foreign-made goods into their country.

   **Answer:** D  Page: 212  Learning Objective: 2  Difficulty: Hard  Taxonomy: Comprehension
   AACSB: Domestic/Global Economic Environments

18. Which of the following statements concerning the effects of fluctuating exchange rates on companies
    competing in foreign markets is not accurate?
   A) Fluctuating exchange rates pose significant risks to a company’s competitiveness in foreign markets.
   B) The advantages of manufacturing goods in a particular country are largely unaffected by fluctuating
      exchange rates.
   C) Exporters win when the currency of the country from which the goods are being exported grows
      weaker relative to the currencies of the countries that the goods are being exported to.
   D) The advantages of manufacturing goods in a particular country can be undermined when that country’s
      currency grows stronger relative to the currencies of the countries where the output is being sold.
   E) Domestic companies under pressure from lower-cost imports are benefited when their government’s
      currency grows weaker in relation to the currencies of the countries where the imported goods are
      being made.

   **Answer:** B  Page: 212  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Domestic/Global Economic Environments

19. Which of the following statements concerning the effects of fluctuating exchange rates on companies
    competing in foreign markets is true?
   A) Fluctuating exchange rates do not pose significant risks to a company’s competitiveness in foreign
      markets.
   B) The advantages of manufacturing goods in a particular country are largely unaffected by fluctuating
      exchange rates.
   C) Companies that are manufacturing goods in a particular country and are exporting much of what they
      produce are disadvantaged when that country’s currency grows weaker relative to the currencies of the
      countries that the goods are being exported to.
   D) Companies that are manufacturing goods in a particular country and are exporting much of what they
      produce are benefited when that country’s currency grows weaker relative to the currencies of the
      countries that the goods are being exported to.
   E) Domestic companies under pressure from lower-cost imports are hurt even more when their
      government’s currency grows weaker in relation to the currencies of the countries where the imported
      goods are being made.

   **Answer:** D  Page: 212  Learning Objective: 2  Difficulty: Hard  Taxonomy: Comprehension
   AACSB: Domestic/Global Economic Environments
20. Which of the following statements concerning the effects of fluctuating exchange rates on companies competing in foreign markets is true?

A) Fluctuating exchange rates pose significant risks to a company’s competitiveness in foreign markets.
B) The advantages of manufacturing goods in a particular country are largely unaffected by fluctuating exchange rates.
C) Companies that are manufacturing goods in a particular country and are exporting much of what they produce lose out when that country’s currency grows weaker relative to the currencies of the countries that the goods are being exported to.
D) The advantages of manufacturing goods in a particular country improve when that country’s currency grows stronger relative to the currencies of the countries where the output is being sold.
E) Domestic companies under pressure from lower-cost imports are hurt even more when their government’s currency grows weaker in relation to the currencies of the countries where the imported goods are being made.

**Answer:** A  Page: 212  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Domestic/Global Economic Environments

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21. Which of the following is not a typical host government requirement that affects the operations of foreign companies?

A) Establishing local content requirement on goods made inside their borders by foreign companies
B) Having rules and policies that protect local companies from foreign competition
C) Placing restrictions on exports to ensure adequate local supplies
D) Requiring foreign companies to use vertical integration to support operations of local companies
E) Imposing burdensome tax structures and regulatory requirements upon foreign companies doing business within their borders

**Answer:** D  Page: 212  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Domestic/Global Economic Environments

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22. Which of the following statements regarding multicountry competition is false?

A) One of the features of multicountry competition is that buyers in different countries are attracted to different product attributes.
B) With multicountry competition, the power and strength of a company’s strategy and resource capabilities in one country significantly enhance its competitiveness in other country markets.
C) One of the features of multicountry competition is that industry conditions and competitive forces in each national market differ in important respects.
D) One of the features of multicountry competition is that the mix of competitors in each country market varies from country to country.
E) With multicountry competition, rivals battle for national championships and winning in one country market does not necessarily signal the ability to fare well in other countries.

**Answer:** B  Page: 213  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Domestic/Global Economic Environments
23. Multi-country competition refers to situations where
   A) no domestic companies have king-sized market shares and each national market has many competitors.
   B) competition in one national market is independent of competition in other national markets and, as a consequence, there is strictly speaking no “international or world market.”
   C) domestic rivals pursue focused or market niche strategies and do not compete internationally.
   D) domestic companies have a competitive disadvantage in competing with foreign rivals that operate in many different countries.
   E) most competitors operate in more than two country markets but rarely in more than 20.

   Answer: B   Page: 213   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Domestic/Global Economic Environments

24. Multi-country competition is best characterized as a situation where
   A) the competitive arena among rival companies involves several neighboring countries rather than either a single country or the world market as a whole.
   B) competition is mainly among the domestic companies of a few neighboring countries (five countries at most).
   C) there are extensive trade restrictions, sharply fluctuating exchange rates, and high tariff barriers in many country markets that work against the formation of a true world market.
   D) competition among domestic companies predominates and foreign competitors are a minor factor.
   E) there is no international or global market, just a collection of mostly self-contained country markets.

   Answer: E   Page: 213   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Domestic/Global Economic Environments

25. Which of the following statements regarding global competition is false?
   A) In global competition, rivals vie for worldwide market leadership.
   B) In globally competitive industries, the power and strength of a company’s strategy and resource capabilities in one country significantly enhance its competitiveness in other country markets.
   C) In global competition, a firm’s overall competitive advantage (or disadvantage) grows out of its entire worldwide operations.
   D) In global competition, there’s more cross-country variation in industry conditions and competitive forces than there is in industries where multicountry competition prevails.
   E) In global competition, many of the same rival companies compete against each other in many different countries, but especially so in countries where sales volumes are large and where having a competitive presence is strategically important to building a strong global position in the industry.

   Answer: D   Page: 213-214   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Domestic/Global Economic Environments
26. Which of the following statements regarding multicountry and global competition is false?

A) In global competition, rivals vie for worldwide market leadership and the leading competitors compete head-to-head in the markets of many different countries.

B) In globally competitive industries, a company’s competitive position in one country both affects and is affected by its position in other countries.

C) One of the features of multicountry competition is there is greater cross-country variation in market conditions and the nature of the competitive contest among rivals than tends to be the case in globally competitive markets.

D) With multicountry competition, the competitive contest is localized, with rivals battling for national market leadership; moreover, winning in one country market does not necessarily signal that a company has the ability to fare well in the markets of other countries.

E) In global competition, the size of a firm’s worldwide competitive advantage (or disadvantage) equals the sum of the competitive advantages (or disadvantages) it has in each country market where it competes.

**Answer:** E  Page: 213-214  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension

AACSB: Domestic/Global Economic Environments

27. The characteristics of a world market where global competition prevails include

A) a market situation where competitive conditions across national markets are linked strongly enough to form a true world market and where leading competitors typically compete head to head in many different countries.

B) minor cost variations from country-to-country (as concerns production, distribution, sales and marketing, and other primary components of the industry value chain) and minimal cross-country trade restrictions.

C) a competitive environment comprised of so many competitors that no company has a sizable worldwide market share.

D) many companies racing for global market leadership, with most contenders using the same basic type of competitive strategy and positioned in the same strategic group.

E) low barriers to entry, such a large number of rivals that the actions of any one rival have little impact on the sales and market shares of other rivals, and key success factors that vary from country to country.

**Answer:** A  Page: 213-214  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension

AACSB: Domestic/Global Economic Environments

28. In global competition

A) the leading companies compete for having the biggest share of the world market, but only occasionally compete head-to-head in different countries.

B) the markets in various countries are part of the world market and competitive conditions across country markets are strongly linked.

C) a company’s overall market strength is the sum of its market shares in each country market where it has a presence.

D) the industry leaders are foreign companies; domestic companies are relegated to runner-up status.

E) a firm’s overall competitive advantage is determined by the size of the competitive advantage it has in each of its profit sanctuaries.

**Answer:** B  Page: 213-214  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension

AACSB: Domestic/Global Economic Environments
Strategy Options for Entering and Competing in Foreign Markets

29. The generic strategic options for competing in foreign markets include
   A) global low-cost, global differentiation, global best-cost, and global focus strategies.
   B) maintaining a national (one-country) production base and exporting goods to foreign markets.
   C) licensing foreign firms to produce and distribute one’s products or to use the company’s technology.
   D) a custom-tailored country-by-country approach based on meeting the particular needs of particular buyers in each target country.
   E) All of the above.

   Answer: E   Page: 215   Learning Objective: 3   Difficulty: Easy   Taxonomy: Knowledge
   AACSB: Value Creation

30. Which of the following is not one of the generic strategy options for competing in the markets of foreign countries?
   A) A profit sanctuary strategy
   B) An export strategy
   C) A global strategy
   D) A multicountry strategy
   E) A franchising strategy

   Answer: A   Page: 215   Learning Objective: 3   Difficulty: Easy   Taxonomy: Knowledge
   AACSB: Value Creation

31. Which of the following are generic strategy options for competing in foreign markets?
   A) Maintaining a national (one-country) production base and exporting goods to foreign markets
   B) Global strategies keyed either to low-cost or differentiation
   C) Franchising and licensing strategies
   D) A multicountry strategy (where a company pursues a custom-tailored country-by-country approach in accordance with local competitive conditions and buyer tastes and preferences)
   E) All of these.

   Answer: E   Page: 215   Learning Objective: 3   Difficulty: Easy   Taxonomy: Knowledge
   AACSB: Value Creation

32. Which of the following are not generic strategy options for competing in foreign markets?
   A) An export strategy and a multicountry strategy
   B) Global strategies keyed either to low-cost or differentiation
   C) Cross-border transfer strategies and home-field advantage strategies
   D) Using strategic alliances and joint ventures with foreign competitors as the primary vehicles for entering and competing in foreign markets
   E) Franchising and licensing strategies

   Answer: C   Page: 215   Learning Objective: 3   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation
Export Strategies

33. Using domestic plants as a production base for exporting goods to selected foreign country markets
   A) can be an excellent initial strategy to test the international waters and learn if attractive market positions
can be established in foreign markets.
   B) can be a competitively successful strategy when a company is focusing on vacant market niches in each
foreign country and does not have to compete head-to-head against strong host country competitors.
   C) can be a powerful strategy since a company can maintain a one-country production base allowing it to
capitalize on company competencies and capabilities.
   D) is usually a weak strategy when competitors are pursuing multi-country strategies.
   E) can be a powerful strategy because a company is not vulnerable to fluctuating exchange rates.

   Answer: A   Page: 215   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

34. The advantages of using an export strategy to build a customer base in foreign markets include
   A) being able to minimize shipping costs, avoid tariffs, and curb the effects of fluctuating exchange
rates.
   B) minimizing risk and capital requirements.
   C) being cheaper and more cost effective than licensing and franchising.
   D) being cheaper and more cost effective than a multicountry strategy.
   E) being more suited to accommodating local buyer tastes and host government regulations than a global
strategy.

   Answer: B   Page: 215   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

35. Which of the following is false as concerns use of an export strategy to compete in foreign markets?
   A) One advantage of an export strategy is the ability to test the international waters before having to
commit substantial sums to establishing operations in foreign countries—the amount of capital required
to begin exporting is frequently quite minimal.
   B) Exporting carries the risk of being vulnerable to adverse shifts in currency exchange rates.
   C) An export strategy is especially well suited to accommodating the different needs and preferences of
buyers in different countries.
   D) An export strategy may allow a company to gain additional scale economies from centralizing
production in one or several giant plants.
   E) An export strategy is disadvantageous when costs in the country where the goods are being manufactured
for export are higher than the costs in those locations where rivals have their plants.

   Answer: C   Page: 215   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
Licensing Strategies

36. The advantages of using a licensing strategy to participate in foreign markets include
   A) being especially well suited to achieve scale economies.
   B) being able to charge lower prices than rivals.
   C) enabling a company to achieve first-mover advantages quickly and easily.
   D) being able to leverage the company’s technical know-how or patents without committing significant
      additional resources to markets that are unfamiliar, politically volatile, economically uncertain, or
      otherwise risky.
   E) being able to achieve higher product quality and better product performance than with an export strategy.

   Answer: D   Page: 216   Learning Objective: 3   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

Franchising Strategies

37. The advantages of using a franchising strategy to pursue opportunities in foreign markets include
   A) having franchisees bear most of the costs and risks of establishing foreign locations and requiring the
      franchiser to expend only the resources to recruit, train, and support foreign franchisees.
   B) being particularly well suited to the global expansion efforts of companies with multicountry
      strategies.
   C) allowing a company to achieve scale economies.
   D) being well suited to companies who employ cross-border transfer strategies.
   E) being well suited to the global expansion efforts of manufacturers.

   Answer: A   Page: 216   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

Strategic Alliances and Joint Ventures with Foreign Partners

38. Strategic alliances, joint ventures, and cooperative agreements between domestic and foreign
    firms are a potentially fruitful means for the partners to
    A) enter additional country markets and compete on a more global scale while still preserving their
       independence.
    B) gain better access to scale economies in production and/or marketing.
    C) fill competitively important gaps in their technical expertise and/or knowledge of local markets.
    D) share distribution facilities and dealer networks, thus mutually strengthening their access to buyers.
    E) All of these.

   Answer: E   Page: 217   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

39. Which of the following is not a potential benefit of strategic alliances or other cooperative arrangements
    between foreign and domestic companies?
    A) Gaining wider access to attractive country markets
    B) Gaining better access to scale economies in production and/or marketing
    C) Filling competitively important gaps in their technical expertise and/or knowledge of local markets
    D) Greater ability to employ a global strategy (as opposed to a multicountry strategy)
    E) Sharing distribution facilities and dealer networks, thus mutually strengthening their access to buyers

   Answer: D   Page: 217   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
40. Strategic alliances between domestic and foreign firms are more effective
   A) in building multiple profit sanctuaries than in forging a mutually supportive global strategy.
   B) in reducing supply chain costs than in reducing distribution costs.
   C) in helping establish a new beachhead of opportunity than in achieving and sustaining global market leadership
   D) in helping the partners pursue a multicountry strategy as compared to a global strategy.
   E) in helping the partners pursue a global strategy as compared to a multicountry strategy.

   Answer: C Page: 219 Learning Objective: 3 Difficulty: Medium Taxonomy: Comprehension
   AACSB: Value Creation

41. Which of the following is not one of the problems and risks of strategic alliances between domestic and foreign firms?
   A) Overcoming language and cultural barriers
   B) The amount of time required to build trust, effective communication, and coordination between allies
   C) Developing mutually agreeable ways of dealing with key issues or differences
   D) Making it harder to pursue a multicountry strategy as compared to a global strategy
   E) Suspicions about whether allies are being forthright in exchanging information and expertise

   Answer: D Page: 219 Learning Objective: 3 Difficulty: Hard Taxonomy: Comprehension
   AACSB: Value Creation

Choosing Between a Localized Multicountry Strategy and a Global Strategy

42. When a company operates in the markets of two or more different countries, its foremost strategic issue is
   A) whether to use strategic alliances to help defeat its rivals.
   B) whether to vary the company’s competitive approach to fit specific market conditions and buyer preferences in each host country or whether to employ essentially the same strategy in all countries.
   C) whether to maintain a national (one-country) manufacturing base and export goods to the other countries.
   D) choosing which foreign companies to team up with via strategic alliances or joint ventures.
   E) whether to test the waters with an export strategy before committing to some other competitive approach.

   Answer: B Page: 220 Learning Objective: 3 Difficulty: Medium Taxonomy: Comprehension
   AACSB: Value Creation

43. A “think local, act local” multicountry type of strategy
   A) is very risky, given fluctuating exchange rates and the propensity of foreign governments to impose tariffs on imported goods.
   B) is usually defeated by a “think global, act global” type of strategy.
   C) becomes more appealing the bigger the country-to-country differences in buyer tastes, cultural traditions, and market conditions.
   D) is generally an inferior strategy when one or more foreign competitors is pursuing a global low-cost strategy.
   E) can defeat a global strategy if the “think local, act local” multicountry strategist concentrates its efforts exclusively in those foreign markets which have superior resources.

   Answer: C Page: 220 Learning Objective: 3 Difficulty: Medium Taxonomy: Comprehension
   AACSB: Value Creation
44. The strength of a “think local, act local” multicountry strategy is that
A) it matches a company’s competitive approach to prevailing market and competitive conditions in each country market, country by country.
B) each of a company’s country strategies is almost totally different from and unrelated to its strategies in other countries.
C) the plants located in different countries can be operated independent of one another, thus promoting greater achievement of scale economies.
D) it avoids host country ownership requirements and import quotas.
E) it eliminates the costs and burdens of trying to coordinate the strategic moves undertaken in one country with the moves undertaken in the other countries.

Answer: A

45. A “think local, act local” multicountry strategy works particularly well when
A) host governments enact regulations requiring that products sold locally meet strictly-defined manufacturing specifications or performance standards.
B) there are significant country-to-country differences in customer preferences and buying habits.
C) diverse and complicated trade restrictions of host governments preclude the use of a uniform strategy from country-to-country.
D) there are significant country-to-country differences in distribution channels and marketing methods.
E) All of the above.

Answer: E

46. A “think-local, act local” multicountry strategy entails
A) a narrow product line aimed at serving buyers in the same segments of country markets worldwide.
B) giving local managers considerable strategy-making latitude and often producing different product versions for different countries.
C) aggressive efforts to locate facilities in those country markets which have superior resources.
D) pursuing strong product differentiation and competing in many buyer segments.
E) extensive efforts to transfer a company’s competencies and resource strengths from one country to another so as to keep entry costs into new country markets low.

Answer: B

47. In which of the following situations is employing a “think local, act local” multicountry strategy highly questionable?
A) When a company wished to transfer competencies and resources across country boundaries and is striving to build a single, uniform competitive advantage worldwide
B) When there are significant country-to-country differences in customer preferences and buying habits industry is characterized by big economies of scale and strong experience curve effects
C) When the trade restrictions of host governments are diverse and complicated
D) When there are significant country-to-country differences in distribution channels and marketing methods
E) When host governments enact regulations requiring that products sold locally meet strictly-defined manufacturing specifications or performance standards

Answer: A
48. The drawbacks of a localized multicountry strategy include
   A) hindering the use of cross-border coordination of a company’s activities and increasing company vulnerability to adverse shifts in currency exchange rates.
   B) making it very difficult to take into account significant country-to-country differences in distribution channels and marketing methods.
   C) making it difficult and costly to be responsive to country-to-country differences in customer needs, buying habits, cultural traditions, and market conditions.
   D) hindering transfer of a company’s competencies and resources across country boundaries and hindering the pursuit of a single, uniform competitive advantage in all country markets where a company operates.
   E) being unsuitable for competing in the markets of emerging countries and posing added difficulty in modifying a company’s business model to compete on the basis of low price.

   **Answer:** D  Page: 222  Learning Objective: 3  Difficulty: Easy  Taxonomy: Comprehension
   AACSB: Value Creation

49. Two drawbacks of a “think local, act local” multicountry strategy are
   A) that it is especially vulnerable to fluctuating exchange rates and that it can usually be defeated by companies employing cross-border coordination techniques.
   B) excessive vulnerability to fluctuating exchange rates and having to craft a separate strategy for each country market in which the company competes.
   C) hindering a company’s transfer of competencies and resources across country boundaries (since somewhat different competencies and capabilities are likely to be employed in different host countries) and not promoting the building of a single, unified competitive advantage in all country markets where a company competes.
   D) greater exposure to both increases in tariffs and restrictive trade barriers and added difficulty in accommodating the diverse trade restrictions and regulatory requirements of host governments.
   E) not being able to export products manufactured in one country to markets in other countries and being largely unsuitable for competing in the markets of emerging countries.

   **Answer:** C  Page: 222  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

50. A “think global, act global” approach to strategy-making is preferable to a “think local, act local” approach when
   A) a big majority of the company’s rivals are pursuing localized multicountry strategies.
   B) country-to-country differences are small enough to be accommodated with the framework of a mostly uniform global strategy.
   C) plants need to be scattered across many countries to avoid high shipping costs.
   D) market growth rates vary considerably from country to country.
   E) host governments enact regulations requiring that products sold locally meet strict manufacturing specifications or performance standards.

   **Answer:** B  Page: 222  Learning Objective: 3  Difficulty: Easy  Taxonomy: Comprehension
   AACSB: Domestic/Global Economic Environments
51. Which of the following is the most unlikely element of a localized multicountry strategy?

A) Granting country managers fairly wide strategy-making latitude
B) Plants scattered across many host countries, each producing product versions for local area markets
C) Marketing and distribution adapted to the buying habits, customs, and culture of each host country
D) Preference for local suppliers (use of some local suppliers may be mandated by host governments)
E) Selling direct to buyers (perhaps via the company’s Web site) to avoid having to establish networks of wholesale/retail dealers in each country market

**Answer:** E   Page: 223   Learning Objective: 3   Difficulty: Easy   Taxonomy: Comprehension
AACSB: Value Creation

52. A “think global, act global” approach to crafting a global strategy involves

A) pursuing the same basic competitive strategy theme (low-cost, differentiation, best-cost, focused) in all countries where the firm does business.
B) selling much the same products under the same brand names everywhere and expanding into most, if not all, nations where there is significant buyer demand.
C) integrating and coordinating the company’s strategic moves worldwide.
D) utilizing the same competitive capabilities, distribution channels, and marketing approaches worldwide.
E) All of the above.

**Answer:** E   Page: 223   Learning Objective: 3   Difficulty: Easy   Taxonomy: Comprehension
AACSB: Value Creation

53. Which of the following is the most unlikely element of a “think global, act global” approach to crafting a global strategy?

A) Minimal responsiveness to buyer tastes, cultural traditions, and market conditions in each country market
B) Scattering plants across many countries, with each plant producing product versions for local area markets
C) Utilizing the same competitive capabilities, distribution channels, and marketing approaches worldwide
D) Requiring local managers in host countries to stick close to the chosen global strategy
E) Selling much the same products under same brand names worldwide

**Answer:** B   Page: 223   Learning Objective: 3   Difficulty: Easy   Taxonomy: Comprehension
AACSB: Value Creation

54. The approach of a firm using a “think global, act local” version of a global strategy entails

A) producing and marketing a variety of product versions under the same brand name, with each different version being designed specifically to accommodate the needs and preferences of buyers in a particular country.
B) little or no strategy coordination across countries.
C) pursuing the same basic competitive strategy theme (low-cost, differentiation, best-cost, focused) in all countries where the firm does business but giving local managers some latitude to adjust product attributes to better satisfy local buyers and to adjust production, distribution, and marketing to be responsive to local market conditions.
D) selling the company’s products under a wide variety of brand names (often one brand for each country or group of neighboring countries) so that buyers in each country market will think they are buying a locally-made brand.
E) selling numerous product versions (each customized to buyer tastes in one or more countries and sometimes branded for each country) but opting to only sell direct to buyers at the company’s Web site so as to bypass the costs of establishing networks of wholesale/retail dealers in each country market.

**Answer:** C   Page: 221-222   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation
55. The competitive strategy of a firm pursuing a “think global, act local” approach to strategy-making
A) entails little or no strategy coordination across countries.
B) usually involves cross-subsidizing the prices in those markets where there are significant country-to-
country differences in the product attributes that customers are most interested in.
C) involves selling a mostly standardized product worldwide, but varying a company’s use of distribution
channels and marketing approaches to accommodate local market conditions.
D) is essentially the same in all country markets where it competes but it may nonetheless give local
managers room to make minor variations where necessary to better satisfy local buyers and to better
match local market conditions.
E) involves having strongly differentiated product versions for different countries and selling them under
distinctly different brand names (one for each country or group of neighboring countries) so that there
will be no doubt in customers’ minds that the product is more local than global.

Answer: D   Page: 222   Learning Objective: 3   Difficulty: Easy   Taxonomy: Comprehension
AACSB: Value Creation

56. The essential difference between a “think global, act global” and a “think global, act local” approach to
strategy-making is that
A) a “think global, act global” approach entails extensive strategy coordination across countries and a
“think global, act local” approach entails little or no strategy coordination across countries.
B) the former aims at implementing the same business model worldwide whereas the latter aims at
implementing customized business models to better match local market circumstances.
C) the “think global, act local” approach gives local managers more latitude to make minor strategy
variations where necessary to better satisfy local buyers and to better match local market conditions.
D) a “think global, act global” approach involves selling a mostly standardized product worldwide whereas
a “think global, act local” approach entails selling products that are highly differentiated from country
to country.
E) a “think global, act global” approach involves selling under a single brand name worldwide whereas
a “think global, act local” approach entails utilizing multiple brands (typically one for each different
country or group of neighboring countries).

Answer: C   Page: 221-222   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

57. Which of the following does not accurately characterize the differences between a localized multicountry
strategy and a global strategy?
A) A global strategy entails extensive strategy coordination across countries and a multicountry strategy
entails little or no strategy coordination across countries.
B) A global strategy often entails use of the best suppliers from anywhere in the world whereas a
multicountry strategy may entail fairly extensive use of local suppliers (especially where use of local
sources is required by host governments).
C) A global strategy tends to involve use of similar distribution and marketing approaches worldwide
whereas a multicountry strategy often entails adapting distribution and marketing to local customs and
the culture of each country.
D) A global strategy involves striving to be the global low-cost provider by economically producing and
marketing a mostly standardized product worldwide whereas a multicountry strategy entails pursuing
broad differentiation and striving to strongly differentiate its products in one country from the products
it sells in other countries.
E) A global strategy relies upon the same technologies, competencies, and capabilities worldwide whereas
a multicountry strategy often entails the use of somewhat different technologies, competencies, and
capabilities as may be needed to accommodate local buyer tastes, cultural traditions, and market
conditions.

Answer: D   Page: 220-223   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation
The Quest for Competitive Advantage in Foreign Markets

58. In expanding outside its domestic market, one way a company can strive to gain competitive advantage (or offset domestic disadvantages) is by
A) using a differentiation-based competitive strategy in those country markets with superior resources
B) deliberately choosing not to compete in countries with high tariffs and high taxes (which then have to be passed along to buyers in the form of higher prices), thus keeping costs and prices lower than rivals.
C) using an export strategy to circumvent the risks of adverse exchange rate fluctuations.
D) using location in a manner that lowers costs or else helps achieve greater product differentiation and allowing for the transfer of competitively valuable competencies and capabilities from its domestic operations to its operations in foreign markets.
E) employing a multicountry strategy instead of a global strategy.

Answer: D  Page: 224  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

59. In expanding into foreign markets, a company can strive to gain competitive advantage (or offset domestic disadvantages) by
A) building a state-of-the-art facility to fully capture scale economies via an export strategy.
B) using export, licensing, or franchising strategies so as to minimize risk and capital investment.
C) locating buyer-related activities in all countries where it sells its product.
D) dispersing its activities among various countries in a manner that lowers costs or else helps achieve greater product differentiation and transferring competitively valuable competencies and capabilities from its domestic operations to its operations in foreign markets.
E) avoiding the use of strategies that entail coordinating its domestic strategic moves with its strategic moves in the various foreign markets that it enters.

Answer: D  Page: 224  Learning Objective: 4  Difficulty: Hard  Taxonomy: Comprehension
AACSB: Value Creation

60. Which one of the following is not one of the ways a company can strive to gain competitive advantage (or offset domestic disadvantages) by expanding into foreign markets?
A) By competing in both developed and emerging country markets and/or by selling direct to foreign buyers via the company’s Web site
B) By dispersing its activities among various countries in a manner that lowers costs.
C) By transferring competitively valuable competencies and capabilities from its domestic operations to its operations in foreign markets
D) By dispersing its activities among various countries in a manner that helps achieve greater product differentiation and, and/or working to deepen/broaden its resource strengths and capabilities
E) By using cross-border coordination of its strategic moves in ways that a domestic-only competitor cannot

Answer: A  Page: 224  Learning Objective: 4  Difficulty: Hard  Taxonomy: Comprehension
AACSB: Value Creation
Using Location to Build Competitive Advantage

61. To use location to build competitive advantage, a company that operates multinationally or globally must
   A) employ either an export strategy or a franchising strategy.
   B) scatter its production plants across many countries in different parts of the world so as to minimize transportation costs.
   C) consider (1) whether to concentrate each activity it performs in a few select countries or disperse performance of the activity to many nations and (2) in which countries to locate particular activities.
   D) locate production plants in those countries having suppliers that can supply all the necessary raw materials and components so as to avoid inbound shipping costs.
   E) concentrate all of its value chain activities in a single country—the one that has the best combination of low wage rates, low shipping costs, and low tax rates on profits.

   Answer: C   Page: 225   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

62. To use location to build competitive advantage when competing in both domestic and foreign markets, a company must
   A) scatter its production plants across many different country markets so as to minimize the costs of shipping to its own distribution centers and/or to wholesalers/retail dealers.
   B) consider (1) whether to concentrate each activity it performs in a few select countries or to disperse performance of the activity to many nations and (2) in which countries to locate particular activities.
   C) concentrate buyer-related activities in a few well-chosen locations so as to maximize the capture of distribution-related scale economies.
   D) disperse both production and distribution activities across many nations in order to hedge against fluctuating exchange rates and lessen the risks of adverse political developments.
   E) avoid selling in countries where there are high trade barriers or where buyers purchase in small quantities.

   Answer: B   Page: 225   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

63. In competing in foreign markets, companies find it advantageous to concentrate their activities in a limited number of locations when
   A) there are significant scale economies in performing an activity.
   B) the costs of manufacturing or other activities are significantly lower in some geographic locations than in others.
   C) when there is a steep learning or experience curve associated with performing an activity in a single location (thus making it economical to serve the whole world market from just one or maybe a few locations).
   D) certain locations have superior resources, allow better coordination of related activities, or offer other valuable advantages.
   E) All of the above.

   AACSB: Value Creation
64. In which of the following circumstances is it not advantageous for a multinational competitor to concentrate its activities in a limited number of locations in order to build competitive advantage?
A) When the costs of performing certain value chain activities are significantly lower in certain geographic locations than in others
B) When a company has competitively superior patented technology that it can license to foreign partners
C) When there is a steep learning or experience curve associated with performing an activity in a single location
D) When certain locations have superior resources, allow better coordination of related activities, or offer other valuable advantages
E) When there are significant scale economies in performing the activity

**Answer:** B   Page: 225-226   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

65. Dispersing the performance of value chain activities to many different countries rather than concentrating them in a few country locations tends to be advantageous
A) when high transportation costs make it expensive to operate from central locations.
B) whenever buyer-related activities are best performed in locations close to buyers.
C) if diseconomies of large size exist, thereby making it more economical to perform an activity on a smaller scale in several different locations.
D) when it is desirable to hedge against (1) the risks of fluctuating exchange rates, (2) supply interruptions or (3) adverse political developments.
E) All of the above.

**Answer:** E   Page: 226-227   Learning Objective: 4   Difficulty: Easy   Taxonomy: Comprehension
AACSB: Value Creation

66. The competitive advantage opportunities that a global competitor can gain by dispersing performance of its activities across many nations include
A) being able to shift production from one country to another to take advantage of exchange rate fluctuations, differing wage rates, differing energy costs, or differing trade restrictions.
B) being in better position to choose where and how to challenge rivals.
C) shortening delivery times to customers by having geographically scattered distribution facilities.
D) locating buyer-related activities (such as sales, advertising, after-sale service and technical assistance) close to buyers.
E) All of these.

**Answer:** E   Page: 226-227   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

67. Dispersing particular value chain activities across many countries rather than concentrating them in a select few countries can be more advantageous when
A) buyer-related activities (such as sales, advertising, after-sale service and technical assistance) need to take place close to buyers.
B) buyers demand short delivery times and/or high transportation costs make it uneconomical to operate from one or just a few locations.
C) it helps hedge against the risks of exchange rate fluctuations, supply disruptions, and adverse political developments.
D) there are diseconomies of scale in trying to operate from a single location.
E) All of these.

**Answer:** E   Page: 226-227   Learning Objective: 4   Difficulty: Easy   Taxonomy: Comprehension
AACSB: Value Creation
Using Cross Border Transfers of Competencies and Capabilities to Build Competitive Advantage

68. Transferring core competencies and resource strengths from one country market to another is
A) a good way for companies to develop broader or deeper competencies and competitive capabilities that can become a strong basis for sustainable competitive advantage.
B) best accomplished with a multicountry strategy as opposed to a global strategy.
C) feasible only with a global strategy; it can’t be done with a multicountry strategy.
D) unlikely to result in a competitive advantage.
E) nearly always the easiest and most sure-fire way to build competitive advantage in trying to compete successfully in foreign markets.

Answer: A Page: 227 Learning Objective: 4 Difficulty: Easy Taxonomy: Comprehension
AACSB: Value Creation

69. A key approach for a company to grow sales and profits in several country markets is to
A) transfer its valuable competencies and resource strengths among these markets to aid in the development of broader competencies and capabilities.
B) employ a multicountry strategy rather than a global strategy.
C) locate technical after-sale services close to buyers.
D) minimize transportation costs among these markets.
E) take advantage of less restrictive restrictions and requirements of host governments.

Answer: A Page: 227 Learning Objective: 4 Difficulty: Easy Taxonomy: Comprehension
AACSB: Value Creation

Strategies to Compete in the Markets of Emerging Countries

70. Companies racing for global market leadership
A) generally have to consider establishing competitive positions in the markets of emerging countries.
B) are well-advised to avoid all the risks and problems of competing in emerging country markets.
C) seldom have the resource capabilities it takes to be effective in competing in emerging country markets and usually are at a strong competitive disadvantage to the domestic market leaders.
D) can usually be expected to earn sizable profits quickly in emerging country markets.
E) usually encounter very low barriers in entering the markets of emerging countries.

Answer: A Page: 228 Learning Objective: 5 Difficulty: Hard Taxonomy: Comprehension
AACSB: Value Creation

71. Which of the following is not a typical option that companies have to consider to tailor their strategy to fit the circumstances of emerging country markets?
A) Prepare to compete on the basis of low price
B) Be prepared to modify aspects of the company’s business model to accommodate local circumstances (but not so much that the company loses the advantage of global scale and global branding)
C) Try to change the local market to better match the way the company does business elsewhere
D) Develop a strategy for the short-term and forget about a long-term strategy because conditions in emerging country markets change so rapidly
E) Stay away from those emerging markets where it is impractical or uneconomic to modify the company’s business model to accommodate local circumstances

AACSB: Value Creation
Chapter 7  Strategies for Competing in Foreign Markets

72. One of the most viable strategic options companies should consider in tailoring their strategy to fit circumstances of emerging country markets include
   A) Try to change the local market to better match the way the company does business elsewhere
   B) Be prepared to modify aspects of the company’s business model to accommodate local circumstances
   C) Prepare to compete on the basis of low price
   D) Stay away from those emerging markets where it is impractical to modify the company’s business model to accommodate local circumstances
   E) All of these

   Answer: E  Page: 230-231  Learning Objective: 5  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

Defending Against Global Giants: Strategies for Local Companies in Emerging Markets

73. The basic strategy options for local companies in competing against global challengers include
   A) best-cost provider, focused low cost, and low-cost leadership strategies.
   B) export strategies, licensing strategies, and cross-border transfer strategies.
   C) utilizing keen understanding of local customer needs and preferences to create customized products or services, developing business models to exploit shortcoming in local infrastructure, and using acquisitions and rapid growth to defend against expansion-minded multinationals
   D) franchising strategies, multicountry strategies keyed to product superiority, global low-cost leadership strategies, and cross-border coordination strategies.
   E) focused differentiation and broad differentiation strategies.

   Answer: C  Page: 232-233  Learning Objective: 5  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

74. The best strategy options for a local company in competing against global challengers include
   A) locating buyer related activities, such as sales, advertising, or technical assistance, close to buyers.
   B) export strategies, entering into alliances and/or joint ventures with one or more foreign companies having globally competitive strengths, and/or cross-border transfer strategies.
   C) export strategies, licensing strategies, franchising strategies, and cross-market coordination strategies.
   D) using understanding of local customer preferences to create customized products or services, transferring the company’s expertise to cross-border markets, and/or using acquisitions and rapid growth strategies to defend against expansion-minded multinationals
   E) offensives aimed at the global challengers’ strengths, promoting anti-dumping legislation, and/or launching some type of guerilla warfare strategy.

   Answer: D  Page: 224  Learning Objective: 5  Difficulty: Hard  Taxonomy: Comprehension
   AACSB: Value Creation
75. Which of the following is not a viable strategy option for a local company in competing against global challengers?

A) Using cross-market transfer strategies to hedge against the risks of exchange rate fluctuations and adverse political developments
B) Developing business models to exploit shortcoming in local distribution networks or infrastructure
C) Taking advantage of low-cost labor and other competitively important local work-force qualities
D) Transferring a company’s expertise to cross-border markets and initiating actions to contend on a global scale
E) Using acquisitions and rapid growth strategies to defend against expansion-minded multinationals

Answer: A  Page: 224  Learning Objective: 5  Difficulty: Hard  Taxonomy: Comprehension
AACSB: Value Creation

Short Answer Questions

76. Identify and briefly discuss the key reasons why a company may consider expanding outside its domestic market.

Page: 208  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Domestic/Global Economic Environments

77. Briefly identify the special features of competing in foreign markets.

AACSB: Domestic/Global Economic Environments

78. Explain how exchange rate fluctuations pose a risk to manufacturing companies who rely upon an export strategy to compete in foreign markets.

Page: 211-212  Learning Objective: 2  Difficulty: Hard  Taxonomy: Comprehension
AACSB: Domestic/Global Economic Environments

79. Identify and explain the significance of each of the following terms and concepts:
   a.) multicountry strategy
   b.) global strategy
   c.) export strategy
   d.) licensing strategy
   e.) franchising strategy

Page: 213 – 214; 215; 216  Learning Objective: 3  Difficulty: Medium  Taxonomy: Knowledge
AACSB: Value Creation

80. Discuss in some detail the difference between a multicountry strategy and a global strategy and give the pros and cons of each.

AACSB: Value Creation
81. What circumstances call for use of a multicountry strategy for competing in international markets? When is a global strategy “superior” to a multicountry strategy?

Page: 213-214   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Domestic/Global Economic Environments

82. Identify and briefly describe any four of the six generic strategic options for competing in foreign markets.

Page: 215   Learning Objective: 3   Difficulty: Medium   Taxonomy: Knowledge
AACSB: Value Creation

83. Compare and contrast the advantages for entering and competing in foreign markets for the strategic options of exporting, licensing, and franchising.

Page: 215-216   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

84. What are the pros and cons of using strategic alliances to try to enhance a company’s ability to compete in foreign markets?

Page: 216-219   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

85. Identify four things a company needs to consider or do if it is to make the most of strategic alliances with foreign partners.

Page: 216-217   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

86. Briefly discuss why a domestic company desirous of entering foreign markets might see attractive advantages in forming strategic alliances with foreign companies. What are the risks and disadvantages of such alliances?

Page: 216-219   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

87. A global strategy embraces the theme “think global, act global” whereas a multicountry strategy relies more on a “think global, act local” mentality. True or false? Explain.

Page: 220-223   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

88. Explain the differences between a “think global, act global” strategy and a “think global, act local” strategy.

Page: 221-222   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation
89. Explain why a company desirous of competing in foreign markets needs to pay careful attention to where it locates its value chain activities.

   AACSB: Value Creation

90. Under what circumstances is it advantageous for a company competing in foreign markets to concentrate its value chain activities in a select few locations?

   Page: 225-226   Learning Objective: 4   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Domestic/Global Economic Environments

91. Under what circumstances is it advantageous for a company competing in foreign markets to disperse certain value chain activities across many countries?

   Page: 226-227   Learning Objective: 4   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Domestic/Global Economic Environments

92. Discuss why a company desirous of competing in foreign country markets needs to pay close attention to the advantages of cross-border transfer of competencies and capabilities. Is such transfer often a key to competitive advantage? Why or why not?

   Page: 227   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

93. Identify and briefly describe the strategic options for tailoring a company’s strategy to compete in emerging country markets.

   Page: 230-231   Learning Objective: 5   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

94. Identify and briefly describe a local company’s strategic options in competing against global challengers.

   Page: 232-234   Learning Objective: 5   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
Multiple Choice Questions

The Four Facets of Crafting Corporate Strategy

1. The task of crafting corporate strategy for a diversified company encompasses
   A) picking the new industries to enter and deciding on the means of entry.
   B) initiating actions to boost the combined performance of the businesses the firm has entered.
   C) pursuing opportunities to leverage cross-business value chain relationships and strategic fits into competitive advantage.
   D) establishing investment priorities and steering corporate resources into the most attractive business units.
   E) All of these.

   Answer: E   Page: 239 - 240   Learning Objective: 1   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

2. Which one of the following is not one of the elements of crafting corporate strategy for a diversified company?
   A) Picking new industries to enter and deciding on the means of entry
   B) Choosing the appropriate value chain for each business the company has entered
   C) Pursuing opportunities to leverage cross-business value chain relationships and strategic fits into competitive advantage
   D) Establishing investment priorities and steering corporate resources into the most attractive business units
   E) Initiating actions to boost the combined performance of the businesses the firm has entered

   Answer: B   Page: 239 - 240   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

When to Diversify

3. Diversification merits strong consideration whenever a single-business company
   A) has integrated backward and forward as far as it can.
   B) is faced with diminishing market opportunities and stagnating sales in its principal business.
   C) has achieved industry leadership in its main line of business.
   D) encounters declining profits in its mainstay business.
   E) faces strong competition and is struggling to earn a good profit.

   Answer: B   Page: 241   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
4. Diversification becomes a relevant strategic option when a company
   A) spots opportunities to expand into industries whose technologies and products complement its present business.
   B) can leverage existing competencies and capabilities by expanding into industries where these same resource strengths are key success factors and valuable competitive assets.
   C) has a powerful and well-known brand name that can be transferred to the products of other businesses and thereby used as a lever for driving up the sales and profits of such businesses.
   D) can open up new avenues for reducing costs by diversifying into closely related businesses.
   E) All of these.

   **Answer:** E   Page: 241   Learning Objective: 1   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

5. Diversification ought to be considered when
   A) a company’s profits are being squeezed and it needs to increase its net profit margins and return on investment.
   B) a company lacks sustainable competitive advantage in its present business.
   C) a company begins to encounter diminishing growth prospects in its mainstay business.
   D) a company has run out of ways to achieve a distinctive competence in its present business.
   E) a company is under the gun to create a more attractive and cost-efficient value chain.

   **Answer:** C   Page: 241   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

6. Diversification becomes a relevant strategic option in all but which one of the following situations?
   A) When a company spots opportunities to expand into industries whose technologies and products complement its present business.
   B) When a company is only earning a low profit margin in its principal business.
   C) When a company has a powerful and well-known brand name that can be transferred to the products of other businesses and thereby used as a lever for driving up the sales and profits of such businesses.
   D) When a company can open up new avenues for reducing costs by diversifying into closely related businesses.
   E) When a company can leverage existing competencies and capabilities by expanding into industries where these same resource strengths are key success factors and valuable competitive assets.

   **Answer:** B   Page: 241   Learning Objective: 1   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

**Building Shareholder Value: The Ultimate Justification For Diversifying**

7. Diversifying into new businesses is justifiable only if it
   A) results in increased profit margins and bigger total profits.
   B) builds shareholder value.
   C) helps a company escape the rigors of competition in its present business.
   D) leads to the development of a greater variety of distinctive competencies and competitive capabilities.
   E) helps the company overcome the barriers to entering additional foreign markets.

   **Answer:** B   Page: 241 - 242   Learning Objective: 1   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation
8. To create value for shareholders via diversification, a company must
   A) get into new businesses that are profitable.
   B) diversify into industries that are growing rapidly.
   C) spread its business risk across various industries by only acquiring firms that are strong competitors in their respective industries.
   D) diversify into businesses that can perform better under a single corporate umbrella than they could perform operating as independent, stand-alone businesses.
   E) diversify into businesses that have either key success factors or value chains that are similar to its present businesses.

   **Answer:** D  Page: 242  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension  
   AACSB: Value Creation

9. The three tests for judging whether a particular diversification move can create value for shareholders are
   A) the attractiveness test, the profitability test, and the shareholder value test.
   B) the strategic fit test, the competitive advantage test, and the return on investment test.
   C) the resource fit test, the profitability test, and the shareholder value test.
   D) the attractiveness test, the cost-of-entry test, and the better-off test.
   E) the shareholder value test, the cost-of-entry test, and the profitability test.

   **Answer:** D  Page: 242  Learning Objective: 1  Difficulty: Hard  Taxonomy: Comprehension  
   AACSB: Value Creation

10. To test whether a particular diversification move has good prospects for creating added shareholder value, corporate strategists should use
    A) the profit test, the competitive strength test, the industry attractiveness test, and the capital gains test.
    B) the better-off test, the competitive advantage test, the profit expectations test, and the shareholder value test.
    C) the barrier to entry test, the competitive advantage test, the growth test, and the stock price effect test.
    D) the strategic fit test, the industry attractiveness test, the growth test, the dividend effect test, and the capital gains test.
    E) the attractiveness test, the cost of entry test, and the better-off test.

    **Answer:** E  Page: 242  Learning Objective: 1  Difficulty: Hard  Taxonomy: Comprehension  
    AACSB: Value Creation

11. The attractiveness test for evaluating whether diversification into a particular industry is likely to build shareholder value involves determining whether
    A) conditions in the target industry are sufficiently attractive to permit earning consistently good profits and returns on investment.
    B) the potential diversification move will boost the company’s competitive advantage in its existing business.
    C) shareholders will viewed the contemplated diversification move as attractive.
    D) key success factors in the target industry are attractive.
    E) there are attractive strategic fits between the value chains of the company’s present businesses and the value chain of the new business it is considering entering.

    **Answer:** A  Page: 242  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension  
    AACSB: Value Creation
12. The cost-of-entry test for evaluating whether diversification into a particular industry is likely to build shareholder value involves
A) determining whether a newly entered business presents opportunities to cost-efficiently transfer competitively valuable skills or technology from one business to another.
B) determining whether the cost to enter the target industry will strain the company’s credit rating.
C) considering whether a company’s costs to enter the target industry are low enough to allow for good profits or so high that potential profits would be eroded.
D) determining whether the cost to enter the target industry will raise or lower the company’s total profits.
E) determining whether the cost a company incurs to enter the target industry will raise or lower production costs.

Answer: C Page: 242 Learning Objective: 1 Difficulty: Medium Taxonomy: Comprehension
AACSB: Value Creation

13. The better-off test for evaluating whether a particular diversification move is likely to generate added value for shareholders involves
A) assessing whether the diversification move will make the company better off because it will produce a greater number of core competencies.
B) assessing whether the diversification move will make the company better off by improving its balance sheet strength and credit rating.
C) assessing whether the diversification move will make the company better off by spreading shareholder risks across a greater number of businesses and industries.
D) evaluating whether the diversification move will produce a 1 + 1 = 3 outcome such that the company’s different businesses perform better together than apart and the whole ends up being greater than the sum of the parts.
E) assessing whether the diversification move will benefit shareholders due to gains in earnings per share and faster stock price appreciation.

Answer: D Page: 242 Learning Objective: 1 Difficulty: Hard Taxonomy: Comprehension
AACSB: Value Creation

Strategies for Entering New Businesses

14. A company can best accomplish diversification into new industries by
A) outsourcing most of the value chain activities that have to be performed in the target business/industry.
B) acquiring a company already operating in the target industry, creating a new business subsidiary internally to compete in the target industry, or forming a joint venture with another company to enter the target industry.
C) integrating forward or backward into the target industry.
D) shifting from a strategic group comprised mostly of single-business companies to a strategic group comprised of diversified companies.
E) employing an offensive strategy with new product innovation as its centerpiece.

Answer: B Page: 242 Learning Objective: 1 Difficulty: Easy Taxonomy: Comprehension
AACSB: Value Creation
Acquisition of an Existing Business

15. The most popular strategy for entering new businesses and accomplishing diversification is
   A) forming a joint venture with another company to enter the target industry.
   B) internal startup.
   C) acquisition of an existing business already in the chosen industry.
   D) forming a strategic alliance with another company to enter the target industry.
   E) None of the above—strategic alliances and joint ventures are equally popular and rank well ahead of acquisition and internal start-up in terms of frequency of use.

   Answer: C   Page: 243   Learning Objective: 1   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

16. Acquisition of an existing business is an attractive strategy option for entering a promising new industry because it
   A) is an effective way to hurdle entry barriers, is usually quicker than trying to launch a brand-new start-up operation, and allows the acquirer to move directly to the task of building a strong position in the target industry.
   B) is less expensive than launching a new start-up operation, thus passing the cost-of-entry test.
   C) is a less risky way of passing the attractiveness test.
   D) is more likely to result in passing the shareholder value test, the profitability test, and the better-off test.
   E) offers the prospect of gaining an immediate competitive advantage in the new industry and thus helps ensure that the diversification move will pass the competitive advantage test for building shareholder value.

   Answer: A   Page: 243   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

Internal Start-Up

17. Internal start-up of a new business subsidiary can be a more attractive means of entering a desirable new business than is acquiring an existing firm already in the targeted industry when
   A) the company has ample time and adequate resources to launch the new internal start-up business from the ground up.
   B) there is a small pool of desirable acquisition candidates.
   C) the target industry is growing rapidly and no good joint venture partners are available.
   D) all of the potential acquisition candidates are losing money.
   E) the target industry is comprised of several relatively large and well-established firms.

   Answer: A   Page: 243   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
18. Which one of the following is *not* a factor that makes it appealing to diversify into a new industry by forming an internal start-up subsidiary to enter and compete in the target industry?

A) When internal entry is cheaper than entry via acquisition.

B) When a company possesses the skills and resources to overcome entry barriers and there is ample time to launch the business and compete effectively.

C) When adding new production capacity will not adversely impact the supply demand balance in the industry by creating oversupply conditions.

D) When the industry is growing rapidly and the target industry is comprised of several relatively large and well-established firms.

E) When incumbent firms are likely to be slow or ineffective in combating a new entrant’s efforts to crack the market.

*Answer:* D  Page: 243  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension  
AACS UB: Value Creation

19. Diversifying into a new industry by forming a new internal subsidiary to enter and compete in the target industry is attractive when

A) all of the potential acquisition candidates are losing money.

B) it is impractical to outsource most of the value chain activities that have to be performed in the target business/industry.

C) there is ample time to launch the new business from the ground up and entry barriers can be hurdled at acceptable cost.

D) the company has built up a hoard of cash with which to finance a diversification effort.

E) none of the companies already in the industry are attractive strategic alliance partners.

*Answer:* C  Page: 243  Learning Objective: 1  Difficulty: Easy  Taxonomy: Comprehension  
AACS UB: Value Creation

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**Joint Ventures**

20. A joint venture is an attractive way for a company to enter a new industry when

A) a firm is missing some essential skills or capabilities or resources and needs a partner to supply the missing expertise and competencies or fill the resource gaps.

B) it needs access to economies of scope and good financial fits in order to be cost-competitive.

C) it is uneconomical for the firm to achieve economies of scope on its own initiative.

D) the firm has no prior experience with diversification.

E) it has not built up a hoard of cash with which to finance a diversification effort.

*Answer:* A  Page: 243 - 244  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension  
AACS UB: Value Creation

21. A joint venture is an attractive way for a company to enter a new industry when

A) the pool of attractive acquisition candidates in the target industry is relatively small.

B) it needs better access to economies of scope in order to be cost-competitive.

C) the industry is growing slowly and adding too much capacity too soon could create oversupply conditions.

D) the firm has no prior experience with diversification and the industry is on the verge of explosive growth.

E) the opportunity is too risky or complex for a company to pursue alone, a company lacks some important resources or competencies and needs a partner to supply them, and/or a company needs a local partner in order to enter a desirable business in a foreign country.

*Answer:* E  Page: 243 - 244  Learning Objective: 1  Difficulty: Easy  Taxonomy: Comprehension  
AACS UB: Value Creation

The Case for Diversifying into Related Businesses

22. The essential requirement for different businesses to be “related” is that
A) their value chains possess competitively valuable cross-business relationships.
B) the products of the different businesses are bought by much the same types of buyers.
C) the products of the different businesses are sold in the same types of retail stores.
D) the businesses have several key suppliers in common.
E) the productions methods that they employ both entail economies of scale.

Answer: A  Page: 244  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

23. Which of the following is an important appeal of a related diversification strategy?
A) Related diversification is an effective way of capturing valuable financial fit benefits.
B) Related diversification offers more competitive advantage potential than does unrelated diversification.
C) Related diversification offers significant opportunities to strongly differentiate a company’s product offerings from those of rivals.
D) Related diversification is more likely to pass the cost-of-entry test and the capital gains test than unrelated diversification.
E) Related diversification is typically more profitable than unrelated diversification, which is a major factor in helping related diversification pass the attractiveness test.

Answer: B  Page: 244  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

24. Businesses are said to be “related” when
A) they have several key suppliers and several key customers in common.
B) their value chains have the same number of primary activities.
C) their products are both sold through retailers.
D) their value chains possess competitively valuable cross-business relationships that present opportunities to transfer resources from one business to another, combine similar activities and reduce costs, share use of a well-known brand name, and/or create mutually useful resource strengths and capabilities.
E) many consumers buy the products/services of both businesses.

Answer: D  Page: 244 - 245  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

25. Which of the following is not one of the appeals of related diversification?
A) It can offer opportunities for transferring expertise, technology, and other capabilities from one business to another.
B) It can offer opportunities for reducing costs and for leveraging use of a competitively powerful brand name.
C) Related diversification is particularly well-suited for the use of first-mover strategies and capturing valuable financial fits.
D) It may present opportunities for cross-business collaboration to create valuable new competencies and capabilities.
E) The relatedness among the different businesses provides sharper focus for managing diversification and a useful degree of strategic unity across the company’s various business activities.

Answer: C  Page: 244 - 245  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation
26. Strategic fit between two or more businesses exists when one or more activities comprising their respective value chains present opportunities
   A) to transfer expertise or technology or capabilities from one business to another.
   B) for cross-business use of a common brand name.
   C) to lower costs by combining the performance of the related value chain activities of different businesses.
   D) for cross-business collaboration to build valuable new resource strengths and competitive capabilities.
   E) All of these.

   **Answer:** E  Page: 244 - 245  Learning Objective: 2  Difficulty: Easy  Taxonomy: Comprehension  
   AACSB: Value Creation

27. One strategic fit-based approach to related diversification would be to
   A) diversify into new industries that present opportunities to transfer competitively valuable expertise, technological know-how, or other capabilities from one business to another.
   B) diversify into those industries where the same kinds of driving forces and competitive forces prevail, thus allowing use of much the same competitive strategy in all of the business a company is in.
   C) acquire rival firms that have broader product lines so as to give the company access to a wider range of buyer groups.
   D) acquire companies in forward distribution channels (wholesalers and/or retailers).
   E) expand into foreign markets where the firm currently does no business.

   **Answer:** A  Page: 244 - 245  Learning Objective: 2  Difficulty: Easy  Taxonomy: Comprehension  
   AACSB: Value Creation

28. A company pursuing a related diversification strategy would likely address the issue of what additional industries/businesses to diversify into by
   A) locating businesses with well-known brand names and large market shares.
   B) identifying industries with the least competitive intensity.
   C) identifying an attractive industry whose value chain has good strategic fit with one or more of the firm’s present businesses.
   D) identifying businesses with the potential to diversify the number and types of different activities in the firm’s value chain make-up.
   E) locating new businesses with high degrees of financial fit with its present businesses.

   **Answer:** C  Page: 246  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension  
   AACSB: Value Creation

**Identifying Cross-Business Strategic Fits Along the Value Chain**

29. The best place to look for cross-business strategic fits is
   A) in R&D and technology activities.
   B) in supply chain activities.
   C) in sales and marketing activities.
   D) in production and distribution activities.
   E) anywhere along the respective value chains of related businesses—no one place is best.

   **Answer:** E  Page: 246  Learning Objective: 2  Difficulty: Easy  Taxonomy: Comprehension  
   AACSB: Value Creation
30. Cross-business strategic fits can be found
   A) in unrelated as well as related businesses and in the markets of foreign countries as well as in domestic markets.
   B) only in businesses whose products/services satisfy the same general types of buyer needs and preferences.
   C) mainly in either technology related activities or sales and marketing activities.
   D) chiefly in the R&D portions of the value chains of unrelated businesses
   E) anywhere along the respective value chains of related businesses.

   Answer: E   Page: 246   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

31. Which of the following statements about cross-business strategic fit in a diversified enterprise is not accurate?
   A) Strategic fit between two businesses exists when the management know-how accumulated in one business is transferable to the other.
   B) Strategic fit exists when two businesses present opportunities to economize on marketing, selling, and distribution costs.
   C) Competitively valuable cross-business strategic fits are what enable related diversification to produce a 1 + 1 = 3 performance outcome.
   D) Strategic fit is primarily a byproduct of unrelated diversification and exists when the value chain activities of unrelated businesses possess economies of scope and good financial fit.
   E) Strategic fit exists when a company can transfer its brand name reputation to the products of a newly acquired business and add to the competitive power of the new business.

   Answer: D   Page: 244 - 246   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

### Strategic Fit, Economies of Scope, and Competitive Advantage

32. What makes related diversification an attractive strategy is
   A) the ability to broaden the company’s product line.
   B) the opportunity to convert cross-business strategic fits into competitive advantages over business rivals whose operations don’t offer comparable strategic fit benefits.
   C) the potential for improving the stability of the company’s financial performance.
   D) the ability to serve a broader spectrum of buyer needs.
   E) the added capability it provides in overcoming the barriers to entering foreign markets.

   Answer: B   Page: 249   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

33. Economies of scope
   A) are cost reductions that flow from operating in multiple related businesses.
   B) arise only from strategic fit relationships in the production portions of the value chains of sister businesses.
   C) are more associated with unrelated diversification than related diversification.
   D) are present whenever diversification satisfies the attractiveness test and the cost-of-entry test.
   E) arise mainly from strategic fit relationships in the distribution portions of the value chains of unrelated businesses.

   Answer: A   Page: 250   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
34. Economies of scope
   A) stem from the cost-saving efficiencies of operating over a wider geographic area.
   B) have to do with the cost-saving efficiencies of distributing a firm’s product through many different
      distribution channels simultaneously.
   C) stem from cost-saving strategic fits along the value chains of related businesses.
   D) refer to the cost-savings that flow from operating across all or most of an industry’s value chain
      activities.
   E) arise from the cost-saving efficiencies of having a wide product line and offering customers a big
      selection of models and styles to choose from.

   Answer: C   Page: 250   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

35. Which of the following best illustrates an economy of scope?
   A) Being able to eliminate or reduce costs by combining related value-chain activities of different
      businesses into a single operation
   B) Being able to eliminate or reduce costs by performing all of the value chain activities of related sister
      businesses at the same location
   C) Being able to eliminate or reduce costs by extending the firm’s scope of operations over a wider
      geographic area
   D) Being able to eliminate or reduce costs by expanding the size of a company’s manufacturing plants
   E) Being able to eliminate or reduce costs by having more value chain activities performed in-house
      rather than outsourcing them

   Answer: A   Page: 250   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

36. A big advantage of related diversification is that
   A) it offers ways for a firm to realize \(1 + 1 = 3\) benefits because the value chains of the different businesses
      present competitively valuable cross-business relationships.
   B) it is less capital intensive and usually more profitable than unrelated diversification.
   C) it involves diversifying into industries having the same kinds of key success factors.
   D) it is less risky than either vertical integration or unrelated diversification due to lower capital
      requirements.
   E) it passes the industry attractiveness test and thus offers the best route to \(2 + 2 = 4\) benefits.

   Answer: A   Page: 250   Learning Objective: 2   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

37. A diversified company that leverages the strategic fits of its related businesses into competitive advantage
   A) has a distinctive competence in its related businesses.
   B) has a clear path to achieving \(1 + 1 = 3\) gains in shareholder value.
   C) has a clear path to global market leadership in the industries where it has related businesses.
   D) passes the value chain test and the profit expectations test for building shareholder value.
   E) achieves economies of scope and passes the reduced-costs test for crafting a diversification strategy
      capable of creating added shareholder value.

   Answer: B   Page: 250   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
The Case for Diversifying into Unrelated Businesses

38. A strategy of diversifying into unrelated businesses
   A) is aimed at achieving good financial fit (whereas related diversification aims at good strategic fit).
   B) is the best way for a company to pass the attractiveness test in choosing which types of businesses/industries to enter.
   C) discounts the importance of strategic fit benefits and instead focuses on building and managing a group of businesses capable of delivering good financial performance irrespective of the industries these businesses are in.
   D) concentrates on diversifying into businesses where a company can leverage use of a well-known brand name in ways that create added value for shareholders.
   E) generally offers more competitive advantage potential than related diversification.

   Answer: C   Page: 250   Learning Objective: 3   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

39. The basic premise of unrelated diversification is that
   A) the least risky way to diversify is to seek out businesses that are leaders in their respective industry.
   B) the best companies to acquire are those that offer the greatest economies of scope rather than the greatest economies of scale.
   C) the best way to build shareholder value is to acquire businesses with strong cross-business financial fit.
   D) any company that can be acquired on good financial terms and that has satisfactory growth and earnings potential represents a good acquisition and a good business opportunity.
   E) the task of building shareholder value is better served by seeking to stabilize earnings across the entire business cycle than by seeking to capture cross-business strategic fits.

   Answer: D   Page: 251   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

40. In diversified companies with unrelated businesses, the strategic attention of top executives tends to be focused on
   A) screening acquisition candidates and evaluating the pros and cons of keeping or divesting existing businesses.
   B) identifying acquisition candidates that can pass the better-off test.
   C) identifying opportunities to achieve greater economies of scope.
   D) identifying opportunities to acquire businesses that can benefit from using the parent company’s potent brand name.
   E) identifying acquisition candidates that can pass the capital gains test

   Answer: A   Page: 251   Learning Objective: 3   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation
41. Which of the following is not likely to command much strategic attention from the top executives of companies pursuing an unrelated diversification strategy?
   A) Acquiring new businesses with attractive profit prospects
   B) Whether existing businesses should be retained or divested based on their ability to meet corporate targets for profit and returns on investment
   C) Looking for new businesses that present good opportunities for achieving economies of scope
   D) Identifying acquisition candidates that are financially distressed, can be acquired at a bargain price, and whose operations can, in management’s opinion, be turned around with the aid of the parent company’s financial resources and managerial know-how
   E) Identifying opportunities to acquire new businesses in industries with bright growth prospects

   **Answer:** C  Page: 251 - 252  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

42. A key issue in companies pursuing an unrelated diversification strategy is
   A) how wide a net to cast in building a portfolio of unrelated businesses.
   B) whether to keep or divest businesses whose technological approaches do not match the overall technology and R&D strategy of the corporation.
   C) how quickly to divest businesses whose competitive strategies do not closely match the competitive strategies of sister businesses.
   D) whether to build shareholder value via paying higher dividends or via actions aimed at increasing the company’s stock price.
   E) whether to acquire new businesses that offer potential for achieving greater economies of scope or businesses that offer potential for achieving greater economies of scale.

   **Answer:** A  Page: 252  Learning Objective: 3  Difficulty: Easy  Taxonomy: Comprehension
   AACSB: Value Creation

43. With an unrelated diversification strategy, the types of companies that make particularly attractive acquisition targets are
   A) struggling companies with good turnaround potential, undervalued companies that can be acquired at a bargain price, and companies that have bright growth prospects but are short on investment capital.
   B) companies offering the biggest potential to reduce labor costs.
   C) cash cow businesses with excellent financial fit.
   D) companies that are market leaders in their respective industries.
   E) companies that are employing the same basic type of competitive strategy as the parent corporation’s existing businesses.

   **Answer:** A  Page: 252  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation
The Merits of an Unrelated Diversification Strategy

44. The success of unrelated diversification is dependent upon management’s ability to
A) acquire new businesses that utilize much the same technology as existing businesses.
B) divest businesses whose competitive strategies do not match the overall competitive strategy of the corporation.
C) acquire new businesses having attractive distribution-related and customer-related strategic fits with existing businesses.
D) spotting bargain-priced companies with big upside potential and then turning around their operations quickly with the aid of the parent company’s financial resources and managerial know-how.
E) identify potential new acquisition candidates that are cash cows (as opposed to cash hogs).

**Answer:** D   Page: 252   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

45. One appealing aspect of unrelated diversification is that it
A) expands a firm’s competitive advantage opportunities to include a wider array of businesses.
B) spreads the business risk across a group of truly diverse industries.
C) increases strategic fit opportunities and the potential for a 1 + 1 = 3 outcome on the bottom line.
D) results in having more cash cow businesses than cash hog businesses.
E) facilitates capturing the financial fits among sister businesses (as compared to a strategy of related diversification).

**Answer:** B   Page: 252   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

46. Which of the following is _not_ one of the appeals of an unrelated diversification strategy?
A) The ability to spread business risk over truly diverse industries (as compared to related diversification which is limited to spreading risk only among businesses with strategic fit)
B) An ability to employ the company’s financial resources to maximum advantage by investing in whatever industries/businesses offer the best profit prospects
C) Superior top management ability to cope with the wide variety of problems encountered in managing a broadly diversified group of businesses
D) A potential for achieving somewhat more stable corporate sales and profits over the course of economic upswings and downswings (to the extent the company diversifies into businesses whose ups and downs tend to occur at different times)
E) The potential to grow shareholder value by investing in bargain-priced or struggling companies with big upside profit potential, turning their operations around fairly quickly with infusions of cash and managerial know-how, and then riding the crest of higher profitability

**Answer:** C   Page: 252 - 253   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation
Chapter 8  Diversification—Strategies for Managing a Group of Businesses

The Drawbacks of Unrelated Diversification

47. The two biggest drawbacks or disadvantages of unrelated diversification are
A) the difficulties of passing the cost-of-entry test and the ease with which top managers can make the mistake of diversifying into businesses where competition is too intense.
B) the difficulties of capturing financial fit and having insufficient financial resources to spread business risk across many different lines of business.
C) demanding managerial requirements and limited competitive advantage potential that cross-business strategic fit provides.
D) ending up with too many cash hog businesses and too much diversity among the competitive strategies of the businesses it has diversified into.
E) the difficulties of achieving economies of scope and conflicts/incompatibility among the competitive strategies of the company’s different businesses.

Answer: C  Page: 254  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

48. The two biggest drawbacks or disadvantages of unrelated diversification are
A) underemphasizing the importance of resource fit and the strong likelihood of diversifying into businesses that top management does not know all that much about.
B) insufficient cash flows to finance so many different lines of business and a lack of uniformity among the strategies of the businesses it has diversified into.
C) volatile sales and profits and making the mistake of diversifying into too many cash cow businesses.
D) the difficulties of competently managing many different businesses and being without the added source of competitive advantage that cross-business strategic fit provides.
E) over-investing in the achievement of economies of scope and the difficulties of achieving a good mix of cash cow and cash hog businesses.

Answer: D  Page: 255  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

49. Which of the following is not among the disadvantages and managerial problems encountered by companies pursuing unrelated diversification strategies?
A) Knowing so little about the industries in which each business competes, that management is unable to properly evaluate strategic proposals put forth by business-unit managers
B) Being too unfamiliar with the issues and problems facing each subsidiary to effectively pick business-unit heads having the requisite combination of managerial skills and know-how
C) The strain it places on corporate-level management in trying to stay on top of fresh industry developments and the strategic progress and plans of each business subsidiary
D) Ending up with too many cash hog businesses (as compared to related diversification strategies where cash hog businesses are rare)
E) The potential that corporate management will not know how to bail a business subsidiary that runs into deep trouble—because the company has diversified into businesses that corporate management has little experience or expertise in running

Answer: D  Page: 255  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation
50. In companies pursuing a strategy of unrelated diversification,
   A) the main basis for competitive advantage and improved shareholder value is increased ability to achieve economies of scope.
   B) each business is on its own in trying to build a competitive edge and the consolidated performance of the businesses is likely to be no better than the sum of what the individual businesses could achieve if they were independent.
   C) there is a strong chance that the combined competitive advantages of the various businesses will produce a $1 + 1 = 3$ performance outcome as opposed to just a $1 + 1 = 2$ performance outcome.
   D) the main basis for improved shareholder value is strong cross-business financial fits.
   E) the main basis for improved shareholder value is increased ability to achieve economies of scale in the businesses it has entered.

   Answer: B   Page: 256   Learning Objective: 3   Difficulty: Hard   Taxonomy: Comprehension
   AACSB: Value Creation

Evaluating the Strategy of a Diversified Company

51. To identify a diversified company’s strategy, one should consider such factors as
   A) the extent to which the firm is broadly or narrowly diversified, whether it is pursuing related or unrelated diversification (or a mixture of both), and the recent moves it has made to divest businesses, acquire new businesses, and strengthen the positions of existing businesses.
   B) whether the company is focusing on “milking its cash cows” or “feeding its cash hogs.”
   C) the technological proficiencies, labor skill requirements, and functional area strategies characterizing each of the firm’s businesses.
   D) each business’s competitive approach—whether it is pursuing a low-cost leadership, differentiation, best-cost, focused differentiation, or focused low-cost strategy.
   E) whether it is emphasizing the pursuit of economies of scale or economies of scope.

   Answer: A   Page: 257   Learning Objective: 1   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation

52. When identifying a diversified company’s present corporate strategy, which of the following would not be something to look for?
   A) Recent moves to build positions in new industries
   B) The company’s approach to allocating investment capital and resources across its present businesses
   C) Recent management actions to strengthen the company’s positions in existing businesses
   D) Recent moves to divest weak or unattractive business units
   E) Actions over the past few years to substitute global strategies for multi-country strategies in one or more business units

   Answer: E   Page: 257   Learning Objective: 1   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Value Creation
53. The procedure for evaluating the pluses and minuses of a diversified company’s strategy includes

A) assessing the attractiveness of the industries the company has diversified into.
B) assessing the competitive strength of each business the company has diversified into to see which ones are the strongest/weakest contenders in their respective industries.
C) ranking the performance prospects of the various businesses from best to worst and determining the priorities for resource allocation.
D) checking the competitive advantage potential of cross-business strategic fits and also checking whether the firm’s resources fit the needs of its present business lineup.
E) All of the above.

**Answer:** E Page: 257 - 258 Learning Objective: 4 Difficulty: Easy Taxonomy: Comprehension AACSB: Value Creation

54. Which of the following is *not* a major consideration in evaluating the pluses and minuses of a diversified company’s strategy?

A) Checking whether the company’s resources fit the requirements of its present business lineup
B) Scrutinizing each industry/business to determine where driving forces are strongest/weakest and how many profitable strategic groups the company has diversified into
C) Ranking the performance prospects of the various businesses from best to worst and determining what the corporate parent’s priorities should be in allocating resources to its different businesses
D) Checking the competitive advantage potential of cross-business strategic fits
E) Assessing the competitive strength of each business the company has diversified into and determining which ones are strong/weak contenders in their respective industries

**Answer:** B Page: 257 - 258 Learning Objective: 4 Difficulty: Medium Taxonomy: Comprehension AACSB: Value Creation

55. A comprehensive evaluation of the group of businesses a company has diversified into involves

A) evaluating the attractiveness of industries the company has diversified into and the competitive strength of each of its business units.
B) evaluating the strategic fits and resource fits among the various sister businesses.
C) ranking the performance prospects of the businesses from best to worst and determining what the corporate parent’s priorities should be in allocating resources to its various businesses.
D) using the results of the prior analytical steps as a basis for crafting new strategic moves to improve the company’s overall performance.
E) All of the above.

**Answer:** E Page: 257 - 258 Learning Objective: 4 Difficulty: Easy Taxonomy: Comprehension AACSB: Value Creation

56. Evaluating a diversified company’s corporate strategy and critiquing the pluses and minuses of its business lineup involves

A) a SWOT analysis of each industry in which the firm has a business interest.
B) applying the cost-of-entry test, the better-off test, the profitability test, and the shareholder value test to each business and industry represented in the company’s business portfolio.
C) evaluating the strategic fits and resource fits among the various sister businesses and deciding what priority to give each of the company’s business units in allocating resources.
D) looking at each industry/business to determine how many profitable strategic groups that the company has diversified into.
E) determining how many of the business units are following focus strategies, differentiation strategies, best-cost provider strategies, and low-cost leadership strategies.

**Answer:** C Page: 257 - 258 Learning Objective: 4 Difficulty: Medium Taxonomy: Comprehension AACSB: Value Creation
57. Which one of the following is not an important aspect of evaluating the merits of a diversified company’s strategy?
A) Assessing the competitive strength of each business the company has diversified into
B) Determining which business units are cash cows and which ones are cash hogs and then evaluating how soon the company’s cash hogs can be transformed into cash cows
C) Evaluating the strategic fits and resource fits among the various sister businesses
D) Assessing the attractiveness of the industries the company has diversified into, both individually and as a group
E) Ranking the performance prospects of the businesses from best to worst and deciding what priority to give each of the company’s business units in allocating resources

**Answer:** B  Page: 257 - 258  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation

### Step 1: Evaluating Industry Attractiveness

58. In judging the attractiveness of the businesses a multi-business company has diversified into, it is important to
A) consider whether each industry the company has diversified into represents a good business for the company to be in.
B) calculate industry attractiveness scores for each industry into which the company has diversified.
C) consider the appeal of the whole group of industries in which the company has invested.
D) consider to what extent the industries a company has invested in hold promise for attractive growth and profitability.
E) All of the above

**Answer:** E  Page: 258  Learning Objective: 4  Difficulty: Easy  Taxonomy: Comprehension  
AACSB: Value Creation

59. As a rule, all the industries represented in a diversified company’s business portfolio should be judged on such attractiveness factors as
A) market size and projected growth rate.
B) emerging opportunities and threats, the intensity of competition, and the degree of industry uncertainty and business risk.
C) resource requirements and the presence of cross-industry strategic fits.
D) seasonal and cyclical factors, industry profitability, and whether an industry has significant social, political, regulatory, and environmental problems.
E) All of these.

**Answer:** E  Page: 258 - 259  Learning Objective: 4  Difficulty: Easy  Taxonomy: Comprehension  
AACSB: Value Creation
60. Which of the following is not generally something that ought to be considered in evaluating the attractiveness of a diversified company’s business makeup?
A) Market size and projected growth rate, industry profitability, and the intensity of competition
B) Industry uncertainty and business risk
C) The frequency with which strategic alliances and collaborative partnerships are used in each industry, the extent to which firms in the industry utilize outsourcing, and whether the industries a company has diversified into have common key success factors
D) Seasonal and cyclical factors, resource requirements, and whether an industry has significant social, political, regulatory, and environmental problems
E) The presence of cross-industry strategic fits

Answer: C   Page: 258 - 259   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

61. Assessments of the long-term attractiveness of each industry represented in a diversified company’s lineup of businesses should be based on
A) a complete value-chain analysis of each industry.
B) whether the industries have the same kinds of driving forces.
C) how many companies in each industry are making money and how many are losing money.
D) quantitative industry attractiveness scores derived from rating each industry on several relevant attractiveness measures (weighted according to their relative importance in determining overall attractiveness).
E) the competitive advantage potential offered by each industry’s key success factors.

Answer: D   Page: 259 - 260   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

62. Calculating quantitative attractiveness ratings for the industries a company has diversified into involves
A) determining each industry’s key success factors, calculating the ability of the company to be successful on each industry KSF, and obtaining overall measures of the firm’s ability to compete successfully in each of its industries based on the combined KSF ratings.
B) determining each industry’s competitive advantage factors, calculating the ability of the company to be successful on each competitive advantage factor, and obtaining overall measures of the firm’s ability to achieve sustainable competitive advantage in each of its industries based on the combined competitive advantage factor ratings.
C) selecting a set of industry attractiveness measures, weighting the importance of each measure, rating each industry on each attractiveness measure, multiplying the industry ratings by the assigned weight to obtain a weighted rating, adding the weighted ratings for each industry to obtain an overall industry attractiveness score, and using the overall industry attractiveness scores to evaluate the attractiveness of all the industries, both individually and as a group.
D) rating the attractiveness of each industry’s strategic and resource fits, summing the attractiveness scores, and determining whether the overall scores for the industries as a group are appealing or not.
E) identifying each industry’s average profitability, rating the difficulty of achieving average profitability in each industry, and deciding whether the company’s prospects for above-average profitability are attractive or unattractive, industry-by-industry.

AACSB: Value Creation
63. The chief purpose of calculating quantitative industry attractiveness scores for each industry a company has diversified into is to
   A) determine which industry is the biggest and fastest growing.
   B) get in position to rank the industries from most competitive to least competitive.
   C) provide a basis for drawing analysis-based conclusions about the attractiveness of the industries a company has diversified into, both individually and as a group, and further to provide an indication of which industries offer the best and worst long-term prospects.
   D) ascertain which industries have the easiest-to-achieve key success factors.
   E) rank the attractiveness of the various industry value chains from best to worst.

   Answer: C   Page: 258 - 259   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

64. A weighted industry attractiveness assessment is generally analytically superior to an unweighted assessment because
   A) a weighted ranking identifies which industries offer the best/worst long-term profit prospects.
   B) an unweighted ranking doesn’t discriminate between strong and weak industry driving forces and industry competitive forces.
   C) it does a more accurate job of singling out which industry key success factors are the most important.
   D) an unweighted ranking doesn’t help identify which industries have the easiest and hardest value chains to execute.
   E) the various measures of attractiveness are not likely to be equally important in determining overall attractiveness.

   Answer: E   Page: 259   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

65. When industry attractiveness ratings are calculated for each of the industries a multi-business company has diversified into, the results help indicate
   A) which industries appear to be the best and worst ones to be in and the attractiveness of all the industries as a group from the standpoint of the company’s long-term performance.
   B) which industries have attractive key success factors and which industries have unattractive key success factors.
   C) which industries have the biggest economies of scale and which industries have the greatest economies of scope and the overall potential for cost reduction in the industries as a group.
   D) which industries are most attractive from the standpoint of long-term growth and the growth prospects of all the industries as a group.
   E) which industries are most attractive from the standpoint of industry driving forces and competitive forces.

   Answer: A   Page: 260   Learning Objective: 4   Difficulty: Hard   Taxonomy: Comprehension
   AACSB: Value Creation
66. Calculating quantitative attractiveness ratings for the industries a diversified company has invested in
A) allows a company to rank the competitive advantage opportunities in each industry from best to worst.
B) helps identify which industries have the best/worst prospects for revenue growth.
C) identifies which industry has the best/worst value chain from the standpoint of cost reduction potential.
D) provides a basis for deciding whether a diversified company has good prospects for growth and profitability, given the attractiveness ratings of the industries in which it has business interests.
E) helps identify which industry is likely to be the largest/smallest contributor to the company’s growth and profitability.

Answer: D  Page: 260  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

Step 2: Evaluating Business-Unit Competitive Strength

67. The basic purpose of calculating competitive strength scores for each of a diversified company’s business units is to
A) rank the business unit from best to worst in terms of potential for cost reduction and profit margin improvement.
B) determine how strongly positioned each business unit is in its industry.
C) determine which business unit has the greatest number of resource strengths, competencies, and competitive capabilities and which one has the least.
D) determine which one has the biggest market share and is growing the fastest.
E) rank each business unit’s strategy from best to worst.

Answer: B  Page: 261  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

68. Assessments of how a diversified company’s subsidiaries compare in competitive strength should be based on such factors as
A) vulnerability to seasonal and cyclical downturns, vulnerability to driving forces, and vulnerability to fluctuating interest rates and exchange rates.
B) relative market share, ability to match or beat rivals on key product attributes, brand image and reputation, costs relative to competitors, and ability to benefit from strategic fits with sister businesses.
C) the appeal of its strategy, relative number of competitive capabilities, the number of products in each businesses product line, which businesses have the highest/lowest market shares, and which businesses earn the highest/lowest profits before taxes.
D) the ability to hurdle barriers to entry, value chain attractiveness, and business risk.
E) cost reduction potential, customer satisfaction potential, and comparisons of annual cash flows from operations.

Answer: B  Page: 261 - 262  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation
69. Relative market share is
   A) calculated by dividing a business’s percentage share of total industry sales volume by the percentage share held by its largest rival—it is a better indicator of a business’s competitive strength than is a simple percentage measure of market share.
   B) calculated by adjusting a company’s dollar market share up or down in proportion to whether the company’s quality and customer service are above/below industry averages.
   C) calculated by dividing a company’s market share (based on dollar volume) by the industry-average market share.
   D) particularly useful in identifying cash cows and cash hogs—cash cow businesses have big relative market shares (above 1.0) and cash hog businesses have low relative market shares (below 0.5).
   E) calculated by subtracting the industry-average market share (based on dollar volume) from a company’s market share to determine how much a company’s market share is above/below the industry average—this amount is a better indicator of a business’s competitive strength than is just looking at the firm’s market share percentage.

   **Answer:** A   Page: 261   Learning Objective: 4   Difficulty: Hard   Taxonomy: Knowledge
   AACSB: Value Creation

70. Calculating quantitative competitive strength ratings for each of a diversified company’s business units involves
   A) determining each industry’s key success factors, rating the ability of each business to be successful on each industry KSF, and adding the individual ratings to obtain overall measures of each business’s ability to compete successfully.
   B) identifying the competitive forces facing each business, rating the strength of these competitive forces industry-by-industry, and then ranking each business’s ability to be profitable, given the strength of the competition it faces.
   C) selecting a set of competitive strength measures, weighting the importance of each measure, rating each business on each strength measure, multiplying the strength ratings by the assigned weight to obtain a weighted rating, adding the weighted ratings for each business unit to obtain an overall competitive strength score, and using the overall competitive strength scores to evaluate the competitive strength of all the businesses, both individually and as a group.
   D) determining which businesses possess good strategic fit with other businesses, identifying the portion of the value chain where this fit occurs, and evaluating the strength of the competitive advantage attached to each of the strategic fits to get an overall measure of competitive advantage potential—businesses with the highest/lowest competitive advantage potential have the most/least competitive strength.
   E) rating the caliber of each businesses strategic and resource fits, weighting the importance of each type of strategic/resource fit, calculating weighted strategic/resource fit scores, and adding the weighted ratings for each business to obtain an overall strength score for each business unit that indicates whether the company has adequate strategic/resource fits to be a strong market contender in each of the industries where it competes.

   **Answer:** C   Page: 262 - 263   Learning Objective: 4   Difficulty: Hard   Taxonomy: Comprehension
   AACSB: Value Creation
71. The value of determining the relative competitive strength of each business a company has diversified into is
   A) to have a quantitative basis for identifying which businesses have large/small competitive advantages or competitive disadvantages vis-à-vis the rivals in their respective industries.
   B) to have a quantitative basis for rating them from strongest to weakest in terms of contributing to the corporate parent’s revenue growth.
   C) to compare resource strengths and weaknesses, business by business.
   D) to have a quantitative basis for rating them from strongest to weakest in contending for market leadership in their respective industries.
   E) to have a quantitative basis for rating them from strongest to weakest in terms of contributing to the corporate parent’s profitability.

   Answer: D  Page: 263  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

Using a Nine Cell Matrix to Simultaneously Display Industry Attractiveness and Competitive Strength

72. The nine-cell industry attractiveness-competitive strength matrix
   A) is useful for helping decide which businesses should have high, average, and low priorities in allocating corporate resources.
   B) indicates which businesses are cash hogs and which are cash cows.
   C) pinpoints what strategies are most appropriate for businesses positioned in the three top cells of the matrix but is less clear about the best strategies for businesses positioned in the bottom six cells.
   D) identifies which sister businesses have the greatest strategic fit.
   E) identifies which sister businesses have the greatest resource fit.

   Answer: A  Page: 264 - 265  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

73. The most important strategy-making guidance that comes from drawing a 9-cell industry attractiveness-competitive strength matrix is
   A) which businesses in the portfolio have the most potential for strategic fit and resource fit.
   B) why cash cow businesses are more valuable than cash hog businesses.
   C) that corporate resources should be concentrated on those businesses enjoying both a higher degree of industry attractiveness and competitive strength and that businesses having low competitive strength in relatively unattractive industries should be looked at for possible divestiture.
   D) which businesses have the biggest competitive advantages and which ones confront serious competitive disadvantages.
   E) which businesses are in industries with profitable value chains and which are in industries with money-losing value chains.

   Answer: C  Page: 265  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

74. One of the most significant contributions to strategy-making in diversified companies that the 9-cell industry attractiveness/competitive strength matrix provides is
   A) identifying which businesses have strategies that should be continued, which business have strategies that need fine-tuning, and which businesses have strategies that need major overhaul.
   B) that businesses having the greatest competitive strength and positioned in the most attractive industries should have the highest priority for corporate resource allocation and that competitively weak businesses in relatively unattractive industries should have the lowest priority and perhaps even be considered for
C) pinpointing what strategies are most appropriate for businesses positioned in the four corners of the matrix (although the matrix reveals little about the best strategies for businesses positioned in the remainder of the matrix).

D) its ability to pinpoint what kind of competitive advantage or disadvantage each business has.

E) pinpointing which businesses to keep and which ones to divest.

**Answer:** B  Page: 265  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation

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**Step 3: Checking the Competitive Advantage Potential of Cross-Business Strategic Fits**

75. In a diversified company, a business subsidiary has more competitive advantage potential when

A) it is a cash cow.

B) it has value chain relationships with other business subsidiaries that present competitively valuable opportunities to transfer skills or technology or intellectual capital from one business to another, combine the performance of related activities and reduce costs, share use of a well-respected brand name, or collaborate to create new competitive capabilities.

C) it is the company’s biggest profit producer or is capable of becoming the biggest.

D) it is in a fast-growing industry.

E) it operates in an industry where competition is less intense and driving forces are relatively weak.

**Answer:** B  Page: 266  Learning Objective: 4  Difficulty: Easy  Taxonomy: Comprehension  
AACSB: Value Creation

76. Checking the competitive advantage potential of cross-business strategic fits in a diversified company involves evaluating the extent to which sister businesses present

A) opportunities to combine the performance of certain cross-business activities and thereby reduce costs.

B) opportunities to transfer skills, technology, or intellectual capital from one business to another.

C) opportunities for the company’s different businesses to share use of a well-respected brand name.

D) opportunities for sister businesses to collaborate in creating valuable new competitive capabilities.

E) All of these.

**Answer:** E  Page: 266  Learning Objective: 4  Difficulty: Easy  Taxonomy: Comprehension  
AACSB: Value Creation

77. Checking a diversified company’s business portfolio for the competitive advantage potential of cross-business strategic fits does **not** involve ascertaining

A) the extent to which sister business units have value chain match-ups that offer opportunities to combine the performance of related value chain activities and reduce costs.

B) the extent to which sister business units have value chain match-ups that offer opportunities to transfer skills or technology or intellectual capital from one business to another.

C) the extent to which sister business units have opportunities to share use of a well-respected brand name.

D) the extent to which sister business units have value chain match-ups that offer opportunities to create new competitive capabilities or to leverage existing resources.

E) which business units are cash cows and which ones are cash hogs.

**Answer:** E  Page: 266  Learning Objective: 4  Difficulty: Easy  Taxonomy: Comprehension  
AACSB: Value Creation
78. Checking a diversified firm’s business portfolio for the competitive advantage potential of cross-business strategic fits entails consideration of
   A) whether the parent’s company’s competitive advantages are being deployed to maximum advantage in each of its business units.
   B) whether the competitive strategies employed in each business act to reinforce the competitive power of the strategies employed in the company’s other businesses.
   C) whether the competitive strategies in each business possess good strategic fit with the parent company’s corporate strategy.
   D) the extent to which there are competitively valuable relationships between the value chains of sister business units and what opportunities they present to reduce costs, share use of a potent brand name, create competitively valuable new capabilities via cross-business collaboration, or transfer skills or technology or intellectual capital from one business to another.
   E) how compatible the competitive strategies of the various sister businesses are and whether these strategies are properly aimed at achieving the same kind of competitive advantage.

**Answer:** D  Page: 266  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation

79. Which of the following is not a part of checking a diversified company’s business units for cross-business competitive advantage potential?
   A) Ascertaining the extent to which sister business units have value chain match-ups that offer opportunities to combine the performance of related value chain activities and reduce costs
   B) Ascertaining the extent to which sister business units have value chain match-ups that offer opportunities to transfer skills or technology or intellectual capital from one business to another
   C) Ascertaining the extent to which sister business units are making maximum use of the parent company’s competitive advantages
   D) Ascertaining the extent to which sister business units have value chain match-ups that offer opportunities to create new competitive capabilities or to leverage existing resources
   E) Ascertaining the extent to which sister business units present opportunities to share use of a well-respected brand name

**Answer:** C  Page: 266  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation

**Step 4: Checking for Resource Fit**

80. A diversified company’s business units exhibit good resource fit when
   A) each business is a cash cow.
   B) a company has the resources to adequately support the requirements of its businesses as a group without spreading itself too thin and when individual businesses add to a company’s overall strengths.
   C) each business is sufficiently profitable to generate an attractive return on invested capital.
   D) each business unit produces large internal cash flows over and above what is needed to build and maintain the business.
   E) the resource requirements of each business exactly match the company’s available resources.

**Answer:** B  Page: 266  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation
81. The businesses in a diversified company’s lineup exhibit good resource fit when
   A) the resource requirements of each business exactly match the resources the company has available.
   B) individual businesses add to a company’s resource strengths and when a company has the resources to
      adequately support the requirements of its businesses as a group without spreading itself too thin.
   C) each business generates just enough cash flow annually to fund its own capital requirements and thus
      does not require cash infusions from the corporate parent.
   D) each business unit produces sufficient cash flows over and above what is needed to build and maintain
      the business, thereby providing the parent company with enough cash to pay shareholders a generous
      and steadily increasing dividend.
   E) there are enough cash cow businesses to support the capital requirements of the cash hog businesses.

   Answer: B   Page: 266   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

82. A “cash cow” type of business
   A) generates unusually high profits and returns on equity investment.
   B) is so profitable that it has no long-term debt.
   C) generates positive cash flows over and above its internal requirements, thus providing a corporate parent
      with cash flows that can be used for financing new acquisitions, investing in cash hog businesses, and/
      or paying dividends.
   D) is a business with such a strong competitive advantage that it generates big profits, big returns on
      investment, and big cash surpluses after dividends are paid.
   E) has good strategic fit with a cash hog business.

   Answer: C   Page: 267   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

83. The tests of whether a diversified company’s businesses exhibit resource fit do not include
   A) whether the excess cash flows generated by cash cow businesses are sufficient to cover the negative
      cash flows of its cash hog businesses.
   B) whether a business adequately contributes to achieving the corporate parent’s performance targets.
   C) whether the company has adequate financial strength to fund its different businesses and maintain a
      healthy credit rating.
   D) whether the corporate parent has sufficient cash to fund the needs of its individual businesses and pay
      dividends to shareholders without having to borrow money.
   E) whether the corporate parent has or can develop sufficient resource strengths and competitive
      capabilities to be successful in each of the businesses it has diversified into.

   Answer: D   Page: 268 - 269   Learning Objective: 4   Difficulty: Hard   Taxonomy: Comprehension
   AACSB: Value Creation
84. Which one of the following is not part of the task of checking a diversified company’s business line-up for adequate resource fit?
   A) Determining whether the excess cash flows generated by cash cow businesses are sufficient to cover the negative cash flows of its cash hog businesses
   B) Determining whether recently acquired businesses are acting to strengthen a company’s resource base and competitive capabilities or whether they are causing its competitive and managerial resources to be stretched too thinly across its businesses
   C) Determining whether some business units have value chain match-ups that offer opportunities to transfer skills or technology or intellectual capital from one business to another
   D) Determining whether the company has adequate financial strength to fund its different businesses and maintain a healthy credit rating
   E) Determining whether the corporate parent has or can develop sufficient resource strengths and competitive capabilities to be successful in each of the businesses it has diversified into

   Answer: C   Page: 266 - 269   Learning Objective: 4   Difficulty: Hard   Taxonomy: Comprehension   AACSB: Value Creation

Step 5: Ranking the Performance Prospects of Business Units and Assigning a Priority for Resource Allocation

85. Which one of the following is the best guideline for deciding what the priorities should be for allocating resources to the various businesses of a diversified company?
   A) Businesses with high industry attractiveness ratings should be given top priority and those with low industry attractiveness ratings should be given low priority.
   B) Business subsidiaries with the brightest profit and growth prospects and solid strategic and resource fits generally should head the list for corporate resource support.
   C) The positions of each business in the nine-cell attractiveness-strength matrix should govern resource allocation.
   D) Businesses with the most strategic and resource fits should be given top priority and those with the fewest strategic and resource fits should be given low priority.
   E) Businesses with high competitive strength ratings should be given top priority and those with low competitive strength ratings should be given low priority

   Answer: B   Page: 270   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension   AACSB: Value Creation

86. The options for allocating a diversified company’s financial resources include
   A) making acquisitions to establish positions in new businesses or to complement existing businesses.
   B) investing in ways to strengthen or grow existing businesses.
   C) funding long-range R&D ventures aimed at opening market opportunities in new or existing businesses.
   D) paying off existing debt, increasing dividends, building cash reserves, or repurchasing shares of the company’s stock.
   E) All of these.

   Answer: E   Page: 271   Learning Objective: 4   Difficulty: Easy   Taxonomy: Comprehension   AACSB: Value Creation
87. Which one of the following is not a reasonable option for deploying a diversified company’s financial resources?
   A) Making acquisitions to establish positions in new businesses or to complement existing businesses
   B) Concentrating most of a company’s financial resources in cash cow businesses and allocating little or no additional resources to cash hog businesses until they show enough strength to generate positive cash flows
   C) Funding long-range R&D ventures aimed at opening market opportunities in new or existing businesses
   D) Paying down existing debt, increasing dividends, or repurchasing shares of the company’s stock
   E) Investing in ways to strengthen or grow existing businesses

   Answer: B Page: 271 Learning Objective: 4 Difficulty: Medium Taxonomy: Comprehension
   AACSB: Value Creation

**Step 6: Crafting New Strategic Moves to Improve Overall Corporate Performance**

88. Corporate strategy options for diversified companies include
   A) broadening the company’s business scope by making new acquisitions in new industries.
   B) divesting weak-performing businesses and retrenching to a narrower base of business operations.
   C) restructuring the company’s business lineup with a combination of divestitures and new acquisitions to put a whole new face on the company’s business makeup.
   D) pursuing growth opportunities within the existing business lineup.
   E) All of these.

   Answer: E Page: 271 Learning Objective: 5 Difficulty: Easy Taxonomy: Comprehension
   AACSB: Value Creation

89. The strategic options to improve a diversified company’s overall performance do not include which of the following categories of actions?
   A) Broadening the company’s business scope by making new acquisitions in new industries
   B) Increasing dividend payments to shareholders and/or repurchasing shares of the company’s stock
   C) Restructuring the company’s business lineup with a combination of divestitures and acquisitions to put a whole new face on the company’s business makeup
   D) Pursuing multinational diversification and striving to globalize the operations of several of the company’s business units
   E) Divesting weak-performing businesses and retrenching to a narrower base of business operations

   Answer: B Page: 271 Learning Objective: 5 Difficulty: Medium Taxonomy: Comprehension
   AACSB: Value Creation

90. Once a company has diversified into a collection of related or unrelated businesses and concludes that some strategy adjustments are needed, which one of the following is not one of the main strategy options that a company can pursue?
   A) Pursue multinational diversification
   B) Restructure the company’s business lineup with a combination of divestitures and new acquisitions
   C) Craft new initiatives to build/enhance the reputation of the company’s brand name
   D) Divest some businesses and retrench to a narrower diversification base
   E) Broaden the diversification base

   Answer: C Page: 273 Learning Objective: 5 Difficulty: Easy Taxonomy: Comprehension
   AACSB: Value Creation
Broadening a Diversified Company's Business Base

91. A company that is already diversified may choose to broaden its business base by building positions in new related or unrelated businesses because
A) it has resources or capabilities that are eminently transferable to other related or complementary businesses.
B) the company’s growth is sluggish and it needs the sales and profit boost that a new business can provide.
C) management wants to lessen the company’s vulnerability to seasonal or recessionary influences or to threats from emerging new technologies.
D) it wants to make new acquisitions to strengthen or complement some of its present businesses.
E) All of these.

Answer: E  Page: 272  Learning Objective: 5  Difficulty: Easy  Taxonomy: Comprehension
AACSB: Value Creation

Divesting Some Businesses and Retrenching to a Narrower Diversification Base

92. Retrenching to a narrower diversification base
A) is usually the most attractive long-run strategy for a broadly diversified company confronted with recession, high interest rates, mounting competitive pressures in several of its businesses, and sluggish growth.
B) has the advantage of focusing a diversified firm’s energies on building strong positions in a few core businesses rather the stretching its resources and managerial attention too thinly across many businesses.
C) is an attractive strategy option for revamping a diverse business lineup that lacks strong cross-business financial fit.
D) is sometimes an attractive option for deepening a diversified company’s technological expertise and supporting a faster rate of product innovation.
E) is a strategy best reserved for companies in poor financial shape.

Answer: B  Page: 274  Learning Objective: 5  Difficulty: Hard  Taxonomy: Comprehension
AACSB: Value Creation

93. Retrenching to a narrower diversification base can be attractive or advisable when
A) certain businesses have questionable long-term potential.
B) a diversified company has businesses that have little or no strategic or resource fits with the “core” businesses that management wishes to concentrate on.
C) certain business units are weakly positioned and show poor prospects for providing a good return on investment.
D) market conditions in a once-attractive business have badly deteriorated.
E) All of these.

Answer: E  Page: 274  Learning Objective: 5  Difficulty: Easy  Taxonomy: Comprehension
AACSB: Value Creation
94. In which of the following instances is retrenching to a narrower diversification base not likely to be an attractive or advisable strategy for a diversified company?
A) When a diversified company has struggled to make certain businesses attractively profitable
B) When a diversified company has too many cash cows
C) When one or more businesses are cash hogs with questionable long-term potential
D) When businesses in once-attractive industries have badly deteriorated
E) When a diversified company has businesses that have little or no strategic or resource fits with the “core” businesses that management wishes to concentrate on

Answer: B  Page: 274  Learning Objective: 5  Difficulty: Easy  Taxonomy: Comprehension
AACSB: Value Creation

95. Divestiture can be accomplished by
A) selling a business outright.
B) spinning the unwanted business off as a managerially and financially independent company by selling shares to the investing public via an initial public offering of stock.
C) spinning the unwanted business off as a managerially and financially independent company by distributing shares in the new company to existing shareholders of the parent company.
D) All of the above.
E) None of the above—the best and quickest ways to divest a business are either to close it down or else just walk away and give the keys to creditors.

Answer: D  Page: 275 - 276  Learning Objective: 5  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

Restructuring a Company’s Business Lineup Through a Mix of Divestures and New Acquisitions

96. Strategies to restructure a diversified company’s business lineup involves
A) revamping the value chains of each of a diversified company’s businesses.
B) focusing on restoring the profitability of its money-losing businesses and thereby improving the company’s overall profitability.
C) revamping the strategies of its different businesses, especially those that are performing poorly.
D) divesting some businesses and acquiring new ones so as to put a new face on a diversified company’s business makeup.
E) broadening the scope of diversification to include a larger number of smaller and more diverse businesses.

Answer: D  Page: 276  Learning Objective: 5  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

97. Corporate restructuring strategies
A) involve making radical changes in a diversified company’s business lineup, divesting some businesses and acquiring new ones so as to put a new face on the company’s business lineup.
B) entails reducing the scope of diversification to a smaller number of businesses.
C) entail selling off marginal businesses to free up resources for redeployment to the remaining businesses.
D) focus on crafting initiatives to restore a diversified company’s money-losing businesses to profitability.
E) focus on broadening the scope of diversification to include a larger number of businesses and boost the company’s growth and profitability.

Answer: A  Page: 276  Learning Objective: 5  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation
98. Conditions that may make corporate restructuring strategies appealing include
   A) ongoing declines in the market shares of one or more major business units that are falling prey to more market-savvy competitors.
   B) a business lineup that consists of too many slow-growth, declining, low-margin, or competitively weak businesses.
   C) an excessive debt burden with interest costs that eat deeply into profitability.
   D) ill-chosen acquisitions that haven’t lived up to expectations.
   E) All of these.

Answer: E   Page: 276 - 277   Learning Objective: 5   Difficulty: Easy   Taxonomy: Comprehension
AACSB: Value Creation

Pursuing Multinational Diversification

99. What sets a multinational diversification strategy apart from other diversification strategies is
   A) the presence of extra degrees of strategic fit and more economies of scope.
   B) the potential to have a higher degree of technological expertise.
   C) a diversity of businesses and a diversity of national markets.
   D) the potential for faster growth, higher rates of profitability, and more profit sanctuaries.
   E) greater diversity in the types of value chain activities in its different businesses.

Answer: C   Page: 278   Learning Objective: 5   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

100. A multinational diversification strategy allows a firm to pursue maximum competitive advantage potential by
   A) fully capturing economies of scale and learning/experience curve effects and also pursuing cross-business economy of scope opportunities.
   B) exploiting opportunities for both cross-business and cross-country collaboration and strategic coordination.
   C) leveraging use of a well-known and competitively powerful brand name.
   D) transferring competitively valuable resources both from one business to another and one country to another.
   E) All of these.

Answer: E   Page: 279 - 281   Learning Objective: 5   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

101. The sources of a competitive advantage for a diversified multinational corporation do not include
   A) transferring competitively valuable resources from one business to another and one country to another.
   B) the ability to exploit opportunities for both cross-business and cross-country collaboration and strategic coordination.
   C) leveraging use of a well-known and competitively powerful brand name.
   D) pursuing cross-business economy of scope opportunities and striving to fully capture scale economies.
   E) trying to maximize the number of cash cow businesses and minimize the number of cash hog businesses.

Answer: E   Page: 279 - 281   Learning Objective: 5   Difficulty: Easy   Taxonomy: Comprehension
AACSB: Value Creation
102. Which one of the following is not a way for a company to build competitive advantage by pursuing a multinational diversification strategy?

A) Fully capturing economies of scale and experience curve effects as well as cross-business economies of scope
B) Using cross-business and cross-country coordination of certain value chain activities to outcompete rivals
C) Expansion of a company’s business model to include revenues from exporting, franchising, and licensing
D) Transferring competitively valuable resources from one business to another and one country to another
E) Leveraging use of a well-known and competitively powerful brand name across two or more of its businesses

**Answer:** C  Page: 279 - 281  Learning Objective: 5  Difficulty: Easy  Taxonomy: Comprehension

AACSBB: Value Creation

103. A diversified company may pursue expansion of several of its businesses into the markets of additional foreign countries in order to

A) fully capture economies of scale and learning/experience curve effects in these businesses.
B) exploit opportunities for both cross-business and cross-country coordination of value chain activities and strategic initiatives.
C) leverage use of a well-known and competitively powerful brand name across two or more of its businesses.
D) transfer competitively valuable resources in these businesses from one country to another.
E) All of these.

**Answer:** E  Page: 279 - 281  Learning Objective: 5  Difficulty: Medium  Taxonomy: Comprehension

AACSBB: Value Creation

**Short Answer Questions**

104. Briefly discuss when it makes good strategic sense for a company to consider diversification.

**Page:** 241  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension

AACSBB: Value Creation

105. Identify and briefly discuss each of the three tests for determining whether diversification into a new business is likely to build shareholder value.

**Page:** 242  Learning Objective: 1  Difficulty: Medium  Taxonomy: Knowledge

AACSBB: Value Creation

106. The attractiveness test is the most important test for determining whether diversification into a new business is likely to result in 1 + 1 = 3 increases in shareholder value (as opposed to simply a 1 + 1 = 2 type of increase). True or false? Justify and explain your answer.

**Page:** 242  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension

AACSBB: Value Creation
107. Explain the relevance of the following as they relate to building shareholder value via diversification:
   a.) the attractiveness test.
   b.) the cost-of-entry test.
   c.) the better-off test.

   **Page:** 242   **Learning Objective:** 1   **Difficulty:** Medium   **Taxonomy:** Knowledge
   **AACSB:** Value Creation

108. Identify and explain the meaning and strategic significance of each of the following terms:
   a.) the attractiveness test (as it relates to a potential diversification move)
   b.) the better-off test (as it relates to a potential diversification move)
   c.) related diversification
   d.) unrelated diversification
   e.) strategic fit
   f.) economies of scope
   g.) divestiture
   h.) corporate restructuring

   **Page:** 242; 244; 245; 250; 275; 276   **Learning Objective:** 1, 2, 3, 5   **Difficulty:** Medium
   **Taxonomy:** Knowledge   **AACSB:** Value Creation

109. Identify and briefly discuss each of the three options for entering new businesses. Which one is the most popular in the sense of being used most frequently?

   **Page:** 243 - 244   **Learning Objective:** 1   **Difficulty:** Medium   **Taxonomy:** Knowledge
   **AACSB:** Value Creation

110. Carefully explain the difference between a strategy of related diversification and a strategy of unrelated diversification.

   **Page:** 244   **Learning Objective:** 2, 3   **Difficulty:** Easy   **Taxonomy:** Knowledge
   **AACSB:** Value Creation

111. Which is the better approach to diversification—a strategy of related diversification or a strategy of unrelated diversification? Explain and support your answer.

   **Page:** 244 - 256   **Learning Objective:** 2, 3   **Difficulty:** Hard   **Taxonomy:** Comprehension
   **AACSB:** Value Creation

112. What is meant by the term strategic fit? What are the advantages of pursuing strategic fit in choosing which industries to diversify into?

   **Page:** 244 - 245   **Learning Objective:** 2   **Difficulty:** Medium   **Taxonomy:** Knowledge
   **AACSB:** Value Creation

113. Discuss the pros and cons of a strategy of unrelated diversification.

   **Page:** 252 - 256   **Learning Objective:** 3   **Difficulty:** Medium   **Taxonomy:** Comprehension
   **AACSB:** Value Creation
114. Identify and briefly describe the six steps involved in evaluating a diversified company’s business lineup and diversification strategy.

*Page: 257 - 258*  Learning Objective: 4  Difficulty: Hard  Taxonomy: Knowledge
AACSB: Value Creation

115. What does the industry attractiveness test involve in evaluating a diversified company’s business lineup? Why is it relevant?

*Page: 258 - 261*  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

116. What is the relevance of quantitatively measuring the competitive strength of each business in a diversified company’s business portfolio and determining which business units are strongest and weakest?

*Page: 261 - 263*  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

117. Briefly explain what is meant by each of the following terms:
   a.) relative market share
   b.) resource fit
   c.) a cash hog business
   d.) a cash cow business

*Page: 261; 266; 267*  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

118. What are the advantages and benefits of using an industry attractiveness-business strength matrix to evaluate a diversified company’s lineup of businesses?

*Page: 264 - 265*  Learning Objective: 4  Difficulty: Hard  Taxonomy: Comprehension
AACSB: Value Creation

119. What is meant by the term resource fit as it applies to evaluating a diversified company’s business lineup?

*Page: 266*  Learning Objective: 4  Difficulty: Medium  Taxonomy: Knowledge
AACSB: Value Creation

120. Explain the difference between a cash cow business and a cash hog business.

*Page: 266 - 268*  Learning Objective: 4  Difficulty: Easy  Taxonomy: Knowledge
AACSB: Value Creation

121. Shareholder interests are generally best served by concentrating corporate resources on businesses that can contend for market leadership. True or false? Explain your answer.

*Page: 270 - 271*  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation
122. Why is it pertinent in evaluating a diversified company’s business lineup to rank a diversified company’s businesses on the basis of their future performance prospects?

Page: 270 - 271 Learning Objective: 4 Difficulty: Medium Taxonomy: Comprehension
AACSB: Value Creation

123. Once a company has diversified into a collection of related or unrelated businesses and concludes that some strategy adjustments are needed, what are the five main strategic alternatives that it can employ to improve the performance of its overall business lineup?

Page: 271; 273 Learning Objective: 5 Difficulty: Medium Taxonomy: Comprehension
AACSB: Value Creation

124. Under what circumstances might an already diversified company chose to enter additional businesses and broaden its diversification base?

Page: 272 - 273 Learning Objective: 5 Difficulty: Hard Taxonomy: Comprehension
AACSB: Value Creation

125. Under what circumstances might a diversified firm choose to divest one of its businesses?

Page: 273 - 276 Learning Objective: 5 Difficulty: Medium Taxonomy: Comprehension
AACSB: Value Creation

126. Under what circumstances might an already diversified company chose to pursue corporate restructuring?

Page: 276 - 277 Learning Objective: 5 Difficulty: Hard Taxonomy: Comprehension
AACSB: Value Creation

127. Identify and briefly describe at least four types of competitive advantages that can accrue to a multinational corporation pursuing related diversification.

Page: 279 - 282 Learning Objective: 5 Difficulty: Medium Taxonomy: Comprehension
AACSB: Value Creation

128. A strategy of multinational diversification contains more built-in competitive advantage potential (above and beyond what is achievable through a particular business’s own competitive strategy) than any other diversification strategy. True or false? Explain and support your answer.

Page: 282 Learning Objective: 5 Difficulty: Medium Taxonomy: Comprehension
AACSB: Value Creation
9
Ethical Business Strategies, Social Responsibility, and Environmental Sustainability

Multiple Choice Questions

What Do We Mean by Business Ethics?

1. Business ethics concerns
   A) developing a consensus among companies worldwide as to what ethical principles that businesses should be expected to observe in the course of conducting their operations.
   B) what ethical behaviors should be expected of company personnel in the course of doing their jobs.
   C) the application of general ethical principles and standards to the actions and decisions of companies and the behavior of company personnel.
   D) developing a special set of ethical standards for businesses to observe in conducting their affairs.
   E) picking and choosing among the consensus ethical standards of society to arrive at a set of ethical standards that apply directly to operating a business.

   **Answer:** C  Page: 290  Learning Objective: 1  Difficulty: Medium  Taxonomy: Knowledge  
   AACSB: Ethics/Legal Responsibilities

2. Ethical principles in business
   A) deal chiefly with the actions and behaviors required to operate companies in a socially responsible manner.
   B) deal chiefly with the rules each company’s top management and board of directors make about “what is right” and “what is wrong.”
   C) are not materially different from ethical principles in general.
   D) are generally less stringent than the ethical principles for society at large.
   E) are generally more stringent than the ethical principles for society at large.

   **Answer:** C  Page: 290  Learning Objective: 1  Difficulty: Easy  Taxonomy: Knowledge  
   AACSB: Ethics/Legal Responsibilities

3. Ethical principles as they apply to business conduct and business decisions
   A) deal chiefly with standards a company has (and that are elaborated in its code of ethics) about what is right and wrong insofar as the conduct of its business is concerned and about what behaviors are expected of company personnel.
   B) deal chiefly with the behaviors that a company’s board of directors expects of all company personnel in both their conduct on-the-job and their conduct off-the-job.
   C) involve the rules a company’s top management and board of directors make about “what is right” and “what is wrong.”
   D) are not materially different from ethical principles in general.
   E) are generally less stringent than the ethical principles for society at large because it is well understood that businesses should not be expected to operate any differently than what the law requires of them.

   **Answer:** D  Page: 290  Learning Objective: 1  Difficulty: Easy  Taxonomy: Knowledge  
   AACSB: Ethics/Legal Responsibilities
How and Why Ethical Standards Impact the Tasks of Crafting and Executing Strategy

4. The litmus test of a company’s code of ethics is
   A) the degree to which it is connected to a company’s statement of core values.
   B) the extent to which it is embraced in crafting strategy and in the day-to-day operations of the business.
   C) the extent to which a company’s approach to ethical behavior mirrors the ethical principles for society at large.
   D) based on the rules a company’s top management and board of directors make about “what is right” and “what is wrong.”
   E) determined by the ethical behaviors expected of company personnel in the course of doing their jobs.

   Answer: B   Page: 290   Learning Objective: 1   Difficulty: Easy   Taxonomy: Knowledge
   AACSB: Ethics/Legal Responsibilities

5. Which of the following is not a key question that senior executives must ask whenever a new strategic initiative is under review?
   A) Would the potential outcome of the proposed action pose a risk of embarrassment?
   B) Is what we are proposing to do fully compliant with our code of ethical conduct?
   C) Is there anything in the proposed action that could be considered ethically objectionable?
   D) Is it apparent that this proposed action is in harmony with our core values?
   E) Are any conflicts or concerns evident between the proposed action and our core values?

   Answer: A   Page: 290   Learning Objective: 1   Difficulty: Easy   Taxonomy: Knowledge
   AACSB: Ethics/Legal Responsibilities

Where Do Ethical Standards Come From—Are They Universal or Dependent on Local Norms and Situational Circumstances?

6. Notions of right and wrong, fair and unfair, moral and immoral, ethical and unethical
   A) vary enormously from religion to religion and country to country across the world.
   B) are present in all societies, organizations, and individuals; some of the most important concepts (for example, being truthful) of what is right and what is wrong resonate with people of most cultures, and are thus universal.
   C) ultimately depend on the circumstances—nothing is really black or white when it comes to ethical standards.
   D) are governed mainly by the thinking and writings of religious clerics at the School of Morally Correct Thinking and Behavior in Geneva, Switzerland.
   E) ultimately depend on a person’s own values and beliefs.

   Answer: B   Page: 291   Learning Objective: 1   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Ethics/Legal Responsibilities
The School of Ethical Universalism

7. The contentions that (1) many of the same standards of what’s ethical and what’s unethical resonate with peoples of most societies regardless of local traditions and cultural norms and (2) to the extent there is common moral agreement about right and wrong actions, common ethical standards can be used to judge the conduct of personnel at companies operating in a variety of country markets and cultural circumstances are defining beliefs of
   A) the school of ethical relativism.
   B) the school of ethical universalism.
   C) integrated social contracts theory.
   D) the School of Morally Correct Thinking and Behavior in Paris, France.
   E) the Global Code of Ethical and Social Morality developed in 1925 at a worldwide convention of distinguished religious clerics.

Answer: B   Page: 292   Learning Objective: 1   Difficulty: Medium   Taxonomy: Knowledge
AACSB: Ethics/Legal Responsibilities

8. The school of ethical universalism holds that
   A) concepts of right and wrong are absolute and leave no room for deviation from country to country or circumstance to circumstance.
   B) concepts of right and wrong are universal within countries but not across countries and cultures.
   C) concepts of right and wrong are governed by the Global Code of Ethical and Social Morality.
   D) some concepts of what is right and what is wrong resonate with peoples of most societies regardless of local traditions and cultural norms—hence common ethical standards can be used to judge the conduct of personnel at companies operating in a variety of country markets and cultural circumstances.
   E) all societies and countries apply essentially the very same set of universally-defined ethical principles of right and wrong in judging individual behavior.

Answer: D   Page: 292   Learning Objective: 1   Difficulty: Easy   Taxonomy: Knowledge
AACSB: Ethics/Legal Responsibilities

9. According to the school of ethical universalism,
   A) concepts of what constitutes ethical behavior and unethical behavior are dictated by subjectively-provable moral principles but not by objectively-provable moral principles.
   B) concepts of right and wrong are universal within countries/societies but not across countries or cultures.
   C) concepts of what is ethical and what is unethical are universal and absolute, leaving no room for deviation from country to country or circumstance to circumstance.
   D) to the extent there is common moral agreement about right and wrong actions and behaviors across multiple cultures and countries, there exists a set of universal ethical standards to which all societies, all companies, and all individuals can be held accountable.
   E) all societies and countries are obligated to apply universally-defined ethical principles of right and wrong as set forth in the Global Code of Ethical Behavior adopted by 150 nations of the world.

Answer: D   Page: 292   Learning Objective: 1   Difficulty: Medium   Taxonomy: Knowledge
AACSB: Ethics/Legal Responsibilities
10. According to the school of ethical universalism,
   A) universal ethical principles or norms put limits on what actions and behaviors fall inside the boundaries of what is right and which ones fall outside—such universal norms include honesty, respecting the rights of others, practicing the Golden Rule, and not acting in a manner that harms others or pillages the environment.
   B) all societies and countries are obligated to apply universally-defined ethical principles of right and wrong as set forth in the Global Code of Ethical and Social Morality (which is subscribed to by 150 nations of the world).
   C) all societies and countries apply essentially the very same set of universally-defined ethical principles of right and wrong in judging the ethical correctness of business behavior.
   D) it is only fair that the standards of what’s ethical and what’s unethical be applied universally to all businesses in all countries irrespective of local business traditions and local business norms.
   E) the standards of what constitutes ethical and unethical behavior in business situations are partly universal, but in the main are governed by local business norms.

   Answer: A   Page: 292   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Ethics/Legal Responsibilities

11. If one concurs with the school of ethical universalism, then one believes that
   A) many basic moral standards travel well across cultures and countries and really do not vary significantly according to local cultural beliefs, social mores, religious convictions, and/or the circumstances of the situation.
   B) since ethical standards are subjectively-determined rather than objectively-determined, each company has a window within which it can define and implement its own ethical principles of right and wrong.
   C) what is deemed right or wrong, fair or unfair, moral or immoral, ethical or unethical in business situations should be judged in light of local customs and social mores and can legitimately vary from one culture or nation to another.
   D) each country should have some degree of latitude in setting its own ethical standards for judging the ethical correctness of business actions/behaviors within its borders.
   E) concepts of right and wrong as they apply to business behavior are always varying shades of gray, never absolute (i.e. black or white).

   Answer: A   Page: 292   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Ethics/Legal Responsibilities

12. The strength of the beliefs underlying ethical universalism is that
   A) ethical universalism recognizes the obvious—basic moral standards vary significantly according to local cultural beliefs, local religious beliefs, and social mores.
   B) ethical standards are objectively-determined by religious and moral experts.
   C) what is deemed right or wrong, fair or unfair, moral or immoral, ethical or unethical is (or should be) grounded in religious doctrine and applied strictly to all business situations.
   D) it draws upon the collective views of multiple societies and cultures to put some clear boundaries on what constitutes ethical business behavior and what constitutes unethical business behavior no matter what country market or culture a company is operating in.
   E) it leaves no room for thinking that concepts of right and wrong can be varying shades of gray—they are always absolute and unambiguous.

   Answer: D   Page: 292   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Ethics/Legal Responsibilities
The School of Ethical Relativism

13. The contention that since different societies and cultures have divergent values and standards of right and wrong it is appropriate to judge behavior as ethical/unethical in the light of local customs and social mores rather than according to a single set of ethical standards
   A) defines what is meant by ethical relativism.
   B) defines what is meant by ethical universalism.
   C) is the foundation of integrated social contracts theory.
   D) is the basis for the theory of ethical variation.
   E) is the guiding principle of the Global Code of Ethical and Social Morality created by the United Nations.

   Answer: A   Page: 292   Learning Objective: 1   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Ethics/Legal Responsibilities

14. The school of ethical relativism holds that
   A) what constitutes ethical or unethical conduct varies according to the religious convictions of each society or each culture within a country.
   B) when there are cross-country or cross-cultural differences in what is deemed fair or unfair, what constitutes proper regard for human rights, and what is considered ethical or unethical in business situations, it is appropriate for local moral standards to take precedence over what the ethical standards may be elsewhere.
   C) concepts of right and wrong are always governed by business norms in each country, culture, or society.
   D) concepts of right and wrong are always a function of each individual’s own set of values, beliefs, and ethical convictions.
   E) concepts of right and wrong as they apply to business behavior are always varying shades of gray, never absolute (i.e. black or white).

   Answer: B   Page: 292   Learning Objective: 1   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Ethics/Legal Responsibilities

15. According to the school of ethical relativism,
   A) concepts of ethically right and ethically wrong are relative across countries and cultures but are universal within countries or cultures.
   B) individuals and businesses have a basic right to “moral free space” and that it is inappropriate to specify ethically permissible and ethically impermissible actions and behaviors.
   C) there are important occasions when local cultural norms and the circumstances of the situation determine whether certain behaviors are right or wrong.
   D) concepts of right and wrong as applied to business situations are always a function of each company’s own set of values, beliefs, and ethical convictions (as stated in the company’s code of ethical conduct).
   E) standards of what is ethically right and ethically wrong as applied to business behavior are determined solely by whatever business norms prevail in a particular country/culture/society and these business norms are certain to vary across countries/cultures/societies.

   Answer: C   Page: 292   Learning Objective: 1   Difficulty: Hard   Taxonomy: Knowledge
   AACSB: Ethics/Legal Responsibilities
16. If one accepts the tenets of the school of ethical relativism, then it follows that
A) there are multiple sets of ethical standards rather than a single universal set.
B) at least some ethical standards are governed by local norms, religious doctrines, and social customs rather than by absolute standards of right and wrong.
C) what constitutes ethical or unethical behavior on the part of businesses must in some cases be judged in the light of local customs and social mores.
D) it is inappropriate to hold businesses accountable for observing a universal set of ethical standards.
E) All of the above.

Answer: E  Page: 292 - 294  Learning Objective: 1  Difficulty: Easy  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

17. Which one of the following statements about the ethical relativism school of thinking is false?
A) In a multinational company, application of ethical relativism equates to multiple sets of ethical standards.
B) There are few absolutes when it comes to business ethics and thus few ethical absolutes for consistently judging a company's conduct in various countries and markets.
C) The best and fairest way for a multinational company to approach the enforcement of ethical standards companywide is to reject ethical universalism and pursue ethical relativism.
D) A company that adopts the principle of ethical relativism and holds company personnel to local ethical standards necessarily assumes that what prevails as local morality is an adequate guide to ethical behavior this assumption is ethically dangerous.
E) According to the ethical relativism school of thinking, a "one-size-fits-all" template for judging the ethical appropriateness of business actions and the behaviors of company personnel does not exist.

Answer: C  Page: 292 - 295  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

18. According to the advocates of ethical relativism,
A) if the use of underage labor and/or the payment of bribes/kickbacks are acceptable in a particular culture/society/country, then a case can be made that it is morally correct and ethical for a company to use these practices in conducting its business activities in that culture/society/country.
B) each company should have the flexibility to set its own standards for deciding whether the use of underage labor and/or the payment of bribes/kickbacks are ethically acceptable or not.
C) if the use of underage labor and/or the payment of bribes/kickbacks are legal in a particular country, then it is morally correct and ethical for a company to use these practices in that country, no matter what the legality of using these practices happens to be in other countries.
D) each industry should have the flexibility to set its own standards for deciding whether the use of underage labor and/or the payment of bribes/kickbacks are ethically acceptable or not.
E) it is very clear that the use of underage labor or the payment of bribes and kickbacks are ethically impermissible—local customs, behavioral norms, and traditions absolutely cannot be taken into account.

Answer: A  Page: 293  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities
19. A belief in ethical relativism leads to the conclusion that
   A) since ethical standards are subjective, it is perfectly appropriate for each company to define and implement its own ethical principles of right and wrong as concerns the use of underage labor and the payment of bribes and kickbacks.
   B) ethical standards are determined objectively (rather than subjectively).
   C) whether the use of underage labor and the payment of bribes/kickbacks should be deemed ethical or unethical depends on the moral standards, values, and business norms that prevail in particular cultures, societies, countries, or circumstances.
   D) ethical standards are objective and universal—thus whether the use of underage labor and the payment of bribes and kickbacks should be deemed ethical or unethical definitely is not dependent on the moral standards, values, and business norms that prevail in particular cultures, societies, countries, or circumstances.
   E) standards of right and wrong are governed by what is legal in a given country—thus whether the use of underage labor and the payment of bribes and kickbacks is ethical or unethical is governed by local law.

   **Answer:** C   Page: 293   Learning Objective: 1   Difficulty: Hard   Taxonomy: Comprehension
   AACSB: Ethics/Legal Responsibilities

20. Paying bribes and kickbacks to grease business transactions
   A) violates ethical principles of right and wrong in all countries.
   B) is ethically acceptable according to the principle of ethical universalism and ethically unacceptable according to the principle of ethical relativism.
   C) is acceptable to immoral managers but not to amoral managers.
   D) is one of the thorniest ethical problems that multinational companies face because paying bribes is normal and customary in some countries and ethically or legally forbidden in others.
   E) is more acceptable in dealing with a company’s suppliers than in dealing with a company’s customers.

   **Answer:** D   Page: 293   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Ethics/Legal Responsibilities

21. Multinational companies that forbid the payment of bribes and kickbacks in their codes of ethical conduct and that are serious about enforcing this prohibition
   A) are generally advocates of the ethical relativism school of thought.
   B) are misguided in their efforts because bribes and kickbacks are really no different from tipping for service at restaurants—whether you tip for service at dinner or make payments to government officials to get goods through customs or give kickbacks to customers to retain their business, you pay for a service rendered.
   C) still have considerable difficulty in preventing the payments of bribes and kickbacks when such payments are entrenched as normal and customary in locations where they do business.
   D) are out-of-step with business reality given that the preponderance of company managers are immoral.
   E) are in a distinct minority compared to companies that view the payment of bribes and kickbacks as a legitimate or permissible practice.

   **Answer:** C   Page: 293   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Ethics/Legal Responsibilities
22. According to the ethical relativism school of thinking,
   A) there can be no one-size-fits-all set of authentic ethical norms against which to gauge the conduct of company personnel.
   B) a company should have a different set of ethical standards for each country in which it operates.
   C) only respected religious experts can provide companies with a higher order moral compass.
   D) the best source of ethical standards in each country where the company operates is that country’s adopted Code of Required Ethical Conduct.
   E) since there can be no one-size-fits-all set of authentic ethical norms it is appropriate for each company to hold company personnel to observing the company’s code of ethical conduct.

   Answer: A   Page: 294   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Ethics/Legal Responsibilities

23. Companies that adopt the principle of ethical relativism in providing ethical guidance to company personnel
   A) base their standards of what is ethical and what is unethical on the Global Code of Ethical Conduct first developed in 1935 and since subscribed to by the governments of 180 countries.
   B) quickly find themselves on a slippery slope with no higher order moral compass if they operate in countries where ethical standards vary considerably from country to country.
   C) have no fair way to judge the ethical correctness of the conduct of company personnel.
   D) have a one-size-fits-all set of ethical standards.
   E) end up allowing each company employee to determine what set of ethical standards to observe.

   Answer: B   Page: 295   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Ethics/Legal Responsibilities

Ethics and Integrative Social Contacts Theory

24. The contention that ethical standards should be governed both by (1) a limited number of universal ethical principles that are widely recognized as putting legitimate ethical boundaries on actions and behavior in all situations and (2) the circumstances of local cultures, traditions, and shared values that further prescribe what constitutes ethically permissible behavior and what does not are the basic principles of
   A) the school of ethical relativism.
   B) the school of ethical universalism.
   C) integrated social contracts theory.
   D) the School of Morally Correct Thinking and Behavior based in Rome, Italy.
   E) the Global Code of Ethical and Social Morality developed by the United Nations.

   Answer: C   Page: 295   Learning Objective: 1   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Ethics/Legal Responsibilities
25. According to integrated social contracts theory, the ethical standards a company should try to uphold
A) are governed by the school of ethical universalism.
B) are governed both by (1) a limited number of universal ethical principles that are widely recognized as putting legitimate ethical boundaries on actions and behavior in all situations and (2) the circumstances of local cultures, traditions, and shared values that further prescribe what constitutes ethically permissible behavior and what does not—but universal ethical norms always take precedence over local norms.
C) are governed by each country’s Code of Required Ethical Conduct which sets forth that each individual/group/business/organization has a “social contract” to observe the ethical and moral standards that the country has adopted.
D) should be determined by the company’s moral managers.
E) should never be absolute but rather always provide some wiggle room according to the circumstances of the situation.

Answer: B   Page: 295   Learning Objective: 1   Difficulty: Easy   Taxonomy: Knowledge
AACSB: Ethics/Legal Responsibilities

26. According to integrated social contracts theory,
A) universal ethical principles apply in those situations where most all societies—endowed with rationality and moral knowledge—have common moral agreement on what is wrong and thereby put limits on what actions and behaviors fall inside the boundaries of what is right and which ones fall outside.
B) commonly held views about what is morally right and wrong form a contract with society that is binding on all individuals, groups, organizations, and businesses in terms of establishing right and wrong and in drawing the line between ethical and unethical behaviors
C) universal ethical principles or norms leave some “moral free space” for the people in a particular country (or local culture or even a company) to make specific interpretations of what other actions may or may not be permissible within the bounds defined by universal ethical principles.
D) universal ethical norms always take precedence over local ethical norms.
E) All of the above.

Answer: E   Page: 295 - 296   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

27. Which one of the following is not a key element of integrated social contracts theory?
A) Universal ethical principles apply in those situations where most all societies—endowed with rationality and moral knowledge—have common moral agreement on what is wrong and thereby put limits on what actions and behaviors fall inside the boundaries of what is right and which ones fall outside.
B) Commonly held views about what is morally right and wrong form a “social contract” (contract with society) that is binding on all individuals, groups, organizations, and businesses in terms of establishing right and wrong and in drawing the line between ethical and unethical behaviors
C) Universal ethical principles or norms leave some “moral free space” for the people in a particular country (or local culture or even a company) to make specific interpretations of what other actions may or may not be permissible within the bounds defined by universal ethical principles.
D) Universal ethical norms always take precedence over local ethical norms.
E) Integrated social contracts theory rejects the slippery slope of ethical relativism and embraces ethical universalism.

Answer: E   Page: 295 - 296   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities
28. Integrated social contracts theory maintains that
   A) there is no such thing as “moral free space”—all ethical standards are determined by societal norms, and individuals have an implied social contract to live up to these standards.
   B) few nations or cultures have common moral agreement on what is ethically right and wrong.
   C) there should be no absolute limits put on what actions and behaviors fall inside the boundaries of what is ethically or morally right and which actions/behaviors fall outside.
   D) adherence to universal ethical norms always take precedence over local ethical norms.
   E) each country/culture/society has commonly held views about what constitutes ethically appropriate actions/behaviors; these common standards of what is ethical and what is not combine to form a “social contract” that all individuals in that country/culture/society are obligated to observe.

   **Answer:** D   Page: 296   Learning Objective: 1   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Ethics/Legal Responsibilities

29. The strength of integrated social contracts theory is that it
   A) correctly recognizes all soundly-reasoned ethical standards are universal.
   B) accommodates the best parts of ethical universalism and ethical relativism.
   C) puts no absolute limits on what actions and behaviors fall inside the boundaries of what is ethically or morally right and which actions/behaviors fall outside.
   D) recognizes the importance of allowing local ethical norms to always take precedence over universal ethical norms.
   E) recognizes that individuals and businesses have a basic right to “moral free space” and that it is inappropriate to specify ethically permissible and ethically impermissible actions and behaviors.

   **Answer:** B   Page: 296   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Ethics/Legal Responsibilities

**The Three Categories of Management Morality**

30. The three categories of managers that stand out with regard to the beliefs and commitments they have to ethical and moral principles in business affairs are:
   A) ethical managers, socially responsible managers, and crooked managers.
   B) mostly ethical managers, somewhat unethical managers, and ethically corrupt managers.
   C) ethically-principled managers, ethically-unprincipled managers, and ethically-neutral managers.
   D) moral managers, amoral managers, and immoral managers.
   E) ethically responsible managers, ethically irresponsible managers, and ethically unconcerned managers.

   **Answer:** D   Page: 297   Learning Objective: 1   Difficulty: Easy   Taxonomy: Knowledge
   AACSB: Ethics/Legal Responsibilities

31. The categories of managerial morality include:
   A) honorable managers, dishonorable managers, and totally corrupt managers.
   B) mostly ethical managers, somewhat ethical managers, and totally unethical managers.
   C) ethically-principled managers, ethically-unprincipled managers, and if-it-is-legal-then-it-is-ethical managers (the latter type of manager believes that ethics don’t really apply to business—their view is that anything that is legal is also ethical).
   D) managers with lots of integrity, managers with some integrity, and managers with no integrity.
   E) moral managers, immoral managers, and amoral managers.

   **Answer:** E   Page: 297   Learning Objective: 1   Difficulty: Easy   Taxonomy: Knowledge
   AACSB: Ethics/Legal Responsibilities
32. Moral managers
   A) are ethically principled.
   B) see themselves as stewards of ethical behavior and believe it is important to exercise ethical leadership.
   C) pursue success within the letter and spirit of what is considered ethical and legal.
   D) view what is legal as the ethical minimum and have a habit of operating at well above what the law requires.
   E) All of the above.

   **Answer:** E   Page: 297   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Ethics/Legal Responsibilities

33. Moral managers
   A) are skeptical about ethics and ethical standards but feel obligated to observe the company code of ethics.
   B) see themselves as stewards of ethical behavior and believe it is important to exercise ethical leadership; they are ethically principled and pursue success within the letter and spirit of what is considered ethical and legal.
   C) try to stay within ethical bounds for fear of being caught doing something unethical and having their careers ruined.
   D) view what is legal as also ethical.
   E) are ethically-principled as long as they see such behavior being in their own self-interest.

   **Answer:** B   Page: 297   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Ethics/Legal Responsibilities

34. An immoral manager is one who
   A) is ethically-principled most of the time but who might stoop to unethical behavior if there’s low risk of discovery and the action or decision has a sizable positive effect on company profitability.
   B) has no regard for so-called ethical standards in business and pays no attention to ethical principles in making business decisions—an immoral manager is driven by greed and self-gain and won’t hesitate to violate ethical principles if it is in his/her best interest to do so.
   C) is ethically unprincipled but nonetheless usually observes ethical standards for fear of getting caught and fired.
   D) believes that ethical standards violate the principle of moral free space and therefore are illegitimate.
   E) strongly believes that it is ethical to do whatever is legal.

   **Answer:** B   Page: 297   Learning Objective: 1   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Ethics/Legal Responsibilities

35. An intentionally amoral manager is one who
   A) is ethically-principled most of the time but who knowingly and willingly stoops to unethical behavior if there’s low risk of discovery and the action or decision has a sizable positive effect on company profitability.
   B) deliberately and maliciously violates ethical principles on a regular basis.
   C) believes business and ethics are not to be mixed because different rules apply in business as compared to other realms of life.
   D) views the observance of high ethical standards (doing more than what is required by law) as too Sunday-schoolish for the tough competitive world of business, even though observing some higher ethical considerations may be appropriate in life outside of business.
   E) strongly believes that whatever is legal is also ethical.

   **Answer:** D   Page: 297   Learning Objective: 1   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Ethics/Legal Responsibilities
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36. An unintentionally amoral manager is one who
   A) is ethically-principled most of the time but who is also prone to being unethical when there’s low risk of being discovered and/or it is in his/her best interests.
   B) is casual about, careless about, or inattentive to the fact that certain types of business decisions or company activities may have adverse impacts on others.
   C) strongly believes in the integrated social contract theory approach to ethics in business.
   D) strongly believes in ethical relativism.
   E) strongly believes in ethical universalism.

**Answer:** B  Page: 298  Learning Objective: 1  Difficulty: Medium  Taxonomy: Knowledge
AACSB: Ethics/Legal Responsibilities

37. The best available evidence indicates that the average manager in the whole population of managers is
   A) ethically corrupt.
   B) ethically amoral most of the time but may slip into a moral or immoral mode based on a variety of impinging factors and circumstances.
   C) mostly ethical.
   D) ethically moral and is fairly steadfast in taking ethically correct positions.
   E) ethically immoral and unprincipled, especially when the chances of being discovered are slim; however, in public, the average manager is prone to give every appearance of being ethically principled and to profess support for ethically correct behavior.

**Answer:** B  Page: 298  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

38. By some accounts, the population of managers is said to be
   A) distributed among moral, immoral, and amoral managers in a bell-shaped curve, with immoral managers and moral managers occupying the two tails of the curve, and amoral managers, especially the intentionally amoral managers, occupying the broad middle ground.
   B) composed of mostly ethically moral managers but perhaps a third of all managers slip into an immoral or unethical mode in certain circumstances.
   C) about 15% highly ethical, 50% mostly ethical, and 35% ethically corrupt.
   D) about 20% highly ethical, 60% mostly ethical, and 20% mostly unethical.
   E) about one-third highly ethical, one-third mostly ethical, and one-third mostly unethical.

**Answer:** A  Page: 298  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

**Evidence of Managerial Immorality in the Global Business Community**

39. Based on data from the Global Corruption Report sponsored by Transparency International,
   A) corruption in emerging country markets is relatively low compared to the rest of the world.
   B) business managers are more corrupt on average than government officials.
   C) corruption among public officials and in business transactions is widespread across the world.
   D) bribery occurs most often in the automotive industry, the drug and pharmaceutical industry, and in the apparel industry.
   E) the ethically “cleanest” industries are public works contracts and construction, the arms and defense industry, and the oil and gas industry.

**Answer:** C  Page: 298  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities
Drivers of Unethical Strategies and Business Behavior?

40. The major drivers of unethical managerial behavior include
   A) greed, atheism, pervasive managerial immorality, and a general lack of scruples on the part of top executives regarding how customers and suppliers should be treated.
   B) ethically corrupt corporate cultures, heavy pressures on company managers to meet or beat performance targets, and overzealous pursuit of personal gain, wealth, and other self interests.
   C) widespread managerial belief in the ethical relativism school of thinking.
   D) an aversion to ethical correctness on the part of top executives and a belief that unethical behavior is unimportant and probably won’t be discovered.
   E) intense competitive pressures.

   **Answer:** B  Page: 299  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Ethics/Legal Responsibilities

41. Unethical managerial behavior tends to be driven by such factors as
   A) the pervasiveness of immoral and amoral businesspeople.
   B) overzealous pursuit of personal gain, wealth, and other selfish interests.
   C) a company culture that puts the profitability and good business performance ahead of ethical behavior.
   D) heavy pressures on company managers to meet or beat earnings targets.
   E) All of these.

   **Answer:** E  Page: 299  Learning Objective: 2  Difficulty: Easy  Taxonomy: Comprehension
   AACSB: Ethics/Legal Responsibilities

42. Which one of the following is **not** one of the major drivers of unethical managerial behavior?
   A) Intense competitive pressures
   B) Overzealous pursuit of personal gain, wealth, and other self interests
   C) A company culture that puts the profitability and good business performance ahead of ethical behavior
   D) Heavy pressures on company managers to meet or beat earnings targets
   E) The pervasiveness of immoral and amoral businesspeople

   **Answer:** A  Page: 299  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Ethics/Legal Responsibilities

Why Ethical Strategies Matter

43. A company’s strategy needs to be ethical because
   A) of the dangers that top management will get embarrassed if the company’s unethical behavior is publicly exposed.
   B) (1) a strategy that is unethical in whole or in part is morally wrong and reflects badly on the character of the company personnel involved and (2) an ethical strategy is good business and in the best interest of shareholders.
   C) everyone is an ethics watchdog and somebody is sure to blow the whistle on the company’s unethical behavior.
   D) of the risks of getting caught and prosecuted by governmental authorities if an unethical strategy is used.
   E) unethical strategies are inconsistent with or else weaken the corporate culture.

   **Answer:** B  Page: 304 - 305  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Ethics/Legal Responsibilities
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44. Which of the following represents a justifiable reason for why a company’s strategy should be ethical?
   A) An unethical strategy reflects badly on the character of the company personnel involved.
   B) A strategy that is unethical in whole or in part is morally wrong.
   C) Pursuing an unethical strategy damages a company’s reputation and can have costly consequences.
   D) An ethical strategy is good business and is in the best interest of shareholders.
   E) All of these.

   **Answer:** E   Page: 304 - 305   Learning Objective: 3   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Ethics/Legal Responsibilities

45. Which of the following is not a particularly sound or valid reason why a company’s strategy should be ethical?
   A) An unethical strategy reflects badly on the character of the company personnel involved.
   B) Most all shareholders believe it is honorable for their company to pursue an ethical strategy (even
      though it usually entails making less profit) and are turned off by company efforts to make greater
      profits via unethical means.
   C) An ethical strategy is in the self-interest of shareholders, partly because an unethical strategy can
      damage a company’s reputation and partly because unethical behavior can be very costly in terms of
      fines and penalties, legal and investigative costs, customer defections, and lower employee morale.
   D) Customers shun companies known for their shady behavior and ethically upstanding company
      personnel are repulsed by a work environment where unethical behavior is condoned.
   E) A strategy that is unethical in whole or in part is morally wrong.

   **Answer:** B   Page: 304 - 305   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Ethics/Legal Responsibilities

46. The strength of the beliefs underlying the moral case for an ethical strategy
   A) begins with managers who themselves have strong character (for example, who are honest, have
      integrity, and truly care about they conduct a company’s business).
   B) starts with managers who walk the talk in displaying the company’s stated values.
   C) involves managers with high ethical principles and standards who are advocates of a corporate code
      of ethics and strong ethics compliance and are genuinely committed to certain corporate values and
      business practices.
   D) starts with managers who understand there is big difference between adopting values statements and
      codes of ethics that serve merely as window dressing and those that truly paint the white lines for a
      company’s actual strategy and business conduct.
   E) all of the above.

   **Answer:** E   Page: 304   Learning Objective: 1   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Ethics/Legal Responsibilities
47. The business case for an ethical strategy
   A) focuses primarily on costs that are difficult to quantify (for example, customer defections and adverse effects on employee productivity) but can often be the most devastating.
   B) emphasizes that pursuing unethical strategies not only damages a company’s reputation but can also have costly consequences that are wide ranging.
   C) starts with numerous ethical rules and guidelines and an environment where employees rely on these rules for moral guidance.
   D) starts with managers who understand there is big difference between adopting values statements and codes of ethics that serve merely as window dressing and those that truly paint the white lines for a company’s actual strategy and business conduct.
   E) begins with ethical guidelines that help send the message that management takes the observance of ethical norms seriously and that behavior falling outside ethical boundaries will have negative consequences.

   **Answer:** B   Page: 304   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Ethics/Legal Responsibilities

**Approaches to Managing a Company's Ethical Conduct**

48. The stance a company takes in dealing with or managing ethical conduct at any given point in time can take such basic forms as
   A) the unconcerned or non-issue approach, the damage control approach, the compliance approach, and the ethical culture approach.
   B) the amoral approach, the immoral approach, and the ethically-principled approach.
   C) the ethically incorrect approach, the ethically correct approach, and the socially responsible approach.
   D) the noncompliance approach, the compliance approach, the public interest approach, and the cultural norm approach.
   E) the empowered employee approach, the cultural values approach, and the authoritarian approach.

   **Answer:** A   Page: 307   Learning Objective: 4   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Ethics/Legal Responsibilities

49. Which of the following is *not* a stance a company can take in dealing with or managing ethical conduct at any given point in time?
   A) The unconcerned or non-issue approach
   B) The damage control approach
   C) The socially responsible approach
   D) The ethical culture approach
   E) The compliance approach

   **Answer:** C   Page: 307   Learning Objective: 4   Difficulty: Easy   Taxonomy: Knowledge
   AACSB: Ethics/Legal Responsibilities
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The Unconcerned or Nonissue Approach

50. The unconcerned or non-issue approach to dealing with or managing ethical conduct
   A) is prevalent at companies whose executives ascribe to the view that notions of right and wrong in business matters are defined entirely by the prevailing laws and government regulations.
   B) is perfectly suited for ethically-principled companies where company personnel are highly accustomed to behaving in an ethical fashion (because at such companies, ethical behavior is mostly a non-issue).
   C) is favored at companies whose managers fear scandal and are desirous of containing any adverse fallout from claims of unethical actions by company personnel.
   D) is favored at companies whose managers are moral and have ethically upstanding reputations.
   E) is appropriate for companies who have a deeply-planted ethical culture.

Answer: A   Page: 307   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

The Damage Control Approach

51. The damage control approach to dealing with or managing ethical conduct
   A) is prevalent at companies whose executives are moral and want to put on a public face of being ethically-principled.
   B) is perfectly suited for ethically-principled companies where company personnel are highly accustomed to behaving in an ethical fashion (because at such companies any ethical lapses are easily subject to damage control).
   C) is favored at companies whose managers are intentionally amoral, but who are wary of scandal and adverse public relations fallout that could cost them their jobs or tarnish their careers.
   D) is appropriate for companies whose managers are highly concerned about having ethically upstanding reputations.
   E) is well-suited for companies with no history of ethical problems.

Answer: C   Page: 307   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

52. Which of the following is not accurate as concerns the damage control approach to dealing with or managing ethical conduct?
   A) The damage control approach is well-suited for companies with no history of ethical problems.
   B) Company executives that practice the damage control approach are prone to look the other way when shady or borderline behavior occurs—adopting a kind of “See no evil, hear no evil, speak no evil” stance.
   C) The damage control approach is favored at companies whose managers are intentionally amoral, but are wary of scandal and adverse public relations fallout that could cost them their jobs or tarnish their careers.
   D) Companies that practice the damage control approach often have a code of ethics that exists mainly as nice words on paper, but company personnel do not operate within a strong ethical context—there’s a notable gap between talking ethics and walking ethics.
   E) Executives at companies that practice the damage control approach are prone to making token gestures to police compliance with codes of ethics; they also rely heavily “spin” to help extricate the company from claims that the company’s strategy has unethical components.

Answer: A   Page: 307, 309   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities
53. One of the big difficulties and challenges that a company encounters in using the “damage control” approach to managing ethics-related issues and ethics conduct is
A) writing a code of ethics that looks strong but is really pretty weak in terms of ethical principles.
B) credibility problems with stakeholders and susceptibility to ethical scandal.
C) a proliferation of ethical rules and guidelines to avoid public scandal.
D) that the locus of moral control is shifted to individual employees.
E) how to discreetly signal employees that the company’s code of ethics will be lightly enforced if at all.

Answer: B   Page: 308   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

The Compliance Approach

54. The compliance approach to dealing with or managing ethical conduct
A) is perfectly suited for ethically-unprincipled companies where company personnel must be spurred into complying with the company’s ethical standards.
B) is favored at companies whose managers (1) lean toward being somewhat amoral but recognize the value of having ethically upstanding reputations or (2) are moral and see strong compliance methods as the best way to impose and enforce high ethical standards.
C) is favored at companies whose managers fear scandal and want to put on a public face of being ethical; they like having some compliance methods in place so they can give the appearance of trying to be ethical (although they are deliberately lax in pushing compliance and punishing unethical conduct).
D) is favored at companies whose managers are immoral but who see having cosmetic compliance methods in place as a safeguard against scandal.
E) is perfectly suited for companies that have had a code of ethics for 10 years or more and that want to spend little top management time exhorting company personnel to be ethical in their actions and behaviors.

AACSB: Ethics/Legal Responsibilities

55. One of the big difficulties and challenges that a company encounters in using the “compliance” approach to managing ethics-related issues and ethics conduct is
A) writing compliance procedures that look strong but really are pretty weak in terms of pushing people to observe the espoused ethical standards.
B) inability to deter inherently immoral company personnel from breaking the rules.
C) a proliferation of ethical rules and guidelines and an environment where employees come to rely on the existing rules for moral guidance—a condition that fosters a mentality of what is not forbidden is allowed.
D) that the locus of moral control is shifted to individual employees and away from top management.
E) being clever in signaling employees that the company’s code of ethics is mere window-dressing and that employees should not expect that top executives will “walk the talk” and actually practice what they preach.

Answer: C   Page: 308   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities
The Ethical Culture Approach

56. The ethical culture approach to dealing with or managing ethical conduct
A) is favored at companies where top managers are very concerned about gaining employee buy-in to the company’s ethical standards, business principles, and corporate values and see the company’s code of ethics and/or its statement of corporate values as integral to the company’s identity and ways of operating.
B) works well in companies desirous of pursuing light ethics compliance.
C) is favored at companies whose managers want to maintain the appearance of an ethical culture to help shield the company from scandal, adverse publicity, and possible unethical conduct on the part of company personnel.
D) is favored at companies whose managers are amoral yet highly concerned about maintaining the appearance of being ethically upstanding.
E) is perfectly suited for companies that have had a code of ethics for 10 years or more and that want to spend little top management time exhorting company personnel to be ethical in the actions and behavior.

Answer: A   Page: 309   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

57. Which one of the following is not a key trait of the ethical culture approach to dealing with or managing ethical conduct?
A) The ethical culture approach is favored at companies where top managers are very concerned about gaining employee buy-in to the company’s ethical standards, business principles, and corporate values and see the company’s code of ethics and/or its statement of corporate values as integral to the company’s identity and ways of operating.
B) The ethical culture approach makes little use of either a code of ethics or ethics compliance procedures.
C) There are strong peer pressures from coworkers to observe ethical norms.
D) Compliance procedures need to be an integral part of the ethical culture approach to help send the message that management takes the observance of ethical norms seriously and that behavior that fall outside ethical boundaries will have negative consequences.
E) The integrity of the ethical culture approach depends heavily on the ethical integrity of the executives who create and nurture the culture.

AACSB: Ethics/Legal Responsibilities

58. One of the big difficulties or challenges that a company encounters in using the “ethical culture” approach to managing ethics-related issues and ethics conduct is
A) relying too heavily on peer pressures and cultural norms to enforce the espoused ethical standards and underutilizing compliance enforcement procedures.
B) the lack of strong compliance procedures to deter morally corrupt company personnel from deliberately flaunting cultural norms and engaging in unethical behavior.
C) overemphasizing the creation of a work climate where everyone is an ethics watchdog and whistle-blowing is required.
D) that the locus of moral control is the company’s code of ethics.
E) greater susceptibility to ethical scandal.

Answer: A   Page: 308   Learning Objective: 4   Difficulty: Hard   Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities
59. Which of the following statements is false as concerns the various approaches company managers can take in dealing with or managing ethical conduct?

A) Companies that adopt a compliance mode usually do such things as making the company’s code of ethics a visible and regular part of communications with employees, having ethics training programs, appointing a chief ethics officer or ethics ombudsperson, instituting formal procedures for investigating alleged ethics violations, conducting ethics audits, and giving ethics awards to employees for outstanding efforts to create an ethical climate.

B) Companies using the damage control approach usually make some concession to window-dressing ethics, going so far as to adopt a code of ethics (so their executives can point to it as evidence of their ethical commitment should any ethical lapses on the company’s part be exposed).

C) One of the weaknesses of the compliance approach is that moral control resides in the company’s code of ethics and in the ethics compliance system rather than in an individual’s own moral responsibility for ethical behavior and in strong peer pressures for ethical behavior.

D) The main objective of the compliance approach is to protect against adverse publicity and any damaging consequences brought on by headlines in the media, outside investigation, threats of litigation, punitive government action, or angry or vocal shareholders.

E) Companies using the unconcerned or non-issue approach ascribe to the view that ethics has no place in the conduct of business and that companies should not be morally accountable for their actions.

**Answer:** D


AACSB: Ethics/Legal Responsibilities

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**Social Responsibility and Corporate Citizenship Strategies**

60. The notion of social responsibility as it applies to businesses concerns

A) a company’s duty to put the public interest ahead of shareholder interests.

B) societal expectations that all company stakeholders will be treated equally and fairly.

C) a company’s duty to establish socially acceptable core values and to have a strictly enforced code of ethical conduct.

D) the responsibility that top management has for ensuring that the company’s actions and decisions are in the best interest of society at large.

E) a company’s duty to operate in an honorable manner, provide good working conditions for employees, be a good steward of the environment, and actively work to better the quality of life in the local communities where it operates and in society at large.

**Answer:** E

Page: 312  Learning Objective: 5  Difficulty: Medium  Taxonomy: Knowledge

AACSB: Ethics/Legal Responsibilities

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61. Which of the following is not generally on a company’s menu of actions to consider in crafting a strategy of social responsibility?

A) Actions to ensure that the company’s strategy is ethical and that ethical principles will be observed in operating the business

B) Making charitable contributions, donating money and the time of company personnel to community service endeavors, supporting various worthy organizational causes, and reaching out to make a difference in the lives of the disadvantaged

C) Actions to look out exclusively for the best interests of shareholders

D) Actions to protect or enhance the environment (apart from what is required by governmental authorities)

E) Actions to create a work environment that enhances employee well-being and makes the company a great place to work

**Answer:** C

Page: 312 - 313  Learning Objective: 5  Difficulty: Medium  Taxonomy: Knowledge

AACSB: Ethics/Legal Responsibilities
62. Which of the following is not something a company should usually consider in crafting a strategy of social responsibility?
A) Actions to benefit shareholders (such as raising the dividend or boost the stock price)
B) Making charitable contributions and donating money and the time of company personnel to community service endeavors.
C) Actions to ensure the company has an ethical strategy and operates honorably and ethically.
D) Actions to protect or enhance the environment
E) Actions to create a workforce diversity program

Answer: A Page: 313 Learning Objective: 5 Difficulty: Medium Taxonomy: Knowledge AACSB: Ethics/Legal Responsibilities

63. Which of the following should be on a company’s menu of actions to consider in crafting a strategy of social responsibility?
A) Actions to ensure that the company’s strategy is ethical and that ethical principles will be observed in operating the business
B) How much and what kinds of resources it will allocate to charitable contributions, community service endeavors, various worthy causes, and helping the disadvantaged
C) Actions (over and above what is required) to protect or enhance the environment, including both those environmental problems stemming from the company’s own business activities and those problems outside the company’s immediate sphere of operations
D) Actions to create a work environment that enhances employee well-being and makes the company a great place to work
E) All of these.

Answer: E Page: 312 - 314 Learning Objective: 5 Difficulty: Easy Taxonomy: Knowledge AACSB: Ethics/Legal Responsibilities

64. A company’s social responsibility strategy is typically comprised of all but which one of the following elements?
A) Actions to enhance workforce diversity and make the company a great place to work
B) Making charitable contributions and donating money and the time of company personnel to community service endeavors
C) Actions to protect or enhance the environment
D) Conscious efforts to ensure that all elements of the company’s strategy are ethical and actions to protect or enhance the environment (beyond what is legally required)
E) Actions to keep prices low enough that the company’s profits will not be viewed by the general public as obscenely high or exorbitant

Answer: E Page: 312 - 314 Learning Objective: 5 Difficulty: Easy Taxonomy: Comprehension AACSB: Ethics/Legal Responsibilities

65. Striving to be socially responsible entails touching such bases as
A) what actions to take to enhance workforce diversity and make the company a great place to work.
B) whether to make charitable contributions and donate money and the time of company personnel to community service endeavors.
C) what, if any, actions to take to protect or enhance the environment (beyond what is legally required).
D) exerting conscious efforts to ensure that all elements of the company’s strategy are ethical and actions to make the company a great place to work.
E) All of these.

Answer: E Page: 312 - 314 Learning Objective: 5 Difficulty: Easy Taxonomy: Comprehension AACSB: Ethics/Legal Responsibilities
66. Good corporate citizens
   F) pursue discretionary activities that contribute to the betterment of society, especially in areas where
government has chosen not to focus its efforts or has fallen short.
   G) are active participants in the political process.
   H) identify up-and-coming managers who have a future in local- or state-level politics.
   I) create a democratic workplace whereby the voices of lower-level employees are heard through
representation on the board of directors.
   J) All of these.

**Answer:** A  Page: 314  Difficulty: Easy  Learning Objective: 5  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

**Environmental Sustainability Strategies: A New and Growing Priority**

67. An environmental sustainability strategy consists of a company’s deliberate actions to
   A) operate in an honorable manner, provide good working conditions for employees, and to actively work
to enhance the quality of life in the local communities where it operates and in society at large.
   B) meet the current needs of customers, suppliers, shareholders, employees and other stakeholders in
a manner that protects the environment, provides for the longevity of natural resources, maintains
ecological support systems for future generations, and guards against ultimate endangerment of the
planet.
   C) apply ethical principles of right and wrong regarding the protection and enhancement of natural
resources and ecological support systems as set forth in the Global Code of Ethical Behavior adopted
by 150 nations of the world.
   D) apply universal norms regarding the protection of the environment to its everyday operations and to
establish guidelines regarding what actions are ecology sound based on the findings of the scientific
community.
   E) balance commonly held views about what constitutes environmentally appropriate actions against its
ability to make a profit.

**Answer:** B  Page: 315  Learning Objective: 5  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

68. Which of the following is not something a company should consider in crafting an environmental
sustainability strategy?
   A) Actions to protect the environment that will guard against the ultimate endangerment of the planet
   B) Actions to maintain ecological support systems for future generations
   C) Actions to provide for the longevity of natural resources
   D) Making contributions to the Global Environmental Council which are distributed based on a competitive
basis
   E) All of these

**Answer:** D  Page: 315  Learning Objective: 5  Difficulty: Easy  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities
Crafting Social Responsibility and Sustainability Strategies

69. Which of the following statements regarding a company’s social responsibility and sustainability strategy is false?

A) A company is not demonstrating an adequate degree of social responsibility or endeavoring to be a model corporate citizen unless it spends 5% (or more) of pretax profits on social responsibility initiatives.

B) Social responsibility strategies that have the effect of both providing valuable social benefits and fulfilling customer needs in a superior fashion can lead to competitive advantage.

C) A few companies have integrated social responsibility and/or environmental sustainability objectives into their missions and overall performance targets; they view social performance and environmental metrics as an essential component of judging the company’s overall future performance.

D) Unless a company’s social responsibility initiatives become part of the way it operates its business every day, the initiatives are unlikely to be fully effective.

E) While the strategies and actions of all socially responsible companies have a sameness in the sense of drawing on the same categories of socially responsible behavior, each company’s version of being socially responsible is unique.

Answer: A  Page: 317 - 318  Learning Objective: 5  Difficulty: Easy  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

The Moral Case for Corporate Social Responsibility and Environmentally Sustainable Business Practices

70. The moral case for why a company should actively promote the betterment of society and act in a manner benefitting all its stakeholders

A) is based on the principle of treating people fairly and with respect.

B) is based on the conviction that improving the well-being of society ranks higher in priority and is certainly more noble than making a profit and serving the interests of shareholders.

C) boils down to “it’s the right thing to do.”

D) rests on the principle that a business is duty bound to fulfill its social contract to serve the interests of all stakeholders in a business enterprise.

E) is based on the principle that business activities lack real legitimacy and have few socially redeeming qualities unless and until a company exerts a significant and sincere effort to give something back to the community.

Answer: C  Page: 318  Learning Objective: 6  Difficulty: Easy  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

71. Which one of the following is not part of the moral case for why a company should actively promote the betterment of society?

A) “It’s the right thing to do.”

B) Most business leaders can be expected to acknowledge that socially responsible actions and environmental sustainability are important and that businesses have a duty to be good corporate citizens.

C) In return for society granting a business a “license to operate” and not be unreasonably restrained in its pursuit of a fair profit, a business is obligated to act as a responsible citizen and do its fair share to promote the general welfare.

D) Acting in a socially responsible manner is in the overall best interest of shareholders.

E) Every business has a moral duty to take corporate citizenship into consideration and to do what’s best for shareholders within the confines of discharging its duties to operate honorably, provide good working conditions to employees, be a good environmental steward, and display good corporate citizenship.

Answer: D  Page: 318 - 319  Learning Objective: 6  Difficulty: Hard  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities
The Business Case for Socially Responsible Behavior and Environmentally Sustainable Business Practices

72. The business case for why companies should act in a socially responsible manner includes such reasons as

A) it generates internal benefits (as concerns employee recruiting, workforce retention, employee morale, and training costs).
B) it reduces the risk of reputation-damaging incidents.
C) it is in the best interest of shareholders.
D) it can lead to increased buyer patronage.
E) All of these.

**Answer:** E   Page: 319 - 321   Learning Objective: 6   Difficulty: Easy   Taxonomy: Comprehension   AACSB: Ethics/Legal Responsibilities

73. Which one of the following is *not* a part of the business case for why companies should act in a socially responsible manner?

A) Every business has a moral duty to be a good corporate citizen.
B) Acting in a socially responsible manner reduces the risk of reputation-damaging incidents.
C) Acting in a socially responsible manner is in the overall best interest of shareholders.
D) To the extent that a company’s socially responsible behavior wins applause from consumers and fortifies its reputation, a company may win additional patronage.
E) Acting in a socially responsible manner can generate internal benefits (as concerns employee recruiting, workforce retention, employee morale, and training costs).

**Answer:** A   Page: 319 - 321   Learning Objective: 6   Difficulty: Medium   Taxonomy: Comprehension   AACSB: Ethics/Legal Responsibilities

74. Which one of the following is *false* as concerns the merits of why acting in a socially responsible manner is “good business”?

A) The higher the public profile of a company or brand, the greater the scrutiny of its activities and the higher the potential for it to become a target for pressure group action.
B) Acting in a socially responsible manner nearly always results in higher profits and a higher stock price for shareholders.
C) To the extent that a company’s socially responsible behavior wins applause from consumers and fortifies its reputation, a company may win additional patronage.
D) Some employees feel better about working for a company committed to improving society—a condition that can contribute to lower turnover and better worker productivity.
E) Companies with deservedly good reputations for contributing time and money to the betterment of society are better able to attract and retain employees compared to companies with tarnished reputations.

**Answer:** B   Page: 319 - 321   Learning Objective: 6   Difficulty: Medium   Taxonomy: Comprehension   AACSB: Ethics/Legal Responsibilities
Short Answer Questions

75. What is the difference between ethics and business ethics?

Page: 290  Learning Objective: 1  Difficulty: Easy  Taxonomy: Knowledge
AACSB: Ethics/Legal Responsibilities

76. What are the strengths and weaknesses of the thesis that ethical standards are (or should be) universal?

Page: 292  Learning Objective: 1  Difficulty: Hard  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

77. Explain the difference between the school of ethical universalism and the school of ethical relativism.

Page: 292 - 295  Learning Objective: 1  Difficulty: Hard  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

78. What are the strengths and weaknesses of the beliefs and tenets underlying the school of ethical relativism?

Page: 292 - 295  Learning Objective: 1  Difficulty: Hard  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

79. Ethical relativism equates to multiple sets of ethical standards. True or false? Explain your answer.

Page: 294  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

80. What is meant by integrated social contracts theory? What is its contribution to the debate about ethical standards?

Page: 295 - 296  Learning Objective: 1  Difficulty: Hard  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

81. Explain the difference between ethical universalism and integrated social contracts theory. Which school of thought do you think is most valid? Explain the reasons for your answer.

Page: 292; 295 - 296  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

82. Discuss briefly what is meant by the terms ethical universalism and ethical relativism. Where does integrated social contracts theory fit into the debate about ethical standards? Which of the three schools of thought stands on the strongest ground?

Page: 292 - 296  Learning Objective: 1  Difficulty: Hard  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities
83. Explain the difference between an immoral manager and an amoral manager. Which type is more representative of the managerial population?

Page: 297 - 298  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
AACSBR: Ethics/Legal Responsibilities

84. Identify and briefly explain the three categories of management morality.

Page: 297 - 298  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
AACSBR: Ethics/Legal Responsibilities

85. What are the chief causes of unethical strategies and unethical business behavior?

Page: 299 - 303  Learning Objective: 2  Difficulty: Medium  Taxonomy: Knowledge
AACSBR: Ethics/Legal Responsibilities

86. Identify and briefly describe the three main drivers of unethical strategies and unethical managerial and business behavior.

Page: 299 - 303  Learning Objective: 2  Difficulty: Medium  Taxonomy: Knowledge
AACSBR: Ethics/Legal Responsibilities

87. What is the case for why business strategies should be ethical?

Page: 304 - 305  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension
AACSBR: Ethics/Legal Responsibilities

88. Identify the three types of business costs of ethical failures; provide examples for each type of cost.

Page: 305  Learning Objective: 3  Difficulty: Hard  Taxonomy: Comprehension
AACSBR: Ethics/Legal Responsibilities

89. Identify and briefly describe any three of the four approaches to managing a company’s ethical conduct?

AACSBR: Ethics/Legal Responsibilities

90. Identify the four approaches to managing a company’s ethical conduct discussed in Chapter 9. Which of the four do you think makes the most sense? Why?

Page: 307  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension
AACSBR: Ethics/Legal Responsibilities

91. Identify the five main types of actions which a company can choose from in crafting a social responsibility strategy?

Page: 313  Learning Objective: 5  Difficulty: Medium  Taxonomy: Comprehension
AACSBR: Ethics/Legal Responsibilities
92. Explain how environmental sustainability strategies go about improving a company’s “Triople-P” performance—people, planet, and profit. Why is it important for strategy-makers to find points of intersection between society and the company’s ability to execute value chain activities or better serve customer needs?

Page: 315 - 317  Learning Objective: 5  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

93. What is the essence of the moral case for why a company should engage in socially responsible actions and environmentally sustainable business practices?

Page: 318 - 319  Learning Objective: 6  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

94. What is the essence of the business case for why a company should engage in socially responsible actions and environmentally sustainable business practices?

Page: 319 - 321  Learning Objective: 6  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities
Multiple Choice Questions

The Managerial Tasks Involved in Implementing and Executing Strategy

1. Once company managers have decided on a strategy, the emphasis turns to
   A) converting the strategy (and any associated strategic plan) into actions and good results.
   B) empowering employees to revise and reorganize value chain activities to match the strategy.
   C) establishing policies and procedures that instruct company personnel in the ways and means of executing the strategy.
   D) developing a detailed implementation plan that sets forth exactly what every department and every manager needs to do to proficiently execute the company’s strategy.
   E) building the core competencies and competitive capabilities needed to execute the strategy.

   Answer: A Page: 327 Learning Objective: 1 Difficulty: Medium Taxonomy: Comprehension AACSB: Value Creation

2. Executing strategy
   A) is primarily an operations-driven activity revolving around the management of people and business processes.
   B) tests a manager’s ability to direct organizational change and achieve continuous improvement in operations and business processes.
   C) tests a manager’s ability to create and nurture a strategy-supportive culture.
   D) tests a manager’s ability to consistently meet or beat performance targets.
   E) All of these.

   Answer: E Page: 327 Learning Objective: 1 Difficulty: Easy Taxonomy: Comprehension AACSB: Value Creation

3. Which one of the following statements falsely characterizes the managerial task of executing strategy?
   A) Executing strategy is an action-oriented, make-things-happen task.
   B) Executing strategy tests a manager’s ability to direct organizational change, achieve continuous improvement in operations and business processes, create and nurture a strategy-supportive culture, and consistently meet or beat performance targets.
   C) The challenge of successfully implementing new strategic initiatives principally involves employing managerial techniques to overcome resistance to change.
   D) Strategy execution requires a team effort that entails every manager thinking through the answer to “What does my area have to do to implement its part of the strategic plan, and what should I do to get these things accomplished effectively and efficiently?”
   E) Implementing and executing strategy is primarily an operations-driven activity revolving around the management of people and business processes.

   Answer: C Page: 327 - 328 Learning Objective: 1 Difficulty: Medium Taxonomy: Comprehension AACSB: Value Creation
4. What makes the managerial task of executing strategy so challenging and demanding is
A) the trial-and-error experimentation that is required to come up with a workable organizational structure.
B) the demanding people-management skills required, the resistance to change that has to be overcome, and the perseverance necessary to get a variety of initiatives launched and kept moving along.
C) the time and effort it takes to build core competencies.
D) the time, training, and creative effort it takes to empower employees and teach them responsible decision-making.
E) the supervisory requirements associated with getting company personnel to do things the right way.

**Answer:** B   Page: 328   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

5. Which of the following statements about implementing and executing a new strategy is true?
A) The managerial tasks of implementing and executing a new strategy call for essentially the same kinds of creative management talent and innovative thinking as does crafting strategy.
B) Executing strategy is chiefly a financially-driven process aimed at squeezing the most profit out of conducting daily operations.
C) Executing strategy is a job for a company’s whole management team, not just a few senior managers; moreover, all employees are participants in the strategy execution process.
D) Executing strategy depends heavily on the caliber of a CEO’s business vision, industry and competitive analysis skills, and entrepreneurial creativity.
E) Executing strategy tends to be a simpler, quicker management task to perform as compared to crafting a winning strategy.

**Answer:** C   Page: 328   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

6. Ultimate responsibility for seeing that strategy is executed successfully primarily falls upon the shoulders of
A) a company’s chief executive officer, its chief operating officer, and the heads of major units (business divisions, functional departments, and key operating units).
B) first-line supervisors who have day-to-day responsibility for seeing that key value chain activities are done properly.
C) the company’s board of directors because board members are the final authority in overseeing and conducting daily operations.
D) a company’s whole management team—each manager is responsible for attending to what needs to be done in his/her respective area of authority and thus should be held accountable for success or failure.
E) all company personnel because all employees are active participants in the strategy execution process and the caliber of their actions have a huge impact on the ultimate outcome.

**Answer:** A   Page: 328   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation
7. While ultimate responsibility for implementing and executing strategy falls upon the shoulders of senior executives,
   A) top-level managers still have to rely on the active support and cooperation of middle and lower-level managers in pushing needed changes in functional areas and operating units.
   B) the pivotal and most decisive strategy-implementing actions are carried out by front-line supervisors who have day-to-day responsibility for seeing that key activities are done properly.
   C) it is a company’s employees who most determine whether the drive for good strategy execution will succeed or fail.
   D) the success or failure of the implementation/execution effort hinges chiefly on doing an effective job of empowering employees to make day-to-day operating decisions that support good strategy execution.
   E) the success or failure of the implementation/execution effort hinges chiefly on a company’s reward system and whether its policies and procedures are strategy-supportive.

**Answer:** A  Page: 328  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

8. Implementing and executing a company’s strategy
   A) is primarily the job of the company’s board of directors since they direct the actions and policies of the top senior executives in executing the strategy.
   B) is a task for every manager and the whole management team but ultimate responsibility for success or failure falls upon the top senior executives.
   C) is primarily a responsibility of all company personnel because all personnel are active participants in the strategy execution process and their actions have a huge impact on the ultimate outcome.
   D) should be delegated to a chief strategy implementer appointed by the chief executive officer.
   E) is primarily a task for middle and lower-level managers because it is they who have responsibility for pushing the needed changes all the way down to the lowest levels of the organization.

**Answer:** B  Page: 328  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

9. Management’s handling of the strategy implementation/execution process can be considered successful
   A) when the internal organization develops 2 or more core competencies in performing value chain activities.
   B) if and when the company meets or beats its performance targets and shows good progress in achieving its strategic vision for the company.
   C) if the company’s culture is strong and strategy-supportive.
   D) if management is able to marshal adequate resources to put the strategy in place within 6-12 months.
   E) if managers and employees express strong support for the company’s strategy and long-term direction.

**Answer:** B  Page: 329  Learning Objective: 1  Difficulty: Easy  Taxonomy: Comprehension
AACSB: Value Creation
The Principal Managerial Components of the Strategy Execution Process

10. Which of the following is not among the principal managerial components of the strategy execution process?
   A) Building an organization with the competencies, capabilities, and resource strengths needed to execute strategy successfully
   B) Instituting policies and procedures that facilitate rather than impede strategy execution
   C) Deciding which core competencies and value chain activities to leave as is and which ones to overhaul and improve
   D) Adopting best practices and pushing for continuous improvement in how value chain activities are performed
   E) Tying rewards directly to the achievement of strategic and financial targets and to good strategy execution

   Answer: C   Page: 329-330   Learning Objective: 1   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation

11. The principal managerial components of the strategy execution process include which of the following?
   A) Deciding how much to spend on employee training
   B) Instituting policies and procedures that facilitate strategy execution and tying rewards to the achievement of strategic and financial targets
   C) Doing an effective job of empowering employees
   D) Revamping the value chain in a manner calculated to maximize operating efficiency
   E) Selecting a capable top management team

   Answer: B   Page: 329-330   Learning Objective: 1   Difficulty: Easy   Taxonomy: Knowledge
   AACSB: Value Creation

12. Which of the following is not among the principal managerial components of the strategy execution process?
   A) Exercising strong leadership to drive execution forward, keep improving on the details of execution, and achieve operating excellence as rapidly as feasible
   B) Marshaling sufficient money and people behind the drive for strategy execution
   C) Selecting and retaining capable employees, thereby enhancing the company’s intellectual capital resources
   D) Instituting best practices and pushing for continuous improvement in how value chain activities are performed
   E) Instilling a corporate culture that promotes good strategy execution

   Answer: C   Page: 329-330   Learning Objective: 1   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation

13. In devising an action agenda to implement and execute a new or different strategy, the place for managers to start is with
   A) the task of revising and enhancing the company’s core competencies.
   B) choosing which leadership style to employ in trying to carry out the strategy successfully.
   C) evaluating whether existing policies and procedures are adequately strategy-supportive.
   D) allocating more resources to strategy-critical parts of the business.
   E) a probing assessment of what the organization must do differently and better to carry out the strategy successfully

   Answer: E   Page: 330 - 331   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
Building an Organization Capable of Good Strategy Execution

14. The three components of building a capable organization are
   A) making periodic changes in the firm’s internal organization to keep people from getting into a comfortable rut, instituting a decentralized approach to decision-making, and developing the appropriate competencies and capabilities.
   B) hiring a capable top management team, empowering employees, and establishing a strategy-supportive corporate culture.
   C) putting a centralized decision-making structure in place, determining who should have responsibility for each value chain activity, and aligning the corporate culture with key policies, procedures, and operating practices.
   D) staffing the organization, building core competencies and competitive capabilities, and structuring the organization and work effort.
   E) optimizing the number of core competencies and competitive capabilities, making sure that all managers and employees are empowered, and maximizing internal operating efficiency.

   **Answer:** D   Page: 331 - 332   Learning Objective: 1   Difficulty: Medium   Taxonomy: Knowledge   AACSB: Value Creation

15. Building an organization capable of good strategy execution entails
   A) staffing the organization, building core competencies and competitive capabilities, and structuring the organization and work effort.
   B) decentralizing authority for performing strategy-critical value chain activities, establishing at least two distinctive competencies, and hiring talented employees.
   C) investing heavily in employee training, using an empowered organization design and organization structure in order to maximize labor productivity, and employing effective incentive compensation systems.
   D) centralizing authority in the hands of a chief strategy implementer so as to create the leadership authority for driving implementation forward at a rapid pace.
   E) empowering employees, maximizing internal operating efficiency, and optimizing core competencies.

   **Answer:** A   Page: 331 - 332   Learning Objective: 1   Difficulty: Medium   Taxonomy: Knowledge   AACSB: Value Creation

Staffing the Organization

16. Putting together a capable top management team
   A) should take top priority in building competitively valuable core competencies.
   B) is particularly important when the firm is pursuing unrelated diversification or making a number of new acquisitions in related businesses.
   C) is important in building an organization capable of proficient strategy execution, but is nearly always less crucial than doing a superior job of training and retraining employees.
   D) entails filling key managerial slots with smart people who are clear thinkers, good at figuring out what needs to be done, and skilled in “making it happen” and delivering good results.
   E) is particularly essential for executing a strategy to keep a company’s costs lower than rivals and become the industry’s low-cost leader.

   **Answer:** D   Page: 332   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension   AACSB: Value Creation
17. The overriding aim in building a management team should be to
   A) select people who are committed to decentralizing decision-making and empowering employees.
   B) assemble a critical mass of talented managers who can function as agents of change, work well together as a team, and produce organizational results that are dramatically better than what one or two star managers acting individually can achieve.
   C) choose managers experienced in controlling costs and flattening the organization structure.
   D) select people who have similar management styles, leadership approaches, business philosophies, and personalities.
   E) choose managers who believe in having a strong corporate culture and deeply ingrained core values.

   **Answer:** B   Page: 333   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

18. Recruiting and retaining capable employees
   A) is usually much more important to good strategy execution than is assembling a capable top management team.
   B) is important because the quality of an organization’s people is always an essential ingredient of successful strategy execution—knowledgeable, engaged employees are a company’s best source of creative ideas for the nuts-and-bolts improvements that lead to operating excellence.
   C) is more important during periods of rapid growth than during periods of crisis and attempted turnarounds.
   D) is an important organization-building element, particularly when it comes to transforming a competence into a core competence or distinctive competence.
   E) is easily the most critical aspect in building competitively valuable core competencies and capabilities.

   **Answer:** B   Page: 334 - 335   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

19. Which one of the following statements about recruiting and retaining capable employees is false?
   A) The quality of an organization’s people is always an essential ingredient of successful strategy execution.
   B) Recruiting and retaining capable employees is a particularly important organization-building task in enterprises where superior intellectual capital is a key resource and also a basis for competitive advantage.
   C) Recruiting and retaining capable employees is usually much more important to good strategy execution and the achievement of true operating excellence than is assembling a capable top management team.
   D) It is very difficult for a company to competently execute its strategy and achieve operating excellence without a large band of capable employees who are actively engaged in the process of making ongoing operating improvements.
   E) In many industries, adding to a company’s talent base and building intellectual capital is more important to good strategy execution than additional investments in plants, equipment, and capital projects.

   **Answer:** C   Page: 333, 335   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
20. Which of the following is generally not among the practices that companies use to staff jobs with the best people they can find, particularly if intellectual capital greatly aids good strategy execution?

A) Careful screening and evaluation of job applicants, along with continuous training and retraining of employees
B) Rotating people through jobs that not only have great content but also span functional and geographic boundaries
C) Weeding out the 20% lowest performing employees each year
D) Encouraging employees to challenge existing ways of doing things, to be creative and innovative in proposing better ways of operating, and to push their ideas for new products or businesses
E) Fostering a stimulating and engaging work environment such that employees will consider the company a great place to work

**Answer:** C  Page: 335 - 336  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation

21. In companies where intellectual capital is crucial to good strategy execution, which of the following is generally not among the practices that companies use to establish a talented knowledge base?

A) Providing promising employees with challenging, interesting, and skill-stretching assignments and also rotating them through jobs that not only have great content but also span functional and geographic boundaries
B) Expecting employees to take full responsibility for staying up to date, thereby minimizing the need to train or retrain employees
C) Coaching average performers to improve their skills and capabilities, while weeding out underperformers and benchwarmers
D) Encouraging employees to challenge existing ways of doing things, to be creative and innovative in proposing better ways of operating, and to push their ideas for new products or businesses
E) Fostering a stimulating and engaging work environment such that employees will consider the company a great place to work

**Answer:** C  Page: 335 - 336  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation

### Building Core Competencies and Competitive Capabilities

22. The capability-building process

A) requires first developing the ability to do something, however imperfectly or inefficiently; second, translating this ability into a competence by learning to do the activity consistently well and at an acceptable cost; and then continuing to polish and refine its know-how in an effort further improve its performance, ideally striving to match or beat rivals in performing the activity.
B) entails establishing a new department with primary responsibility for developing the expertise to give the company the needed core competencies and capabilities.
C) stands a better chance of succeeding if a company employs a traditional functional organization structure.
D) is made much easier if a company abstains from outsourcing important value chain activities.
E) aims at turning the company’s distinctive competencies into core competencies.

**Answer:** A  Page: 337  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation
23. The capability-building process

A) is first and foremost an activity in empowering employees, putting them on a single team (or in a single department), and giving them the tools and training to perform the desired activity with a high degree of proficiency.

B) is a one-step process built around properly training and empowering employees to perform their assigned activities in a tightly-prescribed manner.

C) can be shortcut by weeding out underperforming employees and replacing them with people having stronger skills sets and know-how.

D) is best done by forming a new department charged with developing the desired competence or capability.

E) requires first developing the ability to do something, however imperfectly or inefficiently; second, translating this ability into a competence and/or capability by learning to do the activity consistently well and at an acceptable cost; and then continuing to polish and refine its know-how in an effort further improve its performance, ideally striving to match or beat rivals in performing the activity.

**Answer:** E   Page: 337   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

24. Core competencies and competitive capabilities

A) usually are lodged in the narrow skills and specialized work efforts of a single department, as opposed to the combined expertise and capabilities of specialists scattered across several departments.

B) most usually stem from collaborative efforts with strategic allies.

C) are usually bundles of skills and know-how that most often grow out of the combined efforts of cross-functional work groups and departments performing complementary activities at different locations in a firm’s value chain.

D) tend to result in competitive advantage when they involve highly specific technologies and are grounded in a company’s own deep technical expertise.

E) typically are built rapidly, usually in conjunction with important product innovations.

**Answer:** C   Page: 337   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

25. Which of the following is **not** one of the traits of the capability-building process?

A) Core competencies or capabilities are usually the product of astute company efforts to hire and train talented employees.

B) Normally, core competencies and competitive capabilities emerge incrementally as a company acts to bolster skills that contributed to earlier successes.

C) Core competencies or capabilities are most often bundles of skills and know-how that grow out of the combined efforts of cross-functional work groups and departments performing complementary activities at several places in the firm’s value chain.

D) The key to leveraging a core competence into a distinctive competence (or transforming a capability into a competitively superior capability) is concentrating more effort and talent than rivals on strengthening the competence or capability to achieve competitive advantage.

E) Evolving changes in customer needs and competitive conditions often require tweaking and adjusting a company’s portfolio of competencies and intellectual capital to keep its capabilities freshly honed and on the cutting edge.

**Answer:** A   Page: 337 - 338   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation
26. Which of the following are traits of the capability-building process?

A) Evolving changes in customer needs and competitive conditions often require tweaking and adjusting a company’s portfolio of competencies and intellectual capital to keep its capabilities freshly honed and on the cutting edge.

B) Normally, a core competence or capability emerges incrementally out of company efforts either to bolster skills that contributed to earlier successes or to respond to customer problems, new technological and market opportunities, and the competitive maneuverings of rivals.

C) Core competencies or capabilities are most often bundles of skills and know-how that grow out of the combined efforts of cross-functional work groups and departments performing complementary activities at different locations in a firm’s value chain.

D) The key to leveraging a core competence into a distinctive competence (or transforming a capability into a competitively superior capability) is concentrating more effort and talent than rivals on deepening and strengthening the competence or capability so as to achieve the dominance needed for competitive advantage.

E) All of these.

Answer: E  Page: 337 - 338  Learning Objective: 2  Difficulty: Easy  Taxonomy: Comprehension
AACSB: Value Creation

27. Which of the following statements about developing organizational competencies and capabilities is false?

A) Core competencies or capabilities are most often bundles of skills and know-how that grow out of the combined efforts of cross-functional work groups and departments performing complementary activities at different locations in a firm’s value chain.

B) Evolving changes in customer needs and competitive conditions often require tweaking and adjusting a company’s portfolio of competencies and intellectual capital to keep its capabilities freshly honed and on the cutting edge.

C) Normally core competencies and competitive capabilities emerge incrementally as a company (1) acts to bolster skills that contributed to earlier successes or (2) acts to respond to customer problems, new technological or market opportunities, and the competitive maneuvers of rivals.

D) Building organizational capabilities is best and most cost-effectively accomplished by hiring a cadre of people with the right talent and expertise, putting them together in a single work group, and then teaming the work group with key strategic allies/partners to mesh the skills, expertise, and competencies needed to perform the desired capabilities with some proficiency.

E) The key to leveraging a core competence into a distinctive competence (or transforming a capability into a competitively superior capability) is concentrating more effort and talent than rivals on deepening and strengthening the competence or capability so as to achieve the dominance needed for competitive advantage.

Answer: D  Page: 337 - 338  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation
28. Which of the following is not one of the traits of core competencies and/or competitive capabilities?

A) The key to leveraging core competencies into competitive advantage is concentrating sufficient effort and talent on deepening and strengthening them that the firm achieves dominating depth and gains the capability to outperform rivals by a meaningful margin.

B) Core competencies have to be tweaked and adjusted to keep them fresh and responsive to changing customer needs and market conditions.

C) Core competencies typically are lodged in the combined efforts of different work groups and departments.

D) Core competencies generally grow out of company efforts to master a strategy-critical technology or to invent and patent a valuable technology.

E) Core competencies tend to emerge gradually rather than blossoming quickly.

**Answer:** D  Page: 337 - 338  Learning Objective: 2  Difficulty: Hard  Taxonomy: Comprehension  
AACSB: Value Creation

29. Sometimes a company can short-circuit the task of building an organizational capability in-house by

A) putting in high incentive bonuses to reward individual employees who train hard to develop the desired capability.

B) launching an extensive training effort to develop the capability quickly with newly hired employees.

C) either acquiring a company that has already developed the capability or else acquiring the desired capability through collaborative efforts with outsiders having the requisite skills, know-how, and expertise.

D) using benchmarking and the adoption of best practices to imitate a capability that rivals have already developed.

E) empowering a team of employees to develop the capability however they best fit.

**Answer:** C  Page: 339  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Value Creation

30. Which of the following is not accurate as concerns a company’s competencies and capabilities?

A) Competencies and capabilities that grow stale can impair competitiveness unless they are refreshed, modified, or even phased out and replaced in response to ongoing market changes and shifts in company strategy.

B) Core competencies have to be tweaked and adjusted to keep them fresh and responsive to changing customer needs and market conditions.

C) The imperatives of keeping capabilities in step with ongoing strategy and market changes make it appropriate to view a company as a bundle of evolving competencies and capabilities.

D) Even after core competencies and competitive capabilities are in place and functioning, company managers can’t relax—they still have wrestle with when and how to recalibrate existing competencies and capabilities and when and how to develop new ones.

E) When a company succeeds in hiring talented employees and training them properly, competencies and capabilities tend to blossom quickly and, once put in place, can last for a decade or more.

**Answer:** E  Page: 339  Learning Objective: 2  Difficulty: Easy  Taxonomy: Comprehension  
AACSB: Value Creation
31. In which one of the following instances is the training and retraining of employees likely to make the least important contribution to good strategy execution?

A) When a company shifts to a strategy requiring different skills, competitive capabilities, managerial approaches, and operating methods
B) When an organization is striving to build skills-based competencies
C) When technical know-how is changing so rapidly that a company loses its ability to compete unless its skilled people have cutting-edge knowledge and expertise
D) When the chosen strategy calls for deeper technological capability or building and using new capabilities.
E) When the strategy execution effort is based on tried and true operating practices that vary little from year to year.

**Answer:** E  Page: 339 - 341  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

32. The strategic importance of deliberately trying to develop organizational competencies and capabilities is

A) lower cost for employee training.
B) improved strategy execution and a potential for competitive advantage.
C) increased ability to reduce total operating costs.
D) the added ease with which strategic fit and resource fit benefits can be captured.
E) enhanced ability to avoid the perils of outsourcing.

**Answer:** B  Page: 341  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

33. When it is difficult or impossible to out-strategize rivals (beat them with a superior strategy), the other main avenue to competitive advantage is to

A) do a better job of empowering employees and flattening the organization structure.
B) outcompete them with a stronger corporate culture.
C) outexecute them (beat them by performing certain value chain activities in superior fashion).
D) beat them with a healthy corporate culture based on such core values as high ethical standards, a strong sense of corporate social responsibility, and genuine concern for customer well-being.
E) institute a more motivating and cost-efficient compensation and reward system.

**Answer:** C  Page: 341  Learning Objective: 2  Difficulty: Hard  Taxonomy: Comprehension
AACSB: Value Creation

**Execution-Related Aspects of Organizing the Work Effort**

34. Organizing a company’s work effort to promote successful strategy execution involves

A) deciding how much to spend on training managers and employees.
B) deciding which value chain activities to perform in-house and which to outsource and making internally performed strategy-critical value chain activities the main building blocks in the organization structure.
C) choosing an organization structure that is a tight fit with the corporate culture.
D) hiring a capable management team.
E) instituting a compensation structure that reduces employee turnover and thus stabilizes the make-up of work teams.

**Answer:** B  Page: 342  Learning Objective: 3  Difficulty: Easy  Taxonomy: Comprehension
AACSB: Value Creation
35. Which one of the following is not part of organizing the work effort in ways that promote successful strategy execution?

A) Providing for the necessary collaboration with suppliers and strategic allies
B) Providing for cross-unit coordination and deciding which value chain activities to perform in-house and which ones to outsource
C) Determining how much authority to centralize at the top and how much to delegate to down-the-line managers and employees
D) Determining which functions and organizational units require superior intellectual capital
E) Making internally performed strategy-critical value chain activities the main building blocks in the organization structure

Answer: D  Page: 342  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

36. To organize the work effort around the needs of good strategy execution, management needs to
A) make those strategy-critical activities/capabilities that are to be performed internally the main building blocks in the internal organization structure.
B) determine whether some value chain activities can be outsourced more efficiently or effectively than they can be performed internally.
C) decide how much authority to centralize at the top and how much to delegate to down-the-line managers and employees
D) provide for coordination and collaboration across the various organizational units and also with outside partners.
E) All of these.

Answer: E  Page: 342  Learning Objective: 3  Difficulty: Easy  Taxonomy: Comprehension
AACSB: Value Creation

Deciding Which Value Chain Activities to Perform Internally and Which to Outsource

37. Outsourcing value chain activities has such strategy-executing advantages as
A) less internal bureaucracy, speedier decision-making, quicker responses to changing market conditions, and heightened focus on performing a select few value chain activities (which can improve performance of those activities).
B) facilitating the empowerment of employees (because there are less things to do internally).
C) promoting a total quality management culture.
D) reducing the need to establish a strongly implanted corporate culture.
E) reducing the strategic importance of building valuable core competencies.

Answer: A  Page: 343  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation
38. When a company uses outsourcing to zero in on ever better performance of those truly strategy-critical activities where its expertise is most needed, then it may also be able to
A) create a values-based corporate culture that excels in product innovation.
B) decrease internal bureaucracies, flatten its organizational structure, shorten the time it takes to respond to changing market conditions, and capitalize on its partnerships with outsiders to enhance its arsenal of capabilities and thus contribute to better strategy execution.
C) devote more resources to its social responsibility strategy, better empower employees, and reduce employee turnover.
D) better police compliance with ethical standards, lower overall operating costs, and create two or more distinctive competencies.
E) All of the above.

Answer: B  Page: 343  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

39. Which one of the following is not a reason why companies might use outsourcing to improve performance of strategy-critical activities?
A) Improving a company’s chances for outclassing rivals in the performance of strategy-critical activities and turning a core competence into a distinctive competence
B) Promoting quick establishment of a total quality culture
C) Speeding internal decision-making and shortening the time it takes to respond to changing market conditions
D) Capitalizing on the partnerships with outsiders to enhance its arsenal of capabilities and thus contribute to better strategy execution
E) Helping decrease internal bureaucracies and flatten the organizational structure

Answer: B  Page: 343  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

40. Outsourcing value chain activities to strategic partners can yield such advantages as
A) quick creation of distinctive competencies, enhanced product quality, and better customer service.
B) lower costs, less internal bureaucracy, speedier decision-making, more flexibility, and heightened strategic focus.
C) lower cost adoption of best practices.
D) reduced need to empower employees and rely on team-based organizational arrangements.
E) facilitating the capture of cross-functional strategic fits and resource fits.

Answer: B  Page: 343  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation
41. Outsourcing critics contend that shifting responsibility for performing value-chain activities to outside specialists
   A) has the disadvantage of raising fixed costs and reducing variable costs and makes it harder to develop distinctive competencies.
   B) can hollow out a company’s knowledge base and capabilities, leaving it at the mercy of outsider suppliers, and short of the resource strengths to be a master of its own destiny.
   C) results in less organizational flexibility and leads to sometimes exorbitant costs in collaborating with outside suppliers and strategic partners.
   D) slows down decision-making on key strategic issues because outside suppliers have to be consulted first.
   E) lowers the morale of company employees, dampens a company’s ability to implement best practices, and results in greater bureaucracy and slower decision-making.

   Answer: B   Page: 344   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension   AACSB: Value Creation

42. Which one of the following statements about outsourcing the performance of value-chain activities to outside specialists is false?
   A) Outsourcing support services often has cost-saving benefits but outsourcing primary value chain activities has the disadvantages of raising fixed costs, reducing variable costs, and making it harder to develop distinctive competencies.
   B) Outsourcing critics contend that shifting responsibility for performing value-chain activities to outside specialists can hollow out a company’s knowledge base and capabilities, leaving it at the mercy of outsider suppliers, and short of the resource strengths to be a master of its own destiny.
   C) Outsourcing the performance of certain value chain activities to able suppliers can add to a company’s arsenal of capabilities and contribute to better strategy execution.
   D) The real debate surrounding outsourcing is not about whether too much outsourcing risks loss of control but about how to use outsourcing in a manner that produces greater competitiveness.
   E) Outsourcing can enable a company to heighten its strategic focus and concentrate its full energies and resources on even more competently performing those value chain activities that are at the core of its strategy and for which it can create unique value.

   Answer: A   Page: 343 - 345   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension   AACSB: Value Creation

**Making Strategy-Critical Activities the Main Building Blocks of the Organization Structure**

43. The rationale for making strategy-critical value chain activities the primary building blocks in a company’s organizational scheme is based on
   A) the much shorter time it takes to build core competencies and competitive capabilities.
   B) the benefit such an organizational scheme has in reducing costs.
   C) the benefit such an organizational scheme has in improving the productivity of geographically-scattered organizational units.
   D) the thesis that if activities crucial to strategic success are to have the resources, decision-making influence, and organizational impact they need, they have to be centerpieces in the organizational scheme.
   E) the benefit such an organizational scheme has in making the empowerment of employees more effective.

   Answer: D   Page: 345   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension   AACSB: Value Creation
44. Which of the following is unlikely to be a primary building block in a company’s organizational structure?
A) Traditional functional departments
B) Process departments
C) Empowered employee departments
D) Divisional units performing one or more major processing steps along the value chain (components manufacture, assembly, distribution)
E) Geographic organizational units

**Answer:** C  Page: 345 - 346  Learning Objective: 3  Difficulty: Easy  Taxonomy: Comprehension
AACSB: Value Creation

45. The primary building blocks within a company’s organizational structure
A) are almost always the departments performing such key administrative support functions as finance, accounting, information technology, human resource management, and R&D.
B) can include process departments, traditional functional departments, geographic organizational units, and divisional units performing one or more major processing steps along the value chain (components manufacture, assembly, distribution), and individual businesses (in the case of a diversified company).
C) typically consist of an un-empowered employee department, an empowered employee department, teams of front-line supervisors, teams of middle-level managers and administrators, and the group of top-level executives that comprise the company’s “executive suite.”
D) usually consist of supply chain management, components manufacture, assembly, distribution, and administration.
E) usually consist of two divisions—a division charged with performing primary value chain activities and a division charged with performing support activities.

**Answer:** B  Page: 345 - 346  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

**Determining the Degree of Authority and Independence to Give Each Unit and Each Employee**

46. In a highly centralized organizational structure,
A) top executive retain authority for most strategic and operating decisions.
B) the thesis is that strict enforcement of detailed procedures backed by rigorous managerial oversight is the most reliable way to keep the daily execution of strategy on track.
C) tight control from the top makes it easy to fix accountability when things do not go well.
D) one of the basic tenets is that most company personnel have neither the time nor the inclination to direct and properly control they work they are performing and, further, that they lack the knowledge and judgment to make wise decisions about how best to do their work.
E) All of these.

**Answer:** E  Page: 346 - 347  Learning Objective: 4  Difficulty: Easy  Taxonomy: Comprehension
AACSB: Value Creation
47. Which one of the following *falsely* characterizes a centralized organizational structure?

A) Top executives should retain authority over most strategic and operating decisions and keep a tight rein on business-unit heads, department heads, and the managers of key operating units.

B) Strict enforcement of detailed procedures backed by rigorous managerial oversight is the most reliable way to keep the daily execution of strategy on track.

C) Tight control by the manager in charge makes it easy to fix accountability when things do not go well.

D) Most company personnel have neither the time nor the inclination to direct and properly control the work they are performing and that they lack the knowledge and judgment to make wise decisions about how best to do their work.

E) A company that draws on the combined intellectual capital of all of its people can outperform a company that relies on command-and-control.

**Answer:** E Page: 346 - 347 Learning Objective: 4 Difficulty: Easy Taxonomy: Comprehension AACSB: Value Creation

48. A decentralized organizational structure is predicated on a belief that

A) Top executives should establish a collegial, collaborative culture where decisions are made by general consensus on what to do and when.

B) Strict enforcement of detailed procedures backed by rigorous managerial oversight is necessary because company personnel cannot be counted on to act wisely or keep costs to a bare bones level.

C) Decision-making authority should be pushed down to the lowest organizational level capable of making timely, informed, competent decisions.

D) Most company personnel have neither the time nor the inclination to direct and properly control the work they are performing and that they lack the knowledge and judgment to make wise decisions about how best to do their work.

E) Lower-level managers and employees should go up the ladder of command for approval on most all strategic and operating issues of much importance.

**Answer:** C Page: 347 Learning Objective: 4 Difficulty: Medium Taxonomy: Comprehension AACSB: Value Creation

49. A decentralized organizational structure is predicated on a belief that

A) Decision-making authority should be put in the hands of the people closest to and most familiar with the situation, and these people should be trained to exercise good judgment.

B) A command-and-control organizational scheme is the lowest cost way to organize the work effort.

C) Top executives oftentimes lack the expertise and wisdom to decide what is the wisest and best course of action.

D) The best decisions emerge from a collegial, collaborative culture where decisions are made by general consensus (at least a majority vote) on what to do and when.

E) Organizing into work teams, having team members elect a team leader, and having team members vote on the best way to do things greatly reduces corporate bureaucracy.

**Answer:** A Page: 347 Learning Objective: 4 Difficulty: Medium Taxonomy: Comprehension AACSB: Value Creation
50. The disadvantages of a centralized organizational structure include
A) lengthens response times because increasing the size of the corporate bureaucracy and discouraging lower-level managers and rank-and-file employees from exercising initiative.
B) a loss of top management control.
C) putting too much decision making authority in the hands of lower-level company personnel.
D) making it hard to fix accountability when things do not go well and putting the organization at risk when bad decisions are made.
E) impeding cross-unit coordination and capture of strategic fits.

Answer: A Page: 347 Learning Objective: 4 Difficulty: Medium Taxonomy: Comprehension
AACSB: Value Creation

51. The chief disadvantages of a decentralized organizational structure include
A) increasing the size of the corporate bureaucracy.
B) slowing a company’s response times to changing external events because approval of what course of action to take has to go up the chain of command to the top of the management bureaucracy.
C) discouraging lower-level managers and rank-and-file employees from exercising initiative, engaging in creative thinking, and taking responsibility for their actions.
D) putting the organization at risk if many “bad” decisions are made at lower levels in the organization—top management lacks “full control.”
E) creating more layers of management.

Answer: D Page: 347 Learning Objective: 4 Difficulty: Medium Taxonomy: Comprehension
AACSB: Value Creation

52. Which of the following is *not* one of the chief advantages of a decentralized organizational structure?
A) Reducing the size of the corporate bureaucracy and the layers of management
B) making it easy to fix accountability when company performance targets are not met and enhanced capture of cross-business strategic fits
C) Promoting greater motivation and involvement in the business on the part of more company personnel
D) Spurring new ideas and creative thinking
E) Encouraging lower level managers and rank-and-file employees to exercise initiative and act responsibly

Answer: B Page: 347 Learning Objective: 4 Difficulty: Medium Taxonomy: Comprehension
AACSB: Value Creation

53. The chief advantages of a decentralized organizational structure include
A) reducing the layers of management and encouraging lower-level managers and rank-and-file employees to exercise initiative and act responsibly.
B) making it easy to fix accountability when company performance targets are not met.
C) higher productivity on the part of the work force and greater ability to become an industry low-cost leader.
D) enhancing cross-unit coordination and capture of strategic fits.
E) the emergence of a collegial, collaborative culture where teamwork is a core value and decisions are made on the basis of consensus.

Answer: A Page: 347 Learning Objective: 4 Difficulty: Medium Taxonomy: Comprehension
AACSB: Value Creation
54. Delegating greater authority to subordinate managers and employees

A) creates a more horizontal or flatter organization structure with fewer management layers and usually acts to shorten organizational response times.

B) usually slows down decision-making because so many more people are involved and it takes longer to reach a consensus on what to do and when to do it.

C) can be a de-motivating factor because it requires people to take responsibility for their decisions and actions.

D) is very, very risky because it usually results in lots of “bad” decisions on the part of employees and lower levels of financial performance.

E) enhances greater cross-unit coordination and aids the capture of strategic fit benefits across related businesses.

**Answer:** A Page: 348 Learning Objective: 4 Difficulty: Easy Taxonomy: Comprehension AACSB: Value Creation

55. The organizing challenge of a decentralized structure which stresses employee empowerment is

A) how to keep empowered employees from making lots of stupid decisions.

B) establishing a collegial, collaborative culture so that decisions can be made by gaining a quick consensus on what to do and when to do it.

C) how to avoid de-motivating employees (because empowered employees are expected to take responsibility for their actions and decisions).

D) how to exercise control over the actions and decisions of empowered employees so that the business is not put at risk while trying to capture the benefits of empowerment.

E) how to convince lower-level managers and employees that they are empowered.

**Answer:** D Page: 348 - 349 Learning Objective: 4 Difficulty: Medium Taxonomy: Comprehension AACSB: Value Creation

**Providing for Internal Cross-Unit Coordination**

56. The classic way to coordinate the work efforts of internal organization units is to

A) establish a corporate culture where teamwork is a core value and decisions are made by general consensus among team leaders in the affected work units.

B) have closely related activities report to a single executive who has the authority and organizational clout to coordinate, integrate, and arrange for the cooperation of units under their supervision.

C) have the heads of support activities report to the heads of primary, strategy-critical activities.

D) establish monetary incentives that reward people for being cooperative team players.

E) have frequent meetings among the heads of closely related activities and work units to establish mutually agreeable deadlines.

**Answer:** B Page: 349 Learning Objective: 3 Difficulty: Medium Taxonomy: Comprehension AACSB: Value Creation
57. One of the big weaknesses of traditional functional organization structures is
A) making it hard to effectively empower employees.
B) making it difficult to have closely related activities report to a single executive.
C) that pieces of strategically relevant activities and capabilities often end up scattered across many departments—remedying this deficiency often entails reengineering the work effort and pulling the people who performed the pieces in functional departments into a group that works together to perform the whole process, thus creating process departments.
D) impeding the use of outsourcing.
E) making it hard to fix managerial accountability for poor results.

**Answer:** C  Page: 350 – 351  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

**Providing for Collaboration with Outside Suppliers and Strategic Allies**

58. Building organizational bridges with external allies is aided by
A) appointing “relationship managers” and giving them responsibility for making particular strategic partnerships or alliances generate the intended benefits.
B) agreeing with allies to meet frequently and make all decisions pertaining to the alliance on the basis of mutual agreement and consensus.
C) getting each strategic ally to agree to appoint someone as head of the collaborative effort and to give that person the authority to enforce tight coordination of joint activities.
D) forming a 50-50 joint venture with each strategic partner and then assigning people to the joint venture who have the authority and responsibility to enforce tight coordination.
E) entering into a written agreement detailing the roles and responsibilities of the company and the ally/partner, setting forth the results that are expected, establishing deadlines for achieving these results, and designating the people who are to be responsible for making the collaborative effort work successfully.

**Answer:** A  Page: 351  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

**Current Organizational Trends**

59. The organizational characteristics of many of today’s companies include
A) devoting considerable management attention to building a company capable of outcompeting rivals on the basis of superior resource strengths and competitive capabilities.
B) few barriers between people at different vertical ranks, between functions and disciplines, and between units in different geographic locations.
C) extensive use of Internet technology and e-commerce business practices.
D) extensive collaborative efforts among people in different specialties and different geographic locations.
E) All of these.

**Answer:** E  Page: 352  Learning Objective: 3  Difficulty: Easy  Taxonomy: Comprehension
AACSB: Value Creation
60. Which of the following runs counter to the organizational trends in today’s companies?
   A) Highly centralized decision-making (made possible by much greater use of corporate intranets)
   B) Few barriers between people at different vertical ranks, between functions and disciplines, and between units in different locations
   C) Extensive use of Internet technology and e-commerce business practices
   D) Extensive collaborative efforts among people in different specialties and different geographic locations
   E) Devoting considerable management attention to building a company capable of outcompeting rivals on the basis of superior resource strengths and competitive capabilities

   **Answer:** A Page: 352 Learning Objective: 3 Difficulty: Medium Taxonomy: Comprehension
   AACSB: Value Creation

### Short Answer Questions

61. Who is involved in the strategy execution process and who is ultimately responsible for making sure that the task of implementing and executing strategy goes well?

   **Page:** 328 Learning Objective: 1 Difficulty: Easy Taxonomy: Knowledge
   AACSB: Value Creation

62. What are the eight principal managerial components of the strategy-implementing/strategy-executing process?

   **Page:** 330 Learning Objective: 1 Difficulty: Medium Taxonomy: Knowledge
   AACSB: Value Creation

63. Identify and briefly discuss the three facets of building an organization capable of proficient strategy execution.

   **Page:** 331 - 332 Learning Objective: 1 Difficulty: Medium Taxonomy: Knowledge
   AACSB: Value Creation

64. Identify and briefly discuss four of the recommended practices companies have used to recruit and retain the best employees.

   **Page:** 335 - 336 Learning Objective: 1 Difficulty: Hard Taxonomy: Knowledge
   AACSB: Value Creation

65. Identify and briefly discuss the three stages involved in building core competencies and capabilities.

   **Page:** 337 Learning Objective: 2 Difficulty: Medium Taxonomy: Knowledge
   AACSB: Value Creation

66. Describe at least 3 traits or characteristics of a core competence—where in an organization can a core competence be found and what is involved in building and strengthening a core competence. Give three examples of a core competence.

   **Page:** 336 - 339 Learning Objective: 2 Difficulty: Hard Taxonomy: Comprehension
   AACSB: Value Creation
67. Explain what is involved in building an organization capability? What steps are required? How much time does it take? How hard is it? Support your answer.

68. Building competitively valuable core competencies, resource strengths, and organizational capabilities can be a fruitful avenue to achieving sustainable competitive advantage. True or false? Explain.

69. When it proves infeasible to outcompete rivals by crafting a superior strategy, the next best avenue to beating them out for industry leadership is to outexecute them—that is, beat them with superior strategy execution. True or false? Explain.

70. Identify and briefly discuss/explain three of the five components of structuring a company’s work effort to promote successful strategy execution.

71. What are the advantages of outsourcing non-critical and sometimes even critical value chain activities?

72. Explain the difference between a centralized and a decentralized organization structure. Which one is more likely to further the cause of good strategy execution? Why?

73. A decentralized organization structure is more likely to further the cause of good strategy execution than is a centralized organization structure. True or false? Justify your answer.

74. Identify and discuss the basic tenets, the chief advantages, and the chief disadvantages of centralized organizational structures.
75. Identify and discuss the basic tenets, the chief advantages, and the chief disadvantages of decentralized organizational structures.

**Page:** 347  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

76. What is meant by empowerment of employees? How does it differ from delegation of authority? In what ways can empowerment of employees aid the cause of good strategy execution?

**Page:** 347 - 348  Learning Objective: 4  Difficulty: Hard  Taxonomy: Comprehension
AACSB: Value Creation
Multiple Choice Questions

Marshalling Resources Behind the Drive for Good Strategy Execution

1. A company’s ability to marshal adequate resources in support of new strategic initiatives and steer them to the appropriate organizational units is important to the strategy execution process because
   A) changes in strategy often require resource reallocation and organizational units need the proper funding to carry out their part of the strategic plan effectively and efficiently.
   B) accurate budgets are the key to exercising tight financial controls over what organization units can and cannot do in carrying out management’s directives to execute the chosen strategy proficiently.
   C) tight budget control is management’s most powerful tool for first-rate strategy execution.
   D) lean, carefully managed budgets protect the company’s financial condition and eliminate wasteful use of cash.
   E) lean, strictly enforced budgets are management’s best and most used means of getting organizational units to exercise the fiscal discipline needed to execute the chosen strategy in a cost-efficient manner.

   **Answer:** A   Page: 358   Learning Objective: 1   Difficulty: Easy   Taxonomy: Comprehension   AACSB: Value Creation

2. Managers charged with implementing and executing strategy need to be deeply involved in the budgeting and resource allocation process because
   A) too little funding deprives organizational units of the resources to carry out their piece of the strategic plan and too much funding wastes organizational resources.
   B) a change in strategy nearly always calls for budget reallocations and resource shifting.
   C) without major budget reallocations there is no chance for the desired core competencies and organizational capabilities to emerge.
   D) lean, carefully managed budgets protect the company’s financial condition and eliminate wasteful use of cash.
   E) Both A and B.

   **Answer:** E   Page: 358   Learning Objective: 1   Difficulty: Easy   Taxonomy: Comprehension   AACSB: Value Creation
3. From a strategy-implementing/strategy-executing perspective, budget allocations should
   A) primarily be based on the number of new strategic initiatives being implemented in each department.
   B) be based on the number of people employed in each of the divisions.
   C) be strategy-driven and based primarily on how much each organizational unit needs to carry out its piece of the strategic plan efficiently and effectively.
   D) be linked to the costs of performing value chain activities as determined by benchmarking against best-in-industry competitors.
   E) depend on how much stretch there is in each department’s objectives and what additional resources are needed to help reach these performance targets.

   **Answer:** C  Page: 358  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

4. New strategies often entail budget reallocations because
   A) revamping the performance of value chain activities can be costly.
   B) the accompanying policy revisions and compensation incentives tend to require different levels of funding than before.
   C) units important in the prior strategy but having a lesser role in the new strategy may need downsizing while units and activities that now have a bigger and more critical strategic role may need more people, new equipment, additional facilities, and above-average increases in their operating budgets.
   D) empowering employees to carry out the new strategy elements and shifting to a total quality management type of culture to build skills in competent strategy execution typically require substantial new funding and budget revisions.
   E) adopting best practices and pushing for continuous improvement tends to reduce costs and reduce overall resource requirements.

   **Answer:** C  Page: 358  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

5. Visible actions to reallocate operating funds and move people into different organizational units
   A) can be dysfunctional in trying to implement a new strategy because of the anxiety and insecurity that big changes in budgets cause among company personnel.
   B) signal a determined commitment to strategic change and can help catalyze and give credibility to the implementation process.
   C) run the risk of inadvertently creating barriers to building the needed competencies and capabilities.
   D) tend to impede the task of empowering employees and shifting to new, more strategy-supportive culture.
   E) are rarely necessary in implementing a new strategy unless the new strategy entails a radically different set of value chain activities.

   **Answer:** B  Page: 358  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation
Instituting Policies and Procedures that Facilitate Strategy Execution

6. Prescribing policies and operating procedures aids the task of implementing strategy by
   A) helping ensure that worker eligibility for incentive bonuses is measured consistently and awarded fairly.
   B) fostering the use of best practices, TQM, Six Sigma, and continuous improvement efforts.
   C) acting as a powerful lever for changing employee attitudes about the need for a different incentive and reward system.
   D) helping build employee commitment to strengthening the company’s core competencies and competitive capabilities.
   E) by placing limits on independent action and painting new white lines to steer the actions and behavior of company personnel in a manner that is more conducive to good strategy execution and operating excellence.

Answer: E   Page: 359   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

7. Prescribing new policies and operating procedures can aid the task of implementing strategy
   A) provided they promote greater use of and commitment to best practices and total quality management.
   B) because really effective internal policies and procedures are not easily duplicated by other firms.
   C) because astutely conceived policies or procedures can result in competitive advantage.
   D) by helping align the actions and behavior company personnel with the requirements for good strategy execution, placing limits on independent action, and helping overcome resistance to change.
   E) by making it easier to impose tight budget controls and avoid wasting scarce resources.

Answer: D   Page: 359 - 360   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

8. A useful guideline in designing strategy-facilitating policies and operating procedures is
   A) to prescribe enough policies to give organizational members clear direction in implementing strategy and to place desirable boundaries on their actions, then empower them to act within these boundaries however they think makes sense.
   B) that strictly-enforced policies work better than loosely-enforced policies.
   C) that more policies/procedures work better than few policies/procedures and that strict enforcement always beats lax enforcement.
   D) to let individuals act in an empowered and self-directed way, subject only to the constraint that their actions and behavior be ethical and in step with the corporate culture.
   E) to prescribe enough policies and procedures that little is left to chance in performing value chain activities employees should have no leeway to do things in a manner that deviates from the company’s best practices standard.

Answer: A   Page: 361   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation
9. Which one of the following is *not* a benefit of prescribing policies and operating procedures to aid management’s task of implementing strategy?
   A) Painting a set of white lines that places limits on independent behavior and channels individual and group efforts along a path more conducive to executing the strategy.
   B) Providing top-down guidance to operating managers, supervisory personnel, and employees regarding how things need to be done and what behavior is expected.
   C) Promoting the creation of a work climate that facilitates good strategy execution.
   D) Helping build employee commitment to adopting best practices and using the tools of TQM and Six Sigma.
   E) Helping enforce consistency in how particular activities are performed in geographically scattered organization units.

   **Answer:** D   Page: 359 - 361   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

### Adopting Best Practices and Striving for Continuous Improvement

10. A “best practice” refers to
   A) a policy or procedure that is unusually effective.
   B) a technique for performing an activity or business process that at least one company has demonstrated works particularly well in terms of delivering some highly positive operating outcome.
   C) performing a strategy-critical activity in a fashion that results in sustainable competitive advantage.
   D) the value chain activity that is a company’s distinctive competence.
   E) a particular value chain activity that management has given top priority to performing in world-class fashion.

   **Answer:** B   Page: 361 - 362   Learning Objective: 3   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation

11. A “best practice”
   A) is a technique for performing an activity or business process that at least one company has demonstrated works particularly well in terms of delivering some highly positive operating outcome.
   B) refers to the best-known procedure for performing a specific task or activity so as to achieve the lowest possible costs.
   C) refers to performing activities in a manner that conforms to established industry standards.
   D) refers to a company’s core competence.
   E) refers to performing a particular value chain activity in “world-class” fashion (one unmatched by any other company in the world).

   **Answer:** A   Page: 361 - 362   Learning Objective: 3   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation
12. The idea behind benchmarking and best practices is to
   A) identify which companies are the best performers of a strategically-relevant activity and then exactly copy their methods.
   B) search the world for a company that performs a strategically relevant task or value chain activity at the lowest possible cost and then use business process reengineering techniques to try to meet or beat the costs of the world’s low-cost performer of that activity.
   C) perform each activity in the industry value chain according to standard industry practice and then regularly benchmark the company’s performance to see if it is actually achieving the industry standard.
   D) identify companies that are the best performers of an activity and then modify and adapt their practices to fit the company’s own specific circumstances and operating requirements.
   E) determine whether a company has a “world-class” value chain.

   **Answer:** D  Page: 362  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension  
   AACSB: Value Creation

13. The backbone of identifying, studying, and implementing best practices is
   A) business process reengineering.
   B) a corporate culture that has a core value of operating excellence.
   C) benchmarking.
   D) Six Sigma quality control techniques.
   E) innovative application of TQM techniques.

   **Answer:** C  Page: 362  Learning Objective: 3  Difficulty: Medium  Taxonomy: Knowledge  
   AACSB: Value Creation

14. Which one of the following is *not* a tool that company managers can use to promote operating excellence in performing value chain activities?
   A) Benchmarking
   B) Adoption of best practices
   C) TQM and/or Six Sigma quality control techniques
   D) Business process reengineering
   E) Adoption of standard industry techniques

   **Answer:** E  Page: 362 - 363  Learning Objective: 3  Difficulty: Easy  Taxonomy: Comprehension  
   AACSB: Value Creation

15. Which of the following is *not* a tool that managers can use to promote operating excellence and further the cause of good strategy execution?
   A) Benchmarking and the adoption of best practices
   B) Business process reengineering
   C) Strategic resource training
   D) TQM
   E) Six Sigma quality control techniques

   **Answer:** C  Page: 362 - 363  Learning Objective: 3  Difficulty: Easy  Taxonomy: Comprehension  
   AACSB: Value Creation
Business Process Reengineering, Six Sigma Quality Programs, and TQM: Tools for Promoting Operating Excellence

16. Because functional organization structures often result in pieces of strategically relevant activities and capabilities being scattered across many different functional departments, companies have found that
A) it is necessary to give these functional departments the freedom to collaborate closely with each other to achieve the desired degree of coordination.
B) it is necessary to outsource those activities that are fragmented to strategic partners in order to achieve the needed coordination.
C) there’s merit in using business process reengineering to pull the pieces of strategy-critical processes out of different departments and unify their performance in a single department or cross-functional work group that has charge over the whole process.
D) TQM is a potent way to reengineer the work effort, avoid the shortcomings of a functional organization structure, and achieve rapid-response capability.
E) it makes good organizational sense to combine those functional departments where fragmentation is a problem into a single department.

Answer: C  Page: 363  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension  AACSB: Value Creation

17. Business process reengineering is a tool for
A) expediting the redesign of existing products and shortening the design-to-market cycle.
B) pulling the pieces of strategy-critical activities out of different departments and unifying their performance in a single department or cross-functional work group that has charge over the whole process and can be held accountable for performing the activity in a more strategy-supportive fashion.
C) instituting total quality management.
D) making the most effective use of Six Sigma techniques.
E) rapid redesign of an organization’s structure so as to rapidly create organizational competencies and capabilities.

Answer: B  Page: 363  Learning Objective: 3  Difficulty: Medium  Taxonomy: Knowledge  AACSB: Value Creation

18. Reengineering how a firm performs a business process
A) is a tool for pulling the pieces of strategy-critical processes out of different departments and unifying their performance in a single department or cross-functional work group that has charge over the whole process and can be held accountable for performing the activity in a cheaper, better, and/or more strategy-supportive fashion.
B) is the most frequently used tool of total quality management (TQM).
C) requires that a company have many strategic partnerships and alliances with outsiders.
D) is typically cheaper and easier-to-do than using Six Sigma techniques to achieve the same cost savings.
E) is usually a company’s most important “best practice” for achieving operating excellence.

Answer: A  Page: 363  Learning Objective: 3  Difficulty: Medium  Taxonomy: Knowledge  AACSB: Value Creation
19. Total quality management (TQM)
   A) is a philosophy of managing a set of business practices that emphasizes continuous improvement in all phases of operations, 100% accuracy in performing tasks, involvement and empowerment of employees at all levels, team-based work design, benchmarking, and total customer satisfaction.
   B) is a valuable tool for helping company managers identify what the best practice is for performing a particular activity.
   C) works best when used in conjunction with Six Sigma quality control techniques.
   D) is an excellent tool for reengineering business processes and making quantum gains in the efficiency and effectiveness with which the processes are performed.
   E) is a philosophy of doing things that aims at mistake-free management of a company’s entire business.

   **Answer:** A Page: 364 Learning Objective: 3 Difficulty: Medium Taxonomy: Knowledge
   AACSB: Value Creation

20. Total quality management (TQM) emphasizes all but which one of the following?
   A) 100% accuracy in performing tasks
   B) Continuous improvement in all phases of operations
   C) Widespread adoption of industry standard operating practices
   D) Benchmarking and total customer satisfaction
   E) Empowerment of employees and team-based work design

   **Answer:** C Page: 364 Learning Objective: 3 Difficulty: Easy Taxonomy: Comprehension
   AACSB: Value Creation

21. Total quality management (TQM) programs
   A) deal exclusively with procedures to achieve defect-free manufacturing and assembly.
   B) nearly always contribute more to the achievement of operating excellence than either business process reengineering or Six Sigma quality control techniques.
   C) entail creating a corporate culture bent on continuously improving the performance of every task and every value-chain activity.
   D) are considerably more effective in improving manufacturing and assembly activities than they are in improving such value chain activities as R&D, human resources management, supply chain management, information technology, sales and marketing and finance.
   E) are generally considered the best tool for reengineering strategy-critical business processes.

   **Answer:** C Page: 364 Learning Objective: 3 Difficulty: Medium Taxonomy: Comprehension
   AACSB: Value Creation

22. Which one of the following statements about total quality management (TQM) is false?
   A) TQM aims at instilling enthusiasm and commitment to doing things right from the top to the bottom of the organization.
   B) TQM produces significant results very quickly—very little benefit emerges after the first six months.
   C) TQM doctrine preaches that there’s no such thing as “good enough” and that everyone has a responsibility to participate in continuous improvement.
   D) Effective use of TQM entails creating a corporate culture bent on continuously improving the performance of every task and every value-chain activity.
   E) Total quality management (TQM) is a philosophy of managing a set of business practices that emphasizes continuous improvement in all phases of operations, 100 percent accuracy in performing tasks, involvement and empowerment of employees at all levels, team-based work design, benchmarking, and total customer satisfaction.

   **Answer:** B Page: 364 Learning Objective: 3 Difficulty: Medium Taxonomy: Comprehension
   AACSB: Value Creation
23. Six Sigma quality control
   A) is a strategy-implementer’s best, most reliable tool for simultaneously achieving top-notch product quality and low manufacturing costs.
   B) consists of a disciplined, statistics-based system aimed at producing not more than 2.5 defects per million iterations for a manufacturing or assembly process.
   C) consists of a disciplined, statistics-based system aimed at producing not more than 3.4 defects per million iterations for any business process.
   D) consists of a disciplined, statistics-based system aimed at fewer than 5.0 complaints per million customer transactions.
   E) is a powerful tool for companies whose customers are very picky about product quality and product performance and who can’t afford for the product they use to break down and require repairs.

   Answer: C   Page: 364   D Learning Objective: 3   Difficulty: Medium   Taxonomy: Knowledge
   AACSB: Value Creation

24. Six Sigma processes
   A) are based on three principles: (1) all work is a statistically controllable process; (2) no well-controlled process allows variability; and (3) defect-free work requires tight statistical controls.
   B) can be used for both improving existing business processes and for developing new processes or products.
   C) can be used for improving products or business processes but not for developing new products or new processes.
   D) consists of a disciplined, statistics-based system aimed at producing not more than 10 defects per million iterations for a manufacturing or assembly process.
   E) can be used for developing new products or new business processes but not for improving existing products or business processes.

   Answer: B   Page: 364   Learning Objective: 3   Difficulty: Hard   Taxonomy: Comprehension
   AACSB: Value Creation

25. The Six Sigma process of define, measure, analyze, improve, and control (DMAIC) is
   A) an improvement system for existing processes falling below specification and needing incremental improvement.
   B) an improvement system used to develop new processes or products at 100% defect-free levels.
   C) a system of statistical procedures for achieving 100% control over how a task is performed.
   D) an improvement system used to develop new processes or products at Six Sigma levels.
   E) a system of statistical procedures for eliminating 100% of the variability in how a task is performed.

   Answer: A   Page: 364   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

26. Six Sigma’s DMADV process of define, measure, analyze, design and verify is a particularly good vehicle for
   A) improving performance when there are small variations in how well an activity is performed; if there are wide variations, then the Six Sigma DMVSI process has to be used.
   B) achieving 100% control over how a task is performed and eliminating 100% of the variability in how a task is performed.
   C) improving performance when there are wide variations in how well an activity is performed.
   D) developing new processes or products at Six Sigma quality levels.
   E) improving customer satisfaction whereas Six Sigma DMADV is used to improve manufacturing processes.

   Answer: D   Page: 364   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
27. The statistical thinking underlying Six Sigma is based on the following three principles:
   A) All activities can be controlled, employee empowerment is the best control tool, and 100% control is possible.
   B) All work is a process, all processes have variability, and all processes create data that explains variability.
   C) All work activities can be done accurately most of the time, empowered employees are necessary for effective control, and good statistical data is an empowered employee’s best control tool.
   D) All work is a statistically controllable process; 100% control is possible; and every well-controlled process is defect-free.
   E) Most business processes are subject to control; Six Sigma can totally remove variability in how processes are performed; and most defects can be eliminated.

   **Answer:** B   Page: 365   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension   AACSB: Value Creation

28. Which one of the following statements about Six Sigma quality programs is true?
   A) While Six Sigma programs often improve the efficiency of numerous operating processes, there is evidence that the approach can stifle innovative activities.
   B) Six Sigma is a philosophy of managing a set of business practices that emphasizes continuous improvement in all phases of operations and 100 percent accuracy in performing tasks.
   C) Six Sigma’s DMAIC process is a particularly good vehicle for improving performance when there are small variations in how well an activity is performed.
   D) The focus of Six Sigma programs is on the development of new products or new business processes but not on improving existing products or business processes.
   E) Six Sigma is a system of statistical procedures for eliminating 92% of the variability in how a task is performed.

   **Answer:** A   Page: 367   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension   AACSB: Value Creation

29. The big difference between business process reengineering and continuous improvement programs like TQM or Six Sigma is that
   A) reengineering is a tool for installing process organization whereas TQM/Six Sigma concern defect-free production methods and delivering world-class customer service.
   B) reengineering helps create core competencies whereas TQM/Six Sigma are tools for making a core competence stronger and more efficient.
   C) reengineering is a tool for achieving one-time quantum improvement whereas TQM and Six Sigma programs aim at incremental improvement (striving for inch-by-inch gains again and again in a never-ending stream).
   D) business process reengineering requires benchmarking whereas TQM and Six Sigma do not.
   E) reengineering represents an effort to totally revamp a firm’s value chain whereas TQM looks at incrementally improving the performance of two or three targeted value-chain activities and Six Sigma is primarily for reducing manufacturing defects.

   **Answer:** C   Page: 368   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension   AACSB: Value Creation
Capturing the Benefits of Initiatives to Improve Operations

30. To obtain maximum benefits from benchmarking, best practices, reengineering, TQM, and Six Sigma programs aimed at facilitating better strategy execution, managers need to
A) start with a clear idea of what specific outcomes really matter, such as a Six Sigma defect rate or superior customer satisfaction, and then build a total quality culture that is genuinely committed to achieving these outcomes.
B) have annual contests to see which part of the company is making the greatest strides in approaching operating excellence.
C) strive for 100% control over the variability in how each and every value chain activity is performed.
D) have at least 50% of company personnel earn “green belts” in Six Sigma techniques.
E) build core competencies in TQM, Six Sigma, benchmarking, best practices adoption, and business process reengineering.

Answer: A Page: 369 Learning Objective: 3 Difficulty: Medium Taxonomy: Comprehension
AACSB: Value Creation

31. To build a total quality culture and achieve full value from the use of TQM or Six Sigma initiatives, managers can take such action steps as
A) signaling unequivocal and unyielding commitment to total quality and operating excellence; encouraging quality-supportive behaviors on the part of employees, empowering employees to make changes to improve quality; and using online systems to give employees immediate access to best practice information and experiences.
B) requiring all company personnel to attend Six Sigma training programs and achieve “black belt” status.
C) instituting greater centralization of decision-making to help enforce strict compliance with quality control policies and procedures.
D) stressing 100% accurate individual performance rather than group or team performance.
E) dismissing employees who repeatedly fail to achieve 100% accuracy in their work after a 12-month trial period.

Answer: A Page: 369 Learning Objective: 3 Difficulty: Easy Taxonomy: Comprehension
AACSB: Value Creation

Installing Information and Operating Systems

32. Installing well-conceived state-of-the-art support systems are an important managerial component of implementing and executing strategy because
A) such systems are essential to being able to engage in effective benchmarking and continuous improvement.
B) such support systems not only enable better strategy execution but also strengthen organizational capabilities (perhaps enough to provide a competitive edge over rivals).
C) they help managers run a tight ship and preserve strong, centralized control over internal activities.
D) they are the basis for revamping value chains, boosting labor productivity, and reducing operating costs.
E) decentralized decision-making and employee empowerment cannot work well without having well-conceived information and operating systems to accurately benchmark internally-performed value chain activities against best-in-industry and best-in-class performers.

AACSB: Technology Influence
33. Well conceived, state-of-the-art information and operating systems
   A) are essential because business process reengineering efforts, TQM, Six Sigma, and benchmarking programs can’t be carried out effectively without them.
   B) not only enable better strategy execution but also strengthen organizational capabilities (perhaps enough to provide a competitive edge over rivals).
   C) make it simple and easy to spot cost overruns and inefficiencies.
   D) are valuable tools for shortening a company’s value chain, boosting work force morale and productivity, and simplifying the task of adopting best practices.
   E) All of these.

   **Answer:** B  Page: 371  Learning Objective: 4  Difficulty: Hard  Taxonomy: Comprehension
   AACSB: Technology Influence

34. The areas that information systems need to cover include
   A) Financial performance data
   B) Supplier/partner/collaborative data
   C) Customer data
   D) Operations data
   E) All of the above

   **Answer:** E  Page: 372  Learning Objective: 4  Difficulty: Easy  Taxonomy: Comprehension
   AACSB: Technology Influence

35. The areas that information systems need to cover include all but which one of the following?
   A) Financial performance data
   B) Corporate culture data
   C) Customer data
   D) Operations data
   E) Employee data

   **Answer:** B  Page: 372  Learning Objective: 4  Difficulty: Easy  Taxonomy: Comprehension
   AACSB: Technology Influence

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**Tying Rewards and Incentives to Strategy Execution**

36. Management’s most powerful tool for mobilizing employee commitment to competent strategy execution and operating excellence is
   A) diligent and persistent use of benchmarking and best practices.
   B) proper use of incentives and rewards.
   C) TQM and/or Six Sigma programs.
   D) periodic inspirational speeches aimed at arousing employees’ emotional energy.
   E) providing employees with a high degree of job security (ideally, via a no-layoff policy).

   **Answer:** B  Page: 373  Learning Objective: 5  Difficulty: Easy  Taxonomy: Comprehension
   AACSB: Value Creation
37. Management’s most powerful tool for winning employee commitment to good strategy execution and operating excellence is
A) the establishment of strategy-supportive policies and procedures.
B) empowering employees and encouraging them to adopt best practices.
C) setting stretch objectives.
D) a system of rewards and incentives tied tightly to the achievement of the targeted strategic and financial performance.
E) aggressive use of TQM and Six Sigma quality control programs.

**Answer:** D   Page: 373   Learning Objective: 5   Difficulty: Medium   Taxonomy: Comprehension

AACSBJ: Value Creation

38. The strategic role of a company’s reward system is to
A) compensate employees for performing their assigned duties in a diligent fashion.
B) boost employee morale in ways that create widespread job satisfaction.
C) enlist employees’ energetic commitment to competent strategy execution and operating excellence by rewarding them, both monetarily and non-monetarily, for their contributions.
D) relieve managers of the burden of closely monitoring each employee’s performance.
E) boost labor productivity and help lower the firm’s overall labor costs.

**Answer:** C   Page: 373   Learning Objective: 5   Difficulty: Medium   Taxonomy: Comprehension

AACSBJ: Value Creation

39. Enlisting employees’ sustained and energetic commitment to good strategy execution and achievement of the targeted strategic and financial objectives is best done by
A) having top executives commit to making employees the company’s most valuable competitive asset.
B) developing core competencies in the use of TQM, Six Sigma programs, and business process reengineering.
C) resourceful and effective use of motivational incentives, both monetary and non-monetary.
D) clever and innovative use of benchmarking and best practices.
E) providing employees with a high degree of job security and attractive perks.

**Answer:** C   Page: 373   Learning Objective: 5   Difficulty: Medium   Taxonomy: Comprehension

AACSBJ: Value Creation

40. In trying to gain employees’ wholehearted commitment to good strategy execution and operating excellence, managers are well advised to use such incentives as
A) attractive perks and fringe benefits.
B) frequent words of praise, special recognition at company gatherings, stimulating assignments, and opportunities to transfer to attractive locations.
C) more (or less) job security.
D) opportunities for rapid promotion (or the risk of being sidelined).
E) All of these.

**Answer:** E   Page: 374   Learning Objective: 5   Difficulty: Easy   Taxonomy: Comprehension

AACSBJ: Value Creation
41. Which one of the following is not likely to be effective in trying to gain employees’ wholehearted commitment to good strategy execution and operating excellence?

A) Aggressive management efforts to eliminate stress, anxiety, and job insecurity from the work environment
B) Extensive use of such nonmonetary carrot-and-stick incentives as frequent words of praise (or constructive criticism), special recognition at company gatherings, and being given stimulating assignments
C) More (or less) job security, and opportunities for high-performing employees to transfer to attractive locations
D) Opportunities for rapid promotion (or the risk of being sidelined in a routine job)
E) Performance bonuses

Answer: A  Page: 374  Learning Objective: 5  Difficulty: Easy  Taxonomy: Comprehension
AACSB: Value Creation

**Striking the Right Balance Between Rewards and Punishment**

42. A motivation and incentive system that is aimed at spurring stronger employee commitment to good strategy execution

A) focus on incorporating more positive than negative motivational incentives.
B) should be tied first and foremost to whether employees satisfactorily perform their assigned duties in an ethical and honorable manner.
C) must involve deliberately assigning employees heavy workloads and tight deadlines.
D) needs to put top priority on making employees happy and secure in their jobs.
E) must avoid the potential for negative consequences if performance is subpar.

Answer: A  Page: 375  Learning Objective: 5  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation

43. From the standpoint of promoting successful strategy execution, it is important that the firm’s motivation and reward system

A) be completely free of such elements as tension, pressure, anxiety, job insecurity, and tight deadlines—a no-pressure/no-adverse-consequences work environment is essential.
B) emphasize only positive types of rewards.
C) accentuate positive rewards but also carry the risk of punishment for poor performance.
D) not deny rewards to employees who put forth good effort and try hard.
E) reduce job insecurity and give employees an incentive to stay busy and work hard.

Answer: C  Page: 375  Learning Objective: 5  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Value Creation
44. A reward system that accentuates positive rewards for good performance
   A) works best in strong culture organizations, while negative motivational approaches and reward systems tend to be most successful in weak culture organizations.
   B) is especially effective in aligning the well-being of organizational members with achieving the company’s performance targets; reward systems with negative elements tend to be very dysfunctional in motivating employees.
   C) seldom works very well because the threat of denying rewards to sub-par performers is typically the most powerful motivator.
   D) works fine so long as 100% emphasis is placed on monetary incentives.
   E) has considerable appeal because when cooperation is positively enlisted and rewarded, rather than strong-armed by orders and threats (implicit or explicit), people tend to respond with more enthusiasm, dedication, creativity, and initiative.

   Answer: E   Page: 375, 377   Learning Objective: 5   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

45. Motivational and incentive compensation practices that aim at winning the commitment of company personnel to good strategy execution typically
   A) use only positive rewards and never involve the use of tension, fear, job insecurity, stress, or anxiety.
   B) strike a middle ground—entailing decidedly positive rewards for meeting or beating performance targets but also imposing sufficiently negative consequences when actual performance falls short of the target.
   C) aim at creating a no-pressure/no-adverse-consequences work environment.
   D) entail paying the highest wages and salaries in the industry and also stressing non-monetary rewards for high-performing employees.
   E) put top priority on making employees happy and secure in their jobs.

   Answer: B   Page: 377   Learning Objective: 5   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation

**Linking the Reward System to Strategically Relevant Performance Outcomes**

46. The most dependable way to keep people focused on strategy execution and the achievement of performance targets is to
   A) establish ethical compensation policies and convince employees that they are the firm’s most valuable competitive asset.
   B) design monetary and non-monetary incentives that boost labor productivity and help lower the firm’s overall labor costs.
   C) generously reward and recognize people who meet or beat performance targets and to deny rewards and recognition to those who don’t.
   D) pay employees a bonus for each strategic and financial objective that the company achieves.
   E) allow employees to propose what rewards they would like to receive to achieve the company’s stretch objectives.

   Answer: C   Page: 377   Learning Objective: 5   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Value Creation
47. A well-designed reward system
   A) aligns the well-being of organization members with their contributions to competent strategy execution and the achievement of performance targets.
   B) should be free of elements that induce stress, anxiety, tension, pressure to perform, and job insecurity.
   C) puts the primary emphasis on denying rewards to those who fail to perform tasks in the prescribed fashion.
   D) emphasizes weeding out employees who are consistently low performers.
   E) strives for 50-50 balance between positive and negative rewards and 50-50 balance between monetary and non-monetary rewards.

   **Answer:** A  Page: 378  Learning Objective: 5  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

48. An important consideration in designing a strategy-supportive reward system is to
   A) link the payment of all monetary rewards to the company’s profitability.
   B) employ incentives that will help motivate employees to put in long hours and sacrifice personal ambitions and aspirations to pursue the priorities of management.
   C) choose those types of rewards and incentives that will focus employees’ attention on total customer satisfaction.
   D) make across-the-board wage and salary increases the cornerstone of monetary rewards.
   E) make non-monetary rewards and recognition an integral part of the reward system.

   **Answer:** E  Page: 380  Learning Objective: 5  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

49. The guidelines for designing an incentive compensation system that will help drive successful strategy execution include
   A) making the payoff for meeting or beating performance targets a major, not minor, piece of the total compensation package.
   B) having a bonus and incentive plan that applies to managers only (employees should generally not be included in incentive pay plans but should have attractive wages and salaries).
   C) having an outside wage and salary expert administer the system, so that there is no doubt as to its fairness and impartiality.
   D) basing the incentives on group performance rather than individual performance.
   E) making minimal use of non-monetary incentives and rewarding people for diligently performing their assigned duties.

   **Answer:** A  Page: 379 - 380  Learning Objective: 5  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation

50. Which of the following is **not** a sound guideline for designing a reward and incentive system that helps promote good strategy execution?
   A) The reward system must be administered with scrupulous objectivity and fairness.
   B) The payoff for meeting or beating performance targets must be a major, not minor, piece of the total compensation package.
   C) The incentive plan should extend to all managers and all employees, not just top management.
   D) Ways must be found to reward deserving non-performers who, for some reason, do not fare well under the incentive system.
   E) Make sure that the performance targets each individual or team is expected to achieve involve outcomes that the individual or team can personally affect.

   **Answer:** D  Page: 379 - 380  Learning Objective: 5  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Value Creation
51. Which of the following is *not* characteristic of a compensation and reward system designed to help drive successful strategy execution?

A) Tying incentives to performance outcomes directly linked to good strategy execution and financial performance
B) Keeping the time between achieving the target performance outcome and the payment of the reward as short as possible
C) Making sure that the performance targets that each individual or team is expected to achieve involve outcomes that the individual or team can personally affect
D) Generous rewards for people who turn in outstanding performances
E) A reward system that involves 50 percent non-monetary rewards and a work environment that avoids placing pressure on managers and employees to perform at high levels

*Answer:* E  Page: 379 - 380  Learning Objective: 5  Difficulty: Easy  Taxonomy: Comprehension  
AACSBB: Value Creation

52. Some caution needs to be exercised in using performance-based compensation systems in multinational enterprises because

A) in some countries, incentive compensation runs counter to local customs and cultural norms.
B) managers and employees in some countries are not psychologically and emotionally strong enough to cope with performance-based pay systems.
C) if performance-based pay exceeds 5 percent of total compensation, the result can be a serious decline in employee morale in those countries where pay scales are low.
D) too much emphasis on pay-for-performance tends to have a negative impact on employee productivity.
E) it detracts from having employees focus diligently on the duties and functions they are supposed to perform.

*Answer:* A  Page: 380  Learning Objective: 5  Difficulty: Medium  Taxonomy: Comprehension  
AACSBB: Value Creation

**Short Answer Questions**

53. What is the role of budgets and resource allocation in successfully implementing and executing strategy? Why does a company’s budget need to be closely linked to the needs of good strategy execution?

*Page:* 358  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension  
AACSBB: Value Creation

54. Identify and describe two ways that policies and procedures aid the task of implementing and executing strategy?

*Page:* 359 - 360  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension  
AACSBB: Value Creation

55. What is the value of total quality management from a strategy-executing standpoint? How does TQM differ from business process reengineering?

*Page:* 364, 368  Learning Objective: 3  Difficulty: Medium  Taxonomy: Comprehension  
AACSBB: Value Creation
56. Explain what Six Sigma quality control programs are all about and how their use can contribute to a company’s strategy execution effort.

**Page:** 364 - 367  
**Learning Objective:** 3  
**Difficulty:** Medium  
**Taxonomy:** Comprehension  
**AACSB:** Value Creation

57. What is the difference between Six Sigma DMAIC programs and Six Sigma DMADV programs?

**Page:** 364  
**Learning Objective:** 3  
**Difficulty:** Hard  
**Taxonomy:** Knowledge  
**AACSB:** Value Creation

58. What three principles underlie the statistical thinking of Six Sigma quality control programs?

**Page:** 365  
**Learning Objective:** 3  
**Difficulty:** Hard  
**Taxonomy:** Comprehension  
**AACSB:** Value Creation

59. Discuss how the Six Sigma process of define, measure, analyze, improve, and control (DMAIC) works. What is the logic underlying the DMAIC process?

**Page:** 365  
**Learning Objective:** 3  
**Difficulty:** Hard  
**Taxonomy:** Comprehension  
**AACSB:** Value Creation

60. While Six Sigma programs often improve the efficiency of many operating activities and processes, there is evidence that innovation can be stifled by Six Sigma programs. True or false? Explain.

**Page:** 367  
**Learning Objective:** 3  
**Difficulty:** Medium  
**Taxonomy:** Comprehension  
**AACSB:** Value Creation

61. What action steps can managers take to build a total quality culture and instill a strong commitment to continuously improving how strategy is being executed?

**Page:** 369  
**Learning Objective:** 3  
**Difficulty:** Medium  
**Taxonomy:** Comprehension  
**AACSB:** Value Creation

62. Give three examples of support systems that a company can install to support the execution of its strategy.

**Page:** 372  
**Learning Objective:** 4  
**Difficulty:** Medium  
**Taxonomy:** Comprehension  
**AACSB:** Technology Influence

63. Discuss the type of control mechanisms that managers can use to monitor the performance of empowered employees.

**Page:** 372 - 373  
**Learning Objective:** 4  
**Difficulty:** Medium  
**Taxonomy:** Comprehension  
**AACSB:** Technology Influence

64. The use of incentives and rewards is the single most powerful tool at management’s disposal to win strong employee commitment to carrying out the strategic plan. True or false? Explain.

**Page:** 373  
**Learning Objective:** 5  
**Difficulty:** Medium  
**Taxonomy:** Comprehension  
**AACSB:** Value Creation
65. Give at least 3 non-monetary examples of motivation and rewards practices that have the capability to foster good strategy execution and explain how they act to produce such a result.

Page: 374 - 375   Learning Objective: 5   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

66. Why does it make sense to create some job anxiety, insecurity, and stress as part of a company’s motivational and reward scheme for promoting competent strategy execution?

Page: 375, 377   Learning Objective: 5   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

67. Discuss why it is generally undesirable for approaches to motivation, compensation, and people management to avoid the use of negative consequences or punishment if performance targets are not achieved or if particular people are habitual underperformers and why striking a balance between rewards and punishment generally works better.

Page: 375, 377   Learning Objective: 5   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

68. Focusing jobholders’ attention and energy on what to do as opposed to what to achieve makes the work environment results-oriented. True or false? Explain your answer.

Page: 378   Learning Objective: 5   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

69. In creating a strategy-supportive reward structure, it is important to define jobs and assignments in terms of the results to be accomplished not just in terms of the duties to be performed. True or false? Explain and justify your answer.

Page: 378   Learning Objective: 5   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation

70. Identify at least 5 guidelines for creating an incentive compensation system that will help drive successful strategy execution.

Page: 379 - 380   Learning Objective: 5   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Value Creation
Multiple Choice Questions

Instilling a Corporate Culture that Promotes Good Strategy Execution

1. A company’s corporate culture is best defined and identified by
   A) the strategy and business model that a company has adopted.
   B) the character of a company’s internal work climate and personality—as shaped by the company’s core values, business principles, traditions, ingrained behaviors of “how we do things around here,” and style of operating.
   C) its statement of core values and its code of ethics.
   D) its internal politics.
   E) the traditions that company executives are committed to maintaining.

   Answer: B   Page: 386   Learning Objective: 1   Difficulty: Easy   Taxonomy: Knowledge
   AACSB: Group/Individual Dynamics

2. The character of a company’s corporate culture is a product of
   A) the core values and business principles that management preaches and practices.
   B) its standards of what is ethically acceptable and what is not and the stories that get told over and over to illustrate and reinforce the company’s values, business practices, and traditions.
   C) the company’s approach to people management and the “chemistry” and “personality” that permeates its work environment.
   D) the work practices and behaviors that define “how we do things around here.”
   E) All of these.

   Answer: E   Page: 386   Learning Objective: 1   Difficulty: Easy   Taxonomy: Knowledge
   AACSB: Group/Individual Dynamics

3. Which one of the following is not a fundamental part of a company’s culture?
   A) The work practices and behaviors that define “how we do things around here”
   B) The company’s standards of what is ethically acceptable and what is not, along with the “chemistry” and “personality” that permeates its work environment
   C) The core values and business principles that management preaches and practices
   D) The company’s strategic vision, strategic intent, and strategy
   E) The legends and stories that people repeat to illustrate and reinforce the company’s core values, traditions, and business practices

   Answer: D   Page: 386   Learning Objective: 1   Difficulty: Easy   Taxonomy: Knowledge
   AACSB: Group/Individual Dynamics
4. A company’s culture is in part defined and identified by
   A) a company’s internal work climate and personality—as shaped by its core values, work practices,
      traditions, and ingrained behaviors that define “how we do things around here.”
   B) whether it employs a low-cost provider, best-cost provider, differentiation or focused strategy.
   C) whether decision-making is centralized or decentralized and whether it is a single-business company
      or a diversified company.
   D) how strongly its strategic vision is linked to the company’s core values.
   E) whether it is a well-known industry leader, an up-and-coming company that is gaining market share,
      a middle-of-the-pack company unlikely to move up in the industry ranks, or an industry also-ran that
      may or may not survive.

   Answer: A   Page: 386   Learning Objective: 1   Difficulty: Easy   Taxonomy: Knowledge
   AACSB: Group/Individual Dynamics

**Identifying the Key Features of a Company’s Corporate Culture**

5. A company’s culture is not manifested in which one of the following?
   A) Its approaches to people management and problem-solving and in the “chemistry” and “personality”
      that permeates the work environment
   B) Its revered traditions and the stories that get told over and over to illustrate the importance of certain
      values
   C) The peer pressures that exist to do things in particular ways and conform to expected norms
   D) The company’s approach to people management and its official policies, procedures, and operating
      practices that paint the white lines for the behavior of company personnel
   E) Its strategic vision, strategic intent, and strategy.

   Answer: E   Page: 386 - 387   Learning Objective: 1   Difficulty: Easy   Taxonomy: Knowledge
   AACSB: Group/Individual Dynamics

6. Which one of the following is not something to look for in identifying a company’s culture?
   A) The spirit and character that pervades the work climate
   B) Its resource strengths, core competencies, and competitive capabilities
   C) The company’s revered traditions and oft-repeated stories about “heroic acts” and “how we do things
      around here”
   D) The company’s approach to people management and the official policies, procedures, and operating
      practices that paint the white lines for the behavior of company personnel
   E) The values, business principles, and ethical standards that management preaches and practices

   Answer: B   Page: 386 - 387   Learning Objective: 1   Difficulty: Easy   Taxonomy: Knowledge
   AACSB: Group/Individual Dynamics

7. Which one of the following is something to look for in identifying a company’s culture?
   A) The spirit and character that pervades the work climate and the values, business principles, and ethical
      standards that management preaches and practices
   B) The company’s track record in meeting or beating its financial and strategic performance targets
   C) The make-up of the company’s value chain
   D) Its strategic intent and competitive strategy
   E) Its resource strengths, core competencies, and competitive capabilities

   Answer: A   Page: 386 - 387   Learning Objective: 1   Difficulty: Easy   Taxonomy: Knowledge
   AACSB: Group/Individual Dynamics
8. Frequently, a significant part of a company’s culture is captured in
A) the company’s strategic vision and strategic intent.
B) the stories that get told over and over again to illustrate to newcomers the importance of certain values and the depth of commitment that various company personnel have displayed.
C) how much stretch is built into the company’s financial and strategic performance targets.
D) the vigor and enthusiasm with which it engages in benchmarking and seeks out best practices.
E) the company’s track record in taking market share away from rivals.

Answer: B  Page: 388  Learning Objective: 1  Difficulty: Easy  Taxonomy: Knowledge
AACSB: Group/Individual Dynamics

9. Once established, company cultures can be perpetuated by
A) systematic indoctrination of new members in the culture’s fundamentals, frequent reiteration of core values by senior managers and group members, and regular ceremonies honoring members who display desired cultural behaviors.
B) avoiding frequent or dramatic reorganizations that could disturb existing relationships and networking among departments and company personnel.
C) making adherence to cultural beliefs and cultural norms the defining features of the company’s strategic vision.
D) rewarding departments that observe cultural norms with above-average budget increases and penalizing those who don’t with budget cuts.
E) making cultural values and beliefs the centerpiece of the company’s competitive strategy.

Answer: A  Page: 389  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Group/Individual Dynamics

10. Which one of the following is not particularly helpful in perpetuating a company’s culture?
A) Systematic indoctrination of new members in the culture’s fundamentals
B) Frequent reiteration of core values by senior managers and group members
C) Visibly rewarding those who display cultural norms and penalizing those who don’t
D) Maintaining a consistent strategic vision and strategic intent over time.
E) Telling and retelling of company legends and regular ceremonies honoring members who display desired cultural behaviors.

Answer: D  Page: 389  Learning Objective: 1  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Group/Individual Dynamics
Chapter 12  Corporate Culture and Leadership: Keys to Good Strategy Execution

11. Which one of the following statements about a company’s culture is false?
   A) The more new employees a company is hiring the more important it becomes to screen job applicants every bit as much for how well their values, beliefs, and personalities match up with the culture as for their technical skills and experience.
   B) The longer people stay at an organization, the more that they come to embrace and mirror the corporate culture—their values and beliefs tend to be molded by mentors, fellow workers, company training programs, and the reward structure.
   C) A company’s culture, once established, tends to remain stable and entrenched over time.
   D) Typically, key elements of the culture originate with a founder or certain strong leaders who articulated them as a set of business principles, company policies, operating approaches, and ways of dealing with employees, customers, vendors, shareholders, and local communities where the company has operations.
   E) Company cultures can be perpetuated by the telling and retelling of company legends, by regular ceremonies honoring members who display desired cultural behaviors, and by visibly rewarding those who display cultural norms and penalizing those who don’t.

   Answer: C   Page: 388 - 389   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Group/Individual Dynamics

12. Companies, especially ones with multinational operations and/or newly acquired businesses, typically have
   A) strong cultures multiple cultures (or subcultures) rather than a single culture.
   B) multiple cultures (or subcultures) rather than a single culture.
   C) weak cultures.
   D) adaptive cultures.
   E) low performance cultures.

   Answer: B   Page: 390   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Group/Individual Dynamics

**Strong versus Weak Cultures**

13. The hallmark of a strong-culture company is
   A) strictly enforced policies and procedures.
   B) a strongly entrenched competitive strategy.
   C) the dominating presence of certain deeply-rooted values and operating approaches that “regulate” the conduct of a company’s business and the climate of its workplace.
   D) decentralized decision-making and empowered employees.
   E) a deep commitment to benchmarking, best practices, and operating excellence.

   Answer: C   Page: 390   Learning Objective: 2   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Group/Individual Dynamics

14. In a strong culture company,
   A) values and behavioral norms are like crabgrass—deeply rooted and hard to weed out.
   B) there is wide support for high ethical standards among both managers and employees.
   C) a company has more strategy flexibility because it can change its strategy and be confident that the culture will welcome the strategy changes and be an ally in implementing whatever changes are called for.
   D) there is little room for employee empowerment, because independent-thinking empowered employees may well make decisions or engage in actions that weaken the culture.
   E) management insists that official policies and procedures be followed religiously.

   Answer: A   Page: 391   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Group/Individual Dynamics
15. The characteristics of a strong culture company include
   A) deeply-rooted values and operating approaches that “regulate” the conduct of a company’s business and the climate of its workplace.
   B) a strong managerial commitment to display company values and principles in their own actions and behavior.
   C) dedicated efforts on the part of management to communicating values and business principles to organization members and explaining how they relate to the company’s business environment.
   D) using core values and ingrained business principles as guides in making decisions.
   E) All of these.

   **Answer:** E   Page: 390 - 391   Learning Objective: 2   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Group/Individual Dynamics

16. Which of the following contribute to the emergence and sustainability of a strong culture?
   A) Senior executives that walk the talk of high ethical standards
   B) A strong emphasis on developing innovative core competencies and competitive capabilities
   C) A sincere, long-standing company commitment to operating the business according to established traditions, thereby creating an internal environment that supports decision making and strategies based on cultural norms
   D) Centralized decision-making and strict enforcement of company policies
   E) A longstanding commitment to strict enforcement of established policies and procedures and steadfast unwillingness to change these policies and procedures

   **Answer:** C   Page: 391   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Group/Individual Dynamics

17. Which of the following is *not* a factor in contributing to the emergence and sustainability of a strong culture?
   A) Continuity of leadership, small group size, stable group membership, geographic concentration, and considerable organizational success
   B) A founder or strong leader who establishes values, principles, and practices that are consistent and sensible in light of customer needs, competitive conditions, and strategic requirements
   C) A sincere, long-standing company commitment to operating the business according to established traditions, thereby creating an internal environment that supports decision making and strategies based on cultural norms
   D) Centralized decision-making, strict enforcement of company policies, and a strong commitment to being the market share leader
   E) A genuine concern for the well-being of the organization’s three biggest constituencies—customers, employees, and shareholders

   **Answer:** D   Page: 391   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Group/Individual Dynamics
18. Which of the following statements about a strong-culture company is false?
   A) In a strong-culture company, culturally-approved behaviors and ways of doing things are nurtured while culturally-disapproved behaviors and work practices get squashed.
   B) In strong culture companies, senior managers make a point of reiterating key principles and core values to organization members; more importantly, they make a conscious effort to display these principles and values in their own actions and behavior and they insist that company values and business principles be reflected in the decisions and actions taken by all company personnel.
   C) Continuity of leadership, small group size, stable group membership, geographic concentration, and considerable organizational success all contribute to the emergence and sustainability of a strong culture.
   D) Centralized decision-making, strict enforcement of company policies, diligent pursuit of a distinctive competence, and a bold strategic intent are the hallmarks of a strong-culture company.
   E) In a strong-culture company, values and behavioral norms are like crabgrass: deeply rooted and hard to weed out.

**Answer:** D  Page: 390 - 391  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Group/Individual Dynamics

19. Which one of the following is a typical characteristic of a weak company culture?
   A) Very little cultural support for the company’s strategic vision and strategy
   B) No code of ethics and deep hostility to change and to people who champion new ways of doing things
   C) A complicated value chain that acts to create multiple subcultures
   D) A lack of values and principles that are consistently preached or widely shared
   E) No strong sense of teamwork

**Answer:** D  Page: 391  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Group/Individual Dynamics

20. Which one of the following is not a typical characteristic of a weak company culture?
   A) A lack of values and principles that are consistently preached or widely shared
   B) A tendency among employees to view their jobs as a just a way of making a living.
   C) A complicated value chain and a very diverse set of core competencies—both of which act to create multiple subcultures
   D) Few widely-revered traditions and few culture-induced norms
   E) No strong employee allegiance to what the company stands for or to operating the business in well-defined ways

**Answer:** C  Page: 391 - 392  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Group/Individual Dynamics
21. Which one of the following statements about a weak company culture is true?
   A) In a weak culture company, there is virtually no employee support for the company’s strategic vision and strategy.
   B) Weak culture companies do not usually have a code of ethics and have little regard for high ethical standards.
   C) Weak cultures provide little assistance in executing strategy because there are no traditions, values, or behavioral norms that management can use as levers to mobilize commitment to executing the chosen strategy.
   D) Weak culture companies are fairly receptive to change and to people who champion new ways of doing things.
   E) In a weak culture company, there is usually little teamwork, a dearth of intellectual capital, and inattention to building core competencies.

   Answer: C  Page: 392  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Group/Individual Dynamics

Unhealthy Cultures

22. Which of the following is not a common trait of an unhealthy company culture?
   A) A politicized internal environment and empire-building managers who jealously guard their turf
   B) Hostility to change and a wariness of people who champion new ways of doing things
   C) An aversion to looking outside the company for best practices, new managerial approaches, and innovative ideas
   D) An aversion to incentive compensation, failure to recruit the best and brightest employees, subpar support for employee training, overemphasis on working in teams, and low ethical standards
   E) Overzealous pursuit of wealth and status on the part of key executives

   Answer: D  Page: 392  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Group/Individual Dynamics

23. Unhealthy company cultures typically have such characteristics as
   A) tight budget controls, overly strict enforcement of longstanding polices and procedures, and low ethical standards.
   B) a preference for conservative strategies, an aversion to incentive compensation, and excessive emphasis on profitability.
   C) a politicized internal environment, hostility to change and an aversion to looking outside the company for best practices, new managerial approaches, and innovative ideas.
   D) overemphasis on employee empowerment, a complacent approach to building competencies and capabilities, no coherent business philosophy, and excessively bureaucratic policies and procedures.
   E) too little emphasis on innovation, a strong preference for hiring managers from outside the company, very few core values and traditions, and a weakly enforced code of ethics.

   Answer: C  Page: 392  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension
   AACSB: Group/Individual Dynamics
24. Which of the following is not an example of an unhealthy company culture?
   A) Insular inwardly-focused cultures
   B) Change-resistant cultures
   C) Unethical and greed-driven cultures
   D) Politicized cultures
   E) Hyper-adaptive cultures

   **Answer:** E  Page: 392  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension  
   AACSB: Group/Individual Dynamics

25. Companies with change-resistant cultures
   A) are typically opposed to performance-based incentive compensation and employee empowerment.
   B) are prone to be preoccupied with avoiding risks, are unlikely to pursue bold actions to capture emerging opportunities, are frequently lax when it comes to product innovation and continuous improvement in performing value chain activities, and prefer following rather than leading market change.
   C) are often overly gung-ho about looking outside the company for best practices, new managerial approaches, and innovative ideas.
   D) tend to be preoccupied with making sure the company has a safe, follow-the-industry-leader type of strategic vision and avoids risky business strategies.
   E) are typically run by amoral managers who have little regard for high ethical standards.

   **Answer:** B  Page: 393  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension  
   AACSB: Group/Individual Dynamics

**High-Performance Cultures**

26. The hallmarks of a high performance corporate culture include
   A) frequently revised and updated values and ethics statements, a deep commitment to employee training, and unusually attractive fringe benefit packages for company personnel.
   B) a “can-do” spirit, pride in doing things right, no-excuses accountability, and a pervasive results-oriented work climate where people go the extra mile to meet or beat stretch objectives.
   C) a balanced scorecard approach to measuring performance, strong emphasis on teamwork, strict enforcement of company policies and procedures, and incentive compensation for all employees.
   D) a deep commitment to pioneering new best practices, a preference for being a fast-follower as opposed to a first-mover or late-mover, and across-the-board bonuses for all personnel when the company meets or beats stretch objectives.
   E) a deep commitment to top-notch quality and superior customer service, dedicated use of TQM and/or Six Sigma quality control programs, and the payment of big performance bonuses and stock options.

   **Answer:** B  Page: 394  Learning Objective: 2  Difficulty: Hard  Taxonomy: Comprehension  
   AACSB: Group/Individual Dynamics
27. Which one of the following statements about a high performance culture is false?
   A) Results-oriented, high performance cultures are permeated with a spirit of achievement and have a good track record in meeting or beating performance targets.
   B) High performance cultures often have a low regard for high ethical standards, a strong preference for high-risk strategies, and a slow and methodical approach to responding to changes in the marketplace.
   C) The challenge in creating a high performance culture is to inspire high loyalty and dedication of the part of employees, such that they are both energized and preoccupied with putting forth their very best efforts to do things right and be unusually productive.
   D) In a high performance culture, the clear and unyielding expectation is that all company personnel, from senior executives to front-line employees will display high performance behaviors and a passion for making the company successful.
   E) In high performance cultures, there’s a strong sense of involvement on the part of company personnel and emphasis on individual initiative and creativity.

   **Answer:** B  Page: 394 - 395  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension  
   AACSB: Group/Individual Dynamics

28. Which one of the following statements about a high performance culture is true?
   A) Results-oriented, high performance cultures are permeated with a spirit of achievement and have a good track record in meeting or beating performance targets.
   B) High performance cultures often have a low regard for high ethical standards (because some disregard for ethics is a normal part of meeting or beating performance targets).
   C) The challenge in creating a high performance culture is to come up with a strategic vision and strategy that wins enthusiastic support from most all company personnel.
   D) In a high performance culture, the clear and unyielding expectation is that all company personnel will strictly follow company policies and procedures.
   E) In high performance cultures, there’s a strong managerial commitment to paying big bonuses and granting generous stock options.

   **Answer:** A  Page: 394 - 395  Learning Objective: 2  Difficulty: Easy  Taxonomy: Comprehension  
   AACSB: Group/Individual Dynamics

**Adaptive Cultures**

29. The hallmark of an adaptive corporate culture is
   A) a shared willingness to adapt core values to fit the changing requirements of an evolving strategy.
   B) a conservative strategy, prudent risk-taking, and strong peer pressures to observe cultural norms.
   C) willingness on the part of organizational members to accept change and take on the challenge of introducing and executing new strategies.
   D) a commitment to the types of core values and ethical standards that make a company a great place to work.
   E) a strong preference for performance-based compensation systems—especially the payment of bonuses and stock options.

   **Answer:** C  Page: 395  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension  
   AACSB: Group/Individual Dynamics
30. In adaptive corporate cultures,
   A) the prevailing view is that the best way of looking out for the interests of employees is to change core values and cultural norms in whatever ways are needed to fit the changing requirements of an evolving strategy.
   B) company personnel are amenable to changing policies and operating practices as long as the core elements of the company’s strategic vision and strategy remain intact.
   C) members are willing to embrace a proactive approach to trying new ideas, altering operating practices, and changing pieces of the strategy provided it doesn’t imperil their job security, entail cuts in compensation, or require different work practices.
   D) there’s a spirit of doing what’s necessary to ensure long-term organizational success provided that core values and business principles are not compromised and provided top management undertakes the changes in a manner that exhibits genuine concern for the legitimate interests of stakeholders.
   E) there is little need for policies and procedures because group members willingly accept experimentation and innovation.

**Answer:** D  Page: 395  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Group/Individual Dynamics

31. Which of the following statements about adaptive corporate cultures is false?
   A) The hallmark of adaptive corporate cultures is willingness on the part of organizational members to accept change and take on the challenge of introducing and executing new strategies.
   B) The standout cultural traits are a “can-do” spirit, pride in doing things right, no-excuses accountability, and a pervasive results-oriented work climate where people go the extra mile to meet or beat stretch objectives.
   C) Company personnel share a feeling of confidence that the organization can deal with whatever threats and opportunities come down the pike; they are receptive to risk taking, experimentation, innovation, and changing strategies and practices.
   D) Adaptive cultures are exceptionally well-suited to companies with fast-changing strategies and market environments.
   E) For an adaptive culture to remain intact over time, top management must orchestrate organizational changes in a manner that (1) demonstrates genuine care for the well-being of all key constituencies and (2) tries to satisfy all their legitimate interests simultaneously.

**Answer:** B  Page: 395 - 396  Learning Objective: 2  Difficulty: Medium  Taxonomy: Comprehension  
AACSB: Group/Individual Dynamics

**Culture: Ally or Obstacle to Strategy Execution?**

32. A work environment where the culture is well-matched to the conditions and behaviors requisite for good strategy execution is a valuable managerial ally because
   A) there is much less risk of embarrassing ethical violations.
   B) it provides company personnel with clear guidance regarding “how we do things around here” and produces significant peer pressures from co-workers to conform to culturally acceptable norms.
   C) there is reduced need to incorporate negative motivational practices and punitive-type incentives into the reward structure and in the company’s approach to people management.
   D) there is reduced need to employ benchmarking, best practice programs, reengineering, Six Sigma, and TQM to achieve competitive advantage.
   E) the culture can then be readily incorporated into the company’s strategic vision and facilitate the achievement of stretch objectives.

**Answer:** B  Page: 397  Learning Objective: 2  Difficulty: Easy  Taxonomy: Comprehension  
AACSB: Group/Individual Dynamics
33. Which of the following is a benefit of closely aligning the corporate culture with the requirements for proficient strategy execution?
   A) A good strategy-culture alignment makes it possible to establish a much bolder strategic vision and strategic intent.
   B) A good strategy-culture alignment enhances a company’s cost competitiveness.
   C) A tight strategy-culture fit steers company personnel into displaying behaviors and adopting operating practices that promote good strategy execution.
   D) A tight strategy-culture alignment enhances the creation of core competencies and distinctive competencies.
   E) A tight strategy-culture alignment makes it easier to change a company’s culture over time—as a company’s strategy evolves, the culture automatically evolves also.

   **Answer:** C   Page: 397   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension   AACSB: Group/Individual Dynamics

34. Which of the following statements about the match between a company’s culture and its strategy is false?
   A) When a company’s present work climate promotes attitudes and behaviors that are well suited to first-rate strategy execution, its culture functions as a valuable ally in the strategy execution process.
   B) A deeply embedded culture tightly matched to the strategy aids the cause of competent strategy execution by steering company personnel to culturally-approved behaviors and work practices and thus making it far simpler to root out operating practices that are a misfit.
   C) It is in management’s best interest to dedicate considerable effort to embedding a corporate culture that encourages behaviors and work practices conducive to good strategy execution.
   D) A tight strategy-culture alignment facilitates building core competencies and distinctive competencies that lead to low operating costs and a cost-based competitive advantage.
   E) When a company’s culture is grounded in many of the needed strategy-executing behaviors, employees feel genuinely better about their jobs and what the company is trying to accomplish; as a consequence, greater numbers of company personnel exert their best efforts to execute the strategy and achieve performance targets.

   **Answer:** D   Page: 396 - 398   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension   AACSB: Group/Individual Dynamics

35. When a company’s culture is out of sync with what is needed for strategic success and good strategy execution,
   A) the strategy has to be changed to fit the culture as rapidly as possible.
   B) the company’s strategic vision, strategic intent, and strategy have to be adjusted to better reflect ingrained core values and cultural norms.
   C) management needs to go on the offensive to reinterpret the culture and explain to company personnel why there really is good overall cultural fit with the strategy.
   D) the culture has to be changed to accommodate the requirements of good strategy execution as rapidly as can be managed.
   E) management must urge company to participate in an all-out effort to create a different portfolio of competencies and capabilities that will permit the strategy to be changed in ways that will fit the culture.

   **Answer:** D   Page: 398   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension   AACSB: Group/Individual Dynamics
Changing a Problem Culture

36. Changing a problem culture
   A) is one of the toughest managerial tasks because of the heavy anchor of ingrained behaviors and ways of doing things.
   B) is best done by instituting an aggressive program to train employees in the ways and beliefs of the new culture to be implanted.
   C) is best done by selecting a team of key employees to lead the culture change effort.
   D) requires writing a new statement of core values, having a series of lengthy meetings with employees to explain the new culture and the reasons why cultural change is needed, and then having both employees and shareholders vote to ratify and adopt the new culture.
   E) can be done quickly only if managers tie incentive compensation to exhibiting the desired new cultural behaviors and if managers visibly praise people who exhibit the desired new cultural traits.

   Answer: A   Page: 398   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension   AACSB: Group/Individual Dynamics

37. The single most visible factor that distinguishes successful culture-change efforts from failed attempts is
   A) forceful management actions to empower employees to adopt new operating practices.
   B) competent leadership at the top.
   C) de-layering the management hierarchy.
   D) developing a new values statement that inspires company personnel to put forth their best efforts to achieve performance targets.
   E) convincing employees that top management is genuinely committed to high ethical standards and the exercise of corporate social responsibility.

   Answer: B   Page: 399   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension   AACSB: Group/Individual Dynamics

38. The place for management to begin in trying to change a problem culture is
   A) identifying facets of the present culture that are obstacles to operating excellence and then selling company personnel on a new set of behaviors and work practices.
   B) by spending heavily on programs to train employees in the ways and beliefs of the new culture to be implanted.
   C) to visibly praise and reward people who exhibit traits and behaviors that undermine the existing culture.
   D) writing a new values statement and describing in highly motivating terms the kind of culture that is needed.
   E) to institute incentive compensation programs that generously reward employees for adopting best practices.

   Answer: A   Page: 399   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension   AACSB: Group/Individual Dynamics
39. When trying to change a problem culture, management should undertake such steps as
A) selecting a team of key employees to lead the culture change effort and design a plan for cultural change.
B) identifying which aspects of the present culture are supportive of good strategy execution and which ones are not and then selling the work force on what new actions, behaviors, and work practices are needed to improve performance.
C) drawing up an action plan to change the present culture and then persuading company personnel why this plan of action is good and will be successful.
D) conducting an employee survey to determine the organization’s cultural norms and what company personnel like and dislike about the current culture.
E) employing a consultant with expertise in culture change and following his/her advice on how to proceed.

Answer: B   Page: 399   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Group/Individual Dynamics

40. In moving to alter a problem culture, management should
A) identify which aspects of the present culture are supportive of good strategy execution and which ones are not.
B) specify what new actions, behaviors, and work practices should be prominent in the “new” culture.
C) talk openly about the problems of the present culture and how new behaviors will improve performance.
D) employ visible, forceful actions—both substantive and symbolic—to ingrain a new set of behaviors, practices and cultural norms.
E) All of these.

Answer: E   Page: 399   Learning Objective: 3   Difficulty: Easy   Taxonomy: Comprehension
AACSB: Group/Individual Dynamics

41. Which one of the following is not an appropriate step management can take to change a problem culture?
A) Identifying which aspects of the present culture are supportive of good strategy execution and which ones are not
B) Specifying what new actions, behaviors, and work practices should be prominent in the “new” culture
C) Appointing a team of key managers and employees to design a plan for cultural change and then lead the internal effort to change the culture.
D) Talking openly about the problems of the present culture and how new behaviors will improve performance.
E) Employing visible, forceful actions—both substantive and symbolic—to ingrain a new set of behaviors, practices and cultural norms.

Answer: C   Page: 399   Learning Objective: 3   Difficulty: Easy   Taxonomy: Comprehension
AACSB: Group/Individual Dynamics
42. The menu of actions management can take to change problem culture does not include which one of the following?
A) Making a compelling case for why the company’s new strategic direction and culture-remodeling efforts are in the organization’s best interests and why company personnel should wholeheartedly join the effort to doing things somewhat differently
B) Replacing senior executives who are strongly identified with the old culture and who may be stonewalling needed organizational and cultural changes.
C) Promoting individuals who are known to possess the desired cultural traits, who have stepped forward to advocate the shift to a different culture, and who can serve as role models for the desired cultural behavior
D) Revising policies and procedures in ways that will help drive cultural change
E) Shifting from decentralized to centralized decision-making so as to give senior executives more authority and control in driving cultural change

**Answer:** E Page: 400 - 401 Learning Objective: 3 Difficulty: Medium Taxonomy: Comprehension AACSB: Group/Individual Dynamics

43. Which one of the following is a substantive culture-changing action that a company’s managers can undertake to alter a problem culture?
A) Identifying aspects of the present culture that pose problems
B) Revising policies and procedures in ways that will help drive cultural change and replacing senior executives who are strongly identified with the old culture and may be stonewalling needed changes.
C) Empowering employees to adopt whatever new work practices they believe will be an improvement
D) Making a concerted effort to turn the company’s core competencies into distinctive competencies
E) Shifting from decentralized to centralized decision-making so as to give senior executives more authority and control in driving cultural change

**Answer:** B Page: 401 Learning Objective: 3 Difficulty: Medium Taxonomy: Comprehension AACSB: Group/Individual Dynamics

44. Which one of the following is not a substantive culture-changing action that a company’s managers can undertake to alter a problem culture?
A) Promoting individuals who are known to possess the desired cultural traits, who have stepped forward to advocate the shift to a different culture, and who can serve as role models for the desired cultural behavior
B) Appointing outsiders with the desired cultural attributes to high-profile positions
C) Screening all candidates for new positions carefully, hiring only those who appear to fit in with the new culture
D) Urging company personnel to search outside the company for work practices and operating approaches that may be an improvement over what the company is presently doing and paying sizable bonuses to those employees who identify practices that the company ends up adopting
E) Designing compensation incentives that boost the pay of teams and individuals who display the desired cultural behaviors and hit change-resisters in the pocketbook

**Answer:** D Page: 401 Learning Objective: 3 Difficulty: Medium Taxonomy: Comprehension AACSB: Group/Individual Dynamics
45. Changing a problem culture to create better alignment with strategy generally does not involve
   A) replacing old-culture managers with new-breed managers.
   B) designing compensation incentives that boost the pay of teams and individuals who display the desired cultural behaviors and hit change-resisters in the pocketbook.
   C) altering the company’s strategic vision and/or its strategic and financial objectives.
   D) using company gatherings and ceremonial occasions to praise individuals and groups that display the desired new cultural traits and behaviors.
   E) both symbolic and substantive actions by executives to implant new cultural behaviors.

   Answer: C   Page: 401   Learning Objective: 3   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Group/Individual Dynamics

46. Which one of the following is not likely to be an effective management action to create a better strategy-culture fit and alter a problem culture
   A) Citing why and how certain behavioral norms and work practices in the current culture pose obstacles to good execution of new strategic initiatives
   B) Explaining how certain new behaviors and work practices that are to be introduced and have important roles in the new culture will be more advantageous and produce better results
   C) Calling upon first-level supervisors and rank-and-file employees to identify cultural barriers to good strategy execution and then lead the cultural change effort
   D) Granting pay raises to individuals who step out front, lead the adoption of the desired work practices, display the new-style behaviors, and achieve pace-setting results
   E) Revising policies and procedures in ways that will help drive cultural change

   Answer: C   Page: 400 - 401   Learning Objective: 3   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Group/Individual Dynamics

**Grounding the Culture in Core Values and Ethics**

47. A company’s culture is typically grounded in and shaped by
   A) its core competencies and competitive capabilities.
   B) its long-term strategic success or lack thereof.
   C) the degree to which top management is committed to achieving market leadership.
   D) its core values and the bar it sets for ethical standards.
   E) the company’s strategic intent and its reward system.

   Answer: D   Page: 403   Learning Objective: 4   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Ethics/Legal Responsibilities

48. A company’s values statement and code of ethics
   A) communicate expectations of how employees should conduct themselves in the workplace.
   B) helps prevent it from coming across to customers and the general public as greedy.
   C) serve the valuable purpose of making its suppliers hesitant to engage in business practices that are unethical.
   D) are the most important factors determining its reputation with customers, suppliers, employees, shareholders, and society at large.
   E) should always be made a prominent and visible part of the company’s strategic intent and strategy.

   Answer: A   Page: 405   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Ethics/Legal Responsibilities
49. At companies where executives believe in the merits of practicing the values and ethical standards that have been espoused
A) the executives have usually personally written the statement of core values and the code of ethics.
B) the company’s pursuit of higher profits is tempered, so that the company will not come across to customers and the general public as greedy.
C) the company’s chances for strategic success and market leadership are substantially reduced because company personnel are hesitant to engage in business practices that are unethical.
D) the stated core values and ethical principles are the cornerstones of the corporate culture.
E) the core values and ethical standards are made a prominent and visible part of the company’s strategic intent and strategy.

Answer: D  Page: 405  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension
AACSBB: Ethics/Legal Responsibilities

50. A corporate culture founded on ethical business principles and socially approved values
A) virtually guarantees that a company will be (or soon become) the acknowledged industry leader because of the ethical and socially approved manner in which its business is being conducted.
B) doesn’t necessarily impact a company’s long-term strategic success favorably or unfavorably.
C) does more to detract from a company’s chances for strategic success and market leadership than to help it.
D) is a positive force underlying a company’s long-term success and reduces the likelihood of reputation-damaging behavior on the part of a company’s employees.
E) is seldom more than window-dressing and is generally regarded by customers, suppliers, employees, shareholders, and society at large as nothing more than good public relations.

Answer: D  Page: 405  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension
AACSBB: Ethics/Legal Responsibilities

51. Codes of ethics and statements of core values
A) are the single most effective means of enforcing ethical behavior and cultural norms, provided they are written down and every employee is given a copy.
B) serve as cornerstones of the corporate culture at companies where executives are truly committed to practicing the values and ethical standards that have been espoused.
C) are the best benchmarks for judging whether the corporate culture is deeply planted or not.
D) need to be personally written by the CEO in order to be taken seriously by employees.
E) should always be given top priority emphasis in every employee training program a company conducts.

Answer: B  Page: 405  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension
AACSBB: Ethics/Legal Responsibilities

52. Which of the following topics would least likely be contained in a company’s statement of its core values?
A) A commitment to having fun and creating a fun work environment
B) A commitment to excellence and results
C) Mandating full compliance with all laws and regulations
D) Exhibiting such qualities as integrity, fairness, trustworthiness, pride of workmanship, Golden Rule behavior, respect for co-workers, and ethical behavior
E) Exhibiting teamwork and cooperative attitudes

Answer: C  Page: 404  Learning Objective: 4  Difficulty: Medium  Taxonomy: Comprehension
AACSBB: Ethics/Legal Responsibilities
53. Which of the following topics would least likely be contained in a company’s code of ethics?
A) Prohibiting giving or accepting bribes, kickbacks, or gifts
B) Expecting all company personnel to display honesty and integrity in their actions and avoid conflicts of interest
C) Not dealing with suppliers that employ child labor or engage in other unsavory practices
D) Committing to a no-layoff policy and to adequate funding of employee retirement programs
E) Avoiding use of company assets, resources, and property for personal or other inappropriate purposes

Answer: D   Page: 404   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

54. The two culture-building roles of a company’s stated values and ethical standards are to
A) communicate the company’s good intentions and establish a corporate conscience.
B) confirm the integrity of company personnel and signal the above-board nature of the company’s business principles and operating methods.
C) steer company personnel toward doing the right thing and convince outsiders that the company is socially responsible.
D) help create a work climate where company personnel share common and strongly held convictions about how the company’s business is to be conducted and to signal employees that they are to display the company’s core values in their actions and uphold the company’s ethical standards.
E) provide a basis for designing culture-supportive incentive compensation plans.

Answer: D   Page: 405   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

55. A company’s stated core values and ethical principles
A) are important because of their role in ensuring that company executives will not engage in unethical behavior or behave in a manner that is contrary to the company’s core values.
B) are typically tightly linked to its strategic vision and strategy.
C) are the best indicators of a company’s social responsibility strategy.
D) help create a work climate where company personnel share common and strongly-held convictions about how the company’s business is to be conducted and signal employees that they are expected to display the core values in their actions and behaviors and uphold the company’s ethical standards.
E) are strictly enforced in strong culture companies and weakly enforced in weak culture companies.

Answer: D   Page: 405   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

56. Which of the following is not a technique that companies employ to hammer in and ingrain core values and ethical standards?
A) Incorporating the statement of values and the code of ethics into orientation programs for new employees and training courses for managers and employees
B) Making the display of core values and ethical principles a big factor in evaluating each person’s job performance
C) Encouraging everyone to use their influence in helping enforce observance of core values and ethical standards
D) Periodically having ceremonial occasions to recognize individuals and groups who display the values and ethical principles
E) Downplaying ethics enforcement procedures

Answer: E   Page: 406   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities
57. To deeply ingrain core values and ethical standards, a company must
   A) provide every employee with a copy of the company’s statement of core values and code of ethics.
   B) turn the espoused core values and ethical standards into strictly enforced cultural norms.
   C) encourage company personnel to observe the core values and ethical standards.
   D) give big pay raises and bonuses to individuals and groups who display the company’s core values and
   observe its ethical standards.
   E) fire employees who do not live up to the core values or who are found guilty of violating the code of
   ethics.

   **Answer:** B   Page: 406   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Ethics/Legal Responsibilities

58. Which of the following is not an integral part of transforming core values and ethical standards into cultural
   norms?
   A) Instituting procedures for enforcing ethical standards
   B) Immediately dismissing any employee caught violating the company’s code of ethics or disregarding
   core values
   C) Screening out job applicants who do not exhibit compatible character traits
   D) Periodically having ceremonial occasions to recognize individuals and groups who display the values
   and ethical principles
   E) Having senior executives frequently reiterate the importance and role of company values and ethical
   principles at company events and internal communications to employees

   **Answer:** B   Page: 406   Learning Objective: 4   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Ethics/Legal Responsibilities

59. Which of the following is not one of the positive impacts that a company’s stated values and ethical standards
   have on its corporate culture?
   A) Communicating the company’s good intentions
   B) Validating the integrity and above-board nature of the company’s business principles and operating
   methods
   C) Steering company personnel toward both doing things right and doing the right thing
   D) Ensuring that the company will be a model corporate citizen
   E) Establishing a corporate conscience

   **Answer:** D   Page: 406 - 407   Learning Objective: 4   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Ethics/Legal Responsibilities
Establishing a Strategy-Culture Fit in Multinational and Global Companies

60. Establishing a workable strategy-cultural fit in multinational and global companies
   A) requires treating company personnel in different countries as distinctive individuals or groups and tolerating many sub-cultures, each with their own core values and ethical standards.
   B) requires using a multicountry strategy so that the company’s culture and ethical standards in each country can be matched to its strategy in that country.
   C) can be accomplished by grounding the company’s strategy in values and operating practices that travel well across country borders and that strike a chord with managers and workers in many different areas of the world, despite varying local customs and traditions.
   D) first requires having cross-cultural employee committees work out a set of core values, ethical principles, and operating practices that can win the support of employees worldwide; then it is up to top management to ingrain the consensus core values, ethical principles, and operating practices.
   E) entails insisting that cross-country cultural differences are irrelevant to how the company operates worldwide and making it clear to employees that there is no alternative to having a consistent culture across all countries where the company operates.

   Answer: C   Page: 407 - 408   Learning Objective: 4   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Domestic/Global Economic Environments

Leading the Strategy Execution Process

61. Leading the drive for good strategy execution and operating excellence calls upon senior executives to
   A) be very personable, an effective communicator, and skilled in the empowerment of company personnel.
   B) be out front personally leading the implementation process and driving the pace of progress.
   C) delegate little to subordinates and, instead, personally exert a strong, highly visible influence on the company’s approaches to strategy execution.
   D) be creative in establishing policies and procedures that will instill high standards of operating excellence.
   E) be charismatic, a decisive decision-maker, and make inspiring speeches at company events.

   Answer: B   Page: 408   Learning Objective: 5   Difficulty: Easy   Taxonomy: Comprehension
   AACSB: Group/Individual Dynamics

62. In leading the push for proficient strategy execution and operating excellence, the roles of top-level managers include
   A) Being out in the field, seeing how well operations are going.
   B) Delegating authority to middle and lower-level managers and creating a sense of empowerment among employees to move the implementation process forward.
   C) Gathering information firsthand and gauging the progress being made.
   D) Learning the obstacles in the path of good execution and clearing the way for progress.
   E) All of the above

   Answer: E   Page: 408 - 409   Learning Objective: 5   Difficulty: Medium   Taxonomy: Comprehension
   AACSB: Group/Individual Dynamics
63. Which of the following is not one of the leadership roles that senior managers have to play in pushing for good strategy execution and operating excellence?
A) Learning the obstacles in the path of good execution and clearing the way for progress
B) Being out in the field, seeing how well operations are going.
C) Being out front personally leading the execution process and driving the pace of progress.
D) Weeding out managers who are consistently in the ranks of the lowest performers (the bottom 10%) and who are not enthusiastic about the strategy or how it is being executed
E) Delegating authority to middle and lower-level managers and creating a sense of empowerment among employees to move the implementation process forward.

**Answer:** D  Page: 408 - 409  Learning Objective: 5  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Group/Individual Dynamics

### Making Corrective Adjustments in Timely Fashion

64. The leadership challenges that top executives face in making corrective adjustments when things are not going well include
A) knowing when to replace poorly performing subordinates and when to do a better job of coaching them to do the right things.
B) being able to discern whether to emphasize adjustments that will promote better achievement of strategic performance targets or whether to emphasize adjustments that will promote better achievement of financial performance targets.
C) deciding when adjustments are needed and what adjustments to make.
D) having the analytical skills to separate the problems due to a bad strategy from the problems due to bad strategy execution.
E) deciding whether the company would be better off making adjustments that curtail the achievement of strategic objectives or that curtail the achievement of financial objectives or that curtail the achievement of some of both.

**Answer:** C  Page: 409  Learning Objective: 5  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Group/Individual Dynamics

65. The task of top executives in making corrective adjustments includes
A) knowing when to continue with the present corporate culture and when to shift to a different and better corporate culture.
B) being good at figuring out whether to arrive at decisions quickly or slowly in choosing among the various alternative adjustments.
C) deciding when adjustments are needed and what adjustments to make.
D) deciding whether to try to fix the problems of poor strategy execution or simply shift to a strategy that is easier to execute correctly.
E) deciding how to identify the problems that need fixing.

**Answer:** C  Page: 409  Learning Objective: 5  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Group/Individual Dynamics
Short Answer Questions

66. What is meant by the term corporate culture? Why is corporate culture an important factor in implementing and executing strategy?

Page: 386   Learning Objective: 1   Difficulty: Hard   Taxonomy: Comprehension
AACSB: Group/Individual Dynamics

67. Identify and briefly discuss four key features that can be used to describe the corporate culture of a company.

Page: 386 - 388   Learning Objective: 1   Difficulty: Hard   Taxonomy: Comprehension
AACSB: Group/Individual Dynamics

68. The core of a company’s corporate culture is a shared commitment to achieve the firm’s strategic and financial objectives. True or false? Justify your answer.

Page: 386 - 388   Learning Objective: 1   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Group/Individual Dynamics

69. After a company’s corporate culture is established, what are four approaches that can be used to perpetuate the culture?

Page: 389   Learning Objective: 1   Difficulty: Hard   Taxonomy: Comprehension
AACSB: Group/Individual Dynamics

70. How can one tell whether a company has a strong or a weak corporate culture?

Page: 390 - 392   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Group/Individual Dynamics

71. What are the characteristics of unhealthy cultures?

Page: 392   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Group/Individual Dynamics

72. Briefly identify 3 types of unhealthy corporate cultures.

Page: 392 - 394   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Group/Individual Dynamics

73. What are the distinctive features of high-performance corporate cultures?

Page: 394 - 395   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Group/Individual Dynamics

74. What are the distinctive features of adaptive corporate cultures?

Page: 395 - 396   Learning Objective: 2   Difficulty: Medium   Taxonomy: Comprehension
AACSB: Group/Individual Dynamics
75. What are the benefits of a tight culture-strategy matchup?

Page: 397 - 398 Learning Objective: 2 Difficulty: Medium Taxonomy: Comprehension
AACSB: Group/Individual Dynamics

76. The single most visible factor that distinguishes successful culture-change efforts from failed attempts is competent leadership at the top. True or false? Explain and justify your answer.

Page: 398 - 399 Learning Objective: 3 Difficulty: Medium Taxonomy: Comprehension
AACSB: Group/Individual Dynamics

77. Identify and briefly discuss four steps that managers can take to change a culture that is out of step with the company’s strategy.

Page: 399 Learning Objective: 3 Difficulty: Medium Taxonomy: Comprehension
AACSB: Group/Individual Dynamics

78. Give two examples of “symbolic” culture-changing actions and two examples of “substantive” culture-changing actions.

Page: 400 - 402 Learning Objective: 3 Difficulty: Hard Taxonomy: Comprehension
AACSB: Group/Individual Dynamics

79. What is the difference between a code of ethics and a values statement? Discuss the different things that are covered in each.

Page: 403 - 404 Learning Objective: 4 Difficulty: Hard Taxonomy: Knowledge
AACSB: Ethics/Legal Responsibilities

80. What are the roles of a company’s CEO in leading the effort to operate the company’s business in an ethically principled fashion?

Page: 406 Learning Objective: 4 Difficulty: Medium Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

81. Values and ethical standards not only must be explicitly stated but they also must be deeply ingrained into the corporate culture. True or false? Explain.

Page: 406 Learning Objective: 4 Difficulty: Medium Taxonomy: Comprehension
AACSB: Ethics/Legal Responsibilities

82. What is different and challenging about leading culture change in multinational and global companies?

Page: 407 - 408 Learning Objective: 4 Difficulty: Medium Taxonomy: Comprehension
AACSB: Domestic/Global Economic Environments
83. To ensure the proficient implementation of strategy in an organization, top-level executives can best achieve this by delegating authority to middle and lower-level managers and by creating a sense of empowerment among employees. True or false? Explain and justify your answer.

**Page:** 408 - 409  Learning Objective: 5  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Group/Individual Dynamics

84. What are the two things involved in the leadership challenge to consistently achieve good strategy execution?

**Page:** 409  Learning Objective: 5  Difficulty: Medium  Taxonomy: Comprehension
AACSB: Group/Individual Dynamics
section 6

Lecture Notes for Chapters 1-12
CHAPTER SUMMARY

Chapter 1 explores the concepts surrounding organizational strategy. It begins with an explanation of the term strategy and offers a basis for how to identify a company’s particular strategy. Next, it explores the importance of striving for competitive advantage in the marketplace and examines the role strategy plays in achieving this advantage. The chapter then explores the idea that strategy is partly proactive and partly reactive. Next, a discussion on strategy and ethics is given. This is followed by a close look at the relationship between a company’s strategy and its business model. The chapter proceeds forward with a look at what makes strategy a winner and then presents reasons for why crafting and executing strategy are important. The chapter concludes with thoughts on the equation: good strategy + good strategy execution = good management.

LECTURE OUTLINE

I. Introduction

Managers at all companies face three central questions in thinking strategically about their company’s present circumstances and prospects: What’s the company’s present situation? Where does the company need to go from here? How should it get there? “What’s the company’s present situation?” prompts managers to evaluate industry conditions and competitive pressures, the company’s current performance and market standing, its resource strength and capabilities and its competitive weaknesses. “Where does the company need to go from here?” pushes managers to make choices about the direction the company should be headed—what new or different customer groups and customer needs it should endeavor to satisfy, what market positions it needs to be staking out, what changes in its business makeup are needed. “How should it get there?” challenges managers to craft and execute a strategy—a full-blown action plan—capable of moving the company in the intended direction, growing its business, and improving its financial and market performance.

II. What Do We Mean by Strategy?

1. A company’s strategy is management’s action plan for running the business and conducting operations. The crafting of a strategy represents a commitment to pursue a particular set of actions: how to attract and please customers, how to compete successfully, how to conduct operations, and how to improve the company’s financial and market performance.

2. Normally, companies have a wide degree of strategic freedom in choosing the “hows” of strategy:
   a. They can compete in a single industry.
   b. They can diversify broadly or narrowly.

3. For companies intent on gaining sales and market share at the expense of competitors, managers typically opt for the offensive strategies while risk-avoiding companies prefer conservative strategies.
4. There is no shortage of opportunity to fashion a strategy that tightly fits a company’s own particular situation and that is discernably different from the strategies of rivals.

5. Illustration Capsule 1.1, Starbuck’s Strategy in the Specialty Coffee Industry, offers a concrete example of the actions and approaches involved in crafting strategy.

**Illustration Capsule 1.1, Starbuck’s Strategy in the Specialty Coffee Industry**

**Discussion Question:** 1. Would Starbuck’s be described as a risk taker or risk-averse? Why?

**Answer:** Starbuck’s would be described as a risk taker. The company engaged in expansive growth in metropolitan areas, city perimeters and internationally. The company exploited Starbuck’s name and brand image with out of store sales a (coffee in grocery stores, etc) and launched a series of new initiatives to re-ignite in-store sales. Despite the description as a risk-taker, the strategy was not set in concrete. In early 2008 the pace of expansion was slowed and both underperforming stores and stores that were cannibalizing other stores were closed.

**Core Concept**

A company’s strategy consists of the competitive moves and business approaches that managers employ to attract and please customers, compete successfully, grow the business, conduct operations, and achieve targeted objectives.

**A. Strategy and the Quest for Competitive Advantage**

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

2. What makes a competitive advantage sustainable as opposed to temporary are actions and elements in the strategy that cause an attractive number of buyers to have a lasting preference for a company’s products or services as compared to the offerings of competitors.

**Core Concept**

A company achieves sustainable competitive advantage when an attractive number of buyers prefer its products or services over the offerings of competitors and when the basis for this preference is durable.

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

   a. Striving to be the industry’s low-cost provider, thereby aiming for a cost-based competitive advantage over rivals.

   b. Creating a differentiation-based advantage keyed to such features as higher quality, wider product selection, added performance, value-added services, more attractive styling, technological superiority, or unusually good value for the money.

   c. Focusing on serving the special needs and tastes of buyers comprising a narrow market niche.

   d. Developing expertise and resource strengths that give the company competitive capabilities that rivals cannot easily imitate or trump with substitute capabilities.
4. The bigger and more sustainable the competitive advantage, the better the company’s prospects for winning in the market place and earning superior long-term profits relative to its rivals.

B. Identifying a Company’s Strategy

1. A company’s strategy is reflected in its actions in the marketplace and the statements of senior managers about the company’s current business approaches, future plans, and efforts to strengthen its competitiveness and performance.

2. Figure 1.1, Identifying a Company’s Strategy—What to Look For, shows what to look for in identifying the substance of a company’s overall strategy.

3. Once it is clear what to look for, the task of identifying a company’s strategy is mainly one of researching information about the company’s actions in the marketplace and business approaches.

4. To maintain the confidence of investors and Wall Street, most public companies have to be fairly open about their strategies.

5. Except for some about-to-be-launched moves and changes that remain under wraps and in the planning stage, there is usually nothing secret or undiscoverable about what a company’s present strategy is.

C. Why a Company’s Strategy Evolves over Time

1. Every company must be willing and ready to modify its strategy in response to changing market conditions, advancing technology, competitive moves, shifting buyer needs and preferences, emerging market opportunities, new ideas for improving the strategy, and mounting evidence that the strategy is not working well.

2. Most of the time a company’s strategy evolves incrementally from management’s ongoing efforts to fine tune pieces of the strategy, but, on occasion, major strategy shifts are called for.

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

4. Thus, a company’s strategy at any given point in time is fluid.

Core Concept

Changing circumstances and ongoing management efforts to improve the strategy cause a company’s strategy to emerge and evolve over time—a condition that makes the task of crafting a strategy a work in progress, not a one-time event.

Core Concept

A company’s strategy is shaped partly by management analysis and choice and partly by the necessity of adapting and learning by doing.

D. A Company’s Strategy Is Partly Proactive and Partly Reactive

1. A company’s strategy is typically a blend of (1) proactive actions on the part of managers to improve the company’s market position and financial performance and (2) as-needed reactions to unanticipated developments and fresh market conditions.

2. Figure 1.2, A Company’s Strategy is a Blend of Proactive Initiatives and Reactive Adjustments, depicts the typical blend found within a company’s strategy.
3. The biggest portion of a company’s current strategy flows from previously initiated actions and business approaches that are working well enough to merit continuation and newly launched managerial initiatives to strengthen the company’s overall position and performance. This part of management’s game plan is deliberate and proactive.

4. There will be occasions when market and competitive conditions take an unexpected turn that calls for some kind of strategic reaction or adjustment.

5. A portion of a company’s strategy is always developed on the fly. It comes about as a reasoned response to unforeseen developments.

6. A company’s strategy thus tends to be a combination of proactive and reactive elements.

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

1. In choosing among strategic alternatives, company managers are well advised to embrace actions that are aboveboard and can pass the test of moral scrutiny.

2. Crafting an ethical strategy means more than keeping a company’s strategic actions within the bounds of what is legal.

Core Concept

Ethics goes beyond legality to meet the standard of being ethical, a strategy must entail actions that can pass moral scrutiny in the sense of not being shady, unconscionable, or injurious to others or unnecessarily harmful to the environment.

3. A strategy is ethical only if it meets two criteria:
   a. It does not entail actions and behaviors that cross the line from “can do” to “should not do.”
   b. It allows management to fulfill ethical duties to all stakeholders.

4. It is not always easy to categorize a given strategic behavior as definitely ethical or definitely unethical. Whether they are deemed ethical or unethical hinges on how clearly the boundaries are defined.

5. Senior executives with strong character and ethical convictions are generally proactive in linking strategic action and ethics; they forbid the pursuit of ethically questionable business opportunities and insist all aspects of company strategy reflect high ethical standards.

6. There is little lasting benefit to unethical strategies and behavior and the downside risks can be substantial.

IV. The Relationship Between a Company’s Strategy and Its Business Model

Core Concept

A company’s business model explains the rationale for why its business approach and strategy will be a money maker. Absent the ability to deliver good profitability, the strategy is not viable and the survival of the business is in doubt.

1. Closely related to the concept of strategy is the concept of a company’s business model.
2. A company’s business model is management’s storyline for how and why the company’s product offerings and competitive approaches will generate a revenue stream and have an associated cost structure that produces attractive earnings and return on investment.

3. The concept of a company’s business model is consequently more narrowly focused than the concept of a company’s business strategy. A company’s strategy relates broadly to its competitive initiatives and business approaches while the business model zeros in on whether the revenues and costs flowing from the strategy demonstrate business viability.

4. **Illustration Capsule 1.2, Microsoft and Red Hat Linux: Two Contrasting Business Models**, discusses the contrasting business models of Microsoft and Red Hat Linux.

<table>
<thead>
<tr>
<th>Illustration Capsule 1.2, Microsoft and Red Hat Linux: Two Contrasting Business Models</th>
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<tbody>
<tr>
<td><strong>Discussion Question:</strong> 1. What is the prominent difference between the business models of these two organizations?</td>
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<tr>
<td><strong>Answer:</strong> The prominent difference in the business models employed by Microsoft and Red Hat Linux can be found in their respective different revenue-cost-profit economics. Microsoft sells proprietary code software while giving away service. Red Hat Linux, on the other hand, gives software away and depends heavily on sales of technical support services, training, and consultancy services.</td>
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V. **What Makes a Strategy a Winner?**

1. Three questions can be used to test the merits of one strategy versus another and distinguish a winning strategy from a losing or mediocre strategy:

   a. How well does the strategy fit the company’s situation?

      To qualify as a winner, a strategy has to be well matched to industry and competitive conditions, a company’s best market opportunities, and other aspects of the enterprise’s external environment. Unless a strategy exhibits a tight fit with both the external and internal aspects of a company’s overall situation, it is likely to produce less than the best possible business results.

   b. Is the strategy helping the company achieve a sustainable competitive advantage?

      The bigger and more durable the competitive edge that a strategy helps build, the more powerful and appealing it is.

   c. Is the strategy resulting in better company performance?

      Two kinds of performance improvements tell the most about the caliber of a company’s strategy: (1) gains in profitability and financial strength and (2) gains in the company’s competitive strength and market standing.

2. Strategies that come up short on one or more of the above questions are plainly less appealing than strategies passing all three test questions with flying colors.

3. Other criteria for judging the merits of a particular strategy include internal consistency and unity among all the pieces of strategy, the degree of risk the strategy poses as compared to alternative strategies, and the degree to which it is flexible and adaptable to changing circumstances.
VI. Why are Crafting and Executing Strategy Important?

1. Crafting and executing strategy are top priority managerial tasks for two very big reasons:
   
a. There is a compelling need for managers to proactively shape or craft how the company’s business will be conducted.

b. A strategy-focused organization is more likely to be a strong bottom-line performer.

A. Good Strategy + Good Strategy Execution = Good Management

1. Crafting and executing strategy are core management functions.

2. Among all the things managers do, nothing affects a company’s ultimate success or failure more fundamentally than how well its management team charts the company’s direction, develops competitively effective strategic moves and business approaches, and pursues what needs to be done internally to produce good day-to-day strategy execution and operating excellence.

3. Good strategy and good strategy execution are the most trustworthy signs of good management.

4. The better conceived a company’s strategy and the more competently it is executed, the more likely it is that the company will be a standout performer in the marketplace.
CHAPTER SUMMARY

Chapter 2 presents an overview of the managerial ins and outs of crafting and executing company strategies. Special attention is given to management’s direction-setting responsibilities – charting a strategic course, setting performance targets, and choosing a strategy capable of producing the desired outcomes. The chapter also examines which kinds of strategic decisions are made at what levels of management and the roles and responsibilities of the company’s board of directors in the strategy-making, strategy-executing process.

LECTURE OUTLINE

I. Introduction
   1. Crafting and executing a strategy are the heart and soul of managing a business enterprise.

II. What Does the Process of Crafting and Executing Strategy Entail?
   1. Crafting and executing a company’s strategy is a five-phase managerial process:
      a. Developing a strategic vision of where the company needs to head and what its future product-consumer-market-technology focus should be
      b. Setting objectives and using them as yardsticks for measuring the company’s performance and progress
      c. Crafting a strategy to achieve the objectives and move the company along the strategic course that management has charted
      d. Implementing and executing the chosen strategy efficiently and effectively
      e. Monitoring developments and initiating corrective adjustments in the company’s long-term direction, objectives, strategy, or execution in light of the company’s actual experience, changing conditions, new ideas, and new opportunities
   2. Figure 2.1, The Strategy-Making, Strategy-Executing Process, displays this process.

III. Developing a Strategic Vision: Phase 1 of the Strategy-Making, Strategy-Executing Process
   1. Very early in the strategy-making process, a company’s senior managers must wrestle with the issue of what directional path the company should take and what changes in the company’s product-market-customer-technology focus would improve its current market position and future prospects.
   2. A number of direction-shaping factors need to be considered in deciding where to head and why such a direction makes good business. Table 2.1, Factors to Consider in Deciding on a Company’s Future Direction, explores some of these external and internal considerations.
3. Top management’s views and conclusions about the company’s direction and the product-consumer-market-technology focus constitute a strategic vision.

4. A strategic vision delineates management’s aspirations for the business, providing a panoramic view of “where are we going” and a convincing rationale for why this makes good business sense for the company.

5. A strategic vision points an organization in a particular direction, charts a strategic path for it to follow in preparing for the future, and molds organizational identity.

6. A clearly articulated strategic vision communicates management’s aspirations to stakeholders and helps steer the energies of company personnel in a common direction.

**Core Concept**

A strategic vision describes the route a company intends to take in developing and strengthening its business. It lays out the company’s strategic course in preparing for the future.

7. Well-conceived visions are distinctive and specific to a particular organization; they avoid generic, feel-good statements.

8. For a strategic vision to function as a valuable managerial tool, it must provide understanding of what management wants its business to look like and provide managers with a reference point in making strategic decisions and preparing the company for the future.

9. Table 2.2, Characteristics of an Effectively Worded Vision Statement, lists some characteristics of an effective vision statement.

10. Table 2.3, Common Shortcomings in Company Vision Statements, provides a list of the most common shortcomings in company vision statements.

11. Illustration Capsule 2.1, Examples of Strategic Visions—How Well Do They Measure Up? provides examples of strategic visions of several prominent companies and nonprofit organizations.

**Illustration Capsule 2.1, Examples of Strategic Visions—How Well Do They Measure Up?**

**Discussion Question:** 1. What appears to be missing from the Caterpillar vision statement presented in Capsule 2.1?

**Answer:** Vision statements are presented by organizations to portray the company’s future business scope and thusly respond to the question of “where we are going. The Caterpillar vision statement appears to have the following shortcomings: vague, incomplete, could apply to many companies in the same industry.

A. A How a Strategic Vision differs from a Mission Statement: Whereas the chief concern of a strategic vision is with the company’s future strategic course, a company’s mission statement usually deals with a company’s present business purpose.

1. A company’s mission may or may not single out the company’s present products/services, the buyer needs it seeks to satisfy, the customer groups and market segments it is endeavoring to serve, and the resources and technologies capabilities.
2. Many companies prefer the term business purpose to mission statement, but the two phrases are essentially conceptually identical and are used interchangeably.

3. Company mission statements almost never say anything about where the company is headed, the anticipated changes in its business, or its aspirations. The mission statement of most companies say much more about the enterprise’s present business scope and purpose.

**Core Concept**

The distinction between a strategic vision and a mission statement is fairly clear-cut: A strategic vision portrays a company’s future business scope (“where we are going”), whereas a company’s mission typically describes its present business scope and purpose (“who we are, what we do, and why we are here”).

4. Occasionally, companies couch their mission in terms of making a profit. The notion that a company’s mission or business purpose is to make a profit is misguided – profit is more correctly an objective and a result of what a company does.

5. If a company’s mission statement is to have any managerial value or reveal anything useful about its business, it must direct attention to the particular market arena in which it operates – the buyer needs it seeks to satisfy, the customer groups and market segments it is endeavoring to serve, and the types of resources and technologies that it is deploying in trying to please customers.

**B. Communicating the Strategic Vision**

1. Developing a well-conceived vision is necessary but not sufficient. Effectively communicating the strategic vision down the line to lower-level managers and employees is as important as the strategic soundness of the journey and destination for which top management has opted.

2. Winning the support of organization members for the vision nearly always means putting “where we are going and why” in writing, distributing the statement organization wide, and having executives personally explain the vision and its rationales to as many people as feasible.

**Core Concept**

An effectively communicated vision is a valuable management tool for enlisting the commitment of company personnel to actions that gets the company moving in the intended direction.

3. The more that a vision evokes positive support and excitement, the greater its impact in terms of arousing a committed organizational effort and getting people to move in a committed direction.

4. **Expressing the Essence of the Vision in a Slogan:** The task of effectively conveying the vision to company personnel is made easier when management’s vision of where to head is captured in a catchy slogan.

5. Creating a short slogan to illuminate an organization’s direction and purpose and then using it repeatedly as a reminder of the “where we are headed and why” helps keep organization members on the chosen path.

**Core Concept**

Strategic visions become real only when the vision statement is imprinted in the minds of organization members and then translated into hard objectives and strategies.
6. **Breaking Down Resistance to a New Strategic Vision**: It is particularly important for executives to provide a compelling rationale for a dramatically new strategic vision and company direction. When company personnel do not understand or accept the need for redirecting organizational efforts, they are prone to resist change.

7. **Illustration Capsule 2.2, Yahoo’s Core Values**, relates the importance Yahoo places on the role of values in shaping the Vision.

**Illustration Capsule 2.2, Yahoo’s Core Values**

**Discussion Question**: Yahoo states that its mission statement is influenced by a set of core values. What are these values and how do they influence the mission statement?

**Answer**: The values are standards that guide interactions with fellow Yahoos to be the most essential global internet service for consumers and businesses.

8. **Understanding The Payoffs of a Clear Vision Statement**: A well-conceived, forcefully communicated strategic vision pays off in several respects: (1) it crystallizes senior executives’ own views about the firm’s long-term direction, (2) it reduces the risk of rudder-less decision making, (3) it is a tool for winning the support of organizational members for internal changes that will help make the vision a reality, (4) it provides a beacon for lower-level managers in forming departmental missions, setting departmental objectives, and crafting functional and departmental strategies that are in sync with the company’s overall strategy, and (5) it helps an organization prepare for the future. When management is able to demonstrate significant progress in achieving these five benefits, the first step in organizational direction setting has been successfully completed.

C. Linking the Vision/Mission with Company Values

1. **By values**, we mean the beliefs, traits, and ways of doing things that management has determined should guide the pursuit of its vision and strategy.

**Core Concept**

A company’s values are the beliefs, traits, and behavioral norms that company personnel are expected to display in conducting the company’s business and pursuing its strategic vision and strategy.

2. Company values statements tend to contain between four and eight values, which ideally, are tightly connected to and reinforce the company’s vision, strategy, and operating practices.

3. Company managers connect values to the strategic vision in one of two ways:

   a. In companies with long-standing and deeply entrenched values, managers go to great lengths to explain how the vision is compatible with the company’s value set, occasionally reinterpreting the meaning of existing values to indicate their relevance in pursuing the strategic vision.

   b. In new companies or companies with weak or incomplete sets of values, top management considers what values, beliefs, and operating principles will help drive the vision forward.

   c. The extent to which company values translate into actually living the values varies widely. At one extreme values become the company’s genetic makeup—its DNA. At the other extreme values are simply window dressing (Ex., Enron).
IV. Setting Objectives: Phase 2 of the Strategy-Making, Strategy-Executing Process

1. The managerial purpose of setting **objectives** is to convert the strategic vision into specific performance targets – results and outcomes the company’s management wants to achieve and then use these objectives as yardsticks for tracking the company’s progress and performance.

**Core Concept**

*Objectives* are an organization’s performance targets—the results and outcomes it wants to achieve. They function as yardsticks for measuring how well the organization is doing.

2. Well-stated objectives are quantifiable or measurable and contain a deadline for achievement.

3. The experiences of countless companies and managers teach that precisely spelling out how much of what kind of performance by when and then pressing forward with actions and incentives calculated to help achieve the targeted outcomes will boost a company’s actual performance.

A. What Kinds of Objectives to Set: The Need for a Balanced Scorecard

1. Two very distinctive types of performance yardsticks are required:
   a. Those relating to financial performance
   b. Those relating to strategic performance

2. Achieving acceptable financial results is a must. Without adequate profitability and financial strength, a company’s pursuit of its strategic vision, as well as its long-term health and ultimate survival, is jeopardized.

3. Of equal or greater importance is a company’s strategic performance—outcomes that indicate whether a company’s market position and competitiveness are deteriorating, holding steady, or improving.

4. **Illustration Capsule 2.3, Examples of Company Objectives**, shows selected objectives of several prominent companies.

**Illustration Capsule 2.3, Examples of Company Objectives**

**Discussion Question:** 1. What is the prominent purpose of an organization’s stated objectives?

**Answer:** Objectives identify an organization’s performance targets. They serve to function as measures for tracking the organization’s performance and progress toward achievement of desired goals.

5. **The Case for a Balanced Scorecard: Improved Strategic Performance Fosters Better Financial Performance:** A company’s financial performance measures are really lagging indicators that reflect the results of past decisions and organizational activities. The best and most reliable leading indicators of a company’s future financial performance and business prospects are strategic outcomes that indicate whether the company’s competitiveness and market position are stronger or weaker. The degree to which a company’s managers set, pursue, and achieve stretch strategic objectives tends to be a reliable leading indicator of its ability to generate higher profits from business operations.

6. **Short-Term and Long-Term Objectives are Needed:** As a rule, a company’s set of financial and strategic objectives ought to include both short-term and long-term performance targets. Targets of three to five years prompt considerations of what to do now to put the company in position to
perform better down the road. Short-range objectives can be identical to longer-range objectives if an organization is already performing at the targeted long-term level. The most important situation in which short-range objectives differ from long-range objectives occurs when managers are trying to elevate organizational performance and cannot reach the long-range target in just one year.

7. **Strategic Intent: Relentless Pursuit of an Ambitious Strategic Objective**: A company’s strategic intent can entail becoming the dominant company in the industry, unseating the existing industry leader, delivering the best customer service of any company in the industry or the world, or turning a new technology into products capable of changing the way people work and live.

**Core Concept**

A company exhibits **strategic intent** when it relentlessly pursues an ambitious strategic objective and concentrates its full resources and competitive actions on achieving that objective.

8. **The Need for Objectives at All Organizational Levels**: Objective setting should not stop with top management’s establishing of companywide performance targets. Company performance cannot reach full potential unless each area of the organization does its part and contributes directly to the desired companywide outcomes and results. This means setting performance targets for each organization unit that support, rather than conflict with or negate, the achievement of companywide strategic and financial objectives. The ideal situation is a team effort in which each organizational unit strives to produce results in its area of responsibility that contributes to the achievement of the company’s performance targets and strategic vision.

9. **Objective Setting Needs to be Top-Down Rather Than Bottom-Up**: A top-down process of setting objectives ensures that the financial and strategic performance targets established for business units, divisions, functional departments, and operating units are directly connected to the achievement of companywide objectives. This integration of objectives has two powerful advantages: (1) it helps produce cohesion among the objectives and strategies of different parts of the organization and (2) it helps unify internal efforts to move the company along the chosen strategic path. Bottom-up objective setting, with little or no guidance from above, nearly always signals an absence of strategic leadership on the part of senior executives.

V. **Crafting a Strategy: Phase 3 of the Strategy-Making, Strategy-Executing Process**

A. **Who Participates in Crafting a Company’s Strategy?**

1. A company’s senior executives obviously have important strategy-making roles.

2. An enterprise’s chief executive officer (CEO), as captain of the ship, carries the mantles of chief direction setter, objective setter, chief strategy maker, and chief strategy implementer for the total enterprise. Ultimate responsibility for leading the strategy-making, strategy-executing process rests with the CEO.

3. In most companies, the heads of business divisions and major product lines, the chief financial officer, and vice presidents for production, marketing, human resources, and other functional departments have influential strategy-making roles.

4. It is a mistake to view strategy making as exclusively a top management function, the province of owner-entrepreneurs, CEOs, and other senior executives. The more wide-ranging a company’s operations are, the more that strategy making is a collaborative team effort involving managers and sometimes key employees down through the whole organizational hierarchy.
In most companies, crafting and executing strategy is a collaborative effort in which every manager has a role for the area he or she heads. It is flawed thinking to view crafting and executing strategy as something only high-level managers do.

5. Major organizational units in a company—business divisions, product groups, functional departments, plants, geographic offices, distribution centers—normally have a leading or supporting role in the company’s strategic game plan.

6. With decentralized decision-making becoming common at companies of all stripes, it is now typical for key pieces of a company’s strategy to originate in a company’s middle and lower ranks.

7. Involving teams of people to dissect complex situations and come up with strategic solutions is becoming increasingly necessary in many businesses. Not only are many strategic issues too far-reaching or too involved for a single manager to handle, but they often cut across functional areas and departments, thus requiring the contributions of many different disciplinary experts and the collaboration of managers from different parts of the organization.

8. A valuable strength of collaborative strategy making is that the group of people charged with crafting the strategy can easily include the very people who will also be charged with implementing and executing it.

9. In some companies, top management makes a regular practice of encouraging individuals and teams to develop and champion proposals for new product lines and new business ventures. The idea is to unleash the talents and energies of promising “corporate intrapreneurs.”

B. A Company’s Strategy Making Hierarchy

1. It follows that a company’s overall strategy is really a collection of strategic initiatives and actions devised by managers and key employees up and down the whole organizational hierarchy.

2. The larger and more diverse the operation of an enterprise, the more points of strategic initiative it has and the more managers and employees at more levels of management that have a relevant strategy-making role.

3. Figure 2.2, A Company’s Strategy-Making Hierarchy, shows who is generally responsible for devising what pieces of a company’s overall strategy.

4. In diversified, multi-business companies where the strategies of several different businesses have to be managed, the strategy-making task involves four distinct types or levels of strategy, each of which involves different facets of the company’s overall strategy:
   a. Corporate strategy—consists of the kinds of initiatives the company uses to establish business positions in different industries, the approaches corporate executives pursue to boost the combined performance of the set of businesses the company has diversified into, and the means of capturing cross-business synergies and turning them into competitive advantage. Senior corporate executives normally have lead responsibility for devising corporate strategy and for choosing among whatever recommended actions bubble up from the organization below.

   b. Business strategy—concerns the actions and the approaches crafted to produce successful performance in one specific line of business. The key focus here is crafting responses to changing market circumstances and initiating actions to strengthen market position, build competitive advantage, and develop strong competitive capabilities. Orchestrating the development of business-level strategy is the responsibility of the manager in charge of the business.
c. Functional-area strategies—concerns the actions, approaches, and practices to be employed in managing particular functions or business processes or key activities within a business. Functional-area strategies add specifics to the hows of business-level strategy. The primary role of a functional-area strategy is to support the company’s overall business strategy and competitive approach. Lead responsibility for functional-area strategies within a business is normally delegated to the heads of the respective functions, with the general manager of the business having final approval and perhaps even exerting a strong influence over the content of particular pieces of functional-area strategies.

d. Operating strategies—concerns the relatively narrow strategic initiatives and approaches for managing key operating units (plants, distribution centers, geographic units) and for specific operating activities with strategic significance (advertising campaigns, the management of specific brands, supply chain-related activities, and Website sales and operations). Operating strategies add further detail and completeness to functional-area strategies and to the overall business strategy. Lead responsibility for operating strategies is usually delegated to frontline managers, subject to review and approval by higher-ranking managers.

5. In single-business enterprises, the corporate and business levels of strategy making merge into one level—business strategy. Thus, a single-business enterprise has only three levels of strategy: (1) business strategy for the company as a whole, (2) functional-area strategies for each main area within the business, and (3) operating strategies undertaken by lower echelon managers to flesh out strategically significant aspects for the company’s business and functional-area strategies.

6. Proprietorships, partnerships, and owner-managed enterprises may have only one or two strategy-making levels since in small-scale enterprises the whole strategy-making, strategy-executing function can be handled by just a few people.

C. Uniting the Strategy-Making Effort

1. Ideally, the pieces and layers of a company’s strategy should fit together like a jigsaw puzzle. Anything less than a unified collection of strategies weakens company performance.

2. Achieving unity in strategy making is partly a function of communicating the company’s basic strategy theme effectively across the whole organization and establishing clear strategic principles and guidelines for lower-level strategy making.

D. A Strategic Vision+Objectives+Strategy = A Strategic Plan

1. Developing a strategic vision, setting objectives, and crafting a strategy are basic direction-setting tasks. Together, they constitute a strategic plan for coping with industry and competitive conditions, the expected actions of the industry’s key players, and the challenges and issues that stand as obstacles to the company’s success.

Core Concept

A strategic plan lays out the company’s future direction, performance targets, and strategy.

2. In companies committed to regular strategy reviews and the development of explicit strategic plans, the strategic plan may take the form of a written document that is circulated to managers and perhaps, to selected employees.

3. Short-term performance targets are the part of the strategic plan most often spelled out explicitly and communicated to managers and employees.
VI. Implementing and Executing the Strategy: Phase 4 of the Strategy-Making, Strategy-Executing Process

1. Managing strategy implementation and execution is an operations-oriented, make-things-happen activity aimed at shaping the performance of core business activities in a strategy-supportive manner. It is easily the most time demanding and consuming part of the strategy-management process.

2. Management’s action agenda for implementing and executing the chosen strategy emerges from assessing what the company, given its particular operating practices and organizational circumstances, will have to do differently or better to execute the strategy proficiently and achieve the targeted performance.

3. In most situations, managing the strategy-execution process includes the following principal aspects:
   a. Staffing the organization with the needed skills and expertise
   b. Developing the budgets
   c. Ensuring that policies and operating procedures facilitate rather than impede effective execution
   d. Using the best-known practices to perform core business activities and pushing for continuous improvement
   e. Installing information and operating systems that enable company personnel to better carry out their strategic roles
   f. Motivating people to pursue the target objectives
   g. Tying rewards and incentives directly to the achievement of performance objectives and good strategy execution
   h. Creating a company culture and work climate conducive to successful strategy implementation and execution
   i. Exerting the internal leadership needed to drive implementation forward and keep improving strategy execution

4. Good strategy execution requires diligent pursuit of operating excellence. It is a job for a company’s whole management team. And success hinges on the skills and cooperation of operating managers who can push needed changes in their organization units and consistently deliver good results.

VII. Evaluating Performance and Initiating Corrective Adjustments: Phase 5 of the Strategy-Making, Strategy-Executing Process

1. The fifth phase of the strategy-management process—evaluating the company’s progress, assessing the impact of new external developments, and making corrective adjustments—is the trigger point for deciding whether to continue or change the company vision, objectives, strategy, and/or strategy-execution methods.

Core Concept
A company’s vision, objectives, strategy, and approach to strategy execution are never final; managing strategy is an ongoing process, not an every-now-and-then task.

2. Successful strategy execution entails vigilantly searching for ways to continuously improve and then making corrective adjustments whenever and wherever it is useful to do so.
Chapter 2  Leading the Process of Crafting and Executing Strategy

VIII.  Leading the Strategic Management Process
Staying on top of how well things are going.

A.  Most managers attach great importance to gathering information and opinions from people at different organizational levels about how strategy-execution process is going.

Core Concept
Management by walking around (MBWA) is one of the techniques that effective leaders use to stay on top of how well things are going and to learn what issues they need to address.

1. Making sure the company has a good strategic plan
2. Putting constructive pressure on organizational units to achieve good results and operating excellence.
3. Pushing corrective actions to improve both the company’s strategy and how well it is being executed.
4. Leading the development of stronger core competencies and competitive capabilities.
5. Displaying ethical integrity and leading social responsibility initiatives.

Core Concept
Companies with socially conscious leaders and a core value of corporate social responsibility move beyond the theoretical flourishes of corporate citizenship and enlist the full support of company personnel behind social responsibility initiatives.

IX.  Corporate Governance: The Role of the Board of Directors in the Strategy-Making, Strategy-Executing Process

1.  Although senior managers have lead responsibility for crafting and executing a company’s strategy, it is the duty of the board of directors to exercise strong oversight and see that the five tasks of strategic management are done in a manner that benefits shareholders, in the case of investor-owned enterprises, or stakeholders, in the case of not-for-profit organizations.

2.  In watching over management’s strategy-making, strategy-executing actions and making sure that executive actions are not only proper but also aligned with the interests of stakeholders, a company’s board of directors have three obligations to fill:
   a.  Be inquiring critics and overseers
   b.  Evaluate the caliber of senior executives’ strategy-making and strategy-executing skills
   c.  Institute a compensation plan for top executives that rewards them for actions and results that serve stakeholders interests and most especially those of shareholders
   d.  Oversee the company’s financial accounting and financial reporting practices.

3.  The number of prominent companies that have fallen on hard times because of the actions of scurrilous or out-of-control CEOs, the growing propensity of disgruntled stockholders to file lawsuits alleging director negligence, and the escalating costs of liability insurance for directors all underscore the responsibility that a board of directors has for overseeing a company’s strategy-making, strategy-executing process and ensuring that management actions are proper and responsible.

4.  Every corporation should have a strong, independent board of directors that has the courage to curb management actions they believe are inappropriate or unduly risky.
5. Boards of directors have a very important oversight role in the strategy-making, strategy-executing process.

6. Co-managers should meet and prepare a strategic vision statement for their company. It should be no shorter than one sentence, but no longer than a brief paragraph. Once students are finished they should check to see if their vision statements meet the conditions for an effectively worded strategic vision set forth in Table 2.2 and avoids the shortcomings set forth in Table 2.3. If not, it should be revised accordingly. What would be a good slogan that captures the essence of their strategic vision and that could be used to help communicate the vision to company personnel, shareholders and other stakeholders? At this point in time some groups may still be unclear about what their mission is, so it is a good exercise to come back to in the future.

7. Co-managers should write a sentence that expresses their company’s strategic intent.

8. What are the company’s financial objectives? Strategic objectives?
CHAPTER SUMMARY

Chapter 3 presents the concepts and analytical tools for assessing a single-business company’s external environment. Attention centers on the competitive arena in which a company operates, together with the technological, societal, regulatory, or demographic influences in the macro-environment that are acting to reshape the company’s future market arena.

LECTURE OUTLINE

I. Introduction

1. In the opening paragraph of Chapter 1, we said that one of the three central questions that manager’s must address in evaluating their company business prospects is “What’s the company’s present situation?” Two facets of a company’s situation are especially pertinent:
   a. The industry and competitive environment in which the company operates
   b. The company’s collection of resources and capabilities, its strengths and weaknesses as compared to its rivals, and its windows of opportunities.

2. Managers must be able to insightfully analyze a company’s external and internal environments to succeed in crafting a strategy that is an excellent fit with the company’s situation, is capable of building competitive advantage, and holds good prospect for boosting a company performance – the three criteria of a winning strategy.

3. Developing company strategy begins with a strategic appraisal of the company’s external and internal situations to form a strategic vision of where the company needs to head, then moves toward an evaluation of the most promising alternative strategies and business models, and finally culminates in a choice of strategy.

4. Figure 3.1, From Thinking Strategically about the Company’s Situation to Choosing a Strategy, depicts the sequence recommended for managers to pursue.

II. The Strategically Relevant Components of a Company’s External Environment

1. All companies operate in a macro-environment shaped by influences emanating from the economy at large, population demographics, societal values and lifestyles, governmental legislation and regulation, technological factors, and the industry and competitive arena in which the company operates.

2. Figure 3.2, The Components of a Company’s Macro-environment, identifies the arenas within an organization’s macro-environment.

3. Strictly speaking, a company’s macro-environment includes all relevant factors and influences outside a company’s boundaries.
4. For the most part, influences coming from the outer ring of the macro-environment have a low impact on a company’s business situation and shape only the edges of the company’s direction and strategy. There are exceptions to this, of course, such as the cigarette industry.

5. There are enough strategically relevant trends and developments in the outer-ring of the macro-environment to justify managers maintaining a watchful eye.

6. The factors and forces in a company’s macro-environment having the biggest strategy-shaping impact almost always pertain to the company’s immediate competitive environment.

III. Thinking Strategically About a Company’s Industry and Competitive Environment

1. Thinking strategically about a company’s competitive environment entails using some well defined concepts and analytical tools to get clear answers to seven questions:
   a. What are the dominant economic features of the industry in which the company operates?
   b. What kinds of competitive forces are industry members facing and how strong is each force?
   c. What forces are driving changes in the industry and what impact will these changes have on competitive intensity and industry profitability?
   d. What market positions do industry rivals occupy—who is strongly positioned and who is not?
   e. What strategic moves are rivals likely to make next?
   f. What are the key factors for future competitive success?
   g. Does the outlook for the industry present the company with sufficiently attractive prospects for profitability?

IV. Question 1: What are the Industry’s Dominant Economic Features?

1. Because industries differ so significantly, analyzing a company’s industry and competitive environment begins with identifying the industry’s dominant economic features and forming a picture of the industry landscape.

2. An industry’s dominant economic features are defined by such factors as:
   a. Overall size and market growth rate
   b. Number and sizes of buyers and sellers
   c. Geographic boundaries of the market
   d. The degree to which sellers products are differentiated
   e. The pace of product innovation
   f. Market supply/demand conditions
   g. The extent of vertical integration
   h. Extent to which costs are affected by scale economies
   i. Learning/experience curve effects

3. Table 3.1, What to Consider in Identifying an Industry’s Dominant Economic Features, provides a convenient summary of what economic features to look at and the corresponding questions to consider in profiling an industry’s landscape.
4. Getting a handle on an industry’s distinguishing economic features not only sets the stage for the analysis to come but also promotes understanding of the kinds of strategic moves that industry members are likely to employ.

5. The bigger the scale economies in an industry, the more imperative it becomes for the competing sellers to pursue strategies to win additional sales and market share—the company with the biggest sales volume gains sustainable competitive advantage as the low-cost producer.

V. Question 2: What Kinds of Competitive Forces are Industry Members Facing?

1. The character, mix, and subtleties of the competitive forces operating in a company’s industry are never the same from one industry to another.

2. The most powerful and widely used tool for systematically diagnosing the principal competitive pressures in a market and assessing the strength and importance of each is the five-forces model of competition.

3. Figure 3.3, The Five-Forces Model of Competition: A Key Analytical Tool, depicts this tool.

4. This model holds that the state of competition in an industry is a composite of competitive pressures operating in five areas of the overall market:
   a. Competitive pressures associated with the market maneuvering and jockeying for buyer patronage that goes on among rival sellers in the industry
   b. Competitive pressures associated with the threat of new entrants into the market
   c. Competitive pressures coming from the attempts of companies in other industries to win buyers over to their own substitute products
   d. Competitive pressures stemming from supplier bargaining power and supplier-seller collaboration
   e. Competitive pressures stemming from buyer bargaining power and seller-buyer collaboration

5. The way one uses the five-forces model to determine what competition is like in a given industry is to build the picture of competition in three steps:
   a. Step One: Identify the specific competitive pressures associated with each of the five forces
   b. Step Two: Evaluate how strong the pressures comprising each of the five forces are (fierce, strong, moderate to normal, or weak)
   c. Step Three: Determine whether the collective strength of the five competitive forces is conducive to earning attractive profits

A. Competitive Pressures Associated with the Jockeying among Rival Sellers

1. The strongest of the five competitive forces is nearly always the rivalry among competing sellers—the marketing maneuvering and jockeying for buyer patronage that continually go on.

2. In effect, a market is a competitive battlefield where it is customary and expected that rival sellers will employ whatever resources and weapons they have in their business arsenal to improve their market positions and performance.
Core Concept

Competitive maneuvering among industry rivals is ever changing, as rivals (1) initiate fresh offensive and defensive moves and (2) emphasize first one mix of competitive weapons and then another in efforts to improve their market positions and boost sales and profitability.

3. **Figure 3.4, Weapons for Competing and Factors Affecting the Strength of Rivalry**, shows a sampling of competitive weapons that firms can deploy in battling rivals and indicates the factors that influence the intensity of their rivalry.

4. A brief discussion of some of the factors that influence the tempo of rivalry among industry competitors is in order:
   
a. Rivalry intensifies when competing sellers are active in launching fresh actions to boost their market standing and business performance.

5. Other indicators of the intensity of rivalry among industry members include:
   
a. Whether industry members are racing to offer better performance features or higher quality or improved customer service or a wider product selection
   
b. How frequently rivals resort to such marketing tactics as special sales promotions, heavy advertising, or rebates or low interest rate financing to drum up additional sales
   
c. How actively industry members are pursuing efforts to build stronger dealer networks or establish positions in foreign markets or otherwise expand their distribution capabilities and market presence
   
d. How hard companies are striving to gain a market edge over rivals by developing valuable expertise and capabilities

6. Normally, industry members are proactive in drawing upon their competitive arsenal of weapons and deploying their organizational resources in a manner calculated to strengthen their market position and performance.

7. Additional factors that influence the tempo of rivalry among industry competitors include:
   
a. Rivalry intensifies as the number of competitors increases and as competitors become more equal in size and capability
   
b. Rivalry is usually stronger in slow-growing markets and weaker in fast-growing markets
   
c. Rivalry is usually weaker in industries comprised of so many rivals that the impact of any one company’s actions is spread thinly across all industry members, likewise, it is often weak when there are fewer than five competitors
   
d. Rivalry increases when buyer demand falls off and sellers find themselves with excess capability and/or inventory.
   
e. Rivalry increases as it becomes less costly for buyers to switch brands
   
f. Rivalry increases as the products of rival sellers become more standardized
   
g. Rivalry is more intense when industry conditions tempt competitors to use price cuts or other competitive weapons to boost unit volumes
   
h. Rivalry increases in proportion to the size of the payoff from a successful strategic move
i. Rivalry becomes more volatile and unpredictable as the diversity of competitors increases in terms of visions, strategic intents, objectives, strategies, resources, and countries of origin.

j. Rivalry increases when strong companies outside acquire weak firms in the industry and launch aggressive, well-funded moves to transform their newly acquired competitors into major market contenders.

k. A powerful, successful competitive strategy employed by one company greatly intensifies the competitive pressures on its rivals to develop effective strategic responses or be relegated to also-ran status.

B. Competitive Pressures Associated with the Threat of New Entrants

1. Several factors affect the strength of the competitive threats of potential entry in a particular industry.

2. Figure 3.5, Factors Affecting the Strength of Threat of Entry, identifies several factors that affect how strong the competitive threat of potential entry is in a particular industry.

3. One factor relates to the size of the pool of likely entry candidates and the resources at their command. As a rule, competitive pressures intensify as the pool of entry candidates increases in size.

4. Frequently, the strongest competitive pressures associated with potential entry come not from outsiders but from current industry participants looking for growth opportunities.

5. Existing industry members are often strong candidates to enter market segments or geographic areas where they currently do not have a market presence.

6. A second factor concerns whether the likely entry candidates face high or low entry barriers. The most widely encountered barriers that entry candidates must hurdle include:

   a. The presence of sizable economies of scale in production or other areas of operation—When incumbent companies enjoy cost advantages associated with large-scale operation, outsiders must either enter on a large scale or accept a cost disadvantage and consequently lower profitability.

   b. Cost and resource disadvantages not related to size—Existing firms may have low unit costs as a result of experience or learning-curve effects, key patents, partnerships with the best and cheapest suppliers of raw materials and components, proprietary technology know-how not readily available to newcomers, favorable locations, and low fixed costs.

   c. Strong brand preferences and high degree of customer loyalty—In some industries, buyers are strongly attached to established brands.

   d. High capital requirements—The larger the total dollar investment needed to enter the market successfully, the more limited the pool of potential entrants.

   e. The difficulties of building a network of distributors or retailers and securing adequate space on retailers’ shelves.

   f. Restrictive regulatory policies—Government agencies can limit or even bar entry by requiring licenses and patents.

   g. Tariffs and international trade restrictions—National governments commonly use tariffs and trade restrictions to raise entry barriers for foreign firms and protect domestic producers from outside competition.
h. The ability and willingness of industry incumbents to launch vigorous initiatives to block a newcomer’s successful entry.

7. In evaluating whether an industry’s entry barriers ought to be considered strong or weak, company managers must also look at:
   a. How formidable the entry barriers are for each type of potential entrant
   b. How attractive the growth and profit prospects are for new entrants

**Core Concept**

The threat of entry is stronger when entry barriers are low, when there’s a sizeable pool of entry candidates, when industry growth is rapid and profit potentials are high, and when incumbent firms are unable or unwilling to vigorously contest a newcomer’s entry.

8. The best test of whether potential entry is a strong or weak competitive force in the marketplace is to ask if the industry’s growth and profit prospects are strongly attractive to potential entry candidates.

9. The stronger the threat of entry, the more that incumbent firms are driven to seek ways to fortify their positions against newcomers, pursuing strategic moves to not only protect their market shares, but also make entry more costly or difficult.

10. The threat of entry changes as the industry’s prospects grow brighter or dimmer and as entry barriers rise or fall.

C. **Competitive Pressures from the Sellers of Substitute Products**

1. Companies in one industry come under competitive pressure from the actions of companies in a closely adjoining industry whenever buyers view the products of the two industries as good substitutes.

2. Just how strong the competitive pressures are from sellers of substitute products depends on three factors:
   a. Whether substitutes are readily available and attractively priced
   b. Whether buyers view the substitutes as being comparable or better in terms of quality, performance, and other relevant attributes
   c. How much it costs end-users to switch to substitutes

3. **Figure 3.6, Factors Affecting Competition from Substitute Products**, lists factors affecting the strength of competitive pressures from substitute products and signs that indicate substitutes are a strong competitive force.

4. As a rule, the lower the price of substitutes, the higher their quality and performance, and the lower the user’s switching costs, the more intense the competitive pressures posed by substitute products.

D. **Competitive Pressures Stemming from Supplier Bargaining Power and Supplier-Seller Collaboration**

1. Whether supplier-seller relationships represent a weak or strong competitive force depends on:
   a. Whether the major suppliers can exercise sufficient bargaining power to influence the terms and conditions of supply in their favor
b. The nature and extent of supplier-seller collaboration

2. **How Supplier Bargaining Power Can Create Competitive Pressures:** When the major suppliers to an industry have considerable leverage in determining the terms and conditions of the item they are supplying, they are in a position to exert competitive pressures on one or more rival sellers.

3. The factors that determine whether any of the suppliers to an industry are in a position to exert substantial bargaining power or leverage are fairly clear-cut:
   a. Whether the item being supplied is a commodity that is readily available from many suppliers at the going market price
   b. Whether a few large suppliers are the primary sources of a particular item
   c. Whether it is difficult or costly for industry members to switch their purchases from one supplier to another or to switch to attractive substitute inputs
   d. Whether certain needed inputs are in short supply
   e. Whether certain suppliers provide a differentiated input that enhances the performance or quality of the industry’s product
   f. Whether certain suppliers provide equipment or services that deliver valuable cost-saving efficiencies to industry members in operating their production processes
   g. Whether suppliers provide an item that accounts for a sizable fraction of the costs of the industry’s product
   h. Whether industry members are major customers of suppliers
   i. Whether it makes good economic sense for industry members to integrate backward and self-manufacture items they have been buying from suppliers

4. **Figure 3.7, Factors Affecting the Bargaining Power of Suppliers,** summarizes the conditions that tend to make supplier bargaining power strong or weak

5. **How Collaborative Partnerships Between Industry Members and Their Supplier Can Create Competitive Pressures:** In more and more industries, sellers are forging strategic partnerships with select suppliers in efforts to reduce inventory and logistics costs, speed the availability of next generation components, enhance the quality of the parts and components being supplied and reduce defect rates, and squeeze out important cost-savings for both themselves and their suppliers.

6. The many benefits of effective seller-supplier collaboration can translate into competitive advantage for industry members who do the best job of managing supply chain relationships.

7. The more opportunities that exist for win-win efforts between a company and its suppliers, the less their relationship is characterized by who has the upper hand in bargaining with the other.

E. **Competitive Pressures Stemming from Buyer Bargaining Power and Seller-Buyer Collaboration**

1. Whether seller-buyer relationships represent a weak or strong competitive force depends on:
   a. Whether some or many of the buyers have sufficient bargaining leverage to obtain price concessions and other favorable terms and conditions of sale
   b. The extent and competitive importance of seller-buyer strategic partnerships in the industry

2. **How Buyer Bargaining Power Can Create Competitive Pressures:** The leverage that certain types of buyers have in negotiating favorable terms can range from weak to strong.
3. Even if buyers do not purchase in large quantities or offer a seller important market exposure or prestige, they gain a degree of bargaining leverage in the following circumstances:

   a. If buyers’ costs of switching to competing brands or substitutes are relatively low—Buyers who can readily switch brands or source from several sellers have more negotiating leverage than buyers who have high switching costs.

   b. If the number of buyers is small or if a customer is particularly important to a seller—The smaller the number of buyers, the less easy it is for sellers to find alternative buyers when a customer is lost to a competitor.

   c. If buyer demand is weak and sellers are scrambling to secure additional sales of their products—Weak or declining demand creates a “buyers market” and shifts bargaining power to buyers.

   d. If buyers are well-informed about sellers’ products, prices, and costs—The more information buyers have, the better bargaining position they are in.

   e. If buyers pose a credible threat of integrating backward into the business of sellers—Companies like Anheuser-Busch, Coors, and Heinz have integrated backward into metal-can manufacturing to gain bargaining power in obtaining the balance of their can requirements from otherwise powerful metal-can manufacturers.

   f. If buyers have discretion in whether and when they purchase the product—If consumers are unhappy with the present deals offered on major appliances, hot tubs, home entertainment centers, or other goods for which time is not a critical purchase factor, they may be in a position to delay purchase until prices and financing terms improve.

4. **Figure 3.8, Factors Affecting the Bargaining Power of Buyers**, summarizes the circumstances that make for strong or weak bargaining power on the part of buyers.

5. Not all buyers of an industry’s product have equal degrees of bargaining power with sellers and some may be less sensitive than others to price, quality, or service differences.

6. **How Collaborative Partnerships Between certain Industry Members and Their Key Customers Can Create Competitive Pressures**: Partnerships between sellers and buyers are an increasingly important element of the competitive picture in business-to-business relationships as opposed to business-to-consumer relationships.

F. Is the Collective Strength of the Five Competitive Forces Conducive to Good Profitability?

1. Scrutinizing each competitive force one by one provides a powerful diagnosis of what competition is like in a given market.

2. **Is the Industry Competitively Attractive or Unattractive?** As a rule, the stronger the collective impact of the five competitive forces, the lower the combined profitability of industry participants.

**Core Concept**

The stronger the forces of competition, the harder it becomes for industry members to earn attractive profits.

3. The most extreme case of a competitively unattractive industry is when all five forces are producing strong competitive pressures. Fierce to strong competitive pressures coming from all five directions nearly always drive industry profitability to unacceptably low levels, frequently producing losses for many industry members and forcing some out of business. Intense competitive pressures from just two or three of the five forces may suffice to destroy the conditions for good profitability and prompt some companies to exit the business.
4. In contrast, when the collective impact of the five competitive forces is moderate to weak, an industry is competitively attractive in the sense that industry members can reasonably expect to earn good profits and a nice return on investment.

5. The ideal competitive environment for earning superior profits is one in which both suppliers and customers are in weak bargaining positions, there are no good substitutes, high barriers block further entry, and rivalry among present sellers generates only moderate competitive pressures.

6. **Matching Company Strategy to Competitive Conditions?** Working through the five-forces model step-by-step not only aides strategy makers in assessing whether the intensity of competition allows good profitability but it also promotes sound strategic thinking about how to better match company strategy to the specific competitive character of the marketplace.

7. Effectively matching a company’s strategy to the particular competitive pressures and competitive conditions that exist has two aspects:
   a. Pursuing avenues that shield the firm from as many of the prevailing competitive pressures as possible
   b. Initiating actions calculated to produce sustainable competitive advantage, thereby shifting competition in the company’s favor, putting added competitive pressure on rivals, and perhaps even defining the business model for the industry

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**Core Concept**

A company’s strategy is increasingly effective the more it provides some insulation from competitive pressures and shifts the competitive battle in the company’s favor.

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**VI. Question 3: What Factors are Driving Industry Change and What Impacts Will They Have?**

1. An industry’s present conditions do not necessarily reveal much about the strategically relevant ways in which the industry environment is changing.

2. All industries are characterized by trends and new developments that gradually or speedily produce changes important enough to require a strategic response from participating firms.

3. The popular hypothesis that industries go through a life cycle of takeoff, rapid growth, early maturity, market saturation, and stagnation or decline helps explain industry change – but it is far from complete.

A. **The Concept of Driving Forces**

1. Although it is important to judge what growth stage an industry is in, there is more analytical value in identifying the specific factors causing fundamental industry and competitive adjustments.

2. Industry and competitive conditions change because certain forces are enticing or pressuring industry participants to alter their actions.

3. **Driving forces** are those that have the biggest influence on what kinds of changes will take place in the industry’s structure and competitive environment.

4. Driving-forces analysis has three steps:
   a. Identifying what the driving forces are
   b. Assessing the impact they will have on the industry
   c. Determining what strategy changes are needed to prepare for the impacts of the driving forces
Core Concept

Industry conditions change because important forces are driving industry participants (competitors, customers, or suppliers) to alter their actions; the driving forces in an industry are the major underlying causes of changing industry and competitive conditions—they have the biggest influence on how the industry landscape will be altered. Some driving forces originate in the macro-environment and some originate from the inner ring.

B. Identifying an Industry’s Driving Forces

1. Many developments can affect an industry powerfully enough to qualify as driving forces. Some are unique and specific to a particular industry situation, but most drivers of change fall into one of the following categories:

   a. Changes in the long-term industry growth rate—Shifts in industry growth are a driving force for industry change, affecting the balance between industry supply and buyer demand, entry and exit, and the character and strength of competition.

   b. Increasing globalization of the industry—Competition begins to shift from primarily a regional or national focus to an international or global focus when industry members begin seeking out customers in foreign markets or when production activities begin to migrate to countries where costs are lowest.

   c. Growing use of the Internet and emerging new Internet technology applications—The Internet and the adoption of Internet technology applications represent a driving force of historical and revolutionary proportions.

   d. Changes in who buys the product and how they use it—Shifts in buyer demographics and new ways of using the product can alter the state of competition by opening the way to market an industry’s product through a different mix of dealers and retail outlets.

   e. Product innovation—Competition in an industry is always affected by rivals racing to be first to introduce one new product or product enhancement after another.

   f. Technological change and manufacturing process innovation—Advances in technology can dramatically alter an industry’s landscape, making it possible to produce new and better products at lower cost and opening up whole new industry frontiers.

   g. Marketing innovation—Many firms are successful in introducing new ways to market their products, they can spark a burst of buyer interest, widen industry demand, increase product differentiation, and lower unit costs—any or all of which can alter the competitive positions of rival firms and force strategy revisions.

   h. Entry or exit of major firms—The entry of one or more foreign companies into a geographic market once dominated by domestic firms nearly always shakes up competitive conditions.

   i. Diffusion of technical know-how across more companies and more countries—As knowledge about how to perform a particular activity or execute a particular manufacturing technology spreads, the competitive advantage held by firms originally possessing this know-how erodes.

   j. Changes in cost and efficiency—Widening or shrinking differences in the costs among key competitors tend to dramatically alter the state of competition.

   k. Growing buyer preferences for differentiated products instead of a commodity product or for a more standardized product instead of strongly differentiated products—When buyer tastes and preferences start to diverge, sellers can win a loyal following with product offerings that stand apart from those of rival sellers.
1. Reductions in uncertainty and business risk—An emerging industry is typically characterized by much uncertainty over potential market size, how much time and money will be needed to surmount technological problems, and what distribution channels and buyer segments to emphasize.

m. Regulatory influences and government policy changes—Government regulatory actions can often force significant changes in industry practices and strategic approaches.

n. Changing societal concerns, attitudes, and lifestyles—Emerging social issues and changing attitudes and lifestyles can be powerful instigators of industry change.

2. **Table 3.2, The Most Common Driving Forces**, summarizes these most common forces.

3. The large number of different potential driving forces explains why it is too simplistic to view industry change only in terms of the life-cycle model and why a full understanding of the causes underlying the emergence of new competitive conditions is a fundamental part of industry analysis.

4. Company strategists must resist the temptation to label every change they see as a driving force; the analytical task is to evaluate the forces of industry and competitive change carefully enough to separate major factors from minor ones.

C. **Assessing the Impact of the Driving Forces**

1. The second phase of driving forces analysis is to determine whether the driving forces are acting to make the industry environment more or less attractive. Answers to three questions are needed here:
   a. Are the driving forces causing demand for the industry’s product to increase or decrease?
   b. Are the driving forces acting to make competition more or less intense?
   c. Will the driving forces lead to higher or lower industry profitability?

2. Getting a handle on the collective impact of the driving forces usually requires looking at the likely effects of each force separately, since the driving forces may not all be pushing change in the same direction.

**Core Concept**

An important part of driving-forces analysis is to determine whether the collective impact of the driving forces will be to increase or decrease market demand, make competition more or less intense, and lead to higher or lower industry profitability.

D. **Making Strategy Adjustments to Take the Impact of the Driving Forces into Account**

1. Sound analysis of an industry’s driving forces is a prerequisite to sound strategy making.

**Core Concept**

Driving-forces analysis, when done properly, pushes company managers to think about what’s around the corner and what the company needs to be doing to get ready for it.

2. Driving forces analysis is not something to take lightly; it has practical value and is basic to the task of thinking strategically about where the industry is headed and how to prepare for the changes.

**Core Concept**

The real payoff of driving-forces analysis is to help managers understand what strategy changes are needed to prepare for the impacts of the driving forces.
VII. Question 4: What Market Positions Do Rivals Occupy—Who is Strongly Positioned and Who is Not?

1. Understanding which companies are strongly positioned and which are weakly positioned is an integral part of analyzing an industry’s competitive structure.

2. The best technique for revealing the market positions of industry competitors is strategic group mapping. This analytical tool is useful for comparing the market positions of each firm separately or for grouping them into like positions when an industry has so many competitors that it is not practical to examine each one in depth.

**Core Concept**

**Strategic group mapping** is a technique for displaying the different market or competitive positions that rival firms occupy in the industry.

**A. Using Strategic Group Maps to Assess the Market Positions of Key Competitors**

1. A strategic group consists of those industry members with similar competitive approaches and positions in the market.

**Core Concept**

A strategic group is a cluster of industry rivals that have similar competitive approaches and market positions.

2. The procedure for constructing a strategic group map is straightforward:
   a. Identify the competitive characteristics that differentiate firms in the industry
   b. Plot the firms on a two-variable map using pairs of these differentiating characteristics
   c. Assign firms that fall in about the same strategy space to the same strategic group
   d. Draw circles around each strategic group, making the circles proportional to the size of the group’s respective share of total industry sales revenue

3. **Illustration Capsule 3.1, Comparative Market Positions of Selected Retail Chains: A Strategic Group Map Application** represents a two-dimensional diagram for the retailing industry. **Illustration Capsule 3.1, Comparative Market Positions of Selected Automobile Manufacturers: A Strategic Group Map Application**

**Discussion Question:** 1. According to the diagram, which companies comprise the strategic group of firms to which General Motors/Ford belong? Why is the circle containing General Motors/Ford name larger than the other firm’s circles?

**Answer:** The diagram reveals General Motors/Ford strategic group members would be identified as Nissan/Chrysler/Mazda, Hyundai/Suzuki, Toyota, Volkswagen/Honda, BMW/Mercedes Benz, Porsche/Ferrari. The circle containing General Motors/Ford is larger than others because in a diagram such as this, the circles are proportional to the size of the group’s respective share of total industry sales revenue.
B. What Can Be Learned from Strategic Group Maps

**Core Concept**

Strategic group maps reveal which companies are close competitors and which are distant competitors.

1. Generally speaking, the closer strategic groups are to each other on the map, the stronger the cross-group competitive rivalry tends to be.

**VIII. Question 5: What Strategic Moves Are Rivals Likely to Make Next?**

1. Unless a company pays attention to what competitors are doing and knows their strengths and weaknesses, it ends up flying blind into competitive battle.

2. Competitive intelligence about rivals’ strategies, their latest actions and announcements, their resource strengths and weaknesses, the efforts being made to improve their situation, and the thinking and leadership styles of their executives is valuable for predicting or anticipating the strategic moves competitors are likely to make next in the marketplace.

**Core Concept**

Good scouting reports on rivals provide a valuable assist in anticipating what moves rivals are likely to make next and outmaneuvering them in the marketplace.

A. Identifying Competitor’s Strategies and Resource Strengths and Weaknesses

1. Keeping close tabs on a competitor’s strategy entails monitoring what the rival is doing in the marketplace, what its management is saying in company press releases, information posted on the company’s Web site, and such public documents as annual reports and 10-K filings, articles in the business media, and the reports of securities analysts.

2. Those who gather competitive intelligence on rivals, however, can sometimes cross the fine line between honest inquiry and unethical or even illegal behavior.

3. In sizing up the strategies and the competitive strengths and weaknesses of competitors, it makes sense for company strategists to make three assessments:

   a. Which competitor has the best strategy? Which competitors appear to have flawed or weak strategies?

   b. Which competitors are poised to gain market share and which ones seem destined to lose ground?

   c. Which competitors are likely to rank among the industry leaders five years from now? Do one or more up-and-coming competitors have powerful strategies and sufficient capabilities to overtake the current industry leader?

**Core Concept**

Managers who fail to study competitors closely risk being caught napping when rivals make fresh and perhaps bold strategic moves.
B. Predicting Competitors’ Next Moves

1. Predicting the next strategic moves of competitors is the hardest yet most useful part of competitor analysis.

2. Since the moves a competitor is likely to make are generally predicated on the views their executives have about the industry’s future and their beliefs about their firm’s situation, it makes sense to closely scrutinize the public pronouncements of rival company executives about where the industry is headed and what it will take to be successful, what they are saying about their firm’s situation, information from the grapevine about what they are doing, and their past actions and leadership styles.

3. Considerations in trying to predict what strategic moves rivals are likely to make next include the following:
   a. Which rivals badly need to increase their unit sales and market share?
   b. Which rivals have a strong incentive, along with resources, to make major strategic changes?
   c. Which rivals are good candidates to be acquired?
   d. Which rivals are likely to enter new geographic markets?
   e. Which rivals are strong candidates to expand their product offerings and enter new product segments where they do not currently have a presence?

Core Concept
Managers who fail to study competitors closely risk being caught napping when rivals make fresh and perhaps bold strategic moves.

4. To succeed in predicting a competitor’s next moves, company strategists need to have a good feel for each rival’s situation, how its managers think, and what its best options are.

IX. Question 6: What are the Key Factors for Future Competitive Success?

1. An industry’s key success factors (KSF) are those competitive factors that most affect industry members’ ability to prosper in the marketplace.

Core Concept
Key success factors are the product attributes, competencies, competitive capabilities, and market achievements with the greatest impact on future competitive success in the marketplace.

2. How well a company’s product offering, resources, and capabilities measure up against and industry’s KSFs has a direct bearing on company profitability and determines just how financially and competitively successful that company will be.

3. Table 3.3, Common Types of Industry Key Success Factors (KSFs), lists the common types of KSFs.
4. The answer to three questions help identify an industry’s key success factors:
   a. On what basis do buyers of the industry’s product choose between the competing brands of sellers? What product attributes are crucial?
   b. What resources and competitive capabilities does a company need to have to be competitively successful?
   c. What shortcomings are almost certain to put a company at a significant competitive disadvantage?

5. Only rarely are there more than five or six key factors for future competitive success.

6. Correctly diagnosing an industry’s KSFs raises the company’s chances of crafting a sound strategy.

**Core Concept**

A sound strategy incorporates the intent to stack up well on all of the industry’s KSFs and to excel in one or two KSFs.

7. Being distinctly better than rivals on one or two key success factors tends to translate into competitive advantage.

X. **Question 7: Does the Outlook for the Industry Present the Company with an Attractive Opportunity?**

1. The final step in evaluating the industry and competitive environment is to use the preceding analysis to decide whether the outlook for the industry presents the company with sufficiently attractive prospects for profitability and growth.

2. The important factors on which to base such a conclusion include:
   a. The industry’s growth potential
   b. Whether competitive forces are squeezing industry profitability to subpar levels and whether competition is destined to grow stronger or weaker
   c. Whether industry profitability will be favorably or unfavorably affected by the prevailing driving forces
   d. The degrees of risk and uncertainty in the industry’s future
   e. Whether the industry confronts severe problems
   f. The company’s competitive position in the industry vis-à-vis rivals
   g. The company’s potential to capitalize on the vulnerabilities of weaker rivals
   h. Whether the company has sufficient competitive strength to defend or counteract the factors that make the industry unattractive
   i. Whether continued participation in this industry adds importantly to the firm’s ability to be successful in other industries in which it may have business interests

3. As a general proposition, if an industry’s overall profit prospects are above average, the industry environment is basically attractive; if industry profit prospects are below average, conditions are unattractive.
4. When a company decides an industry is fundamentally attractive and presents good opportunities, a strong case can be made that it should invest aggressively to capture the opportunities it sees and to improve its long-term competitive position in the business.

**Core Concept**

The degree to which an industry is attractive or unattractive is not the same for all industry participants and all potential entrants; the attractiveness of the opportunities an industry presents depends partly on a company has the resource strengths and competitive capabilities to capture them.
CHAPTER SUMMARY

Chapter 4 discusses the techniques of evaluating a company’s internal circumstances—its resource capabilities, relative cost position, and competitive strength versus rivals. The analytical spotlight will be trained on five questions: (1) How well is the company’s present strategy working? (2) What are the company’s resource strengths and weaknesses and its external opportunities and threats? (3) Are the company’s prices and costs competitive? (4) Is the company competitively stronger or weaker than key rivals? (5) What strategic issues and problems merit front-burner managerial attention? In probing for answers to these questions, four analytical tools—SWOT analysis, value chain analysis, benchmarking, and competitive strength assessment will be used. All four are valuable techniques for revealing a company’s competitiveness and for helping company managers match their strategy to the company’s own particular circumstances.

LECTURE OUTLINE

I. Question 1: How Well is the Company’s Present Strategy Working?

1. In evaluating how well a company’s present strategy is working, a manager has to start with what the strategy is.

2. Figure 4.1, Identifying the Components of a Single-Business Company’s Strategy, shows the key components of a single-business company’s strategy.

3. The first thing to pin down is the company’s competitive approach.

4. Another strategy-defining consideration is the firm’s competitive scope within the industry.

5. Another good indication of the company’s strategy is whether the company has made moves recently to improve its competitive position and performance.

6. While there is merit in evaluating the strategy from a qualitative standpoint (its completeness, internal consistency, rationale, and relevance), the best quantitative evidence of how well a company’s strategy is working comes from its results.

7. The two best empirical indicators are:
   a. Whether the company is achieving its stated financial and strategic objectives
   b. Whether the company is an above-average industry performer

8. Other indicators of how well a company’s strategy is working include:
   a. Whether the firm’s sales are growing faster, slower, or about the same pace as the market as a whole
b. Whether the company is acquiring new customers at an attractive rate as well as retaining existing customers

c. Whether the firm’s profit margins are increasing or decreasing and how well its margins compare to rival firms’ margins

d. Trends in the firm’s net profits and returns on investment and how these compare to the same trends for other companies in the industry

e. Whether the company’s overall financial strength and credit rating are improving or on the decline

f. Whether the company can demonstrate continuous improvement in such internal performance measures as days of inventory, employee productivity, unit costs, defect rate, scrap rate, misfilled orders, delivery times, warranty costs, and so on

g. How shareholders view the company based on trends in the company’s stock price and shareholder value

h. The firm’s image and reputation with its customers

i. How well the company stacks up against rivals on technology, product innovation, customer service, product quality, delivery time, getting newly developed products to market quickly, and other relevant factors on which buyers base their choice of brands

9. The stronger a company’s current overall performance, the less likely the need for radical changes in strategy. The weaker a company’s financial performance and market standing, the more its current strategy must be questioned. Weak performance is almost always a sign of weak strategy, weak execution, or both.

10. Table 4.1 Key Financial Ratios: How to Calculate Them and What They Mean

Core Concept
The stronger a company’s financial performance and market position, the more likely it has a well-conceived, well-executed strategy.

II. Question 2: What are the Company’s Resource Strengths and Weaknesses and Its External Opportunities and Threats

1. Appraising a company’s resource strengths and weaknesses and its external opportunities and threats, commonly known as SWOT analysis, provides a good overview of whether its overall situation is fundamentally healthy or unhealthy.

Core Concept
SWOT analysis is a simple but powerful tool for sizing up a company’s resource capabilities and deficiencies, its market opportunities, and the external threats to its future well-being.

a. A first-rate SWOT analysis provides the basis for crafting a strategy that capitalizes on the company’s resources, aims squarely at a capturing the company’s best opportunities, and defends against the threats to its well being.

2. Identifying Company Resource Strengths and Competitive Capabilities
3. A resource strength is something a company is good at doing or an attribute that enhances its competitiveness. A strength can take any of several forms:

   a. A skill, specialized expertise, or competitively important capability
   b. Valuable physical assets
   c. Valuable human assets and intellectual capital
   d. Valuable organizational assets
   e. Valuable intangible assets
   f. An achievement or attribute that puts the company in a position of market advantage
   g. Competitively valuable alliances or cooperative ventures

2. A company’s resource strengths represent competitive assets.

   **Core Concept**

   A company’s resource strengths represent competitive assets and are big determinants of its competitiveness and ability to succeed in the marketplace.

3. The caliber of a firm’s resource strengths and competitive capabilities, along with its ability to mobilize them in the pursuit of competitive advantage, are big determinants of how well a company will perform in the marketplace.

4. **Assessing a Company’s Competencies and Capabilities—What Activities Does it Perform Well?:** One of the most important aspects of appraising a company’s resource strengths has to do with its competence level in performing key pieces of its business.

5. Company competencies can range from merely a competence in performing an activity to a core competence to a distinctive competence.

   **Core Concept**

   A competition is an activity that a company has learned to perform well.

   a. A competence is something an organization is good at doing. It is nearly always the product of experience, representing an accumulation of learning and the buildup of proficiency in performing an internal activity.

   **Core Concept**

   A core competence is a competitively important activity that a company performs better than other internal activities.

   b. A core competence is a proficiently performed internal activity that is central to a company’s strategy and competitiveness. A core competence is a more valuable resource strength than a competence because of the well-performed activity’s core role in the company’s strategy and the contributions it makes to the company’s success in the marketplace.

   c. A distinctive competence is a competitively important activity that a company performs better than its rivals.
Chapter 4  Analyzing a Company’s Resources and Competitive Position

Core Concept

A distinctive competence is a competitively valuable activity that a company performs better than its rivals. A distinctive competence signifies even greater proficiency than a core competence rivals—it thus represents a competitively superior resource strength.

6. The conceptual differences between a competence, a core competence, and a distinctive competence draw attention to the fact that competitive capabilities are not all equal.

7. Core competencies are competitively more important than simple competencies because they add power to the company’s strategy and have a bigger positive impact on its market position and profitability.

8. The importance of a distinctive competence to strategy-making rests with:
   a. The competitively valuable capability it gives a company
   b. Its potential for being the cornerstone of strategy
   c. The competitive edge it can produce in the marketplace

9. What is the Competitive Power of Resource Strength? What is most telling about a company’s strengths is how competitively powerful they are in the marketplace.

10. The competitive power of a company’s strength is measured by how many of the following four tests it can pass:
    a. Is the resource really competitively superior?
    b. Is the resource strength rare—is it something rivals lack?
    c. Is the resource strength hard to copy?
    d. Can the resource strength be trumped by different resource strengths and competitive capabilities of rivals?

11. The vast majority of companies are not well endowed with competitively valuable resources, much less with competitively superior resources capable of passing all four tests with high marks. Most firms have a mixed bag of resources.

12. Only a few companies, usually the strongest industry leaders or up-and-coming challengers, possess a distinctive competence or competitively superior resource.

13. Sometimes a company derives significant competitive vitality, maybe even a competitive advantage, from a collection of good-adequate resources that collectively have competitive power in the marketplace.

Core Concept

A company’s ability to succeed in the marketplace hinges to a considerable extent on the competitive power of its resources—the set of competencies, capabilities, and competitive assets at its command.

B. Identifying Company Resource Weaknesses and Competitive Deficiencies

1. A weakness or competitive deficiency is something a company lacks or does poorly in comparison to others or a condition that puts it at a disadvantage in the marketplace.
2. A company’s weaknesses can relate to:
   a. Inferior or unproven skills or expertise or intellectual capital in competitively important areas of the business
   b. Deficiencies in competitively important physical, organizational, or intangible assets
   c. Missing or competitively inferior capabilities in key areas

3. Internal weaknesses are shortcomings in a company’s complement of resources and represent competitive liabilities.

**Core Concept**
Companies that lack a stand-alone resource strength that is competitively powerful may nonetheless be able to bundle several resource strengths into a competitively valuable core competence.

**Core Concept**
A resource-based strategy uses a company’s valuable and rare resource strengths and competitive abilities to deliver value to customers in ways that rivals find it difficult to match.

4. **Table 4.2, What to Look for in Identifying a Company’s Strengths, Weaknesses, Opportunities, and Threats**, lists the kinds of factors to consider in compiling a company’s resource strengths and weaknesses.

C. **Identifying a Company’s Market Opportunities**

1. Market opportunity is a big factor in shaping a company’s strategy.
2. Managers cannot properly tailor strategy to the company’s situation without first identifying its opportunities and appraising the growth and profitability each one holds.
3. In evaluating a company’s market opportunities and ranking their attractiveness, managers have to guard against viewing every industry opportunity as a company opportunity.

**Core Concept**
A company is well advised to pass on a particular market opportunity unless it has or can acquire the resources to capture it.

4. The market opportunities most relevant to a company are those that match up well with the company’s financial and organizational resource capabilities, offer the best growth and profitability, and present the most potential for competitive advantage.

D. **Identifying the External Threats to Profitability**

1. Certain factors in a company’s external environment pose threats to its profitability and competitive well-being.
2. Examples of threats include: the emergence of cheaper or better technologies, rivals’ introduction of new or improved products, lower-cost foreign competitors’ entry into a company’s market stronghold, new regulations that are more burdensome to a company than to its competitors, vulnerability to a rise in interest rates, the potential of a hostile takeover, unfavorable demographic shifts, adverse changes in foreign exchange rates, political upheaval in a foreign country where the company has facilities, and so on.
3. It is management’s job to identify the threats to the company’s future profitability and to evaluate what strategic actions can be taken to neutralize or lessen their impact.

E. What can be learned from a SWOT analysis?

1. SWOT analysis involves more than making four lists. The two most important parts of SWOT analysis are:
   a. Drawing conclusions from the SWOT listings about the company’s overall situation
   b. Acting on those conclusions to better match the company’s strategy to its resource strengths and market opportunities, to correct important weaknesses, and to defend against external threats

Core Concept

Simply making lists of a company’s strengths, weaknesses, opportunities, and threats is not enough; the payoff from SWOT analysis comes from the conclusions about a company’s situation and the implications for a strategy improvement that flow from the four lists.

2. Figure 4.2, The Three Steps of SWOT Analysis: Identify, Draw Conclusions, Translate into Strategic Action

3. Just what story the SWOT analysis tells about the company’s overall situation can be summarized in a series of questions:
   a. Does the company have an attractive set of resource strengths?
   b. How serious are the company’s weaknesses and competitive deficiencies?
   c. Do the company’s resource strengths and competitive capabilities outweigh its resource weaknesses and competitive deficiencies by an attractive margin?
   d. Does the company have attractive market opportunities that are well suited to its resource strengths and competitive capabilities?
   e. Are the threats alarming or are they something the company appears able to deal with and defend against?
   f. How strong is the company’s overall situation?

4. Implications for SWOT analysis for strategic action:
   a. Which competitive capabilities need to be strengthened immediately?
   b. What actions should be taken to reduce the company’s competitive liabilities?
   c. Which market opportunities should be top priority in future strategic initiatives? Which opportunities should be ignored?
   d. What should the company be doing to guard against the threats to its well-being?

5. A company’s resource strengths should generally form the cornerstones of strategy because they represent the company’s best chance for market success.

6. Sound strategy making requires sifting thorough the available market opportunities and aiming strategy at capturing those that are most attractive and suited to the company’s circumstances.
III. Question 3: Are the Company’s Prices and Costs Competitive?

1. One of the most telling signs of whether a company’s business position is strong or precarious is whether its prices and costs are competitive with industry rivals.

2. Price-cost comparisons are especially critical in a commodity-product industry where the value provided to buyers is the same from seller to seller, price competition is typically the ruling force and lower-cost companies have the upper hand.

**Core Concept**

The higher a company’s costs are above those of close rivals, the more competitively vulnerable it becomes.

3. Two analytical tools are particularly useful in determining whether a company’s prices and costs are competitive and thus conducive to winning in the marketplace: value chain analysis and benchmarking.

A. The Concept of a Company’s Value Chain

**Core Concept**

A company’s **value chain** identifies the primary activities that create customer value and the related support activities.

1. **Figure 4.3, A Representative Company Value Chain**, depicts the linked set of value creating activities.

2. The value chain consists of two broad categories of activities:
   a. Primary activities: foremost in creating value for customers
   b. Support activities: facilitate and enhance the performance of primary activities

B. Why the Value Chains of Rival Companies Often Differ

1. A company’s value chain and the manner in which it performs each activity reflect the evolution of its own particular business and internal operations, its strategy, the approaches it is using to execute its strategy, and the underlying economics of the activities themselves.

2. Because these factors differ from company to company, the value chain of rival companies sometimes differ substantially—a condition that complicates the task of assessing rivals’ relative cost positions.

C. The Value Chain System for an Entire Industry

1. Accurately assessing a company’s competitiveness in end-use markets requires that company managers understand the entire value chain system for delivering a product or service to end-users, not just the company’s own value chain.

2. **Figure 4.4, A Representative Value Chain for an Entire Industry**, explores a value chain for an entire industry.
Core Concept

A company’s cost competitiveness depends not only on the costs of internally performed activities (its own value chain) but also on costs in the value chain of its suppliers and forward channel allies.

3. Suppliers’ value chains are relevant because suppliers perform activities and incur costs in creating and delivering the purchased inputs used in a company’s own value chain.

4. Forward channel and customer value chains are relevant because:
   a. The costs and margins of a company’s distribution allies are part of the price the end user pays
   b. The activities that distribution allies perform affect the end user’s satisfaction

D. Activity-Based Costing: A Tool for Assessing a Company’s Cost Competitiveness

1. The next step in evaluating a company’s cost competitiveness involves disaggregating or breaking down departmental cost accounting data into the costs of performing specific activities.

2. Traditional accounting identifies costs according to broad categories of expense. A newer method, activity-based costing, entails defining expense categories according to the specific activities being performed and then assigning costs to the activity responsible for creating the cost.

3. Table 4.3, The Differences between Traditional Cost Accounting and Activity-Based Cost Accounting: A Supply Chain Activity Example, provides an illustrative example of the difference between traditional cost accounting and activity-based accounting.

4. Perhaps 25% of the companies that have explored the feasibility of activity-based costing have adopted this accounting approach.

5. Illustration Capsule 4.1, Estimated Value Chain Costs for Recording and Distributing Music CDs through Traditional Music Retailers, shows representative costs for various activities performed by the producers and marketers of music CDs.

Illustration Capsule 4.1, Value Chain Costs for Recording and Distributing Music CDs through Traditional Music Retailers

Discussion Question: 1. What are the total costs associated with direct production to a record company when producing a music CD? Why is having this knowledge important to such a company?

Answer: According to the information provided in the table, a record company’s direct production costs equal $2.40 per CD. This information is important because a company must know its actual and correct costs of production in order to establish fair product pricing in the marketplace.

E. Benchmarking: A Tool for Assessing Whether a Company’s Value Chain Costs are in Line

1. Benchmarking is a tool that allows a company to determine whether the manner in which it performs particular functions and activities represent industry “best practices” when both cost and effectiveness are taken into account.
Core Concept

**Benchmarking** is a potent tool for learning which companies are best at performing particular activities and then using their techniques or “best practices” to improve the cost and effectiveness of a company’s own internal activities.

2. Benchmarking entails comparing how different companies perform various value chain activities.

3. The objectives of benchmarking are:
   a. To identify the best practices in performing an activity
   b. To learn how other companies have actually achieved lower costs or better results in performing benchmarked activities
   c. To take action to improve a company’s competitiveness whenever benchmarking reveals that its costs and results of performing an activity do not match those of other companies

4. The tough part of benchmarking is not whether to do it but rather how to gain access to information about other companies practices and costs.

Core Concept

Benchmarking the costs of company activities against rivals provides hard evidence of a company’s cost-competitiveness.

5. Sometimes benchmarking can be accomplished by collecting information from published reports, trade groups, and industry research firms and by talking to knowledgeable industry analysts, customers, and suppliers.

6. Making reliable cost comparisons is complicated by the fact that participants often use different cost accounting systems.

7. The explosive interest of companies in benchmarking costs and identifying best practices has prompted consulting organizations to gather benchmarking data, do benchmarking studies, and distribute information about best practices without identifying sources. Having an independent group gather the information and report it in a manner that disguises the names of individual companies permits participating companies to avoid disclosing competitively sensitive data to rivals and reduces the risk of ethical problems.

8. **Illustration Capsule 4.2, Benchmarking and Ethical Conduct**, lists some guidelines with regard to benchmarking and ethical conduct.

**Illustration Capsule 4.2, Benchmarking and Ethical Conduct**

**Discussion Question:** 1. Identify why ethical conduct is important in benchmarking.

**Answer:** In a benchmarking situation, ethical conduct is important because the discussion between benchmarking partners can involve competitively sensitive data that can conceivably raise questions about possible restraint of trade or improper business conduct.
F. **Strategic Options for Remediying a Cost Disadvantage**

1. Value chain analysis and benchmarking can reveal a great deal about a firm’s cost competitiveness.

2. There are three main areas in a company’s overall value chain where important differences in the costs of competing firms can occur: a company’s own activity segments, suppliers’ part of the industry value chain, and the forward channel portion of the industry chain.

3. **Remediying an Internal Cost Disadvantage**
   
a. When the source of a firm’s cost disadvantage is internal, managers can use any of the following eight strategic approaches to restore cost parity:
   
i. Implement the use of best practices throughout the company, particularly for high-cost activities
   
ii. Try to eliminate some cost-producing activities altogether by revamping the value chain
   
iii. Relocate high-cost activities to geographic areas where they can be performed more cheaply
   
iv. See if certain internally performed activities can be outsourced from vendors or performed by contractors more cheaply than they can be done internally
   
v. Invest in productivity-enhancing, cost-saving technological improvements
   
vi. Find ways to detour around the activities or items where costs are high
   
svii. Redesign the product design so that it can be manufactured or assembled quickly and more economically
   
viii. Try to make up the internal cost disadvantage by achieving savings in the other two parts of the value chain system

4. **Remediying a Supplier-Related Cost Disadvantage:** Supplier-related cost disadvantages can be attacked by pressuring suppliers for lower prices, switching to lower-priced substitute inputs, and collaborating closely with suppliers to identify mutual cost-saving opportunities.

5. **Remediying a Cost Disadvantage Associated with Activities Performed by Forward Channel Allies:** There are three main ways to combat a cost disadvantage in the forward portion of the industry value chain:

   a. Pressure dealer-distributors and other forward channel allies to reduce their costs and markups so as to make the final price to buyers more competitive with the prices of rivals.
   
b. Work closely with forward channel allies to identify win-win opportunities to reduce costs.
   
c. Change to a more economical distribution strategy, including switching to cheaper distribution channels or perhaps integrating forward into company-owned retail outlets.

G. **Translating Proficient Performance of Value Chain Activities into Competitive Advantage**

1. A company that does a first-rate job of managing its value chain activities relative to competitors stands a good chance of leveraging its competitively valuable competencies and capabilities into sustainable competitive advantage.
Performing value chain activities in ways that give a company the capabilities to either outmatch the competencies and capabilities of rivals or else beat them on costs are two good ways to secure competitive advantage.

2. **Figure 4.5, Translating Company Performance of Value Chain Activities into Competitive Advantage**, shows the process of translating proficient company performance into competitive advantage.

IV. **Question 4: Is the Company Competitively Stronger or Weaker Than Key Rivals?**

1. Using value chain analysis and benchmarking to determine a company’s competitiveness on price and cost is necessary but not sufficient.

2. The answers to two questions are of particular interest:
   a. How does the company rank relative to competitors on each of the important factors that determine market success?
   b. Does the company have a net competitive advantage or disadvantage to major competitors?

3. An easy method for answering the questions posed above involves developing quantitative strength ratings for the company and its key competitors on each industry key success factor and each competitively decisive resource capability.

4. The followings are steps for compiling a competitive strength assessment:
   a. Step 1: make a list of the industry’s key success factors and most telling measures of competitive strength or weakness
   b. Step 2: rate the firm and its rivals on each factor
   c. Step 3: sum the strength ratings on each factor to get an overall measure of competitive strength for each company being rated
   d. Step 4: use the overall strength ratings to draw conclusions about the size and extent of the company’s net competitive advantage or disadvantage and to take specific note of areas of strengths and weaknesses

5. **Table 4.4, Illustrations of Unweighted and Weighted Competitive Strength Assessments**, provides two examples of competitive strength assessment.

6. A better method is a weighted rating system because the different measures of competitive strength are unlikely to be equally important.

A weighted competitive strength analysis is conceptually stronger than an unweighted analysis because of the inherent weakness in assuming that all the strength measures are equally important.

7. No matter whether the differences between the important weights are big or little, the sum of the weights must equal 1.0.

8. Weighted strength ratings are calculated by rating each competitor on each strength measure and multiplying the assigned rating by the assigned weight.
9. Summing a company’s weighted strength ratings for all the measures yields an overall strength rating. Comparisons of the weighted overall strength scores indicate which competitors are in the strongest and weakest competitive positions and who has how big a net competitive advantage over whom.

A. Interpreting the Competitive Strengths Assessment

1. Competitive strength assessments provide useful conclusions about a company’s competitive situation.

2. The competitive strength ratings point to which rival companies may be vulnerable to competitive attack and the areas where they are weakest.

Core Concept

High competitive strength ratings signal a strong competitive position and possession of competitive advantage; low ratings signal a weak position and competitive disadvantage.

V. Question 5: What Strategic Issues and Problems Merit Front-Burner Managerial Attention?

1. The final and most important analytical step is to zero in on exactly what strategic issues that company managers need to address and resolve for the company to be more financially and competitively successful in the years ahead.

2. This step involves drawing on the results of both industry and competitive analysis and the evaluations of the company’s own competitiveness.

3. Pinpointing the precise problems that management needs to worry about sets the agenda for deciding what actions to take next to improve the company’s performance and business outlook.

Core Concept

Zeroing in on the strategic issues a company faces and compiling a “worry list” of problems and roadblocks creates a strategic agenda of problems that merit prompt managerial attention.

4. The “worry list” of issues and problems can include such things as:
   a. How to stave off market challenges from new foreign competitors
   b. How to combat rivals’ price discounting
   c. How to reduce the company’s high costs to pave the way for price reductions
   d. How to sustain the company’s present growth rate in light of slowing buyer demand
   e. Whether to expand the company’s product line
   f. Whether to acquire a rival company to correct the company’s competitive deficiencies
   g. Whether to expand into foreign markets rapidly or cautiously
   h. Whether to reposition the company and move to a different strategic group
   i. What to do about the aging demographics of the company’s customer base

Core Concept

A good strategy must contain ways to deal with all the strategic issues and obstacles that stand in the way of the company’s financial and competitive success in the years ahead.
CHAPTER SUMMARY

Chapter 5 describes the five basic competitive strategy options—which of the five to employ is a company’s first and foremost choice in crafting overall strategy and beginning its quest for competitive advantage.

LECTURE OUTLINE

I. Introduction

1. By competitive strategy we mean the specifics of management’s game plan for competing successfully—how it plans to position the company in the marketplace, its specific efforts to please customers, and improve its competitive strength, and the type of competitive advantage it wants to establish.

Core Concept

A competitive strategy concerns the specifics of management’s game plan for competing successfully and achieving a competitive advantage over rivals.

Core Concept

The objective of competitive strategy is to knock the socks off rival companies by doing a better job of satisfying buyer needs and preferences.

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

3. There are many routes to competitive advantage, but they all involve giving buyers what they perceive as superior value.

4. Delivering superior value—whatever form it takes—nearly always requires performing value chain activities differently than rivals and building competencies and resource capabilities that are not readily matched.

II. The Five Generic Competitive Strategies

1. There are countless variations in the competitive strategies that companies employ, mainly because each company’s strategic approach entails custom-designed actions to fit its own circumstances and industry environment.

2. The biggest and most important differences among competitive strategies boil down to:
a. Whether a company’s market target is broad or narrow
b. Whether the company is pursuing a competitive advantage linked to low costs or product differentiation

3. Five distinct competitive strategy approaches stand out:
   a. A **low-cost provider strategy**: striving to achieve lower overall costs than rivals and appealing to a broad spectrum of customers, usually by under pricing rivals.
   b. A **broad differentiation strategy**: seeking to differentiate the company’s product/service offering from rivals’ in ways that will appeal to a broad spectrum of buyers
   c. A **best-cost provider strategy**: giving customers more value for the money by incorporating good-to-excellent product attributes at a lower cost than rivals; the target is to have the lowest (best) costs and prices compared to rivals offering products with comparable attributes
   d. A **focused or market niche strategy based on lower cost**: concentrating on a narrow buyer segment and outcompeting rivals by serving niche members at a lower cost than rivals
   e. A **focused or market niche strategy based on differentiation**: concentrating on a narrow buyer segment and outcompeting rivals by offering niche members customized attributes that meet their tastes and requirements better than rivals products

4. **Figure 5.1, The Five Generic Competitive Strategies—Each Stakes Out a Different Position in the Marketplace**, examines how each of the five strategies stake out a different market position.

III. Low-Cost Provider Strategies

1. A company achieves low-cost leadership when it becomes the industry’s lowest-cost provider rather than just being one of perhaps several competitors with comparatively low costs.
2. In striving for a cost advantage over rivals, managers must take care to include features that buyers consider essential.
3. For maximum effectiveness, companies employing a low-cost provider strategy need to achieve their cost advantage in ways difficult for rivals to copy or match.

**Core Concept**

A low-cost leader’s basis for competitive advantage is lower overall costs than competitors. Successful low-cost leaders are exceptionally good at finding ways to drive costs out of their businesses.

4. A company has two options for translating a low-cost advantage over rivals into attractive profit performance:
   a. **Option 1**: use the lower-cost edge to underprice competitors and attract price-sensitive buyers in great numbers to increase total profits
   b. **Option 2**: maintain the present price, be content with the current market share, and use the lower-cost edge to earn higher profit margin on each unit sold

5. Illustration Capsule 5.1, How Wal-Mart Managed Its Value Chain to Achieve a Huge Low-Cost advantage over Rival Supermarket Chains, describes Wal-Mart’s strategy for out-managing its rivals in efficiently performing various value chain activities to gain a low-cost leadership.
A. The Two Major Avenues for Achieving a Cost Advantage

1. To achieve a low-cost advantage over rivals, a firm’s cumulative costs across its overall value chain are lower than competitors’ cumulative costs. There are two ways to accomplish this:
   a. Do a better job than rivals in performing value chain activities more cost effectively.
   b. Revamp the firm’s overall value chain to eliminate or bypass some cost-producing activities

2. Cost-Efficient Management of Value Chain Activities: Managers must launch a concerted, ongoing effort to ferret out cost-saving opportunities in every part of the value chain.
   a. Striving to capture all available economies of sale
   b. Taking full advantage of learning/experience curve effects
   c. Trying to operate facilities at full capacity
   d. Pursuing efforts to boost sales volumes and thus spread such costs as R&D, advertising, and selling and administrative costs out over more units
   e. Improving supply chain efficiency
   f. Substituting the use of low-cost for high-cost raw materials or component parts
   g. Using online systems and sophisticated software to achieve operating efficiencies.
   h. Adopting labor-saving operating methods
   i. Using the company’s bargaining power vis-a-vis suppliers to gain concessions
   j. Being alert to the cost advantages of outsourcing and vertical integration

3. Revamping the Value Chain to Curb or Eliminate Unnecessary Activities: Dramatic costs advantages can emerge from finding innovative ways to eliminate or bypass cost-producing value chain activities. The primary ways companies can achieve a cost advantage by reconfiguring their value chains include:
   a. Cutting out distributors and dealers by selling direct to customers
   b. Replacing certain value chain activities with faster and cheaper online technology
   c. Streamlining operations by eliminating low-value-added or unnecessary work steps and activities.
   d. Relocating facilities so as to curb the need for shipping and handling activities.
   e. Offering a frills-free product
   f. Offering a limited product line as opposed to a full product line
Illustration Capsule 5.1, How Wal-Mart Managed Its Value Chain to Achieve a Huge Low-Cost Advantage over Rival Supermarket Chains

**Discussion Question:** 1. Which parts of the value chain does Wal-Mart target in order to achieve a low-cost advantage over its rivals?

**Answer:** Wal-Mart has an extensive real-time information sharing network with vendors to make the supply chain much more efficient. It targets purchasing, store delivery, procurement practices that leverage the company’s relative buying power, investment in a large fleet of trucks for distribution of inventory, optimization of the product mix, use of security systems, preferred real estate rental and leasing rates, and lowering labor costs. Together, these initiatives give the company a 22 percent advantage over rival supermarket chains.

4. **Examples of Companies That Revamped Their Value Chains to Reduce Costs:** Nucor Corporation drastically revamped the value chain process for manufacturing steel products by using relatively inexpensive electric arc furnaces

   a. One example of accruing significant cost advantages from creating altogether new value chain systems can be found in the beef-packing industry.

   b. Southwest Airlines has reconfigured the traditional value chain of commercial airlines to lower costs and thereby offer dramatically lower fares to passengers. Dell Computer has proved a pioneer in redesigning its value chain architecture in assembling and marketing personal computers.

B. **The Keys to Success in Achieving Low-Cost Leadership**

   1. To succeed with a low-cost provider strategy, company managers have to scrutinize each cost creating activity and determine what drives its cost.

**Core Concept**

Success in achieving a low-cost edge over rivals comes from outmanaging rivals in figuring out how to perform value chain activities most cost effectively and eliminating or curbing nonessential value chain activities.

2. While low-cost providers are champions of frugality, they are usually aggressive in investing in resources and capabilities that promise to drive costs out of the business.

3. Wal-Mart is one of the foremost practitioners of low-cost leadership. Other companies noted for their successful use of low-cost provider strategies include Lincoln Electric, Briggs & Stratton, Bic, Black & Decker, Stride Rite, Beaird-Poulan, and General Electric and Whirlpool.

C. **When a Low-Cost Provider Strategy Works Best**

   1. A competitive strategy predicated on low-cost leadership is particularly powerful when:

      a. Price competition among rival sellers is especially vigorous
      b. The products of rival sellers are essentially identical and suppliers are readily available from any of several eager sellers
      c. There are a few ways to achieve product differentiation that have value to buyers
      d. Most buyers use the product in the same ways
      e. Buyers incur low costs in switching their purchases from one seller to another
f. Buyers are large and have significant power to bargain down prices

  g. Industry newcomers use introductory low prices to attract buyers and build a customer base

Core Concept
A low cost provider is in the best position to win the business of price-sensitive buyers, set the floor on market price, and still earn a profit.

D. The Pitfalls of a Low-Cost Provider Strategy

1. Perhaps the biggest pitfall of a low-cost provider strategy is getting carried away with overly aggressive price cutting and ending up with lower, rather than higher, profitability.

   a. A low-cost/low-price advantage results in superior profitability only if (1) prices are cut by less than the size of the cost advantage or (2) the added value gains in unit sales are large enough to bring in bigger total profit despite lower margins per unit sold.

2. A second big pitfall is not emphasizing avenues of cost advantages that can be kept proprietary or that relegate rivals to playing catch-up.

3. A third pitfall is becoming too fixated on cost reduction.

   a. Even if these mistakes are avoided, a low-cost competitive approach still carries risk.

Core Concept
A low-cost provider’s product offering must always contain enough attributes to be attractive to prospective buyers—low price, by itself, is not always appealing to buyers.

IV. Broad Differentiation Strategies

1. Differentiation strategies are attractive whenever buyers’ needs and preferences are too diverse to be fully satisfied by a standardized product or by sellers with identical capabilities.

Core Concept
The essence of a broad differentiation strategy is to be unique in ways that are valuable to a wide range of customers.

2. Successful differentiation allows a firm to:

   a. Command a premium price for its product

   b. Increase unit sales

   c. Gain buyer loyalty to its brand

3. Differentiation enhances profitability whenever the extra price the product commands outweighs the added costs of achieving the differentiation.

A. Types of Differentiation Themes

1. Companies can pursue differentiation from many angles.

2. the most appealing approaches to differentiation are those that are hard or expensive for rivals to duplicate.
Core Concept

Easy to copy differentiating features cannot produce sustainable competitive advantage; differentiation based on competencies and capabilities tend to be more sustainable.

B. Where along the Value Chain to Create the Differentiating Attributes

1. Differentiation opportunities can exist in activities all along an industry’s value chain; possibilities include the following:

a. Supply chain activities that ultimately spill over to affect the performance or quality of the company’s end product.

b. Product R&D activities that aim at improved product designs and performance features, expanded end uses and applications, more frequent first-on-the-market victories, wider product variety and selection, added user safety, greater recycling capability, or enhanced environmental protection.

c. Production R&D and technology-related activities that permit custom-order manufacture at an efficient cost, make production methods safer for the environment, or improve product quality, reliability, and appearance.

d. Manufacturing activities that reduce product defects, prevent premature product failure, extend product life, allow better warranty coverages, improve economy of use, result in more end-user convenience, or enhance product appearance.

e. Distribution and shipping activities that allow for fewer warehouse and on-the-shelf stockouts, quick delivery to customers, more accurate order filling, and/or lower shipping costs.

f. Marketing, sales, and customer service activities that result in superior technical assistance to buyers, faster maintenance and repair services, more and better product information provided to customers, more and better training materials for end users, better credit terms, quicker order processing, or greater customer convenience.

4. Managers need keen understanding of the sources of differentiation and the activities that drive uniqueness to devise a sound differentiation strategy and evaluate various differentiation approaches.

C. The Four Best Routes to Competitive Advantage via a Broad Differentiation Strategy

1. While it is easy enough to grasp that a successful differentiation strategy must entail creating buyer value in ways unmatched by rivals, the big question is which of four basic differentiating approaches to take in delivering unique buyer value.

2. One route is to incorporate product attributes and user features that lower the buyer’s overall costs of using the product.

3. A second route is to incorporate features that raise product performance.

4. A third route is to incorporate features that enhance buyer satisfaction in noneconomic or intangible ways.

5. A fourth route is to differentiate on the basis of capabilities—to deliver value to customers via competitive capabilities that rivals do not have or cannot afford to match.

Core Concept

A differentiator’s basis for competitive advantage is either a product/service offering whose attributes differ significantly from the offering of rivals or a set of capabilities for delivering customer value that rivals do not have.
D. **The Importance of Perceived Value and Signaling**

1. Buyers seldom pay for value they do not perceive, no matter how real the unique extras may be. Thus, the price premium commanded by a differentiation strategy reflects the value actually delivered to the buyer and the value perceived by the buyer.

2. Signals of value that may be as important as actual value include: (1) when the nature of differentiation is subjective or hard to quantify, (2) when buyers are making first-time purchases, (3) when repurchase is infrequent, and (4) when buyers are unsophisticated.

E. **When a Differentiation Strategy Works Best**

1. Differentiation strategies tend to work best in market circumstance where:
   a. Buyer needs and uses of the product are diverse
   b. there are many ways to differentiate the product or service and many buyers perceive these differences as having value
   c. Few rival firms are following a similar differentiation approach
   d. Technological change is fast-paced and competition revolves around rapidly evolving product features

**Core Concept**

Any differentiating feature that works well is a magnet to imitators.

G. **The Pitfalls of a Differentiation Strategy**

1. Differentiation strategies can fail for any of several reasons.

2. Attempts at differentiation are doomed to fail if competitors can quickly copy most or all of the appealing product attributes a company comes up with.

3. A second pitfall is that the company’s differentiation strategy produces a ho-hum market reception because buyers see little value in the unique attributes of a company’s product.

4. The third big pitfall of a differentiation strategy is overspending on efforts to differentiate the company’s product offering, thus eroding profitability

5. Other common pitfalls and mistakes in pursuing differentiation may include:
   a. Over differentiating so that the product quality or service level exceeds buyers’ needs
   b. Trying to charge too high a price premium
   c. Being timid and not striving to open up meaningful gaps in quality or service or performance features vis-à-vis the products of rivals—tiny differences between rivals’ product offerings may not be visible or important to buyers

6. A low-cost provider strategy can defeat a differentiation strategy when buyers are satisfied with a basic product and do not think extra attributes are worth a higher price.
V. Best-Cost Provider Strategies

**Core Concept**

The competitive advantage of a best-cost provider is lower costs that rivals in incorporating upscale attitudes, putting the company in a position to underprice rivals whose products have similar upscale attributes.

1. Best-cost provider strategies aim at giving customers more value for the money. The objective is to deliver superior value to buyers by satisfying their expectations on key quality/service/features/performance attributes and beating their expectations on price.

2. A company achieves best-cost status from an ability to incorporate attractive attributes at a lower cost than rivals.

3. Best-cost provider strategies stake out a middle ground between pursuing a low-cost advantage and a differentiation advantage and between appealing to the broader market as a whole and a narrow market niche.

4. From a competitive positioning standpoint, best-cost strategies are a hybrid, balancing a strategic emphasis on low cost against a strategic emphasis on differentiation.

5. The competitive advantage of a best-cost provider is lower costs than rivals in incorporating good-to-excellent attributes, putting the company in a position to underprice rivals whose products have similar appealing attributes.

### A. When a Best-Cost Provider Strategy Works Best

1. A best-cost provider strategy is very appealing in markets where buyer diversity makes product differentiation the norm and where many buyers are also sensitive to price and value.

2. **Illustration Capsule 5.3, Toyota’s Best-Cost Producer Strategy for Its Lexus Line**, describes how Toyota has used a best-cost approach with its Lexus models.

### Illustration Capsule 5.2, Toyota’s Best-Cost Producer Strategy for Its Lexus Line

**Discussion Question:** 1. Discuss how Toyota has been able to achieve its low-cost leadership status in the industry.

**Answer:** Toyota has achieved low-cost leadership status because it has developed considerable skills in efficient supply chain management and low-cost assembly capabilities and because its models are so well-positioned in the low-to-medium end of the price spectrum. These are enhanced by Toyota’s strong emphasis on quality.

### B. The Big Risk of a Best-Cost Provider Strategy

1. The danger of a best-cost provider strategy is that a company using it will get squeezed between the strategies of firms using low-cost and differentiation strategies.

2. To be successful, a best-cost provider must offer buyers significantly better product attributes in order to justify a price above what low-cost leaders are charging.

VI. Focused (or Market Niche) Strategies

1. What sets focused strategies apart from low-cost leadership or broad differentiation strategies is concentrated attention on a narrow piece of the total market.
2. The target segment or niche can be defined by:
   a. Geographic uniqueness
   b. Specialized requirements in using the product
   c. Special product attributes that appeal only to niche members

A. A Focused Low-Cost Strategy

1. A focused strategy based on low cost aims at securing a competitive advantage by serving buyers in the target market niche at a lower cost and lower price than rival competitors.

2. This strategy has considerable attraction when a firm can lower costs significantly by limiting its customer base to a well-defined buyer segment.

3. Focused low-cost strategies are fairly common.

4. **Illustration Capsule 5.4, Motel 6’s Focused Low-Cost Strategy**, describes how Motel 6 has kept its costs low in catering to budget conscious travelers.

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**Illustration Capsule 5.3, Vizio’s Focused Low-Cost Strategy**

**Discussion Question:** 1. Discuss the advantages this organization achieves from its focused low-cost provider strategy.

**Answer:** Through utilization of this type of strategy, Vizio is able to capitalize on the market segment that is comprised of price-conscious buyers who want a quality picture for a reasonable price. Through its relationship with its major supplier and its focus on a single product category sold through limited distribution channels, it allows its customers deep price discounts.

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B. A Focused Differentiation Strategy

1. A focused strategy based on differentiation aims at securing a competitive advantage by offering niche members a product they perceive is better suited to their own unique tastes and preferences.

2. Successful use of a focused differentiation strategy depends on the existence of a buyer segment that is looking for special product attributes or seller capabilities and on a firm’s ability to stand apart from rivals competing in the same target market niche.

3. **Illustration Capsule 5.4, Progressive Insurance’s Focused Differentiation Strategy in Auto Insurance**, provides details about the company’s focused differentiation strategy.

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**Illustration Capsule 5.4, Progressive Insurance’s Focused Differentiation Strategy in Auto Insurance**

**Discussion Question:** 1. How does Progressive’s choice of strategy differentiate it from other insurance companies in the marketplace?

**Answer:** Progressive’s choice of a focused differentiation strategy is one that caters to the more high-risk driver. Such drivers are not overly welcomed in the more traditional insurance companies of today. This company also has teams of roving claim adjusters to settle claims on the spot and offers motorcycle coverage as well as luxury car insurance. These are significantly different offerings from those of the more traditional insurance carriers that have been predominate within the industry.
C. **When a Focused Low-Cost or Focused Differentiation Strategy is Attractive**

1. A focused strategy aimed at securing a competitive edge based either on low cost or differentiation becomes increasingly attractive as more of the following conditions are met:

   a. The target niche is big enough to be profitable and offers good growth potential
   b. Industry leaders do not see that having a presence in the niche is crucial to their own success
   c. It is costly or difficult for multisegment competitors to put capabilities in place to meet specialized needs of the target market niche and at the same time satisfy the expectations of their mainstream customers
   d. The industry has many different niches and segments
   e. Few, if any, other rivals are attempting to specialize in the same target segment
   f. The focuser has a reservoir of customer goodwill and loyalty

D. **The Risks of a Focused Low-Cost or Focused Differentiation Strategy**

1. Focusing carries several risks such as:

   a. The chance that competitors will find effective ways to match the focused firm’s capabilities in serving the target niche
   b. The potential for the preferences and needs of niche members to shift over time toward the product attributes desired by the majority of buyers
   c. The segment may become so attractive it is soon inundated with competitors, intensifying rivalry and splintering segment profits

**VII. The Contrasting Features of the Five Generic Competitive Strategies: A Summary**

1. Deciding which generic competitive strategy should serve as the framework for hanging the rest of the company’s strategy is not a trivial matter.

2. Each of the five generic competitive strategies positions the company differently in its market and competitive environment.

3. Each establishes a central theme for how the company will endeavor to outcompete rivals.

4. Each creates some boundaries or guidelines for maneuvering as market circumstances unfold and as ideas for improving the strategy are debated.

5. Each points to different ways of experimenting and tinkering with the basic strategy.

6. Deciding which generic strategy to employ is perhaps the most important strategic commitment a company makes—it tends to drive the rest of the strategic actions a company decides to undertake.

7. Each entails differences in terms of product line, production emphasis, marketing emphasis, and means for sustaining the strategy. **Table 5.1, Distinguishing Features of the Five Generic Strategies,** examines the distinguishing features of each of the five generic strategies.

8. One of the big dangers here is that managers will opt for “stuck in the middle” strategies that represent compromises between lower costs and greater differentiation and between broad and narrow market appeal.

9. Only if a company makes a strong and unwavering commitment to one of the five generic competitive strategies does it stand much chance of achieving sustainable competitive advantage that such strategies can deliver if properly executed.
CHAPTER 6

Supplementing the Chosen Competitive Strategy—Other Important Business Strategy Choices

CHAPTER SUMMARY

Chapter 6 identifies that once a company has settled on which of the five generic strategies to employ, attention must turn to what other strategic actions can be taken in order to complement the choice of its basic competitive strategy. The chapter contains sections discussing the pros and cons of each of the complementary strategic actions offered.

The chapter also explores the concepts behind the statement, “there is more to be revealed about the hows of matching the choices of strategy to a company’s circumstances.” This chapter looks at the strategy-making task in six other commonly encountered situations including (1) companies competing in freshly emerging markets, (2) companies competing in rapidly growing markets, (3) companies competing in mature, slow-growth markets, (4) companies competing in stagnant or declining markets, (5) companies competing in turbulent markets characterized by rapid fire change and (6) companies competing in fragmented markets comprised of a large number of relatively small sellers. These situations have been selected to shed more light on the factors that managers need to consider in tailoring a company’s strategy.

LECTURE OUTLINE

I. Strategic Alliances and Collaborative Partnerships

1. Companies in all types of industries and in all parts of the world have elected to form strategic alliances and partnerships to complement their own strategic initiatives and strengthen their competitiveness in domestic and international markets.

2. Globalization of the world economy, revolutionary advances in technology across a broad front, and untapped opportunities in national markets in Asia, Latin America, and Europe that are opening up, deregulating, and/or undergoing privatization have made partnerships of one kind or another integral to competing on a broad geographic scale.

3. Many companies now find themselves thrust in the midst of two very demanding competitive races:

   a. The global race to build a presence in many different national markets

   b. The race to seize opportunities on the frontiers of advancing technology

4. Companies may form strategic alliances or collaborative partnerships in which two or more companies join forces to achieve mutually beneficial strategic outcomes.
Core Concept

Strategic alliances are collaborative arrangements where two or more companies join forces to achieve mutually beneficial strategic outcomes. The competitive attraction of alliances is in allowing companies to bundle competencies and resources that are more valuable in a joint effort than when kept separate.

5. Strategic alliances go beyond normal company-to-company dealings but fall short of merger or full joint venture partnership with full ownership ties.

6. Some strategic alliances do involve arrangements whereby one or more allies have minority ownership in certain of the other alliance members.

7. Five factors make an alliance “strategic” as opposed to just a convenient business arrangement.
   a. It is critical to the company’s achievement of an important objective
   b. It helps build, sustain or enhance a core competence or competitive advantage
   c. It helps block a competitive threat.
   d. It helps open up important new market opportunities.
   e. It mitigates a significant risk

A. Why and How Strategic Alliances are Advantageous

1. The most common reasons why companies enter into strategic alliances are to collaborate on technology or the development of promising new products, to overcome deficits in their technical and manufacturing expertise, to acquire altogether new competencies, to improve supply chain efficiency, to gain economies of scale in production and/or marketing, and to acquire or improve market access through joint marketing agreements.

2. A company that is racing for global market leadership needs alliances to:
   a. Get into critical country markets quickly and accelerate the process of building a potent global market presence
   b. Gain inside knowledge about unfamiliar markets and cultures through alliances with local partners
   c. Access valuable skills and competencies that are concentrated in particular geographic locations

3. A company that is racing to stake out a strong position in a technology or industry of the future needs alliances to:
   a. Establish a stronger beachhead for participating in the target technology or industry
   b. Master new technologies and build new expertise and competencies faster than would be possible through internal efforts
   c. Open up broader opportunities in the target industry by melding the firm’s own capabilities with the expertise and resources of partners

4. Allies can learn much from one another in performing joint research, sharing technological know-how, and collaborating on complementary new technologies and products—sometimes enough to enable them to pursue other new opportunities on their own.
B. Capturing the Benefits of Strategic Alliances

1. The extent to which companies benefit from entering into alliances and collaborative partnerships seem to be a function of six factors;
   a. Picking a good partner
   b. Being sensitive to cultural differences
   c. Recognizing that the alliance must benefit both sides
   d. Ensuring that both parties live up to their commitments
   e. Structuring the decision-making process so that actions can be taken swiftly when needed
   f. Managing the learning process and then adjusting the alliance agreement over time to fit new circumstance

2. Alliances are more likely to be long lasting when (1) they involve collaboration with suppliers or distribution allies and each party’s contribution involves activities in different portions of the industry value chain, or (2) both parties conclude that continued collaboration is in their mutual interest.

C. Why Many Alliances are Unstable or Break Apart

1. The stability of an alliance depends on how well the partners work together, their success in adapting to changing internal and external conditions, and their willingness to renegotiate the bargain if circumstances so warrant.

2. A surprisingly large number of alliances never live up to expectations. An article (2007) from the Harvard Business Review found that even though the number of alliances increases by about 25 percent annually, about 60 to 70 percent continue to fail each year.

3. Experience indicates that alliances stand a reasonable chance of helping a company reduce competitive disadvantage but rarely have they proved a durable competitive edge over rivals.

D. The Strategic Dangers of Relying Heavily on Alliances and Collaborative Partnerships

1. The Achilles heel of alliances and collaborative partnerships is dependence on another company for essential expertise and capabilities.

III. Merger and Acquisition Strategies

1. Mergers and acquisitions are a much-used strategic plan. They are especially suited for situations where alliances and partnerships do not go far enough in providing a company with access to the needed resources and capabilities.

Core Concept

Combining the operations of two companies, via merger or acquisition, is an attractive strategic option for achieving operating economies, strengthening the resulting company’s competencies and competitiveness, and opening up avenues of new market opportunity.

2. A merger is a pooling of equals, with the newly created company often taking on a new name. An acquisition is a combination in which one company, the acquirer, purchases and absorbs the operations of another, the acquired.
3. The difference between a merger and an acquisition relates more to the details of ownership, management control, and financial arrangements than to strategy and competitive advantage. The resources, competencies, and competitive capabilities of the newly created enterprise end up much the same whether the combination is the result of acquisition or merger.

4. Many mergers and acquisitions are driven by strategies to achieve one of five strategic objectives:
   a. To create a more cost-efficient operation out of the combined companies.
   b. To expand a company’s geographic coverage.
   c. To extend the company’s business into new product categories or international markets.
   d. To gain quick access to new technologies or other resources and competitive capabilities.
   e. To try to invent a new industry and lead the convergence of industries whose boundaries are being blurred by changing technologies and new market opportunities.

5. **Illustration Capsule 6.1, Clear Channel Communications: Using Mergers and Acquisitions to Become a Global Market Leader**, describes how Clear Channel Worldwide has used mergers and acquisitions to build a leading global position in outdoor advertising and radio and TV broadcasting.

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**Illustration Capsule 6.1, Clear Channel Communications: Using Mergers and Acquisitions to Become a Global Market Leader**

**Discussion Question:** 1. Discuss the impact that the loosening of rules by the FCC had on Clear Channel’s business strategy. Describe how acquisitions benefited this company.

**Answer:** In the late 1980s, following the decision by the FCC to loosen rules regarding the ability of one company to own both radio and TV stations, Clear Channel broadened its strategy and began acquiring small, struggling TV stations. Its new strategy was to buy radio, TV, and outdoor advertising properties with operations in many of the same local markets, share facilities and staffs to cut costs, improve programming, and sell advertising for all three media simultaneously. By 1998, Clear Channel had used acquisitions to build a leading position in radio and television stations. In 2003, this company owned radio and television stations, outdoor advertising, and entertainment venues in 66 countries around the world.

6. Mergers and acquisitions do not always produce the hoped for outcomes.

7. A number of previously applauded mergers/acquisitions have yet to live up to expectations – AOL and Time Warner and Daimler Benz and Chrysler to name a few.

IV. **Vertical Integration Strategies: Operating Across More Stages of the Industry Value Chain**

1. Vertical integration extends a firm’s competitive and operating scope within the same industry. It involves expanding the firm’s range of activities backward into sources of supply and/or forward toward end users.

2. Vertical integration strategies can aim at full integration or partial integration.

A. **The Advantages of a Vertical Integration Strategy**

1. The two best reasons for investing company resources in vertical integration are to strengthen the firm’s competitive position and/or boost its profitability,
Core Concept

A vertical integration strategy has appeal only if it significantly strengthens a firm’s competitive position.

B. Integrating Backward to Achieve Greater Competitiveness: For backward integration to be a viable and profitable strategy, a company must be able to 1) achieve the same scale economies as outside suppliers and 2) match or beat suppliers production efficiency with no drop-off in quality.

2. Backward integration is most likely to reduce costs when:
   a. Suppliers have outsized profit margins
   b. The item being supplied is a major cost component
   c. The needed technological skills and product capability are easily mastered or can be gained by acquiring a supplier with desired expertise

3. Backward vertical integration can produce a differentiation-based competitive advantage when a company, by performing activities in-house that were previously outsourced, ends up with a better quality offering, improves the caliber of its customer service, or in other ways enhances the performance of its final product.

4. Other potential advantages of backward integration include:
   a. Decreasing the company’s dependence on suppliers of crucial components
   b. Lessening the company’s vulnerability to powerful suppliers inclined to raise prices at every opportunity

6. Integrating Forward to Enhance Competitiveness: The strategic impetus for forward integration is to gain better access to end-users and better market visibility.

C. The Disadvantages of a Vertical Integration Strategy

1. Vertical integration has some substantial drawbacks:
   a. It boosts a firm’s capital investment in the industry, increasing business risk
   b. Locks a firm into relying on its own in-house activities and sources of supply
   c. Poses capacity-matching problems
   d. Calls for radical changes in skills and business capabilities

2. Weighing the Pros and Cons of Vertical Integration: A strategy of vertical integration can have both important strengths and weaknesses. The tip of the scales depends on:
   a. Whether vertical integration can enhance the performance of strategy-critical activities in ways that lower cost, build expertise, or increase differentiation
   b. The impact of vertical integration on investments costs, flexibility and response time, and administrative costs of coordinating operations across more value chain activities
   c. Whether the integration substantially enhances a company’s competitiveness

3. Vertical integration strategies have merit according to which capabilities and value chain activities truly need to be performed in-house and which can be performed better or cheaper by outsiders.
4. Absent solid benefits, integrating forward or backward is not likely to be an attractive competitive strategy option.

V. Outsourcing Strategies: Narrowing the Boundaries of the Business

1. The two driving themes behind outsourcing are that:
   a. Outsiders can often perform certain activities better or cheaper
   b. Outsourcing allows a firm to focus its entire energies on its core business

A. When Outsourcing Strategies are Advantageous

1. Outsourcing pieces of the value chain to narrow the boundaries of a firm’s business makes strategic sense whenever:
   a. An activity can be performed more cheaply by outside specialist
   b. An activity is not crucial to the firm’s ability to achieve sustainable competitive advantage and will not hollow out its core competencies, capabilities, or technical know-how
   c. It reduces the company’s risk exposure to changing technology and/or changing buyer preferences
   d. It improves a company’s ability to innovate
   e. It streamlines company operations in ways that cut the time it takes to get newly developed products into the marketplace, lower internal coordination costs, or improve organizational flexibility
   f. It allows a company to assemble diverse kinds of expertise speedily and efficiently.
   g. It allows a company to concentrate on strengthening and leveraging its core competencies

Core Concept

A company should generally not perform any value chain activity internally that can be performed more efficiently or effectively by its outside business partners—the chief exception is when an activity is strategically crucial and internal control over that activity is deemed essential.

B. The Big Risk of Outsourcing Strategy

1. The biggest danger of outsourcing is that a company will farm out too many or the wrong types of activities and thereby hollow out its own capabilities.

VI. Business Strategy Choices for Specific Market Situations

I. Strategies for Competing in Emerging Industries

1. An emerging industry is one in the formative stage.

2. The business models and strategies of companies in an emerging industry are unproved—they may look promising but may not ever result in attractive profitability.

A. The Unique Characteristics of an Emerging Industry

1. Competing in emerging industries presents managers with some unique strategy-making challenges:
   a. Because the market it in its infancy, there’s usually much speculation about how it will function, how fast it will grow, and how big it will get. With little historical information
available there is much guesswork about how rapidly buyers will be attracted and how much they will be willing to pay.

b. Much of the technological know-how underlying the products of emerging industries is proprietary and closely guarded, having been developed in-house by pioneering firms; patents and unique technical expertise are key factors in securing competitive advantage.

c. There may be uncertainties surrounding an emerging industry’s technology, there may also be no consensus regarding which product attributes will prove decisive in winning buyer favor.

d. Since in emerging industry all buyers are first-time users, the marketing task is to induce initial purchase and to overcome customer concerns about product features, performance reliability, and conflicting claims of rival firms.

e. Many potential buyers expect first-generation products to be rapidly improved.

f. Entry barriers tend to be relatively low, even for entrepreneurial start-up companies.

g. Strong learning and experience curve effects may be present.

h. Sometimes firms have trouble securing ample supplies of raw materials and components.

i. Undercapitalized companies may end up merging with competitors or being acquired by financially strong outsiders looking to invest in a growth market.

B. Strategic Options for Competing in an Emerging Industry

1. The lack of established rules of the game gives industry participants considerable freedom to experiment with a variety of different strategic approaches.

Core Concept

Companies in an emerging industry have wide latitude in experimenting with different strategic approaches.

2. In addition to choosing a competitive strategy, companies in an emerging industry usually have to fashion a strategy containing one or more of the following actions:

a. Push to perfect the technology, improve product quality, and develop additional attractive performance features

b. Consider merging with or acquiring another firm to gain added expertise and pool resource strengths

c. As technological uncertainty clears and a dominant technology emerges, adopt it quickly

d. Acquire or form alliances with companies that have related or complementary technological expertise

e. Pursue new customer groups, new user applications, and entry into new geographical areas

f. Makes it easy and cheap for first-time buyers to try the industry’s first-generation product

g. As the product becomes familiar to a wide portion of the market, shift the advertising emphasis from creating product awareness to increasing frequency of use and building brand loyalty.
h. Use price cuts to attract the next layer of price-sensitive buyers into the market
i. Form strategic alliances with key suppliers to gain access to specialized skills, technological capabilities, and critical materials or components

3. Young companies in fast-growing markets face four strategic hurdles: (1) managing their own rapid expansion, (2) defending against competitors trying to horn in on their success, and (3) building a competitive position extending beyond their initial product or market and (4) defending against competitors trying to horn in on their success.

4. Up-and-coming companies can help their cause by: (1) selecting knowledgeable members for their boards of directors, (2) hiring entrepreneurial managers with experience in guiding young businesses through the start-up and takeoff stage.

II. Strategies for Competing in Rapidly Growing Markets

1. A rapidly growing market has the opportunity to achieve double-digit revenue and profit growth if it is aggressive enough to secure new customers to realize a 20 percent gain in sales.

2. To be able to grow at a pace exceeding the market average a company generally must have a strategy that incorporates one or more of the following elements:
   a. Driving down costs per unit so as to enable price reductions that attract droves of new customers.
   b. Pursuing rapid product innovation both to set a company’s product offering apart from rivals to and incorporate attributes that appeal to growing numbers of customers.
   c. Gaining access to additional distribution channels and sales outlets.
   d. Expanding the company’s geographic coverage.
   e. Expanding the product line to add models/styles that appeal to a wider range of buyers.

III. Competing in Slow Growth, Mature Markets

A market is said to be mature when nearly all potential buyers are already users of the industry’s products. In a mature market, demand consists mainly of replacement sales to existing users with growth hinging on the industry’s ability to attract the few remaining buyers and convince existing buyers to up their usage.

A. How Slowing Growth Alters Market Conditions

1. An industry’s transition to maturity does not begin on an easily predicted schedule.

2. When growth rates do slacken, the onset of market maturity usually produces fundamental changes in the industry’s competitive environment:
   a. Slowing growth in buyer demand generates more head-to-head competition for market share
   b. Buyers become more sophisticated, often driving a harder bargain on repeat purchases
   c. Competition often produces a greater emphasis on cost and service
   d. Firms have a topping-out problem in adding new facilities
   e. Product innovation and new end-use applications are harder to come by
f. International competition increases

g. Industry profitability falls temporarily or permanently

h. Stiffening competition induces a number of mergers and acquisitions among former competitors, drives the weakest firms out of the industry, and produces industry consolidation in general

B. Strategies that Fit Conditions in Slow-Growth, Mature Markets

1. As the new competitive character of industry maturity begins to hit full force, any of several strategic moves can strengthen a firm’s competitive positions:

a. **Pruning Marginal Products and Models**: Pruning marginal products from the line opens the door for cost savings and permits more concentration on items whose margins are highest and/or where a firm has a competitive advantage.

b. **Improving on Value Chain Innovation**: Efforts to reinvent the industry value chain can have a fourfold payoff—lower costs, better product or service quality, greater capability to turn out multiple or customized product versions, and shorter design-to-market cycles.

c. **Trimming Costs**: Stiffening price competition gives firms extra incentives to drive down unit costs. Company cost reduction initiatives can cover a broad front.

d. **Increasing Sales to Present Customers**: In a mature market, growing by taking customers away from rivals may not be as appealing as expanding sales to existing customers.

e. **Acquiring Rival Firms at Bargain Prices**: Sometimes a firm can acquire the facilities and assets of struggling rivals quite cheaply.

f. **Expanding Internationally**: As its domestic market matures, a firm may seek to enter foreign markets where attractive growth potential still exists and competitive pressures are not so strong.

g. **Building New or More Flexible Capabilities**: The stiffening pressures of competition in a maturing or already mature market can often be combated by strengthening the company’s resource base and competitive capabilities.

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**Illustration Capsule 6.2, PepsiCo’s Strategy for Growing Rapidly in Mature, Slow-Growth Markets**

**Discussion Question**: 1. Discuss how PepsiCo managed to grow by double digits while in an Industry categorized as a mature, slow-growth market?

**Answer**: In 2008 the company’s primary strategic priorities were developing new “good-for-you” snacks and beverages to appeal to health conscious consumers, strengthening its international markets, where the fastest growth occurred in Russia, the Middle East and Turkey with its “good-for-you” line-up and its traditional snacks achieved double-digit sales, and acquiring rapidly growing snack food and beverage companies. Pepsico was also able to increase US sales through the introduction of new beverages including Amp Energy and SoBe Adrenaline Rush. An equally important component of PepsiCo’s strategy was through divesting marginal products from its line-up of businesses. The spin-off of PepsiCo’s restaurant businesses reduced the company’s revenues by a third but got the company out of low-margin, capital-intensive businesses that were a drag on its overall return on investment.
C. **Mistakes Companies Make in Mature Markets**

1. Perhaps the biggest strategic mistake a company can make as an industry matures is steering a middle course between low cost, differentiation, and focusing—blending efforts to achieve low cost with efforts to incorporate differentiating features and efforts to focus on a limited target market.

2. Other strategic pitfalls include:
   
a. Being slow to mount a defense against stiffening competitive pressures
   
b. Concentrating more on protecting short-term profitability than on building or maintaining long-term competitive position
   
c. Waiting too long to respond to price cutting by rivals
   
d. Overexpanding in the face of slowing growth
   
e. Overspending on advertising and sales promotion efforts in a losing effort to combat growth slowdown
   
f. Failing to pursue cost reduction soon enough or aggressively enough

IV. **Competing in Stagnant or Declining Markets**

1. Many firms operate in industries where demand is growing more slowly than the economy wide average or is even declining.

2. Businesses competing in stagnant or declining industries must resign themselves to performance targets consistent with available market opportunities.

3. In general, companies that succeed in stagnant industries employ one or more of three strategic alternatives:
   
a. Pursue a focused strategy aimed at the fastest growing market segments within the industry
   
b. Stress differentiation based on quality improvement and product innovation
   
c. Strive to drive costs down and become the industry’s low-cost provider

4. These three strategic themes are not mutually exclusive.

C. **End-Game Strategies**

1. An end-game strategy can take either of two paths:
   
a. a slow exit strategy that involves a gradual phasing down of operations
   
b. a fast exit strategy or sell-out-quickly strategy to disengage from the industry during the early stages of the decline

V. **Strategies for Competing in Turbulent, Fast-Changing Markets**

1. Many companies operate in industries characterized by rapid technological change, short product life cycles, the entry of important new rivals, lots of competitive maneuvering by rivals and fast-evolving customer requirements and expectations—all occurring in a manner that creates swirling market conditions.
A. **Ways to Cope with Rapid Change**

1. The central strategy-making challenge in a turbulent market environment is managing change.

2. A company can assume any of three strategic postures in dealing with high-velocity change:
   a. It can react to change
   b. It can anticipate change, make plans for dealing with the expected changes, and follow its plans as changes occur
   c. It can lead change

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**Core Concept**

A sound way to deal with turbulent market conditions is to try to lead change with proactive strategic moves while at the same time trying to anticipate and prepare for upcoming changes and being quick to react to unexpected developments.

3. **Figure 6.1, Meeting the Challenge of High-Velocity Change**, illustrates the three strategic postures a company can assume when dealing with high-velocity change.

4. As a practical matter, a company’s approach to managing change should ideally incorporate all three postures, though not in the same proportion.

5. The best performing companies in high-velocity markets consistently seek to lead change with proactive strategies.

B. **Strategy Options for Fast-Changing Markets**

1. Competitive success in fast-changing markets tends to hinge on a company’s ability to improvise, experiment, adapt, reinvent, and regenerate as market and competitive conditions shift rapidly and sometimes unpredictably.

2. The following five strategic moves seem to offer the best payoffs:
   a. Invest aggressively in R&D to stay on the leading edge of technological know-how
   b. Keep the company’s products and services fresh and exciting enough to stand out in the midst of all the change this is taking place.
   c. Develop quick response capability
   d. Rely on strategic partnerships with outside suppliers and with companies making tie-in products
   e. Initiate fresh actions every few months not just when a competitive response is needed

3. Cutting-edge know-how and first-to-market capabilities are very valuable competitive assets in fast evolving markets.

VI. **Competing In a Fragmented Industry**

1. Any of several reasons can account for why the supply side of an industry is fragmented:
   a. The product or service is delivered at neighborhood locations so as to be conveniently accessible to local residents.
b. Buyer preferences and requirements are so diverse that very large numbers of firms can easily coexist trying to accommodate differing buyer tastes, expectations, and pocketbooks.

c. Low entry barriers allow small firms to enter quickly and cheaply

d. An absence of scale economies permits small companies to compete on an equal cost footing with larger firms

e. The scope of the geographic market for the industry’s product or service is transitioning from national to global.

f. The technologies embodied in the industry’s value chain are exploding into so many new areas and along so many different paths that specialization is essential just to keep abreast in any one area of expertise

g. The industry is young and crowded with aspiring contenders, with no firm having yet developed the resource base, competitive capabilities, and market recognition to command a significant market share

D. Competitive Conditions in a Fragmented Market

1. Suitable competitive strategy options in a fragmented industry include:

   a. Constructing and operating “formula” facilities—This strategic approach is frequently employed in restaurant and retailing businesses operating at multiple locations.

   b. Becoming a low-cost operator—When price competition is intense and profit margins are under constant pressure, companies can stress no-frills operations featuring low overhead, high productivity/low-cost labor.

   c. Specializing by product type—When a fragmented industry’s products include a range of styles or services, a strategy to focus on one product or service category can be effective.

   d. Specialization by customer type—A firm can stake out a market niche in a fragmented industry by catering to those customers who are interested in low prices, unique product attributes, customized features, carefree service, or other extras.

   e. Focusing on a limited geographic area—Even though a firm in a fragmented industry cannot win a big share of total industrywide sales. It can still try to dominate a local or regional geographic area.

Illustration Capsule 6.3, Just Play Golf’s Strategy in the Fragmented Market for Golf Accessories

**Discussion Question:** 1. How was it possible for such a small idea as the Gold Caddy able to make it in the golf accessory industry?

**Answer:** Because the industry is so highly fragmented from a global perspective, no one company dominates the entire market. Instead, small firms can exploit the many market niches that exist.
E. **Blue Ocean Strategy: A Powerful First-Mover Approach**

1. A blue ocean strategy seeks to gain a dramatic and durable competitive advantage by abandoning effort to beat out competitors in existing markets and, instead, inventing a new industry or distinctive market segment that renders existing competitors largely irrelevant and allows a company to create and capture altogether new demand.

2. This strategy views the business universe as consisting of two distinct types of market space:
   a. Industry boundaries are defined and accepted, the competitive rules of the game are well understood by all industry members, and companies try to outperform rivals by capturing a bigger share of existing demand. In such markets lively competition constrains a company’s prospects for rapid growth and superior profitability since rivals move quickly to imitate or counter the successes of competitors.
   b. Industry does not really exist yet, is untainted by competition, and offers wide open opportunity for profitable and rapid growth if a company can come up with a product offering and strategy that allows it to create new demand rather than fight over existing demand. Examples include Cirque du Soleil, which re-invented the circus, and eBay.
   c. Focusing on a limited geographic area—Even though a firm in a fragmented industry cannot win a big share of total industry wide sales. It can still try to dominate a local or regional geographic area.

F. **When Being a Late-Mover Can Be Advantageous**

1. Four instances when there are advantages to being an adept follower:
   a. When pioneering leadership is more costly than imitating followership and only negligible learning/experience curve benefits accrue to the leader—a condition that allows a follower to end up with lower costs than the first-mover.
   b. When the products of an innovator are somewhat primitive and do not live up to buyer expectations, thus allowing a clever follower to win disenchanted buyers away from the leader with better-performing products.
   c. When the demand side of the marketplace is skeptical about the benefits of a new technology or product being pioneered by a first-mover.
   d. When rapid market evolution (due to fast paced changes in either technology or buyer needs and expectations) gives fast-followers and maybe even cautious late-movers the opening to leapfrog a first-mover’s products with more attractive next version products.

G. **Deciding Whether to Be an Early Mover or a Late Mover**

1. In weighing the pros and cons of first-mover versus fast-follower, it matter whether the race to market leadership in a particular industry is a marathon or a sprint. In a marathon a slow-mover is not unduly penalized—first mover advantage can be fleeting.

2. The lesson is that there is a market-penetration curve for every emerging opportunity; typically the curve has an inflection point at which all the pieces of the business model fall into place, buyer demand explodes, and the market takes off. It can come early in a fast-rising curve (like e-mail) or farther up on a slow-rising curve (like use of broadband)
3. Any company that seeks competitive advantage by being a first-mover thus needs to ask some hard questions:
   a. Does market takeoff depend on the development of complementary products or services that currently are not available?
   b. Is new infrastructure required before buyer demand can surge?
   c. Will buyers need to learn new skills or adopt new behaviors? Will buyers encounter high switching costs?
   d. Are there influential competitors in a position to delay or derail the efforts of a first-mover?

4. When the answer to any of these questions is yes, then a company must be careful not to pour too many resources into getting ahead of the market opportunity—the battle for market leadership is likely going to be more of a 10-year marathon than a short-lived contest.

5. Being first off the starting block turns out to be competitively important only when pioneering early introduction of a technology or product delivers clear and substantial benefits to early adopters and buyers.
Chapter 7 focuses on strategy options for expanding beyond domestic boundaries and competing in the markets of either a few or a great many countries. The spotlight will be on four strategic issues unique to competing multinationally. It will introduce a number of core concepts including multi-country competition, global competition, and cross cultural differences in cultural, demographic, and market conditions. Chapter Seven includes sections on strategy options for entering and competing in foreign markets, the importance of locating operations in the most advantageous countries, and the special circumstances of competing in such emerging markets as China, India, and Brazil, Russia and Eastern Europe.

LECTURE OUTLINE

1. Why Companies Expand Into Foreign Markets
   1. A company may opt to expand outside its domestic market for any of four major reasons:
      a. To gain access to new customers—Expanding into foreign markets offers potential for increased revenues, profits, and long-term growth and becomes an especially attractive option when a company’s home markets are mature.
      b. To achieve lower costs and enhance the firm’s competitiveness—Many companies are driven to sell in more than one country because domestic sales volume is not large enough to fully capture manufacturing economies of scale or learning curve effects and thereby substantially improve the firm’s cost-competitiveness.
      c. To capitalize on its core competencies—A company may be able to leverage its competencies and capabilities into a position of competitive advantage in foreign markets as well as just domestic markets.
      d. To spread its business risk across a wider market base—A company spreads business risk by operating in a number of different foreign countries rather than depending entirely on operations in its domestic market.
   A. The Difference between Competing Internationally and Competing Globally
      1. Typically, a company will start to compete internationally by entering just one or maybe a select few foreign markets.
      2. There is a meaningful distinction between the competitive scope of a company that operates in a select few foreign countries (accurately termed an international competitor) and a company that markets its products in 50 to 100 countries and is expanding its operations into additional country markets annually (which qualifies as a global competitor).
II. Factors that Shape Strategy Choices in Foreign Markets

A. Cross-Country Differences In Cultural, Demographic, and Market Conditions

1. Regardless of a company’s motivation for expanding outside its domestic markets, the strategies it uses to compete in foreign markets must be situation driven.

2. Cultural, demographic, and market conditions vary significantly among the countries of the world. Cultures and lifestyles are the most obvious areas in which countries differ; market demographics are close behind.

3. Market growth varies from country to country. In emerging markets, market growth potential is far higher than in the more mature economies.

4. One of the biggest concerns of companies competing in foreign markets is whether to customize their offerings in each different country market to match the tastes and preferences of local buyers or whether to offer a mostly standardized product worldwide.

5. Aside from basic cultural and market differences among countries, a company also has to pay special attention to location advantages that stem from country-to-country variations in manufacturing and distribution costs, the risks of fluctuating exchange rates, and the economic and political demands of host governments.

B. Gaining Competitive Advantage Based on Where Activities are Located

1. Differences in wage rates, worker productivity, inflation rates, energy costs, tax rates, government regulations, and the like create sizable variations in manufacturing costs from country to country.

2. The quality of a country’s business environment also offers locational advantages—the governments of some countries are anxious to attract foreign investments and go all-out to create a business climate that outsiders will view as favorable.

C. The Risks of Adverse Exchange Rate Shifts

1. The volatility of exchange rates greatly complicates the issue of geographic cost advantages. Currency exchange rates often fluctuate as much as 20 to 40 percent annually. Changes of this magnitude can either totally wipe out a country’s low-cost advantage or transform a former high-cost location into a competitive-cost location.

Core Concept

Companies with manufacturing facilities in a particular country are more cost-competitive in exporting goods to world markets when the local currency is weak; their competitiveness erodes when the local currency grows stronger relative to the currencies of the countries to which the locally made goods are being exported.

2. Declines in the value of the U.S. dollar against foreign currencies reduce or eliminate whatever cost advantage foreign manufacturers might have over U.S. manufacturers and can even prompt foreign companies to establish production plants in the United States.

3. Currency exchange rates are rather unpredictable, swinging first one way then another way, so the competitiveness of any company’s facilities in any country is partly dependent on whether exchange rate changes over time have a favorable or unfavorable cost impact.

4. Companies making goods in one country for export to foreign countries always gain in competitiveness as the currency of that country grows weaker. Exporters are disadvantaged when the currency of the country where goods are being manufactured grows stronger.
Fluctuating exchange rates pose significant risks to a company’s competitiveness in foreign markets. Exporters win when the currency of the country where goods are being manufactured grows weaker and they lose when the currency grows stronger. Domestic companies under pressure from lower-cost imports are benefited when their government’s currency grows weaker in relation to the countries where the imported goods are being made.

D. The Impact of Host Government Policies on the Local Business Climate

1. National governments exact all kinds of measures affecting business conditions and the operations of foreign companies in their markets.

2. Host governments may set local content requirements on goods made inside their borders by foreign-based companies, put restrictions on exports to ensure adequate local supplies, regulate the prices of imported and locally produced goods, and impose tariffs or quotas on the imports of certain goods.

III. The Concepts of Multicountry Competition and Global Competition

1. There are important differences in the patterns of international competition from industry to industry.

2. At one extreme is multicountry competition in which there is so much cross-country variation in market conditions and in the companies contending for leadership that the market contest among rivals in one country is not closely connected to the market contests in other countries.

3. The standout features of multicountry competition are that:
   a. Buyers in different countries are attracted to different product attributes
   b. Sellers vary from country to country
   c. Industry conditions and competitive forces in each national market differ in important respects

4. With multicountry competition, rival firms battle for national championships and winning in one country does not necessarily signal the ability to fare well in other countries.

5. In multicountry competition, the power of a company’s strategy and resource capabilities in one country may not enhance its competitiveness to the same degree in other countries where it operates.

Core Concept

Multicountry competition exists when competition in one national market is not closely connected to competition in another national market—there is no global or world market, just a collection of self-contained country markets.

6. At the other extreme is global competition in which prices and competitive conditions across country markets are strongly linked and the term global or world market has true meaning.

7. In a globally competitive industry, much the same group of rival companies competes in many different countries, but especially so in countries where sales volumes are large and where having a competitive presence is strategically important to building a strong global position in the industry.
8. A company’s competitive position in one country both affects and is affected by its position in other countries.

**Core Concept**

**Global competition** exists when competitive conditions across national markets are linked strongly enough to form a true international market and when leading competitors compete head to head in many different countries.

9. Rival firms in globally competitive industries vie for worldwide leadership.

10. An industry can have segments that are globally competitive and segments in which competition is country by country.

11. It is important to recognize that an industry can be in transition from multicountry competition to global competition.

12. In addition to noting the obvious cultural and political differences between countries, a company should shape its strategic approach to competing in foreign markets according to whether its industry is characterized by multicountry competition, global competition, or a transition from one to the other.

**IV. Strategy Options for Entering and Competing in Foreign Markets**

1. There are a host of generic strategic options for a company that decides to expand outside its domestic market and compete internationally or globally:

   a. Maintain a national (one-country) production base and export goods to foreign markets—using either company-owned or foreign-controlled forward distribution channels

   b. License foreign firms to use the company’s technology or to produce and distribute the company’s products

   c. Employ a franchising strategy

   d. Follow a multicountry strategy—varying the company’s strategic approach from country to country in accordance with local conditions and differing buyer tastes and preferences

   e. Follow a global strategy—using essentially the same competitive strategy approach in all country markets where the company has a presence

   f. Use strategic alliances or joint ventures with foreign companies as the primary vehicle for entering foreign markets—and perhaps using them as an ongoing strategic arrangement aimed at maintaining or strengthening its competitiveness

**A. Export Strategies**

1. Using domestic plants as a production base for exporting goods to foreign markets is an excellent initial strategy for pursuing international sales.

2. With an export strategy, a manufacturer can limit its involvement in foreign markets by contracting with foreign wholesalers experienced in importing to handle the entire distribution and marketing function in their countries or regions of the world.

3. Whether an export strategy can be pursued successfully over the long run hinges on the relative cost-competitiveness of the home-country production base.
4. An export strategy is vulnerable when:
   a. Manufacturing costs in the home country are substantially higher than in foreign countries where rivals have plants
   b. The costs of shipping the product to distant foreign markets are relatively high
   c. Adverse fluctuations occur in currency exchange rates

B. Licensing Strategies
   1. Licensing makes sense when a firm with valuable technical know-how or a unique patented product has neither the internal organizational capability nor the resources to enter foreign markets.
   2. Licensing also has the advantage of avoiding the risks of committing resources to country markets that are unfamiliar, politically volatile, economically unstable, or otherwise risky.
   3. The big disadvantage of licensing is the risk of providing valuable technological know-how to foreign companies and thereby losing some degree of control over its use.

C. Franchising Strategies
   1. While licensing works well for manufacturers and owners of proprietary technology, franchising is often better suited to the global expansion efforts of service and retailing enterprises.
   2. Franchising has much the same advantages as licensing.
   3. The franchisee bears most of the costs and risks of establishing foreign locations while the franchisor has to expend only the resources to recruit, train, support, and monitor franchisees.
   4. The big problem a franchisor faces is maintaining quality control.
   5. Another problem that may arise is whether to allow foreign franchisees to make modifications in the franchisor’s product offerings so as to better satisfy the tastes and expectations of local buyers.

D. Strategic Alliances and Joint Ventures with Foreign Partners
   1. Strategic alliances, joint ventures, and other cooperative agreements with foreign companies are a favorite and potentially fruitful means for entering a foreign market or strengthening a firm’s competitiveness in world markets.
      a. Companies intent on international expansion commonly look to alliances and joint ventures as a means of strengthening their ability to compete across a wider geographical area.
      b. Cross-border alliances capture economies of scale in production and/or marketing.
      c. Cross-border alliances is to fill gaps in technical expertise and/or knowledge of local markets.
      d. Distribution facilities and dealer networks can be shared, thus mutually strengthening their access to buyers.
      e. Cross-border allies can direct their competitive energies more toward mutual rivals and less toward one another; teaming up may help them close the gap on leading companies.
      f. Companies desiring to enter a new foreign market often conclude that alliances with local companies are an effective way to establish working relationships with key officials in the host country government.
      g. Alliances can be a particularly useful way for companies across the world to gain agreement on important technical standards;
Core Concept

Cross-border alliances enable a growth-minded company to widen its geographic coverage and strengthen its competitiveness in foreign markets while, at the same time, offering flexibility and allowing a company to retain some degree of autonomy and operating control.

2. Illustration Capsule 7.1, Five Examples of Cross-Border Strategic Alliances, relates the experiences of various companies with cross-border strategic alliances.

Illustration Capsule 7.1, Five Examples of Cross-Border Strategic Alliances

Discussion Question: 1. How is Airbus able to compete with Boeing for world leadership in large commercial aircraft? If Airbus were an independent firm that was not formed of an alliance, do you think it could have successfully entered Boeing’s industry?

Answer: Airbus is able to compete because of the pooling of resources from several companies in different countries throughout Europe. The alliance infused Airbus with resources and knowledge for competing with Boeing. The company likely would not have been successful on the same scale if it were independently started and was trying to break into the industry without the alliance’s resources to back it up.

3. The Risk of Strategic Alliances with Foreign Partners

a. The communication, trust-building, and coordination costs are high in terms of management time. It is not unusual for there to be little personal chemistry among some of the key people on whom success of failure of the alliance depends.

b. Even if allies are able to develop productive, personal relationships, they can still have trouble reaching mutually agreeable ways to deal with key issues or to resolve differences. There is a natural tendency for allies to struggle to collaborate effectively in competitively sensitive areas, thus spawning suspicions on both sides about forthright exchanges of information and expertise.

c. There is the thorny problem of getting alliance partners to sort through issues and reach decision fast enough to stay abreast of rapid advances in technology or fast-changing market conditions.

d. It requires many meeting of many people working in good faith to iron out what is to be shared, what is to remain proprietary, and how the cooperative arrangements will work.

e. Even if the alliance becomes a win-win proposition for both parties, there is danger of becoming overly dependent on foreign partners for essential expertise and competitive capabilities.

f. One of the lessons about cross-border alliances is that they are more effective in helping a company to achieve a beachhead of new opportunity in world markets than they are in enabling a company to achieve and sustain global market leadership.

Core Concept

Strategic alliances are more effective in helping establish a beachhead of new opportunity in world markets than in achieving and sustaining global leadership.
4. **When a Cross-Border Alliance May Be Unnecessary**
   
a. One cannot automatically presume that a company needs the wisdom and resources of a local partner to guide it through the process of successfully entering the markets of foreign countries.

   b. Experienced multinationals often discover that local partners do not always have adequate local market knowledge

E. **Choosing between a Localized Multicountry Strategy and a Global Strategy**

1. **Think-Local, Act-Local Approaches to Strategy Making**:
   
a. The bigger the differences in buyer tastes, cultural traditions, and marker conditions in different countries, the stronger the case for a think-local, act-local approach to strategy making.

   b. **The strength of this approach is that the company’s actions and business approach are deliberately crafted to accommodate differing tastes and expectations of buyers in each country and to stake out the most attractive market positions vis-à-vis local competitors.**

2. **Think-Global, Act-Global Approaches to Strategy Making**
   
a. A global strategy sells the same products under the same brand names everywhere, uses much of the same distribution channels in all countries, and competes on the basis of the same capabilities and marketing approaches worldwide.

   b. This strategic theme prompts company managers to integrate and coordinate the company’s strategic moves worldwide and to expand into most if not all nations where there is significant buyer demand.

3. **Think-Global, Act-Local Approaches to Strategy Making**
   
a. This middle-ground approach entails using the same basic competitive theme in each country but allowing local managers the latitude to (1) incorporate whatever country-specific variations in product attributes are needed to best satisfy local buyers and (2) make whatever adjustments in production, distribution, and marketing are needed to be responsive to local market conditions and compete successfully against local rivals.

4. **Figure 7.1, A Company’s Strategic Options for Dealing with Cross-Country Variations in Buyer Preferences and Market Conditions**, provides a point-by-point comparison of multicountry versus global strategies.
V. The Quest for Competitive Advantage in Foreign Markets

Illustration Capsule 7.2, Multicountry Strategies at Electronic Arts and Coca-Cola and BP.

Discussion Question: 1. Describe EA’s strategy as either localization or globalization.

Answer: EA uses a localization strategy to fit its games to local markets. It develops games that are locally targeted in specific regions to match with the games’ material and content. It produces games in multiple languages, on multiple platforms, and markets them in up to 75 different countries.

1. There are three ways in which a firm can gain competitive advantage or offset domestic disadvantages by expanding outside its domestic markets:
   a. Use location to lower costs or achieve greater product differentiation
   b. Transfer competitively valuable competencies and capabilities from its domestic markets to foreign markets
   c. Use cross-border coordination in ways that a domestic-only competitor cannot

A. Using Location to Build Competitive Advantage

1. To use location to build competitive advantage, a company must consider two issues:
   a. Whether to concentrate each activity it performs in a few select countries or to disperse performance of the activity to many nations
   b. In which countries to locate particular activities

Core Concept

Companies that compete multi-nationally can pursue competitive advantages in world markets by locating their value chain activities in whatever nations prove most advantageous.

2. When to Concentrate Activities in a Few Locations
   a. When the costs of manufacturing or other activities are significantly lower in some geographic locations than in others
   b. When there are significant scale economies
   c. When there is a steep learning curve associated with performing an activity in a single location
   d. When certain locations have superior resources, allow better coordination of related activities, or offer other valuable advantages

3. When to Disperse Activities Across Many Locations
   a. In several instances, dispersing activities is more advantageous than concentrating them.
   b. The classic reason for locating an activity in a particular country is low-cost.
B. Using Cross-Border Transfer of Competences and Capabilities to Build Competitive Advantage

1. Transferring competences, capabilities, and resource strengths from country to country contributes to the development of broader and deeper competences and capabilities—ideally helping a company achieve dominating depth in some competitively valuable area. Dominating depth in a competitively valuable capability, resource, or value chain activity is a strong base for sustainable competitive advantage over multinational or global competitors and especially so over domestic-only competitors.

C. Using Cross-Border Coordination to Build Competitive Advantage

1. Coordinating company activities across different countries contributes to sustainable competitive advantage in several different ways:
   a. Multinational and global competitors can choose where and how to challenge rivals
   b. Using Internet technology applications, companies can collect ideas for new and improved products from customers and sales and marketing personnel all over the world

VI. Strategies to Compete in the Markets of Emerging Countries

Illustration Capsule 7.3, Yum! Brands’ Strategy for Becoming the Leading Food Service Brand in China

Discussion Question: 1. Describe Yum! Brands’ strategy as for becoming the leading food services brand in China.

Answer: In addition to adopting its menu to local tastes by adding new units, Yum! Brands also adapted the restaurant ambience to appeal to local consumer preferences and behavior. The company’s 3,100 units in China represented only 2 restaurants per 1 million people. It is believed that continued expansion in the number of restaurants and additional menu refinements would allow its operating profit from restaurants in China to account for 40 percent of system wide operating profits by 2017.

A. Strategy Options for Emerging Country Markets

1. Prepare to compete on the basis of low price.

2. Be prepared to modify aspects of the company’s business model or strategy to accommodate local circumstances (but not so much that the company loses the advantage of global scale and global branding).

3. Try to change the local market to better match the way the company does business elsewhere.

4. Stay away from emerging markets where it is impractical or uneconomic to modify the company’s business model to accommodate local circumstances.

Core Concept

Profitability in emerging markets rarely comes quickly or easily—new entrants have to adapt their business models and strategies to local conditions and be patient in earning a profit.

B. Defending against Global Giants: Strategies for Local Companies in Emerging Markets

1. Develop business models that exploit shortcomings in local distribution networks or infrastructure.
2. Utilize keen understanding of local customer needs and preferences to create customized products or services.

3. Take advantage of low-cost labor and other competitively important local work-force qualities.

4. Use acquisition and rapid growth strategies to better defend against expansion-minded multinationals.

5. Transfer company expertise to cross-border markets and initiate actions to contend on a global level.

Illustration Capsule 7.4, How Ctrip Successfully Defended against Multinationals to Become China’s Largest Online Travel Agency

Discussion Question: 1. How did Ctrip use a combination of the above five strategies to become the largest travel consolidator and online travel agent.

Answer: Ctrip took advantage of the lack of infrastructure (no national ticketing agency in China and of national or global hotel chains) to create its own proprietary data base to provide travel information for up to 100,000 customers per day. Since the Chinese prefer paper tickets, and only 30 percent of customers use the internet, the company is able to hire low cost couriers to collect payments and deliver tickets.
Chapter 8 moves up one level in the strategy-making hierarchy, from strategy making in a single business enterprise to strategy making in a diversified enterprise. The chapter begins with a description of the various paths through which a company can become diversified and provides an explanation of how a company can use diversification to create or compound competitive advantage for its business units. The chapter also examines the techniques and procedures for assessing the strategic attractiveness of a diversified company’s business portfolio and surveys the strategic options open to already-diversified companies.

LECTURE OUTLINE

I. Introduction

1. In most diversified companies, corporate level executives delegate considerable strategy-making authority to the heads of each business, usually giving them the latitude to craft a business strategy suited to their particular industry and competitive circumstances and holding them accountable for producing good results. However, the task of crafting a diversified company’s overall or corporate strategy falls squarely on the shoulders of top-level corporate executives.

2. Devising a corporate strategy has four distinct facets:
   a. Picking new industries to enter and deciding on the means of entry
   b. Initiating actions to boost the combined performances of the businesses the firm has entered
   c. Pursuing opportunities to leverage cross-business value chain relationships and strategic fits into competitive advantage
   d. Establishing investment priorities and steering corporate resources into the most attractive business units

II. When to Diversify

1. Diversifying into new industries always merits strong consideration whenever a single-business company encounters diminishing market opportunities and stagnating sales in its principle business.

2. There are four other instances in which a company becomes a prime candidate for diversifying:
   a. When it spots opportunities for expanding into industries whose technologies and products complement its present business.
   b. When it can leverage existing competencies and capabilities by expanding into businesses where these same resource strengths are key success factors and valuable competitive assets.
c. When diversifying into closely related businesses opens new venues for reducing costs.

d. When it has a powerful and well-known brand name that can be transferred to the products of other businesses and thereby used as a lever for driving up the sales and profits of such a business.

III. Building Shareholder Value: The Ultimate Justification for Diversifying

1. Diversification must do more for a company than simply spread its risk across various industries.

2. For there to be reasonable expectations that a diversification move can produce added value for shareholders, the move must pass three tests:
   a. The industry attractiveness test—The industry chosen for diversification must be attractive enough to yield consistently good returns on investment.
   b. The cost of entry test—The cost to enter the target industry must not be so high as to erode the potential for profitability.
   c. The better-off test—Diversifying into a new business must offer potential for the company’s existing businesses and the new business to perform better together under a single corporate umbrella than they would perform operating as independent stand-alone businesses.

3. Diversification moves that satisfy all three tests have the greatest potential to grow shareholder value over the long term. Diversification moves that can pass only one or two tests are suspect.

Core Concept

Creating added value for shareholders via diversification requires building a multibusiness company where the whole is greater than the sum of its parts.

IV. Strategies for Entering New Businesses

1. Entry into new businesses can take any of three forms:
   a. Acquisition
   b. Internal start-up
   c. Joint ventures/strategic partnerships

A. Acquisition of an Existing Business

1. Acquisition is the most popular means of diversifying into another industry.

2. The big dilemma an acquisition-minded firm faces is whether to pay a premium price for a successful firm or to buy a struggling company at a bargain price.

B. Internal Start-Up

1. Achieving diversification through internal start-up involves building a new business subsidiary from scratch.

2. This entry option takes longer than the acquisition option and poses some hurdles.

3. Generally, forming a start-up subsidiary to enter a new business has appeal only when:
   a. The parent company already has in-house most or all of the skills and resources it needs to piece together a new business and compete effectively
b. There is ample time to launch the business
c. Internal entry has lower entry costs than entry via acquisition
d. The targeted industry is populated with many relatively small firms such that the new start-up does not have to compete head-to-head against larger, more powerful rivals
e. Adding new production capacity will not adversely impact the supply-demand balance in the industry
f. Incumbent firms are likely to be slow or ineffective in responding to a new entrant’s efforts to crack the market

Core Concept
The biggest drawback to entering an industry by forming an internal start-up are the costs of overcoming entry barriers and the extra time it takes to build a strong and profitable competitive position.

C. Joint Ventures

1. Joint ventures typically entail forming a new corporate entity owned by the partners.

2. A strategic partnership or joint venture can be useful in at least three types of situations:
   a. To pursue an opportunity that is too complex, uneconomical, or risky for a single organization to pursue alone
   b. When the opportunities in a new industry require a broader range of competencies and know-how than any one organization can marshal
   c. To diversify into a new industry when the diversification move entails having operations in a foreign country

3. However, partnering with another company has significant drawbacks due to the potential for conflicting objectives, disagreements, over how to best operate the venture, culture clashes, and so on.

4. Joint ventures are generally the least durable of the entry options, usually lasting only until the partners decide to go their own ways.

V. Choosing the Diversification Path: Related Versus Unrelated Businesses

1. Once the decision is made to pursue diversification, the firm must choose whether to diversify into related businesses, unrelated businesses, or some mix of both. Businesses are said to be related when their value chains possess competitively valuable cross-business value chain matchups or strategic fits. Businesses are said to be related when their value chains possess competitively valuable cross-business relationships that present opportunities for the businesses to perform better under the same corporate umbrella than they could by operating as stand-alone entities.

Core Concepts
Related businesses possess competitively valuable cross-business value chain matchups; unrelated businesses have very dissimilar value chains, containing no competitively useful cross-business relationships.

2. Figure 8.1, Strategy Alternatives for a Company Looking to Diversify, looks at alternatives for companies desiring to diversify.
VI. The Case for Diversifying into Related Businesses

1. A related diversification strategy involves building the company around businesses whose value chains possess competitively valuable strategic fits.

2. **Figure 8.2, Related Businesses Possess Related Value Chain Activities and Competitively Valuable Strategic Fits**, looks at related businesses and strategic fits.

3. **Strategic fit** exists whenever one or more activities comprising the value chains of different businesses are sufficiently similar as to present opportunities for:
   a. Transferring competitively valuable expertise or technological know-how or other capabilities from one business to another
   b. Combining the related activities of separate businesses into a single operation to achieve lower costs
   c. Exploiting common use of a well known brand name
   d. Cross-business collaboration to create competitively valuable resource strengths and capabilities

**Core Concept**

**Strategic fit** exists when the value chains of different businesses present opportunities for cross-business resource transfer, lower costs through combining the performance of related value chain activities, cross-business use of a potent brand name, and cross-business collaboration to build new or stronger competitive capabilities.

4. Related diversification thus has strategic appeal from several angles. It allows a firm to reap the competitive advantage benefits of skills transfer, lower costs, common brand names, and/or stronger competitive capabilities and still spread investor risks over a broad business base.

A. Identifying Cross-Business Strategic Fits Along the Value Chain

1. Cross-business strategic fits can exist anywhere along the value chain – in R&D and technology activities, in supply chain activities and relationships with suppliers, in manufacturing, in sales and marketing, in distribution activities, or in administrative support activities.

2. **Strategic Fits in R&D and Technology Activities**: Diversifying into businesses where there is potential for sharing common technology, exploiting the full range of business opportunities associated with a particular technology and its derivatives, or transferring technological know-how from one business to another has considerable appeal.

3. **Strategic Fits in Supply Chain Activities**: Businesses that have supply chain strategic fits can perform better together because of the potential for skills transfer in procuring materials, greater bargaining power in negotiating with common suppliers, the benefits of added collaboration with common supply chain partners, and/or added leverage with shippers in securing volume discounts on incoming parts and components.

4. **Manufacturing-Related Strategic Fits**: Cross-business strategic fits in manufacturing-related activities can represent an important source of competitive advantage in situations where a diversifier’s expertise in quality manufacture and cost-efficient production methods can be transferred to another business.

5. **Distribution-Related Strategic Fits**: Businesses with closely related distribution activities can perform better together than apart because of potential cost savings in sharing the same distribution facilities or using many of the same wholesale distributors and retail dealers to access customers.
6. **Strategic Fits in Sales and Marketing:** Various cost-saving opportunities spring from diversifying into businesses with closely related sales and marketing activities. Opportunities include:

   a. Sales costs can be reduced by using a single sales force for the products of both businesses rather than having separate sales forces for each business
   
   b. After-sale service and repair organizations for the products of closely related businesses can often be consolidated into a single operation
   
   c. There may be competitively valuable opportunities to transfer selling, merchandising, advertising, and product differentiation skills from one business to another

7. **Strategic Fits in Managerial and Administrative Support Activities:** Often, different businesses require comparable types of skills, competencies, and managerial know-how, thereby allowing know-how in one line of business to be transferred to another. Likewise, different businesses can often use the same administrative and customer service infrastructure.

8. **Illustration Capsule 8.1, Related Diversification at Darden Restaurants, L’Oreal, Johnson & Johnson, and PepsiCo,** lists the businesses of four companies that have pursued a strategy of related diversification.

Illustration Capsule 8.1, Related Diversification at Darden Restaurants, L’Oreal, Johnson & Johnson, and PepsiCo

**Discussion Question:** 1. Pick one company in this example and discuss the cross-business opportunities it has for transferring skills/technology, combining related value chain activities, leveraging a well-respected brand name, and/or establishing collaboration to create new resource strengths and capabilities.

**Answer:** Students could pick from among Darden Restaurants, L’Oreal, Johnson & Johnson, and PepsiCo. Darden is a good example of transferring skills and combining the related value chain activities to achieve lower costs, especially the administrative functions. L’Oreal is a good example of a company establishing cross-business collaboration to create new strengths and capabilities. In some cases it also combined value chain activities, including, perhaps, manufacturing and R&D. J&J is a great example of leveraging a well-respected brand name. PepsiCo provides a good example of combining related value chain activities, especially in production and distribution of its products.

B. **Strategic Fit, Economies of Scope, and Competitive Advantage**

1. What makes related diversification an attractive strategy is the opportunity to convert the strategic fit relationships between the value chains of different businesses into a competitive advantage.

2. **Economies of Scope: A Path to Competitive Advantage:** One of the most important competitive advantages that a related diversification strategy can produce is lower costs than competitors. Related businesses often present opportunities to consolidate certain value chain activities or use common resources and thereby eliminate costs. Such cost savings are termed **economies of scope** —a concept distinctly different from economies of scale. Economies of scale are cost savings that accrue directly from a larger-sized operation. Economies of scope stem directly from cost-saving strategic fits along the value chains of related businesses. Most usually, economies of scope are the result of two or more businesses sharing technology, performing R&D together, using common manufacturing or distribution facilities, sharing a common sales force or distributor/dealer network, or using the same established brand name and/or sharing the same administrative infrastructure. The greater the economies associated with cost-saving strategic fits, the greater the potential for a related diversification strategy to yield a competitive advantage based on lower costs.
3. **From Competitive Advantage to Added Profitability and Gains in Shareholder Value:** Armed with the competitive advantages that come from economies of scope and the capture of other strategic fit benefits, a company with a portfolio of related businesses is poised to achieve a 1+1=3 financial performance and the hoped for gains in shareholder value.

**Core Concept**

Diversifying into related businesses where competitively valuable strategic fit benefits can be captured puts sister businesses in position to perform better financially as part of the same company than they could have performed as independent enterprises, thus providing a clear avenue for boosting shareholder value.

VII. The Case for Diversifying into Unrelated Businesses

1. Companies that pursue a strategy of unrelated diversification generally exhibit a willingness to diversify into any industry where there is potential for a company to realize consistently good financial results.

2. The basic premise of unrelated diversification is that any company that can be acquired on good financial terms and that has satisfactory earnings potential represents a good acquisition and a good business opportunity. Such companies are frequently labeled conglomerates.

3. **Figure 8.3, Unrelated Businesses Have Unrelated Value Chains and No Strategic Fits,** looks at this type of diversification.

4. The company spends much time and effort screening new acquisition candidates and deciding whether to keep or divest existing businesses, using such criteria as:
   a. Whether the business can meet corporate targets for profitability and return on investment
   b. Whether the business is an industry with attractive growth potential
   c. Whether the business is big enough to contribute significantly to the parent firm’s bottom line
   d. Whether the business has burdensome capital requirements
   e. Whether the business is plagued with chronic union difficulties and labor problems.
   f. Whether there is industry vulnerability to recession, inflation, high interest rates, or shifts in government policy

5. Three types of acquisition candidates are usually of particular interest
   a. Companies that have bright growth prospects but are short on investment capital
   a. Companies whose assets are undervalued
   b. Companies that are financially distressed

6. A key issue in unrelated diversification is how wide a net to cast in building a portfolio of unrelated businesses.
7. **Illustration Capsule 8.2, Unrelated Diversification at General Electric, Fortune Brands, and United Technologies** lists the businesses of three companies that have pursued unrelated diversification.

### Illustration Capsule 8.2, Unrelated Diversification at General Electric, Fortune Brands, and United Technologies

**Discussion Question:** 1. Pick one of the four companies listed and explain why you think that company has an unrelated diversification strategy.

**Answer:** Students can pick from GE, Fortune Brands and United Technologies. In their answers, students should reflect an understanding of the basic premise of unrelated diversification, which is that any company that can be acquired on good financial terms and that has satisfactory growth and earnings potential represents a good acquisition and a good business opportunity for the diversifying enterprise.

### A. The Merits of an Unrelated Diversification Strategy

1. A strategy of unrelated diversification has appeal from several angles:
   a. Business risk is scattered over a set of truly diverse industries
   b. The company’s financial resources can be employed to maximum advantage by investing in whatever industries offer the best profit prospects
   c. To the extent that corporate managers are exceptionally astute at spotting bargain-priced companies with big upside profit potential, shareholder wealth can be enhanced by buying distressed businesses at a low price, turning their operations around fairly quickly with infusions of cash and managerial know-how supplied by the parent company
   d. Company profitability may prove somewhat more stable over the course of economic upswings and downswings

2. Unrelated diversification certainly merits consideration when a firm is trapped in or overly dependent on an endangered or unattractive industry.

3. **Building Shareholder Value via Unrelated Diversification:** Building shareholder value via unrelated diversification ultimately hinges on the business acumen of corporate executives. In more specific terms, this means that corporate level executives must:
   a. Do a superior job of diversifying into new businesses that can produce consistently good earnings and returns on investment
   b. Do an excellent job of negotiating favorable acquisition prices
   c. Do such a good job overseeing the firm’s business subsidiaries and contributing to how they are managed that the subsidiaries perform at a higher level than they would otherwise be able to do
   d. Shift corporate resources out of businesses where profit opportunities are dim and into businesses with the potential for above-average earnings growth and returns on investment
   e. Discern when it is the right time to sell a particular business
B. The Drawbacks of Unrelated Diversification

1. Unrelated diversification strategies have two important negatives that undercut the positives:
   a. Very demanding managerial requirements
   b. Limited competitive advantage potential

Core Concept
The two biggest drawbacks to unrelated diversification are the difficulties of competently managing many different businesses and being without the added source of competitive advantage that cross-business strategic fit provides.

2. Demanding Managerial Requirements: Successfully managing a set of fundamentally different businesses operating in fundamentally different industry and competitive environments is a very challenging and exceptionally difficult proposition for corporate level managers.

3. The greater the number of businesses a company is in and the more diverse those businesses are, the harder it is for corporate managers to:
   a. Stay abreast of what is happening in each industry and each subsidiary and thus judge whether a particular business has bright prospects or is headed for trouble
   b. Know enough about the issues and problems facing each subsidiary to pick business-unit heads having the requisite combination of managerial skills and know-how
   c. Be able to tell the difference between those strategic proposals of business-unit managers that are prudent and those that are risky or unlikely to succeed
   d. Know what to do if a business unit stumbles and its results suddenly head downhill

4. As a rule, the more unrelated businesses that a company has diversified into, the more corporate executives are reduced to “managing by the numbers.”

5. Overseeing a set of widely diverse businesses may turn out to be much harder than it sounds. In practice, comparatively few companies have proved that they have top management capabilities that are up to the task. Far more companies have failed at unrelated diversification than have succeeded.

Core Concept
Relying solely on the expertise of corporate executives to wisely manage a set of unrelated businesses is a much weaker foundation for enhancing shareholder value than is a strategy of related diversification where corporate performance can be boosted by competitively valuable cross-business strategic fits.

6. Limited Competitive Advantage: Unrelated diversification offers no potential for competitive advantage beyond that of what each individual business can generate on its own.

7. Without the competitive advantage potential of strategic fits, consolidated performance of an unrelated group of businesses stands to be little or no better than the sum of what the individual business units could achieve if they were independent.

VII. Combination Related-Unrelated Diversification Strategies

1. There is nothing to preclude a company from diversifying into both related and unrelated businesses.
2. Indeed, in actual practice the business makeup of diversified companies varies considerably:
   a. Dominant-business enterprises—one major core business accounts for 50 to 80 percent of total revenues and a collection of small related or unrelated businesses accounts for the remainder
   b. Narrowly diversified—2 to 5 related or unrelated businesses
   c. Broadly diversified—wide ranging collection of related businesses, unrelated businesses, or a mixture of both

3. **Figure 8.4, Identifying a Diversified Company’s Strategy**, indicates what to look for in identifying the main elements of a company’s diversification strategy.

**VIII. Evaluating the Strategy of a Diversified Company**

1. The procedure for evaluating a diversified company’s strategy and deciding how to improve the company’s performance involves six steps:
   a. Assessing industry attractiveness
   b. Assessing business-unit competitive strength
   c. Checking the competitive advantage potential of cross-business strategic fits
   d. Checking for resources fit
   e. Ranking the business units on the basis of performance and priority for resource allocation
   f. Crafting new strategic moves to improve overall corporate performance

A. **Step 1: Evaluating Industry Attractiveness**

1. A principal consideration in evaluating a diversified company’s business makeup and the caliber of its strategy is the attractiveness of the industries in which it has business operations. Answers to several questions are required:
   a. Does each industry the company has diversified into represent a good business for the company to be in?
   b. Which of the company’s industries are most attractive and which are least attractive?
   c. How appealing is the whole group of industries in which the company has invested?

2. **Calculating Industry Attractiveness Scores for Each Industry into Which the Company Has Diversified**: A simple and reliable analytical tool involves calculating quantitative industry attractiveness scores, which can then be used to gauge each industry’s attractiveness, rank the industries from most to least attractive, and make judgments about the attractiveness of all the industries as a group. **Table 8.1, Calculating Weighted Industry Attractiveness Scores**, provides a sample calculation. The following measures of industry attractiveness are likely to come into play for most companies:
   a. Market size and projected growth rate
   b. The intensity of competition
   c. Emerging opportunities and threats
   d. The presence of cross-industry strategic fits
   e. Resource requirements
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4. The Difficulties of Calculating Industry Attractiveness Scores
   
   a. There are two hurdles to calculating industry attractiveness scores.
      
      — One is deciding on appropriate weights for the industry attractiveness measure.
      
      — The second hurdle is gaining sufficient command for the industry to assign accurate and objective ratings.

   b. Despite the hurdles, calculating industry attractiveness scores is a systematic and reasonably reliable method for ranking a diversified company’s industries from most to least attractive.

B. Step 2: Evaluating Business-Unit Competitive Strength

   1. The second step in evaluating a diversified company is to appraise how strongly positioned each of its business units are in their respective industry.

   2. Calculating Competitive Strength Scores for Each Business Unit: Quantitative measures of each business unit’s competitive strength can be calculated using a procedure similar to that for measuring industry attractiveness. The following factors are in quantifying the competitive strength of a diversified company’s business subsidiaries:

      a. Relative market share
      
      b. Costs relative to competitors’ costs
      
      c. Ability to match or beat rivals on key product attributes
      
      d. Ability to benefit from strategic fits with sister businesses
      
      e. Ability to exercise bargaining leverage with key suppliers or customers
      
      f. Caliber of alliances and collaborative partnerships with suppliers and/or buyers
      
      g. Brand image and reputation
      
      h. Competitively valuable capabilities
      
      i. Profitability relative to competitors

   3. After settling on a set of competitive strength measures that are well matched to circumstances of the various business units, weights indicating each measure’s importance need to be assigned. As before, the importance weights must add up to 1. Each business unit is then rated on each of the chosen strength measures, using a rating scale of 1 to 10. Weighted strength ratings are calculated by multiplying the business unit’s rating on each strength by the assigned weights. The sum of weighted ratings across all the strength measures provides a quantitative measure of a business unit’s overall market strength and competitive standing.
4. **Interpreting the Competitive Strength Scores:** Business units with competitive strength ratings above 6.7 on a rating scale of 1 to 10 are strong market contenders in their industries.

5. **Using a Nine-Cell Matrix to Simultaneously Portray Industry Attractiveness and Competitive Strength:** The industry attractiveness and business strength scores can be used to portray the strategic positions of each business in a diversified company. Industry attractiveness is plotted on the vertical axis and competitive strength on the horizontal axis. A nine-cell grid emerges from dividing the vertical axis into three regions and the horizontal axis into three regions. Figure 8.5, *A Nine-Cell Industry Attractiveness-Competitive Strength Matrix*, depicts this tool. Each business unit is plotted on the nine-cell matrix according to its overall attractiveness score and strength score and then shown as a “bubble.” The location of the business units on the attractiveness-strength matrix provides valuable guidance in deploying corporate resources to the various business units. In general, a diversified company’s prospects for good overall performance are enhanced by concentrating corporate resources and strategic attention on those business units having the greatest competitive strength and positioned in highly attractive industries.

6. The nine-cell attractiveness-strength matrix provides clear, strong logic for why a diversified company needs to consider both the industry attractiveness and business strength in allocating resources and investment capital to its different businesses.

C. **Step 3: Checking the Competitive Advantage Potential of Cross-Business Strategic Fits**

1. Checking the competitive advantage potential of cross-business strategic fits involves searching and evaluating how much benefit a diversified company can gain from four types of value chain matchups:
   a. Opportunities to combine the performance of certain activities thereby reducing costs
   b. Opportunities to transfer skills, technology, or intellectual capital from one business to another
   c. Opportunities to share the use of a well-respected brand name
   d. Opportunities for sister businesses to collaborate in creating valuable new competitive capabilities

2. **Core Concept**
   Sister businesses possess *resource fit* when they add to a company’s overall resource strengths and when a company has adequate resources to support their requirements.

   2. **Figure 8.6, Identifying the Competitive Advantage Potential of Cross-Business Strategic Fits**, illustrates the process of searching for competitively valuable cross-business strategic-fits and value chain matchups.

3. More than just strategic fit identification is needed. The real test is what competitive value can be generated from these fits.

D. **Step 4: Checking for Resource Fit**

1. The businesses in a diversified company’s lineup need to exhibit good resource fit.

2. Resource fit exists when:
   a. Businesses add to a company’s resource strengths, either financially or strategically
   b. A company has the resources to adequately support its businesses as a group without spreading itself too thin
3. **Financial Resource Fits: Cash Cows versus Cash Hogs:** Different businesses have different cash flow and investment characteristics. For example, business units in rapidly growing industries are often *cash hogs*—the annual cash flows they are able to generate from internal operations are not big enough to fund their expansion. Business units with leading market positions in mature industries may be *cash cows*—businesses that generate substantial cash surpluses over what is needed for capital reinvestment and competitive maneuvers to sustain their present market position.

### Core Concept
A **cash hog** business generates cash flows that are too small to fully fund its operations and growth; a cash hog requires cash infusion to provide additional working capital and finance new capital investment.

### Core Concept
A **cash cow** generates cash flows over and above its internal requirements, thus providing a corporate parent with funds for investing in cash hogs, financing new acquisitions, or paying dividends.

4. Viewing the diversified group of businesses as a collection of cash flows and cash requirements is a major step forward in understanding what the financial ramifications of diversification are and why having businesses with good financial resource fit is so important.

5. **Star businesses** have strong or market-leading competitive positions in attractive, high-growth markets and high levels of profitability and are often the cash cows of the future.

E. **Other Tests of Resource Fit.**

1. Does the business adequately contribute to achieving companywide performance targets?

2. Does the company have adequate financial strength to fund its different businesses and maintain a healthy credit?

3. Does the company have (or can it develop) the specific resource strengths and competitive capabilities needed to be successful in each of its businesses?

4. Are recently acquired businesses acting to strengthen a company’s resource base and competitive capabilities or are they causing its competitive and managerial resources to be stretched too thin?

5. **A Cautionary Note about Transferring Resources from One Business to Another:** Hitting a home run in one business does not mean a company can easily enter a new business with similar resource requirements and hit a second home run.

F. **Step 5: Ranking the Performance Prospects of Business Units and Assigning a Priority for Resource Allocation**

1. Once a diversified company’s strategy has been evaluated from the perspectives of industry attractiveness, competitive strength, strategic fit, and resource fit, the next step is to rank the performance prospects of the businesses from best to worst and determine which businesses merit top priority for new investments by the corporate parent.

2. The most important considerations in judging business-unit performance are sales growth, profit growth, contribution to company’s earnings, and the return on capital.

3. The industry attractiveness/business strength evaluations provide a basis for judging a business’s prospects. It is a short step from ranking the prospects of business units to drawing conclusions about whether the company as a whole is capable of strong, mediocre, or weak performance.
4. The rankings of future performance generally determine what priority the corporate parent should give to each business in terms of resource allocation.

5. Business subsidiaries with the brightest profit and growth prospects and solid strategic and resource fits generally should head the list for corporate resource support.

6. Figure 8.7, The Chief Strategic and Financial Options for Allocating a Diversified Company’s Financial Resources, shows the chief strategic and financial options for allocating a diversified company’s financial resources.

G. Step 6: Crafting New Strategic Moves to Improve Overall Corporate Performance

1. The diagnosis and conclusions flowing from the five preceding analytical steps set the agenda for crafting strategic moves to improve a diversified company’s overall performance. The strategic options boil down to five broad categories of actions: (pictured in Figure 8.8, A Company’s Five Main Strategic Alternatives after it Diversifies)
   a. Sticking closely with the existing business lineup and pursuing the opportunities it presents
   b. Broadening the company’s diversification base by making new acquisitions in new industries
   c. Divesting certain businesses and retrenching to a narrower diversification base
   d. Restructuring the company’s business lineup and putting a whole new face on the company’s business makeup
   e. Pursuing multinational diversification and striving to globalize the operations of several of the company’s business units.

2. Sticking Closely with the Existing Business Lineup makes sense when the company’s present businesses offer attractive growth opportunities and can be counted on to generate good earnings and cash flow.

3. In the event that corporate executives are not entirely satisfied with the opportunities they see in the company’s present set of businesses and conclude that changes in the company’s direction and business makeup are in order, they can opt for any of the four strategic alternatives listed above.

4. Broadening a Diversified Company’s Business Base—Motivating factors to build positions in new industries
   a. Sluggish growth the makes the potential revenue and profit boost of a newly acquired business look attractive
   b. Vulnerability to seasonal or recessionary influences or to threats from emerging new technologies
   c. The potential for transferring resources and capabilities to other related or complementary businesses
   d. Rapidly changing conditions in one or more of a company’s core businesses brought on by technological, legislative or new product innovations
   e. To complement and strengthen the market position and competitive capabilities of one or more of its present businesses.

5. Reasons for Divesting Some Businesses and Retrenching to a Narrower Diversification Base:
   a. Retrenching to a narrower diversification base is usually undertaken when top management concludes that its diversification strategy has ranged too far afield and that the company can
improve long term performance by concentrating on a smaller number of core businesses and industries.

b. Market conditions in a once-attractive business have badly deteriorated

c. A business lacks adequate strategic or resource fit, either because it’s a cash cow or it is weakly positioned in the industry.

d. A diversification move that seems sensible from a strategic-fit stand-point turns out to be a poor cultural fit.

e. To complement and strengthen the market position and competitive capabilities of one or more of its present businesses.

**Core Concept**

Focusing corporate resources on a few core and mostly related businesses avoids the mistake of diversifying so broadly that resources and management attention are stretched too thin.

**Illustration Capsule 8.3, Managing Diversification at Johnson & Johnson—The Benefits of Cross-Business Strategic Fits**

**Discussion Question:** 1. Discuss the view held by Johnson & Johnson’s corporate management about the benefits of collaboration with others in its various business lines.

**Answer:** J&J’s corporate management believes close collaboration among people in diagnostics, medical devices, and pharmaceuticals businesses, where numerous cross-business strategic fits exist, will give it an edge on competitors, most of whom cannot match the company’s breadth and depth of expertise.

6. **The Two Options for Divesting a Business: Selling It or Spinning It Off as an Independent Company:** Selling a business outright to another company is far and away the most frequently used option for divesting a business. Sometimes a business selected for divestiture has ample resource strengths to compete successfully on its own. In such cases, a corporate parent may elect to spin the unwanted business off as a financially and managerially independent company. When a corporate parent decides to spin off one of its businesses as a separate company, there is the issue of whether or not to retain partial ownership. Selling a business outright requires finding a buyer. This can prove hard or easy, depending on the business. Liquidation is obviously a last resort.

7. **Restructuring a Company’s Business Lineup through a Mix of Divestitures and New Acquisition:** Restructuring strategies involve divesting some businesses and acquiring others to put a whole new face on the company’s business lineup. Performing radical surgery on the group of businesses a company is in becomes an appealing strategy alternative when a diversified company’s financial performance is being squeezed or eroded by:

   a. Too many businesses in slow-growth, declining, low-margin, or otherwise unattractive industries

   b. Too many competitively weak businesses

   c. Ongoing declines in the market share of one or more major business units that are falling prey to more market-savvy competitors
d. An excessive debt burden with interest costs that eat deeply into profitability

e. Ill-chosen acquisitions that have not lived up to expectations

8. Restructuring can also be mandated by the emergence of new technologies that threaten the survival of one or more of a diversified company’s important businesses or by the appointment of a new CEO who decides to redirect the company.

**Core Concept**

Restructuring involves divesting some businesses and acquiring others so as to put a whole new face on the company’s business lineup.

D. Pursuing Multinational Diversification

1. The distinguishing characteristics of a multinational diversification strategy are a diversity of businesses and a diversity of national markets.

2. The geographic operating scope of individual businesses within a diversified multinational company can range from one country only to several countries to many countries to global.

3. Illustration Capsule 8.4, The Corporate Restructuring Strategy That Made VF the Star of the Apparel Industry

**Illustration Capsule 8.4, The Corporate Restructuring Strategy that Made VF the Star of the Apparel Industry**

**Discussion Question:** 1. Describe the restructuring strategy which made VF the leader in profits and innovation in its industry

**Answer:** VF divested itself of slow-growing businesses, acquired brands that connected with the way people lived, did years of research before acquiring companies and developed a relationship with the acquisition candidates chief managers before closing the deal. VF made a practice of leaving management of acquired companies in place; each company was able to keep its long standing traditions that shaped culture and spurred creativity. In 2007 VF was the most profitable apparel firm in the industry.

4. The Appeal of Multinational Diversification: More Opportunities for Sustained Growth and Maximum Competitive Advantage Potential: Despite their complexity, multinational diversification strategies have great appeal. They contain two major avenues for growing revenues and profits: (1) to grow by entering additional businesses and (2) to grow by extending the operations of existing businesses into additional country markets. A strategy of multinational diversification contains six attractive paths to competitive advantage, all of which can be pursued simultaneously:

   a. Full capture of economies of scale and experience and learning-curve effects

   b. Opportunities to capitalize on cross-business economies of scope

   c. Opportunities to transfer competitively valuable resources both from one business to another and from one country to another

   d. Ability to leverage use of a well-known and competitively powerful brand name
e. Ability to capitalize on opportunity for cross-business and cross-country collaboration and strategic coordination

**Illustration Capsule 8.5, The Global Scope of Four Prominent Diversified Multinational Corporations**

**Discussion Question:** 1. Describe the benefits these diversified multinational companies have received from their chosen strategic maneuvers.

**Answer:** These four organizations have been able to: tap into markets they previously did not operate in, obtain more opportunities for sustained growth, and achieve maximum competitive advantage.

5. **The Combined Effects of These Advantages is Potent:** A strategy of diversifying into related industries and then competing globally in each of these industries thus has great potential for being a winner in the marketplace because of the long-term growth opportunities. A strategy of multinational diversification contains more competitive advantage potential than any other diversification strategy.

**Core Concept**

A strategy of multinational diversification has more built-in potential for competitive advantage than any other diversification strategy.

6. It is important to recognize that cross-subsidization can only be used sparingly.

7. As a general rule, cross-subsidization tactics are justified only when there is a good prospect that the short-term impairment to corporate profitability will be offset by stronger competitiveness and better overall profitability over the long term.
CHAPTER SUMMARY

Chapter 9 focuses on examining what link, if any, there should be between a company’s efforts to craft and execute a winning strategy and its duties to (1) conduct its activities in an ethical manner; (2) demonstrate socially responsible behavior by being committed corporate citizens and attending to the needs of non-owner stakeholders—employees, the communities in which it operates, the disadvantaged, and society as a whole; and (3) limit its strategic initiatives to those that meet the needs of consumers without depleting resources needed by future generations.

LECTURE OUTLINE

I. What Do We Mean By Business Ethics?

1. Business ethics is the application of general ethical principles and standards to business behavior.

2. Business ethics does not involve a special set of ethical standards applicable only to business situations.

3. Ethical principles in business are not materially different from ethical principles in general.

Core Concept

Business ethics concerns the application of general ethical principles and standards to the actions and decisions of companies and the conduct of company personnel.

I. How and Why Ethical Standards impact the Tasks of Crafting and Executing Strategy?

a. In the U.S. the Sarbanes-Oxley Act companies whose stock is publicly traded to have a code of ethics or explain to the SEC in writing why they do not.

b. The Litmus test of a company’s code of ethics is the extent to which it is embraced in crafting strategy and in operating the business day to day.

c. It is up to the executives to walk the talk and make a point of considering two sets of questions
   • Is what we are proposing to do fully compliant with our code of ethical conduct? Is there anything here that could be considered ethically objectionable?
   • Is it apparent that this proposed action is in harmony with our core values? Are any conflicts or concerns evident?
II. Where Do Ethical Standards Come from—Are They Universal or Dependent on Local Norms and Situational Circumstances?

A. The School of Ethical Universalism

1. According to the school of ethical universalism, some concepts of what is right and what is wrong are universal; that is, they transcend all cultures, societies, and religions.
   a. To the extent that there is common moral agreement about right and wrong actions and behaviors across multiple cultures and countries, there exist a set of universal ethical standards to which all societies, all companies, and all individuals can be held accountable.

   **Core Concept**

   According to the school of ethical universalism, the same standards of what’s ethical and what’s unethical resonate with peoples of most societies regardless of local traditions and cultural norms; hence, common ethical standards can be used to judge the conduct of personnel at companies operating in a variety of country markets and cultural circumstances.

2. Many ethicists believe that the most important moral standards travel well across countries and cultures and are thus universal.
   a. Universal norms include honesty or trustworthiness, respecting the rights of others, practicing the Golden Rule, avoiding unnecessary harm to workers or to the users of the company’s product or service, and respect for the environment.

3. The strength of ethical universalism is that it draws on the collective views of multiple societies and cultures to put some clear boundaries on what constitutes ethical business behavior and what constitutes unethical business behavior no matter what country market or culture a company or its personnel are operating in.

B. The School of Ethical Relativism

1. There are meaningful variations in what societies generally agree to be right and wrong in the conduct of business activities. Ethical relativism holds that when there are cross-country or cross-cultural differences in what is deemed fair or unfair, what constitutes proper regard for human rights, and what is considered ethical or unethical in business situations, it is appropriate for local moral standards to take precedence over what the ethical standards may be elsewhere.

   **Core Concept**

   According to the school of ethical relativism different societal cultures and customs have divergent values and standards of right and wrong—thus what is ethical or unethical must be judged in the light of local customs and social mores and can vary from culture or nation to another.

2. The Use of Underage Labor
   a. In industrialized nations, the use of underage workers is considered taboo; social activists are adamant that child labor is unethical and that companies should neither employ children under the age of 18 as full-time employees nor source any products from foreign suppliers that employ underage workers.

   b. In India, Bangladesh, Botswana, Sri Lanka, Ghana, Somalia, Turkey, and 100-plus other countries, it is customary to view children as potential, even necessary, workers.

   c. Many poverty-stricken families cannot subsist without the income earned by young family
members. If such children are not able to work they may be forced to take jobs in the “hidden” parts of the economy, beg on the street, or traffic in drugs or prostitution.

3. The Payment of Bribes and Kickbacks

a. In many countries in Eastern Europe, Africa, Latin America, and Asia, it is customary to pay bribes to government officials in order to win a government contract, obtain a license or permits, or facilitate an administrative ruling.

b. Some people stretch to justify the payment of bribes and kickbacks on grounds that bribing government officials to get goods through customs or giving kickbacks to customer to retail their business or win an order is simply a payment for services rendered.

4. Ethical Relativism Equates to Multiple Sets of Ethical Standards

a. The existence of varying ethical norms such as those cited above explains why the adherents of ethical relativism maintain that there are few absolutes when it comes to business ethics and thus few ethical absolutes for consistently judging a company conduct in various countries and markets.

b. A company has to be very cautious about exporting its home-country values and ethics to foreign countries where it operates—“photocopying” ethics is disrespectful of other cultures and neglects the important role of moral free space.

**Core Concept**

Under ethical relativism, there can be no one-size-fits-all set of authentic ethical norms against which to gauge the conduct of company personnel.

5. Pushed to Extreme, Ethical Relativism Breaks Down

a. When the envelope starts to be pushed, as will inevitably be the case, it is tantamount to rudderless ethical standards.

b. A company that adopts the principle of ethical relativism and holds company personnel to local ethical standards necessarily assumes that what prevails as local morality is an adequate guide to ethical behavior. Ethical relativism results in a maze of conflicting ethical standards.

**Core Concept**

Managers in multinational enterprises have to figure out how to navigate the gray zone that arises when operating in two cultures with two sets of ethics.

C. Ethics and Integrative Social Contracts Theory

1. Social contract theory provides a middle position between the opposing views of universalism and relativism.

**Core Concept**

According to integrated social contracts theory, universal ethical principles or norms based on the collective views of multiple cultures and societies combine to form a “social contract” that all individuals in all situations have a duty to observe. Within the boundaries of this social contract, local cultures or groups can specify other impermissible actions; however, universal ethical norms always take precedence over local ethical norms.
2. The ethical standards a company should try to uphold are governed both by a limited number of universal ethical principles that are widely recognized as putting legitimate ethical boundaries on actions and behavior in all situations and the circumstances of local cultures, tradition, and shared values that further prescribe what constitutes ethically permissible behavior and what does not.

3. Universal ethical norms take precedence over local ethical norms.

4. These mostly uniform agreements about what is morally right and wrong form a “Social contract” or contract with society that is binding on all individuals, groups, organizations, and businesses in terms of establishing right and wrong and in drawing the line between ethical and unethical behaviors.

5. It is indisputable that cultural differences impact how business is conducted in various parts of the world and that these cultural differences sometimes give rise to different ethical norms.

6. This is precisely what integrated social contract theory maintains—universal or first-order ethical norms should always take precedence over local or second-order norms.

7. Even with the guidance provided by integrated social contracts theory, there are many instances where cross-country differences in ethical norms create gray areas in which it is tough to draw a line in the sand between right and wrong decisions, actions, and business practices.

III. The Three Categories of Management Morality

1. Three categories of managers stand out with regard to ethical and moral principles in business affairs:

   a. The moral manager—Moral managers are dedicated to high standards of ethical behavior, both in their own actions and in their expectations of how the company’s business is to be conducted.

   b. The immoral manager—Immoral managers have no regard for so-called ethical standards in business and pay no attention to ethical principles in making decisions and conducting the company’s business.

   c. The amoral manager—A moral managers appear in two forms: the intentionally amoral manager and the unintentionally amoral manager. Intentionally amoral managers consciously believe business and ethics are not to be mixed because different rules apply in business versus other realms of life. Unintentionally amoral managers do not pay much attention to the concept of business ethics either, but for different reasons. They are simply causal about, careless about, or inattentive to the fact that certain kinds of business decisions or company activities have deleterious effects on others—in short, they are simply blind to the ethical dimension of decisions and business actions.

   **Core Concept**

   Amoral managers believe that businesses ought to be able to do whatever current laws and regulations allow them to do without being shackled by ethical considerations—they think that what is permissible and what is not is governed entirely by prevailing laws and regulations, not by societal concepts of right and wrong.

2. Evidence of Managerial Immorality in the Global Business Community: There is considerable evidence that a sizeable majority of managers are either amoral or immoral.

3. Table 9.1, Corruption Perception Index (CPI) (A CPI Score of 10 is “highly clean” and a score of 0 is “highly corrupt.”), shows some of the countries where corruption is believed to be lowest and highest.
IV. Drivers of Unethical Strategies and Business Behavior

1. The apparent pervasiveness of immoral and amoral businesspeople is one obvious reason why companies may resort to unethical strategic behavior. Three other main drivers of unethical business behavior stand out:

   a. Faulty oversight by top management and the board of directors that implicitly allows the overzealous pursuit of personal gain, wealth, and other self interests.

   b. Heavy pressures on company managers to meet or beat earnings targets

   c. A company culture that puts the profitability and good business performance ahead of ethical behavior.

2. Overzealous Pursuit of Personal Gain, Wealth and Self-Interest: A general disregard for business ethics can prompt all kinds of unethical strategic maneuvers and behaviors at companies. This, combined with people who are obsessed with wealth accumulation, greed, power, status, and other self interests often push ethical principles aside to achieve their goals. The CEO of Tyco, Int’l, conspired with the company’s CFO to steal more than $170 million from the company.

3. Heavy Pressures on Company Managers to Meet or Beat Earnings Targets: When companies find themselves scrambling to achieve ambitious earnings growth and meet quarterly and annual performance expectations of Wall Street analysts and investors, managers often feel enormous pressure to do whatever it takes to sustain the company’s reputation for delivering good financial performance. Once ethical boundaries are crossed in efforts to “meet or beat the numbers,” the threshold for making more extreme ethical compromises becomes lower. Company executives often feel pressured to hit financial performance targets because their compensation depends heavily on the company’s performance. The fundamental problem with a “make the numbers and move on” syndrome is that a company does not really serve its customers or its shareholders by putting top priority on the bottom line.

4. Heavy pressures on Company Managers to Meet or Beat Earnings Targets: Performance expectations of Wall Street Analysts and investors may create enormous pressure on management to do whatever it takes to sustain the company’s reputation for delivering good financial reports. Company executives often feel pressured to hit financial performance targets because their compensation depends on company’s performance.

5. Company Culture That Put the Bottom Line ahead of Ethical Behavior: When a company’s culture spawns an ethically corrupt or amoral work climate, people have a company-approved license to ignore “what’s right” and engage in most any behavior or employ most any strategy they think they can get away with.

IV. Why Ethical Strategies Matter

1. Two reasons why a company’s strategy should be ethical:

   a. A strategy that is unethical in whole or in part is morally wrong and reflects on the character of the company personnel involved

   b. An ethical strategy is good business and in the best interest of shareholders.

2. The Moral Case for an Ethical Strategy

   a. Ethical strategy generally begins with managers who themselves have strong character. Strong managers consciously opt for strategic actions that can pass moral scrutiny—they display no tolerance for strategies with ethically controversial components.

3. The Business Case for an Ethical Strategy
a. Pursuing unethical strategies not only damage a company’s reputation but can also have costly consequences that are wide ranging.

b. Figure 9.1 breaks costs down into three levels and shows some of the costs that are readily visible while others are hidden and difficult to track down.

c. Rehabilitating a company’s shattered reputation is time-consuming and costly. Customers shun companies known for their shady behavior.

C. Why Should Company Strategies Be Ethical?

1. There are two reasons why a company’s strategy should be ethical:
   a. Because a strategy that is unethical in whole or in part is morally wrong and reflects badly on the character of the company personnel involved
   b. Because an ethical strategy is good business and is in the self-interest of shareholders

2. The Business Case for an Ethical Strategy: There are solid business reasons to adopt ethical strategies even if most company managers are not of strong moral character and personally committed to high ethical standards:
   a. Pursuing unethical strategies puts a company’s reputation at high risk and can do lasting damage
   b. Rehabilitating a company’s shattered reputation is time consuming and costly
   c. Customers shun companies known for their shady behavior
   d. Companies with reputations for unethical conduct have considerable difficulty in recruiting and retaining talented employees.

Illustration Capsule 9.1 A Test of Your Business Ethics

Discussion Question: As a gauge of your own ethical and moral standards, take the quiz and see how you stack up against other members of your class. For the test to be valid, you need to answers the questions candidly and not on the basis of what you think the “ethically correct” answer is.

Answer: The answers to questions 1, 2 and 4 probably shift from no/unsure to a definite yes when the second part of the circumstances comes into play. We think a strong case can be made that the answers to the remaining 9 questions are yes, although it can be argued that more information about the circumstances might be needed in responding to questions 5, 7, 9 and 12.

V. Approaches to Managing a Company’s Ethical Conduct

1. A company can take any of four basic approaches with regard to clinical conduct.
   a. The unconcerned or non-issue approach.
   b. The damage control approach
   c. The compliance approach
   d. The ethical culture approach.

2. Table 9.2, Four Approaches to Managing Business Ethics
3. **The Unconcerned or Non-Issue Approach:** The unconcerned approach is prevalent at companies whose executives are immoral and unintentionally amoral. Companies using this approach ascribe to the view that business ethics is an oxymoron in a dog-eat-dog, survival-of-the-fittest world and that under-the-table dealing can be good business. Companies in this mode are usually out to make the greatest possible profit at any cost and the strategies they employ, while legal, may well embrace elements that are ethically shady or unsavory.

4. **The Damage Control Approach:** Damage control is favored at companies whose managers are intentionally amoral but who fear scandal and are desirous of containing adverse fallout from claims that the company’s strategy has unethical components or that company personnel engage in unethical practices. Companies using this approach usually make some concessions to window-dressing ethics, going so far as to adopt a code of ethics so that their executives can point to it as evidence of their ethical commitment should any ethical lapses on the company’s part be exposed. The main objective of the damage control approach is to protect against adverse publicity brought on by angry or vocal stakeholders, outside investigation, threats of litigation, or punitive government action.

### Core Concept

The main objective of the damage control approach is to protect against adverse publicity and any damaging consequences brought on by headlines in the media, outside investigation, threats of litigation, punitive government action, or angry or vocal stakeholders.

5. **The Compliance Approach:** Anywhere from light to forceful compliance is favored at companies whose managers lean toward being somewhat amoral but are highly concerned about having ethically upstanding reputations or are amoral and see strong compliance methods as the best way to impose and enforce ethical rules and high ethical standards. Companies that adopt a compliance mode usually do some or all of the following to display their commitment to ethical conduct: make the code of ethics a visible and regular part of communications with employees, implement ethics training programs, appoint a chief ethics officer or ethics ombudsperson, have ethics committees to give guidance on ethics matters, institute formal procedures for investigating alleged ethics violations, conduct ethics audits to measure and document compliance, give ethics awards to employees for outstanding efforts to create an ethical climate and improve ethical performance, and/or install ethics hotlines to help detect and deter violations. Emphasis here is usually on securing broad compliance and measuring the degree to which ethical standards are upheld and observed. One of the weaknesses of the compliance approach is that moral control resides in the company’s code of ethics and in the ethics compliance system rather than in an individual’s own moral responsibility for ethical behavior.

6. **The Ethical Culture Approach:** A company using the ethical culture approach seeks to gain employee buy-in to the company’s ethical standards, business principles, and corporate values. Many of the trappings used in the compliance approach are also manifest in the ethical culture mode, but one other is added—strong peer pressure from coworkers to observe ethical norms. One of the challenges to overcome in the ethical culture approach is that moral control resides in the code and in the ethics compliance system rather than in an individual’s own moral responsibility for ethical behavior.

7. **Why a Company Can Change Its Ethics Management Approach:** Regardless of the approach they have used to managing ethical conduct, a company’s executives may sense they have exhausted a particular mode’s potential for managing ethics and that they need to be become more forceful in their approach to ethics management.
IV. Social Responsibility and Corporate Citizenship Strategies.

1. That businesses have an obligation to foster social betterment took root in the 19th century when progressive companies, in the aftermath of the industrial revolution, began to provide workers with housing and other amenities.

Illustration Capsule 9.2 How General Electric’s Top Management Built a Culture that Fuses High Performance with High Integrity

Discussion Question: General Electric is not so naïve as to believe it successfully hired only moral managers. What has GE done to ensure that the company maintains the highest ethical practices?

Answer: The first step was to establish an ethical culture at GE. Jeff Immelt begins and ends with a recitation of the company’s fundamental ethical principles. Top management is careful not to violate these principles themselves or to give implied consent for others to do so. GE has a one strike and you’re out standard. Because it operates in more than 100 countries, the company has turned to global ethical standards rather than allow local cultures to shape business practice. Operating level managers are responsible for ensuring ethical compliance in their divisions and must submit quarterly tracking reports to GE corporate offices on violations. GE’s approach to culture building also includes instilling ethical principles into the behavior of the 300,000-plus employees. Employees are provided training, and can lodge complaints about ethics compliance anonymously.

2. Today, corporate social responsibility is a concept that resonates in Western Europe, the United States, Canada, and such developing nations as Brazil and India.

Core Concept

The notion of social responsibility as it applies to businesses concerns a company’s duty to operate in an honorable manner, provide good working conditions for employees, be a good steward of the environment, and actively work to better the quality of life in the local communities where it operates and in society at large.

A. What Do We Mean By Social Responsibility and Corporate Citizenship?

1. The essence of socially responsible business behavior is that a company should strive to balance the benefits of strategic actions to benefit shareholders against the duty to be a good corporate citizen.

2. Figure 9.2, Demonstrating a Social Conscience: The Five Components of Socially Responsible Business Behavior, depicts a company’s menu for crafting its social responsibility strategy, and includes:

a. Efforts to employ an ethical strategy and observe ethical principles in operating the business

b. Making charitable contributions, donating money and the time of company personnel to community service endeavors, supporting various worthy organizational causes, and reaching out to make a difference in the lives of the disadvantaged

c. Actions to protect or enhance the environment and in particular, to minimize or eliminate any adverse impact on the environment stemming from the company’s own business activities

d. Actions to create a work environment that enhances the quality of life for employees and makes the company a great place to work
e. Actions to build a workforce that is diverse with respect to gender, race, national origin, and perhaps other aspects that different people bring to the workplace

**Core Concept**

A company’s social responsibility strategy is defined by the specific combination of socially beneficial and community citizenship activities it opts to support with its contribution of time, money and other resources.

**B. Environmental Sustainability Strategies: A New and Growing Priority**

1. A rapidly growing number of companies are expanding their exercise of social responsibility and corporate and corporate citizenship to include the impact of their strategies and operations on future generations and the well-being of the planet.

2. Sustainability initiatives undertaken by companies are frequently directed at improving the company’s “Triple-P” performance—people, planet, and profit.

3. Sometimes cost savings and improved profitability are drivers of environmental sustainability strategies.

**Core Concept**

A company’s environmental sustainability strategy consists of its deliberate actions to meet the current needs of customers, suppliers, shareholders, employees, and other stakeholders in a manner that protects the environment, provides for the longevity of natural resources, maintains ecological support systems for future generations, and guards against ultimate endangerment of the planet.

4. Many environmentally conscious companies now make a point of citing the beneficial of their sustainability strategies in press releases and issue special sustainability reports for consumers and investors to review.

5. The Dow Jones Sustainability World Index consists of the top 10 percent of the 2,500 companies listed in the Dow Jones World Index in terms of economic performance, environmental performance, and social performance (Table 9.3).

**C. Crafting Social Responsibility and Sustainability Strategies**

1. A company may choose to focus its social responsibility strategy on generic social issues, but social responsibility strategies keyed to points of intersection between a company and society may also contribute to a company’s competitive advantage.

2. Unless a company’s social responsibility initiatives become part of the way it operates its business every day, the initiatives are unlikely to be fully effective.

**D. The Moral Case for Corporate Social Responsibility**

1. The moral case for why businesses should actively promote the betterment of society and act in a manner that benefits all of the company’s stakeholders boils down to a basic concept—It is the right thing to do.

**E. The Business Case for Socially Responsible Behavior**

1. There are several reasons why the exercise of social responsibility is good business:
a. It generates internal benefits particularly as concerns employee recruiting, workforce retention, and training costs

b. It reduces the risk of reputation-damaging incidents and can lead to increased buyer patronage

**Core Concept**

The higher the public profile of a company or brand, the greater scrutiny of its activities and the higher the potential for it to become a target for pressure group action.

c. It is in the best interest of shareholders
CHAPTER SUMMARY

Chapter Ten examines the process of executing an organizational strategy. It has an emphasis on the conversion of a strategy into actions and good results for organizations. The chapter explores how executing strategy is an operations-driven activity that revolves around the management of people and business processes. It denotes that successfully executing a strategy depends on doing a good job of working with and through others, building and strengthening competitive capabilities, motivating and rewarding people in a strategy-supportive manner, and instilling a discipline of getting things done. Chapter Ten defines executing strategy as an action-oriented, make-things-happen task that tests a manager’s ability to direct organizational change, achieve continuous improvement in operations and business practices, create and nurture a strategy-supportive culture, and consistently meet or beat performance targets.

LECTURE OUTLINE

I. Introduction

1. Just because senior managers announce a new strategy does not mean that organizational members will agree with it or enthusiastically move forward in implementing it. It takes adept managerial leadership to convincingly communicate the new strategy and the reasons for it, overcome pockets of doubt and disagreements, secure the commitment and enthusiasm of concerned parties, build consensus on all the hows of implementation and execution, and move forward to get all the pieces into place.

2. Executing strategy is a job for the whole management team, not just a few senior managers.

3. Strategy execution requires every manager to think through the answer to “What does my area have to do to implement its part of the strategic plan and what should I do to get these things accomplished effectively and efficiently?”

Core Concept

Good strategy execution requires a team effort. All managers have strategy-executing responsibility in their areas of authority, and all employees are participants in the strategy execution process.

II. A Framework for Executing Strategy

1. Implementing and executing strategy entails figuring out all the hows—the specific techniques, actions, and behaviors—that are needed for a smooth strategy-supportive operation—and then following through to get things done and deliver results.
2. The first step in implementing strategic changes is for management to communicate the case for organizational changes so clearly and persuasively to organizational members that a determined commitment takes hold throughout the ranks to find ways to put the strategy into place, make it work, and meet performance targets.

3. Management’s handling of the strategy implementation process can be considered successful if and when the company achieves the targeted strategic and financial performance and shows good progress in making its strategic vision a reality.

A. The Principal Management Components of the Strategy Executing Process

1. Despite the need to tailor a company’s strategy-executing approaches to the particulars of its situation, certain managerial bases have to be covered no matter what the circumstances.

2. **Figure 10.1, The Eight Components of the Strategy Execution Process**, depicts the eight managerial tasks that come up repeatedly in a company’s efforts to execute strategy.

3. The eight managerial tasks that crop up repeatedly in company efforts to execute strategy include:
   a. Building an organization with the competencies, capabilities, and resource strengths to execute strategy successfully
   b. Marshaling sufficient money and people
   c. Instituting policies and procedures that facilitate strategy execution
   d. Adopting best practices and striving for continuous improvement
   e. Installing information and operating systems that enable company personnel to carry out their strategic roles proficiently
   f. Tying rewards and incentives directly to the achievement of strategic and financial targets and to good strategy execution
   g. Instilling a corporate culture that promotes good strategy execution
   h. Exerting the internal leadership needed to drive implementation forward and keep improving on how the strategy is being executed

4. In devising an action agenda for implementing and executing strategy, the place for managers to start is with a probing assessment of what the organization must do differently and better to carry out the strategy successfully. They should then consider precisely how to make the necessary internal changes as rapidly as possible.

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**Core Concept**

When strategies fail, it is often because of poor execution—things that were supposed to get done slip through the cracks.

5. The bigger the organization, the more that successful strategy execution depends on the cooperation and implementing skills of operating managers who can push needed changes at the lowest organizational levels and deliver results.

6. Regardless of the organization’s size and the scope of the changes, the most important leadership trait is a strong, confident sense of what to do and how to do it.

7. **Managing the Strategy Execution Process: What’s Covered in Chapters 10, 11, and 12**: This chapter and the next two will explore what is involved in performing the eight key managerial
tasks that shape the process of implementing and executing strategy. This chapter is concerned with building resource strengths and organizational capabilities organizations. Chapter 10 looks at marshaling resources, instituting strategy-facilitating policies and procedures, adopting best practices, installing operating systems, and tying rewards to the achievement of good results. Chapter 12 deals with creating a strategy-supportive corporate culture and exercising appropriate strategic leadership.

III. Building a Capable Organization

1. Building a capable organization is always a top priority in strategy execution. Three types of organization-building actions that are paramount include:
   a. Staffing the organization
   b. Building core competencies and competitive capabilities
   c. Structuring the organization and work effort

2. Figure 10.2, The Three Components of Building an Organization Capable of Proficient Strategy Execution, looks at the three components necessary for building a capable organization.

IV. Staffing the Organization

1. No company can hope to perform the activities required for successful strategy execution without attracting and retaining talented managers and employees with suitable skills and intellectual capital.

A. Putting Together a Strong Management Team

1. Assembling a capable management team is a cornerstone of the organization-building task.

Core Concept

Putting together a talented management team with the right mix of skills and experiences and abilities to get things done is one of the first strategy implementing steps.

2. Illustration Capsule 10.1, How General Electric Develops a Talented and Deep Management Team, describes General Electric’s widely acclaimed approach to developing a high-caliber management team.

Illustration Capsule 10.1, How General Electric Develops a Talented and Deep Management Team

Discussion Question: 1. Identify the four key elements that support General Electric’s efforts to build a talent-rich stable of managers. Has this approach proven to be successful? Explain.

Answer: The four key elements employed by this organization include: transferring managers across divisional, business, or functional lines for sustained periods of time, exhibition of the four “E”s by potential executive candidates, proficiency in what is termed “workout”, and attendance in the Leadership Development Center. This approach has proven to be highly successful for the organization. Today, General Electric is widely considered to be one of the best-managed companies in the world, partly because of its concerted effort to develop outstanding managers.
B. Recruiting and Retaining Capable Employees

1. Staffing the organization with the right kinds of people must go much deeper than managerial jobs in order to build an organization capable of effective strategy execution.

2. In high-tech companies, the challenge is to staff work groups with gifted, imaginative, and energetic people who can bring life to new ideas quickly.

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Core Concepts

In many industries adding to a company’s talent base and building intellectual capital is more important to strategy execution than additional investments in plants, equipment, and capital projects.

Core Concepts

The best companies make a point of recruiting and retaining talented employees—the objective is to make the company’s entire workforce (managers and rank-and-file employees) a genuine resource strength.

3. In instances where intellectual capital greatly aids good strategy execution, companies have instituted a number of practices aimed at staffing jobs with the best people they can find:

   a. Spending considerable effort in screening and evaluating job applicants
   b. Putting employees through training programs that continue throughout their careers
   c. Provide promising employees with challenging, interesting, and skills-stretching assignments
   d. Rotating people through jobs that not only have great content but also span functional and geographic boundaries
   e. Encouraging employees to be creative and innovative
   f. Fostering a stimulating and engaging work environment such that employees will consider the company a great place to work
   g. Exerting efforts to retain high-potential, high-performing employees
   h. Coaching average performers to improve their skills while weeding out underperformers and benchwarmers

VI. Building Core Competencies and Competitive Capabilities

1. A top organization-building priority in the strategy implementing/executing process is the need to build and strengthen competitively valuable core competencies and organizational capabilities.

A. The Three-Stage Process of Developing and Strengthening Competencies and Capabilities

1. Building core competencies and competitive capabilities is a time consuming, managerially challenging exercise.

2. The capability building process has three stages:

   a. **Stage 1:** First, the organization must develop the ability to do something, however imperfectly or inefficiently
b. **Stage 2:** As experience grows and company personnel learn how to perform the activity consistently well and at an acceptable cost, the ability evolves into a tried and true competence or capability.

c. **Stage 3:** Should the organization continue to polish and refine its know-how and otherwise sharpen its performance such that it becomes better than rivals at performing the activity, the core competence rises to the rank of a distinctive competence, thus providing a path to competitive advantage.

3. **Managing the Process:** Four traits concerning core competencies and competitive capabilities are important in successfully managing the organization-building process:

   a. Core competencies and competitive capabilities are bundles of skills and know-how that most often grow out of the combined efforts of cross-functional work groups and departments performing complementary activities at different locations in the firm’s value chain.

   b. Normally, a core competence or capability emerges incrementally out of company efforts either to bolster skills that contributed to earlier successes or to respond to customer problems, new technological and market opportunities, and the competitive maneuverings of rivals.

   c. The key to leveraging a core competence into a distinctive competence or a capability into a competitively superior capability is concentrating more effort and more talent than rivals on deepening and strengthening the competence or capability so as to achieve the dominance needed for competitive advantage.

   d. Evolving changes in customer’s needs and competitive conditions often require tweaking and adjusting a company’s portfolio of competencies and intellectual capital to keep its capabilities fresh honed and on the cutting edge.

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### Core Concept

Building competencies and capabilities that are very difficult or costly for rivals to emulate has a huge payoff—improved strategy execution and a potential for competitive advantage.

4. Managerial actions to develop core competencies and competitive capabilities generally take one of two forms:

   a. Strengthening the company’s base of skills, knowledge, and intellect.

   b. Coordinating and networking the efforts of the various work groups and departments.

5. One organization-building question is whether to develop the desired competencies and capabilities internally or to outsource them by partnering with key suppliers or forming strategic alliances. The answer depends on what can be safely delegated to outsiders suppliers or allies versus what internal capabilities are key to the company’s long-term success.

6. Sometimes the tediousness of internal organization building can be shortcut by buying a company that has the requisite capability and integrating its competencies into the firm’s value chain. Capabilities-motivated acquisitions are essential when a market opportunity can slip by faster than a needed capability can be created internally and when industry conditions, technology, or competitors are moving at such a rapid clip that time is of the essence.

7. **Updating and Remodeling Competencies and Capabilities as External Conditions and Company Strategy Change:** Competencies and capabilities that grow stale can impair competitiveness unless they are refreshed, modified, or even replaced in response to ongoing market changes.
and shifts in company strategy. Thus, it is appropriate to view a company as a bundle of evolving competencies and capabilities. Management’s organization-building challenge is one of deciding when and how to recalibrate existing competencies and capabilities and when and how to develop new ones. Although the task is formidable, ideally it produces a dynamic organization.

B. The Strategic Role of Employee Training

1. Training and retraining are important when a company shifts to a strategy requiring different skills, competitive capabilities, managerial approaches, and operating methods.

2. The strategic importance of training has not gone unnoticed. Over 600 companies have established internal “universities” to lead the training effort, facilitate continuous organizational learning, and help upgrade company competencies and capabilities.

3. Illustration Capsule 10.2, Toyota’s Legendary Production System: A Capability That Translates into Competitive Advantage, demonstrates Toyota’s famed Production System, which allows the firm to produce top-quality vehicles at relatively low prices.

Illustration Capsule 10.2, Toyota’s Legendary Production System: A Capability That Translates into Competitive Advantage

Discussion Question: 1. What two TPS techniques do you think are the most unusual? How do you think these help Toyota to pursue a more efficient manufacturing operation?

Answer: Students should select two choices from among the eight listed in this example. Student responses will vary, but students should be exhibiting some personal viewpoints or perspectives that otherwise may not have been brought to light. This sharing should facilitate further classroom discussion about quality control.

C. From Competencies and Capabilities to Competitive Advantage

1. Strong core competencies and competitive capabilities are important avenues for securing a competitive edge over rivals in situations where it is relatively easy for rivals to copy smart strategies.

2. Cutting-edge core competencies and organizational capabilities are not easily duplicated by rival firms; thus any competitive edge they produce is likely to be sustainable, paving the way for above-average organizational performance.

Core Concept

Building competencies and capabilities that are very difficult or costly for rivals to emulate has a huge payoff—improving strategy execution and a potential for competitive advantage

VII. Execution-Related Aspects of Organizing the Work Effort

A. Deciding Which Value Chain Activities to Perform Internally and Which to Outsource

1. Outsourcing assorted administrative support activities and perhaps even core or primary value chain activities can enable the company to concentrate its full energies and resources on even more competently performing those value chain activities that are at the core of its strategy and for which it can create unique value.
2. **Figure 10.3, Structuring the Work Effort to Promote Successful Strategy Execution**, looks at some of the considerations that are common to most all organizations.

3. When a company uses outsourcing to zero in on even better performance of those truly strategy-critical activities where its expertise is most need, then it may be able to realize three very positive benefits.
   
a. The company improves its chances for outclassing rivals in the performance of those activities and turning a core competence into a distinctive competence.
   
b. The streamlining of internal operations that flows from outsourcing often acts to decrease internal bureaucracies, flatten the organization structure, speed internal decision making and shorten the time it takes to respond to changing market conditions.
   
c. Partnerships can add to a company’s arsenal of capabilities and contribute to better strategy execution.

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**Core Concept**

Wisely choosing which activities to perform internally and which to outsource can lead to several strategy-executing advantages—lower costs, heightened strategic focus, less internal bureaucracy, speedier decision making, and a better arsenal of competencies and capabilities.

4. As a general rule, companies refrain from outsourcing those value chain activities over which they need direct strategic and operating control in order to build core competencies, achieve competitive advantage, and effectively manage key customer-supplier-distributor relationships.

5. **The Dangers of Excessive Outsourcing**: A company that goes overboard on outsourcing can hollow out its knowledge base so as to leave itself at the mercy of outside suppliers and short of the resource strengths to be master of its own destiny.

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**B. Making Strategy-Critical Activities the Main Building Blocks of the Organization Structure**

1. Some activities in the value chain are always more critical to strategic success and competitive advantage than others.

2. The rationale for making strategy-critical activities the main building blocks in structuring a business is compelling: if activities crucial to strategic success are to have the resources, decision-making influence, and organizational impact they need, they have to be centerpieces in the organizational scheme.

3. **What Types of Organization Structures Fit Which Strategies?** The primary organizational building blocks within a business are usually traditional functional departments such as R&D, engineering and design, production and operations, sales and marketing, information technology, finance and accounting, and human resources and process-complete departments such as supply chain management, filling customer orders, customer service, quality control, and direct sales via the company’s web site. In enterprises with operations in various countries around the world, the basic building blocks may also include geographical organizational units, each of which has profit/loss responsibility for its assigned geographic areas. In vertically integrated firms, the major building blocks are divisional units performing one or more of the major processing steps along the value chain. The typical building blocks of a diversified company are its individual businesses.

4. Reengineering strategy-critical business processes to reduce fragmentation across traditional departmental lines and cut bureaucratic overhead has proved to be a legitimate organizational design tool, not just a passing fad.
C. Determining the Degree of Authority and Independence to Give Each Unit and Each Employee

1. The two extremes are to centralize decision-making at the top (the CEO and a few close lieutenants) or to decentralize decision-making by giving managers and employees considerable decision-making latitude in their areas of responsibility.

2. Table 10.1, Advantages and Disadvantages of Centralized versus Decentralized Decision-Making, shows the two approaches to decision-making are based on sharply different underlying principles and beliefs, with each having pros and cons.

3. Centralized Decision-Making: Pros and Cons In a highly centralized organization structure, top executives retain authority for most strategic and operating decisions and keep a tight rein on business-unit heads, department heads, and the managers of key operating units; comparatively little discretionary authority is granted to front-line supervisors and rank and file employees. The command-and-control paradigm of centralized structures is based on the underlying assumption that frontline personnel have neither the time nor the inclination to direct and properly control the work they are performing and that they lack the knowledge and judgment to make wise decisions about how best to do it—hence the need for managerially prescribed policies and procedures, close supervision, and tight control.

4. Decentralized Decision-Making: Pros and Cons In a highly decentralized organization, decision-making authority is pushed down to the lowest organizational level capable of making timely, informed, competent decisions. The objective is to put adequate decision-making authority in the hands of those closest to and most familiar with the situation and train them to weigh all the factors and exercise good judgment.

5. Decentralized organization structures have much to recommend them. Delegating greater authority to subordinate managers and employees creates a more horizontal organization structure with fewer management layers.

6. The past decade has seen a growing shift from authoritarian, multilayered hierarchical structures to flatter, more decentralized structures that stress employee empowerment.

7. Maintaining Control in a Decentralized Organization Structure: Maintaining adequate organizational control over empowered employees is generally accomplished by placing limits on the authority that empowered personnel can exercise, holding people accountable for their decisions, instituting compensation incentives that reward people for doing their jobs in a manner that contributes to good company performance, and creating a corporate culture where there is strong peer pressure on individuals to act responsibly.

8. Capturing Strategic Fits in a Decentralized Structure: Diversified companies striving to capture cross-business strategic fits have to beware of giving business heads full rein to operate independently when cross-business collaboration is essential in order to gain strategic fit benefits.
D. Providing for Internal Cross-Unit Coordination

1. The classic way to coordinate the activities of organizational units is to position them in the hierarchy so that those most closely related report to a single person.

2. A big weakness of traditional functionally organized structures is that pieces of strategically relevant activities and capabilities often end up scattered across many departments with the results that no one group or manager is accountable. For example, the following strategy-critical activities cut across different functions:
   a. Filling customer orders accurately and promptly
   b. Fast, ongoing introduction of new products
   c. Improving product quality
   d. Supply chain management
   e. Building the capability to conduct business via the Internet
   f. Obtaining feedback from customers and making product modifications to meet their needs

E. Providing for Collaboration with Outside Suppliers and Strategic Allies

1. Someone or some group must be authorized to collaborate with each major outside constituency involved in strategy execution.

2. Forming alliances and cooperative relationships presents immediate opportunities and opens the door to future possibilities, but nothing valuable is realized until the relationship grows, develops, and blossoms.

3. Building organizational bridges with external allies can be accomplished by appointing “relationship managers” with responsibility for making particular strategic partnerships or alliances generate the intended benefits.

VIII. Current Organizational Trends

1. Many of today’s companies are winding up the task of remodeling their traditional hierarchical structures once built around functional specialization and centralized authority.

2. The organizational adjustments and downsizing of companies in 2001–2002 have brought further refinements and changes to streamline organizational activities and shake out inefficiencies. The goals have been to make the organizations leaner, flatter, and more responsive to change. Many companies are drawing on five tools of organizational design:
   a. Empowered managers and workers
   b. Reengineered work processes
   c. Self-directed work teams
   d. Rapid incorporation of Internet technology applications
   e. Networking with outsiders to improve existing capabilities and create new ones
3. The organization of the future will have several new characteristics:
   a. Extensive use of Internet technology and e-commerce business practices—real-time data and information systems, greater reliance on online systems for transacting business with suppliers and customers, and Internet-based communication and collaboration with suppliers, customers, and strategic partners
   b. Fewer barriers between vertical ranks, between functions and disciplines, between units in different geographic locations, and between the company and its suppliers, distributors/dealers, strategic allies, and customers
   c. A capacity for change and rapid learning
   d. Collaborative efforts among people in different functional specialties and geographic locations—essential to create organization competencies and capabilities
CHAPTER SUMMARY

Chapter Eleven discusses five additional managerial actions that facilitate the success of a company’s strategy execution efforts. These include (1) marshaling resources to support the strategy execution effort, (2) instituting policies and procedures that facilitate strategy execution, (3) adopting best practices and striving for continuous improvement in how value chain activities are performed, (4) installing information and operating systems that enable company personnel to carry out their strategic roles proficiently, and (5) tying rewards and incentives directly to the achievement of strategic and financial targets and to good strategy execution.

LECTURE OUTLINE

I. Marshalling Resources behind the Drive for Good Strategy Execution

1. Early in the process of implementing and executing a new or different strategy, managers need to determine what resources will be needed and then consider whether the current budgets of organizational units are suitable.

2. A company’s ability to marshal the resources needed to support new strategic initiatives and steer them to the appropriate organizational units has a major impact on the strategy execution process.

Core Concept

The funding requirements of a new strategy must drive how capital allocations are made and the size of each unit’s operating budgets. Underfunding organizational units and activities pivotal to strategic success impedes execution and the drive for operating excellence.

3. A change in strategy nearly always calls for budget reallocations.

4. Visible actions to relocate operating funds and move people into new organizational units signal a determined commitment to strategic change and frequently are needed to catalyze the implementation process and give it credibility.

5. Just fine-tuning the execution of a company’s existing strategy seldom requires big movements of people and money from one area to another.

II. Instituting Policies and Procedures that Facilitate Strategy Execution

Core Concept

Well-conceived policies and procedures aid strategy execution; out-of-sync ones are barriers.
Chapter 11  Managing Internal Operations: Actions that Promote Better Strategy Execution

1. **Figure 11.1, How Prescribed Policies and Procedures Facilitate Strategy Execution**, looks at some of these effects.

2. Prescribing new policies and operating procedures acts to facilitate strategy execution in three ways:
   a. Instituting new policies and procedures provides top-down guidance regarding how certain things now need to be done
   b. Policies and procedures help enforce needed consistency in how particular strategy-critical activities are performed in geographically scattered operating units.
   c. Well conceived policies and procedures promote the creation of a work climate that facilitates good strategy execution

3. There is wisdom in a middle approach: *Prescribe enough policies to give organization members clear direction in implementing strategy and to place desirable boundaries on employees’ actions: then empower them to act within these boundaries however they think makes sense.*

III. Adopting Best Practices and Striving for Continuous Improvement

1. Company managers can significantly advance the cause of competent strategy execution by pushing organization units and company personnel to identify and adopt the best practices for performing value chain activities and insisting on continuous improvement in how internal operations are conducted.

2. One of the most widely used and effective tools for gauging how well a company is executing pieces of its strategy entails benchmarking the company’s performance of particular activities and business processes against “best in industry” and “best in world” performers.

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<tr>
<th>Core Concept</th>
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<tr>
<td>Managerial efforts to identify and adopt best practices are a powerful tool for promoting operating excellence and better strategy execution.</td>
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A. Identifying and Incorporating Best Practices to Improve Operating effectiveness and Efficiency

1. A **best practice** is a technique for performing an activity or business process that at least one company has demonstrated works particularly well.

2. To qualify as a legitimate best practice, the technique must have a proven record in significantly lowering costs, improving quality or performance, shortening time requirements, enhancing safety, or delivering some other highly positive operating outcome.

<table>
<thead>
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<th>Core Concept</th>
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<tbody>
<tr>
<td>A best practice is any practice that at least one company has proved works particularly well.</td>
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3. Benchmarking is the backbone of the process for identifying, studying, and implementing outstanding practices.

4. Informally, benchmarking involves being humble enough to admit that others have come up with world-class ways to perform particular activities yet wise enough to try to learn how to match and even surpass them.

5. **Figure 11.2, From Benchmarking and Best Practices Implementation to Operating Excellence**, explores the potential pay-off from benchmarking.
6. However, benchmarking is more complicated than simply identifying which companies are the best performers of an activity and then trying to exactly copy other companies’ approaches.

7. Normally, the outstanding practices of other organizations have to be adapted to fit the specific circumstances of a company’s own business and operating requirements.

8. A best practice remains little more than an interesting success story unless company personnel buy into the task or translating what can be learned from other companies into real action and results.

9. Legions of companies across the world now engage in benchmarking to improve their strategy execution and gain a strategic, operational, and financial advantage over rivals.

10. Scores of trade associations and special interest groups have collected best-practices data and have made databases available online to members—good examples include the Benchmarking Exchange (www.bench.net.com); Best Practices, LLC (www.best-in-class.com); and the American Productivity and Quality Center (www.apqc.org).

B. Business Process Reengineering, Six Sigma Quality Programs, and TQM: Tools for Promoting Operational Excellence

1. Best practice implementation has stimulated greater management awareness of the importance of business process reengineering, total quality management (TQM) programs, Six Sigma quality control techniques, and other continuous improvement methods.

2. **Total Quality Management Programs:** Total quality management (TQM) is a philosophy of managing a set of business practices that emphasizes continuous improvement in all phases of operations—100 percent accuracy in performing tasks, involvement and empowerment of employees at all levels, team-based work design, benchmarking, and total customer satisfaction. The managerial objective is to kindle a burning desire in people to use their ingenuity and initiative to progressively improve their performance of value chain activities. TQM doctrine preaches that there is no such thing as good enough and that everyone has a responsibility to participate in continuous improvement. The long-term payoff of TQM, if it comes, depends heavily on management’s success in implanting a culture within which TQM philosophies and practices can thrive.

**Core Concept**

TQM entails creating a total quality culture bent on continuously improving the performance of every task and value chain activity.

3. **Six Sigma Quality Control:** Six Sigma quality control consists of a disciplined, statistics-based system aimed at producing not more than 3.4 defects per million iterations for any business process—from manufacturing to customer transactions. The Six Sigma process of define, measure, analyze, improve, and control (DMAIC) is an improvement system for existing processes falling below specification and needing incremental improvement. The Six Sigma process of define, measure, analyze, design, and verify (DMADV) is an improvement system used to develop new processes or products at Six Sigma quality levels. Both Six Sigma processes are executed by personnel who have earned Six Sigma “green belts” and Six Sigma “black belts” and are overseen by personnel who have completed Six Sigma “master black belt” training. The statistical thinking underlying Six Sigma is based on the following three principles: all work is a process, all processes have variability, and all processes create data that explains variability. Six Sigma’s DMAIC process is a particularly good vehicle for improving performance when there are wide variations in how well an activity is performed. A problem tailor-made for Six Sigma occurs in the insurance industry, where it is common for top agents to outsell poor agents by a factor of 10 to 1.

4. **Illustration Capsule 11.1, Whirlpool’s Use of Six Sigma to Promote Operating Excellence,** describes Whirlpool’s use of Six Sigma in its appliance business.
Illustration Capsule 11.1, Whirlpool’s Use of Six Sigma to Promote Operating Excellence

Discussion Question: 1. What did Whirlpool do to sustain the productivity gains and cost savings derived through its implementation of Six Sigma?

Answer: To sustain these benefits, Whirlpool embedded Six Sigma practices within each of its manufacturing facilities worldwide and instilled a culture based on Six Sigma and lean manufacturing skills and capabilities.

5. The Difference Between Process Reengineering and Continuous Improvement Programs Like Six Sigma And TQM: The essential difference between business process reengineering and continuous improvement programs is that reengineering aims at quantum gains on the order of 30 to 50 percent or more whereas total quality programs stress incremental progress, striving for inch-by-inch gains again and again in a never ending stream. The two approaches to improved performance of value chain activities and operating excellence are not mutually exclusive; it makes good sense to use them in tandem.

Core Concept

Business process reengineering aims at one time quantum improvement; continuous programs like TQM and Six-Sigma aim at ongoing incremental improvements.

C. Capturing the Benefits of Initiatives to Improve Operations

1. Usually, the biggest beneficiaries are companies that view such programs not as ends in themselves but as tools for implementing and executing company strategy more effectively.

2. To get the most from programs for facilitating better strategy execution, managers must have a clear idea of what specific outcomes really matter.

3. The action steps managers can take to realize full value from TQM or Six Sigma initiatives include:
   a. Visible, unequivocal, and unyielding commitment to TQM and continuous improvement
   b. Nudging people toward TQM-supportive behaviors by:
      i. Screening job applicants rigorously
      ii. Providing quality training
      iii. Using teams and team-building exercises
      iv. Recognizing and rewarding individual and team efforts
      v. Stressing prevention not inspection
   c. Empowering employees
   d. Using online systems to provide all relevant parties with the latest best practices and actual experiences with them
   e. Preaching that performance can and must be improved
4. When used effectively, TQM, Six Sigma, and other similar continuous improvement techniques can greatly enhance a company’s product design, cycle time, production costs, product quality, service, customer satisfaction, and other operating capabilities and can help to deliver competitive advantage.

IV. Installing Information and Operating Systems

1. Company strategies cannot be executed well without a number of internal systems for business operations.

2. Well-conceived, state-of-the-art operating systems not only enable better strategy execution but also can strengthen organizational capabilities – perhaps enough to provide a competitive edge over rivals.

3. It is nearly always better to put infrastructure and support systems in place before they are actually needed than to have to scramble to catch up to customer demand.

Core Concept

State-of-the-art support systems can be a basis for competitive advantage if they give a firm capabilities that rivals cannot match.

A. Instituting Adequate Information Systems, Performance Tracking, and Controls

1. Accurate and timely information about daily operations is essential if managers are to gauge how well the strategy execution process is proceeding. Information systems need to cover five broad areas:
   
a. Customer data
b. Operations data
c. Employee data
d. Supplier/partner/collaborative ally data
e. Financial performance data

2. Real time information systems permit company managers to stay on top of implementation initiatives and daily operations and to intervene if things seem to be drifting off course.

3. Statistical information gives managers a feel for the numbers, briefings and meetings provide a feel for the latest developments and emerging issues, and personal contacts add a feel for the people dimension. All are good barometers.

Core Concept

Having good information systems and operating data are integral to competent strategy execution and operating excellence.

B. Exercising Adequate Controls over Empowered Employees

1. Leaving empowered employees to their own devices in meeting performance standards without appropriate checks and balances can expose an organization to excessive risk.

V. Tying Rewards and Incentives to Strategy Execution

1. It is important for both organization subunits and individuals to be enthusiastically committed to executing strategy and achieving performance targets.
2. To get employees’ sustained, energetic commitment, management has to be resourceful in designing and using motivational incentives—both monetary and nonmonetary.

**Core Concept**

A properly designed reward structure is management’s most powerful tool for mobilizing organizational commitment to successful strategy execution.

**A. Strategy-Facilitating Motivational Practices:**

1. Financial incentives generally lead the list of motivating tools for trying to gain wholehearted employee commitment to good strategy execution and operating excellence.

2. In addition, companies use a host of other motivational approaches to spur stronger employee commitment to the strategy execution process. Some of the most important include:
   
   a. Providing attractive perks and fringe benefits
   
   b. Relying on promotion from within whenever possible
   
   c. Making sure that the ideas and suggestions of employees are valued and respected
   
   d. Creating a work atmosphere where there is genuine sincerity, caring, and mutual respect among workers and between management and employees
   
   e. Stating the strategic vision in inspirational terms that make employees feel they are a part of doing something worthwhile in a larger social sense
   
   f. Sharing information with employees about financial performance, strategy, operational measures, market conditions, and competitors’ actions
   
   g. Having knockout facilities—an appealing work environment with appealing features and amenities
   
   h. Being flexible in how the company approaches people management—motivation, compensation, recognition, recruitment—in multinational, multicultural environments

**Core Concept**

One of management’s biggest strategy-executing challenges is to employ motivational techniques that build a wholehearted commitment to operating excellence and winning attitudes among employees.

3. **Illustration Capsule 11.2, What Companies do to Motivate and Reward Employees,** examines some of the varieties of techniques utilized by organizations to motivate employees.

**Illustration Capsule 11.2, What Companies do to Motivate and Reward Employees**

**Discussion Question:** 1. Companies engage a vast variety of employee motivational techniques. What is the primary purpose of implementation of these techniques?

**Answer:** Companies utilize a myriad of motivational and reward practices and techniques to help create a work environment that facilitates better strategy execution.
B. **Striking the Right Balance Between Rewards and Punishment**

1. While most approaches to motivation, compensation, and people management accentuate the positive, companies also embellish positive rewards with the risk of punishment.

2. As a general rule, it is unwise to take off the pressure for good individual and group performance or play down the stress, anxiety, and adverse consequences of shortfalls in performance.

3. High performing organizations nearly always have a cadre of ambitious people who relish the opportunity to climb the ladder of success, love a challenge, thrive in a performance-oriented environment, and find some competition and pressure useful to satisfy their own drives for personal recognition, accomplishment, and self-satisfaction.

4. If an organization’s motivational approaches and reward structure induce too much stress, internal competitiveness, job insecurity, and unpleasant consequences, the impact on work force morale and strategy execution can be counterproductive.

5. Evidence shows that managerial initiatives to improve strategy execution should incorporate more positive than negative motivational elements because when cooperation is positively enlisted and rewarded, rather than strong-armed by orders and threats, people tend to respond with more enthusiasm, dedication, creativity, and initiative.

C. **Linking the Reward System to Strategically Relevant Performance Outcomes**

1. The most dependable way to keep people focused on strategy execution and the achievement of performance targets is to generously reward and recognize individuals and groups who meet or beat performance targets and deny rewards and recognition to those who do not.

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**Core Concept**

A properly designed reward system aligns the well being of organization members with their contributions to competent strategy execution and the achievement of performance targets.

2. Strategy driven performance targets need to be established for every organization unit, every manager, every team or work group, and perhaps, every employee.

3. **Illustration Capsule 11.3, Nucor and Bank One: Two Companies that Tie Incentives Directly to Strategy Execution**, provides two vivid examples of how companies have designed incentives linked directly to outcomes reflecting good strategy execution.

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**Illustration Capsule 11.3, Nucor and Bank One: Two Companies that Tie Incentives Directly to Strategy Execution**

**Discussion Question:** 1. Identify the prominent result that each organization sustained from implementing a strategy that tied incentives directly to strategy execution.

**Answer:** Nucor’s management uses an incentive system to promote high worker productivity and drive labor costs per ton below rivals. Bank One ties its pay scales in each of its branch offices to that branch’s customer satisfaction ratings—the higher that branch’s satisfaction rating, the higher the pay scale at that branch.

4. **The Importance of Basing Incentives on Achieving Results, Not on Performing Assigned Duties:** To create a strategy-supportive system of rewards and incentives, a company must emphasize rewarding people for accomplishing results, not for just dutifully performing assigned functions.
Core Concept
It is folly to reward one outcome in hopes of getting another outcome.

5. Incentive compensation for top executives is typically tied to company profitability, the company’s stock price performance, and perhaps such measures as market share, product quality, or customer satisfaction.

6. Which performance measures to base incentive compensation on depends on the situation—the priority placed on various financial and strategic objectives, the requirements for strategic and competitive success, and what specific results are needed in different facets of the business to keep strategy execution on track.

Core Concept
The role of the reward system is to align the well being of organization members with realizing the company’s vision, so that organization members benefit by helping the company execute its strategy competently and fully satisfy customers.

7. Guidelines for Designing Incentive Compensation Systems: The concepts and company experiences discussed yield the following perspective guidelines for creating an incentive compensation system to help drive successful strategy execution:

a. The performance payoff must be a major not minor piece of the total compensation package
b. The incentive plan should extend to all managers and workers, not just top management
c. The reward system must be administered with scrupulous objectivity and fairness
d. The incentives to performance outcomes directly linked to good strategy execution and financial performance
e. The performance targets each individual is expected to achieve should involve outcomes that the individual can personally affect
f. Keep the time between performance review and payment of the reward short
g. Make liberal use of nonmonetary rewards—do not rely solely on monetary rewards
h. Absolutely avoid skirting the system to find ways to reward effort rather than results

8. Once the incentives are designed, they have to be communicated and explained.

Core Concept
The unwavering standard for judging whether individuals, teams, and organizational units have done a good job must be whether they meet or beat performance targets that reflect good strategy execution.

9. Performance-Based Incentives and Rewards in Multinational Enterprises: In some foreign countries, incentive pay runs counter to local customs and cultural norms.

10. Thus, multinational companies have to build some degree of flexibility into the design of incentives and rewards in order to accommodate cross-cultural traditions and preferences.
CHAPTER SUMMARY

Chapter Twelve explores the two remaining managerial tasks that shape the outcome of efforts to execute a company’s strategy: creating a strategy-supportive corporate culture and exerting the internal leadership needed to drive the implementation of strategic initiatives forward and achieve higher plateaus of operating excellence.

LECTURE OUTLINE

I. Instilling a Corporate Culture that Promotes Good Strategy Execution

1. Every company has its own unique culture. The character of a company’s culture or work climate is a product of the core values and business principles that executives espouse, the standards of what is ethically acceptable and what is not, the work practices and behaviors that define “how we do thing around here,” its approach to people management and the “chemistry” and the “personality” that permeates its work environment.

2. The meshing together of stated beliefs, business principles, style of operating, ingrained behaviors and attitudes, and work climate define a company’s corporate culture.

3. Corporate cultures vary widely.

Core Concept

Corporate culture refers to the character of a company’s internal work climate and personality—as shaped by its core values, beliefs, business principles, traditions, ingrained behaviors, and style of operating.

A. Identifying the Key Features of a Company’s Corporate Culture

1. A company’s corporate culture is mirrored in the character or “personality” of it work environment: The chief things to look for include the following:

   a. The values, business principles, and ethical standards that management preaches and practices—actions speak louder than words

   b. The company’s approach to people management and the official policies, procedures and operating practices that paint the white lines for the behavior of company personnel

   c. The spirit and character that pervades the work climate. Is the workplace vibrant and fun? Methodical and all-business? Tense and harried? Highly competitive and politicized? Are people excited about their work and emotionally connected to the company’s business, or are they just in it for the paycheck
d. How managers and employees interact and relate to each other—the reliance on teamwork and open communication, the extent to which there is good camaraderie, whether people are called by their first names, what the dress codes are

e. The strength of peer pressure

f. The company’s revered traditions and oft-repeated stories about “heroic act” and “how we do things around here:

g. The manner in which the company deals with external stakeholders (particularly vendors and local communities where it has operations.

2. Some of sociological forces are readily apparent and others operate quite subtly.

3. The values, beliefs, and practices that undergird a company’s culture can come from anywhere in the organization hierarchy, most often representing the business philosophy and managerial style of influential executives.

Illustration Capsule 12.1, The Corporate Cultures at Google and Alberto-Culver

Discussion Question: 1. What does the statement describing Alberto-Culver’s work climate/culture indicate?

Answer: The statement made by this organization represents its core values and beliefs. It defines how it will address problems and identifies the value and importance it puts on its employees. Alberto-Culver’s guiding work philosophies for its employees are clearly presented within this statement.

4. The Role of Stories: Frequently, a significant part of a company’s culture is captured in the stories that get told over and over again to illustrate to newcomers the importance of certain values and the depth of commitment that various company personnel have displayed.

5. Perpetuating the Culture: Once established, company cultures are perpetuated in six important ways:

   a. By screening and selecting new employees that will mesh well with the culture

   b. By systematic indoctrination of new members in the culture’s fundamentals

   c. By the efforts of senior group members to reiterate core values in daily conversations and pronouncements

   d. A company’s corporate culture is mirrored in the character or “personality” of its work environment

   e. By the telling and retelling of company legends

   f. By regular ceremonies honoring members who display desired cultural behaviors

   g. By visibly rewarding those who display cultural norms and penalizing those who do not

7. Forces that Cause a Company’s Culture to Evolve: New challenges in the marketplace, revolutionary technologies, and shifting internal conditions tend to breed new ways of doing things and, in turn, cultural evolution.

8. Company Subcultures: The Problems Posed by New Acquisitions and Multinational Operations: Values, beliefs, and practices within a company sometimes vary significantly by department,
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geographic location, division, or business unit. Global and multinational companies tend to be at least partly multicultural because cross-country organization units have different operating histories and working climates, as well as members who have grown up under different social customs and traditions and who have different sets of values and beliefs. Many companies that have merged with or acquired foreign companies have to deal with language and custom-based differences. In today’s globalizing world, multinational companies are learning how to make strategy-critical cultural traits travel across country boundaries and create a workably uniform culture worldwide.

B. Strong versus Weak Cultures

1. Corporate cultures vary widely in the degree to which they are embedded in company practices and behavioral norms.

2. **Strong-Culture Companies**: Strong-culture companies have a well-defined corporate character, typically underpinned by a creed or values statement. Three factors contribute to the development of strong cultures:
   a. A founder or strong leader who establishes values, principles, and practices that are consistent and sensible in light of customer needs, competitive conditions, and strategic requirements
   b. A sincere, long-standing company commitment to operating the business according to these established traditions, thereby creating an internal environment that supports decision making and strategies based on cultural norms
   c. A genuine concern for the well-being of the organization’s three biggest constituencies—customers, employees, and shareholders

   **Core Concept**

   In a strong-culture company, culturally-approved behaviors and ways of doing things are nurtured while culturally-disapproved behaviors and work practices get squashed.

3. **Weak-Culture Companies**: In direct contrast to strong-culture companies, weak-culture companies are fragmented in the sense that no one set of values is consistently preached or widely shared, few behavioral norms are evident in operating practices, and few traditions are widely revered or proudly nurtured by company personnel. Very often, cultural weaknesses stems from moderately entrenched subcultures that block the emergence of a well-defined companywide work climate.

4. Weak cultures provide little or no strategy-implementing assistance because there are no traditions, beliefs, values, common bonds, or behavioral norms that management can use as levers to mobilize commitment to executing the chosen strategy.

D. Unhealthy Cultures

1. The distinctive characteristic of an unhealthy corporate culture is the presence of counterproductive cultural traits that adversely impact the work climate and company performance.

2. The following four traits are particularly unhealthy:
   a. A highly politicized internal environment in which many issues get resolved and decisions made on the basis of which individuals or groups have the most political clout to carry the day
   b. Hostility to change and a general wariness of people who champion new ways of doing things
   c. A “not invented here” mindset that makes company personnel averse to looking outside the company for best practices, new managerial approaches, and innovative ideas
d. A disregard for high ethical standards and overzealous pursuit of wealth and status on the part of key executives.

3. Politicized Cultures: What makes a politicized internal environment so unhealthy is that political infighting consumes a great deal of organizational energy. Often with the result that political maneuvering takes precedence over what is best for the company.

4. Change-Resistant Cultures: In less adaptive cultures where skepticism about the importance of new developments and resistance to change are the norm, managers prefer waiting until the fog of uncertainty clears before steering a new course.

5. Change-resistant cultures encourage a number of undesirable or unhealthy behaviors—risk avoidance, timidity regarding emerging opportunities, and laxity in product innovation and continuous improvement.

6. Insular, Inwardly Focused Cultures: The third unhealthy cultural trait—the not-invented-here mind-set—tends to develop when a company reigns as an industry leader or enjoys great market success for so long that its personnel start to believe they have all the answers or can develop them on their own.

7. Unethical and Greed-Driven Cultures: Companies that have little regard for ethical standards or that are run by executives driven by greed and ego gratification are scandals waiting to happen.

E. High-Performance Cultures

1. The standard cultural traits of high performance cultures are a can-do spirit, pride in doing things right, no-excuses accountability, and a pervasive result-oriented work climate. There is a strong sense of involvement on the part of company personnel and emphasis on individual initiative and creativity.

2. The challenge in creating a high performance culture is to inspire high loyalty and dedication on the part of employees.

3. Why does an adaptive culture not become unglued with ongoing changes in strategy, operating practices and behavioral norms. The answer lies in two distinctive and dominant traits of an adaptive culture.

F. Adaptive Cultures

1. The hallmark of adaptive corporate cultures is willingness on the part of organizational members to accept change and take on the challenge of introducing and executing new strategies.

Core Concept

In adaptive cultures, there is a spirit of doing what is necessary to ensure long-term organizational success provided the new behaviors and operating practices that management is calling for are seen as legitimate and consistent with the core values and business principles underpinning the culture.

2. In direct contrast to change-resistant cultures, adaptive cultures are very supportive of managers and employees at all ranks who propose or help initiate useful change.

3. What sustains an adaptive culture is that organization members perceive the changes that management is trying to institute as legitimate and in keeping with the core values and business principles that form the heart and soul of the culture.
4. For an adaptive culture to remain intact over time, top management must orchestrate the responses in a manner that demonstrates genuine care for the well-being of all key constituencies and tries to satisfy all their legitimate interests simultaneously.

5. In fast-changing business environments, a corporate culture that is receptive to altering organizational practices and behaviors is a virtual necessity.

6. *As a company’s strategy evolves, an adaptive culture is a definite ally in the strategy-implementing, strategy-executing process as compared to cultures that have to be coaxed and cajoled to change.*

**Core Concept**

Adaptive cultures are exceptionally well suited to companies with fast-changing strategies and market.

G. **Culture: Ally or Obstacle to Strategy Execution.**

1. A company’s present culture and work climate may or may not be compatible with what is needed for effective implementation and execution of the chosen strategy.

2. When a company’s present work climate promotes attitudes and behaviors that are well suited to first-rate strategy execution, its culture functions as a valuable ally in the strategic execution process.

3. When the culture is in conflict with some aspect of the company’s direction, performance targets, or strategy, the culture becomes a stumbling block.

4. **How a Company’s Culture Can Promote Better Strategy Execution:** A culture grounded in strategy-supportive values, practices, and behavioral norms adds significantly to the power and effectiveness of a company’s strategy execution effort.

5. A tight culture-strategy match-up furthers a company’s strategy execution effort in three ways:

   a. A culture that encourages actions, behaviors, and work practices supportive of good strategy execution not only provides company personnel with clear guidance regarding “how we do things around here” but also produces significant peer pressure from coworkers to conform to culturally acceptable norms.

   **Core Concept**

The tighter the culture-strategy fit, the more the culture steers company personnel into displaying behaviors and adopting operating practices that promote good strategy execution.

   b. A deeply embedded culture tightly matched to the strategy aids the cause of competent strategy execution by steering company personnel to culturally approved behaviors and work practices, thus making it far simpler for management to root out operating practices that are a misfit.

   c. A culture embedded with values and behaviors that facilitate strategy execution promotes strong employee identification with and commitment to the company’s vision, performance targets, and strategy.

   **Core Concept**

It is in management’s best interest to dedicate considerable effort to building a corporate culture that encourages behaviors and work practices conducive to good strategy execution—a tight strategy-culture fit automatically nurtures culturally approved behaviors and squashes culturally disapproved behaviors.
6. **The Perils of Strategy-Culture Conflict:** A real dilemma is posed by conflicts between behaviors approved by the culture and behaviors needed for good strategy execution.

7. *When a company’s culture is out of sync with the actions and behaviors needed to execute the strategy successfully, the culture has to be changed as rapidly as can be managed.* This presumes that one or more aspects of the culture are out of whack rather than the strategy execution approach.

H. **Changing a Problem Culture**

1. Changing a problem culture is one of the toughest tasks because of the heavy anchor of ingrained behaviors and ways of doing things.

2. The single most visible factor that distinguishes successful culture-change efforts from failed attempts is competent leadership at the top. Great power is needed to force major cultural change and overcome the springback resistance of entrenched cultures.
   a. The first step in fixing the problem culture, as shown in Figure 12.1, is for top management to identify those facets of the present culture that are dysfunctional and pose obstacles to executing new strategic initiatives and meeting or beating company performance targets.
   b. Second, managers have to clearly define the desire new behaviors and features of the culture they want to create.
   c. Third, managers have to convince company personnel why the present culture poses problems and why and how new behaviors and operating approaches will improve company performance—the case for cultural reform has to be persuasive.
   d. Finally, and most important, all the talk about remodeling the present culture has to be followed swiftly by visible, forceful actions to promote the desired new behaviors and work practices.

3. **Making a Compelling Case for Culture Change:** Management must sell company personnel on the need for new-style behaviors and work practices by making a compelling case for why the company’s new strategic direction and culture-remodeling efforts are in the organization best interest. This can be done by:
   a. Citing reasons why the current strategy has to be modified and why new strategic initiatives that are being undertaken will bolster the company’s competitiveness and performance.
   b. Explaining why and how certain behavioral norms and work practices in the current culture pose obstacles to good execution of new strategic initiatives.
   c. Explaining how new behavior and work practices that are to have important roles in the new culture will be more advantageous and produce better results.

4. **Figure 12.1, Changing a Problem Culture**

5. Arguments for new ways of doing things and new work practices tend to be embraced more readily if employees understand how they will benefit company stakeholders.

6. **Substantive Culture-Changing Actions:** Company executives have to give the culture-change effort some teeth by initiating a series of actions that company personnel will see as credible and unmistakably indicative of management’s commitment.
   a. Replacing key executives who are strongly associated with the old culture and are stonewalling needed organizational and cultural changes.
   b. Promoting individuals who are known to possess the desired cultural traits and can serve as role models for the desired cultural behavior.
c. Appointing outsider with the desired cultural attributes to high-profile positions.
d. Screening all candidates for new positions carefully, hiring only those who appear to fit in with
the new culture.
e. Mandating that all company personnel attend culture training programs.
f. Pushing hard to implement new-style work practices and operating procedures.
g. Designing compensation incentives that boost the pay of teams and individuals who display the
desired cultural behaviors and hit change-resisters in the pocketbook.
h. Granting generous pay raises to individuals who step out front, lead the adoption of the desired
work practices, display the new-style behaviors, and achieve pace-setting results.
i. Revising policies and procedures in ways that will help drive cultural change.

7. **Symbolic Culture-Changing Actions** to alter a problem culture and tighten the strategy—culture
fit:

a. Lead by example.
b. Hold ceremonial events to single out and honor people whose actions and performance
exemplify what is called for in the new culture.
c. Use symbols in culture-building (such as employee of the month award).

8. **How Long Does It Take to Change a Problem Culture?**

a. Planting and growing the seeds of a new culture require a determined effort by the chief
executive and other senior managers.
b. Overnight transformations simply don’t occur, and it takes even longer for a new culture to
become deeply embedded.
c. It is usually tougher to reform an entrenched problematic culture than it is to instill strategy-
supportive culture from scratch in a brand-new organization.

9. **Illustration Capsule 12.2, Changing the “Old Detroit” Culture at Chrysler**, discusses the
approaches being used at Chrysler in 2007-2008 to change a culture that was grounded in a 1970’s
view of the automobile industry.

<table>
<thead>
<tr>
<th>Illustration Capsule 12.2, Changing the “Old Detroit” Culture at Chrysler</th>
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| **Discussion Question:** 1. What elements were put in place in this organization’s
concerted effort to implement cultural change? |
| **Answer:** The new CEO of Chrysler replaced managers unwilling to commit themselves to the new
culture. Decisions began to be made based on what was best for the customer vs. the bottom line.
Promotion and compensation were changed to reward performance, not seniority, and a former Toyota
executive was brought in as vice chairman of the company to push the drive for improved product
quality. It was expected to take many years on management’s part to break the ingrained behaviors
that had damaged the company. |
I. **Grounding the Culture in Core Values and Ethics**

1. A corporate culture grounded in socially approved values and ethical business principles is a vital ingredient in a company’s long-term strategic success.

2. **Table 12.1, Representative Content of Company Values Statements and Codes of Ethics**, indicate the kinds of topics that are commonly found in values statements and codes of ethics.

3. **The Culture-Building Role of Values and Codes of Ethics**: At companies where executives are truly committed to practicing the values and ethical standards that have been espoused, the stated core values and ethical principles are the cornerstones of the corporate culture.

4. **Transforming Core Values and Ethical Standards into Cultural Norms**: Once values and ethical standards have been formally adopted, they must be institutionalized in the company’s policies and practices and ingrained in the conduct of company personnel. Embedding the values and code of ethics entails several actions:
   
   a. Giving explicit attention to values and ethics in recruiting and hiring to screen out applicants who do not exhibit compatible character traits.
   
   b. Incorporation of the statement of values and the code of ethics into employee training and educational programs
   
   c. Having senior executives frequently reiterate the importance and roles of company values and ethical principles
   
   d. Using values statements and codes of ethical conduct as benchmarks for judging the appropriateness of company policies and operating practices.
   
   e. Making the display of core values and ethical principles a big factor in evaluating each person’s job performance
   
   f. Active management involvement, from the CEO down to frontline supervisors, in stressing the importance of values and ethical conduct and in overseeing the compliance process
   
   g. Encouraging everyone to use their influence in helping enforce observance of core values
   
   h. Ceremonies and awards for individuals and groups who display the values
   
   i. Instituting ethics enforcement procedures

**Core Concept**

A company’s culture is grounded in and shaped by its core values and the bar it sets for ethical behavior.

5. **Figure 12.2, The Two Culture Building Roles of a Company’s Core Values and Ethical Standards**, explains the vitality of a company’s core values and ethical standards.

6. **The benefits of Cultural Norms Grounded in Core Values and Ethical Principles**: The more the managers succeed in making the espoused values and ethical principles the main drivers of “how we do things around here,” the more that the values and ethical principles function as cultural norms.
7. By promoting behaviors that mirror the values and ethics standards, a company’s stated core values and ethical standards nurture the corporate culture in three highly positive ways:
   a. They communicate the company’s good intentions and validate the integrity and aboveboard character of its business principles and operating methods
   b. They steer company personnel toward doing the right thing
   c. They establish a corporate conscience and provide yardsticks for gauging the appropriateness of particular actions, decisions, and policies

J. Establishing a Strategy-Culture Fit in Multinational and Global Companies

1. In multinational and global companies where some cross-border diversity in the corporate culture is normal, efforts to establish a tight-strategy-culture fit is complicated by the diverse social circumstances societal circumstances.

2. Cross-country diversity is more tolerable if the company is pursuing a multicountry strategy and if the company’s culture in each country is well aligned with its strategy in that country.

3. The trick to establishing a workable strategy-culture fit in multinational and global companies is to ground the culture in strategy-supportive values and operating practices that can travel well across country borders and strike a chord with managers and workers in many different areas of the world, despite the diversity of local customs and traditions.

4. Aside from trying to ground the culture in a set of core values and operating principles that have universal appeal, management can seek to minimize the existence of subcultures and cross-country cultural diversity by:
   a. Instituting culture training in each country to communicate the meaning of core values in language that resonates with company personnel, and explaining the case for common operating principles and work practices
   b. Creating a cultural climate where it is the norm to adopt best practices, use common work procedures and pursue operating excellence.
   c. Giving local managers the flexibility to modify people management approaches or operating styles in those situations where adherence to companywide cultural traditions simply doesn’t work well.
   d. Giving local managers discretionary authority to use somewhat different motivational and compensation incentives to induce local personnel to adopt and practice the desired cultural behaviors.

Core Concept

A multinational company needs to build its corporate culture around values and operating practices that travel well across borders.

III. Leading the Strategy-Execution Process

1. Top executives have to be out front personally leading the implementation/execution process and driving the pace of progress for an enterprise to execute its strategy in a truly proficient fashion.

2. Top executives—and, to some degree, the enterprise’s entire management team, must seek to engage the full organization. A fully engaged workforce is a necessary element to producing great results.
3. Top level executives can usually best create fully engaged organizations by delegating authority to middle and lower-level managers and by creating a sense of empowerment among employees.

4. When the situation allows managers to proceed more deliberately in deciding when to make changes and what changes to make, most managers seem to prefer a process of incrementally solidifying commitment to a particular course of action.

5. Success in initiating corrective actions usually hinges on thorough analysis of the situation, the exercise of good business judgment in deciding what actions to take, and good implementation of the corrective actions that are initiated.

IV. A Final Word on Managing the Process

1. In practice it is hard to separate the leadership requirements of executing strategy from the other pieces of the strategy process. The process is continuous and the conceptually separate acts of crafting and executing strategy blur together in real-world situations.

2. The best tests of good strategic leadership are whether the company has a good strategy and whether the strategy execution effort is delivering the hoped-for results.
Founded in 1980, Whole Foods Market had evolved from a local supermarket for natural and health foods in Austin, Texas, into the world’s largest retail chain of natural and organic foods supermarkets. In 2008, the company had 276 stores in the United States, Canada, and Great Britain and 2007 sales of $6.6 billion. Revenues had grown at a compound annual rate of 30 percent since 1991 and 20 percent since 2000. Management’s near-term growth objectives for Whole Foods were to have 400 stores and sales of $12 billion in fiscal year 2010.

During its 27-year history, Whole Foods Market had been a leader in the natural and organic foods movement across the United States, helping the industry gain acceptance among growing numbers of consumers concerned about the food they ate. The company sought to offer offering the highest quality, least processed, most flavorful and naturally preserved foods available. John Mackey, the company’s cofounder and CEO, believed Whole Foods’ rapid growth and market success had much to do with its having “remained a uniquely mission-driven company—highly selective about what we sell, dedicated to our core values and stringent quality standards and committed to sustainable agriculture.”

Mackey’s vision was for Whole Foods to become an international brand synonymous with not just natural and organic foods, but with being the best food retailer in every community in which Whole Foods stores were located. He wanted Whole Foods Market to set the standard for excellence in food retailing. Mackey’s philosophy was that marketing high quality natural and organic foods to more and more customers in more and more communities would over time gradually transform the diets of individuals in a manner that would help them live longer, healthier, more pleasurable lives. But as the company’s motto “Whole Foods, Whole People, Whole Planet” implied, its core mission extended well beyond food retailing. At its web site, the company proclaimed that its deepest purpose as an organization was helping support the health, well-being, and healing of both people—customers, team members, and business organizations in general—and the planet.

Whole Foods’ stores were highly appealing places to shop. Management put considerable emphasis on attractive stores, a colorful décor, and appealing product displays. The company got very high marks from merchandising experts and customers for its presentation—from the bright colors and hand-stacked fruits to the quality of the foods and customer service to the wide aisles and cleanliness. Most stores featured hand-stacked produce, in-store chefs and open kitchens, scratch bakeries, prepared foods stations, European-style charcuterie departments, sampling displays, and ever-changing selections and merchandise displays. Whole Foods’ merchandising skills were said to be a prime factor in its success in luring shoppers back time and again. The company’s newest and biggest stores were generating average weekly sales in excess of $600,000 (over $30 million annually).

The focus of the case is on Whole Foods’ strategy and operations in the rapidly developing natural and organic foods segment of the roughly $850 billion food retailing industry in the U.S. The company is interesting in several important respects: it is an up-and-coming grocery chain—one that is making a name for itself and starting to move into the ranks of the industry leaders; it “walks the talk” in striving to live up to its core values (which are pretty impressive and are featured in the case); it is deservedly ranked among the best companies to work for in America (the only grocery chain to make the list each of the past 9 years); it has a pretty impressive strategy; and until 2008 when the economy soured, its financial performance was quite good.
But in late 2008, the company’s rapid growth strategy and recent acquisition of rival Wild Oats Market had strained the company’s financial resources; moreover, deepening recessionary conditions had caused the once-buoyant sales at Whole Foods stores to stagnate. Can and should the company cut back on new store openings, despite having signed leases for the facilities? Are other strategy changes needed? And was the acquisition of Wild Oats proving to be as good a move as had originally been thought?

SUGGESTIONS FOR USING THE CASE

This case was written to (1) illustrate the CEO’s role as chief strategist and organization leader, (2) demonstrate how a company’s business principles and core values can link tightly to and drive a company’s strategy and operating practices, and (3) give students practice in evaluating a company’s direction and strategy in the context of a fast-emerging segment of an important industry. The case requires that students draw upon most all of the concepts discussed in Chapters 1 and 2 in preparing the case for class discussion.

We think Whole Foods Market is an excellent leadoff case for the course (other good choices are Costco Wholesale, JetBlue, and Robin Hood—all three of which require that students draw upon the material covered in Chapters 1 and 2). Student familiarity with supermarkets and food retailing, the growing popularity of healthy foods, the very interesting character of Whole Foods Market, and the very close connection between the case and the material in Chapters 1 and 2 make this an especially good leadoff case. You may want to consider covering Chapter 1 in your first day’s lecture, Chapter 2 on your second day’s lecture, and then assigning Whole Foods Market for class discussion on Day 3.

However, if you opt for another lead-off case, we think you will find that the Whole Foods case works exceptionally well (1) as part of a business strategy module—because there is some good information in the case on the organic foods industry and the competition that Whole Foods faces from growing supermarket interest in stocking a wider selection of natural and organic foods, (2) as part of your module on strategy execution—the case has considerable material on compensation, the use of empowered teams, and corporate culture, for example, or (3) as a comprehensive written case towards the end of the course or final exam case (because the case contains issues that cut across the material covered in all 12 chapters). Thus, Whole Foods is one of those multi-issue, multi-faceted cases that fits nicely in any of several places in your lineup of case assignments—although our preference is to use it as a leadoff case.

You’ll find ample opportunity here to explore John Mackey’s strategic vision for Whole Foods (presented in Exhibit 1), the company’s core values and operating practices (Exhibit 3), the components of Whole Foods’ strategy, and the striking success that Whole Foods is having with its supermarket concept for natural and organic foods in the marketplace. If you wait to assign the case until students have read Chapters 3, 4, and 5, then you can expect students to probe a bit deeper in evaluating the extent to which Whole Foods can contend with competition from other organic/natural foods rivals and major supermarket chains. But students will really have no trouble wrestling with the competitive issues and generating opinions without the benefit of having first covered Chapters 3, 4, and 5—this is because they not only have some personal familiarity with the supermarket industry but also because the issues and analysis turn out to be fairly clear-cut, which is why Whole Foods makes such a good leadoff case.

We suggest use of a teaching plan that focuses on John Mackey’s strategic vision, the company’s “Whole Foods, Whole People, Whole Planet” motto (Exhibit 1), the company’s core values (Exhibit 3), the company’s strategy, the fit between the company’s strategy and recent developments in the natural and organic foods segment of the food retailing industry, the shopping atmosphere that Whole Foods has managed to create in its stores, the recent acquisition of Wild Oats Market, whether Whole Foods has achieved a competitive advantage over rivals, and the unexpected challenges of dealing with a severe recession and tight financial resources.

The assignment questions and teaching outline presented in upcoming sections of this TN reflect our thinking about how to conduct the class discussion of the Whole Foods case.
To give students guidance in what to do and think about in preparing the Costco case for class discussion, we strongly recommend providing class members with a set of study questions and insisting that they prepare good notes/answers to these questions in preparing for class discussion of the case.

*To facilitate your use of study questions and making them available to students, we have posted a file of the Assignment Questions contained in this teaching note for the Whole Foods Market on the student section of the publisher’s Online Learning Center for the 17th edition ([www.mhhe.com/thompson](http://www.mhhe.com/thompson)). (We should also point out that there is a set of study questions posted in the student section of the OLC for each of the 26 cases included in the 17th edition.)*

It is really very difficult to have an insightful and constructive class discussion of the Costco case unless students have not only read the case but also conscientiously worked their way through a set of well-conceived study questions before they come to class. In our classes, we expect students to bring their notes to the study questions to use/refer to in responding to the questions that we pose. Students often find having a set of study questions is useful in helping them prepare oral team presentations and written case assignments—in addition to whatever directive questions you supply for these assignments.

You may also find it beneficial to have your class read the Guide to Case Analysis that is posted in the student section of the Online Learning Center for the 17th edition at [www.mhhe.com/thompson](http://www.mhhe.com/thompson). Students will find the content of this Guide particularly helpful if this is their first experience with cases and they are unsure about the mechanics of how to prepare a case for class discussion, oral presentation, or written analysis.

The range of issues in the Whole Foods case and the rich information it contains makes it suitable for both oral team presentations and a written case assignment. Our suggested assignment question for the Whole Foods case is as follows:

What is your assessment of John Mackey’s strategic vision for Whole Foods Market, the strategic objectives he has set for the company, the core values that Whole Foods displays in its operations, and the company’s strategy? How well is Whole Foods’ strategy working? Was the Wild Oats Market acquisition a good move or a mistake? What recommendations would you make to John Mackey in light of recent events at the company?

ASSIGNMENT QUESTIONS

1. What are the chief elements of the strategy that Whole Foods Market is pursuing?
2. Is the strategy well matched to recent developments and conditions in the natural and organic foods segment of the food retailing industry?
3. Do you think John Mackey has a good strategic vision for Whole Foods? Why or why not? What do you like/dislike about the company’s motto “Whole Foods, Whole People, Whole Planet?” Do the motto and the principles underlying it (Exhibit 1) really matter at this company or are they just nice words and cosmetic window dressing? Explain.
4. Do Whole Foods Market’s core values as presented in case Exhibit 3 really matter? Are they “real” or just cosmetic window dressing? What evidence can you cite to support your answer? Have Whole Foods’ core values contributed to the company’s success? Why or why not?
5. How well is Whole Foods Market performing from a financial perspective? Do some number-crunching using the data in case Exhibits 9 and 10 to support your answer. Use the financial ratios presented in Table 4.1 of Chapter 4 (pages 104-105) as a basis for doing your assessment of the company’s financial statements and financial condition.
6. How well is Whole Foods Market performing from a strategic perspective? Does Whole Foods enjoy a competitive advantage over its rivals? Does the company have a winning strategy?
7. Do you approve of the decision to acquire Wild Oats Market? What pros and cons do you see?

8. Were John Mackey’s Internet postings unethical or in any way inappropriate? What actions, if any, do you disapprove of? What actions, if any, should the company’s board of directors take with regard to his Internet posting and blogs?

9. What recommendations would you make to John Mackey regarding the actions that Whole Foods’ management needs to take to get through the recession that began in earnest in 2008? Should the company severely cut back on opening so many new stores? Should the company vigorously contest the reopening of the FTC’s challenge to the Wild Oats acquisition? Are any other strategy changes needed?

TEACHING OUTLINE AND ANALYSIS

1. What are the chief elements of the strategy that Whole Foods Market is pursuing?

Students ought to be able to identify the following central elements of Whole Foods Market’s strategy:

- The company’s growth strategy was to expand via a combination of opening its own new stores and acquiring existing stores.

  - About one-half of the company’s store base had come from acquisitions (since 1991, the company had acquired 134 stores through 15 acquisitions)—see case Exhibit 4.

  - The acquisition of Wild Oats Market was far and away the company’s biggest and most important acquisition—and also something of a departure for Whole Foods, given the smaller format of Wild Oats’ stores and Whole Foods focus on opening large-supermarket stores.

  - But the acquisition phase would seem to be pretty much over as of 2008. The company is (and probably should be) concentrating on opening new stores in the 40,000 to 60,000 square-foot range and there are almost no organic/natural foods companies with stores of this size to acquire—there seems little reason for Whole Foods to consider acquiring Trader Joe’s or Fresh Markets, for example. The company’s “sweet spot” for most markets it had entered since 2000 (except for the acquisition of Wild Oats Market which had substantially smaller stores) was a store footprint between 45,000 and 60,000 square feet. All told, in early 2008, WFM had 82 stores that were 40,000 square feet or larger—the biggest was a 99,800 square-foot store in London. The 100+ stores that company had opened since 2000 averaged 48,000 square feet and 18 Whole Foods stores were over 60,000 square feet. Whole Foods had the two largest supermarket stores in New York City, a 58,000 square-foot store on Columbus Circle in Manhattan and a 71,000 square-foot store in the Bowery area. Whole Foods had a 74,500 square foot store in Columbus, OH; a flagship 78,000 square-foot store in Austin, TX; a 77,000 square-foot store in Pasadena, CA; and two 75,000 square-foot stores in the suburbs of Atlanta, GA.

  - It was the company’s practice each year to relocate some of its smaller stores to larger sites with improved visibility and parking.

  - In early 2008, the company had 89 stores averaging 51,500 square feet in in the planning and pre-opening stages; 13 of these were over 65,000 square feet in size (the new stores of supermarket chains like Safeway and Kroger averaged around 55,000 square feet) and 15 were in new geographic markets. Case Exhibit 5 provides store-related statistics.

  - The cash investment needed to get a new Whole Foods Market site ready for opening varied with the metropolitan area, store size, amount of work performed by the landlord, and the complexity of site development issues—the average capital cost was $15.1 million in 2007. In addition to the
capital cost of a new store, it took about $850,000 to stock a store with inventory, a portion of which was financed by vendors. Pre-opening expenses (including rent) averaged $2.6 million for the 21 new stores opened and relocated in fiscal 2007. Until the $534 million Wild Oats acquisition in fiscal 2007 and the recent cash crunch in 2008, Whole Foods was able to finance most of the expansion with internally-generated funds—financially-savvy students will be able to glean this from the company’s financial statements, particularly case Exhibits 10 and 11.

Many of Whole Foods newest stores were larger partly to provide the space needed for an assortment of attractive sections and departments calculated to heighten the experience and thrill of shopping at a Whole Foods store. For instance, Whole Foods’ 78,000 square-foot flagship Austin store was a top Central Texas tourist destination and downtown Austin landmark; it had an intimate village-style layout, six mini-restaurants within the store, a raw food and juice bar, more than 600 varieties of cheese and 40 varieties of olives, a selection of 1800 wines, a Candy Island with handmade lollipops and popcorn balls, a hot nut bar with an in-house nut roaster, a world foods section, a walk-in beer cooler with 800 selections, 14 pastry chefs making a variety of items, a natural home section with organic cotton apparel and household linens, an extensive meat department with an in-house smoker and 50 oven-ready items prepared by in-house chefs, and a theater-like seafood department with more than 150 fresh seafood items and on-the-spot shucking, cooking, smoking, slicing and frying to order. The Columbus Circle store in Manhattan had a 248-seat café where shoppers could enjoy restaurant-quality prepared foods while relaxing in a comfortable community setting; a Jamba Juice® smoothie station that served freshly blended-to-order fruit smoothies and juices; a full service Sushi Bar by Genji Express where customers sat on bar stools wrapped in Nori seaweed enjoying fresh-cut sushi wrapped in organic seaweed; a walk-in greenhouse showcasing fresh cut and exotic flowers; a wine shop with more than 700 varieties of wine from both large and small vineyards and family estates; and a chocolate enrobing station in the bakery where customers could request just about anything covered in chocolate. The two-story store in Pasadena, California (Whole Foods’ largest store west of the Rocky Mountains), had a wine and tapas lounge, a seafood bar, an Italian Trattoria, 1200 selections of wine, fresh donuts made hourly, a 6,000 square-foot produce department that featured more than 500 items daily, and free wireless Internet access. The 3-floor, 99,800 square-foot store in London had 55 in-store chefs, 13 dining venues (including a tapas bar, a champagne and oyster bar, a pub, and a sushi and dim sum eatery) that accommodated 350 diners, a self-service bulk foods center with 100 selections, and a 12-meter display of fresh seafood (many of the seafood selections were hook-and-line caught of the shores of the UK).

However, now that Whole Foods has acquired and begun operating the much smaller-scale Wild Oats stores, Whole Foods has to institute a small-scale store strategy/format alongside its preferred large-scale store format/strategy. It is too early to say how well this will work out.

The driving concept of Whole Foods’ merchandising strategy was to create an inviting and interactive store atmosphere that turned shopping for food into a fun, pleasurable experience. Management at Whole Foods wanted customers to view company stores as a “third place” (besides home and office) where people could gather, learn, and interact while at the same time enjoying an intriguing food-shopping and eating experience.

Stores had a colorful décor, and products were attractively merchandised (as shown in case Exhibit 7). According to one industry analyst, Whole Foods had “put together the ideal model for the foodie who’s a premium gourmet and the natural foods buyer. When you walk into a Whole Foods store, you’re overwhelmed by a desire to look at everything you see.”

Most stores featured hand-stacked produce, in-store chefs and open kitchens, scratch bakeries, prepared foods stations, European-style charcuterie departments, sampling displays, and ever-changing selections and merchandise displays.

Whole Foods got very high marks from merchandising experts and customers for its presentation—from the bright colors and hand-stacked fruits to the quality of the foods and customer service to the wide aisles and cleanliness.
Management continually experimented with new merchandising concepts to keep stores fresh and exciting for customers. According to a Whole Foods regional manager, “We take the best ideas from each of our stores and try to incorporate them in all our other stores. We’re constantly making our stores better.”

Whole Foods’ merchandising skills were said to be a prime factor in its success in luring shoppers back time and again—Whole Foods large-scale stores had annual sales averaging more than $800 per square foot of space about double the sales per square foot of a Kroger or Safeway supermarket.

Whole Foods sought to locate its new stores in the upscale areas/suburbs of major metropolitan areas.

- In 2008, Whole Foods had stores in 36 states. Most stores were in high-traffic shopping locations; some were freestanding and some were in strip centers.
- Whole Foods had its own internally-developed model to analyze potential markets based on education levels, population density, and income. After picking a target metropolitan area, the company’s site consultant did a comprehensive site study and developed sales projections; potential sites had to pass EVA hurdles. New stores opened 12 to 24 months after a lease was signed.

While product and brand selections varied from store to store (because stores were differing store sizes and clienteles), Whole Foods’ product line at its large-scale stores included some 30,000 natural, organic, and gourmet food and nonfood items:

- Fresh produce—fruits; vegetables; displays of fresh-cut fruits; and a selection of seasonal, exotic, and specialty products like cactus pears, cippolini onions, and Japanese eggplant.
- Meat and poultry—natural and organic meats, house-made sausages, turkey, and chicken products from animals raised on wholesome grains, pastureland, and well water (and not grown with the use of by-products, hormones, or steroids).
- Fresh seafood—a selection of fresh fish; shrimp; oysters; clams; mussels; homemade marinades; and exotic items like octopus, sushi, and black tip shark. A portion of the fresh fish selections at the seafood station came from the company’s Pigeon Cove and Select Fish seafood processing subsidiaries. Seafood items coming from distant supply sources were flown in to stores to ensure maximum freshness.
- A selection of daily baked goods—breads, cakes, pies, cookies, bagels, muffins, and scones.
- Prepared foods—soups, canned and packaged goods, oven-ready meals, rotisserie meats, hearth-fired pizza, pastas, patés, salad bars, a sandwich station, and a selection of entrees and side foods prepared daily.
- Fine quality cheeses, olives (up to 40 varieties in some stores), chocolates and confections.
- Frozen foods, juices, yogurt and dairy products, smoothies, and bottled waters.
- A wide selection of dried fruits, nuts, and spices (either prepackaged or dispensed from bins).
- Beer and wines—the selection of domestic and imported wines varied from store to store. Organic wines were among those available.
- Coffees and teas. The company’s Allegro coffee subsidiary supplied all stores with specialty and organic coffees and several of the newer stores had in-store coffee-roasting equipment that allowed customers to order any of 20 varieties roasted while they shopped. The tea selections included environmentally correct, premium exotic teas from remote forests. Most stores had a coffee and tea bar where shoppers could enjoy freshly brewed drinks.
A body care and nutrition department containing a wide selection of natural and organic body care and cosmetics products, along with assorted vitamin supplements, homeopathic remedies, yoga supplies, and aromatherapy products—all items entailed the use of non-animal testing methods and contained no artificial ingredients.

Natural and organic pet foods (including the company’s own private-label line), treats, toys, and pest control remedies.

Grocery and household products—canned and packaged goods, pastas, soaps, cleaning products, and other conventional household items that helped make Whole Foods’ larger stores a one-stop grocery shopping destination where people could get everything on their shopping list.

A floral department with sophisticated flower bouquets and a selection of plants for inside and outside the home.

A “365 Everyday Value” line and a “365 Organic Everyday Value” line of private-label products that were less expensive than comparable name brands; and a family of private-label products with consistent logos and packaging for specific departments (examples included “Whole Kitchen” for pre-packaged fresh and frozen grocery items, “Whole Treat” for cookies, candies, and frozen desserts, “Whole Pantry” for herbs, spices, and condiments, and “Whole Catch” for pre-packaged fresh and frozen seafood items).

Educational products (information on alternative healthcare) and books relating to healing, cookery, diet, and lifestyle. In some stores, there were cooking classes and nutrition sessions.

Perishables accounted for about 67 percent of sales at Whole Foods stores in 2007 (versus about 40-50 percent at conventional supermarkets).

Wild Oats stores carried much the same categories of item, but the breadth and depth of selection was obviously smaller for the approximately 20,000-square foot Wild Oats stores that were being rebranded as Whole Foods stores.

Whole Foods Market sold foods that were high quality in terms of nutrition, freshness, appearance, and taste and that met strict standards. Whole Foods guaranteed 100 percent satisfaction on all items purchased and went to great lengths to live up to its core value of satisfying and delighting customers—see Exhibit 6 for the company’s product quality standards.

Whole Foods stocked conventional household products so its stores could function as a one-stop grocery shopping destination where people could get everything on their shopping list.

Whole Foods Market did not have a standard store design. Rather, each store’s layout was customized to fit the particular site and building configuration and to best show off the particular product mix for that store’s target clientele.

Stores typically included sit-down eating areas, customer comment boards, and “Take Action” centers for customers who wanted information on such topics as sustainable agriculture, organics, the sustainability of seafood supplies and over-fishing problems, the environment, and similar issues.

A few stores offered valet parking, home delivery, and massages.

Whole Foods wanted customers to view company stores as a “third place” (besides home and office) where people could gather, learn, and interact while at the same time enjoying an intriguing and enjoyable food shopping and eating experience.
Whole Foods spent about 0.5% percent of its revenues on advertising, a much smaller percentage than conventional supermarkets, preferring instead to rely primarily on word-of-mouth recommendations and testimonials from customers.

- Stores spent most of their marketing budgets on in-store signage and store events such as taste fairs, classes, and product samplings.

- The corporate marketing budget was allocated to region-wide programs, marketing efforts for individual stores, and a national brand awareness initiative focused primarily on national in-store marketing programs.

Competent, knowledgeable, and friendly service was a hallmark of shopping at a Whole Foods Market. The aim was to turn highly satisfied customers into advocates for Whole Foods, talking to close friends and acquaintances about their positive experiences shopping at Whole Foods.

Store personnel were encouraged to extend company efforts to encourage the adoption of a natural and organic lifestyle by going out into the community and conducting a proactive public relations campaign.

- Each store also had a separate budget for making contributions to philanthropic activities and community outreach programs.

Once the chief elements of the strategy have been brought out, you may want to poll the class on what they think of the strategy. How good is it? What grade would they give to John Mackey and other top executives for the caliber of the strategy they have crafted for Whole Foods? We think the company deserves an A for its strategy (maybe an A– or B+, given the somewhat questionable nature of the Wild Oats acquisition). Class members will struggle to make a convincing case for a grade below a B+, unless they want to leap on the recent and largely unexpected developments at Whole Foods—most of which were unforeseeable.

If students have been exposed to the material in Chapter 5 at the time you discuss the case, then you should ask the class which of the five generic competitive strategies Whole Foods is pursuing. Our vote is for broad differentiation, although some students may argue that it is focused differentiation since organic and natural foods have a limited appeal and relatively low sales level compared to traditional grocery and supermarket items. We would not quibble too much over whether it is broad or focused differentiation, but it should be clear that Whole Foods is going all out to broaden its appeal to more and more food shoppers—thus over time the company has every intention of making the transition from focused differentiation to broad differentiation.

2. **Is Whole Foods' strategy well matched to recent developments and conditions in the natural and organic foods segment of the food retailing industry?**

In our view, a very strong case can be made that Whole Foods’ strategy is quite well-suited to capitalizing on the growing consumer interest in natural and organic foods and a healthy-eating lifestyle. Points that students might make in support of the tight fit include:

- The combined sales of foods labeled as organic or natural—about $62 billion in 2007—represented about 7.3 percent of the roughly $850 billion in total U.S. grocery store sales.

- According to the Organic Consumers Association, sales of organic foods in the U.S. hit $17 billion in 2006, up 22 percent from $13.8 billion in 2005. If natural foods and beverages were lumped in with organic foods and beverages, the U.S. retail sales total came to $28.2 billion in 2006, up from $23.0 billion in 2005. Organic food sales were said to represent about 3 percent of total U.S. retail sales of food and beverages. About 31 percent of overall organic sales in 2006 were through mainstream...
supermarkets/grocery stores, and 24 percent were through the leading natural food supermarket chains such as Whole Foods/Wild Oats (and Fresh Market and Trader Joe’s). Another 22 percent of all organic sales were through independent, small chain natural grocery stores.

- Organic foods and beverages were available in nearly every food category in 2008 and were available in over 75 percent of U.S. retail food stores.

- Most observers believed that organic products had staying power in the marketplace as opposed to being a passing fad.

- There is tremendous room for natural and organic foods to become a larger and larger percent of total grocery store sales.

- The new USDA standards for labeling organic food products should help Whole Foods’ efforts to promote the merits of organically grown products. An organic label has long been a selling point for shoppers wanting to avoid pesticides or to support environmentally friendly agricultural practices.

- Whole Foods merchandising strategy, its appealing stores, and its wide product selection put it in excellent position to effectively promote organic products and to sell consumers on the advantages of buying organic products. *Whole Foods Market is probably in the best position of any company in the natural and organic foods segment (and perhaps in the entire supermarket industry) to ride the wave of the growth opportunity in organic foods.*

- However, conventional supermarkets are not standing idly by and are expanding their offerings of natural and organic food products so as to better meet the needs and expectations of consumers shopping for organic natural foods products. In 2000, for the first time, more organic food was sold in conventional supermarkets than in the approximately 14,500 stores that specialized in natural and health foods.

- But whereas organics are a “sideline” for conventional supermarkets, they are the central focus of Whole Foods’ merchandising and marketing strategy and its main business. Since Whole Foods carries many household items in its product line and is becoming more of a one-stop place where shoppers can buy grocery and household items, Whole Foods is in good position to compete not only for the business of consumers who want to buy natural and organic products but also to draw sales and market share away from traditional supermarkets (like those in case Exhibit 2).

**Key Conclusion and Teaching Point:** Whole Foods’ strategy meets one of the key tests of a “winning strategy”: it is well matched to the industry situation. The company seems to have put together just the right strategy at just the right time, putting it in a very good position to attract new customers, outcompete such rivals as Fresh Market and Fresh & Easy, draw shoppers away from leading supermarket chains, and grow its sales and market share at the expense of rivals.

**3. Do you think John Mackey has a good strategic vision for Whole Foods? Why or why not?** What do you like/dislike about the company’s “Whole Foods, Whole People, Whole Planet” motto? Do the motto and the principles underlying the motto (case Exhibit 1) really matter at this company or are they just nice words and window dressing? Explain.

We would give John Mackey an “A” for the job he has done in leading the task of developing a clear and effective strategic vision for Whole Foods. What is there to dislike or to criticize?

- The vision is very much in step with the growth or natural and organic foods, and the mounting interest of consumers in nutritious foods, in helping advance the cause of long-term sustainable agriculture methods, and in doing their part to promote a pesticide-free and healthier environment.
Whole Foods is coming on strong at just the right time to emerge as not only the clear industry leader in organic and natural foods but also as a company that can challenge traditional supermarkets on their own turf.

The company’s “Whole Foods, Whole People, Whole Planet” slogan might at first come across as “pretentious” or “idealistic” or “pious pontification” or “just a bunch of nice words” when students are reading the first few pages of the case. But by the end of the case, it should be apparent to them that the slogan and core values definitely have an important and meaningful role in Whole Foods’ strategy, core values, and operating practices. We think the slogan and the explanation of what it means in case Exhibit 1 very much mirrors what this company is really all about.

Both management and company personnel take the slogan and the core values set forth in Exhibit 3 very seriously—the core values are widely shared among company personnel and the company seems to sincerely and systematically endeavor to operate the business in accord with the core values and the beliefs embraced in the slogan. John Mackey’s quote in the case is very telling:

This slogan taps into perhaps the deepest purpose of Whole Foods Market. It’s a purpose we seldom talk about because it seems pretentious, but a purpose nevertheless felt by many of our team members and by many of our customers (and hopefully many of our shareholders too). Our deepest purpose as an organization is helping support the health, well-being, and healing of both people (customers and Team Members) and of the planet (sustainable agriculture, organic production and environmental sensitivity). When I peel away the onion of my personal consciousness down to its core in trying to understand what has driven me to create and grow this company, I come to my desire to promote the general well-being of everyone on earth as well as the earth itself: This is my personal greater purpose with the company and the slogan perfectly reflects it.

To stimulate class discussion of the merits and role of Whole Foods’ slogan and core values, you may wish to pose some of the following questions to class members:

What evidence is there that John Mackey is committed to conducting the business of Whole Foods in a manner consistent with the beliefs and principles expressed in the “Whole Foods, Whole People, Whole Planet” slogan and the company’s core values statement in Exhibit 3?

- There’s no evidence in the case that John Mackey’s commitment is anything other than genuine and deeply held. In the company’s 2001 annual report, he stated:

  We do not carry natural and organic products to help boost our sales, we carry natural and organic products because we believe that food in its purest state—unadulterated by artificial additives, sweeteners, colorings and preservatives—is the best tasting and most nutritious food available. We actively support organic farming because we believe it is the best method for promoting sustainable agriculture as well as for protecting the environment and farm workers. It is our authenticity as a wellness lifestyle brand that is our major competitive advantage. We recognize this and are very committed long term to strengthening our brand by remaining true to our mission, core values and quality standards.

- Moreover, there are statements and posters all over the company’s stores detailing the company’s position on a variety of issues related to agricultural and seafood sustainability, the merits of organic foods, and so on.

- The company’s seafood facility and processing plant, Pigeon Cove Seafood, located in Gloucester, Massachusetts, and its Select Fish subsidiary—both of which seem to practice the principles that the company advocates on seafood sustainability (case Exhibit 8)—are testimony to the company’s commitment to “walking the talk” on the issue of seafood sustainability.

- The company has a number of programs to educate customers about the merits of the company’s position statements.
What evidence is there that company personnel embrace and practice the core values?

Several pieces of evidence can be cited:

- Many Whole Foods team members felt good about their jobs because they saw themselves as contributing to the welfare of society and to the company’s customers by selling clean and nutritious foods, by helping advance the cause of long-term sustainable agriculture methods, and by promoting a pesticide-free and healthier environment.

- A team member at Whole Foods’ store in Austin, Texas, said, “I really feel like we’re a part of making the world a better place.”

- Team members were quite knowledgeable and enthusiastic about the products in their particular department and tried to take advantage of opportunities to inform and educate customers about natural foods, organics, healthy eating, and food-related environmental issues.

What evidence can you cite that indicates the company’s core values are merely cosmetic window dressing—as opposed to a genuine commitment?

We think students will be hard-pressed to come up with convincing arguments or evidence that Whole Foods is not trying to live up to its stated core values. Indeed, we think one of the most impressive things about Whole Foods is that this appears to be “a good company” genuinely trying to practice what it preaches as concerns its core values. The core values seem to us to be deeply ingrained in the company’s culture and operating practices.

What do you think about Whole Foods’ policy of having a salary cap that limits the compensation (wages plus profit incentive bonuses) of any Team Member to fourteen times the average total compensation of all full-time Team Members in the company? Do you think employees like this policy? Why or why not?

Such a cap is part of the company’s core values—see the Shared Fate item under Team Member Happiness and Excellence in case Exhibit 3. As stated in the case, the company in recent years has raised the cap from 8 to 10 to 14, presumably in order to allow it to have compensation packages that will better enable it to recruit and retain top executives. In 2005, the average annual compensation was $73,061 for salaried workers and $25,451 for hourly workers—we do not have information about what the average compensation for all employees at Whole Foods was in 2005.

Another interesting practice at Whole Foods is that any employee has the capability to look up anyone else’s pay.

4. Do WFM’s core values as presented in case Exhibit 3 really matter? Have they contributed to the company’s success? Why or why not?

We suspect most class members will agree that the core values definitely matter at this company. There is nothing in the case that leads to any other conclusion.

Whole Foods is a company dedicated to its mission. It is “crusading” for what it believes in. And it practices what it preaches. Such qualities are to be admired and respected. We think Whole Foods Market is a “model” company in this sense—it is a company that makes one “feel good” about business and the contribution that a company can make to bettering society while pursuing a profit.

But you still may want to spend 5 minutes having class members present evidence of the connection between the company’s core values and its success in the marketplace.

- One of Whole Foods Market’s core values was to satisfy and delight customers. Store personnel seem quite dedicated to this effort.
Another core value was “We appreciate and celebrate the difference natural and organic products can make in the quality of one’s life.” Commitment to this core value seems evident in the company’s product line, in the company’s educational programs, and in the enthusiasm with which employees promote the company’s products with customers.

The core values relating to innovation (We value retail experiments….We constantly innovate and raise our retail standards and are not afraid to try new ideas and concepts.) and “inviting store environments” seem to be very much in play in the appealing product displays in the company’s stores and in the company’s overall merchandising scheme.

The core values of “empowering work environments”, “self-directed teams”, and “self-responsibility” are the principles upon which the stores are organized and managed.

As one reads through the core values in Exhibit 3, one cannot help but be very impressed with the extent to which these core values are highly visible in the company’s stores, in its operating practices, and in its strategy. Whole Foods management has done a rather remarkable job of using the company’s strategic vision, core values, and culture to underpin the execution of its strategy and serve as the foundation of the company’s financial performance and success in the marketplace.

5. How well is Whole Foods Market performing from a financial perspective?

The company’s financial statements point squarely at good (though not spectacular) financial performance through fiscal 2006. But 2007 was a down year in terms of profitability despite continued strong revenue growth. Students can point to any of several statistics and measures to support this conclusion:

- Revenues have grown at an average annual compound rate of 20.3% since 2003 (case Exhibit 9).
- Net income rose from $98.9 million in 2003 to $203.8 million in 2006, a strong compound average growth rate of 27.3% (case Exhibit 9). But net income then dropped 10.4% to $182.7 million in fiscal 2007, resulting in 16.6% compound rate of growth for the whole 2003-2007 period.
- Diluted earnings per share have increased from $0.79 in 2003 to $1.29 in 2007, a decent compound average growth rate of 13.0% (case Exhibit 9).
- Whole Foods profitability and expense ratios (from case Exhibits 9 and 10) reveal the following:

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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross profit margin</td>
<td>34.8%</td>
<td>34.9%</td>
<td>35.1%</td>
<td>34.7%</td>
<td>34.2%</td>
</tr>
<tr>
<td>Direct store expenses</td>
<td>26.0%</td>
<td>25.4%</td>
<td>25.5%</td>
<td>25.5%</td>
<td>25.2%</td>
</tr>
<tr>
<td>Store contribution</td>
<td>8.9%</td>
<td>9.6%</td>
<td>9.6%</td>
<td>9.2%</td>
<td>9.0%</td>
</tr>
<tr>
<td>General and admin expenses</td>
<td>3.3%</td>
<td>3.2%</td>
<td>3.2%</td>
<td>3.1%</td>
<td>3.2%</td>
</tr>
<tr>
<td>Operating profit margin</td>
<td>4.5%</td>
<td>5.7%</td>
<td>4.9%</td>
<td>5.6%</td>
<td>5.3%</td>
</tr>
<tr>
<td>Net profit margin</td>
<td>2.8%</td>
<td>3.6%</td>
<td>2.9%</td>
<td>3.4%</td>
<td>3.1%</td>
</tr>
<tr>
<td>Return on equity</td>
<td>12.5%</td>
<td>14.5%</td>
<td>---</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>Return on assets</td>
<td>5.7%</td>
<td>10.0%</td>
<td>---</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>Current ratio</td>
<td>0.85</td>
<td>1.22</td>
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</tbody>
</table>

The company’s gross profit margins are holding steady—in the 34.2% to 35.1% range, but were stronger in 2005-2007 than in 2003-2004.
General and admin expenses seem under control but are creeping up slightly.

Direct store expenses as a % of sales have also been creeping up, but more so in fiscal 2007.

Store contribution as a % of sales revenues, while a bit inconsistent over the five-year period, was strong in 2005 and 2006 before dropping off to a five-year low of 8.9% has moved up an encouraging amount each of the last three fiscal years.

Clearly 2007 was not a good year from an earnings standpoint. But some of this is attributable to the added expenses associated with the Wild Oats acquisition.

- The current ratio has eroded to a rather disconcerting number (see case Exhibit 10); there is a definite liquidity issues as of the end of fiscal 2007.

- The company’s cash position was very tight at the end of fiscal 2007 (but it does have some receivables that should relieve some of the stress). There is certainly a strong reason to be concerned about the company’s weakened financial condition, lack of liquidity, and balance sheet as of the end of fiscal 2007. This is a new and dramatically different condition. In 2005, for example, the case states that although this historical financial information was not included in case Exhibit 10, the company generated $411 million in cash flows from operations, an amount sufficient to pay off $152 million in long-term debt, cut its long-term debt to a measly $12.9 million, self-fund the costs of new store openings, and pay a respectable dividend. Whole Foods paid its first quarterly dividend of $0.15 per share in January 2004; the quarterly dividend was increased to $0.19 per share in January 2005, to $0.25 per share in April 2005, and to $0.30 per share starting in January 2006 (before a scheduled 2-for-1 stock split).

Information in the case also states that capital expenditures totaled $324.1 million in fiscal 2005, $340.2 million in fiscal 2006, and $529.7 million in fiscal 2007, of which $207.8 million, $208.6 million and $389.3 million, respectively was for new store development and $116.3 million, $131.6 million, and $140.3 million, respectively, was for remodels and other additions.

During fiscal 2008, Whole Foods expected capital expenditures to be in the range of $575 to $625 million, of which 65 to 70 percent was related to new store opening in 2008 and beyond and approximately 7 to 8 percent related to remodels of the acquired Wild Oats stores. To aid in financing the Wild Oats acquisition and continue fast-paced opening of new stores, Whole Foods had taken on long-term debt of over $700 million and negotiated a $250 million line of credit with its banks.

- The company’s long-term debt and capital lease obligations mushroomed from a paltry and very affordable $8.6 million in fiscal 2006 to a very burdensome $736.1 million in fiscal 2007 (see case Exhibit 10).

- But in 2008 Whole Foods’ financial condition deteriorated became even more alarming. In August 2008, Whole Foods announced that quarterly dividend payments would be suspended indefinitely. The company had cash of about $30 million and about $100 million available on existing lines of credit as of November 2008; in recent quarters, Whole Foods’ capital expenditures for store expansion had exceeded its cash flows from operations, pushing total debt to $929 million. To bolster its financial position and provided needed funding for opening additional stores and revamping former Wild Oats stores, Whole Foods had recently arranged to sell $425 million of preferred stock to private equity investors, which equated to an ownership interest of 17 percent in the event the private equity investors exercised rights to convert their preferred stock into common stock.
The data on store operations (see the bottom of case Exhibit 4) look fine for the most part. Pretty clearly, the stores the company is adding are performing well in terms of pulling up the average weekly sales numbers and realizing acceptable gains in comparable store sales growth.

- Average weekly sales at the stores are growing briskly—from $324,710 per week in fiscal 2000 to an average of $616,706 per week in fiscal 2007 (equal to a healthy compound average growth rate of 9.6%).

- Comparable store sales growth were very good until 2007:

<table>
<thead>
<tr>
<th>Year</th>
<th>Growth Rate</th>
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<tbody>
<tr>
<td>2000</td>
<td>8.6%</td>
</tr>
<tr>
<td>2002</td>
<td>10.0%</td>
</tr>
<tr>
<td>2004</td>
<td>14.9%</td>
</tr>
<tr>
<td>2005</td>
<td>12.8%</td>
</tr>
<tr>
<td>2006</td>
<td>11.0%</td>
</tr>
<tr>
<td>2007</td>
<td>7.1%</td>
</tr>
</tbody>
</table>

Another recent negative is the decline in store contribution to 8.9% in 2007, versus numbers in the 9.3% to 9.6% range in the 2000-2006 period.

**Conclusions:** Whole Foods financial performance, while very solid through 2006, went downhill in 2007. The company has gone from being financially strong with ample capital to fund expansion (through 2006) to financially stressed and burdened by excessive debt (2007 and 2008). The extent to which Whole Foods can recover from its recent financial difficulties is unclear.

**6. How well is Whole Foods Market performing from a strategic perspective? Is the strategy working? Does the company have a winning strategy?**

Until the Wild Oats acquisition and the sharp economic downturn in 2008, there were clear signs that WFM’s strategy was producing excellent strategic outcomes. Whole Foods has become the standout leader in the natural and organic foods segment. Up until the Wild Oats acquisition and the recession that emerged in Fall 2008, Whole Foods had been adding new and bigger stores at an accelerating pace and thus expanding its market reach and brand name recognition. There still seems to be ample room in the marketplace to add many more Whole Foods stores annually for many years to come (though the sizes of new stores in smaller metropolitan areas may have to be scaled back to the 30,000 to 40,000 square-foot range to accommodate the economics of a smaller customer base and smaller traffic volumes per store—the experience Whole Foods is getting with rebranding and operating the smaller Wild Oats stores as Whole Foods stores should provide Whole Foods management with good insight into whether its format will work for smaller stores. If it does, then it makes sense for Whole Foods to gradually expand its store operation into communities with populations in the 200,000 to 500,000 range).

But adverse economic conditions and depleted financial resources at Whole Foods require scaling back the company’s expansion plans at least for a year or two (depending on how fast the economy recovers). The company cannot afford to open as many new stores as planned. The strategic objective of 400 stores and sales of $12 billion by 2010, which looked achievable in 2006, almost certainly cannot be achieved at this juncture.

Here is a good time to ask the class whether Whole Foods strategy has led to competitive advantage. We think the answer is yes; Whole Foods appears to have a decided competitive edge over Fresh Market, Trader Joe’s, Fresh & Easy, and Sunflower as concerns:

- Product breadth and selection—it also has much bigger stores than such rivals as Fresh Market, Trader Joe’s, Fresh & Easy, and Sunflower
- Geographic coverage
- Store appeal and shopping environment
- Product merchandising

Another question you can pose is whether Whole Foods Market has a winning strategy based on the three criteria discussed in Chapter 1. We think students ought to be able to make a strong case that the company’s strategy passes all three tests of a winning strategy:

- The strategy seems very well matched to both its external and internal situation.
- WFM’s strategy seems to have produced a competitive advantage over Fresh Market, Trader Joe’s, Fresh and Easy, and Sunflower and also broadly focused supermarket chains (so far, supermarket chains do not have the breadth and depth of organic and natural foods selections to even come close to matching the selection and shopping experience at Whole Foods).
- Until recently, WFM’s strategy has definitely produced gains in the company’s financial performance, but costs of ambitious numbers of new store openings, the strains of the Wild Oats acquisition, and slowdowns in customer traffic at WFM stores have eroded Whole Foods financial performance and financial strength (temporarily? or maybe more long term?).

7. Do you approve of the decision to acquire Wild Oats Market? What pros and cons do you see?

**Pros of Acquiring Wild Oats**

- Expands the number of geographic locations in which Whole Foods has stores—small Wild Oats (now Whole Foods) stores may be a good way for Whole Foods to enter geographic areas which are too small to support a large Whole Foods store.
- Reduces the potential for costly battles with Wild Oats for customer patronage in those locations where both companies have nearby stores
- Allows Whole Foods to concentrate its full attention on competing with major supermarket chains

**Cons of Acquiring Wild Oats**

- The acquisition is expensive and forces Whole Foods to go pretty deeply in debt to finance the acquisition—at a time when it is already engaged in an aggressive expansion program to open significant numbers of large-scale Whole Foods stores
- Wild Oats stores are considerably smaller than those of Whole Foods, and Whole Foods is zeroed in on opening and operating stores that are twice the size of the typical Wild Oats store. Small stores are not Whole Foods’ “sweet spot”—will having a bunch of new small stores prove advantageous or profitable for Whole Foods or will the former Wild Oats stores prove too small to generate attractive profitability?
- Will absorbing Wild Oats and making its store profitable divert too much management attention away from Whole Foods’ current growth strategy?
- Does Whole Foods have the financial resources to support the overhaul of the former Wild Oats stores and also the capital needed to go forward with the expansion plans it has for opening all the larger Whole Foods stores it has signed leases for? The answer seems to be no, in light of recent developments to raise capital from the private equity firm (but this is due in part to the global credit crunch and financial crisis that began unfolding in September 2008).
8. Were John Mackey's Internet postings unethical or in any way inappropriate? What actions, if any, do you disapprove of? What actions, if any, should the company's board of directors take with regard to his Internet postings and blogs? Should the board be supportive of what Mackey did or reprimand him?

It is worth spending 5-10 minutes of the period having class members discuss and critique John Mackey’s anonymous Internet postings prior to the Wild Oats acquisition and his blog stating his opposition to the FTC’s challenges of the Wild Oats acquisition.

Some questions you might pose to the class to stimulate discussion:

- Should a company CEO make anonymous Internet postings about a competitor if such postings merely represent personal opinion and contain no proprietary information about the CEO’s company? Are such postings unethical if they contain anything unfavorable about a competitor (even if they are “correct” or “accurate”)? Would an anonymous posting be unethical if it entailed favorable comments about a competitor? Should such postings—either favorable or unfavorable—be “protected” and considered as merely a constitutional exercise of free speech?
- Does it matter that John Mackey’s anonymous postings were just his personal opinion? Does it matter that John Mackey’s anonymous postings contained no proprietary information about Whole Foods?
- What, if anything is objectionable with the Mackey-authored blog entitled “Whole Foods, Wild Oats and the FTC” that was posted on the company’s website on June 19, 2007. Is it wrong or unethical for Mackey (who objected strenuously to the grounds on which the Federal Trade Commission was trying to block Whole Foods’ acquisition of Wild Oats) to state his reasons in a public forum? Is it wrong or unethical for Mackey to publicly state his case for why Whole Foods’ acquisition of Wild Oats Market should be allowed to go forward? Do you agree with the critics who claimed Mackey was wrong to write such blog? Should citizens not be “allowed” to publicly disagree with government agencies and state their reasons why?
- If John Mackey is “guilty” of anything, is it anything other than poor judgment?

9. What recommendations would you make to John Mackey regarding the actions that management needs to take to restore and then sustain the company's growth and financial performance? Should any special actions be taken to get through the recession that began in earnest in 2008? Can anything be done to revive the growth in sales at existing Whole Foods stores? Should the company severely cut back on opening so many new stores? Should the company vigorously contest the reopening of the FTC’s challenge to the Wild Oats acquisition? Are any other strategy changes needed?

All of a sudden, this is a company with problems that need to be addressed and fixed. The two most pressing issues are figuring out how best to curtain new store openings (given that leases have been signed for those stores in the planning stage) and restoring strength to the company’s balance sheet—the company is suddenly overwhelmed with too much debt. Then, too, there is the issue of the FTC trying to reverse the Wild Oats acquisition over a year after the acquisition has been completed and the rebranding/overhaul of the former Wild Oats stores virtually done. We think that students should propose most of the following recommendations:

- Immediately begin efforts to *cut back the number of new store openings* and delay as many as possible of the currently planned new store openings to 2010 or 2011 (hopefully, when economic conditions are much improved).
- Cut capital expenditures to the bone—*use most of the company’s cash flows from operations to pay down debt* and accumulate cash reserves.

- Maintain the suspension of dividend payments for the foreseeable future—certainly until debt levels are reduced to under $100 million.

- Run special price promotions to emphasize to shoppers that it is possible to shop at Whole Foods and also be budget conscious. Put more merchandising emphasis on “bargain buys” and “discount specials” via aisle displays and signage. It is important to keep shoppers coming to Whole Foods as often as possible and persuading them to spend as much as possible. Now is a good time to plant the notion in shoppers’ minds that there are numerous ways to save money while shopping at Whole Foods.

- Perhaps trim back on the number of perishables that entail “high” prices and/or relatively low sales volumes (so as to curtail waste and spoilage costs). In other words, shift some of the merchandising emphasis away from “luxury” items and put more merchandising emphasis on items that will appeal to budget-constrained shoppers—but this must be done judiciously so as not to impair the company’s gross profit margin (about 35%—as shown in the financial ratio table above and as students can calculate from case Exhibit 9).

- Pay particular attention to boosting the sales and profitability of the former Wild Oats stores—WFM needs to prove quickly that it can realize a good return on its investment in acquiring Wild Oats and that 20,000-square-foot Whole Foods stores can be operated in a profitable manner.

- Vigorously contest the FTC’s attempts to undo the acquisition of Wild Oats at this late date.

Otherwise, we think students should recommend that Whole Foods “stay the course” and continue with its present merchandising strategy, its approaches to store operations, and its strategy to clearly differentiate itself from rivals. But even when the economy improves, Whole Foods should pursue a less aggressive strategy to open new stores—top management probably got carried away with WFM’s success in 2004-2006 and pushed the number of new store openings up too quickly. Now, the company is overcommitted and without the needed financial resources to follow through on what has become an overly ambitious growth strategy. This, coupled with the Wild Oats acquisition has put the entire business at risk.

*Herein lies some good lessons for students to learn from the Whole Foods case:*

- Don’t go overboard in pursuing rapid growth.

- Unexpected events and fast-changing market conditions can turn what looked like a sure-fire winning strategy into a train wreck.

- There is merit in being somewhat conservative in growing the business (going too fast can turn out to be worse than going too slow!!!)
EPILOGUE

In January 2008, Whole Foods was named to Fortune’s 2008 list of the “100 Best Companies to Work For” for the 11th year in a row—it was ranked 16th on the 2008 list, down from 5th on the 2007 list and 15th on the 2006 list but up from 30th on the 2005 list and 47th on the 2004 list. Whole Foods had made the list every year—the only grocer to do so.

Whole Foods’ stock price closed at $11.04 on December 17, 2008, far below its all-time high of $77.44 on January 6, 2006. Since January 2006, WFM’s stock had trended downward rather steadily.

In fiscal 2008 (ending September 28, 2008), Whole Foods reported sales of $7.95 billion, up 20.7% over 2007 revenues of $6.6 billion. Net income was $114.5 million, down 37.3% from $182.7 million in 2007. Diluted EPS was $0.84 in fiscal 2008 versus $1.29 in fiscal 2007. Gross profit margins were 34.0% in fiscal 2008 (versus 34.8% in 2007); direct store expenses were 26.5% of sales revenues (versus 26.0% in 2007); store contribution was 7.5% of sales revenues (versus 8.9% in 2007 and 9.6% in 2006)—however, store contribution excluding the results of the former Wild Outs stores was 8.2%; and general and administrative expenses were 3.4% of sales revenues (versus 3.3% in 2007 and 3.2% in 2006).

As of early November 2008, Whole Foods had been successful in terminating the leases for 21 stores that were in development. Some 66 new stores were in various stages of development, with opening dates extending through fiscal 2012.

In fiscal 2009, Whole Foods planned to open 15 stores, have annual sales of about $8.3 billion, have capital expenditures of $400 to $450 million, and incur annual interest costs of $35 to $40 million.

Whole Foods opened 20 new stores in fiscal 2008 (including 6 that were relocations of existing stores); the average size of these new stores was 53,500 square feet.

In December 2008, Whole Foods announced it had filed an action in U.S. District Court to bar the Federal Trade Commission (FTC) from conducting a trial that would violate the company’s due process rights because the FTC had already publicly prejudged the case against Whole Foods Market and had refused to give the company enough time to prepare for trial. Citing the Queen of Hearts’ famous pronouncement in “Alice in Wonderland,” which exemplifies indifference to due process rights, Whole Foods Market’s complaint began:

“Now for the evidence,” said the King. “And then the sentence.”

“No!” said the Queen. “First the sentence, and then the evidence.”

The complaint continued: “The Defendant FTC has acted no less blatantly than the Queen of Hearts in violating both the Constitutional due process rights of Plaintiff Whole Foods Market, Inc.”

For the most recent information on developments at Whole Foods Market, we urge that you check the company’s latest financial results and press releases at www.wholefoodsmarket.com.
OVERVIEW

In 2008, Costco’s sales totaled almost $71 billion at 544 warehouses in 40 states, Puerto Rico, Canada, the United Kingdom, Taiwan, Japan, Korea, and Mexico. More than 50 of Costco’s warehouses generated sales exceeding $200 million annually and 2 stores had sales exceeding $300 million. Sales per store averaged $130 million annually, about 75 percent more than the $75 million per store average at Sam’s Club, Costco’s chief competitor in the membership warehouse retail segment.

The membership warehouse concept was pioneering by discount merchandising sage Sol Price who opened the first Price Club in San Diego in 1976. Originally conceived as a place where small local business members could obtain needed merchandise at very economical prices, Sol Price soon concluded that his fledgling Price Club operation could achieve far greater sales volumes and gain buying clout with suppliers by also granting membership to individuals—Price’s decision to add individual memberships was the trigger that launched the deep discount warehouse club industry on a steep growth curve. Within a few years, Sol Price’s Price Club stores emerged as the unchallenged leader in member warehouse retailing, operating primarily on the West Coast.

The wholesale club and warehouse segment of retailing in 2008 was estimated to be a $120 billion business in the U.S., and it was growing about 20 percent faster than retailing as a whole. There were 1,200-plus warehouse locations across the U.S. and Canada; most every major metropolitan area had one, if not several, warehouse club operations. The three main competitors were Costco Wholesale, Sam’s Club (713 warehouses in six countries—the U.S., Canada, Brazil, Mexico, China, and Puerto Rico), and BJ’s Wholesale (177 locations in 16 states). Costco had close to a 53 percent share of warehouse club sales across the U.S. and Canada, with Sam’s Club (a division of Wal-Mart) having roughly a 37 percent share and BJ’s Wholesale and several small warehouse club competitors having about a 10 percent share.

Competition among the warehouse clubs was based on such factors as price, merchandise quality and selection, location, and member service. However, warehouse clubs also competed with a wide range of other types of retailers, including retail discounters like Wal-Mart and Dollar General, supermarkets, general merchandise chains, specialty chains, gasoline stations, as well as Internet retailers. Wal-Mart, the world’s largest retailer, not only competed directly with Costco via its Sam’s Club subsidiary but its Wal-Mart Supercenters sold many of the same types of merchandise at attractively low prices as well. Target and Kohl’s had emerged as significant retail competitors in certain merchandise categories. Low-cost operators selling a single category or narrow range of merchandise, such as Lowe’s, Home Depot, Office Depot, Staples, Best Buy, Circuit City, PetSmart, and Barnes & Noble, had significant market share in their respective product categories.

Costco was founded in 1983 by Jim Sinegal and Seattle entrepreneur Jeff Brotman (now chairman of the board of directors). The first Costco store began operations in Seattle in 1983, the same year that Wal-Mart launched its warehouse membership format called Sam’s Club. By the end of 1984 there were 9 Costco stores in five states serving over 200,000 members. In December 1985 Costco became a public company, selling shares to the public and raising additional capital for expansion. Costco became the first company to reach $1 billion in sales in less than 6 years. In October 1993, Costco merged with The Price Company. When the two companies merged in 1993, Jim Sinegal became CEO, presiding over 206 PriceCostco locations generating $16 billion in annual sales. When the company reincorporated from Delaware to Washington in August 1999, the name was changed to Costco Wholesale Corporation. The company’s headquarters was in Issaquah, Washington, not far from Seattle.
Costco’s mission in the membership warehouse business was “To continually provide our members with quality goods and services at the lowest possible prices.” The company’s business model was to generate high sales volumes and rapid inventory turnover by offering members very low prices on a limited selection of nationally branded and selected private label products in a wide range of merchandise categories. Management believed that rapid inventory turnover, when combined with the operating efficiencies achieved by volume purchasing, efficient distribution and reduced handling of merchandise in no-frills, self-service warehouse facilities, enabled Costco to operate profitably at significantly lower gross margins than traditional wholesalers, mass merchandisers, supermarkets, and supercenters. Examples of the incredible volume that Costco generated included selling 110,000 carats of diamonds (2007), 40 million rotisserie chickens (2008), 40 percent of the Tuscan olive oil bought in the U.S., 29 million prescriptions (2007), 150 million croissants (2007), 100 million pounds of ground beef (2007), 1 million pumpkin pies during Thanksgiving week (2007), annual gasoline sales of $4.6 billion (2007), and 1.5 million $1.50 hot dog/soda pop combinations per week; Costco was also the largest seller of fine wines in the world ($499 million out of total 2007 wine sales of $1.01 billion). At one of Costco’s largest volume stores, which had annual sales of $285 million and 232,000 members, annual volume ran 283,000 rotisserie chickens, 375,000 gallons of milk, and 8.4 million rolls of toilet paper—this store had an average customer bill per trip of $150.

Costco’s high sales volume-rapid inventory turnover business model allowed it to sell and receive cash for inventory before it had to pay many of its merchandise vendors, even when vendor payments were made in time to take advantage of early payment discounts. Thus Costco was able to finance a big percentage of its merchandise inventory through the payment terms provided by vendors rather than by having to maintain sizable working capital (defined as current assets minus current liabilities) to facilitate timely payment of suppliers.

The cornerstones of Costco’s strategy were low prices, a limited product line and limited selection, and a “treasure hunt” shopping environment.

The focus of the case is on Costco’s business model, strategy, and operations. The company is interesting in several important respects:

- Costco’s markups and prices were so low that Wall Street analysts had criticized Costco management for going all out to please customers at the expense of charging prices that would increase profits for shareholders—retailing and investment analysts believed that Costco could charge more for a lot of the items it sold.

- Whereas typical supermarkets stocked about 40,000 items and a Wal-Mart Supercenter or SuperTarget might have as many as 150,000 items for shoppers to choose from, Costco’s merchandising strategy was to provide members with a selection of only about 4,000 items. About one-fourth of Costco’s product offerings were constantly changing and consisted mainly of “treasure hunt” specials. Costco’s merchandise buyers were constantly on the lookout to make one-time purchases of items that would appeal to the company’s clientele and that would sell out quickly. A sizable number of these items were high-end or name brand products that carried big price tags—like big-screen HDTVs selling for $1,000 to $2,500 and $800 leather sofas. The idea was to entice shoppers to spend more than they might by offering irresistible deals on luxury items. In many cases, Costco did not obtain its luxury offerings directly from high-end manufacturers like Calvin Klein or Waterford (who were unlikely to want their merchandise marketed at deep discounts at places like Costco); rather Costco buyers searched for opportunities to source such items legally on the gray market from other wholesalers or distressed retailers looking to get rid of excess or slow-selling inventory. Examples of treasure hunt specials included $800 espresso machines, Italian-made Hathaway shirts priced at $29.99, Movado watches, exotic cheeses, Coach bags, $5,000 necklaces, cashmere sports coats, $1500 digital pianos, and Dom Perignon champagne.

- Costco attracted the most affluent customers in discount retailing—the average income of individual members was about $75,000, with over 30 percent having incomes of $100,000 or more annually. Many members were affluent urbanites, living in nice neighborhoods not far from where Costco warehouses were located.
Jim Sinegal, the company’s CEO and driving force behind Costco’s 23-year march to become the 4th largest retailer in the U.S. and the 8th largest in the world, was far from a stereotypical CEO. Sinegal was regarded as an exceptionally savvy merchandiser, with a keen eye for what would sell and where it ought to be located on the sales floor to generate maximum volume. A grandfatherly 70-year old, Sinegal dressed casually and unpretentiously, often going to the office or touring Costco stores wearing an open-collared cotton shirt that came from a Costco bargain rack and sporting a standard employee name tag that said “Jim.” Sinegal spent much of his time touring Costco stores, using the company plane to fly from location to location and sometimes visiting 8 to 10 stores daily (the record for a single day was 12). Treated like a celebrity when he appeared at a store (news that “Jim’s in the store” spread quickly), Sinegal made a point of greeting store employees, observing “The employees know that I want to say hello to them, because I like them. We have said from the very beginning: ‘We’re going to be a company that’s on a first-name basis with everyone.’”

Employee compensation at Costco was higher than at Sam’s Club. Starting wages for new Costco employees were in the $10.50-$11 range in 2008. Depending on the job classification, the median pay scales for Costco employees with five or more years experience were in the $17-$21 per hour range. Warehouse employees received time-and-a-half pay for working on Sundays and were paid double time in the event they were called on to work more than 12 hours in a given shift. Median salaries for managerial positions at Costco warehouses were in the $55,000 to $75,000 range. Employees enjoyed the full spectrum of benefits. Jim Sinegal was convinced that having a well-compensated workforce was very important to executing Costco’s strategy successfully. He said, “It has to be a significant advantage for you….. paying good wages and keeping your people working with you is very good business.” Moreover, executives at Costco did not earn the outlandish salaries that had become customary over the past decade at most large corporations.

**SUGGESTIONS FOR USING THE CASE**

This case was written to (1) illustrate the CEO’s role as chief strategist and organization leader, (2) demonstrate how a company’s business principles and core values can link tightly to and drive a company’s strategy and operating practices, and (3) give students practice in evaluating a company’s direction and strategy in the highly competitive retail marketplace. The case requires that students draw upon most all of the concepts discussed in Chapters 1 and 2 in preparing the case for class discussion.

We think Costco Wholesale is an excellent leadoff case for the course (other good choices are Whole Foods Market and Robin Hood—both of which require that students draw upon the material covered in Chapters 1 and 2). Student familiarity with “big box” discount retailing, the very interesting character of Costco Wholesale and its CEO Jim Sinegal, and the very close connection between the case and the material in Chapters 1 and 2 make this an especially good leadoff case. You may want to consider covering Chapter 1 in your first day’s lecture, Chapter 2 on your second day’s lecture, and then assigning Costco Wholesale for class discussion on Day 3.

However, if you opt for another lead-off case, we think you will find that the Costco Wholesale case works exceptionally well as part of your business strategy module (where you want students to draw from Chapters 1-7 in doing their analysis and making action recommendations), (2) as a comprehensive written case or oral team presentation case, or (3) as an end-of-the-course or final exam case (because the case contains issues that cut across topics covered in many of the 12 chapters). If you want to cover Chapters 1-6 before assigning a case for class discussion, you’ll find that the Costco case contains plenty of good information on industry and competitive conditions and the competition that Costco faces from Sam’s Club and BJ’s Wholesale. Thus, Costco Wholesale is one of those multi-faceted cases that fits nicely in any of several places in your lineup of case assignments—although our preference is to use it as a leadoff case.

You’ll find ample opportunity here to explore Jim Sinegal’s style of managing, his values and business principles, the company’s clever and innovative business model, the chief elements of its business strategy, and the company’s financial performance. If you wait to assign the case until students have read Chapters 3, 4, and
5, then you can expect students to probe a bit deeper in evaluating Costco’s competitive strengths/weaknesses, its potential for continued growth, and how well it is positioned to compete against Sam’s Club, BJ’s Wholesale, and other big-box discounters like Wal-Mart and Target. But students will really have no trouble wrestling with the competitive issues and generating opinions without the benefit of having first covered Chapters 3, 4, and 5—this is because they not only are likely to have shopped at one or more membership warehouses but also because the strategic issues and analysis turn out to be fairly clear-cut, which is why Costco Wholesale makes such a good leadoff case.

There is a stage-setting 4-minute video accompanying the Costco case entitled “Costco Vs. Sam’s Club: Big Warehouses, Big Savings” that we suggest showing at the beginning of the class—it will be particularly helpful to students who have never been in a Costco or Sam’s Club store and it also embellishes some of the themes in the case.

We suggest use of a teaching plan that focuses on Jim Sinegal’s business principles and management philosophy, the various aspects of Costco’s business model, the company’s strategy and growth initiatives, its compensation and benefits practices, why shopping at Costco appeals to upscale consumers, and whether the strategy is delivering good financial performance.

The assignment questions and teaching outline presented below reflect our thinking about how to conduct the class discussion.

To give students guidance in what to do and think about in preparing the Costco case for class discussion, we strongly recommend providing class members with a set of study questions and insisting that they prepare good notes/answers to these questions in preparing for class discussion of the case.

To facilitate your use of study questions and making them available to students, we have posted a file of the Assignment Questions contained in this teaching note for the Costco Wholesale case on the student section of the publisher’s Online Learning Center for the 17th edition (www.mhhe.com/thompson). (As a point of information, there is a set of study questions posted in the student section of the OLC for each of the 26 cases included in the 17th edition.)

It is really very difficult to have an insightful and constructive class discussion of the Costco case unless students have not only read the case but also conscientiously worked their way through a set of well-conceived study questions before they come to class. In our classes, we expect students to bring their notes to the study questions to use/refer to in responding to the questions that we pose. Students often find having a set of study questions is useful in helping them prepare oral team presentations and written case assignments—in addition to whatever directive questions you supply for these assignments—in addition to whatever directive questions you supply for these assignments.

You may also find it beneficial to have class members read the Guide to Case Analysis that is posted in the student section of the Online Learning Center for the 17th edition at www.mhhe.com/thompson. Students will find the content of this Guide particularly helpful if this is their first experience with cases and they are unsure about the mechanics of how to prepare a case for class discussion, oral presentation, or written analysis.

The Costco Wholesale case is quite suitable for both oral team presentations and a written case assignment. Our suggested assignment question for either an oral presentation or a written case assignment is as follows:

What is your assessment of Costco’s business model and strategy? How well is Costco’s strategy working? What recommendations would you make to Jim Sinegal to sustain the company’s growth and improve the company’s financial performance?
ASSIGNMENT QUESTIONS

1. What is Costco’s business model? Is the company’s business model appealing? Why or why not?

2. What are the chief elements of Costco’s strategy? How good is the strategy?

3. Do you think Jim Sinegal is an effective CEO? What grades would you give him in leading the process of crafting and executing Costco’s strategy? What support can you offer for these grades? Refer to Figure 2.1 in Chapter 2 in developing your answers.

4. How well is Costco performing from a financial perspective? Do some number-crunching using the data in case Exhibit 1 to support your answer. Use the financial ratios presented in Table 4.1 of Chapter 4 (pages 104-105) to help you diagnose Costco’s financial performance.

5. Based on the data in case Exhibits 1 and 4, is Costco’s financial performance superior to that at Sam’s Club and BJ’s Wholesale?

6. Does the data in case Exhibit 2 indicate that Costco’s expansion outside the U.S. is financially successful? Why or why not?

7. How well is Costco performing from a strategic perspective? Does Costco enjoy a competitive advantage over Sam’s Club? Over BJ’s Wholesale? If so, what is the nature of its competitive advantage? Does Costco have a winning strategy? Why or why not?

8. Are Costco’s prices too low? Why or why not?

9. Does Costco pay its employees too much? Does it make sense for Costco to compensate its employees so much better than the employees at Wal-Mart/Sam’s Club? Why or why not?

10. What recommendations would you make to Jim Sinegal regarding the actions that Costco management needs to take to sustain the company’s growth and improve its financial performance?

TEACHING OUTLINE AND ANALYSIS

1. **What is Costco’s business model? Is the company’s business model appealing? Why or why not?**

As discussed in Chapter 1, a company’s business model explains the rationale for why its business approach and strategy will be a moneymaker. This rationale sets forth the key components of the company’s business approach, indicates how revenues will be generated, and makes a case for why the strategy can deliver value to customers and at the same time be profitable.

The information in the case lays out the chief components of Costco’s business model in a straightforward manner:

- Generate high sales volumes and rapid inventory turnover by offering members very low prices on a limited selection of nationally branded and selected private label products in a wide range of merchandise categories.

- The broad appeal of the company’s low prices created high levels of store traffic and produced big sales volumes on many items. Examples of the large unit sales numbers generated by Costco’s low prices and effective merchandising included selling 110,000 carats of diamonds (2007), 40 million rotisserie chickens (2008), 40 percent of the Tuscan olive oil bought in the U.S., 29 million prescriptions (2007),
150 million croissants (2007), 100 million pounds of ground beef (2007), 1 million pumpkin pies during Thanksgiving week (2007), annual gasoline sales of $4.6 billion (2007), and 1.5 million $1.50 hot dog/soda pop combinations per week; Costco was also the largest seller of fine wines in the world ($499 million out of total 2007 wine sales of $1.01 billion). At one of Costco’s largest volume stores, which had annual sales of $285 million and 232,000 members, annual volume ran 283,000 rotisserie chickens, 375,000 gallons of milk, and 8.4 million rolls of toilet paper.

- Management believed that rapid inventory turnover, when combined with the operating efficiencies achieved by volume purchasing, efficient distribution and reduced handling of merchandise in no-frills, self-service warehouse facilities, enabled Costco to operate profitably at significantly lower gross margins than traditional wholesalers, mass merchandisers, supermarkets, and supercenters.

- Furthermore, Costco’s high sales volume and rapid inventory turnover generally allowed it to sell and receive cash for inventory before it had to pay many of its merchandise vendors, even when vendor payments were made in time to take advantage of early payment discounts. Thus Costco was able to finance a big percentage of its merchandise inventory through the payment terms provided by vendors rather than by having to maintain sizable working capital (defined as current assets minus current liabilities) to facilitate timely payment of suppliers.

2. What are the chief elements of Costco’s strategy? How good is the strategy?

The cornerstones of Costco’s strategy were low prices, a limited product line and limited selection, and a “treasure hunt” shopping environment. The company was, moreover, a low-cost operator.

- Costco is pursuing a low-cost leader strategy (as students should quickly recognize from the discussions in both Chapter 1 and Chapter 5). Costco’s CEO Jim Sinegal left no doubt about the company’s efforts to be a low-cost operator when he stated:

  Costco is able to offer lower prices and better values by eliminating virtually all the frills and costs historically associated with conventional wholesalers and retailers, including salespeople, fancy buildings, delivery, billing, and accounts receivable. We run a tight operation with extremely low overhead which enables us to pass on dramatic savings to our members.

- Costco’s strategic approach to pricing was to keep customers coming in to shop by wowing them with low prices. Costco was known for selling top quality national and regional brands at prices consistently below traditional wholesale or retail outlets. The company only stocked items which could be priced at bargain levels and provide members with significant cost savings; this was true even if an item was oft-requested by customers.

  - A key element of Costco’s strategy to keep prices low to members was to cap the margins on brand name merchandise at 14 percent (compared to 20 to 50 percent margins at other discounters and many supermarkets).

  - The margins on Costco’s 400 private-label Kirkland Signature items were a maximum of 15 percent, but the fractionally higher markups on Costco’s private label items still resulted in its private-label prices being about 20 percent below comparable name brand items. The company’s private label Kirkland Signature products—which included juice, cookies, coffee, tires, housewares, luggage, appliances, clothing and detergent—were designed to be of equal or better quality than national brands.

- Whereas typical supermarkets stocked about 40,000 items and a Wal-Mart Supercenter or SuperTarget might have as many as 150,000 items for shoppers to choose from, Costco’s merchandising strategy was to provide members with a selection of only about 4,000 items.

  - However, Costco’s product range covered a broad spectrum—rotisserie chicken, prime steaks, caviar, flat-screen TVs, digital cameras, fresh flowers, fine wines, caskets, baby strollers, toys and
games, musical instruments, ceiling fans, vacuum cleaners, books, DVDs, chandeliers, stainless steel cookware, seat cover kits for autos, prescription drugs, gasoline, and one-hour photo finishing. But the company deliberately limited the selection in each product category to fast-selling models, sizes, and colors. Many consumable products like detergents, canned goods, office supplies, and soft drinks were sold only in big container, case, carton, or multiple-pack quantities.

- The selections of appliances, equipment and tools often included commercial and professional models because of the so many of Costco’s members were small businesses.

- The approximate percentage of net sales accounted for by each major category of items stocked by Costco is in Exhibit 1 below.

### Exhibit 1  Costco Sales by Product Category, 2003-2006

<table>
<thead>
<tr>
<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Food (fresh produce, meats and fish, bakery and deli products, and dry and institutionally packaged foods)</td>
<td>31%</td>
<td>30%</td>
<td>30%</td>
<td>31%</td>
<td>30%</td>
</tr>
<tr>
<td>Sundries (candy, snack foods, tobacco, alcoholic and nonalcoholic beverages, and cleaning and institutional supplies)</td>
<td>23%</td>
<td>24%</td>
<td>25%</td>
<td>25%</td>
<td>26%</td>
</tr>
<tr>
<td>Hardlines (major appliances, electronics, health and beauty aids, hardware, office supplies, garden and patio, sporting goods, furniture, cameras, and automotive supplies)</td>
<td>21%</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
</tr>
<tr>
<td>Softlines (including apparel, domestics, jewelry, housewares, books, movie DVDs, video games and music, home furnishings, and small appliances)</td>
<td>11%</td>
<td>12%</td>
<td>12%</td>
<td>13%</td>
<td>14%</td>
</tr>
<tr>
<td>Ancillary and Other (gasoline, pharmacy, food court, optical, one-hour photo, hearing aids, and travel)</td>
<td>14%</td>
<td>14%</td>
<td>13%</td>
<td>11%</td>
<td>10%</td>
</tr>
</tbody>
</table>

- To encourage members to shop at Costco more frequently, the company operated ancillary businesses within or next to most Costco warehouses; the number of ancillary businesses at Costco warehouses is shown below:

<table>
<thead>
<tr>
<th>Category</th>
<th>2007</th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total number of warehouses</td>
<td>488</td>
<td>458</td>
<td>433</td>
<td>417</td>
</tr>
<tr>
<td>Warehouses having stores with</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Food Court and Hot Dog Stands</td>
<td>482</td>
<td>452</td>
<td>427</td>
<td>412</td>
</tr>
<tr>
<td>One-Hour Photo Centers</td>
<td>480</td>
<td>450</td>
<td>423</td>
<td>408</td>
</tr>
<tr>
<td>Optical Dispensing Centers</td>
<td>472</td>
<td>442</td>
<td>414</td>
<td>397</td>
</tr>
<tr>
<td>Pharmacies</td>
<td>429</td>
<td>401</td>
<td>374</td>
<td>359</td>
</tr>
<tr>
<td>Gas Stations</td>
<td>279</td>
<td>250</td>
<td>225</td>
<td>211</td>
</tr>
<tr>
<td>Hearing Aid Centers</td>
<td>237</td>
<td>196</td>
<td>168</td>
<td>143</td>
</tr>
<tr>
<td>Print Shops and Copy Centers</td>
<td>8</td>
<td>9</td>
<td>10</td>
<td>10</td>
</tr>
</tbody>
</table>

About 1,000 of the 4,000 items were constantly changing; these items were intended to help create a “treasure hunt” atmosphere. Costco’s merchandise buyers were constantly on the lookout to make one-time purchases of items that would appeal to the company’s clientele and that would sell out quickly. A sizable number of these items were high-end or name brand products that carried big price tags—like big-screen HDTVs selling for $1,000 to $1,500 or $800 leather sofas. The idea was to entice shoppers to spend more than they might by offering irresistible deals on luxury items. In many cases, Costco did
not obtain its luxury offerings directly from high-end manufacturers like Calvin Klein or Waterford (who were unlikely to want their merchandise marketed at deep discounts at places like Costco); rather Costco buyers searched for opportunities to source such items legally on the gray market from other wholesalers or distressed retailers looking to get rid of excess or slow-selling inventory. Examples of treasure hunt specials included $800 espresso machines, expensive jewelry and diamond rings (with price tags of $50,000 to as high as $250,000), Italian-made Hathaway shirts priced at $29.99, Movado watches, exotic cheeses, Coach bags, $5,000 necklaces, cashmere sports coats, $1500 digital pianos, and Dom Perignon champagne.

Costco’s low prices and its reputation for making shopping at Costco something of a treasure hunt made it unnecessary to engage in extensive advertising or sales campaigns. Marketing and promotional activities were generally limited to special campaigns for new warehouse openings occasional direct mail marketing to prospective new members, and regular direct mail programs promoting selected merchandise to existing members. The company’s primary direct mail program for members was The Costco Connection, a multipage mail-out that contained a host of savings coupons for featured specials. For new warehouse openings, marketing teams personally contacted businesses in the area that were potential wholesale members; these contacts were supplemented with direct mailings during the period immediately prior to opening.

- Potential Gold Star (individual) members were contacted by direct mail or by promoting membership offerings at local employee associations and businesses with large numbers of employees. After a membership base was established in an area, most new memberships came from word-of-mouth (existing members telling friends and acquaintances about their shopping experiences at Costco), follow-up messages distributed through regular payroll or other organizational communications to employee groups, and ongoing direct solicitations to prospective Business and Gold Star members.

- Management believed that its emphasis on direct mail advertising kept its marketing expenses low relative to those at typical retailers, discounter, and supermarkets.

Most Costco stores were located in the upscale areas/suburbs of major metropolitan areas.

Costco’s strategy to grow sales and profits had three main elements: open more new warehouses, build an ever larger and fiercely loyal membership base, and employ well-executed merchandising techniques to induce members to shop at Costco more often and purchase more per shopping trip.

Costco opened 127 new warehouses in fiscal years 2005-2008; management planned to open another 20-24 by the end of fiscal 2009. Most were in the United States where efforts were focused on entering cities and states where Costco did not yet have a warehouse (as of 2008 there were no Costco stores in 10 states) and opening additional warehouses in metropolitan areas big enough to support two or more Costco locations. Expansion was underway internationally as well. As of October 2008, Costco had a total of 102 wholly-owned warehouses outside the U.S., including 76 in Canada, 20 in the United Kingdom, 8 in Japan, 6 in Korea, and 5 in Taiwan. Costco was a 50-50 partner in a venture to operate 31 Costco warehouses in Mexico. Case Exhibit 2 shows a breakdown of Costco’s geographic operations for fiscal years 2005-2008—the data in the case Exhibit 2 presentation do not include the 31 warehouses in Mexico because the 50-50 venture in Mexico was accounted for using the equity method.

- Another element of Costco’s strategy to grow via new store openings had involved experimenting with entry into entirely different stores. Costco had recently opened two free-standing high-end furniture warehouse businesses called Costco Home. Sales in 2005 at these two locations increased 132% over 2004 levels and profits were up significantly. However, as of 2008, the Costco Home experimentation seemed to have been abandoned in favor of simply adding about 45,000 square feet to the size of selected new Costco stores and using the extra space to stock a much bigger selection of furniture—furniture was one of the top 3 best-selling categories at Costco’s website.
Costco’s strategy to attract more members and entice members to do a bigger percentage of their shopping at Costco had three components:

- Give members a place to buy supplies of practical, frequently-used business and household items at money-saving prices. A recent initiative that management believed would spur sales was to expand the offerings of Kirkland Signature private-label items from some 400 items in 2005 to as many as 600 items by 2009.

- Make shopping at Costco interesting and rewarding because of opportunities to purchase an ever-changing array of big ticket items and indulgences at rock bottom prices—in this regard, it was important that members be able to spot appealing new items on the sales floor each time they shopped at Costco. Costco buyers constantly scanned the manufacturing landscape, looking for one-time opportunities to buy items that would appeal to bargain-hunting members. And warehouse personnel strived to do an effective job of displaying and merchandising the special buys on the sales floor.

- Acclimate members to the merits of visiting Costco on a weekly or bi-monthly basis so as to not miss out on the special one-time-only merchandise selections that typically sold out in a matter of days.

Once the chief elements of Costco’s strategy have been brought out, you may want to poll the class on what they think of the strategy. How good is it? Based on Costco’s rapid growth, its status as market leader, and its financial performance, we see no basis for a grade of less than B+. A grade of A would seem appropriate.

3. Do you think Jim Sinegal is an effective CEO? What grades would you give him in leading the process of crafting and executing Costco’s strategy? What support can you offer for these grades? Refer to Figure 2.1 in Chapter 2 in developing your answers.

Class members are likely to approve of the way Jim Sinegal manages Costco and the overall job he is doing. We suggest that you push the class to evaluate Sinegal in terms of how well he has performed the five tasks of strategic management portrayed in Figure 2.1 in Chapter 2. You might want to ask the following questions:

- Is it a good idea for Sinegal to spend time visiting Costco stores? Why or why not?
- Should Sinegal “cross-examine” store managers pretty aggressively as he tours the stores he visits?
- Should he expect solid, reasoned answers to the questions he poses? Should he offer suggestions?
- What should Sinegal strive to accomplish on his store visits?

We would give Jim Sinegal an “A” for the job he has done in leading the strategy-making process at Costco. But there is always merit in pushing class members to justify their reasons for approving of Jim Sinegal’s performance. Very likely, students will find little to criticize. Most will concur that the strategy is fundamentally sound and that there is every indication it is working well. Some points that class members ought to make:

- Jim Sinegal has set forth a clear and well-defined strategic path for the company to follow.
- He is the architect of Costco’s business model and has presided over the development of the company’s strategy.
- Sinegal has savvy merchandising skills and has orchestrated the company’s effective strategy to create a “treasure hunt” atmosphere in the stores, to keep prices ultra-low, and to build a high volume of store traffic that promotes rapid inventory turnover. He is the driving force behind the company’s ability to achieve annual sales volume of close to $130 million annually per store.
Moreover, Sinegal is doing a nice job in leading the strategy execution process at Costco. He spends a lot of time in the stores, checking out store layouts and merchandising, speaking with employees, and in general staying in close touch with how well things are going. He is apparently very quick to take action when he spots ways a store can improve. In touring a Costco store with the local store manager, Sinegal is very much the person in-charge. He functions as producer, director, and knowledgeable critic. He cuts to the chase quickly, exhibiting intense attention to detail and pricing, wandering through store aisles firing a barrage of questions at store managers about sales volumes and stock levels of particular items, critiquing merchandising displays or the position of certain products in the stores, commenting on any aspect of store operations that catch his eye, and asking managers to do further research and get back to him with more information whenever he found their answers to his questions less than satisfying. Information in the case indicates that Sinegal has tremendous merchandising savvy, that he demands much of store managers and employees, and that his views about discount retailing set the tone for how the company operates. Knowledgeable observers claim that Jim Sinegal’s merchandising expertise was on a par with that of the legendary Sam Walton.

In short, there is very little about Jim Sinegal’s performance that merits criticism. Students ought to concur that his performance of the 5 tasks shown in Figure 2.1 of Chapter 2 is commendable.

**Key Conclusion and Teaching Point:** Jim Sinegal is an effective CEO and is doing a very creditable job of strategic leadership. Students should see that Costco is a good illustration of a point much emphasized at the end of Chapter 1: good strategy + good strategy execution = good management.

### 4. What core values or business principles is Jim Sinegal stressing at Costco?

Two core values or business principles seem to stand out at Costco:

- Delivering value to customers in the form of low prices.
- Treating employees well.

Jim Sinegal’s comments in the case make it clear that he is dedicated to instilling these values as part of Costco’s culture. He seems to have drawn a line in the sand in insisting that these two values/business principles are reflected in the way Costco operates.

### 5. How well is Costco performing from a financial perspective? Do some number-crunching using the data in case Exhibit 1 to support your answer. Use the financial ratios presented in Table 4.1 of Chapter 4 (pages 104-105) to help you diagnose Costco’s financial performance.

The financial and operating summary in case Exhibit 1 indicate that Costco’s financial performance during the 2000-2008 period has been good (but short of what could be termed “excellent”). Students can point to any of several statistics and measures to support this conclusion:

- Net sales increased from $31.6 billion in fiscal 2000 to $71.0 billion in fiscal 2008, equal to a respectable compound average growth rate (CAGR) of 12.3% since 2000.
- Total revenues (sales plus membership fees) increased from $32.2 billion in fiscal 2000 to $72.5 billion in fiscal 2008, also equal to an average annual compound rate of 12.3% from 2000 through 2008.
- Net income rose from $631 million in 2000 to $1.1 billion in 2006, a respectable (though not outstanding) compound average growth rate of 9.76%.
- Diluted earnings per share have increased from $1.35 in 2000 to $2.30 in 2006, a compound average growth rate of 9.3%.
- Costco’s profitability and expense ratios are shown below:
<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Merchandise costs as a % of net sales</td>
<td>89.5%</td>
<td>89.5%</td>
<td>89.5%</td>
<td>89.4%</td>
<td>89.6%</td>
</tr>
<tr>
<td>Selling, general, and administrative expenses as a % of total revenues</td>
<td>9.6%</td>
<td>9.7%</td>
<td>9.5%</td>
<td>9.5%</td>
<td>8.6%</td>
</tr>
<tr>
<td>Operating income as a % of total revenues (operating profit margin)</td>
<td>2.7%</td>
<td>2.5%</td>
<td>2.7%</td>
<td>2.8%</td>
<td>3.2%</td>
</tr>
<tr>
<td>Net income as a % of total revenues (net profit margin)</td>
<td>1.8%</td>
<td>1.7%</td>
<td>1.8%</td>
<td>2.0%</td>
<td>2.0%</td>
</tr>
<tr>
<td>Return on equity (net income as a % of stockholders’ equity)</td>
<td>14.0%</td>
<td>12.6%</td>
<td>12.1%</td>
<td>12.0%</td>
<td>14.9%</td>
</tr>
<tr>
<td>Return on assets (net income as a % of total assets)</td>
<td>6.2%</td>
<td>5.5%</td>
<td>6.3%</td>
<td>6.4%</td>
<td>7.3%</td>
</tr>
<tr>
<td>Current ratio</td>
<td>1.07</td>
<td>1.09</td>
<td>1.05</td>
<td>1.22</td>
<td>1.02</td>
</tr>
<tr>
<td>Days of inventory*</td>
<td>29.0</td>
<td>31.5</td>
<td>31.6</td>
<td>31.6</td>
<td>32.1</td>
</tr>
</tbody>
</table>

*Days of inventory equals merchandise inventories ÷ (merchandise costs ÷ 365); students can get the formula for days of inventory from Table 4.1 in Chapter 4 of the text.

- Selling, general, and administrative expenses have crept upward since 2000.
- Both operating income as a % of total revenues (operating profit margin) and net income as a % of total revenues (net profit margin) have both eroded slightly since 2000—but the 2008 figures are marginally better than for 2007 and on a par with those for 2006.
- Return on equity eroded from 14.9% in 2000 to 12.0% in 2005 and then has climbed back to 12.1% in 2006, 12.6% in 2007, and 14.0% in 2008.
- Return on assets also eroded, dropping from 7.3% in 2000 to 5.5% in 2007 before increasing to 6.2% in fiscal 2008.
- The company’s liquidity is adequate, as indicated by the slightly above 1.0 levels in the past 3 years.
- Days of inventory at Costco has improved since 2000, indicating that Costco management has done a good job of inventory control.
- On the whole, while Costco’s net income profits rose during the 2000-2008 period (dropping slightly in fiscal 2007 before recovering in 2008), the company’s overall profitability is not as good in 2008 as it was in 2000. Yet, fiscal 2008 was a stronger year in terms of profitability than was fiscal 2007.

- Net cash provided by operating activities has trended upward, running in the $1.78-2.08 billion range the past 4 years.
- In 2008, Costco’s long-term debt was $2.2 billion, up significantly from 2006 levels.

**Conclusions:** Costco’s financial performance, while acceptable, could certainly be better. Profit margins, return on equity, and return on assets have gotten skimpier since 2000 and SG&A expenses as a % of total revenues seem to be creeping upward. While none of the performance measures show an alarming deterioration (and the upticks in fiscal 2008 are comforting), there is definitely room for Costco’s financial performance to improve.
6. Based on the data in case Exhibits 1 and 4, is Costco’s financial performance superior to that at Sam’s Club and BJ’s Wholesale?

Students can use the data in case Exhibits 1 and 4 to develop the following comparisons:

<table>
<thead>
<tr>
<th></th>
<th>Costco</th>
<th>Sam’s Club</th>
<th>BJ’s Wholesale</th>
</tr>
</thead>
<tbody>
<tr>
<td>CAGR* in sales revenues, 2000-2007</td>
<td>12.2%</td>
<td>8.8%</td>
<td>10.8%</td>
</tr>
<tr>
<td>CAGR* in operating income, 2000-2007</td>
<td>7.6%</td>
<td>9.4%</td>
<td>-1.1%</td>
</tr>
<tr>
<td>CAGR* in net income, 2000-2007</td>
<td>9.4%</td>
<td>n.a.</td>
<td>-1.2%</td>
</tr>
<tr>
<td>Operating income as a % of total revenues</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td>2.5%</td>
<td>3.6%</td>
<td>2.0%</td>
</tr>
<tr>
<td>2006</td>
<td>2.7%</td>
<td>3.6%</td>
<td>1.7%</td>
</tr>
<tr>
<td>2005</td>
<td>2.8%</td>
<td>3.5%</td>
<td>2.6%</td>
</tr>
<tr>
<td>SG&amp;A expenses as a % of total revenues</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td>9.7%</td>
<td>n.a.</td>
<td>7.0%</td>
</tr>
<tr>
<td>2006</td>
<td>9.5%</td>
<td>n.a.</td>
<td>8.3%</td>
</tr>
<tr>
<td>2005</td>
<td>9.5%</td>
<td>n.a.</td>
<td>7.7%</td>
</tr>
<tr>
<td>Operating income as a % of total assets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td>8.2%</td>
<td>13.8%</td>
<td>9.5%</td>
</tr>
<tr>
<td>2006</td>
<td>9.3%</td>
<td>12.9%</td>
<td>7.2%</td>
</tr>
<tr>
<td>2005</td>
<td>8.9%</td>
<td>13.3%</td>
<td>10.3%</td>
</tr>
<tr>
<td>Net income as a % of total assets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td>5.5%</td>
<td>n.a.</td>
<td>6.0%</td>
</tr>
<tr>
<td>2006</td>
<td>6.3%</td>
<td>n.a.</td>
<td>3.6%</td>
</tr>
<tr>
<td>2005</td>
<td>6.4%</td>
<td>n.a.</td>
<td>6.5%</td>
</tr>
<tr>
<td>Average sales per location, 2007</td>
<td>$129.3 million</td>
<td>$75.1 million</td>
<td>$49.8 million</td>
</tr>
</tbody>
</table>

*CAGR = compound average growth rate

The comparisons are mixed. Costco had fastest rate of growth in sales revenues and far and away the highest sales per store location. But operating income at Sam’s Club grew faster in 2005-2007 and Sam’s has higher operating profit margins (which might partially be due to the fact that some of its distribution expenses might be shared with the its sister division, Wal-Mart stores and supercenters). Facilities-sharing with other Wal-Mart operations probably also explains why operating income as a % of total assets at Sam’s Club far exceeds the operating return on assets at both Costco and BJ’s. BJ’s Wholesale had lower SG&A expenses as a % of total sales than did Costco and also higher operating income and net income as a % of total assets than Costco in 2 of the 3 most recent years. On the whole, there are pluses and minuses for all three competitors in the comparisons.

7. How well is Costco performing from a strategic perspective? Does Costco enjoy a competitive advantage over Sam’s Club? Over BJ’s Wholesale? If so, what is the nature of its competitive advantage? Does Costco have a winning strategy? Why or why not?

Costco’s strategic performance seems rather solid.

- Costco was the 4th largest retailer in the U.S. and the 8th largest in the world.
- Costco was the clear leader in the membership warehouse industry.
- In 2008, its stores generated annual sales per store of $130.5 million, up from $101 million in 2000 (based on data in case Exhibit 1).
- The number of business members has risen from 4.4 million to 5.6 million, a modest CAGR of 2.4% (as per information in case Exhibit 1).
The number of Gold Star individual members is up from 12.7 million to 20.2 million, a solid CAGR of 6.85% (as per information in case Exhibit 1).

The company sees opportunities to open about 25 stores per year.

The company’s stores attract upscale consumers in large numbers; many members are loyal Costco shoppers. One of Costco’s stores generated average sales per customer visit of ~$150.

We think students should conclude that Costco has a competitive advantage over Sam’s Club and certainly an advantage over BJ’s Wholesale. The basis for Costco’s competitive advantage relates chiefly to:

- Costco’s more appealing “treasure hunt” atmosphere and better selection of bargain-priced, upscale merchandise.

In addition, Costco has slightly bigger stores than Sam’s Club—Costco’s stores average about 141,000 square feet versus 132,000 square feet at Sam’s Club. Costco might also have an edge over Sam’s Club in having store locations that are conveniently located for upscale shoppers—the fact that Costco’s clientele consists of a fairly high proportion of upscale shoppers is a definite plus for Costco.

Another piece of evidence pointing to a competitive advantage for Costco is that its annual sales per store (about $130.5 million in 2008) far exceeds the averages at Sam’s Club (average sales per store of $75.1 million in 2007) and BJ’s Wholesale (average sales per store of $49.8 million in 2007). Such larger sales volumes at Costco stores, along with the short operating hours at its stores, translate into lower labor costs per dollar of sales and a cost-based competitive advantage.

BJ’s Wholesale is clearly a distant third in the membership warehouse segment and will likely never match the other two rivals in terms of total numbers of stores or sales per store or overall customer draw and allure.

But all 3 competitors—Costco, Sam’s Club, and BJ’s Wholesale—appeal to members because of (1) their low prices (it is not clear that any one of the three has lower prices than the other two on such merchandise as paper towels or meats or toothpaste or pet foods) and (2) their ability to save customers money on the merchandise they stock.

**Conclusions Regarding Whether Costco Has a Winning Strategy.** In our view, it is fair to conclude that Costco has a winning strategy. As discussed in Chapter 1, there are three tests of a winning strategy: (1) Does the strategy fit the company’s situation?; (2) Is the strategy building competitive advantage?; and (3) Is the strategy improving company performance? The answers to these 3 questions are yes.

- Costco’s strategy seems quite well matched to market conditions in the membership warehouse segment of the retailing industry and to the company’s resources and competitive capabilities.

- As indicated above, Costco enjoys a competitive advantage over its rivals. Its stores are outperforming those of both Sam’s Club and BJ’s Wholesale. Costco is the standout leader in the membership warehouse retailing segment.

- And Costco’s bottom-line performance is improving (although, as indicated above, there is room for profit margin improvement and better returns on investment). Costco is adding new stores at somewhat faster pace and there seems to be ample room in the marketplace to add more Costco warehouse stores annually for some years to come—this should lay a solid foundation for further growth in revenues, net income, and earnings per share, along with boosting Costco’s stock price.

What really seals the case for Costco having a winning strategy is that Costco is likely destined to remain the clear market leader in the membership warehouse segment for some time to come. Neither of Costco’s two rivals in the membership warehouse segment seems to be in a position to challenge or overtake Costco as the market leader in sales.
8. Are Costco’s prices too low? Why or why not?

This is an important question to pose to the class. In the case, students will read that Costco’s markups and prices were so low that Wall Street analysts had criticized Costco management for going all out to please customers at the expense of charging prices that would increase profits for shareholders. In commenting on Costco’s pricing strategy, one retailing analyst said, “They could probably get more money for a lot of the items they sell.”

However, it is clear from reading the case that Costco’s pricing strategy was to keep customers coming in to shop by wowing them with low prices. A key element of Costco’s strategy to keep prices low to members was to cap the margins on brand name merchandise at 14 percent (compared to 20 to 50 percent margins at other discounters and many supermarkets). The margins on Costco’s 400 private-label Kirkland Signature items were a maximum of 15 percent, but the fractionally higher markups on Costco’s private label items still resulted in its private-label prices being about 20 percent below comparable name brand items. According to Jim Sinegal:

We always look to see how much of a gulf we can create between ourselves and the competition. So that the competitors eventually say, “These guys are crazy. We’ll compete somewhere else.” Some years ago, we were selling a hot brand of jeans for $29.99. They were $50 in a department store. We got a great deal on them and could have sold them for a higher price but we went down to $29.99. Why? We knew it would create a riot.

We’re very good merchants, and we offer value. The traditional retailer will say: “I’m selling this for $10. I wonder whether we can get $10.50 or $11.” We say: “We selling this for $9. How do we get it down to $8?” We understand that our members don’t come and shop with us because of the window displays or the Santa Claus or the piano player. They come and shop with us because we offer great values.

Furthermore, Sinegal was quite unimpressed with Wall Street calls for Costco to abandon its ultralow markups and pricing strategy, commenting “Those people are in the business of making money between now and next Tuesday. We’re trying to build an organization that’s going to be here 50 years from now.”

Hence, class members have strong reason to believe that Costco’s prices are indeed low (and perhaps at “rock bottom” levels). A good case can be made that Costco might indeed boost its profitability by charging a fraction more for much of the merchandise it sells—and as discussed above, an increase in Costco’s thin profit margins is needed to materially improve its bottom-line performance.

Key Teaching Point Concerning Costco’s Prices. Perhaps the best way to demonstrate to students just how low Costco’s prices are is to have them look at case Exhibit 1 and lead the class through some number-crunching. The numbers in the table below—which you might want to use as the basis for a slide or transparency shown in class (or as a handout to class members)—reveals that Costco is selling its merchandise at barely more than breakeven prices. This becomes clear when one looks at the size of Costco’s revenues from membership fees and then checks out what proportion these revenues represent of Costco’s income before income taxes.
Membership fees (in millions)  
Income before income taxes (in millions)  
Membership fees as a % of Costco’s income before income taxes  
Amount of income before income taxes that was contributed by merchandise sales (in millions of dollars)  
Net merchandise sales (in millions)  
Dollar contribution of merchandise sales to income before income taxes as a % of Costco’s net sales of merchandise

What students ought to see from the above calculations is that anywhere from two-thirds to three-fourths of Costco’s income before taxes is in effect coming from membership fees. This means that Costco’s markup on the merchandise it sells ends up covering the company’s operating expenses with only a paltry 0.7% to 1% left over for contributing to pretax profit—in other words, Costco’s prices are just barely above the breakeven level. These calculations also bolster the case of outsiders that Costco should consider increasing its prices at least slightly in order to boost profitability (and profitability is indeed in need of being boosted!).

The above calculations should suffice to demonstrate to class members that Costco’s prices are indeed quite low (about as low as possible!!)—especially given that the company operates very lean and goes all-out to keep its operating expenses to a minimum.

Students should realize that Costco is very much a low-cost operator. As Jim Sinegal stated in a recent Costco annual report:

Costco is able to offer lower prices and better values by eliminating virtually all the frills and costs historically associated with conventional wholesalers and retailers, including salespeople, fancy buildings, delivery, billing, and accounts receivable. We run a tight operation with extremely low overhead which enables us to pass on dramatic savings to our members.

9. Does Costco pay its employees too much? Does it make sense for Costco to compensate its employees so much better than the employees at Wal-Mart/Sam’s Club? Why or why not?

This is something of a deliberately loaded question. What is clear from the case is that Costco’s compensation and benefit levels are substantially higher than those at Wal-Mart (and presumably those at Wal-Mart’s Sam’s Club subsidiary—many of the Sam’s Club locations are adjacent to Wal-Mart Supercenters).

Starting wages for new Costco employees were in the $10.50-$11 range in 2008. Depending on the job classification, the median pay scales for Costco employees with five or more years experience were in the $17-$21 per hour range. Warehouse employees received time-and-a-half pay for working on Sundays and were paid double time in the event they were called on to work more than 12 hours in a given shift. Median salaries for managerial positions at Costco warehouses were in the $55,000 to $75,000 range. Costco employees received bi-annual bonuses.

According to information in the case, wages and fringe benefits at Wal-Mart/Sam’s Club were skimpier than those at Costco.
Moreover, Costco employees enjoyed a benefit package that included the following:

- Health and dental care plans.
- Convenient prescription pick-up at Costco’s pharmacies, with co-payments as low as $5 for generic drugs and generally no more than 15% co-pay for the most expensive branded drugs.
- A vision program which paid $45 for an optical exam (the amount charged at Costco’s optical centers) and generous allowances for the purchase of glasses and contact lens.
- A 401(k) plan where Costco matched hourly employee contributions 50 cents on the dollar for the first $1,000 annually to a maximum company match of $500 per year. Company contributions to employee 410(k) plans were $238.8 million in fiscal 2007, $233.6 million in fiscal 2006, $191.6 million in fiscal 2005, and $169.7 million in fiscal 2004.
- A dependent care reimbursement plan.
- Confidential professional counseling services.
- Company-paid long term disability coverage equal to 60 percent of earnings for workers that were out for more than 180 days on a non-worker’s compensation leave of absence.
- All employees who passed their 90-day probation period and were working at least 10 hours per week were automatically enrolled in a short-term disability plan covering non-work related injuries or illnesses for up to 26 weeks.
- Generous life insurance and accidental death and dismemberment coverage.
- An employee stock purchase plan.
- A health care reimbursement plan where benefit eligible employees could arrange to have pre-tax money automatically deducted from their paychecks and deposited in a health care reimbursement account that could be used to pay medical and dental bills.
- A long-term care insurance plan.

Salaried employees were eligible for benefits on the first of the month after the date of hire. Full-time hourly employees were eligible for benefits of the first of the month after working a probationary 90 days; part-time hourly employees became benefit-eligible on the first of the month after working 180 days.

Good wages and benefits were said to be why employee turnover at Costco ran under 6 percent after the first year of employment. Some Costco employees had been with the company since its founding in 1983. Many others had started working part-time at Costco while in high-school or college and opted to make a career at the company. One Costco employee told an ABC 20/20 reporter, “It’s a good place to work; they take good care of us.” A Costco vice president and head baker said working for Costco was a family affair: “My whole family works for Costco, my husband does, my daughter does, my new son-in-law does. Another employee, a receiving clerk that made about $40,000 a year, said “I want to retire here. I love it here.” An employee with over two years of service could not be fired without the approval of a senior company officer.

**Although admitting that paying good wages and good benefits was contrary to conventional wisdom in discount retailing,** Jim Sinegal was convinced that having a well-compensated workforce was very important to executing Costco’s strategy successfully. He said, “Imagine that you have 120,000 loyal ambassadors out there who are constantly saying good things about Costco. It has to be a significant advantage for you….. paying good wages and keeping your people working with you is very good business.” When a reporter asked him about why Costco treated its workers so well compared to other retailers (particularly Wal-Mart which paid lower wages and had a skimpier benefits package), Sinegal replied: “Why shouldn’t employees
have the right to good wages and good careers?” ……It absolutely makes good business sense. Most people agree that we’re the lowest-cost producer. Yet we pay the highest wages. So it must mean we get better productivity. Its axiomatic in our business—you get what you pay for.”

Having brought out these points, you should then press the class for their opinions as to whether Jim Sinegal is right. There are several questions you can pose to stimulate discussion:

- Do you agree with Jim Sinegal’s views about the importance of having well-compensated employees at Costco?
- Are Costco’s employees overpaid?
- Could Costco boost profitability by trimming back on its fairly high levels of compensation and its probably pricey fringe benefit package?
- What are the benefits to Costco and its shareholders of compensating employees so well?
- Are shareholders well-served by the company’s practice of paying good wages and fringe benefits? Would Costco shareholders be better off if the company’s pay scales were somewhat lower and its fringe benefit offerings less costly? Why or why not?
- What does Costco’s practice of paying good wages/salaries and having an attractive fringe benefit package tell us about the company’s values?
- If Costco strives to boost profitability, would it be better to raise prices very slightly (say 0.5%) rather than to trim back on compensation and benefits for its work force?

10. **What recommendations would you make to Jim Sinegal regarding the actions that Costco management needs to take to sustain the company’s growth and improve its financial performance?**

Costco is not a company with glaring problems and shortcomings that desperately need to be fixed. On the whole, we think students should recommend that the company “stay the course” and continue with the present strategy largely unchanged from what we see the company doing as of 2008. The company has a sound strategy and no major overhaul is called for—but some minor tweaking and fine-tuning might well be proposed by class members.

But there are a couple of issues that stand out:

- What can/should Costco management do to try to boost profit margins and spur improvements in the company’s bottom-line? The above analysis of the company’s financial performance indicated there was room for improvement in the company’s overall profitability.

- Does the company have someone who can take over for Jim Sinegal in the near future? Sinegal is the driving force of the company and he is 70 years old—a Costco without Jim Sinegal to guide it might well stumble or begin to lose its merchandising magic.

- Should the company trim the number of new store openings just enough to avoid incurring additional long-term debt?

Costco’s options for boosting its profit margins are fairly limited:

- Boost profitability by doing a better job of holding down costs. The problem with this option is that Costco is already a lean operator; management has long been has been aggressive in controlling costs and finding ways to operate efficiently. There are not likely may ways to cut costs by very much.
Case 2  Costco Wholesale Corp.: Mission, Business Model, and Strategy

- Raise prices fractionally. This is probably the quickest and surest route to better profitability. But the culture at Costco and Jim Sinegal’s strong conviction about charging the lowest possible prices will make this option a tough sell.

- Continue to open new stores and grow sales at existing stores.
  - Sales growth at existing stores might well over time produce better profitability, since costs at existing stores might not rise appreciably as store traffic and sales volumes grow. Costco might be able to spur sales growth at existing stores by adding new product lines (like furniture) or having more big ticket “treasure hunt” items in its merchandise lineup.
  - Aggressively recruiting new members for existing stores would help grow membership fees and boost store traffic and sales volume
  - Opening new stores should definitely act to boost total sales and total profits—but it may not do much for profit margins due to the extra costs associated with a new store opening—see the pre-opening expenses shown in case Exhibit 1.

Jim Sinegal and Costco’s board of directors are likely to be alert to the fact that a management succession plan is needed. Very likely, one or more of Costco’s senior executives are being groomed to replace Jim Sinegal at some juncture. But whether these executives will have as keen an eye for merchandising and as effective a leadership style as Jim Sinegal is yet to be seen.

The company has the financial resources to continue to grow its business, but the recent pace of new store openings produced a rather sizable amount of new long-term debt in 2007-2008—see case Exhibit 1. It would seem advisable to avoid further increases in Costco’s long-debt, even if this means slowing the number of new store openings (or raising prices slightly so as to boost cash flows from operations and thereby generate more funds to finance growth internally).

Winding Up the Class: You can end the class by pointing out that Costco Wholesale is a perfect example of a company that

- Has a good strategy and
- Is executing the strategy with a high degree of proficiency.

Costco, in our view, is a company that illustrates why Chapter 1 stressed the point that

- Good strategy + Good strategy execution = Good management.

EPILOGUE

There is no significant news to report since the case was prepared in Fall 2008.

For the latest information on developments at Costco Wholesale, we suggest that you check the company’s latest financial results and press releases at [www.costco.com](http://www.costco.com).
OVERVIEW

JetBlue Airways was founded in 2000 by David Neeleman, whose vision was to “bring humanity back to air travel.” Neeleman believed that airlines should be able to provide a high level of customer service at an affordable price and founded JetBlue Airways on this notion. JetBlue was able to become the industry’s low cost provider through strategies and operating practices such as operating flights on a point-to-point system, using only two types of aircraft, eliminating in-flight meals, and encouraging customers to book flights through its web site. Although the company was the industry’s low cost provider, it offered a higher quality of service than did other low fare carriers with such amenities as leather seating and in-flight live television. JetBlue also had one of the industry’s lowest number of customer complaints and reports of mishandled baggage. In order to further provide better customer service, JetBlue made a point to listen to the little things that its customers liked and disliked about all airlines. Neeleman himself would ride on flights and talk with passengers so that he could get a better understanding of how to improve JetBlue to the customers. JetBlue management also believed that if it was able to keep employees happy, then employees would go the extra step of providing exceptional customer service.

By 2007, the company had become the 8th largest passenger carrier in the United States and had been recognized with such awards as “Best Domestic Airline,” “Best Domestic Airline for Value,” and “Best Overall Airline” for onboard service. However, the company’s reputation suffered a crushing blow during a 6-day ice storm in February 2007 when it cancelled 1,100 flights affecting 130,000 passengers. The widespread groundings created miserable conditions for some passengers who had boarded JetBlue aircraft and then were forced to wait on the JFK International Airport tarmac for 11 hours or more before returning to the terminal to deplane.

Neeleman issued several apologies on news programs, talk shows, and even on YouTube. In an email to passengers dated February 21, 2007, he wrote: “We are sorry and embarrassed. But most of all, we are deeply sorry. Last week was the worst operational week in JetBlue’s seven year history. Following the severe winter ice storm in the Northeast, we subjected our customers to unacceptable delays, flight cancellations, lost baggage . . . Words cannot express how truly sorry we are for the anxiety, frustration and inconvenience that we caused.” Neeleman also announced a “Passenger’s Bill of Rights,” the first of its kind among US airline carriers, in which the company disclosed its policies regarding vouchers and refunds in the event of delays, cancellations, and other inconveniences.

Nonetheless, JetBlue’s tarnished reputation caused a shakeup among top management that went as high as the CEO. Among those replacing JetBlue’s senior management was Russell Chew, a former chief operating officer at the Federal Aviation Administration, who was hired as JetBlue’s COO in March 2007. Chew assumed the additional post of president on September 13, 2007. John Harvey, JetBlue’s chief financial officer, resigned on November 9, 2007, after 18 months on the job and was replaced by Ed Barnes, a JetBlue senior vice president in finance and accounting officer. Neeleman’s tenure as CEO was over on May 10, 2007, when JetBlue’s board of directors said that he would resign as CEO and become its non-executive board chairman. On April 10, 2008, Neeleman announced that he was leaving the company and starting an airline company in Brazil. David Barger, who had been president, became the new CEO.
JetBlue’s new management team faced many challenges ahead. JetBlue’s shares were in a downward spiral—dropping from $12.99 per share on February 13, 2007 to $3.97 per share on May 30, 2008. The new management team had quickly put new operating procedures, communication systems and information technology solutions to prevent another weather-related debacle, but many issues remained unresolved. Barger and his senior management had yet to deal with rising jet fuel prices and it was still undecided if the company’s new strategies to improve revenues and lower operating costs would prove successful.

SUGGESTIONS FOR USING THE CASE

This is an interesting case that deals with an industry many students are likely to have some experience with and have a relatively strongly opinion about—air travel. Additionally, JetBlue’s story is one that is likely to appeal to students—this is an interesting company with an interesting strategy, some novel ways of doing business, and a company with some different cultural traits. JetBlue has succeeded by treating customers fairly and offering a solid value for the money. Also, some students may have strong opinions about the inconveniences suffered by JetBlue passengers during the February 2007 ice storm because of similar personal experiences. All these factors combine to set the stage for a lively debate among students about JetBlue and its prospects in a turbulent industry where profits are hard to come by.

This is a versatile case that can be used very early in lineup of assigned cases to tie with coverage or Chapters 1 and 2 and have students wrestle with what effective strategic leadership is all about. But there is also ample information to use the case after you have lectured on Chapters 1 through 6—students can be asked to identify and appraise industry driving forces, identify key success factors, and closely examine JetBlue business strategy. The case contains a potent exhibit showing how JetBlue’s costs compare against those of Southwest (the industry’s traditional low-cost provider) and other major airlines. Also, this case can easily be used in the strategy execution part of the course following coverage of Chapters 10-12 because it has considerable information about JetBlue’s policies, practices, and culture. The somewhat comprehensive nature of the case content makes JetBlue a solid candidate for a comprehensive written case assignment near the end of the course, a final exam case, or an oral team presentation.

If you choose to use the case early in the course to demonstrate the various strategic leadership roles of senior executives (as discussed in Chapters 1 and 2), the focus should be on Neeleman and how he developed his vision for JetBlue and then built a company that incorporated his vision. If the case is used later in the course, it can provide an excellent venue for examining how a company can successfully build key function strategies to support the company’s business level strategy and to explore various aspects of management’s efforts to pursue policies, practices, and culture-building efforts that facilitate good strategy execution. The case also successfully illustrates how years of good will and customer loyalty can quickly dissolve because of inept managerial responses to a crisis that causes distress or harm to customers.

There is an accompanying 10:15-minute video that you can show either at the beginning of the class period or, alternatively, just before you ask the class for their recommendations to improve JetBlue’s future performance.

We suggest using a teaching plan for the case that is built around the questions that appear in the next section of the teaching note—the Teaching Outline and Analysis portion of this TN provides you with “answers” to the assignment questions and a solid outline for leading the class discussion of the JetBlue case. The Student Edition of the Online Learning Center (OLC) provides students with copies of these same assignment questions. We suggest that you always direct students to the assignment questions posted on the Crafting & Executing OLC and instruct them to use the assignment questions to prepare for the class discussion of the case. We always instruct our students to read the case once to gain a general understanding of the issues presented in the case and then return to the case to prepare written responses to each of the assignment cases. We’ve found that our students who follow this approach are well-prepared to make a meaningful contribution to the class discussion.
This case is suitable for both written and oral presentations. Our recommended questions for written assignments are as follows:

1. David Barger, CEO of JetBlue Airways, has employed you to develop a plan to restore the company’s growth in revenues and healthy profit margins enjoyed in earlier years. In developing the plan Neeleman would like you to assess the U.S. airline industry, including an examination of the industry’s driving forces and key success factors. In assessing JetBlue’s internal situation Neeleman wants you to pay special attention to whether the company’s functional strategies are consistent with, and supportive of, the company’s business level strategy. Finally, the plan should offer specific, actionable recommendations that will allow JetBlue to restore its growth and profitability in the face of an increasingly challenging external environment. Your recommendations should be well supported with arguments and justifications for each recommendation. Your report should include 4-6 pages in length and include whatever supporting charts, tables or exhibits you deem useful.

2. As a new member of JetBlue’s corporate management team, you have been asked to prepare an analysis of the company’s strategic situation and make recommendations to restore its growth and profitability. Your 2-3 page executive summary should list strategic issues confronting JetBlue Airways and make recommendations that address each issue. The executive summary should be supported by your analysis of the industry’s driving forces and key success factors and JetBlue’s internal situation. You should also consider the extent to which JetBlue’s functional level strategies and operating practices support its current strategic approach. Please prepare and attach exhibits for all analyses used to shape your recommendations. Your supporting exhibits and executive summary of recommendations will be given equal weighting in your grade for the written assignment.

ASSIGNMENT QUESTIONS

1. What was David Neeleman’s original strategic vision for JetBlue? Should JetBlue’s strategic vision be revised now that the company has new executive leadership?

2. What were the key elements of JetBlue’s strategy in 2008? How has the company chosen to attract customers in sufficient volume to earn profits? How does JetBlue offer its customers value?

3. Are JetBlue’s functional area strategies consistent with its overall strategic approach? What policies, practices, and procedures have been developed to execute its business strategy and functional area strategies with proficiency?

4. What is your assessment of JetBlue’s financial performance during fiscal years 2003-2007? Use the various financial ratios presented in Table 4.1 of Chapter 4 to guide your assessment of the company’s financial statements. Does the company’s recent financial performance support the board’s decision to replace top management?

5. What are the factors driving change in the airline industry? How are they likely to impact the future attractiveness of the industry?

6. What are the key success factors in the airline industry? How well do JetBlue’s resource strengths and competitive capabilities match these industry success factors?

7. Do the strategy and changes to operating practices initiated in 2008 seem well-matched to industry conditions and the company’s internal situation? What recommendations would you make to help speed JetBlue’s turnaround and revive its growth in revenues and earnings?
TEACHING OUTLINE AND ANALYSIS

1. What was David Neeleman’s original strategic vision for JetBlue? Should JetBlue’s strategic vision be revised now that the company has new executive leadership?

Students should have little trouble identifying the key elements of David Neeleman’s original strategic vision for JetBlue. The vision changed little during Neeleman’s tenure as CEO and, in essence, sought to combine the low fares of a discount airline carrier with the comforts found in the dens of people’s homes.

Central elements of Neeleman’s vision for JetBlue included:

- Neeleman’s desire to “Bring humanity back to air travel”
- Neeleman’s intent to focus on customer satisfaction which was ingrained in him by his grandfather during his teenage years. He learned to never disappoint customers, and the customers would return.
- Neeleman’s dedication to frugality which he learned while in Brazil as a missionary. He transferred these ideas to JetBlue, enabling the company to have one of the lowest costs per seat mile in the entire industry.
- Neeleman’s vision for the company eventually was expanded to include the rapid addition of routes.

Even though in 2007 new senior management was brought in to lead the company’s turnaround, students will find it difficult to argue against continuing to pursue Neeleman’s vision for the company. JetBlue’s performance has declined dramatically since 2003, but there’s little evidence that the company is at a strategic inflection point requiring a radical change in long-term direction. In fact, some students may argue that the vision has protected the company from the sizeable losses that have caused more poorly managed airlines to exit the industry.

2. What were the key elements of JetBlue’s strategy in 2008? How has the company chosen to attract customers in sufficient volume to earn profits? How does JetBlue offer its customers value?

You’re likely to find that students in the class will be split on how best to characterize JetBlue’s competitive strategy, with some seeing the strategy as a differentiation strategy and others categorizing it as a low cost provider approach. Both groups should recognize that the company has focused on selected domestic routes rather than choosing to compete in the broad market for air travel. We believe the strategy is best described as a focused low-cost strategy because of the company’s focus on minimizing operating costs and competing on price. However, JetBlue does attempt to provide customers additional value with inexpensive differentiating service features such as leather seating, in-flight entertainment, and in-flight yoga cards.

Students should have little trouble identifying the primary elements of JetBlue’ strategy. It is possible to group these elements into the three following general categories:

- Emphasis on efficiency and keeping costs low

Case Exhibit 3 indicates that JetBlue was the overall low cost provider in every year between 2005 and Q1 2008. Its efficiency cut across most categories including pilot and copilot salaries, total salaries and fringe benefits, maintenance, or general and administrative costs.
Commitment to customer service

Examination of case Exhibit 5 provides on-time flights, mishandled baggage, and passenger complaints for the largest U.S. carriers for the 2005 – 2007 time period. JetBlue had the fewest mishandled bags per 1,000 passengers in 2006 and the second and third fewest mishandled bags in 2005 and 2007, respectively. Although customer complaints had risen from 0.29 per 100,000 passengers boarded in 2005 to 0.78 complaints per 100,000 passengers boarded in 2007, the company continued to be among the leaders in satisfied customers in 2006 and 2007.

The rapid expansion in the first years of business

- Increased number of cities served from 12 in 2000 to 53 in 2007.
- Increased its fleet of aircraft from 10 in 2000 to 134 in 2007.
- Number of employees increased from 1,028 in 2000 to 9,909 in 2007.
- Raised $182 million from an IPO in March 2002 and $301 million in 2008 through the issue and sale of 42.6 million shares to Lufthansa.

3. Are JetBlue's functional area strategies consistent with its overall strategic approach? What policies, practices, and procedures have been developed to execute its business strategy and functional area strategies with proficiency?

This case provides and excellent opportunity for students to evaluate how a company translates its overall strategy into functional strategies and operating activities. JetBlue has implemented various policies throughout its organization in order to support its core strategy of providing customers with low cost flights and top quality service. These policies cover four main strategic categories: Operations, Human Resources, Marketing and Customer Service, and Finance.

Operations

- Operated on a point-to-point system.
- Based flights only from cities with high traffic and profitability
- Turnaround time averaged 20-30 minutes.
- Using only two types of aircraft (150-seat Airbus A320 and 100-seat Embraer 190).
  - Cuts down on training since pilots and maintenance only have to be trained for two types of aircraft.
  - Small parts inventory.
- Serving only snacks in-flight, rather than full meals.
- Utilized technology in order to keep costs low.
  - Used “Open Skies” software to conduct electronic ticketing (it cost $1.00 to process an e-ticket versus $10 to process a paper ticket).
  - Allowed reservation agents to work from home.
- Notified crew members of work schedules via the Internet or wireless devices
Computerized baggage tracking system

Encouraged customers to make over-the-phone or Internet reservations, rather than purchasing paper tickets

Equipped all plane with leather seats.

**Human Resources**

- Base salaries for JetBlue employees was lower than that offered by rival airlines, but JetBlue offered employees attractive health coverage, profit-sharing, and 401(K) retirement plans.
- No layoff policy
- Developed a staff of stay-at-home reservation agents
- Hired employees who mirrored JetBlue’s values
- Encouraged teamwork
- Implemented an extensive training program for all employees
- Gave pilots immediate benefits and profit sharing opportunities in their first year of service
- Developed an extensive employee screening process

**Marketing/Customer Service**

- Supplied customers with vouchers and coupons if they were inconvenienced by a delayed or cancelled flight
- On September 11, 2001 JetBlue pilots found hotel accommodations not only for JetBlue customers, but also other airlines’ customers who were stranded
- Offered more entertaining flights via satellite radio, satellite television, and in-flight movie channels
- Offered unique amenities
  - Provided free Bally Total Fitness in-flight yoga cards.
  - Partnered with Oasis Day Spa to offer private massages, manicures, and hair styling in the JFK airport in New York.
  - Offered passengers Dunkin Donuts for in-flight snacks
- Offered flights for a low price
- Treated all passengers equally well
- One of the first airlines to install new safety features in all of its aircraft after September 11, 2001

**Finance**

- Made investments in JFK Terminal 5 expansion to gain additional gates that would allow for more JetBlue flights out of JFK each day
- Equity issues in 2002 and 2008 provided capital to support investments in new aircraft, Live TV, and airport facilities expansions
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- Funded Live TV subsidiary to support in-flight entertainment
- Expanded fleet of aircraft between 2000 and 2007 to support growth
- Entered into agreement to sell 9 Airbus A320s from its fleet of aircraft in 2008 to increase cash reserves by $100 million
- Made the decision in 2008 to delay delivery of 21 Airbus A320 aircraft planned for 2009 through 2011 to 2014 and 2015 to reduce expenses

4. What is your assessment of JetBlue’s financial performance during fiscal years 2003-2007? Use the various financial ratios presented in Table 4.1 of Chapter 4 to guide your assessment of the company’s financial statements. Does the company’s recent financial performance support the board’s decision to replace top management?

Although JetBlue’s annual revenues, number of routes, and passenger enplanements are a fraction of those of American Airlines, Continental Air Lines, Delta, Northwest Airlines Southwest, United, and US Airways, the company has remained the industry’s low-cost leader through Q1 2008. The company’s performance began to decline in 2004 as global fuel prices began to rise, but students’ analysis of the company’s financial performance should produce some positive comments. While the fuel price turmoil has taken a toll on all airlines in the industry, JetBlue’s commitment to other aspects of its strategy, such as customer service, has enabled it to maintain a level of profitability that eludes most of its competitors. Also, the company has recorded several years of impressive growth. Key aspects of the company’s financial performance between 2003 and 2007 include:

- JetBlue’s operating revenues have increased from $998 million in 2003 to $2.8 billion in 2007—a compound annual growth rate (CAGR) of 29.9 percent.
- JetBlue’s annual operating income varied considerably between 2003 and 2007, with an overall annual growth rate of 0.3 percent.
- Net income has declined from $103 million in 2003 to $18 million in 2007.
- Passenger enplanements have increased from nearly 9.0 million in 2003 to 21.3 million in 2007—see case Exhibit 11.
- Case Exhibit 8 shows that JetBlue’s Revenue Passengers have increased from 9 million in 2003 to nearly 21.4 million in 2007.
- Load factors have decreased from 84.9 percent in 2005 to 78.2 percent in Q1 2008.
- Case Exhibit 8 also shows that JetBlue’s available seat miles have increased from 13.6 million in 2003 to 31.9 million in 2007 as it has added aircraft and routes. The relationship of paying passengers to available seats along with fare increases has allowed its passenger revenue per available set mile to increase from 7.08 cents in 2003 to 8.26 cents in 2007.
- The company’s operating expenses per available seat mile has increased from 6.09 cents in 2003 to 8.91 cents in 2007, which reflects its increasing operating expenses and declining load factor—see case Exhibits 4 and 8.
- JetBlue’s declining profitability is likely a result of increasing fuel prices and its ultra-low pricing strategy. Between 2004 and Q1 2008, JetBlue’s Fuel and Oil Expense has increased from 2.42 cents per revenue passenger mile to 4.87 cents per revenue passenger mile. Case Exhibit 8 shows that JetBlue’s...
average fare increased from $107.09 to $123.23 between 2003 and 2007. Case Exhibit 8 shows that aircraft fuel expense increased from $147 million in 2003 to $929 million in 2007—a 58.6 percent compounded annual growth rate. The annual growth in aircraft fuel expense was nearly twice as great as the company’s annual increase in operating revenues (29.9 percent CAGR between 2003 and 2007).

Table 1 below presents selected financial statistics for JetBlue for the 2003 through 2007.

### Table 1: Selected Financial Ratios for JetBlue Airways, 2003-2007

<table>
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<tbody>
<tr>
<td>Aircraft fuel as a % of revenues</td>
<td>32.7%</td>
<td>31.8%</td>
<td>28.7%</td>
<td>20.2%</td>
<td>14.7%</td>
</tr>
<tr>
<td>Other operating expenses as a % of revenues</td>
<td>61.4%</td>
<td>62.8%</td>
<td>68.5%</td>
<td>71.1%</td>
<td>68.5%</td>
</tr>
<tr>
<td>Operating profit margin</td>
<td>5.9%</td>
<td>5.4%</td>
<td>2.8%</td>
<td>8.8%</td>
<td>16.7%</td>
</tr>
<tr>
<td>Interest expense as a % of revenues</td>
<td>6.4%</td>
<td>6.2%</td>
<td>5.3%</td>
<td>3.6%</td>
<td>2.4%</td>
</tr>
<tr>
<td>Other non-operating expense as a % of revenues</td>
<td>1.9%</td>
<td>1.2%</td>
<td>1.1%</td>
<td>0.7%</td>
<td>0.8%</td>
</tr>
<tr>
<td>Net profit margin</td>
<td>0.6%</td>
<td>0.0%</td>
<td>-1.2%</td>
<td>3.6%</td>
<td>10.3%</td>
</tr>
<tr>
<td>Debt to assets ratio</td>
<td>54.4%</td>
<td>58.6%</td>
<td>59.8%</td>
<td>55.2%</td>
<td>50.8%</td>
</tr>
<tr>
<td>Return on equity</td>
<td>1.7%</td>
<td>-0.1%</td>
<td>-2.2%</td>
<td>6.1%</td>
<td>15.4%</td>
</tr>
</tbody>
</table>

Calculated from case Exhibit 7.

Analysis of JetBlue’s financial performance should lead students to the conclusion that the company’s decline in financial performance is more closely related to the recent increase in fuel prices than overall mismanagement. Table 1 indicates that fuel as a percent of revenues has increased from 14.7 percent in 2003 to 32.7 percent in 2007. However, other operating expenses as a percent of revenues have declined from 68.5 percent in 2003 to 61.4 percent in 2007. The inadequate response by management to the February 2007 ice storm clearly harmed the company’s reputation and may have exacerbated its deteriorating financial condition. However, students should find it difficult to suggest that JetBlue’s board had little choice but to replace top management.

### 5. What are the factors driving change in the airline industry? How are they likely to impact the future attractiveness of the industry?

- **Increases in the cost of jet fuel.** Students will easily recognize that the rising cost of jet fuel is making it more difficult for the industry’s air carriers to earn profits. The Airport Transport Association estimated that a one cent increase in the price per gallon of jet fuel cost the industry an additional $190 million to $200 million. The effect of increasing fuel costs is also evident in case Exhibit 3, which shows that Fuel and Oil costs between 2000 and Q1 2008 has increased my more than 100% for every major airline operating in the United States. Some airlines have relied on hedging contracts to protect against rapid spikes in jet fuel prices, with some having more success than others. However, as David Neeleman states in the case, hedging can keep operating costs high when fuel prices unexpectedly drop.

- **Potential increase in pilot and co-pilot expense.** The International Air Transport Association estimated that the global airline industry needed 3,000 more pilots each year than what training schools were providing. The combination of pilot retirements and flight time requirements for new first officers was expected to result in higher salaries for pilots and co-pilots as larger airlines offered more attractive compensation to qualified pilots at smaller airlines.
Prevalence of bankruptcies and attrition in the industry. The case comments on the bankruptcy of small and large airlines alike. The case mentions that Frontier Airlines, Aloha Airgroup, ATA Airlines and SkyBus Airlines all filed for bankruptcy and ceased all operations. Delta Airlines and Northwest Airlines had recently emerged from bankruptcy and agreed to a merger to better protect against future bankruptcies.

6. What are the key success factors in the airline industry? How well do JetBlue’s resource strengths and competitive capabilities match these industry success factors?

Students should be able to identify the following key success factors for the airline industry:

- **Maximizing load factors and revenue passenger miles.** Once a flight is confirmed, an airline must work to fill as many passenger seats as possible. Consider a flight which breaks even at 125 passengers at $100 per ticket. If an airline accepts the 125 passenger load but still pushes for last minute and discounted ticket sales, it will likely still sell quite a few additional tickets. If approximately 30 more tickets are sold at $100 each, $3000 more dollars in revenue is earned, while the fixed costs have already been covered. This leaves a large portion of the $3000 that goes directly to profit for the flight.

- **Maximizing the number of flights per gate.** Airplanes and yearly airport fees place a huge financial burden on an airline, regardless of how many flights arrive and depart at a gate per day. Successful airlines were proficient at maximizing its utilization of gate and aircraft capacity.

- **Minimizing time preparing for takeoff and landing and gate turnaround times.** A clear key to success in the airline industry is to keep the planes in the air and full of passengers. Airlines using congested airports tended to burn excess fuel waiting for clearance to takeoff and land. Also, the number of flights scheduled per day for a particular aircraft declines as clearance times and gate turnaround times increase.

- **Building and maintaining a strategy-supportive organizational culture.** Each airline relies on a large number of employees with a range of different jobs. Corporate cultures that don’t promote teamwork and commitment to excellence can contribute to higher operating costs and poor customer service.

- **Building and maintaining a well-respected brand name.** An airline’s brand name is crucial to its success. A brand name can signify safety, timeliness, customer service, and affordability. Even more important than working towards an exceptional brand name, avoiding a negative brand name is an absolute requirement in the airline industry. Being labeled as overpriced, late, rude, or especially unsafe can mean a dramatic loss of business.

- **Minimizing fuel costs.** In recent years, the most volatile variable cost in the airline industry has been fuel. Dollar increases in the price of fuel can add hundreds of millions of dollars in cost to a firm’s bottom line. Fuel hedging is one of the major protections against a spike in fuel prices. Regardless of method, firms must find a way to maintain profitability through managing variable costs.

With the exception of fuel costs, students should commend JetBlue management on its performance of the industry’s key success factors.
7. Do the strategy and changes to operating practices initiated in 2008 seem well-matched to industry conditions and the company’s internal situation? What recommendations would you make to help speed JetBlue’s turnaround and revive its growth in revenues and earnings?

Student will generally agree that JetBlue’s turnaround strategy was well-matched to industry conditions and its internal situation. There should be few complaints with the new management’s efforts to:

1. Improve asset utilization;
2. Reduce capacity and cut costs;
3. Raise fares;
4. Attract business travelers;
5. Exploit strategic partnerships with Aer Lingus, Lufthansa, Travelocity, and Expedia; and
6. Increase ancillary revenues.

Key strategies and tactics used by Barger and his senior management team to improve asset utilization, reduce capacity and lower costs included:

- Agreeing to sell nine used Airbus A320s in 2008 which would result in a net cash gain of $100 million.
- Delaying the delivery of 21 new Airbus A320s scheduled for 2009 through 2011 to 2014 and 2015. This would enable JetBlue to postpone payment of the airplanes and save on operating expenses it would incur;
- Reducing its aircraft utilization rate from 13 hours per day to 12 ½ hours per day in the fourth quarter of 2008;
- Suspending service in and out of Columbus, Ohio; Nashville, Tennessee; and Tucson, Arizona;
- Cancelling planned service between Los Angeles LAX International airport and Boston and New York. The cost to fill an Airbus 320 with fuel for a transcontinental flight had risen from $9,600 in 2007 to over $15,000 in 2008.

JetBlue management also expected its Expedia and Travelocity would result in increased business and leisure bookings since its flights and fares would be easier for some Internet users to find. The company’s route sharing with Aer Lingus and Lufthansa were expected to increase JetBlue flights with passengers arriving from outside the United States. The company’s strategies to increase ancillary revenues included:

- Imposed a call center charge of $10 on passengers who booked a flight on the phone or at the airport;
- Intended to create a cashless cabin whereby passengers could pay for extra food items via handheld devices carried by flight attendants;
- Stopped handing out free headphones and sold only upgraded versions for $1 at the gate;
- Charged passengers additional fees to reserve seats with extra legroom available in some rows. This was popular on long haul flights. The program generated over $40 million in incremental revenue in nine months in 2008;
- Charged passengers a $20 service fee for checking a second bag beginning June 1, 2008. The new policy was expected to generate over $20 million in new revenues in the last six months in 2008.

Student should be able to make recommendations to build upon JetBlue’s turnaround strategy and speed the company’s growth in revenues and earnings. Possible recommendations likely to be made by the class include:

- **Improve the company’s fuel price management policy and hedging practices**—Fuel prices are a key element of JetBlue’s cost structure. With the current fluctuations in fuel prices the ability of the company to maintain its low cost strategy could be in jeopardy. Fuel prices will continue to vary over time and JetBlue needs to find some stability around which to base their budget. Fuel futures are a viable means to reduce the price variability. If the company is not able to enter into its own contracts at this time, it may be able to purchase futures contracts from other firms, especially airlines that may be exiting the market.

- **Adopt a cautious approach to adding new routes**—There are still many large markets that JetBlue might add, but the company should resist the temptation to expand aggressively while its profitability is in doubt. However, some limited expansion will be in order. It will be possible to pick up profitable routes from carriers that are bankrupt or no longer able to justify the route. In implementing this strategy, JetBlue will need to continue to evaluate the cost structure of each route and add profitable routes where rivals with high cost structures are particularly vulnerable.

- **Develop extensive crisis management policies to prepare for a wide variety of potential events affecting passengers**—While there may be quite a few students who did not believe it was necessary to replace JetBlue’s top management team because of the failed response to the February 2007 ice storm, there should be little debate that such an event should have been anticipated and planned for. JetBlue (and all airlines) should have contingency plans in place for most any type of calamity or disaster. Further employees should be trained on a regular basis on how to carry out their assignments during a crisis. It’s likely that JetBlue did have plans in place to respond to an ice storm, so students should recommend that the company conduct an extensive review of the situation to locate where breakdowns in executing their plans broke down.

- **Increase marketing efforts**—JetBlue is still a relatively new firm in the airline industry and it is involved in rapid growth. Marketing is essential to this growth and branding, and as such should be a focus. However, the company should be careful to keep its marketing efforts consistent with its best cost provider strategy and it may need to alter its message if the company is not able to maintain its relative cost position due to rising fuel costs and lack of hedging, and its slipping on-time percentage.
EPILOGUE

JetBlue’s total revenues increased by 19.2% during 2008 to reach nearly $3.4 billion. The company continued to struggle with high fuel prices, which contributed to a pre-tax loss of $76 million in 2008. JetBlue management hedged approximately 24% of its fuel consumption during the fourth quarter of 2008, which resulted in a realized fuel price of $2.67 per gallon compared to a realized fuel price of $2.34 per gallon during the same period in 2007. Falling fuel prices on the open market caused JetBlue to record $58 million in losses on fuel hedges that settled during the fourth quarter of 2008. JetBlue management hedged approximately 8% of its projected fuel requirements for 2009 and expected an average price per gallon of fuel, including the impact of hedges, of $1.99 for the full-year 2009. JetBlue management also strengthened the company’s balance sheet in 2008 by paying down almost $700 million of its long-term debt. A summary of its financial performance in 2007 and 2008 at the end of this note. You can review the latest company news and financial releases for JetBlue Airways at www.jetblue.com.

JetBlue Airways Corporation’s Consolidated Statements of Operations, 2007-2008
(In millions, except share and per share amounts)

<table>
<thead>
<tr>
<th>OPERATING REVENUES</th>
<th>2008</th>
<th>2007</th>
<th>Percent Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Passenger</td>
<td>$3,056</td>
<td>$2,636</td>
<td>16%</td>
</tr>
<tr>
<td>Other</td>
<td>332</td>
<td>206</td>
<td>61</td>
</tr>
<tr>
<td>Total operating revenues</td>
<td>3,388</td>
<td>2,842</td>
<td>19</td>
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</table>

<table>
<thead>
<tr>
<th>Operating Expenses</th>
<th></th>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Aircraft fuel</td>
<td>1,352</td>
<td>929</td>
<td>46</td>
</tr>
<tr>
<td>Salaries, wages, and benefits</td>
<td>694</td>
<td>648</td>
<td>7</td>
</tr>
<tr>
<td>Landing fees and other rents</td>
<td>200</td>
<td>180</td>
<td>11</td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td>205</td>
<td>176</td>
<td>17</td>
</tr>
<tr>
<td>Aircraft rent</td>
<td>129</td>
<td>124</td>
<td>4</td>
</tr>
<tr>
<td>Sales and marketing</td>
<td>151</td>
<td>121</td>
<td>26</td>
</tr>
<tr>
<td>Maintenance materials and repairs</td>
<td>127</td>
<td>106</td>
<td>19</td>
</tr>
<tr>
<td>Other operating expenses</td>
<td>421</td>
<td>389</td>
<td>8</td>
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<tr>
<td>Total operating expenses</td>
<td>3,279</td>
<td>2,673</td>
<td>23</td>
</tr>
<tr>
<td>Operating Income</td>
<td>109</td>
<td>169</td>
<td>(35)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Other Income (Expense)</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest Expense</td>
<td>(232)</td>
<td>(225)</td>
<td>3</td>
</tr>
<tr>
<td>Capitalized interest</td>
<td>48</td>
<td>43</td>
<td>11</td>
</tr>
<tr>
<td>Interest income and other</td>
<td>(1)</td>
<td>54</td>
<td>(102)</td>
</tr>
<tr>
<td>Total other income (expense)</td>
<td>(185)</td>
<td>(128)</td>
<td>45</td>
</tr>
<tr>
<td>Income (Loss) Before Income Taxes</td>
<td>($76)</td>
<td>$41</td>
<td></td>
</tr>
</tbody>
</table>

OVERVIEW

In 2008, the golf equipment industry was confronted by the convergence of serious hazards to the industry that had caused the retail value of the golf equipment industry to decline from approximately $4 billion in 2000 to about $3 billion in 2003. Golf equipment sales had rebounded to an estimated $3.8 billion in 2007, but many threats to the industry continued to exist. The number of golfers in the U.S. had declined from an all time high of 27.5 million in 1998 to 22.7 million in 2007. Also, the number of rounds of golf played in the United States had not grown appreciably since 2000 and had declined by 2.2% during the first six months of 2008. In addition, golf equipment manufacturers had become stifled in their abilities to pursue innovation-based strategies directed at making golf easier to play for those of modest talent. Revenues and profits of golf equipment manufacturers soared during the mid- and late-1990s as such companies as Callaway Golf, TaylorMade Golf, Titleist, and Ping Golf developed innovation after innovation that helped minimize the negative effects of recreational golfers’ swing flaws. But beginning in 1998, golf’s governing organizations, the United States Golf Association (USGA) and the Royal & Ancient Golf Club (R&A), put a series of new rules in place that limited manufacturers’ abilities to develop more forgiving golf equipment. The major concern of the USGA and the R&A was that the rapid advances in golf club and golf ball technology had given golfers too much of an advantage and that continued technological innovation might pose a threat to the game.

The combined effect of technological limitations imposed by golf’s governing organizations, a decline in the number of golfers, and blurred differentiation between brands had begun to affect profit margins in the industry. Industry leader, Callaway Golf Company, which had earned a record $132 million when it enjoyed a large technology-based competitive advantage over rivals in 1997, had seen its profits drop abruptly and sharply after limitations to innovation were enacted by the USGA and R&A. The company’s share price declined from a peak of $35 in 1997 to about $13.50 in mid-2008 as the company turned more and more to price discounting and costly endorsement deals with professional golfers to boost sales. TaylorMade Golf, which was an adidas business unit and another technological leader in the industry, suffered consistent declines in operating profits between 2003 and 2007. Titleist, a division of Fortune Brands and a leader in golf technology, had also struggled to maintain its operating profit margins as it was forced to rely more on discounting and endorsement contracts to capture sales gains.

Some industry rivals with less developed technological capabilities had actually benefited from the USGA and R&A performance regulations, since it provided those companies with an opportunity to catch up to TaylorMade, Titleist, and Callaway Golf from a technology standpoint. Revenues for Adams Golf, which had been a niche seller with limited technological capabilities, increased from $41.7 million in 2000 to nearly $95 million in 2007 after the performance of its products grew closer to those offered by industry leaders. The sizeable increase in revenues allowed Adams Golf to swing from a $37 million loss in 2000 to a $9.4 million profit in 2007.

Even though the equalization of technological capabilities had resulted in increased profits for some golf equipment manufacturers, the overall slim operating profit margins in the industry and a growing reliance on price competition presented a variety of strategy-making challenges for golf’s premier equipment manufacturers.
SUGGESTIONS FOR USING THE CASE

Students should find the case intriguing not only because of golf’s popularity with young adults but also because the golf equipment industry is undergoing changes that pose very interesting strategy problems. We recommend using the case immediately following your coverage of Chapter 3. This is an excellent leadoff case for drilling students in industry and competitive analysis and was included specifically for this purpose. The case is ideal for demonstrating use of the five-forces model and analyzing the impact of the five competitive forces on overall industry attractiveness. In addition, the driving forces analysis is quite important as it demonstrates that the dynamics of competition in the industry are in the midst of dramatic change. There is ample material in the case to allow students to go beyond five-forces analysis and determine the dominant industry economic characteristics, examine strategic positioning through the use of a strategic group map, and evaluate industry key success factors. The decision focus of the case centers on what strategy changes industry rivals might consider given the dramatic change underway in the industry.

The Student Edition of the Online Learning Center (OLC) provides students with copies of the assignment questions contained in this note. The list of assignment questions leads students through a thorough industry analysis and prepares them to make strategy recommendations for selected companies. We suggest that you always direct students to the assignment questions posted on the Crafting & Executing OLC and instruct them to use the assignment questions to prepare for the class discussion of the case. We always instruct our students to read the case once to gain a general understanding of the issues presented in the case and then return to the case to prepare written responses to each of the assignment cases. We’ve found that our students who follow this approach are well-prepared to make a meaningful contribution to the class discussion.

To signal students of your expectations regarding the preparation of answers to the case assignment questions, we always recommend that you remind them to bring printed versions of their work to class to use as notes during the discussion and to argue their positions more forcefully and completely. Based on our experiences, we believe that you will have a more insightful and constructive class discussion of the Golf Equipment Industry case if students have conscientiously worked their way through the case assignment questions before they come to class.

The case can be used effectively for a written assignment. Our recommended questions for written assignments or oral team presentations are as follows:

1. Fortune Brands is considering you for a position in its Titleist/Cobra Golf product development department. You have been asked to prepare an analysis of the golf equipment industry as part of the selection process. Please prepare a 5-6 page report that includes a description of the industry’s dominant business and economic characteristics, evaluates competition in the industry, assesses industry driving forces, and lists industry key success factors. The company’s management also asks that you propose the basic elements of a strategic action plan that will allow the company to sustain its market leading position in golf balls, golf outerwear, and golf shoes, while improving its position in golf clubs.

2. As a new member of Callaway Golf Company’s management team, you have been asked to prepare an analysis of the golf equipment industry. Your 2-3 page executive summary should list strategic issues confronting Callaway Golf and make recommendations to address such issues. The executive summary should be supported by your analysis of the industry. Exhibits such as a Five Forces model, dominant industry characteristics, key success factors, driving forces, and a strategic group map should be attached to your report. Your supporting exhibits and executive summary of recommendations will be given equal weighting in your grade for the written assignment.

ASSIGNMENT QUESTIONS

1. What are the defining characteristics of the golf equipment industry? What is the industry like?

2. What is competition like in the golf equipment industry? What competitive forces seem to have the greatest effect on industry attractiveness? What are the competitive weapons that rivals are using to try to outmaneuver one another in the marketplace? Is the pace of rivalry quickening and becoming more intense? Why or why not?
3. How is the golf equipment industry changing? What are the underlying drivers of change and how might those driving forces change the industry?

4. What does your strategic group map of the golf equipment industry look like? Which strategic groups do you think are in the best positions? Which are in the worst positions?

5. What key factors determine the success of companies competing in the golf equipment industry? Which companies seem to perform these factors the best? What is the overall competitive strength of the major golf equipment manufacturers?

6. How do the financial results of the major golf equipment manufacturers compare? Which rivals seem to be coping best with the competitive forces prevailing in the industry? How do the growth rates of golf’s major equipment manufacturers compare? Have Callaway Golf Company and TaylorMade-adidas Golf found growth easier to achieve in some product categories than others?

7. What recommendations would you make to Callaway Golf to improve the company’s competitive position in the industry and its financial and market performance? To Fortune Brands? To TaylorMade-adidas Golf?

TEACHING OUTLINE AND ANALYSIS

1. What are the distinguishing features of the golf equipment industry? What economic characteristics of the golf equipment industry stand out?

   - Market size and growth rate: In 2007 there were approximately 22.7 million Americans played golf at least once per year—which was about 5 million less than the number of Americans playing golf in 1998. There were approximately 2 million golfers in Europe and 17 million golfers in Asia in 2007.

     - The number of men playing golf in the United States had declined from 20 million in 2000 to 16.2 million in 2007. Golf participation among women had declined from 5.8 million in 2002 to 5.1 million in 2007 and the number of junior golfers had declined from 2.4 million in 1998 to 1.4 million in 2007.

     - About one-third of golfers were considered core golfers—those playing at least 8 rounds per year and averaging 37 rounds per year. Core golfers accounted for 91 percent of rounds played and 87 percent of industry equipment sales, membership fees, and green fees.

     - Minority participation was relatively low in the U.S. with only 1.3 million African-American golfers, 1.1 million Asian-American golfers, and 1 million Hispanic-American golfers in the U.S. during 2003.

     - The retail value of golf equipment sold in the U.S. had declined from $4.0 billion in 2000 to $3 billion in 2003, but had rebounded to $3.8 billion in 2007.

   - Scope of rivalry: Golf equipment companies from outside the U.S. did not appear to be a strong competitive threat. However, the products produced and marketed by United States golf equipment companies were popular worldwide.

   - Presence of forward/backward vertical integration: Little vertical integration existed in the industry. Golf equipment companies tended to design products and outsource the production of club heads and shafts to others. Some manufacturers also contracted out assembly of golf clubs.

   - Consumer characteristics: Income level was associated with golf participation. A National Golf Foundation study indicated about 28% of adults with household incomes exceeding $100,000 played golf, regardless of race. For golfers with household incomes lower than $100,000, White Non-Hispanic and Asians were nearly twice as likely to play golf as African-Americans or Hispanic-Americans.
Technology/innovation: Since most golfers were only modestly skilled, industry growth was spurred primarily by technological advances in golf club design and performance that could offset poor swing characteristics. Most manufacturers introduced new product lines at 12-18 month intervals.

2. What does a five-forces analysis of the golf equipment industry reveal about the intensity of competition and overall industry attractiveness? Which competitive forces are strongest? Weakest?

A representative 5-forces model for the golf industry is shown below:

- **Rivalry among competing sellers:** A very strong competitive force

  Competition among rival makers of golf clubs centered on innovation in club design, endorsements from professional golfers, advertising, and distribution. Most golf equipment companies attempted to build and sustain advantage in the industry through the use of differentiation strategies. New lines of next-generation clubs were introduced every 12-18 months. Exposure in PGA Tour events was also critical to a company’s image and reputation with consumers. In addition, price competition had become a factor in the industry with the average prices for drivers and woods declining from $231 in 1997 to $174 in 2007. The average price of irons had declined from $75 per club in 1997 to $60 in 2004, but had rebounded to $71 by 2007. Case Exhibit 1 provides the retail value, units sold, and average selling price for golf equipment in the U.S. between 1997 and 2007.
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Competition was similarly strong in the golf ball segment of the industry. Technological innovation and endorsements from touring professional golfers were key competitive weapons in the category. Golf balls having few innovative qualities and no exposure on the PGA Tour were forced to compete aggressively on price to gain shelf space with golf equipment retailers and discount stores.

- **The bargaining power and leverage of buyers:** A weak competitive force overall, but off-course pro shop chains and the mass merchandisers have a bit more leverage and power than the other buyers in the case of certain brands.

  Buyers, for the most part, had very little power in their relationships with the leading golf equipment manufacturers. The products of leading golf equipment manufacturers (e.g. Callaway Golf, Ping Golf, TaylorMade, Titleist, Cobra Golf, and a few others) were available from on-course pro shops, off-course pro shops, and online golf retailers. On-course and off-course pro shops had personnel knowledgeable about the products and experienced in club fitting. On-course pro shops usually were low volume dealers of golf equipment. Some off-course shops like Edwin Watts and online golf retailers such as TGW.com sold a considerable volume of equipment, but still had little leverage with golf equipment manufacturers since their customers expected to find the leading brands of equipment in their retail locations.

  On-course pro shops, off-course pro shops, and Internet retailers possessed some strength in negotiating with lesser-known golf club manufacturers, since both types of pro shops generally stocked a limited number of golf equipment brands and preferred the name brands. The case does not provide much detail on the distribution of less technologically advanced golf equipment, but it is reasonable to assume that large discount stores, mass merchandisers, and sporting goods stores would have considerable leverage in negotiating with the sellers of low-end equipment.

- **Bargaining power and leverage of suppliers:** A weak to moderately strong competitive force, but bargaining strength varies by type of component

  Suppliers of golf club grips and club heads had little leverage in negotiations with golf club manufacturers since these products were available from multiple sources. The bargaining power of club head foundries were enhanced somewhat because of the critical nature of the components they supply to golf club manufacturers. Manufacturers of golf equipment carefully screened potential club head foundries to those with good reputations and track records for quality, since poor workmanship or quality on the suppliers’ part would affect the overall quality of the golf club. However, it’s likely an adequate number of club head foundries and shaft producers exist to allow for price competition among suppliers.

  Shaft manufacturers had gained notable strength as differences in club head performance began to disappear after USGA and R&A club head performance limitations were established. The improved leverage of shaft manufacturers in their negotiations with club manufacturers improved the overall profitability of shaft manufacturers in the mid-2000s.

- **Competition from substitutes:** a weak competitive force

  The substitutes to golf equipment were numerous if you considered recreational activities in addition to golf. However, sports such as softball, tennis, swimming, skiing, racquetball, and camping were attractive substitutes only for occasional golfers. Core golfers were much less likely to see these activities as acceptable substitutes for golf. You may wish to poll students on how many of the recreational activities listed in case Exhibit 2 would be strong substitutes for golf for occasional versus core golfers.

- **Threat of entry:** a weak competitive force

  There were substantial barriers to becoming a viable competitor in the golf equipment industry. The image and reputation of a company’s golf clubs were very important in building sales and market share. A company’s image came about as a result of the technological innovations associated with their clubs, the number and caliber of professional golfers using the company’s equipment, word-of-mouth among golfers, TV and print ads, and stories in golfing magazines. Both technological innovation and
endorsements required considerable capital investments. In 2007, the top-10 golfers on the PGA Tour all earned at least $4 million annually through endorsements and PGA Tour professionals ranked 40 to 70 on the Money List could expect anywhere from $450,000 to $800,000 in annual endorsement fees.

Market saturation and the struggles of existing companies to sustain sales levels also worked against new entry.

Access to retailers was also a considerable barrier to entry. Since on-course pro shops carried a limited number of brands, it was difficult for many golf companies to find retailers willing to stock their equipment. Makers of a popular-selling item usually gained display space easily; makers of a slow-selling item found it difficult to get much attention from retailers. For a new brand of a new company to get good distribution access, it had to have convincing evidence, based on innovative differentiating features, that its product would command meaningful sales volumes.

3. How is the golf equipment industry changing? What are the underlying drivers of change and how might those driving forces change the industry?

Students ought to identify several driving forces at work in the golf equipment industry:

- **Declining industry growth rate.** The number of golfers in the United States had declined from an all time high of 27.5 million in 1998 to 22.7 million in 2007—see case Exhibit 2. Also, the number of rounds of golf played in the United States had not grown appreciably since 2000 and had declined by 2.2% during the first six months of 2008 (Total rounds played between 2001 and 2007 is presented in case Exhibit 3). The decline in the number of golfers had affected industry sales with the retail value of the U.S. golf equipment industry declining from $4 billion in 2000 to about $3 billion in 2005. However, the retail value of golf equipment sales in the United States had rebounded to $3.8 billion in 2007. Case Exhibit 1 indicates that some segments of the golf equipment industry had grown in unit volume, but had declined in retail value. For example, the retail value of both drivers and irons had declined even though unit volume had increased between 1997 and 2007.

- **USGA and R&A performance limitations.** The USGA’s 1998 ruling limiting the coefficient of restitution (COR) for club head performance to 0.83 and the subsequent 2006 joint R&A/USGA ruling on club head Characteristic Time (CT) made product differentiation more difficult to achieve for golf club manufacturers. The 2004 USGA limitation on club head size and volume and 2006 Moment of Inertia (MOI) limit has also made innovation in the industry more difficult to achieve. With innovation limited as a differentiating feature, golf club manufacturers were forced to compete more aggressively on price—see case Exhibit 1. Prior to the establishment of the performance limitations by the USGA and R&A, there was only modest price competition in the industry. Also, the increased difficulty of achieving differentiation led to a narrowing of market share differences between major sellers and profitability declines for industry leaders.

Beginning in 2009, USGA performance limitations would be extended to wedges and the organization’s 2005 request for a lesser-performing golf ball seemed to signal some performance limitation on golf balls was under consideration. These additional measures are likely to force stronger price competition in the industry.

- **Rise in counterfeiting.** The decision by golf equipment companies to source components from Chinese manufacturers contributed to a significant increase in counterfeiting in the golf equipment industry. In 2008, close copies of branded golf club sets could be purchased for as little $100 - $200 in China. Chinese-made copies were frequently offered to consumers in other parts of the world through eBay sellers. The industry’s six leading manufacturers created an alliance in December 2003 to identify and pursue counterfeiters and sellers of counterfeit clubs. However, these efforts had done little to curb counterfeiting of branded goods in 2008.
4. **What does your strategic group map of the golf equipment industry look like? Which strategic groups do you think are in the best positions? Which are in the worst positions?**

Students can choose a variety of factors to categorize the golf equipment industry into strategic groups. We have chosen to look at brand image/tour exposure and revenue concentration by product line. We have also chosen to place Titleist, Cobra and FootJoy on the strategic group map, since each of Fortune Brands’ golf brands occupies a unique position in the industry. Students who construct strategic group maps similar to what is depicted in Figure 1 should suggest that industry participants with a superior image and broad tour exposure and that have extensive sales across product lines are positioned most favorably in the industry. Core golfers were less interested in brands with poor images or those that were not likely to be used by touring pros. Also companies with a full product line including golf balls, apparel, and footwear were better able to fully exploit brand equity.

**Figure 1  Strategic Group Map of the Golf Equipment Industry**
5. What key factors determine the success of companies competing in the golf equipment industry? Which companies seem to perform these factors the best? What is the overall competitive strength of the major golf equipment manufacturers?

We see the following as being key success factors in the golf equipment industry:

- **Continuous product innovation and product improvement**—Even though product innovation was more difficult to achieve in 2008, it remained critical that golf equipment manufacturers develop innovations that would appeal to golfers. Companies that lack the expertise, know-how, resources, and organizational capability to develop and market an innovative, high-performance club design will likely find themselves relying excessively on discount pricing to attract sales. Companies that come up with distinctive designs, that are successful in differentiating their products, and that keep improving their products will be better able to maintain market share and operating profit margins.

- **A strong image and reputation among golfers**—A no-name company with no track record will have a difficult time gaining attention and credibility in the marketplace (unless it comes up with an innovative, high-performing club). A company whose clubs are widely used on professional tours and are regularly seen in televised golfing events gains important credibility with core golfers, making them more likely to consider purchasing the company’s brand of clubs.

- **Gaining good distribution in on-course and off-course pro shops**—Real market success is contingent upon having strong exposure in pro shops.

- **Having sufficient financial resources and sales volumes to advertise and promote the company’s brand**—TV and print ads and endorsements by PGA Tour professionals are important in creating a strong brand image and in attracting the attention of golfers.

Students should be able to complete a competitive strength assessment as described in Chapter 4 using the information provided in the vignettes covering the industry’s major sellers. Students are likely to determine that all industry leaders are very close in competitive strength with the exception of Nike Golf. However, Nike is a strong competitor in golf apparel and footwear and has a respectable position in golf balls. The company has also become the number-two seller of golf shoes behind FootJoy and had achieved a 10% market share in golf balls.

**Figure 2  Weighted Competitive Strength Assessment for the Leading Sellers of Golf Equipment**

<table>
<thead>
<tr>
<th>Key Success Factor/Strength Measure</th>
<th>Importance Weight</th>
<th>Callaway Golf Rating Score</th>
<th>TaylorMade-adidas Rating Score</th>
<th>Titleist/Cobra Golf Rating Score</th>
<th>Ping Golf Rating Score</th>
<th>Nike Golf Rating Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Product innovation skills</td>
<td>0.20</td>
<td>10</td>
<td>2.0</td>
<td>10</td>
<td>2.0</td>
<td>9</td>
</tr>
<tr>
<td>Image/reputation</td>
<td>0.20</td>
<td>9</td>
<td>1.8</td>
<td>10</td>
<td>2.0</td>
<td>1.8</td>
</tr>
<tr>
<td>PGA Tour exposure</td>
<td>0.20</td>
<td>7</td>
<td>1.4</td>
<td>10</td>
<td>2.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Broad product line</td>
<td>0.15</td>
<td>10</td>
<td>1.5</td>
<td>8</td>
<td>1.2</td>
<td>1.5</td>
</tr>
<tr>
<td>Distribution network</td>
<td>0.15</td>
<td>10</td>
<td>1.5</td>
<td>10</td>
<td>1.5</td>
<td>1.5</td>
</tr>
<tr>
<td>Financial resources</td>
<td>0.10</td>
<td>8</td>
<td>0.8</td>
<td>9</td>
<td>0.9</td>
<td>0.9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1.00</strong></td>
<td><strong>9.0</strong></td>
<td><strong>9.6</strong></td>
<td><strong>9.5</strong></td>
<td><strong>8.4</strong></td>
<td><strong>6.7</strong></td>
</tr>
</tbody>
</table>
6. How do the financial results of the major golf equipment manufacturers compare? Which rivals seem to be coping best with the competitive forces prevailing in the industry? How do the growth rates of golf’s major equipment manufacturers compare? Have Callaway Golf Company and TaylorMade-adidas Golf found growth easier to achieve in some product categories than others?

Student that evaluate the operating profit margins for Callaway Golf, TaylorMade-adidas Golf, and Fortune Brands’ Golf Division will note that Fortune Brands has achieved much higher levels of profitability than its key rivals. Fortune Brands’ industry-leading operating profit margins likely resulted from its 40% market share in golf balls and its strength in putters and golf outerwear and shoes. The Pro V1 golf ball, with a 22% market share and a suggested retail price of $58 per dozen, likely accounted for a sizeable amount of Fortune Brands Golf Division’s operating profit. Also, Fortune Brands’ Scotty Cameron putter line with a 10% market share in putters and an average retail price of $300 obviously offered exceptional profits per unit sold. FootJoy’s 60% market share in golf outerwear, golf gloves, and golf shoes was also a likely contributor to the division’s operating profits. The operating profit margins for Fortune Brands’ Golf Division, TaylorMade-adidas Golf, and Callaway Golf Company are provided in the table below.

<table>
<thead>
<tr>
<th>Operating Profit Margin</th>
<th>2007</th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fortune Brands’ Golf Division</td>
<td>12.0%</td>
<td>12.6%</td>
<td>13.6%</td>
<td>12.7%</td>
</tr>
<tr>
<td>TaylorMade-adidas Golf</td>
<td>8.1%</td>
<td>8.5%</td>
<td>7.1%</td>
<td>9.5%</td>
</tr>
<tr>
<td>Callaway Golf Company</td>
<td>8.0%</td>
<td>3.6%</td>
<td>1.7%</td>
<td>(2.6)%</td>
</tr>
</tbody>
</table>

Source: Calculated from case tables and case Exhibit 4.

Even though Fortune Brands’ was the golf equipment industry’s most profitable manufacturer, it had achieved the least amount of growth between 2004 and 2008. Students who have examined case Exhibit 1 will note that the fastest growing product categories in the golf equipment industry between 1997 and 2007 were Drivers and Woods and Irons. Case Exhibit 1 also shows very little growth between 1997 and 2007 in Putters, Wedges, Golf Balls, Footwear, and Gloves, which are Fortune Brands’ strongest product categories. The company’s Titleist and Cobra Golf brands are relatively minor players in the Driver and Iron categories. The table below presents the annual growth rates for revenues and operating profits for Fortune Brands’ Golf Division, TaylorMade-adidas Golf, and Callaway Golf Company for 2004 – 2008. Students should note that the operating profits for Fortune Brands and TaylorMade-adidas Golf have grown slower than revenues between 2004 and 2008, which reflects the effects of increasing rivalry and a greater reliance on price competition in the industry.

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Fortune Brands’ Golf Division</td>
<td>4.9%</td>
<td>2.9%</td>
</tr>
<tr>
<td>TaylorMade-adidas Golf</td>
<td>8.3%</td>
<td>2.7%</td>
</tr>
<tr>
<td>Callaway Golf Company</td>
<td>6.4%</td>
<td>n/a</td>
</tr>
</tbody>
</table>

n/a—CAGR for Callaway Golf Company’s operating profit cannot be calculated because of its operating loss in 2004. The CAGR for its operating profits between 2005 and 2007 is 128.9%.

Source: Calculated from case tables and case Exhibit 4.

Examination of case exhibits and analysis of compounded annual growth rates for TaylorMade-adidas Golf’s revenues by product line show that the majority of the company’s growth has come from footwear and apparel sales. Only €34 million of its €171 million increase in sales between 2004 and 2007 was attributable to increased sales of TaylorMade’s metalwoods. Student should note that while Callaway Golf’s sales of “Accessories and other” have grown by more than 25% per year between 2005 and 2007, its sales of woods
and irons have also grown at respectable rates between 2004 and 2007. However, the company’s sales of golf balls have declined between 2004 and 2007 and its sales of putters have been flat since 2005. The tables below provide compounded annual growth rates for TaylorMade-adidas Golf and Callaway Golf’s revenues by product line:

### Compounded Annual Growth Rates for TaylorMade-adidas Golf Revenues by Product Line, 2004-2008

<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Metalwoods</td>
<td>3.6%</td>
</tr>
<tr>
<td>Apparel</td>
<td>27.6%</td>
</tr>
<tr>
<td>Footwear</td>
<td>17.8%</td>
</tr>
<tr>
<td>Other Hardware*</td>
<td>5.0%</td>
</tr>
</tbody>
</table>

*Other hardware includes irons, putters, golf balls, golf bags, gloves, and other accessories.

### Compounded Annual Growth Rates for Callaway Golf Company Revenues by Product Line, 2004-2008

<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Woods</td>
<td>8.6%</td>
</tr>
<tr>
<td>Irons</td>
<td>6.1%</td>
</tr>
<tr>
<td>Putters (2005 – 2007)*</td>
<td>-0.1%</td>
</tr>
<tr>
<td>Golf balls</td>
<td>-2.7%</td>
</tr>
<tr>
<td>Accessories and other (2005 – 2007)*</td>
<td>26.8%</td>
</tr>
</tbody>
</table>

Source: Calculated from case tables and case Exhibit 4.

Also, students who have closely examined case Exhibit 4 will note the significant negative effect of USGA and R&A performance limitations on the profitability of golf’s chief equipment manufacturers. Callaway Golf’s net profit margins of 16% - 18% between 1995 and 1997 illustrates the importance of product differentiation in the industry and are unlikely to be repeated as price becomes a more important competitive weapon in the industry.

### 7. What recommendations would you make to Callaway Golf to improve the company’s competitive position in the industry and its financial and market performance? To Fortune Brands? To TaylorMade-adidas Golf?

Students should be able to make strategic recommendations for the leading golf equipment manufacturers after completing a thorough analysis of the industry. Recommendations should include the following:

**Callaway Golf Company.** Students who have analyzed the golf equipment industry and Callaway Golf’s competitive and financial situations are likely to note that the company’s situation had stabilized to some extent by 2007. However, students should recognize that industry and competitive conditions will make
it quite difficult to return to the extraordinary operating and net profit margins achieved between 1995 and 1997. Even though the company’s performance has improved since 2004, students should be able to identify a number of troubling strategic issues confronting Callaway Golf in 2008. The following actions have merit:

- Callaway Golf Company needs to develop new technologically-advanced models of its drivers and fairway woods to recapture market share lost to TaylorMade Golf. However, new innovations must not exceed USGA and R&A limitations on driver dimensions, volume, MOI, or CT. Students may recommend that Callaway Golf lower the price of its new I-Mix driver combinations. The company’s $550 - $700 price for a club head and single interchangeable shaft will discourage many golfers from trying the company’s custom fitting solution.

- Callaway must also develop new models of its 2-Ball putter and develop other innovative putters to achieve growth in putters. Odyssey was the leading brand of putters in 2008, but its growth rate between 2005 and 2007 was -0.1%. Students will likely recommend that Odyssey sign noteworthy PGA Tour professionals to use its Black Series of putters if the company hopes to capture market share from Titleist’s Scotty Cameron line of premium putters.

- Students are likely to approve of Callaway Golf’s performance in the iron category and its strategy that covers all major segments of the market. Some students in the class may recommend that Callaway Golf Company divest its Ben Hogan iron line since it competes directly with its X-Forged irons. There should also be students in the class who will recommend that the company divest its Top-Flite iron line. The product line accounts for only a negligible percentage of Callaway’s total iron sales and, at best, offers low profit margins and may create operating losses.

- Students may commend the company on its strategies to turn around its golf ball operations. The decision to outsource production to suppliers in China and its focus on product and marketing innovation at Top-Flite have allowed its golf ball business to record a profit for a first time in 2007. However, some students will remain critical of Callaway Golf’s performance in the category because of its decline in sales since 2004. Recommendations for the company’s golf ball business will likely include further innovations in the HX Tour line of balls and the transfer of innovations used in Callaway Golf golf balls to the Top-Flite golf ball line. Students may also suggest that Callaway Golf match many of Titleist’s promotional activities such as providing golf balls to top amateurs and club champions.

- Callaway Golf needs a plan to address the increasing number of counterfeit clubs and near exact fakes available on the Internet. Suggestions for attacking the problem should include careful supplier screening, on-site supplier monitoring, careful security on club heads, components, and finished goods, and continued cooperation with other golf manufacturers to lobby the Chinese government for greater penalties against counterfeiters.

- Callaway Golf management should evaluate its footwear and licensing contracts since the company’s revenues from such sources have declined from $8.6 million in 2005 to $7.1 million in 2007. The case doesn’t provide any reasons for the decline in footwear and licensing revenues, but students may suggest the problems lies with factors such as poor designs, inadequate distribution, or excessively high pricing.

- Even though Callaway Golf products are endorsed by famous touring professionals Phil Mickelson, Ernie Els, Lorena Ochoa, and Annika Sorenstam, it should expand its number of endorsement contracts. In 2008, Callaway Golf’s endorsement contracts were limited to 12 staff professionals and 7 contract professionals. Rival, TaylorMade Golf, had endorsement contracts with 70 professional golfers in 2008. Titleist had endorsement contracts with more than 100 golfers to use Titleist Pro V1 golf balls during professional tournaments. Fifty of Titleist’s touring staff was also compensated to use Titleist golf clubs and Foot Joy shoes and apparel during professional events.
**Fortune Brands.** Students will note that the combined sales of Titleist, Cobra, and FootJoy golf products made Fortune Brands the largest seller of golf equipment in 2007 with total revenues of $1.4 billion. It also led the golf ball category with an approximate market share of 40% and 2007 revenues of about $600 million. Fortune Brands’ FootJoy business was the leading seller of golf footwear, golf gloves, and golf outerwear with a 60% market share and 2007 revenues of about $400 million. Titleist and Cobra branded golf clubs and accessories accounted for 2007 revenues of approximately $200 million each. Recommendations for Fortune Brands’ golf division should include the following:

- Students should argue forcefully that Fortune Brands must lobby the USGA and begin a public relations campaign against limitations of golf ball performance. Such a move by the USGA would have the same effect on golf balls as it did on drivers with price competition eroding industry profits. Students should note that case Exhibit 1 indicates prices of golf balls have increased at a relatively stable rate since 2003.

- Some students may recommend that Fortune Brands keep its Foot Joy outerwear and footwear lines fresh to defend against growing competition from Nike Golf and adidas Golf. Students will likely approve of Foot Joy’s focus on more expensive product categories such as outerwear and footwear.

- Students may recommend that Fortune Brands divest its Cobra line. With the exception of Cobra Golf, all of the company’s brands and sub-brands (Titleist golf balls, Titleist golf clubs, Vokey wedges, Scotty Cameron putters, and Foot Joy) compete in the premium end of their respective categories. Cobra Golf is not thought of as a technological leader and has a poor image with consumers and therefore is required to compete to a greater extent on price. (The same is true for Pinnacle golf balls, but this sub-brand likely provides economies of scale for Fortune Brands’ golf ball business.) Even if students do not recommend divesting the Cobra line, students may suggest that Cobra abandon its forged blade line of irons since the line competes directly with Titleist models. In addition, it’s very likely that low-handicap golfers sufficiently skilled to play forged irons would avoid Cobra products because of their inferior image.

- Students will also recommend that Fortune Brands pursue continued innovation in golf balls, Titleist golf clubs, Vokey wedges, Scotty Cameron putters, and Foot Joy shoes, gloves, and outerwear.

- Students’ recommendations for Titleist/Cobra Golf should include some plan to address the increasing number of counterfeit clubs and near exact fakes available on the Internet. Suggestions for attacking the problem should include careful supplier screening, on-site supplier monitoring, careful security on club heads, components, and finished goods, and continued cooperation with other golf manufacturers to lobby the Chinese government for greater penalties against counterfeiters.

**TaylorMade-adidas Golf.** TaylorMade Golf has the number-one position in drivers and fairway woods, but Callaway Golf’s 8.6% annual growth rate in the category between 2004 and 2007 is more than twice as great as TaylorMade’s 3.6% growth rate in metalwoods during the same period of time. Also, while TaylorMade-adidas Golf has led the industry in revenue growth between 2004 and 2007, most of its growth in is apparel and footwear. Some students may note that the company’s unstable operating profit margins as a strategic issue that must be addressed. Recommendations for TaylorMade-adidas Golf should include:

- Like Callaway Golf Company, TaylorMade Golf must continue to develop innovative new models of drivers, while not exceeding USGA and R&A dimension, volume, MOI, and CT standards. Students may suggest that a geometric-shaped driver be evaluated by the company’s R&D department. An argument can be made that, like Callaway Golf, TaylorMade must reduce the price of its r7 CGB Max Limited interchangeable shaft package that retailed for $1,000. New models of hybrid clubs could also be on students’ list of recommendations.
TaylorMade should promote its iron usage on the PGA Tour and other professional tours to increase its market share in the category. In 2007, the category was among the more attractive product categories in the industry with the size of iron category approaching $580 million and the average selling price per club increasing steadily since 1999—see case Exhibit 1. In 2007, the company’s 15.2% market share in irons gave it a number-three ranking in the category, behind Callaway Golf and Ping Golf.

It makes sense for the company to address its major weakness in the wedge and putter categories. Case Exhibit 1 indicates that both segments are relatively small compared to the size of the markets for drivers, irons, and golf balls, but nevertheless represent an opportunity to increase revenues and operating profits.

Sales of footwear and apparel have been increasingly important contributors to TaylorMade-adidas Golf’s overall revenues between 2004 and 2007. Students will suggest that the company continue to develop new apparel and footwear styles, models, and lines to further increase revenues from these sources. Students may also recommend that TaylorMade-adidas Golf sign additional endorsement contracts with stylish golfers on the PGA Tour and LPGA tour to wear adidas Golf clothing and footwear.

There may be some debate among members of the class concerning the future of TaylorMade’s golf ball business. With the exception of the Noodle sub-brand, the company divested its MaxFlite golf ball assets in 2008 after years of consistently dismal results. TaylorMade management may find it equally difficult to increase its market share beyond 5% with its new TaylorMade TP Red and TP Black premium lines of golf balls. Students should be able to argue rather easily that TaylorMade should divest its Noodle brand and abandon the TaylorMade brand of golf balls to exit the segment.

Students’ recommendations for TaylorMade-adidas Golf should include some plan to address the increasing number of counterfeit clubs and near exact fakes available on the Internet. Suggestions for attacking the problem should include careful supplier screening, on-site supplier monitoring, careful security on club heads, components, and finished goods, and continued cooperation with other golf manufacturers to lobby the Chinese government for greater penalties against counterfeitors.

EPILOGUE

The rate of new product introductions seemed to be speeding as of late 2008. Callaway Golf Company and Nike Golf each launched new product lines immediately prior to the 2008 holiday retail season. Callaway Golf introduced the FT-iq driver and X-22 irons and Nike Golf launched its new SQ DYMO geometric drivers and Victory Red forged irons in November 2008. TaylorMade-adidas Golf did not launch any new golf club models during the 2008 holiday shopping season, but did acquire well-known golf apparel manufacturer, Ashworth, Inc. The Ashworth’s traditional line of golf shirts, shorts, and pants was would broaden the company’s apparel line beyond its athletically-inspired adidas Golf clothing items.

At year-end 2008, a U.S. Court of Appeals upheld an earlier court ruling that found Titleist’s Pro V1 golf balls infringed upon five Callaway Golf patents related to producing multilayer, solid core golf balls. The court ruling required that Titleist remove infringing Pro V1 golf balls from the market beginning January 1, 2009. In January 2009, Callaway Golf also acquired uPlay, which was the maker of a GPS device for measuring distances on golf courses. Also in January 2009, Callaway Golf signed veteran PGA Tour golfer, Stuart Appleby, to a multi-year endorsement contract that called for Appleby to use Callaway Golf equipment and golf balls during PGA events.

Callaway Golf Company’s net sales declined from $1.124 billion in 2007 to $1.17 billion in 2008. The company’s 2008 gross profit margins and operating profit margins were unchanged from 2007, but its net profit margin increased from 5% in 2007 to 6% in 2008 as a result of a one-time $19.9 million adjustment related to an energy
derivative valuation account. Callaway Golf Company’s statements of operations for 2007 and 2008 are provided at the end of this epilogue. More recent industry and company news can be found at the investor relations sites for Callaway Golf ([ir.callawaygolf.com](http://ir.callawaygolf.com)), Fortune Brands ([www.fortunebrands.com/investor](http://www.fortunebrands.com/investor)), TaylorMade-adidas Golf ([www.adidas-group.com/en/investor/welcome.asp](http://www.adidas-group.com/en/investor/welcome.asp)), and Nike Golf ([www.nikebiz.com](http://www.nikebiz.com)).

### Callaway Golf Company’s Statements of Operations, 2007-2008

*(In thousands, except per share amounts)*

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>100%</th>
<th>2007</th>
<th>100%</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net sales</strong></td>
<td>$1,117,204</td>
<td>100%</td>
<td>$1,124,591</td>
<td>100%</td>
</tr>
<tr>
<td><strong>Cost of sales</strong></td>
<td>630,371</td>
<td>56%</td>
<td>631,368</td>
<td>56%</td>
</tr>
<tr>
<td><strong>Gross profit</strong></td>
<td>486,833</td>
<td>44%</td>
<td>493,223</td>
<td>44%</td>
</tr>
<tr>
<td><strong>Operating expenses</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Selling</td>
<td>287,802</td>
<td>26%</td>
<td>281,960</td>
<td>25%</td>
</tr>
<tr>
<td>General and administrative</td>
<td>85,473</td>
<td>8%</td>
<td>89,060</td>
<td>8%</td>
</tr>
<tr>
<td>Research and development</td>
<td>29,370</td>
<td>3%</td>
<td>32,020</td>
<td>3%</td>
</tr>
<tr>
<td><strong>Total operating expenses</strong></td>
<td>402,645</td>
<td>36%</td>
<td>403,040</td>
<td>36%</td>
</tr>
<tr>
<td><strong>Income from operations</strong></td>
<td>84,188</td>
<td>8%</td>
<td>90,183</td>
<td>8%</td>
</tr>
<tr>
<td>Other expense, net</td>
<td>(2,803)</td>
<td></td>
<td>(1,908)</td>
<td></td>
</tr>
<tr>
<td><strong>Change in energy derivative valuation account</strong></td>
<td>19,922</td>
<td></td>
<td>33,688</td>
<td></td>
</tr>
<tr>
<td><strong>Income before income taxes</strong></td>
<td>101,307</td>
<td>9%</td>
<td>88,275</td>
<td>8%</td>
</tr>
<tr>
<td><strong>Income tax provision</strong></td>
<td>35,131</td>
<td></td>
<td>33,688</td>
<td></td>
</tr>
<tr>
<td><strong>Net income</strong></td>
<td>$66,176</td>
<td>6%</td>
<td>$54,587</td>
<td>5%</td>
</tr>
</tbody>
</table>

**Earnings per common share**

<table>
<thead>
<tr>
<th></th>
<th>Basic</th>
<th>$1.05</th>
<th>Diluted</th>
<th>$0.82</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Basic</td>
<td>$1.04</td>
<td>Diluted</td>
<td>$0.81</td>
</tr>
</tbody>
</table>

**Weighted-average shares outstanding**

<table>
<thead>
<tr>
<th></th>
<th>Basic</th>
<th>63,055</th>
<th>66,371</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Diluted</td>
<td>63,798</td>
<td>67,484</td>
</tr>
</tbody>
</table>

OVERVIEW

Since 2000, the introduction of new technologies and electronics products had rapidly multiplied consumer opportunities to view movies. It was commonplace in 2008 for movies to be viewed at theaters, on airline flights, in hotels, from the rear seats of motor vehicles equipped with video consoles, in homes, or most anywhere on a laptop PC or small handheld device like a video iPod. Home viewing was possible on PCs, televisions, and video game consoles. The digital video disc (DVD) player was one of the most successful consumer electronic products of all time; as of 2008, more than 85 percent of U.S. households had DVD players (many had more than one) and increasing numbers of households had combination DVD players/recorders. Moreover, consumers were increasingly interested in watching movies on their big-screen high-definition TVs and were upgrading to Blu-ray DVD players or players-recorders; both Blu-ray and high-definition technologies enabled more spectacular pictures and a significantly higher caliber in-home movie-viewing experience.

Consumers could obtain movie DVDs through a wide variety of channels. They could purchase movie DVDs from such retailers as Wal-Mart, Target, Best Buy, and Amazon.com or rent movie DVDs from a host of local video outlets that frequently included Blockbuster and/or Movie Gallery. They could rent movie DVDs online from Netflix, Blockbuster, and several other subscription services and have them mailed directly to their own homes. They could subscribe to any of several cable movie channels (such as HBO, Showtime, and Starz), download movies from Apple iTunes and other Internet sites, watch movies streamed to their PCs or TVs from a host of Internet sites (including those of Netflix and Blockbuster), use their cable or satellite TV remotes to order movies instantly streamed directly to their TVs on a pay-per-view basis, or utilize the services of several other video-on-demand providers (including local phone companies like Verizon and AT&T and Web-based sources such as iTunes, Amazon.com, VOD.com, and hulu.com).

According to Adams Media Research (AMR), movie DVD sales and rentals amounted to a $24.9 billion market in the U.S. in 2007, up from $22.0 million in 2004. Movie DVD purchases were $15.4 billion and consumer expenditures for rental movies amounted to $9.5 billion. Movie rental was the most popular means of obtaining movies for in-home viewing, chiefly because of the much lower cost per movie; an estimated 2.5 billion movies were rented in 2006. The movie rental industry consisted of four segments:

1. In-store rentals (2007 expenditures of $5.8 billion).
2. Rentals via mail (2007 expenditures of $2.0 billion).
3. Video-on-demand (2007 expenditures of $1.3 billion). Video on-demand (VOD) providers delivered rented movies via (1) a file downloaded to a PC (the downloaded movie file could be watched an unlimited number of times during the rental period) or (2) streaming the rented movie directly to a TV via a high-speed Internet connection, a cable TV connection, satellite, or a fiber-optic network.
4. Vending machines (2007 expenditures of $400 million)

AMR projected online subscription spending for rented DVDs would increase 68 percent between 2007 and 2011, rising to $3.2 billion, or about 37.5% of the total video rental market.
The wave of the future in viewing movies at home was widely thought to be in streaming rented movies directly to big-screen high-definition TVs. Household members could order the movies they wanted to rent and instantly watch either online (from Netflix, Blockbuster, or other online subscription services with instant video streaming capability via the Internet) or by using their TV remotes to place orders from their cable or satellite provider. In addition, there were a number of other important trends and developments in the movie rental marketplace:

- Sales of movie DVDs had slowed from double-digit to single-digit levels in 2006-2007. Online rentals of movie DVDs, computer downloads of music and movie files, growing consumer interest in video-on-demand (VOD) services, and growing popularity of high-definition TV programs were cited as factors.

- Prices for wide-screen, high definition TVs had been dropping rapidly and picture quality was exceptionally good, if not stunning, on increasing numbers of models.

- Starting in 2009, all TV stations in the U.S. were required by law to use digital technology and equipment to broadcast all their programs, a requirement that would result in far more programs being transmitted in high-definition format.

- The flood of new and old TVs shows on DVDs that had recently hit retailers’ shelves had cut into the sales of movie DVDs—however, the multi-disc sets of many of these TVs shows were more expensive than most new releases of movie DVDs.

- Hollywood movie producers were hoping that next-generation, high-definition optical disc format DVDs that incorporated Blu-ray technology would rejuvenate sales of movie DVDs. The Blu-ray format offered more than five times the storage capacity of traditional DVDs and utilized advanced video and audio capabilities that provided users with an unprecedented HD experience. But it remained to be seen whether Blu-ray movie DVDs would spur movie DVD sales, given growing popularity of digital video recorders (DVRs), VOD, and online rentals.

- Cable companies like Comcast were offering VOD options for many of their premium movie channels. The Starz Entertainment Group claimed its research showed that Comcast customers who were using the Starz on Demand VOD service tended to reduce their purchases and rentals of movie DVDs due to the ease of using the VOD service.

- Cable and satellite TV companies were promoting their VOD services making more movie titles available to their customers.

- Cable and satellite TV customers with DVRs could readily substitute VOD movie offerings from their cable/satellite TV provider for purchasing or renting movie DVDs (although selection was generally more limited).

- Online rentals and VOD services were not only cutting into sales of movie DVDs but also taking business away from local video rental stores. Just as Netflix posed a competitive threat to customers patronizing local Blockbuster and Movie Gallery stores in the U.S., market research in Great Britain indicated that one out of every five DVDs rented was rented online.

In 2008, Netflix grown to become the world’s largest online entertainment subscription service, having revolutionized the way that many people rented movies. It had attracted 8.4 million subscribers who paid monthly fees ranging from $4.99 to $47.99; subscribers went to Netflix’s Web site, selected one or more movies from its library of 100,000 titles, and received the movie DVDs by first-class mail generally within 1 business day—more than 95 percent of Netflix’s subscribers lived within 1-day delivery of the company 50 distribution centers (plus 50 other shipping points) located throughout the United States. Subscribers could keep a DVD for as long as they wished, with no due dates or late fees, although they were limited to having a certain number of DVDs in their possession at any one time (depending on which fee plan they had chosen). Subscribers returned DVDs via the U.S. Postal Service in a prepaid return envelope that came with each movie order. The company also had a growing library of over 12,000 full-length movies and television episodes that subscribers could watch instantly on their televisions or PCs for no additional cost.
Netlix management’s latest forecast called for having between 9.1 million and 9.7 million subscribers by year-end 2008, full-year revenues of about $1.37 billion, net income in the range of $75 million to $83 million, and diluted earnings per share of $1.19 to $1.31.

Blockbuster was the global leader in the movie rental industry. In 2008, it had an estimated 40 percent share of the roughly $9.5 billion U.S. market for renting movies for in-home viewing and a globally recognized brand in movie rentals. Founded in Dallas, Texas, in 1985, Blockbuster had pursued an aggressive growth strategy, reaching a peak of 9,094 company-operated and franchised movie rental stores worldwide by year-end 2004 with 7,265 company-operated stores (including 2,557 outside the U.S.) and 1,829 franchised Blockbuster stores (some 734 of which were outside the U.S.). However, during 2005-2007, amidst adverse market and competitive conditions and hemorrhaging losses, Blockbuster closed over 700 of its company-operated stores in the U.S. and nearly 500 of its company operated stores outside the U.S.; an additional 137 company-owned stores and 96 franchised stores were closed or sold worldwide in the first six months of 2008.

Blockbuster recorded net losses of $2.8 billion during the 2003-2005 period, earned a modest $39.2 million after-tax profit in 2006, and lost $85.1 million in 2007. The company had announced that it expected to report full-year 2008 net income in the range of $21 to $36 million, despite reporting a net loss of $2.1 million for the first six months of 2008. To improve the company’s 2008 financial performance and avoid another year of losses, senior management had launched efforts to cut general and administrative expenses at the corporate-level by $100 million and, during the first half of 2008 alone, advertising expenses had been trimmed by $65 million (about 60 percent).

In July 2007, James F. Keyes, former president and CEO of 7-Eleven, was appointed to replace John F. Antioco who had served as Blockbuster’s CEO since 1997. Keyes quickly initiated a series of efforts to recast Blockbuster’s strategy and put the company in better position to improve its dismal bottom-line performance. Under Keyes, Blockbuster was focusing on three strategic priorities:

- Growing its core movie rental business.
- Broadening the product offerings at local Blockbuster stores
- Developing new channels for delivery of digital content.

**SUGGESTIONS FOR USING THE CASE**

This case has all the ingredients for an outstanding and enlightening class discussion. The movie rental industry is undergoing change and Netlix is driving hard to overtake Blockbuster as the industry leader. Long-time industry leader Blockbuster is a troubled enterprise and has been scrambling to revamp its business model and ward off the challenge from Netlix. Students will easily grasp the ins and outs of the movie rental business and they are virtually sure to have some convictions and opinions about the market battle between Netlix and Blockbuster. And students will welcome the fact that the case is a relatively short 16 pages.

There is an accompanying 4:50-minute video entitled “Movie Night Done Right: Is It Better to Join One of Those DVD Mail Clubs or Just Rent One On Demand?” that we suggest showing at the very beginning of the class period. It is a good stage-setting video to launch the class discussion.

We think the case is probably best assigned after you have covered Chapters 1-6. It is an ideal case for drilling students in the tools of analysis covered in Chapters 3 and 4. So in this sense it is best used in the first half of your module on single-business strategy. The material in Chapters 5 and 6 is useful for helping students translate their analysis into action recommendations. We highly recommend the movie rental industry case as a candidate for a written case assignment or oral team presentation.

In working their way through this case, students will need to evaluate industry and competitive conditions, weigh an assortment of competitive factors, draw a strategic group map, identify driving forces and key success factors, think strategically about Netlix’s resources and capabilities versus those of Blockbuster, do a weighted
competitive strength assessment of Netflix versus Blockbuster and perhaps other rivals described in the case, do some number-crunching (there’s some good financial data in the case that merits careful scrutiny), and be thoughtful in making substantive action recommendations regarding what Netflix can do to overtake Blockbuster and what Blockbuster can do to overcome the challenge from Netflix.

There is an accompanying video for this case; the video is an August 2008 interview of Netflix CEO Reed Hastings. We suggest showing this video just before asking the class for their recommendations on what Netflix should do to succeed in its drive to overtake Blockbuster as the industry leader in movie rentals.

To give students guidance in what to do and think about in preparing the movie rental industry case for class discussion, we strongly recommend providing class members with a set of study questions and insisting that they prepare good notes/answers to these questions in preparing for class discussion of the case.

To facilitate your use of study questions and making them available to students, we have posted a file of the Assignment Questions contained in this teaching note for the movie rental industry case on the student section of the publisher’s Online Learning Center for the 17th edition (www.mhhe.com/thompson). (You should be aware that there is a set of study questions posted in the student OLC for each of the 26 cases included in the 17th edition.)

In our experience, it is quite difficult to have an insightful and constructive class discussion of an assigned case unless students have conscientiously have made use of pertinent core concepts and analytical tools in preparing substantive answers to a set of well-conceived study questions before they come to class. In our classes, we expect students to bring their notes to the study questions to use/refer to in responding to the questions that we pose. Moreover, students often find having a set of study questions is useful in helping them prepare oral team presentations and written case assignments—in addition to whatever directive questions you supply for these assignments. Hence, we urge that you have students make full use of study questions—either those we have provided or a set of your own questions—in preparing each and every case assignment.

We heartily recommend use of the Competition in the Movie Rental Industry case for written assignments and oral team presentations. Our suggested assignment questions are as follows:

- Please prepare a report to your instructor that includes (1) a five-forces analysis of competitive in the movie rental business, (2) an identification of the forces driving change in the movie rental industry and whether these driving forces will act to strengthen/weaken competitive pressures and profitability in the movie rental industry in the years ahead, (3) the industry’s key success factors, (4) a strategic group map showing the market positions of key rivals, and (5) the factors that make the industry attractive and those that make it unattractive. Your report should leave no doubt about your skills and capabilities to wisely and astutely utilize the analytical tools in Chapter 3.

- Netflix CEO Reed Hastings has employed you as a consultant to assess the company’s overall situation and recommend a set of actions to improve the company’s future prospects. Please prepare a report to Mr. Hastings that includes (1) an evaluation of competitive forces in the movie rental industry, (2) the forces driving change in the industry, (3) the industry’s key success factors, (4) a critique of the company’s strategy and its business model, (5) an assessment of Netflix’s strengths, weaknesses, opportunities and threats, (6) an evaluation of Netflix’s strategic and financial performance, (7) a weighted competitive strength assessment using the methodology in Table 4.4, and (8) a set of action recommendations that clearly define the course of action Netflix should pursue. Your report should be 5-6 pages plus it should include an assortment of charts, tables and exhibits to support your analysis and recommendations.

- Blockbuster’s new CEO James F. Keyes has asked you to provide him with (1) an evaluation of competitive forces in the movie rental industry, (2) the forces driving change in the industry, (3) the industry’s key success factors, (4) an assessment of Blockbuster’s strengths, weaknesses, opportunities and threats, (5) an evaluation of pluses and minuses that you see in Blockbuster’s recent financial performance, (6) a weighted competitive strength assessment using the methodology in Table 4.4, and (7) a set of action recommendations that clearly define the course of action Blockbuster should pursue.
Your report to Mr. Keyes should be 5-6 pages plus whatever charts, tables and exhibits you believe are needed to support your analysis and recommendations.

- Prepare a brief report to Netflix CEO Reed Hastings outlining the actions you think he should take to gain ground on Netflix and boost the company’s performance. Your report should contain detailed and convincing reasons in support of each one of your recommendations; it is imperative that the support offered for each of your recommendation be based on analysis-based conclusions drawn from application of the concepts and analytical tools discussed in Chapters 3 and 4.

- Prepare a brief report to Blockbuster CEO James Keyes outlining the actions you think he should take to improve Blockbuster’s strategic and financial performance. Your report should contain comprehensive and convincing reasons in support of each one of your recommendations; furthermore, it is imperative that the support offered for each of your recommendations be based on analysis using the concepts and tools discussed in Chapters 3 and 4.

ASSIGNMENT QUESTIONS

1. How strong are the competitive forces in the movie rental marketplace? Do a five-forces analysis to support your answer.

2. What forces are driving change in the movie rental industry and are the combined impacts of these driving forces likely to be favorable or unfavorable in term of their effects on competitive intensity and future industry profitability?

3. What does your strategic group map of this industry look like? Which company is best-positioned—Netflix or Blockbuster? Why?

4. What key factors will determine a company’s success in the movie rental industry in the next 3-5 years?

5. What is Netflix’s strategy? Which of the five generic competitive strategies discussed in Chapter 5 most closely fit the competitive approach that Netflix is taking? What type of competitive advantage is Netflix trying to achieve?

6. What does a SWOT analysis of Netflix reveal about the overall attractiveness of its situation?

7. What is your appraisal of Netflix’s operating and financial performance based on the data in case Exhibits 2, 3, and 4? What positives and negatives do you see in Netflix’s performance? Use the financial ratios in Table 4.1 of Chapter 4 as a guide in doing the calculations needed to arrive at an analysis-based answer to your assessment of Netflix’s recent financial performance.

8. What does a SWOT analysis of Blockbuster reveal about the overall attractiveness of its situation?

9. What is your appraisal of Blockbuster’s performance as shown in case Exhibit 5? What pluses and minuses do you see? Use the financial ratios in Table 4.1 of Chapter 4 as a guide in doing the calculations needed to arrive at an analysis-based answer to your assessment of Blockbuster’s recent performance.

10. How does Netflix’s competitive strength compare against that of Blockbuster? Do a weighted competitive strength assessment using the methodology presented in Table 4.4 of Chapter 4 to support your answer. Does Netflix have a sustainable competitive advantage over Blockbuster? Why or why not?

11. What 2-3 top priority issues does Netflix management need to address? What 2-3 top priority issues does Blockbuster management need to address?

12. What recommendations would you make to Netflix CEO Reed Hastings? At a minimum, your recommendations should cover what to do about each of the top priority issues identified in question 11.

13. What recommendations would you make to Blockbuster CEO James Keyes? At a minimum, your recommendations should cover what to do about each of the top priority issues identified in question 11.
TEACHING OUTLINE AND ANALYSIS

1. How strong are the competitive forces in the movie rental marketplace? Do a five-forces analysis to support your answer.

Below is a representative five-forces model of competition in the movie rental industry:

- **Rivalry among companies competing in movie rentals**—a strong to fierce competitive force that is likely to intensify in the years ahead

In assessing this competitive force, students should be directed to consider the presentation in Figure 3.4.

Students should conclude that rivalry among Netflix, Blockbuster, and other movie rental competitors seems destined to grow more intense. All competitors are scrambling to attract the patronage of individuals/households that rent movies—this is a hotly contested marketplace. Rivalry is centered on such factors as

- Price of movie rentals (rented either individually or via a subscription plan); variety of subscription plans to choose from
- Convenience in renting movies (including returning rented DVDs)
• Breadth of selection (size and diversity of movie library)

• Availability of the DVD (are all the copies out on rental or are some available either in the store or in distribution inventory ready to be shipped?) Customers tend to be annoyed when the DVD they want to rent is not immediately available.

• Ease of browsing through all the selections to determine which movies to rent

• Late fees (if any) and policies regarding how long the renter can keep the DVD (or view the movie if it is downloaded or rented online)

• Advertising and promotion—Much of the advertising is being done online in the case of both Blockbuster and Netflix; however, Blockbuster utilizes in-store promotions on a regular basis. But the DVD rental business is not one that is a heavy user of TV, radio, and newspaper advertising on a regular basis.

• Image and reputation

Most movie rental competitors pursue a differentiation strategy to try to set themselves apart on the basis of one or more competitive factors.

Several factors were working to intensify rivalry among movie rental industry participants:

• All rivals are actively and busily launching fresh promotional initiatives (the free trials at Netflix and Blockbuster, for example) and engaging in new marketing tactics and market maneuvers to spur their movie rental revenues and build a loyal customer base. The large number of fresh strategic initiatives on the part of various movie rental rivals heightens rivalry.

• Low switching costs on the part of buyers—it is pretty easy for people wanting to rent a DVD to (a) go to one store location or another to rent a DVD or (b) switch their subscription from Netflix to Blockbuster or (c) choose to obtain the movie from any of several online providers or (d) order the movie through their cable provider.

• Some rivals have utilized price cuts (or reduced subscription rates) to cut price as a means of attracting new customers—a factor which intensifies rivalry. However, there does not appear to be much room for further price cutting in the online subscription segment—Netflix and Blockbuster have probably cut their subscription rates about as far as they can and still eke out respectable profitability.

• Rivalry increases when one or more rivals are dissatisfied with their market position and launch moves to bolster their standing at the expense of rivals. A case can be made that Netflix, Blockbuster, the cable TV companies, streaming video providers, and Internet sites offering downloadable movie rentals are likely to make further moves to bolster their unit volumes and market positions. All movie rental competitors seem to be desirous of growing their business.

• Rivalry is likely to increase significantly as video-on-demand becomes the “wave of the future” means of delivering rented movies to individuals/households. Students may (quite correctly) see video-on-demand as a new technology-driven way of delivering movie-viewing services to consumers—a channel which will greatly increase the competitive pressures on competitors with brick-and-mortar movie rental locations. Over time, there is reason to expect that movie rental competitors with VOD capability will take sales and market share away from local movie rental stores.

• Rivalry increases as the product offerings of rivals become more standardized. We see the differentiation between Netflix’s online product offering and the online offering of Blockbuster as growing smaller, not larger. Differentiation between these two leading competitors is growing
weaker, not stronger, now that Blockbuster is pursuing the online movie rental business. But there is continued differentiation among the means whereby the movie rental competitors actually deliver the movies to renters for viewing.

On the other hand, there is at least one factor acting to make rivalry somewhat weaker—somewhat rapid growth of the market for movie rentals, especially via online means. Most students are likely to take the position that the demand for online movie rentals will grow rapidly in the years ahead. Rapid market growth acts to weaken rivalry—but in this case, market growth is probably not fast enough to override all the factors acting to intensify rivalry.

We think it is hard to be definitive about just where the demand for movie rentals is in the life-cycle. There is some reason to believe that the online rental segment is still in the rapid growth stage (although perhaps approaching the transition to market maturity); demand is, however, fairly stagnant for DVD rentals at retail stores—as evidenced by Blockbuster’s fairly flat revenues. Video-on-demand probably has the biggest growth potential as of 2008 and beyond. The growth potential of renting movies from vending machines is unclear, but would not seem to qualify as a “wave of the future” distribution channel relative to the Internet and VOD segments. Thus, the growth potential in the various movie rental segments is a mixed bag.

- Threat of entry—a weak to moderate to strong competitive force, depending on the segment or means of distribution.

In assessing this competitive force, students should be directed to consider the presentation in Figure 3.5.

Heading into 2009, we see that the window for entering the online or brick-and-mortar segment of the movie DVD rental business is closing fairly fast. It will become increasingly difficult for new entrants using a business model like either Netflix or Blockbuster to overcome entry barriers and capture enough subscribers to compete profitably in the online rental segment against Netflix or Blockbuster. Moreover, the barriers to entry into online subscription segment of the movie rental business are moderately high for enterprises wanting to cover a large geographic area and compete on a “national” scale:

- The costs of developing a Web site.
- Developing order fulfillment capability to equal the short delivery times offered by Netflix and Blockbuster.
- The added investment in DVD inventories.
- Expenditures for advertising and promotion needed to draw visitors to the web site and convert them into paying subscribers. (From case Exhibit 3, students can see that Netflix is spending over $200 million annually on marketing.)

In the brick-and-mortar movie rental segment, there may be entry opportunities for small niche players in local markets to get into renting movie DVDs to customers living near their store locations. It is relatively easy for a local retailer to open a DVD rental outlet and compete on a very small scale for business within a 2-5 mile radius; but such entry poses little direct threat to market leaders Blockbuster and Movie Gallery (or even Netflix) as of 2008.

However, the biggest entry threat into the movie rental marketplace on the road ahead are enterprises that enter the video-on-demand movie rental segment—such as cable companies, telephone providers, and others with the capability to deliver rented movies “instantaneously” via cable or telephone lines or high speed Internet connections. The entry threat from this type of competitor is relatively high (to the extent that VOD becomes the wave of the future for renting and viewing movies) and will trigger fierce competitive pressures from entrants touting this means of delivering movie
viewing services to prospective viewers (although it appears that Netflix and probably Blockbuster will have online delivery capabilities that allow viewers to rent movies “on-demand” from Netflix and Blockbuster and watch the rented movie directly on their big-screen TVs within minutes of placing the order. Technology is advancing in a manner that makes video-on-demand more and more feasible and more and more attractive to Netflix, other movie rental Internet sites, cable and broadband providers, and perhaps others (including the movie studios themselves). A variety of movie rental providers are gearing up to offer video-on-demand. As more and more households sign on for broadband service and as download speeds advance, then delivering all kinds of entertainment products via high speed Internet means will almost certainly catch on in the marketplace.

Hence, the overall entry threat into the movie rental industry in the years to come should be viewed as moderate to strong.

- **Competition from substitutes**—a moderately strong competitive force depending on the extent to which consumers prefer to rent movies versus seeing them at the movie theaters or buying movie DVDs for their own personal library.

In assessing this competitive force, students should be directed to consider the presentation in Figure 3.6.

There are currently three principal substitutes for renting movies: (1) buying movie DVDs and/or the DVDs of new and old TV shows for one’s own personal library, (2) watching a movie on any of various TV channels (such as Bravo, Turner Classic Movies, HBO, and Cinemax), and (3) seeing the desired movie at movie theaters. Buying movie DVDs has recently become less expensive (but still not as cheap as renting a movie from any of several sources), since the strategy of some movie makers is now to price new releases of movie DVDs low enough to cause more and more people to buy a movie DVD rather than rent it. To a lesser extent, another substitute is watching movies on all the various TV channels. However, the multi-disc sets of TVs shows tend to be more expensive than many new releases of movie DVDs. Moreover, the selection of movie DVDs at retailers like Wal-Mart or Best Buy or Target is nowhere near as broad as the selection available for rental from Netflix and Blockbuster—which to some movie enthusiasts limits the appeal of substitutes for movie rentals.

In addition, there are hordes of entertainment substitutes for watching movies altogether—but these other entertainment forms may not be good substitutes for people who prefer to watch movies in their home at their own convenience and are frequent or dedicated movie watchers.

However, in the years just ahead, video-on-demand could well prove to be a very formidable substitute for the product offerings of Netflix, Blockbuster, and Movie Gallery.

Students should probably conclude that substitutes for renting movies are a relatively strong competitive force, given that:

- Acceptable substitutes are readily available and competitively priced (in some cases)
- Buyer costs to switch to substitutes are relatively low
- Many consumers are familiar with and comfortable with using substitutes (buying their own movie DVDs, going to movie theaters, and watching movies on TV)

- **The bargaining power and leverage of suppliers**—a moderately strong competitive force, depending on the type of supplier.

In assessing this competitive force, students should be directed to consider the presentation in Figure 3.7.
Students should recognize that movie studios have considerable bargaining power and leverage over Netflix, Blockbuster, and other movie rental enterprises because of their power to heavily influence the price and other terms and conditions under which their movies will be supplied to movie rental providers. Movie studios are in a particularly powerful position to dictate the dates when their movies will be released to all the different movie rental providers.

Other suppliers to movie rental participants, however, are relatively weak and have little or no bargaining power. Web site services, servers, mail services for shipping and returning DVDs, and the services required for operating retail stores can all be obtained from a variety of sources at the going market price.

**The bargaining power and leverage of people renting DVDs—a weak competitive force**

In assessing this competitive force, students should be directed to consider the presentation in Figure 3.8.

- Individuals have virtually no power to bargain for a lower price on movies they rent from Netflix, Blockbuster, or other movie rental providers. They can choose to rent or not at the going rates or to subscribe or not to one rental plan or another, but no one individual is in a position to negotiate the terms and conditions under which he or she will rent a movie DVD from Netflix or Blockbuster or Movie Gallery or a cable TV company or a video-on-demand provider.

**Conclusions concerning the overall strength of competitive forces:** Competitive pressures in the movie rental industry are pretty strong and are likely to grow stronger in upcoming years, particularly as video-on-demand becomes more of a factor in the marketplace. Currently, we see rivalry as far and away the strongest of the five competitive forces, followed by competition from substitutes and the bargaining power of movie studios. But while competition is fairly strong, it is not so strong as to prevent many movie rental companies from being profitable. The movie rental companies appear to be able to cope with the bargaining power of the movie studios and with competition from substitutes, at least currently.

The financial performance of both Netflix and Blockbuster confirm that competitive conditions for earning attractive profits are pretty tough.

2. **What forces are driving change in the movie rental industry? Are these driving forces likely to have a favorable or unfavorable impact on competitive intensity and future industry profitability?**

You may want to direct students to Table 3.2 in Chapter 3 in singling out the driving forces that are at work in this industry.

Students should identify most all of the following as driving forces:

- The technology of streaming rented movies directly to big-screen high-definition TVs is improving very quickly and is likely to become the “wave of the future” in delivering rented movies to viewers. *This is probably the biggest and most important driving force in the movie rental business as of 2008.*

- Blu-ray technology enhances the attractiveness of viewing movies at home.

- More and more households are signing up for high-speed broadband Internet service—which broadens the market for V-O-D delivery of movies.

- Prices for wide-screen, high definition TVs have been dropping rapidly and picture quality was exceptionally good, if not stunning, on increasing numbers of models. Purchases of these TVs by more households are likely to boost the viewing of movies at home and spur growth in the movie rental industry.
Starting in 2009, all TV stations in the U.S. were required by law to use digital technology and equipment to broadcast all their programs, a requirement that would result in far more programs (including movies) transmitted in high-definition format. This could cause more households to watch the movies shown on all the various cable TV channels rather than to rent them.

Rapid increases in the number of household having digital video recorders (DVRs) which made it simple to record a TV program or movie and then replay it at a convenient time. Falling prices for DVRs with Blu-ray technology were spurring sales of DVRs—which could translate into growth in movie rentals for home viewing.

Availability and use of file-sharing programs that facilitated movie-pirating.

**Conclusions:** The combined impact of these driving forces in the marketplace should be analyzed by answering three questions:

- **What is the likely effect of the driving forces on demand for movie rentals?** Students should conclude that the driving forces will likely result in growing overall demand for movie rentals (via either the Netflix subscription-based business model or via video-on-demand technology and devices).

- **Are the driving forces acting to strengthen or weaken competition in the movie rental business?** The weight of evidence indicates that the driving forces will all act to intensify competition among the various movie rental providers. All the new entrants offering video-on-demand will be trying to wrest rental revenues and market share away from traditional movie rental providers.

- **Will the driving forces lead to higher profitability among the movie rental companies?** We think the best answer here is probably yes in the case of competitors with the ability to supply movie rentals on demand via VOD technology/devices and probably not in the case of brick-and-mortar movie rental companies.

The DVD rental marketplace is likely to be fast-changing and turbulent for some years to come, as all the driving forces come into play and the battle among new and existing rivals shakes out.

3. **What does your strategic group map of this industry look like? Is Netflix well-positioned? Why or why not?**

Strategic group maps are beneficial for determining relative company placement in the industry. A good strategic group map should utilize two strategic variables that differentiate the various competitors in the movie rental marketplace.

Students can choose among any of several strategic variables to divide the DVD rental industry into strategic groups and illustrate the different market positions they occupy. We have chosen to employ breadth of product line (in terms of number/variety of movies offered) and the type of distribution channel or approach to getting the movie rental to customers for viewing. Other possibilities for axes might include scope of geographic coverage and image/reputation/brand name recognition.

A representative strategic group map is shown in Figure 1.

Once students have come up with their proposed map, then we think you should press them for their evaluation of what we learn from the map; you might pose any of the following questions to help draw out their views:

- Which company is better positioned—Netflix or Blockbuster? (We favor Netflix because of its lead in migrating to VOD technology and devices for delivering rented movies to subscribers.)

- Which industry members are best positioned? (Our answer is that companies with the capabilities to be successful in the VOD channel are best positioned.)

- Which industry members are weakly positioned? (Traditional brick-and-mortar movie rental stores)
Which industry members are likely to benefit from the impacts of industry driving forces? (Movie rental providers that capitalize on VOD technology)

Which industry members are likely to be injured by the impacts of industry driving forces? (Traditional brick-and-mortar movie rental stores)

The point here is that students should not stop their analysis with just drawing a strategic group map. The most important part of strategic group mapping is to draw some conclusions about the story the map tells.

On the whole we like Netflix’s position on the map, especially since it can move vertically over time and is rapidly enhancing its ability to migrate to a VOD delivery system. However, Blockbuster is also now better positioned to enter the VOD segment now that it is in the online segment, but it trails Netflix in this regard. If Blockbuster got into VOD, it would be a potent competitor in the sense of being able to access the casual DVD movie rental customer (via its large network of retail stores and VOD) and the heavier movie-watching segment (via online ordering/mail delivery and VOD)—in other words, it would be positioned in all three delivery channel segments rather than just two.

We are not particularly enthused about the attractiveness of the market positions of any of the brick-and-mortar movie rental providers. This segment of the movie rental industry seems destined to lose sales and market share in the years ahead because it is most vulnerable to competition from new VOD technology and the convenience of subscription-based movie rental providers.

**Figure 1** A Representative Strategic Group Map of the Movie Rental Industry
4. What key factors will determine a company’s success in the movie rental industry in the next 3-5 years?

We see perhaps 5 key success factors for companies that want to make money in providing movies for home viewing:

- **A wide selection of titles** that probably includes video games and perhaps TV show DVDs, as well as movies. But a wide variety of movie titles seems absolutely essential.

- **A delivery system that includes both online DVDs rentals (delivered and returned via mail) and VOD;** technology is going to make it less necessary to have brick-and-mortar stores scattered across the landscape that consumers patronize to get the movies they want to view.

- **A well-known brand name/reputation** that draws customers to use that industry member’s service as opposed to that of rivals.

- **Competitive subscription fees and convenient movie rental delivery arrangements.** Customers will remain with online rental as long as it is economically beneficial for them to stay. If they don’t rent a sufficient number of movies to justify a monthly subscription fee, then they are likely to go to the brick-and-mortar stores for their movie rentals or else watch rented movies occasionally that can be accessed through their cable TV provider or some other VOD provider). Delivering movies by mail or going to a local store to pick up a rented movie DVD rental will gradually give way to delivery of rented movies via the Internet or cable/telephone wires or wireless technology.

- **Ability to attract and retain a subscriber/customer base that is large enough to be profitable.** In order for a movie rental competitor to be profitable, it must be able to generate sufficient revenues to cover its operating expenses (which can be fairly substantial if a company is to rank among the industry leaders). There are very definitely scale economies in the online rental segment, so a company must attract a sufficient number of subscribers/customers to keep its costs low and its prices competitive. In this regard, a well-known brand name and reputation will be a valuable competitive asset.

5. What is Netflix’s strategy? Which of the five generic competitive strategies discussed in Chapter 5 most closely fit the competitive approach that Netflix is taking? What type of competitive advantage is Netflix trying to achieve?

Netflix’s strategy is built around utilizing **its proprietary CineMatch software technology** and its **quick delivery capabilities** to differentiate itself from rivals and attract a growing subscriber base big enough to make the company profitable.

A second key strategy element is to be a leader in transitioning to Internet delivery of movie and other entertainment content.

The company’s strategy to continue to grow its business had three primary components:

- **Continue to innovate and enhance the consumer experience.**

- **Use Netflix’s market-leading position to lead the transition to high-definition DVDs and digital delivery of rented movies.**

- **Focus on rapid subscriber growth in order to**
  - Maintain market leadership
  - Realize economies of scale
Other strategy elements include:

- A big, ever-growing, and diverse variety of movie titles to choose from
- A wide choice of subscriptions plans
- Free trial offers
- Online advertising (to help attract new visitors to the Netflix web site and convert them into subscribers—or at least into signing up for a free trial)—Netflix spent over $200 million annually on marketing in 2006 and 2007 (see case Exhibit 3)
- Continue to add distribution centers to enhance quick mail delivery capabilities, minimize shipping costs, and hold down DVD inventories (with the aid of the software that Netflix had developed to track its inventory and fill orders).

Use CineMatch to steer customers to lesser-known movies of interest (which helped generate revenues across a larger number of titles), provide subscribers with detailed information about each title in the Netflix library and personalized movie recommendations every time they visited the Netflix web site. The information included for each title included length, rating, cast and crew, screen formats, movie trailers, plot synopses, and reviews written by Netflix editors, third parties, and subscribers. The personalized recommendations were based on a subscriber’s individual likes and dislikes (determined by their rental history, their personal ratings of movies viewed, movies in the subscriber’s queue for future delivery, and titles posted to a wish list), movie ratings, and the average rating by all subscribers. Subscribers often began their search for movie titles by starting from a familiar title and then using the recommendations tool to find other titles they might enjoy.

The CineMatch recommendation software was designed around an Oracle database and proprietary algorithms that organized Netflix’s library of movies into clusters of similar movies and analyzed how customers rated them after they rented them. Those customers who rated similar movies in similar clusters were then matched as likeminded viewers. When a customer was online, the software was programmed to check the clusters the subscriber had rented from in the past, determine which movies the customer had yet to rent in that cluster, and recommended only those movies in the cluster that had been highly rated by viewers. Viewer ratings determined which available titles were displayed to a subscriber and in what order. The recommendations helped subscribers quickly create a list of movies they wanted to see; subscribers used this list to specify the order in which movies would be delivered and could alter the list at any time. Netflix management saw the movie recommendation tool as a powerful means of enticing customers to spend time browsing through its expansive content library and locating movies they would like to see.

In 2008, Netflix had more than 2 billion movie ratings from customers in its database, and the average subscriber had rated more than 200 movies. These ratings were used to determine which titles to feature most prominently on the company’s Web site, to generate lists of similar titles, and to select the promotional trailers that a subscriber would see when using the Previews feature. Netflix management believed that over 50 percent of its rentals came from the recommendations generated by its recommendation software. The software algorithms were thought to be particularly effective in promoting selections of smaller, high-quality films to subscribers who otherwise might have missed spotting them in the company’s massive 100,000-film library (to which new titles were continuously being added). On average, more than 85 percent of the movie titles in the Netflix library of offerings were rented each quarter, an indication of the effectiveness of the company’s CineMatch software in steering subscribers to movies of interest and achieving broader utilization of the company’s entire library of titles.

- Sell used DVDs once their useful rental life had expired—helps recover investment costs in DVD inventory and improve return on assets. Netflix assumed that used DVDs would bring at least a salvage value of $3.
Students will likely have different opinions of which of the five generic competitive strategies that Netflix is using, with a portion of the class asserting that Netflix is pursuing a broad differentiation strategy, others arguing that it is using a focused differentiation strategy, and perhaps still other arguing that Netflix is quickly transitioning to a best-cost provider (because Internet/digital delivery of rented movies is far cheaper and faster than the mail delivery). The case states that Netflix’s subscriber base consisted of three types of customers: (1) those who liked the convenience of home delivery, (2) bargain-hunters who were enthused about being able to watch unlimited movies a month at an economical price (3 titles out at a time and unlimited streaming on the $16.99 per month plan; watching 12 movies monthly on this $16.99 plan equated to a rental fee of $1.42 per movie), and (3) movie buffs who wanted access to a very wide selection of films. This supports the argument of the focused differentiation proponents. However, we would not take great issue with those who claim that the strategy is one of broad differentiation—the company is definitely headed towards broad differentiation in the sense that it is trying to widen its subscriber base and in the sense that technology is changing in a manner that makes it easier for Netflix to target an ever wider customer base (the number of households with broadband Internet service is growing daily) with its online strategy approach. The strength of the best-cost provider strategy argument is that Netflix is moving as quickly as possible to transition to digital delivery of movie content—which will get it “instant’ delivery capability (an upscale feature) and also (reduce its operating expenses by curtailing the need for so many distribution centers and mail delivery costs).

**Netflix’s Competitive Advantage.** Currently, Netflix has something of a five-pronged competitive advantage—(1) a wider selection of titles, (2) one-day business delivery (with movement toward instant digital delivery as fast as technology will allow—Netflix is an early mover in this regard), (3) its CineMatch software that makes identifying appealing movies to rent quick and easy as well as promoting broad use of its entire rental library, (4) its distribution system software, and (5) a growing reputation and brand name recognition. But we would argue that only two of these are durable or sustainable. Blockbuster has moved rapidly to match Netflix on one-day-business delivery to online subscribers and a number of Netflix’s rivals will at some juncture will have good digital delivery capability (although Netflix’s may retain some first-mover advantage with respect to VOD technological capability). Moreover, Blockbuster (and perhaps others in the future) can over time add enough titles to match Netflix on variety and number of titles; still Netflix remains in the lead in breadth/variety of movie titles in its library of offerings and may be able to retain an edge over Blockbuster and other movie rental providers.

But CineMatch is a much more troublesome capability for rivals to match—Netflix’s competitors may or may not be able to program better software than Netflix has at an acceptable cost. And, as detailed above, CineMatch appears to give Netflix very desirable capabilities—capabilities that may very well provide Netflix with a sustainable competitive edge over rivals.

While in the near term it may well prove difficult for Netflix’s online rivals to match or beat Netflix’s advanced distribution center system for managing inventories and fulfilling orders for movie DVDs, this advantage will evaporate as the movie rental marketplace transitions from mail delivery of DVDs to instant delivery of movies in digital form. But in the meantime Netflix’s sophisticated software to track its inventory and minimize delivery times will help contain its operating costs and maintain its ability to fill customer orders for movie DVDs. According to information in the case:

Netflix’s system allowed distribution centers to communicate to determine the fastest way of getting the DVDs to the customers. When a customer placed an order for a specific DVD, the system first looked for that DVD at the shipping center closest to the customer. If that center didn’t have the DVD in stock, the system then moved the next closest center and checked there. The search continued until the DVD was found, at which point the shipping center was provided with the information needed to initiate the order fulfillment and shipping process. If the DVD was unavailable anywhere in the system, it was wait-listed. The system then moved to the customer’s next choice and the process started all over. And no matter where the DVD was sent from, the system knew to print the return label on the pre-paid envelope to send the DVDs to the shipping center closest to the customer to reduce return mail times and permit more efficient use of its DVD inventory.
Netflix seems to be building an ever-stronger brand name and reputation in the movie rental industry. Brand name recognition and reputation is likely to be a key success factor in movie rentals, and Netflix may well end up with a sustainable competitive advantage over many (most? all except maybe Blockbuster?) of its movie rental competitors as concerns brand name recognition and reputation.

6. What does a SWOT analysis of Netflix reveal about the overall attractiveness of its situation?

**Netflix’s Resource Strengths and Competitive Assets**

- Netflix has capitalized on being the first-mover in the online DVD rental business—it is now the leading DVD online rental company in the world and has a growing subscriber base.

- A strategy that seems to be working and that is delivering acceptable strategic and financial performance.

- Growing brand name recognition and brand power—growing consumer awareness of Netflix and its service helps attract more subscribers and free trials.

- Its proprietary CineMatch technology (a distinctive competence?—we think “yes”); CineMatch makes it easy and convenient for customers to identify and select movies of their liking (due to the more than 2 billion movie ratings from customers in its database) and greatly simplifies the task of ordering their next round of movies.

- 100,000 movies titles to choose from (with more continuously being added)

- A proprietary set-top box device that enabled Netflix’s instant-watching selections of movies (about 12,000 titles in 2008) to be viewed on subscribers’ TV screens. Netflix has a first-mover advantage in transitioning to digital delivery of its movie title library.

- Efficiency-enhancing distribution system software—the distribution system software reduced return mail times and permitted more efficient use of its DVD inventory.

- 50 regional distribution centers that, along with Netflix’s distribution system software technology, translate into an industry-leading distribution system that enables one-business-day delivery to 95% of U.S. subscribers.

- Operating cash flows are positive and, except for 2007, have been large enough to cover cash requirements for investing in the business; the company’s year-end cash balances rose until 2006 before dropping in 2007—see case Exhibit 4.

- An apparently capable top management team—Reed Hastings is experienced in managing growth companies and has done a good job of maneuvering Netflix into its position as a market leader (with the potential to seriously challenge Blockbuster)

**Netflix’s Resource Weaknesses and Competitive Liabilities**

- Netflix’s service is not appealing to households who rent movie DVDs occasionally—it appeals only to those who want to watch movies on a regular basis and see the monthly fee as a good bargain.

- Netflix has limited financial resources and its profits are relatively small (only $67 million in 2007)—see case Exhibit 3.

- Subscriber “churn” is pretty high. There are a large number of subscriber cancellations annually—3.1 million in 2006 and 4.2 million in 2007 (see case Exhibit 2); to grow its subscriber base, Netflix must attract millions of new subscribers each year (more than are canceling their service)
The costs of acquiring new subscribers has trended upward since 2003 (but is still well below the costs in Netflix’s early years—see the last line of case Exhibit 2).

Brand awareness, while definitely improving, is still not where it needs to be—Netflix is not yet a household name in the same way that Blockbuster is.

Netflix doesn’t have any presence in the retail store segment (currently where DVD rental revenues are largest); but this segment is vulnerable to driving forces and seems destined to decline in size.

Geographically, the company has no presence outside of the U.S.

**Netflix’s External Market Opportunities**

- Leading the transition to digital delivery of rented movies
- Attracting millions more subscribers—online movie rental is still in the growth stage of the industry life cycle (as evidenced by growth in the number of new subscribers that Netflix has been able to attract)
- Expansion into foreign markets (but this would entail perhaps significant costs in terms of adding distribution center capability and added DVD inventory)

**External Threats to Netflix’s Future Profitability**

- Growing use of file-sharing to pirate movies
- Movie studios and DVD retailers lower the prices of movie DVDs, thus making it somewhat more attractive for some consumers to buy movie DVDs rather than rent them
- The entry of movie rental competitors in the emerging VOD and digital delivery segment that have the name recognition, brand power, and resources to draw subscribers away from Netflix
- Consumers, for any of several reasons, become less interested in watching movies at home

You should not miss the opportunity to take the SWOT list to a higher analytical plateau by getting the class to identify which of Netflix’s resource strengths qualify as core competencies and/or distinctive competencies.

A good case can be made that Netflix’s CineMatch technology qualifies as a distinctive competence—one that provides competitive advantage currently and has potential for delivering sustainable competitive advantage. CineMatch makes it unusually easy and convenient for customers to find and obtain movies to their liking—this is bound to translate into high levels of customer satisfaction with Netflix’s service and, ultimately, high levels of customer loyalty. Searching through 100,000+ movie titles without the aid of CineMatch’s capabilities to steer one to movies of interest could be a pain in the neck (very time-consuming and unproductive) and lead subscribers to drop their service.

Currently, Netflix also seems to have two important core competencies:

- Quick delivery capability
- Efficient inventory management and order fulfillment (some of which appears attached to features of its CineMatch technology, so this may not be a purely separate core competence)

**Conclusions concerning Netflix’s situation.** You should not let students escape with just compiling four SWOT lists. The really important part of SWOT analysis comes from drawing conclusions about what we learn from the four SWOT lists.
All things considered, we think the four SWOT lists indicate that Netflix’s overall situation is good and that its outlook is promising. Netflix is currently well positioned in the movie rental business, with expanding capabilities to offer VOD and deliver its content digitally as market demand for VOD grows and more consumers become accustomed to using VOD services. Netflix’s variety of titles, its 37 distribution centers and quick delivery capabilities, and its proprietary CineMatch technology combine to make its competitive position attractive and capable of profitability on the road ahead.

7. What is your appraisal of Netflix’s operating and financial performance based on the data in case Exhibits 2, 3, and 4? What positives and negatives do you see in Netflix’s performance? Use the financial ratios in Table 4.1 of Chapter 4 as a guide in doing the calculations needed to arrive at an analysis-based answer to your assessment of Netflix’s recent financial performance.

Class members need to do some number-crunching here. The following seem pertinent in evaluating Netflix’s performance:

- Netflix’s subscriber base is growing rapidly—from 292,000 in 2000 to 7,479,000 in 2007. From 2004 through 2007, Netflix’s subscribers grew from 2,610,000 to 7,479,000, a compound average growth rate of 42%.

- The company is attracting free trial subscribers in greater numbers.

- The number of subscriber cancellation each year is rising rather rapidly—from 330,000 in 2000 to 1,593,000 in 2004 to 4,177,000 in 2007. The rising number of cancellation is cutting into the number of net subscriber additions each year.

- Revenues grew from $35.9 million in 2000 to $1,205.3 million in 2007—a compound average growth rate (CAGR) of 79.6%.

- After losing money in its early years, Netflix’s profits have increased from $21.8 million in 2004 to $67 million in 2007, a compound average growth rate of 45.8%.

- Netflix’s profit margins have changed as follows:

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<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>Gross profit margin</td>
<td>2.2%</td>
<td>36.2%</td>
<td>34.1%</td>
<td>31.9%</td>
<td>37.2%</td>
<td>34.8%</td>
</tr>
<tr>
<td>(gross profit as a % of revenues)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operating profit margin</td>
<td>-162.7%</td>
<td>-8.1%</td>
<td>3.9%</td>
<td>0.4%</td>
<td>6.5%</td>
<td>7.6%</td>
</tr>
<tr>
<td>(operating income as a % of revenues)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net profit margin</td>
<td>-162.9%</td>
<td>-14.7%</td>
<td>4.3%</td>
<td>6.2%</td>
<td>4.9%</td>
<td>5.6%</td>
</tr>
<tr>
<td>(net income as a % of revenues)</td>
<td></td>
<td></td>
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</table>

Calculated from information in case Exhibit 3.

- The following table shows assorted expense ratios for Netflix:

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<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Subscription costs as a % of subscription revenues</td>
<td>69.3%</td>
<td>51.1%</td>
<td>54.6%</td>
<td>57.7%</td>
<td>53.4%</td>
<td>55.1%</td>
</tr>
<tr>
<td>Fulfillment costs as a % of total revenues</td>
<td>28.5%</td>
<td>12.7%</td>
<td>11.2%</td>
<td>10.4%</td>
<td>9.4%</td>
<td>10.1%</td>
</tr>
<tr>
<td>Technology and development costs as a % of total revenues</td>
<td>46.9%</td>
<td>9.6%</td>
<td>4.5%</td>
<td>4.5%</td>
<td>4.5%</td>
<td>5.6%</td>
</tr>
<tr>
<td>Marketing costs as a % of total revenues</td>
<td>71.6%</td>
<td>23.4%</td>
<td>19.6%</td>
<td>20.8%</td>
<td>22.4%</td>
<td>17.9%</td>
</tr>
<tr>
<td>General and admin costs as a % of total revenues</td>
<td>19.5%</td>
<td>5.8%</td>
<td>3.3%</td>
<td>4.3%</td>
<td>3.0%</td>
<td>3.8%</td>
</tr>
</tbody>
</table>

Calculated from information in case Exhibit 3.
From the balance sheet and cash flow data in case Exhibit 4, class members should be able to determine the following:

- Netflix’s year-end cash position got impressively stronger from 2000 through 2006, but weakened (though not alarmingly so) in 2007.
- Netflix’s current ratio indicates adequate short-term liquidity; it was 2.57 in 2005, 2.22 in 2006, and 1.96 in 2007.
- Working capital (defined as current assets minus current liabilities) has been trending upward, despite a small decline in 2007.
- The company has no long-term debt.
- Net cash provided by operating activities has increased each year and was adequate to finance new investing activities in 2004, 2005, and 2006. A big increase in cash used for investing activities in 2007 accounted for the drawdown in the company’s cash balance.

Positives (or strengths) in Netflix’s operating and financial performance based on the data in case Exhibits 2, 3, and 4:

- The growth in Netflix’s subscriber base
- Netflix has been profitable for the last four years and profitability is rising. The company earned a respectable $67 million in 2007, equal to a net profit margin of 5.6% (versus profit margins of 4.3% in 2004, 6.2% in 2005, and 4.9% in 2006).
- Netflix is investing regularly and substantially in technology and development, boosting spending from $16.8 million in 2000 to $67.7 million in 2007. Netflix’s spending for technology and development equaled 46.8% of revenues in 2000 (understandably large during the company’s start-up period) but has remained a strong 4.5% in 2005, 4.5% in 2006, and 5.6% in 2006.
- For the most part, Netflix’s profit margins and expense ratios have been improving.
- Marketing costs as a % of revenues dropped significantly in 2007.
- The company has zero long-term debt. The jump in funds used for investing activities in 2007 accounted for the company’s lower year-end cash balance. But, significantly, Netflix was able to finance all of the big increase in its 2007 capital requirements with internal funds.
- Netflix has decent working capital ($203.9 million at year-end 2007) and its lack of long-term debt gives it borrowing power if internal funds for investing activities prove inadequate.
- On the whole, investors have reason to pleased with Netflix’s financial performance so far—performance would have been better had the price war over monthly subscription plans starting in late 2004 not weakened profitability.

Negatives (or weaknesses) in Netflix’s operating and financial performance based on the data in case Exhibits 2, 3, and 4:

- The number of net subscriber additions in 2007 dropped alarmingly from 2006 levels.
- Subscriber acquisition costs have risen from $32.80 per new subscriber in 2003 to $42.96 per new subscriber in 2006 to $40.88 per new subscriber in 2007. The decline in costs in 2007 is welcome but still is well above the levels of 2003-2004.
Subscriber cancellations have increased by about 1,000,000 in each of the past two years, jumping from 2,160,000 in 2005 to 3,113,000 in 2006 to 4,177,000 in 2007. These increases are somewhat disconcerting because they keep pressure on boosting the numbers of new subscribers (unless the number of new subscribers is greater than the number of subscriber cancellations each year, the size of the company’s subscriber base drops).

8. What does a SWOT analysis of Blockbuster reveal about the overall attractiveness of its situation?

Blockbuster’s Resource Strengths and Competitive Assets

- A large network of Blockbuster store locations—the biggest of any movie rental competitor in the world. Blockbuster’s store network, along with its online subscription business, combine to give Blockbuster somewhat stronger access to the renters of movies than Netflix (which access customers via online means only). But Blockbuster’s store network is also a weakness, because of eroding store traffic and store sales.
- A growing presence in the online subscription segment called Total Access which has some appealing features (but Blockbuster’s customer base in this segment is smaller than Netflix’s)
- Is beginning to expand its capabilities to deliver content digitally (but behind Netflix in this high-growth potential arena?)
- A new CEO and a series of new strategic initiatives to revitalize store traffic and store sales (but will CEO Jim Keyes’ new strategy work?—initial signs are promising since store sales have risen slightly for the past 4 quarters)
- Very strong brand name recognition—most all movie rental customers in the U.S. and those foreign countries where Blockbuster has a sizable presence know about Blockbuster.

Blockbuster’s Resource Weaknesses and Competitive Liabilities

- Monstrous losses in 2003-2005 (chiefly, but not wholly, due to goodwill write-offs) and struggling to return to profitability due to declining rental revenues and merchandise sales at its stores, an eroding gross profit margin on rentals, high interest expenses (caused by burdensome amounts of long-term debt), and a number of unprofitable stores (many of which have been or are being closed). As a consequence, Blockbuster is now in a greatly weakened and precarious financial condition.
- Blockbuster is strongly positioned in the brick-and-mortar segment of the movie rental industry—which as discussed above—is the very segment where movie rental revenues seem destined to continue to erode. Hence, Blockbuster’s store network is something of a competitive weakness. Industry driving forces are working against Blockbuster being successful in revitalizing store traffic and store sales. Online subscriptions and digital delivery of content appear to be where the movie rental industry’s future lies and Blockbuster trails Netflix in these two important industry arenas.
- It is unclear whether Blockbuster has a strategy to revitalize store sales and grow movie rental revenues that will prove successful.

Blockbuster’s External Market Opportunities

- Growing its online subscription/Total Access business
- Capitalizing on the growth potential associated with digital delivery of media content
Revitalizing customer traffic in its stores and growing store revenues, perhaps by expanding the range of products carried in its stores but perhaps not (the aborted acquisition of Circuit City was probably a blessing in disguise—Circuit City went bankrupt in late 2008 and Circuit City’s entire business was being liquidated as of early 2009)

**External Threats to Blockbuster’s Future Prospects**

- Netflix’s continued growth and success—Netflix is the biggest challenger to Blockbuster’s marketing leading position and is clearly gaining ground on Blockbuster
- Consumers, for any of several reasons, become less interested in watching movies at home
- Growing use of file-sharing to pirate movies
- Movie studios and DVD retailers lower the prices of movie DVDs, thus making it somewhat more attractive for some consumers to buy movie DVDs rather than rent them

9. **What is your appraisal of Blockbuster’s performance as shown in case Exhibit 5? What pluses and minuses do you see? Use the financial ratios in Table 4.1 of Chapter 4 as a guide in doing the calculations needed to arrive at an analysis-based answer to your assessment of Blockbuster’s recent performance.**

Class members should have little trouble discerning from the data in that Blockbuster’s performance has been generally dismal. The past 5 years have, in virtually every respect, been very tough ones for Blockbuster, although the company’s performance in 2006-2007 was far better than in the three prior years. The important things that students should glean from Exhibit 5 include the following:

- Blockbuster revenues are eroding—total revenues in 2007 were about $500 million below total revenues in 2004.
- The gross profit margin on rentals is eroding; the gross margin on merchandise sales has increased substantially since 2003 (rising from 19.8% in 2003 to 24.9% in 2006 and 23.3% in 2007).
- The company has made some progress in trimming operating costs. General and administrative expenses dropped from $2.835 billion in 2004 to $2.525 billion in 2007. Advertising costs have dropped from $257.4 million in 2004 to $194 million in 2007—but this was more a financial necessity than a positive since Netlix is now outspending Blockbuster on marketing and advertising (Netlix had marketing and advertising expenses of $214 million in 2007).
- Depreciation and amortization expenses have declined in recent years (principally because of goodwill write-downs of almost $3.2 billion in 2003-2005).
- Blockbuster has made good progress in paying down its long-term debt (from over $1 billion 2005 to just $665.6 million at the end of 2007). Nonetheless Blockbuster’s long-term debt is still too high and considerable of its future cash flows will have to be allocated to debt payback in upcoming years rather than being re-invested in the business.
- Net cash flow from operations was a negative $56.2 million in 2007, and has been negative in 2 of the past three years. Moreover, net cash flows from operations have been far smaller in the past three years that was the case in 2002-2004.
- Same store sales have been negative in 4 of the past six years.
- Blockbuster had 1,264 fewer company-owned and franchised store locations in 2007 than it had in 2004; most of the reductions (1,192 stores) were company-owned stores. **Does this signal that franchised stores were better located and/or better managed than company-owned stores?**
**Conclusions:** Clearly, Blockbuster is a troubled company and is struggling to get its performance turned around. The fact that store revenues are eroding confirms that Blockbuster is positioned most strongly in the declining part of the movie rental industry—while Netflix is strongly positioned in the industry segments with the greatest growth and profit potential. *It is hard to get excited about Blockbuster’s future prospects, although it may well survive; but it is definitely a weak and wounded industry leader at this point.*

10. **How does Netflix’s competitive strength compare against that of Blockbuster?**

Do a weighted competitive strength assessment using the methodology presented in Table 4.4 of Chapter 4 to support your answer. Does Netflix have a sustainable competitive advantage over Blockbuster in the movie rental business? Why or why not?

There is ample information in the Netflix case for students to do a competitive strength assessment and practice using the methodology presented in Table 4.4 in Chapter 4. We urge spending about 10-15 minutes of class time drilling students on proper use of this tool.

A representative competitive strength analysis is presented in Table 1.

We think the two most important competitive strength measures are breadth/variety of movie offerings and the ease/convenience of choosing and returning rented DVDs. Lesser strength measures include (1) competitive pricing and subscription plan variety, (2) image/reputation, (3) order-filling capabilities (as measured by inventory size and distribution centers in the case of online operators like Netflix and GreenCine and by whether stores have copies of the DVD in stock that customers want to rent in the case of Movie Gallery and Blockbuster), (4) geographic coverage, and (5) financial strength and capabilities.

We rated Netflix quite high (a 10) on number and variety of titles offered for rental (it has 55,000) and on ease and convenience of choosing and returning rented DVDs (because of its CineMatch technology, which seems clearly superior to the capabilities of rivals).

**Table 1 Competitive Strength Assessments of Netflix and Blockbuster**

(Rating scale: 1 = very weak; 5 = average; 10 = very strong)

<table>
<thead>
<tr>
<th>Competitive Strength Measures</th>
<th>Importance</th>
<th>Netflix</th>
<th>Blockbuster</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Weight</td>
<td>Rating</td>
<td>Score</td>
</tr>
<tr>
<td>Number/variety of titles in library of content offerings</td>
<td>0.20</td>
<td>10</td>
<td>2.00</td>
</tr>
<tr>
<td></td>
<td></td>
<td>9</td>
<td>1.80</td>
</tr>
<tr>
<td>Ease and convenience of choosing movies to rent</td>
<td>0.15</td>
<td>10</td>
<td>1.50</td>
</tr>
<tr>
<td></td>
<td></td>
<td>9</td>
<td>1.35</td>
</tr>
<tr>
<td>Ease and convenience of returning rented DVDs</td>
<td>0.15</td>
<td>10</td>
<td>1.50</td>
</tr>
<tr>
<td></td>
<td></td>
<td>9</td>
<td>1.35</td>
</tr>
<tr>
<td>Competitive pricing/variety of subscription plans</td>
<td>0.05</td>
<td>8</td>
<td>0.40</td>
</tr>
<tr>
<td></td>
<td></td>
<td>9</td>
<td>0.45</td>
</tr>
<tr>
<td>Brand image/ability to attract customers</td>
<td>0.10</td>
<td>8</td>
<td>0.80</td>
</tr>
<tr>
<td></td>
<td></td>
<td>10</td>
<td>1.00</td>
</tr>
<tr>
<td>Order-filling capabilities</td>
<td>0.10</td>
<td>9</td>
<td>0.90</td>
</tr>
<tr>
<td></td>
<td></td>
<td>7</td>
<td>0.70</td>
</tr>
<tr>
<td>Geographic market coverage</td>
<td>0.10</td>
<td>8</td>
<td>0.80</td>
</tr>
<tr>
<td></td>
<td></td>
<td>10</td>
<td>1.00</td>
</tr>
<tr>
<td>Ability to access movie rental customers</td>
<td>0.05</td>
<td>8</td>
<td>0.40</td>
</tr>
<tr>
<td></td>
<td></td>
<td>10</td>
<td>0.50</td>
</tr>
<tr>
<td>Financial strength</td>
<td>0.10</td>
<td>5</td>
<td>0.50</td>
</tr>
<tr>
<td></td>
<td></td>
<td>3</td>
<td>0.30</td>
</tr>
<tr>
<td>Sum of weights</td>
<td>1.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Rating/Score</td>
<td></td>
<td>76</td>
<td>8.80</td>
</tr>
<tr>
<td></td>
<td></td>
<td>76</td>
<td>8.45</td>
</tr>
</tbody>
</table>
The competitive strength ratings in Table 1 indicate that Blockbuster and Netflix are very evenly matched, but with a slight overall edge to Netflix, chiefly because its business model and strategy seem better matched to future industry conditions, driving forces, and the industry’s growth opportunities than are Blockbusters’. Netflix has an edge over Blockbuster in (1) product line breadth and (2) the ease and convenience of choosing movies to rent (because of its CineMatch software). We also think Netflix’s competitiveness is significantly enhanced by its somewhat stronger capabilities—at least currently—to offer VOD as movie rental demand shifts to digital delivery. But Blockbuster has stronger capability to reach and satisfy both casual/occasional renters of DVDs via its many retail locations while at the same time using its Total Access program to attract avid/regular movie watchers who like the convenience of online ordering and mail delivery/return.

A good case can be made that Netflix has a potent strategy and has a slight, but likely to grow, competitive advantage over Blockbuster. Blockbuster is trapped somewhat in aggressively pursuing online subscribers and digital delivery of media content because such actions will likely erode traffic and sales at its network of 7,800 stores. Netflix has no such constraints and thus, in time, may overtake Blockbuster.

**11. What 2-3 top priority issues does Netflix management need to address? What 2-3 top priority issues does Blockbuster management need to address?**

We think it is always a good idea to push the class for their assessment of what issues management needs to address before proceeding to ask for action recommendations. Issue identification (or compilation of a “worry list”) is a way for students to draw conclusions from all the preceding analysis, plus it sets the stage for what actions need to be taken.

In Netflix’s case, we see several issues that should concern management:

- Is Netflix doing all it should to attract new subscribers? (Continued subscriber growth is the key to the company’s long-term success.)
- What, if anything, can Netflix do to curtail the growing number of subscriber cancellations?
- What should Netflix do to prepare for the coming marketing campaigns by the cable companies and the telephone companies to offer VOD to their broadband customers and thereby compete head-on with Netflix? How can Netflix deal with this new competitive threat on the horizon?
- What can Netflix do to improve profitability?
- Should Netflix expand internationally?

There are several top priority issues that Blockbuster management needs to address:

- Is there more that Blockbuster can do to revitalize store traffic and store sales? Is broadening Blockbuster’s product offering to, say, more electronic products the answer?
- Should Blockbuster begin a long-term effort to migrate its business to online subscriptions and digital delivery and accept the need to gradually close its Blockbuster stores as store traffic and store sales “inevitably” erode?
- Should Blockbuster accelerate its efforts to build its digital delivery capabilities (and close the gap with Netflix, which seems to be ahead of Blockbuster at this point—Netflix is already offering subscribers unlimited free video streaming, probably to begin “training” its customers to utilize digital delivery technology and hasten their migration to digital delivery of rented movies instead of the more expensive mail delivery)
12. What recommendations would you make to Netflix CEO Reed Hastings? At a minimum, your recommendations should cover what to do about each of the top priority issues identified in question 11.

Coming up with good action recommendations for Netflix beyond what it is already doing is likely to prove challenging. The company seems to be on the right track. The present strategy is working well. A major strategy overhaul does not seem needed at this juncture. But neither can management afford to just coast along doing what it is already doing.

A reasonable set of action recommendations might include the following:

- Continue to add more titles to Netflix’s library. Maintain efforts to have a bigger library than Blockbuster.

- Continue to refine and invest in new CineMatch features—this is one of the keys to sustainable competitive advantage over Blockbuster and other movie rental competitors. CineMatch would seem to be an enormous timesaver for Netflix subscribers when it comes to screening all the titles for movies of particular interest and placing the next round of orders.

- Continue and, when opportunities appear, expand efforts to lead the transition to digital delivery of rented movies (which over time will allow Netflix to cut back on its distribution centers and on expenditures for mail delivery of DVDs to and from subscribers). In particular, build the library of movies that can be delivered digitally.

- Continue to build the Netflix brand and to make households more aware of Netflix—this will be very important in trying to contend with the VOD services of broadband providers, as well as in maintaining rapid growth of the business. Most households know there is a Blockbuster alternative, but many more need to know there is a Netflix alternative and they need to know why using Netflix is easy and very convenient. The more subscribers that Netflix can add now, the better able it will be to retain these customers later.

- Explore what can be done to increase subscriber retentions and minimize subscriber cancellations. If Netflix can learn what the mains reasons are for the cancellations, it may be able to come up with a subscription offering that addresses the reasons for cancellations.

- Make no moves that will provoke further subscription plan price-cutting from Blockbuster.

- Keep a tight rein on expenses. This will help improve profitability, as well as enhancing Netflix’s cost competitiveness. What Netflix needs is profitable growth, not growth at any cost just to hit subscriber growth targets.

- Avoid international expansion at this time due to the costs of establishing quick delivery capabilities in foreign markets, the added investment in DVDs for inventories in foreign distribution centers, and the added marketing costs to establish a brand name and attract customers. We believe Netflix needs to concentrate all of its resources on growing its base of U.S customers before getting into the international arena. Any initial foreign expansion might be into Canada, where some of the delivery of DVDs could possibly be handled by some of Netflix’s northernmost distribution centers. Furthermore, international expansion will be less costly if and when movie renters become accustomed to digital delivery of the movies they rent.
13. What recommendations would you make to Blockbuster CEO James Keyes? At a minimum, your recommendations should cover what to do about each of the top priority issues identified in question 11.

- For the time being, continue efforts to rejuvenate traffic and sales at Blockbuster stores, including adding products and services to induce customers to visit and shop Blockbuster stores more frequently. But if these efforts do not pan out in 2008-2009, then begin a long-term program to close company-owned Blockbuster stores that are no longer generating enough sales to be unprofitable.

- Consider offering online subscribers unlimited streaming of movies (like Netflix, for the same reasons that Netflix is offering unlimited streaming).

- As quickly as possible, begin to offer online subscribers a set-top box that enables them to watch digitally delivered movies on their TVs. Such boxes might well be sold/rented in Blockbuster stores and picked up there by online subscribers.

- Develop and implement movie selection software that is comparable to Netflix’s CineMatch software. Such software will be essential in a digital delivery world.

- Aggressively pursue efforts to build Blockbuster’s online subscriber base; it is essential to Blockbuster’s future competitiveness that Blockbuster have a base of online subscribers that is as big or bigger than Netflix’s.

EPILOGUE

Netflix reported revenues of $1.36 billion for 2008 (versus $1.2 billion in 2007) and net income of $83 million (equal to $1.32 per diluted share) versus net income of $66.6 million in 2007 and diluted EPS of $0.97. Net cash flows from operating activities were $284.0 million versus $277.4 million in 2007. At year-end 2008, Netflix had cash and cash equivalents of $139.9 million (versus $177.4 million at the end of 2007) and short-term investments of $157.4 million (versus $207.7 million at the end of 2007).

Netflix ended 2008 with approximately 9,390,000 total subscribers, representing 26% year-over-year growth from 7,479,000 total subscribers at the end of 2007 and 8% sequential growth from 8,672,000 subscribers at the end of the third quarter of 2008. Subscriber acquisition cost for 2008 was $29.12 per gross subscriber addition compared to $40.86 for 2007.

In January 2009, Netflix announced partnerships with LG Electronics and Vizio, both makers of big-screen high-definition TVs, that would enable Netflix subscribers to watch movies streamed from Netflix directly to new Internet-connected LG and Vizio TV models that would be equipped with manufacturer-installed devices enabling such streaming. Netflix subscribers with such TVs would no longer need an external device to enable Netflix to stream movies directly to their TVs. Earlier, in November 2008, Netflix announced that its subscribers could have movies and TV episodes instantly streamed to their TVs via the Xbox 360 video game and entertainment system utilizing the New Xbox Experience that premiered nationwide on November 19. The Xbox 360 was the only game and entertainment console that let users instantly watch movies and TV episodes streamed from Netflix to the TV. There was no additional monthly fee for Netflix members who were also Xbox LIVE Gold members.

Netflix management projected that full-year 2009 results would be as follows:

- Ending subscribers of 10.6 million to 11.3 million
- Revenue of $1.58 billion to $1.635 billion
- Net income of $88 million to $98 million
- EPS of $1.43 to $1.59 per diluted share
For the first three quarters of 2008, Blockbuster reported total revenues of $3.90 billion versus total revenues of $3.975 billion for the first nine months of 2007. Both rental revenues and merchandise sales were down slightly from 2007 levels. The company reported a net loss of $22.7 million for the first nine months of 2008, significantly better than the loss of $123.2 million for the first nine months of 2007. Net cash flows from operations for the first nine months of 2008 were a negative $101.1 million. To contain its operating losses, Blockbuster management cut advertising expenditures to $94.8 million during the first nine months of 2008 (versus $158.9 million for the first three quarters of 2007). Long-term debt was $614.8 million, down from $665.6 million at the end of 2007.

At the end of the third quarter of 2008, Blockbuster had 5,843 company-owned stores, of which 3,909 were domestic and 1,934 were foreign. Counting franchised stores, Blockbuster had 7,525 stores as of October 5, 2008, down 305 stores since January 1, 2008. Domestic same-store revenues increased 5.1% in the third quarter of 2008 as compared to the third quarter of 2007, due to a 0.8% growth in same-store rental revenues and a 30.7% increase in same-store merchandise sales, largely driven by a significant increase in sales of games software and hardware. International same-store revenues decreased 3.4% as compared to the same period last year, reflecting a 2.2% decline in same-store rental revenues and a 5.0% decline in same-store merchandise sales. Worldwide same-store revenues grew 1.9% from the same period last year.

On March 3, 2009, Blockbuster announced that it had hired a prominent law firm that specialized in financially-troubled enterprises to advise the company on financing and capital-raising efforts; the company’s stock price plunged from about $1 per share to $0.22 on the announcement. On March 4, Standard & Poors placed Blockbuster on its credit watch list, including its speculative ‘B-’ corporate credit rating, in light of pending maturities of a revolving credit line and term loan A debt in August 2009. There were doubts that Blockbuster would be able to refinance the debt that was maturing in August. On March 5, Blockbuster announced that same-store sales rose 4.4% in the fourth quarter of 2008 and that domestic same-store sales were up 6.4% for full-year 2008. The increase in 4th quarter 2008 same-store sales was comprised of a 2.6% decrease in domestic same-store rental comparables and a 36.5% increase in domestic same-store retail comparables, which was largely driven by increased sales of games, game merchandise and consumer electronics. These sales increases prompted Blockbuster’s stock price to rise to the $0.50-$0.65 range as of March 6, 2009.

Please check the investor relations sections and the press releases at www.netflix.com and www.blockbuster.com for the latest developments on how these two movie rental competitors are faring.
OVERVIEW

In 1984, at the age of 19, Michael Dell invested $1,000 of his own money and founded Dell Computer with a simple vision and business concept—that personal computers (PCs) could be built to order and sold directly to customers. Michael Dell believed his approach to the PC business had two advantages: (1) bypassing distributors and retail dealers eliminated the markups of resellers, and (2) building to order greatly reduced the costs and risks associated with carrying large stocks of parts, components, and finished goods. Between 1986 and 1993 the company worked to refine its strategy, build an adequate infrastructure, and establish market credibility against better-known rivals. In the mid- and late 1990s, Dell’s strategy started to click into full gear. By 2003, Dell’s sell-direct and build-to-order business model and strategy had provided the company with the most efficient procurement, manufacturing, and distribution capabilities in the global PC industry and given Dell a substantial cost and profit margin advantage over rival PC vendors.

During 2004-2005, Dell overtook Hewlett-Packard (HP) to become the global market leader in PCs. But Dell’s global leadership proved short-lived; Hewlett-Packard, energized by a new CEO who engineered a revitalized strategy, dramatically closed the gap on Dell in 2006 and regained the global market share lead by a fairly wide margin in 2007—winning an 18.8 percent global share versus Dell’s 14.9 percent. In the U.S., Dell also struggled to fend off a resurgent Hewlett-Packard during 2006-2007. Whereas Dell had a commanding 33.6 percent share of PC sales in the United States in 2005, comfortably ahead of Hewlett-Packard (19.5 percent) and far outdistancing Apple, Acer, Toshiba, Gateway, and Lenovo/IBM, by the end of 2007, Dell’s U.S. share had slipped to 28.0 percent while HP’s share was up to 23.9 percent.

Since the late 1990s, Dell had also been driving for industry leadership in servers. In the mid-to-late 1990s, a big fraction of the servers sold were proprietary machines running on customized Unix operating systems and carrying price tags ranging from $30,000 to $1 million or more. But a seismic shift in server technology, coupled with growing cost-consciousness on the part of server users, produced a radical shift away from more costly, proprietary, Unix-based servers during 1999–2004 to low-cost x86 machines that were based on standardized components and technology, ran on either Windows or Linux operating systems, and carried price tags below $10,000. Servers with these characteristics fit Dell’s strategy and capabilities perfectly and the company seized on the opportunity to utilize its considerable resources and capabilities in making low-cost, standard-technology PCs to go after the market for low- and mid-range x86 servers in a big way. During 2004-2007, Dell reigned as the number one domestic seller of x86 servers for Windows and Linux (based on unit volume), with just over a 30 percent market share (up from about 3-4 percent in the mid-1990s). Dell ranked number two in the world in x86 server shipments during this same period, with market shares in the 24-26 percent range that put it in position to contend with HP for global market leadership.

In addition, Dell was making market inroads in other product categories. Its sales of data storage devices had grown to nearly $2.5 billion annually, aided by a strategic alliance with EMC, a leader in the data storage. In 2001–2002, Dell began selling low-cost, data-routing switches—a product category where Cisco Systems was the dominant global leader. Starting in 2003, Dell began marketing Dell-branded printers and printer cartridges, product categories that provided global leader HP with the lion’s share of its profits; as of 2008, Dell’s sales of printers and printer supplies was believed to exceed $3 billion. Also in 2003, Dell began selling flat-screen LCD
TVs and retail-store systems, including electronic cash registers, specialized software, services, and peripherals required to link retail-store checkout lanes to corporate information systems. Dell’s MP3 player, the Dell DJ, was number 2 behind the Apple iPod. Dell added plasma screen TVs to its TV product line in 2004. Since the late 1990s, Dell had been marketing CD and DVD drives, printers, scanners, modems, monitors, digital cameras, memory cards, data storage devices, and speakers made by a variety of manufacturers. Dell products were sold in more than 170 countries, but sales in 60 countries accounted for about 95 percent of total revenues.

With recently-appointed CEO Mark Hurd at the helm, Hewlett Packard gained considerable traction in the marketplace in 2006-2007. HP’s sales of laptop computers increased 47 percent in fiscal 2007 and its PC business in China nearly doubled, making China HP’s third biggest market for PCs. The company posted revenues of $91.7 billion in fiscal 2006 and $104.3 billion in fiscal 2007. Earnings climbed from $2.4 billion in 2005 to $6.2 billion in 2006 and to $7.3 billion in 2007. By late fall 2007, HP’s stock price was more than double what it had been when Hurd was appointed CEO. HP’s 2007 share of the estimated $1.2 trillion global IT market was almost 9 percent. It was the global leader in both PCs and x86 servers running on Windows and Linux operating systems. About 67 percent of HP’s sales were outside the U.S. In May 2008, HP announced that it was expecting fiscal 2008 revenues of about $114 billion.

HP’s strategy in PCs and servers differed from Dell’s in two important respects:

1. Although HP had a direct sales force that sold direct to large enterprises and select other customers, a very sizable share of HP’s sales of PCs were made through distributors, retailers, and other channels.

2. While in-house personnel designed the company’s PCs and x86 servers, the vast majority were assembled by contract manufacturers located in various parts of the world. Big-volume orders from large enterprise customers were assembled to each customer’s particular specifications. The remaining units were assembled and shipped to HP’s retail and distribution partners; these were configured in a variety of ways (different microprocessor speeds, hard drive sizes, display sizes, memory size, and so on) that HP and its resellers thought would be attractive to customers and then assembled in large productions runs to maximize manufacturing efficiencies.

In 2008, it was unclear whether Dell’s strategy, while powerful enough to make Dell a major player in the global IT market, would be up to the task of overtaking Hewlett-Packard.

**SUGGESTIONS FOR USING THE CASE**

This freshly updated and timely case details Dell’s climb to become a global low-cost provider of PCs and servers, to expand its reach into new geographic and product arenas, and to contend against Hewlett-Packard for global leadership in PCs. Our experience in teaching earlier versions of this case is that it has a particularly powerful impact on students and opens their eyes about how to manage the value chain, build competencies and competitive capabilities, and build sustainable competitive advantage. Dell is a fascinating company with a potent competitive strategy and strong resource capabilities, but the company has hit some bumps in the road and now must contend with a far more formidable Hewlett-Packard.

This latest version of the Dell case describes Michael Dell’s background and management style, explores Dell’s strategy in some detail, has detailed information on how Dell manages its value chain, introduces the struggles and setbacks that Dell has recently encountered, presents some data on the global IT industry, and provides a fairly lengthy profile of Hewlett-Packard so that class members can draw conclusions about Dell’s chances of overtaking HP in the global PC market. You’ll find that the Dell case is a study in value-chain restructuring, crafting a low-cost leadership strategy in the high-velocity/hyper-competitive IT marketplace, building core competencies and competitive capabilities, leveraging its resource strengths to grow the product line, and then perfecting the process of strategy execution.
The case contains two big lessons for students. One is “how to do it right”, how to build competencies and capabilities that translate into sustainable competitive advantage, and how to conduct a battle for global market leadership. The second is that even a very successful company with a very successful strategy doesn’t always have smooth sailing—Dell has suffered some setbacks, has lost its cost advantage in laptop PCs (now the most popular type of PC), and is all of a sudden facing an energized and well-known competitor which has gotten its act together under a new CEO. Dell now has some strategy issues and some performance issues, and students will be challenged to come up with action recommendations that will not only get Dell back on track but give it the ability to overtake Hewlett-Packard.

Accompanying this case is a 5:38-minute video that consists of an interview with Michael Dell on “How Strategy Evolves in a Large Organization.” We recommend showing the video at the opening of the class discussion; this will give students immediate opportunity to size up Michael Dell and make use of what he says in the course of the class discussion. Another option is to show the video immediately before or after having the class identify/critique Dell’s strategy.

Because the Dell case tends to be a huge eye-opener for students, exposing them to some pretty powerful strategizing on Dell’s part and how Dell has maneuvered itself into a very enviable market position, we strongly suggest including the Dell case somewhere in your list of assigned cases, ideally in the first third or first half of your module on business strategy. It contains an exceptionally rich set of teaching points and will help students to connect the material in the text chapters to actual management practice.

Also in this 17th edition is a freshly researched case on Apple Computer (Case 7). We suggest giving consideration to assigning both cases, starting first with the Dell case and then proceeding to the Apple Computer case. However, you can certainly assign the Apple case without first assigning the Dell case, but the Dell/Apple cases will make an attractive case series when taught back-to-back.

Since Dell’s strategy in PCs and other IT products is embedded in restructuring the industry value chain to drive costs out of the business and provide customers globally with more value-added for their IT dollars as compared to rivals, we urge that you defer assigning the case until you have covered Chapters 3, 4, and 5 and maybe even Chapter 7 (because there are modest global aspects to the case). We like to use the Dell case immediately after covering Chapters 4 and 5 (or sometimes Chapter 7), because the case is a beautiful illustration of astute value chain management and the use of a low-cost provider strategy (topics much discussed in Chapters 4 and 5—the global aspects of a low-cost strategy are covered in Chapter 7). There is ample information in the case for students to do a SWOT analysis and to use the methodology discussed in Table 4.4 of Chapter 4 to do a competitive strength assessment of Dell versus Hewlett-Packard. We recommend concluding the Dell case by asking class members to identify the issues that Dell management needs to address and then call upon them to propose action recommendations to resolve these issues.

To give students guidance in what to do and think about in preparing the Dell case for class discussion, we strongly recommend providing class members with a set of study questions and insisting that they prepare good notes/answers to these questions in preparing for class discussion of the case.

To facilitate your use of study questions and making them available to students, we have posted a file of the Assignment Questions contained in this teaching note for Dell on the student section of the publisher’s Online Learning Center for the 17th edition (www.mhhe.com/thompson). (You should be aware that there is a set of study questions posted in the student OLC for each of the 26 cases included in the 17th edition.)

In our experience, it is quite difficult to have an insightful and constructive class discussion of an assigned case unless students have conscientiously have made use of pertinent core concepts and analytical tools in preparing substantive answers to a set of well-conceived study questions before they come to class. In our classes, we expect students to bring their notes to the study questions to use/refer to in responding to the questions that we pose. Moreover, students often find having a set of study questions is useful in helping them prepare oral team
presentations and written case assignments—in addition to whatever directive questions you supply for these assignments. Hence, we urge that you insist students spend quality time preparing answers to study questions—either those we have provided or a set of your own questions.

The Dell case works very nicely for a written case assignment or oral team presentation. Our suggested assignment questions are as follows:

1. Prepare a report to your instructor presenting a full-blown SWOT analysis of Dell, a competitive strength assessment of Dell versus HP, an identification of the issues and problems that Dell management needs to address, and a set of action recommendations to resolve these issues/problems. End your report with an assessment of Dell’s prospects for outcompeting Hewlett-Packard and becoming the recognized world leader in PCs.

2. Who has the best strategy in PCs—Dell or Hewlett-Packard? In what specific respects is Dell’s strategy vis-à-vis HP particularly strong; in what respects is Dell’s strategy weak in compared to HP’s strategy? What specific actions and strategy changes should Dell undertake to become the global leader in PCs and boost its long-term financial performance?

3. Michael Dell has asked you to present him with a 2-4 page report outlining and supporting the strategic changes which he should institute at Dell in the upcoming months. The persuasive arguments and support offered for your recommendations are as important as the recommendations themselves. Moreover, it is imperative that the support for your recommendations be analysis-based and reflect command of the materials discussed in Chapters 3-5.

ASSIGNMENT QUESTIONS

1. What is your evaluation of Michael Dell’s performance in his roles as Dell’s CEO and Chairman? How well has he performed the five tasks of crafting and executing strategy that were discussed in Chapter 2?

2. What are the elements of Dell’s strategy? Which one of the five generic competitive strategies is Dell employing? How well do the different pieces of Dell’s strategy fit together? In what ways is Dell’s strategy evolving?

3. Does Dell’s expansion into other IT products and services make good strategic sense? Why or why not?

4. Is Dell’s strategy working? What is your assessment of the financial performance that Dell’s strategy has delivered during fiscal years 2000-2008? Use the financial ratios presented in Table 4.1 of Chapter 4 (pages 104-105) as a basis for doing your calculations and drawing conclusions about Dell’s performance.

5. What does a SWOT analysis reveal about the attractiveness of Dell’s situation in 2008?

6. Which company is competitively stronger—Dell or Hewlett-Packard? Use the weighted competitive strength assessment methodology shown in Table 4.4 of Chapter 4 to support your answer.

7. In what respects, if any, is Hewlett-Packard’s strategy in PCs more appealing or better than Dell’s strategy?

8. What issues and problems does Michael Dell need to address?

9. What actions and strategy changes would you recommend to Michael Dell to boost the company’s performance and its prospects for overtaking HP in global sales of PCs?
1. **What, if anything, strikes you as impressive about Dell? In reading and preparing the case, was there anything that you thought was particularly outstanding about this company?**

This is a fun question to trigger the discussion of Dell and gives you a chance to gauge the mood and preparation of the class. Students are prone to come up with a fairly lengthy list, but the list certainly ought to include the following:

- Michael Dell—he has, at a very early age, emerged as one of the world’s most respected and influential business leaders. Plus, of course, he has been instrumental in creating from scratch what has turned out to be a very impressive and competitively potent company.

- The company’s meteoric rise from irrelevant also-ran to a global market leader

- The strategy that Dell had crafted and executed to make it a strong contender in the global IT marketplace

2. **What is your assessment of the job Michael Dell has done in his roles as the company’s CEO and Chairman? What grade would you give him for his leadership of the company over the past 20+ years? Has he done a good job performing the five strategy-making/strategy-executing tasks described in Chapter 2?**

We think Michael Dell deserves a solid A (maybe even an A+). It is hard to see how he could have done a much better job, given his age and lack of experience in the company’s early years. In 2008, at age 43, he is a multi-billionaire and one of the most respected and influential top executives in the world—not bad for a college dropout!!!!

To structure this facet of the discussion, you can go to the board and create five headings: (1) Vision, (2) Objective-Setting, (3) Crafting Strategy, (4) Implementing/Executing Strategy, and (5) Making Corrective Adjustments. As students offer their evaluations, you can have them suggest the proper category for their assessment. Most of the following points ought to be identified by class members.

**Forming a Strategic Vision**

- Michael Dell is definitely the company’s chief strategic visionary and chief strategist (although he was assisted for a few years by Kevin Rollins).

- He came up with the concept for the business and has guided the evolution of Dell’s business model and strategy.

**Objective Setting**

- In 1990, Michael Dell set an objective for Dell Computer to become one of the top three PC companies.
  - It achieved this objective in 1998 and since 2003 has been battling Hewlett-Packard for first place worldwide.

- He has presided over Dell’s generally good financial performance, although the company’s profitability has not been up to par in several recent years (see case Exhibits 2 and 3).
Crafting a Strategy

- Michael Dell is the chief architect of the company’s strategy—although for a few years Dell’s strategy was a joint product of the strategic thinking of both Michael Dell and Kevin Rollins. There is plenty of evidence in the case that Michael Dell’s prints are on many key pieces of the company’s strategy.
  - The direct sales approach and the build-to-order approach are both Michael Dell contributions.
  - Since Rollins departure, Michael Dell is clearly leading the strategic efforts to get the company back on track.

- Michael Dell has been a driving force behind the company’s initiatives to revamp the traditional industry value chain, cutting out middlemen by selling direct, streaming supply chain activities, becoming a low-cost and innovative manufacturer/assembler, being a pioneer in the use of Internet technology and e-commerce, and expanding into related products (handheld PCs, printers and printer accessories, data storage, switches and routers, and IT services).

- Using alliances with suppliers, Michael Dell and Dell, Inc. have pioneered the creation of an exceptionally efficient supply chain. Supply chain management is a Dell distinctive competence.

Implementing/Executing Strategy

- Dell’s senior management appears to have been quite active in pushing for better execution of just-in-time inventory management and reduction in the number of days of parts inventories.

- Dell’s strategy requires smooth execution—from customers all the back to the operations of suppliers; top management has proven itself capable of leading the drive for good strategy execution and operating excellence.

- The company has become quite adept at driving the costs out of its manufacturing/assembly activities—until very recently there’s every indication that it has lower manufacturing/assembly costs than its leading rivals (in the last year or so, there does appear to be very significant erosion of Dell’s cost advantage in laptop PCs). Strong (and successful) efforts to squeeze out cost savings have become a standard part of Dell’s annual operating plan.

- The company’s astute application of Internet and e-commerce technology is also one of its keys to effective strategy execution.

Leading Corrective Adjustments

- Michael Dell stays in close personal touch with customers.
  - Selling direct gives Dell firsthand intelligence about customer preferences and needs, as well as immediate feedback on design problems and quality.

- Michael Dell has helped lead the evolving refinements in the company’s strategy.
  - The most recent refinement is the expansion into other IT products/services—data storage products, Internet switches, printers and cartridges, handheld PCs, and IT services.

- Since reassuming the CEO’s position, Michael Dell has plainly had a heavy hand in orchestrating the strategy changes at Dell to get the company back on track.

On the whole, it should be clear to class members that Michael Dell is an effective CEO and that the 5 components of the process of crafting and executing strategy are given very close attention by top management at Dell, Inc.
3. What are the elements of Dell’s strategy? Which one of the five generic competitive strategies is Dell employing? How well do the pieces of Dell's strategy fit together? Is the strategy evolving and, if so, in what ways?

Students should easily recognize that Dell’s competitive strategy is one of global low-cost leadership.

Dell’s strategy to be the global low-cost provider has a number of key elements:

- **Employ a cost-efficient approach to build-to-order manufacturing and mass customization**
  - Most products are assembled in-house at 8 Dell plants across the world
  - All PCs were built to customer specifications—Dell was a pioneer in cost-efficient mass production of customized products
  - Over the years, the company has built a record of being a world-class manufacturing innovator—a distinctive competence

- **Strong quality control procedures** (to enhance product reliability and give customers a good user experience)
  - Extensive testing of parts, components, and subassemblies obtained from suppliers
  - Participation in quality certification programs with suppliers
  - All plants had been certified as meeting ISO 9002 quality standards

- **Partner with suppliers to squeeze cost-savings out of the supply chain**—a key element of Dell’s strategy to be a global low-cost leader
  - Form long-term partnerships with reputable suppliers of name-brand parts and components and stick with them as long as they maintain their leadership in technology, performance, quality, and cost
  - Partner with as few vendors as possible
  - Dell commits to purchase a specific percentage of its requirements from each of its long-term suppliers—assures Dell of getting the volume of components needed on a timely basis
  - Alliances and partnerships have enabled just-in-time delivery—Dell’s long-term commitment to its suppliers has enabled many suppliers to locate plants or distribution centers within a few miles of Dell’s assembly plants
  - Suppliers help correct flaws or quality problems related to their products
  - Alliances enlist greater cooperation from suppliers in driving costs out of the supply chain

- **Strong commitment to just-in-time inventory practices**
  - Minimize the number of days of component inventories
  - Take advantage of the economies of minimal inventories

Over the years, Dell has refined and improved its inventory tracking capabilities and its procedures for operating with small inventories, driving the average number of days of parts/components inventory down from 6 days in 1999-2000 to 5 days in fiscal 2001 to 4 days in fiscal 2002, and 2.7 to 4 days in fiscal years 2003-2007.
A strong commitment to direct sales to customers

- A customer-based market focus that featured extensive market segmentation and specialized sales and marketing for each identifiable customer group (corporate, small business, government, consumers, etc.)

- Special in-house groups developed sales and service programs appropriate to the needs and expectations of customers in different market categories
  - global enterprise accounts
  - large and midsize companies (over 400 employees)
  - health care businesses (over 400 employees)
  - federal, state, and local government agencies
  - educational institutions: K-12 and higher education (including special programs for faculty, staff, and students)
  - small businesses
  - individual consumers

- Large business and institutional customers were assigned their own direct sales force

- Orders come in by phone, fax, Internet, and field sales force

- Direct sales helped the company keep its pulse on the market, be customer-driven, and respond quickly

- Special sales and marketing efforts to build Dell’s sales and market share in specific countries—i.e., Japan, China, Europe, Latin America

- Use of Dell Direct Store kiosks to access individuals and households in Japan and U.S.

Most recently, though, Dell has begun selling PCs through selected retailers in order to improve its access to individuals and households.

Providing good customer service and technical support

- Contract with local service providers to handle customer requests for repairs; on-site service was provided on a next-day basis; some on-site Dell support for large enterprise customers

- Provide customer service and technical support via toll-free number, fax, e-mail, and online chats

- Bundled service policies

- First-call resolution initiative

- Premier pages

- Value-added services and on-site services—place asset tags on PCs for corporate customers and load software, provide training, institute ways to bring down costs incurred by customer to use Dell products

- www.dell.com sales and technical support

- Provide a range of IT services (for a fee) that aim at freeing customers from overpriced proprietary products and technology marketed by rivals

- Customer forums
- **Customer-driven R&D and reliance upon standardized technology**
  - R&D focus was to track and test new developments in components and software; ascertain which ones would prove most useful and cost-effective for customers, and then design them into Dell products.
  - Management believed it was Dell’s job on behalf of its customers to sort out all the new technology coming into the marketplace and help steer customers to options and solutions most relevant to their needs.
  - Be a strong advocate of incorporating standardized components in its products so as not to tie either it or its customers to one company’s proprietary technology and components, which almost always carried a price premium and increased costs for its customers.
  - Actively promote the use of industrywide standards and press suppliers of a particular part or component to agree on common standards.
  - Dell had about 4,000 engineers working on product development and was spending $430-$500 million annually on R&D before boosting expenditures to more than $600 million in fiscal 2008.
  - Pursue patents—in 2008 Dell had 1,954 U.S. patents and another 2,196 patent applications were pending.

- **Expansion into new products**
  - Leverage the company’s strong capabilities in supply chain management, low-cost manufacturing, and direct sales to expand into product categories where it could provide added value to its customers (chiefly in the form of good products at lower prices than rivals charged).
  - The standard pattern of attack was to identify an IT product with good margins, figure out how to build it (or else have others build it) cheaply enough to be able to significantly underprice the competitive products of rivals; and then market the item to Dell’s steadily growing customer base.
  - Dell had entered several new product categories in recent years:
    - Data storage hardware (the PowerVault line)
    - Data routing switches (PowerConnect switches)—go after Cisco’s high profits
    - Handheld PCs (the Axim line)—later abandoned due to weak sales and lack of profitability
    - Printers and cartridges—an attack on Hewlett-Packard (go after HP’s biggest and profitable business at the same time it is trying to beat out HP for global market leadership in PCs)
    - Entry into white-box (unbranded) PC segment
    - Increase company efforts to market fee-based IT services that cost customers less than what they are paying rivals like IBM and Hewlett-Packard

Dell’s strategic offensives in servers, printers, and IT services put real pressure on the prices and profits of key rivals, making it harder for them to keep their PC prices low (in order to be more competitive with Dell) and then cover low profits or losses in PCs with high profits earned on other products (particularly, servers, printers, printing products and IT services) where price competition from Dell was weaker—until Dell entered these same categories with its low-cost/low-price strategy.
Other lesser elements of Dell’s strategy

- **Pioneering use of Internet and e-commerce technology**
  - Using Internet technology and sharing information with supply partners and customers to squeeze cost-savings out of supply chain
  - Streamline order-to-delivery process
  - Provide order-status information to customers
  - Use Web site as a powerful sales and technical support tool

- **Build the Dell brand via advertising**
  - Run regular, prominent ads in leading computer publications as well as in USA Today, Wall Street Journal, and other business publications.
  - Use direct mail
  - Newsletters and promotional efforts via Internet

*Yes, the pieces of Dell’s strategy fit together beautifully.* It covers all the bases. And the whole is probably greater than the sum of the parts.

*Yes, Dell’s strategy is evolving*—as evidenced by

- The series of recent product line expansions.
- The initiative to begin selling PCs at the stores of select retail partners—in order to counter the loss of market share in the home segment in 2006 and 2007 (see case Exhibit 5).
- The somewhat surprising decision to sell Dell’s plants and outsource all manufacture and assembly to contract manufacturers. In the last two years, contract manufacturers appear to have caught up to Dell (and perhaps beat Dell) in being able to assemble PCs (especially laptop or notebook PCs) at costs as low as Dell’s. Dell’s cost advantage in manufacturing/assembly has eroded—most probably because contract manufacturers have at long last found ways to drive their costs down (by imitating Dell?!!!) Dell’s eroding cost advantage may also be due to the fact that Dell has run out of manufacturing innovations to keep its assembly costs below those of contract manufacturers. In any case, Dell must now make some strategy adjustments to deal with the new-found capabilities of contract manufacturers to match Dell’s assembly costs.

At this point in the class discussion, we suggest posing the following question to the class: *What grade would you give Dell management for the job it has done in managing the company’s value chain in support of the company’s strategy?*

We think the best answer is somewhere from A- to A+. It is hard to imagine how Dell management could have done very much better.

**Key Teaching Point:** Now is a good time to drive home how astute management of a company’s value chain can make a positive contribution to achieving sustainable competitive advantage—the process of translating proficient company performance of value chain activities into competitive advantage is shown in Figure 4.5 of Chapter 4. The discussion surrounding Figure 4.5 emphasizes that the road to competitive advantage begins with management efforts to build more organizational expertise in performing certain competitively important value chain activities and deliberately striving to develop competencies and capabilities that add power to a company’s strategy and competitiveness. The following points merit emphasis:
■ Dell’s management team has consciously and deliberately made the company’s competencies and capabilities in performing critical value chain activities key cornerstones of the Dell strategy.

■ Dell continues to invest resources in (1) building greater and greater proficiency in performing the value chain activities crucial to executing its strategy successfully and (2) endeavoring to build core and distinctive competencies in performing these crucial value chain activities.

■ The astuteness with which Dell has managed all of its value chain activities had given Dell significant competitive clout in the marketplace and, at least arguably, given Dell some degree of competitive advantage.

■ Dell’s competitive advantage may prove sustainable because
  - It is very, very difficult for its rivals to match or offset Dell’s competencies and capabilities with competencies and capabilities of their own making. As a general rule, it is substantially harder for rivals to achieve “best in industry” proficiency in performing a key value chain activity (like top-notch supply chain management) than it is for them to clone the features and attributes of a hot-selling product or service. This is especially true when a company with a distinctive competence avoids becoming complacent and works diligently to maintain its industry-leading expertise and capability.
  - Dell has one of the most appealing (the best?) value chain in the PC/server industry.
  - Dell has outmanaged rivals when it comes to managing the cost drivers and driving costs out of its value chain.

4. **Does Dell’s expansion into other IT products and services make good strategic sense? Why or why not?**

Dell’s expansion into other IT products and services signals a major offensive on Dell’s part to leverage its low-cost expertise and brand name reputation and enter important product categories where the leaders are companies charging premium prices for their proprietary technology. Dell, using standardized low-cost technology, seems to be in an excellent position to takes sales and market share away from the current market leaders in high-end servers, in printers and ink cartridges, and in certain IT services—and capitalize on customers’ desire to cut their IT costs.

While Dell’s entry into handheld PCs, MP3 players, and flat-screen TVs may have also seemed well suited to its resource strengths and competitive capabilities, the company’s entry into handheld PCs and MP3 players soon proved unprofitable and were abandoned. Dell’s sales in flat screen TVs are thought to be disappointingly low so far, although it still marketed them in 2008.

On the whole though, Dell’s strategic initiatives to enter the markets for printers and printing supplies, storage products, data-routing switches, and IT services—where there apparently are very big growth opportunities for a company pursuing a low-cost leadership strategy (in competition against companies pursuing high-end differentiation strategies)—makes excellent strategic sense. And, as of 2008, Dell appears to be making headway in these markets.

Again, it is important to stress how Dell’s invasion of the server, printer, and IT services market significantly heightens the competitive pressures it puts on HP. We think it is brilliant strategizing on Dell’s part to attack its principal competitor in PCs in the very market arenas where HP enjoys big sales and profits. Such an attack is a classic example of a strategic offensive aimed at weakening a competitor by denying it sales and market share in the very product markets critical to the competitor’s success.
5. **Given that Dell is a global player, how would you characterize the company’s strategy—is Dell using a multi-country strategy or a global strategy? And if it is a global strategy, what kind of global strategy?**

This is an appropriate question if you have assigned and covered Chapter 7 prior to assigning this case. Otherwise you should skip this question.

We think students should see that Dell is employing a global low-cost leadership strategy. Some might claim that Dell is using a multi-country strategy because of its product customization approach, but we would argue that Dell customizes its products to fit the customer’s needs and wants, not those of a particular country market. So there’s little support for labeling Dell’s strategy as being multi-country. It is fair to say that Dell does tweak its global strategy somewhat to tune it to local country conditions (i.e., China and in Japan where it has used kiosks to reach individual PC buyers). In this sense, students might argue (with some justification) that Dell is employing a “think global, act local” approach to being a global low-cost leader.

6. **Is Dell’s strategy working? What is your assessment of the financial performance that Dell’s strategy has delivered during fiscal years 2000-2008? Use the financial ratios presented in Table 4.1 of Chapter 4 (pages 104-105) as a basis for doing your calculations and drawing conclusions about Dell’s performance.**

Students need to get in the habit of crunching the numbers in company financial statements and coming up with an insightful diagnosis of the company’s financial performance and financial condition. You can always signal class members that you expect them to spend time assessing the financial statements in the case by spending a few minutes questioning the class about the company’s performance and pushing them for supporting numbers rather than off-the-cuff opinions.

Students who have done a conscientious job of studying and crunching the numbers in case Exhibit 2 should come up with the following:

- Dell’s revenues grew from $25.3 billion in FY2003 to $61.1 billion in FY2008, equal to a compound annual growth rate (CAGR) of 13.4%.
- Net income rose from $1.67 billion in fiscal 2000 to $2.95 billion in fiscal 2008—a compound average growth rate (CAGR) of 8.5%. However, Dell’s 2008 earnings were down from $3.6 billion in FY 2006.
- Although Dell’s sales rose annually throughout 2000-2008, earnings performance was uneven, with both net income and EPS going up in some years and going down in other years.
- Likewise, Dell’s net profit margin (shown in Exhibit 2) has varied, hitting highs of 6.6% in 2000, 6.5% in 2006, and 6.4% in 2004 and lows of 4.0% in 2002 and 4.8% in 2008.
- Due to stock repurchases, the number of outstanding shares of common stock has been trending downward.
- Despite the earnings volatility, Dell earned a spectacular 78.7% return on total stockholders’ equity in fiscal 2008; the ROEs in earlier years were also very, very good: 59.7% in fiscal 2007, 89.0% in fiscal 2006, 46.5% in fiscal 2005, 41.8% in fiscal 2004, 26.5% in fiscal 2002, and 31.4% in 2000.
- Profit margin performance has been uneven; gross profit and operating profit margins in 2008 were better than in 2007 but the net margin was lower. The pattern of profit margin changes is shown below:

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Gross profit margin</td>
<td>19.1%</td>
<td>16.6%</td>
<td>17.7%</td>
<td>18.4%</td>
<td>18.3%</td>
<td>17.7%</td>
<td>20.7%</td>
</tr>
<tr>
<td>Operating profit margin</td>
<td>5.6</td>
<td>5.3</td>
<td>7.9</td>
<td>8.6</td>
<td>8.5</td>
<td>5.7</td>
<td>9.0</td>
</tr>
<tr>
<td>Net profit margin</td>
<td>4.8</td>
<td>5.8</td>
<td>6.5</td>
<td>6.1</td>
<td>6.4</td>
<td>4.0</td>
<td>6.6</td>
</tr>
</tbody>
</table>
As shown just below, operating expenses as a percentage of sales revenues at Dell trended downward from 11.7% in 2000 to 9.8% in 2005, but then have increased rather sharply to 13.5% in 2008—part of the rise in expenses stems from accounting requirements to show stock-based compensation as an operating expense. The rising operating expense percentages have been factors in crimping Dell’s profits.

<table>
<thead>
<tr>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>11.7%</td>
<td>11.9%</td>
<td>9.8%</td>
<td>9.8%</td>
<td>9.9%</td>
<td>11.2%</td>
<td>13.5%</td>
</tr>
</tbody>
</table>

The company’s research, development, and engineering spending jumped significantly in 2008 to $693 million versus spending of $430-$500 million in earlier years.

S,G,&A expenses as a percent of revenues have been creeping upward at Dell since FY2004; the big jumps in 2007-2008 were due in large part to the new accounting requirement to report stock-based compensation as an operating expense.

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>9.4%</td>
<td>8.9%</td>
<td>8.7%</td>
<td>8.9%</td>
<td>9.1%</td>
<td>10.4%</td>
<td>12.3%</td>
</tr>
</tbody>
</table>

From the cash flow and balance sheet data in the bottom portion of case Exhibit 2, students should see that:

- The company’s operations are generating sizable positive cash flows—$3.9 billion in both fiscal 2007 and 2008, but these were down from the amounts in 2006 ($4.75 billion) and 2005 ($5.8 billion).
- The company is in a strong cash position, with $7.97 billion in cash and marketable securities as of February 1, 2008. However, the amounts held in cash and marketable securities are down from earlier years.
- The company has very little long-term debt—$362 million in 2008 versus stockholders’ equity of $3.7 billion, a very good debt-to-equity ratio of just under 10%.
- Long-term debt has trended down the past 3 years.

Overall, it is fair to say that Dell’s financial performance has weakened in the past two years. But the company’s balance sheet is strong and it has ample financial resources to undertake whatever new strategic moves may be called for. Dell is by no means a financially troubled company.

The data in case Exhibit 3 merits some comment:

- Dell generates a big fraction of its revenues in the Business segment of North America.
- Dell’s revenues in the U.S. consumer segment have dropped for two consecutive years, after rising in all the other years shown.
- Europe is Dell’s second biggest market.
- Dell lost money in the U.S. consumer segment in FY2008—the profit erosion is this segment over the past two years is alarming!!!!
- Dell’s operating profit margins in the Americas are larger than its margins in other parts of the world. For example:

<table>
<thead>
<tr>
<th>Region</th>
<th>Operating Income as a % of Net Revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2008</td>
</tr>
<tr>
<td>Americas</td>
<td>6.7%</td>
</tr>
<tr>
<td>Europe/Middle East/Africa</td>
<td>6.6</td>
</tr>
<tr>
<td>Asia-Pacific/Japan</td>
<td>5.5</td>
</tr>
</tbody>
</table>
Dell’s operating profit margins in the Business segment of the Americas region are quite good:

<table>
<thead>
<tr>
<th>Year</th>
<th>Margin (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>8.2%</td>
</tr>
<tr>
<td>2007</td>
<td>8.1%</td>
</tr>
<tr>
<td>2006</td>
<td>10.4%</td>
</tr>
<tr>
<td>2005</td>
<td>10.0%</td>
</tr>
<tr>
<td>2004</td>
<td>10.2%</td>
</tr>
</tbody>
</table>

7. What does SWOT analysis reveal about the attractiveness of Dell’s situation in 2008?

The Dell case is an excellent vehicle for drilling the class in proper SWOT analysis. It should be apparent that much of Dell’s success stems from the core competencies and strong competitive capabilities that top management has built and conscientiously nurtured—having students do a SWOT analysis tests their ability to identify just what makes Dell such a strong competitor and why it has rapidly climbed into contention for global market leadership.

**Dell’s Resource Strengths/Capabilities/Competitive Assets**

- Build-to-order capability—capability to mass produce customized products (a Dell distinctive competence)
- Proven capabilities as a world-class manufacturing innovator and a low-cost manufacturer/assembler—a one-time Dell distinctive competence that has eroded to a core competence as contract manufacturers have found ways to match (beat?) Dell on low-cost assembly, at least in laptop PCs
- Just-in-time inventory know-how and exceptional supply chain management capabilities (a Dell distinctive competence)
- Long-term partnerships with key suppliers
- Pioneering use of Internet and e-commerce technology—information-sharing and close collaboration with both parts/component suppliers and Dell customers
- Dell appears to be the low-cost leader among the major players in the IT industry—a very powerful strength and competitive asset
- Capability to load customer software, install asset tags, create Premier Pages for corporate customers; Dell’s value-added approach to customer service lowers customer costs and gives them a cost-based reason to “buy Dell” (a likely core competence!)
- Intimate knowledge of customer requirements
- Dell’s global manufacturing and global sales capabilities
- More potent direct sales capability than any other rival
- R&D expertise in selecting the “best” technologies and parts/components, coming up with low-cost designs, improving users’ experience with Dell’s products, improving product quality, and identifying ways to streamline the assembly process
- A good reputation and brand image
- Growing breadth of product line (backed by the resources and competitive strengths/capabilities to win sales and market share in several new product categories the company has entered)
Dell's Resource Weaknesses/Deficiencies/Competitive Liabilities

- Dell has recently lost its cost advantage over contract manufacturers in assembling PCs, most especially in laptop PCs; as a consequence, Dell’s 8 assembly plants may have become a competitive liability rather than a competitive asset.

- Selling direct to end-users is probably not the best way to access first-time buyers and the home/individual segment; Dell is clearly weak in selling through retail channels.

- No in-house repair service capabilities (as some rivals have)—warranty repairs and fulfilling service contracts is outsourced to local service providers.

- Lacks the product line and IT service breadth of Hewlett-Packard.

- The direct sales approach is not the “preferred” or “normal” distribution channel in Europe, China, and in several other parts of the world; Dell’s heavy reliance on direct sales has disadvantages in Japan and China where buyers like to look and touch before buying.

- A somewhat weaker brand name image and reputation as compared to HP (at least for large enterprise customers).

Dell's Market Opportunities

- Take sales and market share away from rivals in PCs across all of the world’s major markets.

- Make further inroads in the global markets for servers, data storage products, data routing switches, printers and ink cartridges, and IT services—Dell has a tiny share of the overall global IT market and thus plenty of room to grow its sales and market shares (see case Exhibit 11).

External Threats to Dell's Future Profitability and Well-Being

- Contract manufacturers find ways to cut assembly costs of PCs even further, thus putting Dell at a cost disadvantage and allowing other brands (HP, Acer) to supplant Dell as the low-cost leader.

- A long-term slow-down in global sales of PCs, servers, and other IT products—many large enterprises are looking to cut their IT costs.

You should not miss the opportunity to take the SWOT list to a higher analytical plateau by getting the class to (1) identify which of Dell’s resource strengths qualify as core competencies and/or distinctive competencies and (2) draw conclusions about Dell’s overall situation and future prospects.

Dell’s Distinctive Competencies

- Just-in-time inventory practices and supply chain management (no one in the PC industry does it better—or even comes close to matching what Dell can do).

- Direct sales capabilities (no rival can yet match Dell)—and the capabilities are global; but strong capability to sell direct does not translate into a competitive advantage in the Home segment (where Dell has recently lost market share, as shown in case Exhibit 5).

- Leadership in use of the Internet and e-commerce technologies—but this distinctive competence probably has minimal competitive impact as of 2008 versus the late 1990s and early 2000s when Dell was a pioneer in use of the Internet—today, most large enterprises (and certainly HP) have Internet/e-commerce capabilities on a par with Dell’s. Class members could thus make a strong argument that any distinctive competence in this area Dell once enjoyed has probably evaporated entirely and that Dell’s use of the Internet and e-commerce technologies no longer qualifies as a distinctive competence and is a core competence at most.
Dell’s Core Competencies

- Low-cost build-to-order manufacturing and mass customization—a world-class manufacturing innovator (a former distinctive competence that has been reduced to a core competence by the fast-emerging capabilities of contract manufacturers to match or beat Dell’s assembly costs; furthermore, Dell’s resources in plants and assembly may be on the verge of becoming a competitive liability if contract assemblers achieve further cost reductions
- Value-added customer services and knowledge of customer needs/expectations
- Cost efficient and award-winning technical support
- Dell’s customer-focused R&D capabilities

**SWOT Analysis Conclusions:** Class members should probably draw the following conclusions about the overall attractiveness of Dell’s situation:

- Dell’s strategy, resource strengths, and capabilities make it a formidable competitor in the global IT market.
- Dell’s status as the low-cost leader in a market where IT customers are becoming increasingly interested in reducing their IT costs and where many products are incorporating standardized components and technology (as opposed to proprietary technology) puts it in position to be competitively successful.
- Two of Dell’s resource strengths and competitive capabilities seem to have recently lost their competitive power in the marketplace. Contract assemblers have caught up with Dell in assembling PCs at low costs. Since 2005, Dell’s direct sales approach has not worked to its advantage in winning sales and market share in the Home segment (in years past, Dell’s direct sale model worked much better in this segment, as can be seen from the data in case Exhibit 5).
- There’s reason to agree with Michael Dell that

  “There are enormous opportunities for us to grow across multiple dimensions in terms of products, with servers, storage, printing and services, representing a huge realm of expansion for us. There’s geographic expansion and market share expansion back in the core business. The primary focus for us is picking those opportunities, seizing on them, and making sure we have the talent and the leadership growing inside the company to support all that growth.”

Overall, Dell’s situation is very attractive, but the road just ahead will be a tough one. Outcompeting HP is going to be far harder that it was under HP’s former CEO, Carly Fiorina. HP, under its new CEO, has recently begun flexing its muscles and has considerable competitive capabilities of its own to do battle with against Dell. Moreover, the global financial crisis and global economic recession that unfolded in Fall 2008 is going to pose all kinds of challenges to grow revenues and profit—not just to Dell but to HP and other IT companies.

**8. Which company is competitively stronger—Dell or Hewlett-Packard?** Use the weighted competitive strength assessment methodology shown in Table 4.4 of Chapter 4 to support your answer.

There is ample information in the case for students to do a competitive strength assessment and practice using the methodology presented in Table 4.4 in Chapter 4. We urge spending about 10-15 minutes of class time drilling students on proper use of this tool.

A representative competitive strength analysis is presented in Table 1.
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We think the most important competitive strength measure is relative cost position. Relative cost position is becoming increasingly important because of falling prices, mounting price competition, and greater use of standardized technologies in PCs. Other factors that students could assign high importance weights to include (1) product customization capabilities, (2) customer service capabilities (since many buyers are looking for value-added services from PC suppliers who can meet their particular needs for technical support and after-the-sale service), and (3) brand image and reputation (which also reflects buyer perceptions about product quality and reliability).

### Table 1 Competitive Strength Assessment of Dell versus Hewlett-Packard

(Rating scale: 1 = very weak; 10 = very strong)

<table>
<thead>
<tr>
<th>Competitive Strength Measures</th>
<th>Importance Weight</th>
<th>Dell</th>
<th>Rating</th>
<th>Score</th>
<th>Hewlett-Packard</th>
<th>Rating</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Relative cost position</td>
<td>0.30</td>
<td>9</td>
<td>2.70</td>
<td>8</td>
<td>2.40</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Product customization capabilities</td>
<td>0.10</td>
<td>10</td>
<td>1.00</td>
<td>6</td>
<td>0.60</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Brand image/reputation</td>
<td>0.10</td>
<td>8</td>
<td>0.80</td>
<td>10</td>
<td>1.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Breadth of product line</td>
<td>0.15</td>
<td>6</td>
<td>0.90</td>
<td>10</td>
<td>1.50</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Range of IT service offerings</td>
<td>0.05</td>
<td>3</td>
<td>0.15</td>
<td></td>
<td>9</td>
<td>0.45</td>
<td></td>
</tr>
<tr>
<td>Distribution strength and access to IT customers and PC users</td>
<td>0.10</td>
<td>8</td>
<td>0.80</td>
<td>10</td>
<td>1.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Global market coverage</td>
<td>0.10</td>
<td>8</td>
<td>0.80</td>
<td>9</td>
<td>0.90</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customer service capabilities/after-sale technical support</td>
<td>0.10</td>
<td>7</td>
<td>0.70</td>
<td>8</td>
<td>0.80</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Sum of weights</strong></td>
<td>1.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Rating/Score</strong></td>
<td>59</td>
<td>7.85</td>
<td>70</td>
<td>8.65</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The competitive strength ratings in Table 1 shows HP as being the strongest overall, chiefly because of its good cost competitiveness, stronger brand image/reputation, breadth of product line (especially in diversity of IT services), and its global distribution strength.

In PCs, the two are probably very evenly matched. Dell’s competitiveness is strongest in PCs and low-cost servers. Its preference for incorporating standardized technology and avoiding proprietary technology serves it well because of the cost savings that accrue to customers. IT customers are going to be very cost-conscious in the recessionary environment that lies just ahead, so Dell’s low-cost/low price strategy should serve it well and make its products/services appealing to price-conscious customers.

### 9. In what respects, if any, is Hewlett-Packard’s strategy in PCs more appealing or better than Dell’s strategy?

We see HP’s strategy in PC as having two main strengths/appeal:

- Its strategy of outsourcing assembly to contract manufacturers in now paying off. Prior to 2007-2008, Dell’s assembly costs were typically lower than those of contract manufacturers, which weakened HP’s ability to compete with Dell on price and still earn acceptable profits. Most recently, Dell’s cost advantage has evaporated—and Dell’s strategy of operating its own assembly plants may prove to be a disadvantage instead of an advantage (why else would Dell suddenly and somewhat shockingly want to sell its entire fleet of assembly plants?)
HP’s strategy of selling primarily through resellers and retailers now seems to be paying off, particularly in the Home market segment. Such was not the case in the years prior to 2005 when Dell’s market share in the Home segment was rising. Dell has, in fact, backed off of its 100% sell-direct distribution approach (something that Michael Dell vowed not to do years earlier) and has begun complementing its direct-sales approach with sales through select retail partners. HP’s distribution strategy of utilizing resellers and retailers to reach customers looks much better than it once did—and HP has very, very strong global distribution capability using this approach.

But it is much too early to declare a strategy winner. The Dell-HP battle for market leadership is going to be a marathon not a sprint. Both companies are formidable competitors, with multiple resource strengths and capabilities. And both will employ strategies that evolve in ways yet unknown.

Hence, you should caution class members about a “rush to final judgment.” They should be led to recognize that any conclusions they draw are “temporary” and subject to change as events unfold and the market contest between Dell and HP seesaws back and forth.

10. What issues and problems does Michael Dell need to address?

We think it is always a good idea to push the class for their assessment of what issues management needs to address before proceeding to ask for action recommendations. Issue identification (or compilation of a “worry list”) is a way for students to draw conclusions from all the preceding analysis, plus it sets the stage for what actions need to be taken.

Based on the prior analysis, there are three top priority issues/problems that should concern Michael Dell and Dell management:

- What to do about the company’s eroding cost advantage in assembling PCs, especially laptops.
- What to do to turn things around in the U.S. consumer segment, which has become a disaster area in the past two years.
- Are there still further ways to drive costs out of the business and help preserve Dell’s longstanding cost advantage over rivals?

11. What actions and strategy changes would you recommend to Michael Dell to boost the company’s performance and its prospects for overtaking HP in global sales of PCs?

The action recommendations that class members propose should probably include most of the following:

- Consider carefully whether selling the company’s assembly plants and shifting to contract assembly is the best answer for Dell. It is difficult to tell from the data in the case; the competitive sensitivity of Dell’s costs at its plants versus those at contract manufacturers accounts for why such data was not available for inclusion in the case. Outsourcing assembly would be a huge strategy shift for Dell and would likely mean that it would lose a major source of low-cost advantage over rivals—historically, Dell has been a manufacturing innovator and has used its innovations to achieve what appears to have been lower assembly costs than rivals had from using contract manufacturers to assemble their PCs.

There are some things to think about here:

- Will a shift to relying on contract assemblers result in Dell losing some of its cost advantages in supply chain management and just-in-time inventory—or maybe the most capable contract manufacturers have caught up to Dell in these areas and Dell no longer has any cost advantages in these areas where it once enjoyed sizable advantages.
• What if no buyers for Dell’s plants materialize? Can Dell then once again do some innovating to achieve cost parity or cost advantage in PC assembly?

• To what extent will using contract assemblers increase the time (in days) from order to delivery of PCs customized to buyer needs and specifications?

Do some research to determine exactly what Dell’s sales in the U.S. Consumer segment have fallen off a cliff. It is unclear what the root causes were for the sales decline. What changed? Was it more snappy products from HP or Apple or others? Some options for initiating a new strategic offensive in the consumer segment:

• Introduce some snappy, “cool” PCs for the consumer segment—new models, new features, new colors, etc.

• Consider expanding the number of retail outlets where Dell computers are sold at retail. The problem here is what will selling a bigger percentage of PCs through retail partners do to Dell’s margins. Selling Dell PCs at wholesale to retailers is not likely to be anywhere near as profitable as selling PCs directly to consumers at retail prices (via taking orders at Dell’s Web site or by phone).

• Spend a bit more on advertising Dell PCs to the Home segment.

EPILOGUE

In January 2009, Dell announced it would migrate all production of computer systems for customers in Europe, the Middle East and Africa from its Limerick, Ireland plant to its Polish facility and third-party manufacturing partners. The manufacturing migration was to be completed in a phased transition during 2009 and was among a series of steps Dell was taking to simplify operations, improve productivity, reduce costs, and deliver even higher levels of customer satisfaction. The move was part of a $3 billion cost-reduction initiative the company announced in late 2008 and was being made as a result of an ongoing comprehensive review of Dell’s global supply chain.

In November 2008, Dell announced its revenues and earnings through the third quarter of fiscal 2009—Dell’s third quarter ended October 31, 2008. Net revenues compared to the first nine months of fiscal 2008 were up 6% to $47.7 billion (versus $45.1 billion the prior fiscal year). Net income was down 6% to $2.13 billion from $2.27 billion in the prior year’s first nine months. However, Dell’s ongoing repurchases of its common stock resulted in an increase in diluted EPS from $1.00 to $1.06. The following shows how Dell’s performance for the first nine months of fiscal 2009 compared with that for the first nine months of 2008:

<table>
<thead>
<tr>
<th>Percentage of Total Net Revenue</th>
<th>First Nine Months</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2008</td>
</tr>
<tr>
<td>Gross margin</td>
<td>18.1%</td>
</tr>
<tr>
<td>Selling, general and administrative</td>
<td>1.4%</td>
</tr>
<tr>
<td>Total research and development</td>
<td>1.0%</td>
</tr>
<tr>
<td>Operating expenses</td>
<td>12.4%</td>
</tr>
<tr>
<td>Operating income</td>
<td>5.7%</td>
</tr>
<tr>
<td>Income before income taxes</td>
<td>6.0%</td>
</tr>
<tr>
<td>Net income</td>
<td>4.5%</td>
</tr>
<tr>
<td>Income tax rate</td>
<td>25.9%</td>
</tr>
</tbody>
</table>
### Net Revenue by Product Category

<table>
<thead>
<tr>
<th>Product Category</th>
<th>2008</th>
<th>2007</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Desktop PCs</td>
<td>$13,712</td>
<td>$14,713</td>
<td>(7%)</td>
</tr>
<tr>
<td>Mobility</td>
<td>14,624</td>
<td>12,610</td>
<td>16%</td>
</tr>
<tr>
<td>Software and Peripherals</td>
<td>8,116</td>
<td>7,254</td>
<td>12%</td>
</tr>
<tr>
<td>Servers and Networking</td>
<td>4,928</td>
<td>4,862</td>
<td>1%</td>
</tr>
<tr>
<td>Services</td>
<td>4,359</td>
<td>3,919</td>
<td>11%</td>
</tr>
<tr>
<td>Storage</td>
<td>1,934</td>
<td>1,786</td>
<td>8%</td>
</tr>
</tbody>
</table>

### Percentage of Total Net Revenue

<table>
<thead>
<tr>
<th>Product Category</th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Desktop PCs</td>
<td>29%</td>
<td>32%</td>
</tr>
<tr>
<td>Mobility</td>
<td>31%</td>
<td>28%</td>
</tr>
<tr>
<td>Software and Peripherals</td>
<td>17%</td>
<td>6%</td>
</tr>
<tr>
<td>Servers and Networking</td>
<td>10%</td>
<td>11%</td>
</tr>
<tr>
<td>Services</td>
<td>9%</td>
<td>9%</td>
</tr>
<tr>
<td>Storage</td>
<td>4%</td>
<td>4%</td>
</tr>
</tbody>
</table>

### Net Revenue by Geographic Region

<table>
<thead>
<tr>
<th>Geographic Region</th>
<th>2008</th>
<th>2007</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Americas Commercial</td>
<td>$22,623</td>
<td>$22,765</td>
<td>(1%)</td>
</tr>
<tr>
<td>EMEA Commercial</td>
<td>10,581</td>
<td>9,927</td>
<td>7%</td>
</tr>
<tr>
<td>Asia Pacific - Japan Commercial</td>
<td>5,896</td>
<td>5,262</td>
<td>12%</td>
</tr>
<tr>
<td>Global Consumer</td>
<td>8,573</td>
<td>7,190</td>
<td>19%</td>
</tr>
<tr>
<td>Consolidated net revenue</td>
<td>$47,673</td>
<td>$45,144</td>
<td></td>
</tr>
</tbody>
</table>

### Percentage of Total Net Revenue

<table>
<thead>
<tr>
<th>Geographic Region</th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Americas Commercial</td>
<td>48%</td>
<td>50%</td>
</tr>
<tr>
<td>EMEA Commercial</td>
<td>22%</td>
<td>22%</td>
</tr>
<tr>
<td>Asia Pacific - Japan Commercial</td>
<td>12%</td>
<td>12%</td>
</tr>
<tr>
<td>Global Consumer</td>
<td>18%</td>
<td>16%</td>
</tr>
</tbody>
</table>

### Consolidated Operating Income

<table>
<thead>
<tr>
<th>Geographic Region</th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Americas Commercial</td>
<td>$2,051</td>
<td>$2,064</td>
</tr>
<tr>
<td>EMEA Commercial</td>
<td>409</td>
<td>695</td>
</tr>
<tr>
<td>Asia Pacific - Japan Commercial</td>
<td>411</td>
<td>304</td>
</tr>
<tr>
<td>Global Consumer</td>
<td>142</td>
<td>(1)</td>
</tr>
</tbody>
</table>

Dell’s Global Consumer business increased revenue 10% over the third quarter of 2008 on a 32% increase in unit shipments—led by growing sales in global retail channels and a more diversified product portfolio. Dell’s growth in this segment was more than two times the rate of the industry.

In late December 2008, Dell announced that to serve business customers with faster innovation and greater responsiveness it would organize globally around three major customer segments—large enterprise, public sector, and small and medium businesses. Dell’s consumer business had been organized globally earlier.

Because Dell management believed that global IT end-user demand would continue to be weak in 2009, the company expected to continue to focus on improving competitiveness, lowering costs, and improving its mix of products and services to optimize liquidity, profitability, and growth. On the other hand, management also expected that it would incur increased costs from realigning its business to improve competitiveness, reduce headcount in certain areas and invest in infrastructure, growth opportunities and acquisitions.

For up-to-the-minute developments at Dell, we suggest that you check the company’s latest financial results and press releases at [www.dell.com](http://www.dell.com).
OVERVIEW

Founded in 1976 by Steve Wozniak and Steven Jobs, Apple has enjoyed incredible success with its product lines. It was the first highly successful company to mass produce personal computers with the original introduction of its Apple I shortly after being founded. However, Apple’s competitive position in the computer industry is relatively weak. Its introduction of the iPod into the digital music player industry in 2001 was met with overwhelming success resulting in their occupying a position of dominance. This success was augmented by Apple’s introduction of iTunes which has allowed the company to maintain a position of strong market dominance. However, this position is being challenged by large capable competitors. In an effort to diversity its product line, Apple introduced the first edition of its iPhone in 2007. The iPhone met with incredible success and sold one million units in seventy-four days. Its second generation 3G phone sold one million units in three days surpassing analysts’ estimates.

However, Apple’s success with its product lines has not always been stable. Steve Jobs was with the company from the beginning but had some key decision-making authority taken away after an unsuccessful coup. In 1985, Steve Jobs resigned as chairman of the company following his unsuccessful removal attempt of John Sculley (the board voted unanimously to retain him as president and CEO) and after the board stripped Jobs of all decision-making authority. However, after an extended period with little success and after several CEO changes, Steve Jobs was rehired in 1996. In 2000, Steve Jobs announced that he was the permanent CEO of Apple. The current leadership includes Steve Jobs (CEO), Peter Oppenheimer (responsible for supervision of the controller, treasury, investor relations, tax, information systems, internal audit, corporate development and human resources departments) and Timothy Cook (executive vice president of worldwide sales and operations; responsible for managing supply chain, sales activities and service and support in all markets and countries).

Apple’s recent performance has been stellar. In 2008, the company reported its best third quarter in history with revenues of $7.7 billion and a net quarterly profit of $1 billion. The company also set a company record for Mac sales in that quarter. Additionally, Apple retired $300 million in debt without hurting its operating areas. In 2008 Apple took home several silver and gold Industrial Design Excellence Awards, sponsored by the Industrial Designers Society of America.

Apple’s successes in 2008 are not without challenges. Specifically, Steve Jobs addressed the issue of competitors in each of its industries. For instance, how will Apple continue to dominate the digital music player industry considering the growing number of well-funded competitors? How should Apple go about increasing its share of the market form mobile smart phones? How should the company improve its relatively weak position in the computer industry? How might changes in customer preferences (e.g., desire for sophisticated products) and changing market dynamics (e.g., impending recession) affect the company’s outlook for growth?

*This teaching note reflects the thinking and analysis of the case authors, Professor Lou Marino, John Hattaway, and Katy Beth Jackson, all of the University of Alabama. We are most grateful for their insight, analysis and contributions to how the case can be taught successfully.
SUGGESTIONS FOR USING THE CASE

Students should be very interested in discussing this case given the increasing popularity of its products. A quick poll of the class should reveal that students have either owned or used an Apple computer, iPod or iPhone. Comments will mention positive and negative aspects of their experiences and should result in a lively discussion.

This case provides a unique opportunity for students to compare Apple’s overwhelming success in the digital music player industry to its increasingly strong position in the mobile phone industry to its relatively weak position in the computer industry. Students should develop an appreciation for the need for companies to tailor a strategy and develop capabilities that fit the specific industry to build a sustainable competitive advantage. Additionally, students should better understand the role that strong and visionary leadership plays in a company’s ability to build and sustain a competitive advantage.

This case is well suited to help students better understand the importance of strategy formulation and strategy implementation. Because of the interesting products discussed to which students can easily relate, this case can be used early in the course to help them develop the analytical skills needed to prepare and discuss cases. This case can also be used later in the course to test students’ ability to apply their skills. The information provided in the case allows students to:

- Analyze the leadership style, skills and performance regarding the five tasks of strategic management of a premier company (Chapters 1 and 2).
- Complete analysis of the computer, mobile phone and digital music player industries including key success factor, driving forces, Porter’s five forces and competitor analysis (Chapter 3).
- Understand and appreciate the challenges associated with building organizational capabilities able to serve as the basis for developing a competitive advantage (Chapters 4 and 10) and then developing a strategy that successfully leverages these advantages (Chapter 5).
- Perform a thorough financial analysis of a company and understand the contribution of different product lines to a company’s success. The financial ratio summary presented in Table 4.1 of Chapter 4 should be a very valuable guide for students in doing the financial calculations to support their assessment of Apple’s financial performance. We strongly recommend that students use Table 4.1 to complete their financial analyses.

The case also provides students with the opportunity to make recommendations to Apple on three product lines in very different positions. Despite recent gains, the computer product line is still struggling against well-funded competitors that are dedicated to the industry. Apple has experienced initial success in the mobile phone industry but there are many iPhone killers being made by resource-rich competitors. In the digital music player market, Apple is the undisputed leader, but the market is filled with many competitors and several substitutes based upon the attractiveness of this profitable market.

The assignment questions and teaching outline presented below reflect our thinking and suggestions about how to conduct the class discussion and what aspects to emphasize.

To give students guidance in what to think about and what analytical tools to utilize in preparing the Apple, Inc. in 2008 case for class discussion, we strongly recommend providing class members with a set of study questions and insisting that they prepare good notes/answers to these questions in preparing for class discussion of the case.

To facilitate your use of study questions and making them available to students, there is file of suggested study questions for the Apple, Inc. in 2008 case that is posted on the student section of the publisher’s Online Learning Center for the 17th edition (www.mhhe.com/thompson); these study questions correspond to the assignment questions that appear in the next section of this TN. (As a point of information, there is a set of study questions posted in the student section of the OLC for each of the 26 cases included in the 17th edition.)
It is really very difficult to have an insightful and constructive class discussion of the Apple case unless students have conscientiously made use of pertinent core concepts and analytical tools in preparing substantive answers to a set of well-conceived study questions before they come to class. In our classes, we expect students to bring their notes to the study questions to use/refer to in responding to the questions that we pose. Moreover, students often find having a set of study questions is useful in helping them prepare oral team presentations and written case assignments—in addition to whatever directive questions you supply for these assignments. Hence, we urge that you have students make full use of study questions—either those we have provided or a set of your own questions—in preparing each and every case assignment.

This case is suitable for both written and oral presentations. Our recommended assignment question is as follows:

Steve Jobs, the CEO of Apple, has learned of your considerable skills in strategic analysis and has hired you to develop a strategic plan that will enable Apple to improve its position in the computer and mobile phone industries and to maintain its leadership position in the digital music player industry. In developing your recommendations, Jobs would like you to assess the U.S. computer, mobile phone and digital music player industries including the industries’ driving forces, key success factors, competitive intensity, and the positions of major rivals in each. Jobs would also like you to assess Apple’s current situation including its strengths and weaknesses, as well as the opportunities and threats facing the company. In assessing Apple’s internal situation Jobs wants you to analyze the strengths of Apple’s Macintosh, iPhone and iPod operations separately. Finally, the plan should offer specific, actionable recommendations that will allow Apple to improve its position in the computer and mobile phone industries and to maintain its leadership position in the digital music player industry. Your recommendations should be well supported with arguments and justifications for each recommendation. Your report should include 4-6 pages of recommendations and whatever supporting charts, tables or exhibits you deem useful.

ASSIGNMENT QUESTIONS

1. How well has Steve Jobs done as Apple’s CEO? Has he done a good job of performing the five tasks of strategic management discussed in Chapter 2? Why or why not? What grade would you give him?

2. What are the chief elements of Apple’s strategy? How well do the pieces fit together? Is the strategy evolving?

3. Does it make good strategic sense for Apple to be a competitor in the computer, digital music player, and mobile phone industries? Are the value chain activities that Apple performs in computers, digital music players, and mobile phones very similar and “compatible” or are there very important differences from product to product? Which of the three products lines—computers, digital music players, or mobile phones—do you think is most important to Apple’s future growth and profitability? Why?

4. In which industry—computers or digital music players—is competition more intense? Prepare a five-forces analysis of each industry to support your position.

5. What does a competitive strength assessment reveal about Apple, as compared to the leaders in the personal computer industry? Use the methodology in Table 4.4 to support your answer. Among these competitors, who enjoys the strongest competitive position? Who is in the weakest overall competitive position? Has Apple’s strategy resulted in a substantial competitive advantage over its rivals in the computer industry? What is the basis for whatever competitive advantage it has?

6. What does a competitive strength assessment reveal about Apple, as compared to other main players in the digital music industry? Use the methodology in Table 4.4 to support your answer. Among these digital music player competitors, which company enjoys the strongest competitive position? Who is in the weakest overall competitive position? Has Apple’s strategy resulted in a substantial competitive advantage over its rivals in the digital music player industry? What is the basis for whatever competitive advantage Apple has?
7. What is your assessment of Apple Computer’s financial performance the past three years? (Use the financial ratios in Table 4.1 of Chapter 4 as a guide in doing your financial analysis.)

8. What accounts for Apple’s noteworthy success in the markets for mobile smart phones and digital music players, but its overall weak showing in the computer industry?

9. Is Apple’s strategy in its computer business strong enough to compete successfully against Dell and HP?

10. Does Apple’s strategy for its iPod business seem capable of allowing the company to remain on top of the digital music player industry over the next 5 years?

11. What steps should Apple take to improve its corporate performance and to strengthen its position in its most important markets?

**TEACHING OUTLINE AND ANALYSIS**

1. **How well has Steve Jobs done as Apple’s CEO? Has he done a good job of performing the five tasks of strategic management discussed in Chapter 2? Why or why not? What grade would you give him?**

Students should identify the following as being the five tasks of strategic management according to Chapter 2:

1) Develop a strategic vision
2) Set objectives
3) Craft a strategy to achieve objectives and vision
4) Implement and execute the strategy
5) Monitor developments, evaluate performance and make corrective adjustments

According to these five tasks, Apple’s CEO, Steve Jobs, has done an excellent job to date. Students should be encouraged to produce supporting evidence to substantiate their positions. Below is some evidence that they might discuss:

**Developing a Strategic Vision**

From the beginning, Steve Jobs demonstrated a strong sense of visionary leadership. Although Steven Wozniak was the true designer of the Apple I in 1976, Steve Jobs had the vision to recognize its commercial value and to insist that they sell the computer. He also quickly recognized the importance of the GUI he saw at PARC and convinced then Apple President, Michael Scott, to use it. Jobs challenged the Macintosh team to make something “insanely great,” which led to the introduction of the first computer to use a 3.5 inch drive. In 1997, the Apple store became the third largest e-commerce site on the web within three weeks of its announcement. Under Jobs’ leadership, the company took a risk and entered the digital music player industry by introducing the iPod in 2001. The subsequent release of iTunes in 2003 helped propel iPod to the forefront of the digital music player industry. Both continued to contribute to the ongoing success of Apple. Moreover, upon his return to the CEO position in 2005, Steve Jobs had idea after idea about how to move Apple forward both strategically (including the investigation of touch screen technology which led to the development of its iPhone) and in terms of performance. Jobs’ performance regarding this task can be characterized as strong.
Setting Objectives

Jobs set several objectives, which helped increase Apple’s success. Among those was the insistence on intense innovation. Students may note that Jobs’ quest for innovation and excellence led to personal conflicts between him and some of his top management team members. Students might also infer that one of Jobs’ objectives was to be a market leader in the industries in which it competes.

Crafting a Strategy

Students should first understand what crafting a strategy entails (i.e., answering questions about the “how” questions of strategy). Steve Jobs has been very effective at crafting a strategy to meet the changing needs of Apple’s customers with plans for innovative hardware and software products. Jobs has helped Apple to develop a strategy that would outcompete its rivals as evidenced by its strong financial performance and increasing market share with products like its iPod and iPhone as well as its growing presence in the computer industry. Apple crafted an approach to meet the demands of changing markets by focusing on products that offered the benefits associated with the convergence of the digital electronics and computer markets. Jobs also developed plans to achieve functional goals and to develop competencies and capabilities that could be used to build a sustainable competitive advantage. For instance, his focus on the GUI that would be used to build Apple computers and on the touch screen technology that would be leveraged by Apple’s iPod exemplify Jobs’ capabilities in the area of meeting Apple’s financial and strategic objectives. Jobs’ performance regarding this task can be characterized as very strong.

Implementing the Strategy

Students should identify several key elements that indicate Steve Jobs’ successful ability to implement his strategy – allocating resources to critical goals, creating an innovative corporate culture, motivating people to meet targets, and staffing with the right people. Jobs emphasized the need to focus on research and development to improve existing products and to introduce innovative products and services to the market at competitive prices. Through his passion for using new technologies such as Apple’s GUI and the touch screen Jobs set the example for the organization to follow and infused it with an innovative culture. He reinforced this culture by supporting the introduction of non-computer products to the market and by motivating Apple employees to strive for innovative excellence. Finally, students should note that later in his career Jobs surrounded himself with people who had relevant expertise to realize his vision and move the company forward. Peter Oppenheimer (responsible for supervision of controller, treasury, investor relations, tax, information systems, internal audit, corporate development and human resources departments) and Timothy Cook (executive vice president of worldwide sales and operations; responsible for managing supply chain, sales activities and service and support in all markets and countries) are two strong examples of his staffing decisions. Jobs’ performance regarding this task can be characterized as strong.

Monitoring Developments and Making Corrections

Steve Jobs has continually been involved in the operations of Apple by monitoring its developments and reacting to firm and market activities. Students may argue that his involvement during his first stint with Apple was counterproductive due to personal conflicts with project leaders and top management. However, upon returning to the company in 2000, Jobs made adjustments and additions to its software and hardware product lines as required. He made necessary structural changes for the company to realize his innovative ideas. Jobs also successfully turned around the financial performance of the company with his blended leadership style, which represents an excellent example of his having made personal adjustments. Jobs’ performance regarding this task can be characterized as strong.

Upon returning to Apple, Steve Jobs led a remarkable turnaround of Apple over the past few years. Under his strategic leadership, Apple has built a dominant market share in the digital music player industry and has begun to recapture a portion of the computer market with its new product introductions. Apple’s recent successful entry into the mobile phone market and increasing market share along with solid stock prices suggest that Steve Jobs has been very effective as a strategic leader. Still, while Jobs and Apple continue to dominate the digital music player industry, they are still trying to improve their competitive position within
the computer industry. Thus, we would give Jobs an A for his leadership in the digital music player industry but only a B in the computer industry. He would receive a grade of an A- in the mobile phone industry. These grades reflect Jobs’ strategic intent and commitment to projects that interest him.

2. What are the chief elements of Apple’s strategy? How well do the pieces fit together? Is the strategy evolving?

Students should recognize that Apple has done an excellent job of developing and piecing together its very distinct strategy through effective innovation, new product introductions, and improvement of existing products. Apple has employed a differentiation strategy through successful innovation with its three core products – computers, digital music players and mobile phones. More specifically, Apple attempts to meet the needs of a global market by offering customers innovative new products and improved existing products. A key piece of their strategy involves meeting the needs of the converging digital electronics and computer markets. Finally, students should indicate that Apple has elected to implement its strategy by designing and developing its own operating systems and hardware and software technologies, thus allowing for strict protection of its intellectual rights.

Apple’s strategy with its computer division is sound. The introduction of the Apple I in 1976, with relatively little success, was substantiated by later introductions of innovative products that enjoyed great success. Some of the later versions of its computers, including the second Macintosh in 1987 and first PowerMac in 1994, were marvels of performance both technologically and financially. The recent introduction of the MacBook Air helped strengthen Apple’s relatively weak position in this market. Apple’s dedication to innovation and excellence in strategic execution were complemented by the strategic pursuit of entry in the digital music player industry.

Apple’s entry into the market for digital music players was a strategic success. The iPod was introduced in 2001 with great risk and success on the basis of unique style, design and technology. The release of iTunes in 2003 catapulted iPod to the front of the industry by its subsequent capture of seventy percent of the market among all legal online music download services. The decision to introduce iPods and iTunes continued to contribute to the success of Apple for years to come. In addition to the synergies created between iPod and iTunes, the success of the iPod along with the iPhone helped to create a “halo” effect by introducing consumers to Apple products, which might lead to subsequent increased interest in Apple’s computer products.

Most recently, Apple entered the mobile phone industry with the introduction of its iPhone in 2007 that was wildly successful. The first version sold one million units in seventy-four days. The second widely anticipated release with 3G technology sold one million units in three days. Apple’s decision to enter yet another non-computer market has been met with overwhelming success. This entry and ensuing success was made possible by Apple’s strategy of differentiation, innovative capabilities, product introductions and desire to continuously improve its existing products.

Generally, the pieces of Apple’s strategy fit well together with one slight exception. Below is a description of how the pieces successfully or unsuccessfully complement one another.

- The strategic approach of differentiation by attracting customers with innovative, fashionable and stylish products has worked well with Apple’s strategic decision to provide direct sales and non-computer sales. The non-computer products facilitate the stylish appearance and the style niche facilitates the non-computer products resulting in greater differentiation. (Successful Fit)

- Improving iTunes along with the iPod has resulted in a symbiotic relationship for both. Since iPod is a large digital music and video player, it goes hand-in-hand with a computer based player that offers seamless syncing with the iPod and a virtually unlimited store of songs and videos. (Successful Fit)

- Because of Apple’s innovation and tight lock on its intellectual property, Apple was able to gain buy-in from major labels and television networks in providing access to music and videos online. Without this
access, iTunes and iPod would not be nearly as successful. Conversely, without an avenue to access the music and videos (i.e., iTunes) this alliance would not have happened. (Successful Fit)

- The strict protection of intellectual property worked great for the Music Store library but has also created some strategic issues. It has been the largest obstacle to Apple’s success in the computer industry. Apple lacked the necessary software to be competitive against computers, which was due to the restrictions on the Apple Certified Developer Program. This made it difficult for software developers to obtain Macs at a discount and receive informational materials about the operating system that they could use to develop software for the Macintosh. Additionally, Apple’s computer success was limited because very few companies ever chose to license the MAC OS because many felt the licensing agreements were far too restrictive. (Unsuccessful Fit)

As technology evolves, so has Apple’s strategy. Initially, Apple focused on the computer industry by introducing innovative products. Apple continues to introduce innovative products in the computer industry but recently has focused a great deal of strategic attention and resources on meeting the needs of customers in the converging digital electronics and computer markets. This, along with the successful entry into the digital music player industry, marks a clear evolution in Apple’s strategy. Most recently, Apple entered the mobile phone industry with its iPhone indicating even further evolution of its strategy. These activities reflect evolutions in Apple’s strategy; however, students will rightfully note that Apple continues to stress innovation as a key linchpin in its overall strategy.

3. Does it make good strategic sense for Apple to be a competitor in the computer, digital music player, and mobile phone industries? Are the value chain activities that Apple performs in computers, digital music players, and mobile phones very similar and "compatible" or are there very important differences from product to product? Which of the three products lines—computers, digital music players, or mobile phones—do you think is most important to Apple’s future growth and profitability? Why?

It has made strategic sense for Apple to compete in the computer, digital music player and mobile phone industries. The success of and synergies associated with the digital music player and mobile phone industries will be clearly evident to the students, suggesting strategic soundness. However, Apple’s involvement in the computer industry might not make as much sense. Students should explore the extent to which Apple’s core business, designing and manufacturing computers, has helped them enjoy long-term success in its other divisions. For instance, Apple discovered the touch screen technology that was used in its iPhone when exploring new technologies for its computers. Also, iTunes was initially developed for use on Apple’s computers but was quickly adapted to be used with iPods which helped catapult it to a position of dominance in the digital music player industry. Despite these benefits, there is some question regarding the way Apple continues to compete in the computer industry based upon great secrecy and protection, which limits the opportunity for developers to introduce software which is compatible with Apple computers.

There are similarities in Apple’s value chain activities when comparing its computer, digital music player and mobile phone activities. Students should infer that the supporting activities (i.e., product R&D, human resource management and general administration) are similar. Of the supporting activities, R&D has been most important to Apple who competes on the basis of differentiation through innovation and style. Much of the technology developed for one of its product lines has been in or used to build the popularity of its other products. Students should also note that there are similarities in its primary activities (i.e., supply chain management, operations, distribution, sales and marketing, and service) with a few key exceptions. Apple’s operations and service is different for each product due to the significant differences in product specifications such as size and function, particularly when comparing computer with non-computer products. The specifications and, thus, value chain similarities for non-computer Apple products are very similar with some versions of the iPod and the iPhone using some of the same touch screen technology. Hence, although there are many similarities in the value chain activities of Apple’s computer, digital music player, and mobile phone activities, students should point out that greater differences exist in creating value when comparing its computers to its digital music players and mobile phones.
Apple’s strong dominance (despite several capable competitors) in the digital music player industry makes it very important to Apple’s long-term success. Although this market is maturing locally (the U.S. market), it is growing internationally, which provides Apple with long-term growth potential. The increasing number of capable competitors in the computer and mobile phone industries helps to drive down profitability in those industries. Students should point out that Apple has enjoyed great success in the mobile phone industry, which is very promising. However, a $200 price drop in the second generation of iPhones relative to the first is evidence of a highly competitive market, which might not sustain Apple’s long-term growth and profitability. Apple’s performance in the computer industry is less promising with only 2% market share internationally. However, Apple had a 38.1% growth in total U.S. shipments from the second quarter of 2007. The worldwide PC market grew by 16% in that time. Students will find evidence to argue that all of Apple’s core divisions are important to its growth and profitability, but when compelled to select the most important, they may conclude that its iPod business is most likely to have the largest effect on future revenues and earnings.

4. In which industry—computers or digital music players—is competition more intense? Prepare a five-forces analysis of each industry to support your position.
Five-Forces Model for the Computer Industry

In the discussion of the five competitive forces that follows, we use a + sign to indicate factors acting to strengthen rivalry and a – sign to indicate factors acting to weaken rivalry. The +/- signs are shown in parentheses.

Rivalry among competing computer manufacturers—a strong competitive force

- The computer industry is growing rapidly as it has experienced ten consecutive quarters of double digit growth. (–)
- Switching costs for consumers are moderate. While some consumers are quite loyal to particular brands, others are less concerned with brand. (neutral)
- Product differentiation is low among computer makers but moderate when Apple is considered. There is an innovation race between manufacturers, which provides a temporary differentiation for the first mover. However, competitors soon catch up and differentiation subsides. (neutral)
- Most competitors have the same strategy of allowing consumer customization. This nearly eliminates product differentiation. (+)
- With industry growth expected to slow, many of the small competitors will be forced to fight for survival. (+)
- The industry is highly consolidated with the top 5 players controlling 79% of the market. (+)
- Sellers are often changing strategies and innovating to gain more market share. (+)

Threat of Entry—a weak competitive force

- The effect of economies of scale in production is extremely significant in this industry. (–)
- Due to the infrastructure, research and development expertise, and distribution requirements the capital requirements for entry are large. (–)
- Since growth is expected to subside in the coming years and minor players are expected to fall out of the industry, it may not be an attractive industry to new entrants. (–)
- Access to distribution channels is key to reaching a critical mass of consumers. These distribution channels may be difficult to access for new entrants. (–)
- Although individual brand loyalty is fairly neutral, consumers are aware of the major players. Thus, a new entrant will have a significant hurdle to overcome with a lack of brand recognition. (–)
- The industry is heavily consolidated and run by 5 major players that can easily contest new entrants. (–)
- Given the current booming growth of the computer industry, attractive profits are available to new entrants. (+)

Competition from substitutes—a weak competitive force

- At the moment, here are very few substitutes to personal computers. The substitutes for an individual consumer are a work computer, public computer, a PDA, or paper and pencil. However, the PDA does not have the processing power or speed and a work or public computer is simply another consumer’s computer. (–)
- The switching costs to one of the above substitutes are high. It costs the user time and inconvenience to use any of the substitutes mentioned. (–)
The bargaining power and leverage of suppliers—weak for suppliers of commodity-like inputs; strong for essential components such as microprocessors

- For some standard parts such as screws, circuit boards, and casings, switching costs are minimal for suppliers. (–)
- It is not costly for sellers to find and use substitutes for standard parts. (–)
- The computer industry makes up a large part of the business for these essential parts, such as processors. (–)
- It is possible that some industry players may integrate backwards. (–)
- There is opportunity for a win-win situation when a seller and supplier collaborate. (–)
- For essential parts such as Intel processors, switching costs are high and there are few other suitable and equal alternatives. (+)
- It is very costly for sellers to find and use substitutes for essential parts. (+)
- It is possible that some suppliers may integrate forward. (+)

The bargaining power and leverage of buyers—weak for consumers; moderate to strong for corporate buyers

- Individual buyer switching costs between PC brands are low, but they are high between PC brands and Apple. While there is some brand loyalty, many buyers will not mind switching to a brand that is perceived as equivalent in quality and price. (neutral)
- The individual buyer is a very small portion of the total business. (–)
- The individual buyer purchases infrequently and in small quantities. (–)
- Individual buyers have the ability to postpone their purchase. (+)
- Corporate buyers have a much more limited timeframe to purchase computers. (–)
- Corporate buyers often have larger switching costs due to contracts. (+)
- The corporate buyer purchases in much larger quantities and more frequently. (+)
- There is little to no threat of the buyer vertically integrating (–)
- There are competitor products of equal performance capabilities readily available. (+)

Five-Forces Model for the Digital Music Player Industry

In the discussion of the five competitive forces that follows, we use a + sign to indicate factors acting to strengthen rivalry and a – sign to indicate factors acting to weaken rivalry. The +/- signs are shown in parentheses.

Rivalry among competing producers of digital music players—a moderately strong competitive force

- The digital music player industry is growing rapidly, a growth that is expected to continue. (–)
- Competitors have varying strategies targeting different consumers. (–)
- Switching costs for the stylish user are high. The stylish user cares about the look and feel of the unit as much or more than the actual performance. However, this consumer will be more apt to purchase the new “hot item,” which lowers switching costs. (neutral)
- Product differentiation is moderate. Style, simplicity of use, and new innovative functionalities differentiate the products. However, many of the performance features are identical. (neutral)
Switching costs for the functional user are low. The functional user is concerned about functionality, simplicity, and price. As long as competing units are equal on these grounds, the brand name makes little difference. (+)

The industry is comprised of one major player and several competitors trying to stay in the game. (+)

Sellers are often changing strategies and innovating to gain more market share. (+)

**Threat of Entry**—a weak competitive force

- The effect of economies of scale in production is significant in this industry. (–)
- Due to the infrastructure, research and development expertise, and distribution requirements, the capital requirements for entry are large. (–)
- Access to distribution channels is key to reaching a critical mass of consumers. These distribution channels may be difficult to access for new entrants. (–)
- Although individual brand loyalty is fairly neutral, consumers are aware of the major players. Thus, a new entrant will have a significant hurdle to overcome with a lack of brand recognition. (–)
- There are over 100 manufacturers offering digital music players, but only one is enjoying tremendous success. (–)
- All players are looking to expand given the current booming growth of the digital music player industry; attractive profits are available to new entrants. (+)

**Competition from substitutes**—a strong competitive force

- There are many good substitutes for a digital music player such as a PDA, portable CD players, portable radios and mobile phones with digital music capabilities. (+)
- More and more products are adding digital music functionality as the lines between portable electronics’ genres are disappearing. (+)
- Switching costs to substitutes are moderate. While some users are satisfied with any digital music functionality from any device, many other users are concerned with style and portability (such as using one for working out). (neutral)

**The bargaining power and leverage of suppliers**—a weak competitive force

- Since most digital music players involve proprietary designs that use standard hardware, the parts are readily available by many suppliers. (–)
- It is not costly for sellers to find and use substitutes. (–)
- The digital music player industry represents significant accounts for suppliers and makes up a moderate part of the business for these essential parts, such as processors. (–)
- There is opportunity for a win-win situation when a seller and supplier collaborate. (–)
- It is not likely that suppliers will integrate forward. (–)
- It is not likely that industry competitors will integrate backwards into board fabrication or the making of any other part. (+)

**The bargaining power and leverage of buyers**—a weak competitive force

- Switching costs for the functional user are low. The functional user is concerned about functionality, simplicity, and price. As long as competing units are equal on these grounds, the brand name makes little difference. Individual buyer switching costs are moderate. While there is some brand loyalty, many buyers will not mind switching to a brand that is perceived as equivalent in quality and price. (neutral)
Switching costs for the stylish user are high. The stylish user cares about the look and feel of the unit as much or more than the actual performance. However, this consumer will be more apt to purchase the new “hot item,” which lowers switching costs. (neutral)

The individual buyer is a very small portion of the total business. (–)

The individual buyer purchases infrequently and in small quantities. (–)

Buyers will not integrate backwards. (–)

Individual buyers have the ability to postpone their purchase. (+)

There are competitor products of equal performance capabilities readily available. (+)

A comparison of the two industries reveals much about the level of competition in each. A worthwhile exercise would include having students make two columns that summarize each of the five forces, force by force, on the whiteboard. After completing a detailed analysis of each market, ask students which industry they would rather compete in if they were Apple. From a listing perspective, both industries seem somewhat attractive. However, a closer analysis of some details about the nature of competition in each industry should help students realize that the intensity of competition in the computer industry is much more fierce than for the digital music player industry and that the digital music player industry has a greater potential for profitability in the near and extended future than does the computer industry.

5. What does a competitive strength assessment reveal about Apple, as compared to leaders in the personal computer industry? Use the methodology in Table 4.4 to support your answer. Among these competitors, who enjoys the strongest competitive position? Who is in the weakest overall competitive position? Has Apple’s strategy resulted in a substantial competitive advantage over its rivals in the computer industry? What is the basis for whatever competitive advantage it has?

Students should be able to prepare a competitive strength assessment for the major producers of personal computers. Although the students’ strength measures, respective weightings, and ratings may vary, conclusions reached by students should be consistent with what we show in Table 1.

Table 1  Competitive Strength Assessment for the Leading Rivals in the Computer Industry

<table>
<thead>
<tr>
<th>Key Success Factors/Strength Measures</th>
<th>Importance Weight</th>
<th>Apple</th>
<th>Dell</th>
<th>HP</th>
<th>Acer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price</td>
<td>0.1</td>
<td>6</td>
<td>9</td>
<td>8</td>
<td>10</td>
</tr>
<tr>
<td>Quality/Product performance</td>
<td>0.15</td>
<td>8</td>
<td>7</td>
<td>7</td>
<td>6</td>
</tr>
<tr>
<td>Peripheral synchronization capabilities</td>
<td>0.1</td>
<td>9</td>
<td>7</td>
<td>7</td>
<td>7</td>
</tr>
<tr>
<td>New product innovation capabilities</td>
<td>0.2</td>
<td>10</td>
<td>6</td>
<td>7</td>
<td>6</td>
</tr>
<tr>
<td>Customization availability</td>
<td>0.15</td>
<td>5</td>
<td>10</td>
<td>9</td>
<td>5</td>
</tr>
<tr>
<td>Software compatibility</td>
<td>0.1</td>
<td>5</td>
<td>8</td>
<td>8</td>
<td>8</td>
</tr>
<tr>
<td>Reputation/Image</td>
<td>0.1</td>
<td>8</td>
<td>8</td>
<td>8</td>
<td>6</td>
</tr>
<tr>
<td>Market position</td>
<td>0.05</td>
<td>4</td>
<td>10</td>
<td>8</td>
<td>4</td>
</tr>
<tr>
<td>Breadth of product offerings</td>
<td>0.05</td>
<td>8</td>
<td>8</td>
<td>7</td>
<td>6</td>
</tr>
<tr>
<td>Total</td>
<td>1.0</td>
<td>63</td>
<td>73</td>
<td>69</td>
<td>58</td>
</tr>
</tbody>
</table>

Rating Scale: 1 = very weak; 10 = very strong
As indicated by Table 1, Dell is the strongest player in the computer industry, something that is supported by case Exhibit 3’s display of Dell’s leading market share of 31.9%. They have managed to secure this spot through their superior manufacturing process, design for assembly mentality, direct business model with customization, and relatively good prices. Conversely, Table 1 indicates Acer as the industry’s weakest link in part because they currently hold a lower market share than Apple. Acer acquired Packard Bell and Gateway and is quickly becoming a major player, particularly in geographic segments such as Europe, the Middle East and Africa.

6. What does a competitive strength assessment reveal about Apple, as compared to other main players in the digital music industry? Use the methodology in Table 4.4 to support your answer. Among these digital music player competitors, which company enjoys the strongest competitive position? Who is in the weakest overall competitive position? Has Apple’s strategy resulted in a substantial competitive advantage over its rivals in the digital music player industry? What is the basis for whatever competitive advantage Apple has?

The competitive strength assessment (CSA) for this question can be found below. Although the students’ strength measures, respective weightings, and ratings may vary, the CSA that is presented is a good indication of the relative position of each competitor.

### Table 2 Competitive Strength Assessment for Apple and Selected Rivals in the Digital Music Player Industry

<table>
<thead>
<tr>
<th>Key Success Factors/Strength Measures</th>
<th>Apple</th>
<th>Creative</th>
<th>Microsoft</th>
<th>iRiver</th>
<th>SanDisk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price</td>
<td>0.05</td>
<td>7</td>
<td>0.35</td>
<td>8</td>
<td>0.4</td>
</tr>
<tr>
<td>Quality/Product performance</td>
<td>0.15</td>
<td>8</td>
<td>1.2</td>
<td>9</td>
<td>1.35</td>
</tr>
<tr>
<td>Peripheral synchronization capabilities</td>
<td>0.1</td>
<td>8</td>
<td>0.8</td>
<td>9</td>
<td>0.9</td>
</tr>
<tr>
<td>New product innovation capabilities</td>
<td>0.2</td>
<td>10</td>
<td>2</td>
<td>9</td>
<td>1.8</td>
</tr>
<tr>
<td>Product features</td>
<td>0.15</td>
<td>9</td>
<td>1.35</td>
<td>9</td>
<td>1.35</td>
</tr>
<tr>
<td>Simplicity of use</td>
<td>0.1</td>
<td>10</td>
<td>1</td>
<td>8</td>
<td>0.8</td>
</tr>
<tr>
<td>Reputation/Image/Style perception</td>
<td>0.2</td>
<td>10</td>
<td>2</td>
<td>8</td>
<td>1.6</td>
</tr>
<tr>
<td>Breadth of product offerings</td>
<td>0.05</td>
<td>9</td>
<td>0.45</td>
<td>10</td>
<td>0.5</td>
</tr>
<tr>
<td><strong>Total Weight</strong></td>
<td><strong>1</strong></td>
<td><strong>71</strong></td>
<td><strong>9.15</strong></td>
<td><strong>70</strong></td>
<td><strong>8.7</strong></td>
</tr>
</tbody>
</table>

From Table 2, it is quite evident that Apple enjoys the strongest competitive position. Apple’s innovation capabilities along with the simplistic use, bountiful features, and stylish perception of their iPod have secured Apple a foothold in the digital music player industry. Even though the price of their digital music players is among the highest in the industry, consumers are willing to pay due to its style, features and simplicity. SanDisk has the second strongest competitive position with Microsoft following very closely. Microsoft possesses the greatest competitive threat because of their plentiful resources, innovative capabilities and ability to provide network externalities.
The reason for Apple’s tremendous success of 70% and 40% market share of the hard drive and flash memory digital music player markets respectively is due to several competitive advantages including:

- Unique brand recognition and consumer loyalty resulting from first mover advantages
- Company-wide dedication to innovation and new product introductions
- Consumer perception of the iPod as stylish and fashionable
- The simplistic use and small learning curve of the iPod
- The compatibility of the iPod with iTunes and the iTunes Music Store

7. What is your assessment of Apple Computer’s financial performance the past three years? (Use the financial ratios in Table 4.1 of Chapter 4 as a guide in doing your financial analysis.)

Students should be able to use the financial information provided in case Exhibit 1 and the financial ratios provided in Table 4.1 of the text to make calculations similar to what are shown in Table 3.

<table>
<thead>
<tr>
<th>Performance Ratios</th>
<th>2007</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue Growth</td>
<td>24.3%</td>
<td>38.7%</td>
<td>68.3%</td>
</tr>
<tr>
<td>Gross Profit Margin</td>
<td>51.4%</td>
<td>40.8%</td>
<td>40.9%</td>
</tr>
<tr>
<td>Operating Profit Margin</td>
<td>18.4%</td>
<td>12.7%</td>
<td>11.8%</td>
</tr>
<tr>
<td>R&amp;D as % of Sales</td>
<td>3.0%</td>
<td>4.0%</td>
<td>4.0%</td>
</tr>
<tr>
<td>Return on Assets (ROA)</td>
<td>13.8%</td>
<td>11.6%</td>
<td>11.5%</td>
</tr>
<tr>
<td>Return on Equity (ROE)</td>
<td>24.1%</td>
<td>19.9%</td>
<td>17.9%</td>
</tr>
<tr>
<td>Current Ratio</td>
<td>1.9</td>
<td>1.8</td>
<td>2.7</td>
</tr>
<tr>
<td>Inventory Turns</td>
<td>69.4</td>
<td>71.5</td>
<td>84.4</td>
</tr>
<tr>
<td>Debt-to-Equity</td>
<td>0.10</td>
<td>0.08</td>
<td>0.08</td>
</tr>
</tbody>
</table>

Calculated from case Exhibit 1.

Students should quickly recognize that Apple’s performance over the past three years has been strong but there are some concerns. Revenues and gross margins continue to be strong although its stock price has taken a slight dip. In the third quarter of 2008, Apple enjoyed record performance relative to its revenues and profit margin although its gross margin dropped and was expected to drop further.

Further analysis reveals the following:

In recent years, revenue growth has decreased every year, ending with revenues in 2007 of 24.29%. However, the gross profit margin has significantly improved. Additionally, there has been a steady improvement in operating profit margin, which shows that operations are in control and everyday operating expenses have been reduced.

Both the ROA and ROE are quite impressive as both have increased with ROE having the largest increase of 4.14% in 2007. This trend indicates that each year they are achieving more “bang for their buck,” so to speak. In other words, they are making more money with fewer assets and not as much equity. Astonishingly, they are making all this money with the use of very low long term debt for the last three years as indicated by the low debt-to-equity ratio.
While there is not enough information in the case to establish an industry average of inventory turns, one might assume that the current 69 days is a reasonably good number since computers will naturally turn fairly slowly and computers are still a core business for Apple. The current inventory level of 69 does not seem too unreasonable. However, it is quite evident that Apple has not improved their inventory management over the last three years due to a declining inventory turns ratio.

8. What accounts for Apple’s noteworthy success in the markets for mobile smart phones and digital music players, but its overall weak showing in the computer industry?

Apple’s success in the digital music player industry can be attributed to the following factors:

- **The realization of first mover advantages in the form of unmatched and inimitable brand recognition and consumer loyalty.** Although Apple was not officially the first mover in this market, they were the ones to really make this market known. They shaped this market and thus became perceived by the consumer as the first mover. Had Apple failed to revolutionize this industry, their success would have been greatly limited.

- **Apple’s systematic dedication to and support of continuously developing market leading innovation of products and product features.** Apple has consistently changed and reinvented the iPod to meet more consumer needs and offer more features. As a prime example, Apple introduced the iPod offering video capabilities. By being the first to market with this product and supplementing it by offering video downloads through iTunes, Apple captured more consumers.

- **The relationship between the iPod and iTunes.** Perhaps one of the best moves Apple made was to customize iTunes to seamlessly sync with the iPod. By transforming iTunes from a software tunes player to a full online music and video store, it played directly to the strengths of the iPod. Since iTunes was only available on Mac’s at first, this all but mandated current Apple consumers to buy the iPod if they desired online music. By strategically offering iTunes to Windows users after the iPod and iTunes established a strong brand name, this mutually beneficial relationship between iPod and iTunes was extended to a much larger consumer base.

- **Strategic partnerships.** By developing key partnerships with major recording labels and networks, Apple was able to offer a media library that was temporarily unmatched by competitors. Had Apple been unable to secure these partnerships, iTunes’ success, and thus the iPod’s success, would have been severely limited.

Conversely, Apple’s lack of success in the computer industry can be explained by the following reasons:

- **Early lost ground in performance.** Although the Apple I and Apple II were first to market innovations, the performance of Apple products when the personal computer market was in full swing was not sufficient. They had great trouble in competing with systems that utilized Intel processors. In fact, it wasn’t until Apple’s 1994 release of the PowerMac that they could even compete with the Intel processor.

- **Lack of price competitiveness.** Apple has always been among the higher priced systems in the computer industry. However, until the introduction of the iMac, there was no Apple computer designed for the low-end consumer. While power users could justify the price of a PowerMac due to its performance capabilities, a low-end user had no need for such capabilities and thus had no motivation to buy a high end product.

- **Overly devout commitment to intellectual property protection.** This refers to Apple’s commitment to keep everything Apple from two perspectives. The first part of this mentality is to have only Apple software on Apple computers. The second element of this strategy is to prevent licensing Apple software or hardware to other competitors or businesses. As described in greater detail below, both had quite a limiting effect on Apple’s success in the computer industry.
 Strict requirements for software development. Since Apple had such strict requirements to certify a person as an Apple software developer, there was not enough interest or presence of Apple software developers to produce quality software that could be mass produced. To further exaggerate this problem, until 1998 Apple would not use any outside software, such as Microsoft products, on its Apple computers. However, it was products such as Windows and Microsoft Office that had become popular both nationally and internationally. Since Apple computers were not compatible with these products, the Apple computers did not meet the functional needs and desires of most consumers.

No/strict licensing. For most of Apple’s corporate life, they have been against the licensing of Apple products. With the exception of Spindler’s half-hearted attempt, licensing was nowhere to be found. Even when Spindler attempted to license Apple’s OS to a major corporation, the guidelines were so strict that not many companies were interested. The result was that the Windows OS along with Microsoft software became the “standard” software instead of Apple’s products. Since Apple’s products did not reach a critical mass of consumers nor were they compatible with the “standard” software, Apple computers were thus functionally deficient.

One you have laid these differences out with the students it is worthwhile to ask them whether they believe Apple’s struggles in the computer industry had any impact on their success on the digital music player industry. Astute students are likely to realize that the commoditization of the computer industry largely negated any significant benefits Apple could have gained from its innovative capabilities, while these capabilities are a key success factor in the digital music player industry. Additionally, it is likely that Apple learned from its struggles in the computer industry when it decided to enter the digital music player industry.

9. Is Apple’s strategy in its computer business strong enough to compete successfully against Dell and HP?

To understand if Apple’s strategy in computers is strong enough to compete successfully against Dell and HP, it is necessary to understand three things:

1. The KSFs of the industry
2. The components of Dell’s and HP’s strategies that make them successful
3. The components of Apple’s strategy

Key Success Factors of the Personal Computer Industry

1. Quick innovation – Companies must be able to innovate quickly and keep up with the curve. Great rewards are available to the company that wins the innovation race.
2. Product breadth – Enough products must be available to meet the needs of the low-end consumer all the way to the power user.
3. Functional capabilities and support – Without the appropriate functional capabilities (ranging from software to hardware performance) and support to help the user, consumers will go with a competitor more proficient in this area.
4. Controlling costs – By controlling costs, competitors can enjoy greater margins at lower prices. These lower prices will attract more consumers.
5. Customization capabilities – The ability of a consumer to customize a computer for their needs has propelled companies like Dell to success.
Components of Dell’s Strategy
- Customization – Dell has led the industry in developing this business model.
- Customer Support – Dell is known for their excellent and friendly customer support.
- Cost control – Dell’s design for assembly has reduced costs and enabled customization at a relatively low cost.
- Functionality – Dell’s products meet the hardware and software requirements of its users.
- Product breadth – Because of its customization, the product offerings are suitable for any type of consumer.

Components of HP’s Strategy
- Support – HP has built their name through consulting services. This capability is quite attractive to corporations and power users.
- Customization – Copying from Dell, HP offers its consumers a customization capability that drives prices higher as more and better components are added.
- Peripheral Synchronization – HP has designed their computers so that peripherals such as digital music players and televisions are compatible.

Components of Apple’s Strategy
- Style – Apple has carved a niche that attracts consumers due to its appearance and fashion status.
- Proprietary Capabilities – Apple computers use technology and programs that are unique to Apple.
- Limited Products – Consumers buy a certain line of products rather than a customized product.

After reviewing the above elements, it is likely that Apple’s current strategy will not be able to successfully compete with Dell and HP for the following reasons:

- **No customization ability.** Dell and HP are so successful because consumers can design a computer that meets their specific needs. Apple does not have this capability, which severely limits their market appeal.

- **Limited functionality.** Apple is unable to hit mainstream due to limited mainstream functionality. For example, most consumers can’t survive without Microsoft Office products. Although Apple’s compatibility with these products is improving, it is not sufficient enough for consumers’ needs.

- **Limited synergies.** Wintel PC makers benefit from many synergies from which Apple does not. These synergies give those manufacturers a competitive advantage. Additionally, greater “openness” allows software developers to keep PCs that run other operating systems at a competitive advantage relative to Apple’s computers.

10. Does Apple’s strategy for its iPod business seem capable of allowing the company to remain on top of the digital music player industry over the next 5 years?

To understand if Apple’s strategy is strong enough to allow it to remain on top of the digital music player industry over the next 5 years it is necessary to look at the following:

1. KSFs of the digital music industry
2. The components of Apple’s strategy
3. The competitive advantages of Apple
**Key Success Factors of the Digital Music Player Industry**

1. Innovation speed and capability
2. Breadth of product capabilities
3. Simple product operation
4. Style

**Components of Apple’s Strategy**

- **First to market innovation** – Apple has single-handedly shaped how companies compete in this industry. They are consistently beating the competition to market with new features such as including touch screen technology in their digital music players.

- **Fashionable perception** – Apple has turned the digital music player into a fashion statement. They have engrained in the consumer that a digital music player is more than just a music player, it is a status symbol.

- **Music Store support** – By leveraging the downloading abilities of iTunes, Apple has launched iPod to success. Once again, greater innovation of iTunes leads to more capabilities of the iPod.

**Competitive Advantages of Apple**

Students should recall from the competitive strength assessment for the digital music player industry that Apple’s tremendous success of 70% and 40% market share of the hard drive and flash memory digital music player markets respectively is due to several competitive advantages.

- Unique brand recognition and consumer loyalty resulting from first mover advantages
- Consumer perception of the iPod as stylish and fashionable
- The simplistic use and small learning curve of the iPod
- The compatibility of the iPod with iTunes and the iTunes Music Store
- The new touch screen interface in some of its iPods

In this analysis we concluded that Apple had a sustainable advantage due to systematic innovative capabilities and a strong brand image that was built with a solid first mover advantage, continuous improvement of its existing products and the introduction of exciting newsworthy new products.

The analysis above suggests that Apple’s current strategy is adequate to keep them at the top of the industry for the next five years for the following reasons:

1. **Strategy is consistent with KSFs of the industry** – All of the components of Apple’s strategy are consistent with what it takes to be successful in this industry, although this fact is not surprising as they are the ones who have shaped this industry.

2. **Key advantages with considerable longevity** – Apple’s competitive advantages, although only one is sustainable, are strong enough to last for five years. It will most likely take more than five years for a competitor to build the status and stylish reputation of a product like an iPod. Additionally, as companies are forced to add more and more functionality to stay in the game, it will become harder and harder to keep things simple.

3. **Leader in innovation** – One way that a competitor could grab market share from Apple would be to beat them to market with a product. However, Apple has shown that they lead the industry in this category. Thus, if they continue to do this, no company can consume a significant amount of the market share.
4. **Moderate rivalry** – While there is some rivalry, most companies will look for niches in the market to not compete with Apple, which dominates it. By the same token, many companies will shy away from entry or drop out of the industry because of Apple’s dominance.

11. **What steps should Apple take to improve its corporate performance and to strengthen its position in its most important markets?**

**Personal Computer Industry**

The analysis above suggests that Apple’s shortcomings in the computer industry stem from a lack of compatibility, a lack of customization, and overly strict intellectual property policies. Hence, Apple should take actions that reduce the impact of these factors or eliminate them altogether. Below is a list of steps Apple should take:

- **Adopt customization into their business model**

  Apple should enable the user to “design their own” computer. This step towards computer customization will help offset the competitive advantage upon which Dell has developed much of its industry-leading performance. Specifically, Apple should allow for the specification of such things as amount of RAM, processing speed, memory, peripherals, etc.

  Apple has a perception of fashion and style that it can leverage in its effort to include customization of its products. It should bring to the industry an exaggerated concept of customization by allowing consumers to customize the style. This would allow users to customize certain parts of their computer to fit their liking. While the exact elements should be decided upon according to feasibility, an example includes an option in the color of the computer.

  Apple should, however, keep the idea of different types of models. This will give some structure and allow for a greater amount of marketing to consumers with different computing needs and preferences. Other leading competitors such as Dell and HP also use this concept.

- **Relax development and licensing requirements/policies**

  As Apple relaxes its software development requirements, it can increase its software innovation by increasing the amount of developers working on new products. This is an efficient way to increase the utility of its products without increasing the cost of developing this software. Moreover, these new software developments can be released in part to regular Intel PC users so Apple can enjoy immediate profits. To protect its ability to continue generating profit, certain functions should expire. Conversely, the version of the software on Apple computers will be fully functional. This will ideally increase desire for a Mac and may help introduce it to the mainstream.

  Relaxing the licensing policies should also help more software and hardware to get into the mainstream, which will increase consumers’ perceptions about Apple computer capabilities. This should help to reintroduce Apple to its original base of educators and to corporate users. This will then result in a network effect of employees of these establishments purchasing Macs for their own homes since they are familiar with them.

  Finally, Apple should develop a version of their OS for PCs. This would essentially mimic the event when Apple made Windows 98 available on Macs. Moreover, this move will allow for collaborations that do not currently exist between Apple and its competitors and potential suppliers resulting in the increasing popularity of its stable operating systems.
Advertise Aggressively

Although Apple has become much more compatible with products such as Office, few in the market realize this. Advertising more heavily will help Apple put to bed the notion of incompatibility of its system with Office software that most use. Some potential and interested buyers believe that Apple does not easily accept documents produced on PCs without significant conversion issues.

Apple should also advertise the stylish component of their computers in a way that is similar to the iPod. They should capitalize on the “halo” effect of consumers who have used their iPods and iPhones since both are very popular and generate excitement.

Apple should advertise their product as being different but superior. In particular, Apple should concentrate on the ease of synchronization with peripherals such as the iPod and iPhone that many consumers already use. Apple should also point out their “superior” OS along with its compatibility.

Digital Music Player Industry

Apple has shaped and led the digital music player industry upon entering in 2001. Keys to its competitive advantage include innovation, strategic partnerships, iTunes compatibility and brand identity resulting in over 70% market share. This stellar performance should be continued.

Continue innovation with product features

A microcosm of the industry, the iPod has closed the gap with other electronic devices with every new development. iPod should continue and extend this trend through innovation. Utilizing the touch screen interface and developing its mobile phone is a key step in this direction.

Apple should also consider expanding the utility of the iPod for some users by offering a device that has more PDA-like navigation or exercise-related functions. There may be a niche group of users who would pay for additional features and functions on the iPod. Apple should offer these features on some of its premium products allowing it to innovate further and appeal to a larger base of consumers.

Stay with only iTunes compatibility

It may be tempting for iPod to become compatible with several different types of players and online music stores. However, a step in this direction will have adverse effects on its relationship with iTunes. The growing popularity and synergistic relationship between the two would not warrant expanding iPod’s compatibility with other players.

While some may be concerned that the limitation of iTunes only will turn consumers away, this will not be the case since iTunes is available for all PC users. Apple should continue to promote iPod’s compatibility with iTunes and iTunes’ compatibility with all PCs.

By continuing to leverage this iTunes relationship, Apple can maintain an innovative competitive advantage by building in iTunes functions to meet future releases of the iPod of which the competitors are not yet aware. Since Apple develops both the hardware and software for its products, it should further its competitive advantage by developing compatibilities between its product lines.

Continue the stylish marketing

The iPod has swept away the competition in no small part due to the unique consumer perception that it is fashionable to own one. Apple should continue to differentiate its iPod not only on the basis of innovation but also on the basis of style to attract a wide demographic and psychographic consumer base.

This stylish perception has attracted both younger and older consumers, which has caused a halo effect to extend to the Apple computers. Apple should attempt to subtly link its iPod with its computers to leverage this halo effect.
Although Apple has a wide variety of customers, it is especially important to reel in the younger consumers to leverage the benefits of consumer loyalty. If consumers are attracted at a younger age, they become comfortable with the names Apple, iPod and any other product beginning with “i,” such as iBook. Moreover, they can buy more Apple products and services over their lifetime. Finally, young consumers help to introduce these products to older consumers such as their parents.

Strengthening Apple’s position in each of these industries benefits the other. Hence, successfully implementing the above-mentioned recommendations should have synergistic long-term benefits for Apple. However, these benefits are not easily recognized since great strategic focus is required in both. Both industries have strong competitors with adequate resources to build competitive advantages. Additionally, several of the competitive advantages that Apple enjoys can be imitated with the exception of brand recognition and loyalty.

**EPILOGUE**

The most significant updates since the writing of the teaching note are:

1. On January 14, 2009 Steve Jobs acknowledged that his health problems were more complex than he originally thought and he announced he would be stepping down as Apple’s CEO at least until June 2009. Tim Cook, the company’s Chief Operating Officer, was appointed to run Apple in Jobs’ absence. Shares of Apple Computer fell 10% on the news.

2. In the holiday season of 2008, a dismal period for the COMPUTER industry, sales of Apple Macs rose 8.3% as compared to the same quarter of the previous year. This was especially significant as shipments from Dell fell 16.4% in the same quarter and shipments from HP dropped 3.4%.

3. Apple started selling iPhones through Wal-Mart in the first quarter of 2009. A leading analyst predicted that by 2013, Apple could capture as much as 40% of the growing smart phone market, selling over 77 million annually.

4. On January 11, 2009 Apple announced that users had downloaded over 500 million applications from the iTunes App Store since the store was introduced in July 2008. The leading category of downloads was games, followed by entertainment utilities.

You can visit [www.apple.com](http://www.apple.com) to read the company’s recent financial results and press releases.
OVERVIEW

As Panera Bread Company headed into 2007, it was continuing to swiftly expand its market presence. The company’s strategic intent was to make great bread broadly available to consumers across the United States. It had opened 155 new company-owned and franchised bakery-cafes in 2006, bringing its total to 1,027 units in 36 states. Plans were in place to open another 170 to 180 cafe locations in 2007 and to have nearly 2,000 Panera Bread bakery-cafes open by the end of 2010. Management was confident that Panera Bread’s attractive menu and the dining ambiance of its bakery-cafés provided significant growth opportunity, despite the fiercely competitive nature of the restaurant industry.

Panera Bread competed with specialty food, casual dining and quick service restaurant retailers including national, regional and locally owned restaurants. Its closest competitors were restaurants in the so-called “fast casual” restaurant category. Fast casual restaurants filled the gap between fast-food and casual, full table service dining. A fast casual restaurant provided quick-service dining (much like fast-food enterprises) but were distinguished by enticing menus, higher food quality, and more inviting dining environments; typical meal costs per guest were in the $7-$12 range. Some fast casual restaurants had limited table service and some were self-service (like fast-food establishments).

Between January 1999 and December 2006, close to 850 additional Panera Bread bakery-cafes were opened, some company-owned and some franchised. Panera Bread reported sales of $829.0 million and net income of $58.8 million in 2006. Sales at franchise-operated Panera Bread bakery-cafes totaled $1.2 billion in 2006.

Already Panera Bread was widely recognized as the nationwide leader in the specialty bread segment. In 2003, Panera Bread scored the highest level of customer loyalty among quick-casual restaurants according to a study conducted by TNS Intersearch. The J.D. Power and Associates’ 2004 Restaurant Satisfaction Study of 55,000 customers ranked Panera Bread highest among quick service restaurants in the Midwest and Northeast regions of the United States in all categories, which included environment, meal, service, and cost. In 2005, for the fourth consecutive year, Panera Bread was rated among the best of 121 competitors in the Sandleman & Associates national customer satisfaction survey of more than 62,000 consumers. Panera Bread had also won “Best of” awards in nearly every market across 36 states.

The case lays out Panera Bread strategy in some considerable detail, plus it provides good financial data on Panera, information about the fast-casual segment of the restaurant industry, and brief coverage of Panera’s chief rivals.

SUGGESTIONS FOR USING THE CASE

The Panera Bread case is a good vehicle for having students identify a company’s strategy and evaluate its pros and cons. There is plenty of information in the case for students to conduct a full-blown SWOT analysis. Doing a SWOT analysis, evaluating Panera’s financial performance, and sizing up the competition from rival restaurant chains constitutes the bulk of the analysis that student will need to do here, once they get a solid grip on Panera’s competitive strategy (which mirror that of broad differentiation). The relatively modest length of the case will please students, and students will easily grasp the nature of Panera’s business.
Because the analysis of Panera Bread is not as demanding as several of the other cases, it is highly suitable for an early case assignment. We suggest assigning the Panera Bread case anytime after coverage of Chapters 1-5.

The assignment questions and teaching outline presented below reflect our thinking and suggestions about how to conduct the class discussion and what aspects to emphasize.

To give students guidance in what to think about and what analytical tools to utilize in preparing the Panera Bread case for class discussion, we strongly recommend providing class members with a set of study questions and insisting that they prepare good notes/answers to these questions in preparing for class discussion of the case.

To facilitate your use of study questions and making them available to students, there is file of suggested study questions for the Panera Bread case that is posted on the student section of the publisher’s Online Learning Center for the 17th edition (www.mhhe.com/thompson); these study questions correspond to the assignment questions that appear in the next section of this TN. (As a point of information, there is a set of study questions posted in the student section of the OLC for each of the 26 cases included in the 17th edition.)

It is really very difficult to have an insightful and constructive class discussion of the Panera Bread case unless students have conscientiously have made use of pertinent core concepts and analytical tools in preparing substantive answers to a set of well-conceived study questions before they come to class. In our classes, we expect students to bring their notes to the study questions to use/refer to in responding to the questions that we pose. Moreover, students often find having a set of study questions is useful in helping them prepare oral team presentations and written case assignments—in addition to whatever directive questions you supply for these assignments. Hence, we urge that you have students make full use of study questions—either those we have provided or a set of your own questions—in preparing each and every case assignment.

There is a splendid accompanying video for the Panera Bread case—about 10 minutes in length—which we suggest showing at the very beginning of the class discussion. Alternatively, you can show the video just prior to asking students for their recommendations on what Panera Bread should do.

We heartily recommend use of the Panera Bread case for written assignments and oral team presentations. Three good assignment questions are:

1. Panera Bread management has employed you as a consultant and asked you to assess the company’s strategy, competitive market position and overall situation, and recommend a set of actions to improve the company’s future prospects. Please prepare a report to the senior executives at Panera Bread that includes
   - an identification of the key elements of the company’s strategy,
   - a discussion of which of the five generic competitive strategies described in Chapter 5 seem most closely match the competitive strategy that Panera bread is employing,
   - the pros and cons of the company’s strategy,
   - an assessment of Panera’s strengths, weaknesses, opportunities and threats,
   - an evaluation of Panera Bread’s financial performance,
   - which rival restaurant chains appear to be Panera’s closest rivals,
   - the strategic issues and problems that Panera Bread’s management needs to address, and
   - a set of action recommendations to deal with these issues and problems.
Your report should be 5-6 pages, plus it should include an assortment of charts, tables, and exhibits to support your analysis and recommendations.

2. (Short written case assignment) What are the pros and cons of Panera Bread’s strategy? What evidence indicates that the strategy is working well or not so well?

3. (Short written case assignment) What does a SWOT analysis reveal about Panera Bread’s overall situation?

ASSIGNMENT QUESTIONS

1. What is Panera Bread’s strategy? Which of the five generic competitive strategies discussed in Chapter 5 most closely fit the competitive approach that Panera Bread is taking? What type of competitive advantage is Panera Bread trying to achieve?

2. What does a SWOT analysis of Panera Bread reveal about the overall attractiveness of its situation? Does the company have any core competencies or distinctive competencies?

3. What is your appraisal of Panera Bread’s financial performance based on the data in case Exhibits 1, 2 and 8? How well is the company doing financially? Use the financial ratios in Table 4.1 of Chapter 4 as a guide in doing the calculations needed to arrive at an analysis-based answer to your assessment of Panera’s recent financial performance.

4. Based on the information in case Exhibit 9, which rival restaurant chains appear to be Panera’s closest rivals?

5. What strategic issues and problems does Panera Bread management need to address?

6. What does Panera Bread need to do to strengthen its competitive position and business prospects vis-à-vis other restaurant chain rivals?

TEACHING OUTLINE AND ANALYSIS

1. What is Panera Bread’s strategy? Which of the five generic competitive strategies discussed in Chapter 5 most closely fit the competitive approach that Panera Bread is taking? What type of competitive advantage is Panera Bread trying to achieve?

The driving concept behind Panera Bread was to provide a premium specialty bakery and café experience to urban workers and suburban dwellers. Its artisan sourdough breads made with a craftsman’s attention to quality and detail and its award-winning bakery expertise formed the core of the menu offerings. Panera Bread specialized in fresh baked goods, made-to-order sandwiches on freshly baked breads, soups, salads, custom roasted coffees and other café beverages. Panera’s target market was urban workers and suburban dwellers looking for a quick service meal and a more esthetically pleasing dining experience than that offered by traditional fast food.

Management’s long-term objective and strategic intent was to make Panera Bread a nationally recognized brand name and to be the dominant restaurant operator in the specialty bakery-café segment. Two key objectives were to expand the number of Panera Bread locations by 17 percent annually through 2010 (see Exhibits 3 and 4) and to achieve earnings per share growth of 25 percent annually.
The Chief Elements of Panera Bread’s Strategy

- Grow the business rapidly by opening both company-owned and franchised outlets.

  - Panera Bread’s franchising strategy was to enter into franchise agreements which required the franchise developer to open a number of units, typically 15 bakery-cafes in a period of 6 years. Franchisee candidates had to be well-capitalized, have a proven track record as excellent multi-unit restaurant operators, and agree to meet an aggressive development schedule. Applicants had to meet eight stringent criteria to gain consideration for a Panera Bread franchise.

- Create a menu featuring “crave-able” food that people trust, serve the food in a warm, community gathering place that makes guests feel comfortable, and provide great service. Management believed that the company’s key to success was “Product, Environment, and Great Service (PEGS).”

- A distinctive menu that positioned Panera Bread to compete successfully in five sub-markets of the food-away-from-home industry: breakfast, lunch, day-time “chill out” (the time between breakfast and lunch and between lunch and dinner when customers visited its bakery-cafes to take a break from their daily activities), light evening fare for eat-in or take-out, and take home bread.

- Regularly review and revise the menu to sustain the interest of regular customers, satisfy changing consumer preferences; and be responsive to various seasons of the year.

- Include healthy items on the menu

- Add more menu items to attract patron to have a light dinner at Panera

- A signature café design with inviting ambiance—make Panera “better than the guys across the street” and make the experience of dining at Panera so attractive that customers will be willing to pass by the outlets of other fast-casual restaurant competitors to dine at a Panera Bread bakery-café. Each bakery-cafe sought to provide a distinctive and engaging environment (what management referred to as “Panera Warmth”), in many cases using fixtures and materials complementary to the neighborhood location of the bakery-cafe.

- Locate Panera Bread units in suburban, strip mall, and regional mall locations. In evaluating a potential location, Panera studied the surrounding trade area, demographic information within that area, and information on competitors. Based on analysis of this information, including utilization of predictive modeling using proprietary software, Panera developed projections of sales and return on investment for candidate sites. Cafes had proven successful as free-standing units, as both in-line and end-cap locations in strip mall, and in large regional malls.

- Supply dough to all Panera Bread stores, both company-owned and franchised—dough-making operations functioned as a profit center. Management believed the company’s fresh dough-making capability provided a competitive advantage by ensuring consistent quality and dough-making efficiency (it was more economical to concentrate the dough-making operations in a few facilities dedicated to that function than it was to have each bakery-cafe equipped and staffed to do all of its baking from scratch).

- Introduce a catering program to extend its market reach into the workplace, schools, and parties and gathering held in homes. Panera management saw catering as an opportunity to grow lunch and dinner hour sales without making capital investments in additional physical facilities.

- Compete on the basis of providing an entire dining experience rather than by attracting customers on the basis of price only. Strive to make dining at Panera a good value—meaning high quality food at reasonable prices—so as to encourage frequent visits.

- Do extensive market research, including utilizing focus groups, to determine customer food and drink preferences and price points.
Grow sales at existing Panera locations through menu development, product merchandising, and promotions at every day prices and by sponsorship of local community charitable events.

Build the Panera Bread brand name and grow consumer awareness of Panera. Franchise-operated bakery-cafes were required to contribute 0.7% of their sales to a national advertising fund and 0.4% of their sales as a marketing administration fee and were also required to spend 2.0% of their sales in their local markets on advertising. Panera contributed similar amounts from company-owned bakery-cafes towards the national advertising fund and marketing administration. The national advertising fund contribution of 0.7% had been increased from 0.4% starting in 2006. Beginning in fiscal 2006, national advertising fund contributions were raised to 0.7% of sales, and Panera could opt to raise the national advertising fund contributions as high as 2.6 percent of sales.

Raise the quality of awareness about Panera by continuing to feature the caliber and appeal of its breads and baked goods, by hammering the theme “food you crave, food you can trust”, and by enhancing the appeal of its bakery-cafes as a neighborhood gathering place.

- Boost consumer trials of dining at Panera Bread at multiple meal times (breakfast, lunch, “chill out” times, and dinner).
- Avoid hard-sell or “in your face” marketing approaches; instead employ a range of ways to softly drop the Panera Bread name into the midst of consumers as they moved through their lives and let them “gently collide” with the brand—the idea was to let consumers “discover” Panera Bread and then convert them into loyal, repeat customers by providing a very satisfying dining experience when they tried Panera bakery-cafes for the first time or opted to try dining at Panera at a different part of the day particularly during breakfast or dinner as opposed to the busier lunchtime hours.
- Increase perception of Panera Bread as a viable evening meal option and attract consumers to try Panera for dinner (particularly among existing Panera lunch customers).

We think students should have little trouble recognizing the Panera Bread’s competitive strategy most closely resembles that of a broad differentiation strategy. Management, we believe, is striving to build a competitive advantage based on the triple combination of Product, Environment, and Great Service (PEGS).

2. What does a SWOT analysis of Panera Bread reveal about the overall attractiveness of its situation? Does the company have any core competencies or distinctive competencies?

**Panera’s Resource Strengths and Competitive Assets**

- An attractive and appealing menu (see case Exhibit 6)—Panera offers high quality food at a good price (the company delivers good value for the money); moreover, it has menu offerings for the more health/weight-conscious diner
- Bread-baking expertise (definitely a core competence)—artisan breads are Panera’s signature product
- Panera Bread is the nationwide leader in the bakery-café segment
- Panera Bread has high ratings in customer satisfaction studies
- A good brand name that management is continuing to strengthen
- The fresh dough operations and sales of fresh dough to franchised stores is a source of revenue and profit (see case Exhibit 1 showing that fresh dough cost of sales to franchisees run well below the revenues from fresh dough sales to franchisees)
- Initial success in catering—extends the company’s market reach
Has attracted good franchisees—sales at franchised stores run a bit higher than those at company-owned stores (see case Exhibit 2)

The financial strength to fund the company’s growth and expansion (see case Exhibit 1) without burdening the company’s balance sheet unduly with debt

**Panera’s Resource Weaknesses and Competitive Liabilities**

- A less well-known brand name than some rivals (Applebee’s, Starbucks)
- Sales at franchised stores run a bit higher than those at company-owned stores—why is this occurring? Are franchisees better operators?

**Panera’s Market Opportunities**

- Open more outlets, both company-owned and franchised—there is untapped growth potential in a number of suburban markets as shown in case Exhibit 3
- Open Panera Bread locations outside the U.S. as market opportunities in the U.S. begin to dry up

**External Threats to Panera’s Future Well-Being and Profitability**

- Rivals begin to imitate some of Panera’s menu offerings and/or dining ambience, thus stymieing to some extent Panera’s ability to clearly differentiate itself from rival chains
- New rival restaurant chains grab the attention of consumers and draw some patrons away from Panera—in other words, competition from other restaurant chains (either those in the fast-casual segment or other restaurant categories) becomes more intense
- Panera Bread begins to saturate the market with outlets, such that it becomes harder to find attractive locations for new stores and the company’s growth slows

**Conclusions Concerning the Attractiveness of Panera Bread’s Overall Situation:** It is nearly always a good idea to impress upon students that SWOT analysis involves more than making four lists. One of the most important parts of SWOT analysis is drawing conclusions from the SWOT listings about the company’s overall situation.

The above SWOT listings for Panera Bread reveal that Panera has some formidable resource strengths/competitive assets and few resource weaknesses/competitive liabilities. And it seems to have adequate market opportunities. Panera’s external threats are, on the whole, modest.

Hence, Panera’s overall situation is attractive and its future prospects seem very promising. The company has a good strategy. It has been successful so far in differentiating itself from other restaurant chains. It has plenty of growth opportunities it can pursue for several years to come, and it has the resource strengths and capabilities to pursue them.

3. What is your appraisal of Panera Bread’s’s financial performance based on the data contained in case Exhibits 1, 2, and 8? How well is the company doing financially?

It is beneficial to push class members to be a regular user of the financial ratios in Table 4.1 of Chapter 4 in doing the number-crunching needed to arrive at an analysis-based answer to their assessment of Panera’s recent financial performance.
If your students do a creditable job of poring through the data in case Exhibits 1 and 2 and crunching some numbers, they should come up with the following:

- Panera’s total revenues have grown from $282.2 million in 2002 to nearly $829 million in 2006, equal to a strong compound average growth rate (CAGR) of 30.9%.
- Franchise royalties and fees are up from $27.9 million in 2002 to $61.5 million in 2006, a CAGR of 21.8%.
- Fresh dough sales to franchisees have grown from $41.7 million (14.8% of total revenues) in 2002 to $101.3 million (12.2% of total revenues) in 2006, a CAGR of 24.8%.
- Net income is up from $21.3 million in 2002 to $58.8 million in 2006, a CAGR of 28.9%.
- EPS is up from $0.71 per diluted share to $1.84 per diluted share, a CAGR of 27.6%.
- Net cash provided by operating activities rose from $46.3 million in 2002 to $104.9 million in 2006, a CAGR of 22.7%.
- Fresh dough sales to franchisees is a nicely profitable and growing part of Panera’s business:

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<tbody>
<tr>
<td>Fresh dough sales to franchisees (in millions of $)</td>
<td>$101.3</td>
<td>$86.5</td>
<td>$72.6</td>
<td>$61.5</td>
<td>$41.7</td>
</tr>
<tr>
<td>Fresh dough cost of sales to franchisees (in millions of $)</td>
<td>85.6</td>
<td>75.0</td>
<td>65.6</td>
<td>55.0</td>
<td>38.4</td>
</tr>
<tr>
<td>Contribution profit (or gross profit) from fresh dough sales to franchisees (in millions of $)</td>
<td>$ 15.7</td>
<td>$ 11.5</td>
<td>$ 7.0</td>
<td>$ 6.5</td>
<td>$ 3.3</td>
</tr>
</tbody>
</table>

- The following table shows various operating and financial ratios calculated for case Exhibit 1:

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<tbody>
<tr>
<td>Bakery café expenses as a % of bakery café sales</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Food and paper products</td>
<td>29.6%</td>
<td>28.6%</td>
<td>28.1%</td>
<td>27.8%</td>
<td>29.8%</td>
</tr>
<tr>
<td>Labor</td>
<td>30.8</td>
<td>30.3</td>
<td>30.6</td>
<td>30.5</td>
<td>29.7</td>
</tr>
<tr>
<td>Occupancy</td>
<td>7.3</td>
<td>7.5</td>
<td>7.4</td>
<td>7.1</td>
<td>7.2</td>
</tr>
<tr>
<td>Other operating expenses</td>
<td>13.8</td>
<td>14.0</td>
<td>14.1</td>
<td>13.8</td>
<td>13.2</td>
</tr>
<tr>
<td>Total bakery café expenses</td>
<td>81.5%</td>
<td>80.4%</td>
<td>80.2%</td>
<td>79.2%</td>
<td>79.9%</td>
</tr>
<tr>
<td>General and administrative expenses as a % of total revenues</td>
<td>7.2%</td>
<td>7.2%</td>
<td>7.0%</td>
<td>7.7%</td>
<td>8.9%</td>
</tr>
<tr>
<td>Operating profit as a % of total revenues (operating profit margin)</td>
<td>11.0%</td>
<td>12.7%</td>
<td>12.9%</td>
<td>13.7%</td>
<td>12.0%</td>
</tr>
<tr>
<td>Net income as a % of total revenues (net profit margin)</td>
<td>7.1%</td>
<td>8.1%</td>
<td>8.0%</td>
<td>8.4%</td>
<td>7.5%</td>
</tr>
<tr>
<td>Current ratio</td>
<td>1.16</td>
<td>1.18</td>
<td>1.05</td>
<td>1.58</td>
<td>1.83</td>
</tr>
<tr>
<td>Working capital</td>
<td>$18.0 mil</td>
<td>$15.9 mil</td>
<td>$2.5 mil</td>
<td>$26.4 mil</td>
<td>$26.9 mil</td>
</tr>
<tr>
<td>Net income as a % of stockholders’ equity (ROE)</td>
<td>14.8%</td>
<td>16.5%</td>
<td>15.9%</td>
<td>15.8%</td>
<td>14.1%</td>
</tr>
</tbody>
</table>
The numbers in the table show fractional increases in Panera’s bakery café operating expense percentages (not a desirable trend!), declines in the G&A expense percentage (which is good), some erosion of the operating profit margin and net profit margin over time (definitely not a good trend!), declines in liquidity (as measured by the current ratio and working capital numbers), and a fluctuating but still acceptable ROE.

- Overall, the data in case Exhibit 1 show that Panera is growing quite rapidly and is performing well, although not spectacularly. There are, as noted above, some areas of concern; while the areas of weakness as of 2006 are far from alarming, management should be concerned.

- There are some important data of interest in case Exhibit 2:
  - Revenues at company-operated stores have risen from $125.5 million in 2000 to $666.1 million in 2006, a healthy CAGR of 32.1%.
  - Revenues at franchised stores have risen from $199.4 million in 2000 to $1,245.5 million in 2006, an even healthier CAGR of 35.7%.
  - Systemwide store revenues have risen from $324.9 million in 2000 to $1,911.6 million in 2006, also a quite healthy CAGR of 34.4%.
  - Average annual revenues per company-operated bakery café have risen from $1,473,000 in 2000 to $1,967,000 in 2006, a CAGR of 4.9%.
  - Average annual revenues per franchised bakery café have risen from $1,707,000 in 2000 to $2,074,000 in 2006, a CAGR of 3.3%. While sales growth at franchised cafés has been slower, the level of sales is higher (although the gap seems to be narrowing).
  - Comparable bakery café sales percentage increases (which refers to the rate at which sales at existing bakery-cafés are growing once they have been open a year or more) were fairly strong (in the mid-single digits or higher) in 2005 and 2006, up nicely from the sluggish growth experienced in 2003-2004. The 2005-2006 percentage sales gains were comparable to those during 2000-2002.

- There is also some important financial performance data of interest in case Exhibit 8:
  - Students should see that the lion’s share of Panera Bread’s revenues and profits come from its operations of company-owned bakery-cafés.
  - Panera’s profits from franchise operations are quite lucrative. For instance in 2006, revenues from franchise operations were $61.5 million and operating profits from this business segment were $54.2 million—equal to a terrific 88.1% profit margin. The operating profit margins in 2002-2005 were also quite impressive. Hence continuing to open more new franchised stores is quite important to the company’s bottom-line.
  - Fresh dough operations are a distant third among the three business segments in contributing to operating profits.
  - Operating profit as a % of revenues is highest for franchise operations, second highest for company bakery-café operations (equal to 18.5% in 2006, 19.6% in 2005, and 19.8% in 2004), and third highest in fresh dough operations (9.9% in 2006, 9.0% in 2005, and 6.7% in 2004).
  - The company’s capital expenditures were $109.3 million in 2006, of which $86.7 million (or 79.3%) was for company bakery-café operations (presumably most of which went to pay for opening new company-operated cafés)

**Conclusions:** On the whole, we would rate Panera Bread’s overall financial performance as a B+. The company’s growth rate is quite strong, meriting a grade of A- to A. Clearly, the company’s strategy is working from the standpoint of delivering strong growth and good profitability.
4. Which rival restaurant chains appear to be Panera’s closest rivals?

The data in case Exhibit 9 provides a fairly complete list of the primary restaurant chains that could be considered as competing in some way with Panera Bread. Those chains which seem most likely to be Panera Bread’s closest competitors include:

- Atlanta Bread Co.
- Applebee’s
- Bruegger’s
- California Pizza Kitchen
- Corner Bakery Café
- Jason’s Deli
- McAlister’s Deli
- Noodles & Company

and to a lesser extent:

- Cracker Barrel
- Chili’s Grill and Bar

5. What strategic issues and problems does Panera Bread management need to address?

There are several issues that students might wisely choose to put on Panera Bread management’s worry list:

- What to do to correct Panera Bread’s narrowing profit margins.
- What more to do, if anything, to try to boost Panera’s traffic counts at its stores during dinner hours.
- What actions to take to boost sales at company-owned bakery cafés (and put them more on a par or even above the annual and weekly sales levels being achieved at franchised cafés)

6. What does Panera Bread need to do to strengthen its competitive position and business prospects vis-à-vis other restaurant chain rivals?

There are no big or threatening problems/issues that needs fixing or correcting at Panera Bread. There is certainly no need to overhaul or do major surgery on the company broad differentiation strategy. But there are some actions that students should definitely recommend:

- Perhaps the most important thing Panera Bread management can do to further solidify the company’s market standing and competitive position is to continue to open new stores at a rapid clip. There is a first-mover advantage in securing prime retail locations in urban areas—the first restaurants to open in a hot new location or area have a jump on attracting customers, cultivating a loyal clientele, and establishing their brand—it is sometimes harder on the second and third newcomers to justify a big investment in a new facility because of having to compete directly against already existing establishments. Case Exhibit 3 shows the locations where Panera Bread has little or no market penetration.
Attack the causes of Panera Bread’s eroding operating and net profit margins. This probably entails doing a bit better job of controlling expenses at Panera’s company-owned bakery cafés and perhaps increasing menu prices very slightly (1-2%) if cost savings sufficient to restore profit margins to 2002-2003 levels cannot be identified.

Continue to work hard on developing new menu items that will drive up traffic counts at Panera locations, particularly during the evening meal hours when traffic is somewhat light.

Continue with the strategy of opening both company-owned and franchised stores. The recent mix/balance of new company-owned store openings and new franchised store openings (see the bottom of case Exhibit 2) seems about right. Opening more franchised stores is essential to continuing to open so many stores annually—trying to raise the percentages of company-owned stores would likely strain Panera Bread’s balance sheet (due to the need to take on additional debt—each new store costs roughly $2+ million, according to the data in case Exhibit 7). Panera Bread is already spending about $110 million on capital expansion annually (see the capital expenditures data in case Exhibit 8); to cut back on the number of newly-opened franchised stores and thereby pave the way to increase the number of newly-opened company stores would strain Panera’s financial resources.

EPILOGUE

During the first quarter of 2007, Panera Bread purchased 51% of the outstanding stock of Paradise Bakery and Café, owner and operator of 22 company-owned bakery-cafés and 22 franchise-operated bakery-cafés. Panera’s total of 1,101 bakery-cafés open at the end of Q1 of 2007 included 46 Paradise bakery-cafés.

Panera reported 2007 revenues of $1.07 billion (up 28.6% over the 2006 revenues of $829 million), net income of $57.5 million (versus $58.8 million in 2006), and diluted EPS of $1.81 (versus $1.84 in 2006). The company had 1,230 bakery-café locations at the end of 2007, compared to 1,027 at the end of 2006.

Chairman and CEO Ronald Shaich had this to say about the company’s experiences in fiscal 2007:

To understand 2007, we need to understand 2006. The first quarter of 2006 brought comparable bakery-café sales growth of approximately 9%. At that time, we decided to roll out a new pizza-like product called Crispani in an effort to grow our evening business. Based on 18 months of research and testing, we introduced Crispani system wide in late 2006.

As 2006 ended and 2007 began, we saw something we had not anticipated. System wide, our comparable bakery-café sales growth was weaker than we expected. Crispani was delivering incremental sales of 2 percent as expected, but overall transactions were actually decreasing in the rest of the business. Thus, our immediate attention quickly turned to transaction growth, which is system-wide comparable bakery-café sales growth without the effect of price increases. We decided to rebuild transaction growth through a summer seasonal menu rotation, or celebration, featuring several very successful salads and a renewed focus on the quality of operations.

While we were successful in re-energizing transaction growth, several consequences of that effort emerged. First, Crispani compressed our margins significantly. We knew that Crispani required incremental labor and expected that increased sales resulting from Crispani would offset that labor cost. However, we discovered that we could only maintain increased sales when we utilized most, if not all, of our in-store customer communications to make our visitors aware of Crispani’s presence on the menu.

However, we also needed those in-store communication resources to build excitement for our summer celebration. After careful consideration, we choose to sacrifice Crispani sales and Crispani profitability as we refocused on transaction growth in our lunch business in
summer 2007. In addition, in the face of a weakened consumer environment and our own weak transaction growth in the first and second quarters of 2007, we chose to hold off on the price increase that we typically take in August of each year (even though we knew our costs were up). This decision led to further compressed margins. And compressed margins, in turn, lead to weaker returns on new bakery-cafés.

In 2008, management planned to focus on improving Panera Bread’s profit margins, increasing the returns on capital invested in opening new bakery-cafés, and growing the number of customer transactions at its bakery-cafés, all the while trying to increase Panera’s differentiation versus rival restaurant concepts.

For the first 3 quarters of 2008, Panera Bread reported revenues of $941 million (up 23% from the first 9 months of 2007) and net income of $71 million (22% above the earnings for the first 9 months of 2007). As of September 23, 2008, Panera had 1,294 bakery-café locations (555 company-owned and 739 franchised).

Panera expected diluted earnings per share for all of fiscal 2008 to be $2.20 to $2.24 per diluted share—a 23% to 25% increase over fiscal 2007. Its preliminary EPS target for fiscal 2009 was $2.55 to $2.71, an increase of 15% to 22% over 2008. But tough economic conditions were making projections difficult, particularly since customer traffic at Panera stores in Fall 2008 had declined slightly, producing about 3% fewer transactions per store—revenues at locations open at least a year were still running above year earlier levels because of an average 6.5% increase in menu prices.

Management was targeting about 80 to 90 new unit openings in 2009. And the company had already locked in many of its costs for ingredients for 2009. The company had purchased all of its requirements for wheat for fiscal 2009 at an all-in cost of $9.50 per bushel, consisting of a futures cost of approximately $8.50 per bushel and basis cost of approximately $1.00 per bushel. Management was projecting inflation in other costs of approximately 4.0% and retail price increases of approximately 3.5% for 2009.

For the very latest information on developments at Panera Bread, we urge that you check the press releases and the investor relations sections at www.panerabread.com.
OVERVIEW

Rogers’ Chocolates was founded in 1885 by Charles Rogers in Victoria, British Columbia and, in 2007, was Canada’s oldest chocolate company. The privately-held company had achieved spectacular results during the 1980s and 1990s, but had been troubled with declining sales and earnings in its recent history. Ready to see improvements in the company’s performance, Rogers’ Chocolates’ board hired a new president and general manager in March 2007. The new president’s directive from the board was to double or triple the company’s revenues within the next 10 years.

There were multiple options that might produce the desired growth—each of which required a different set of resources and capabilities. The primary growth opportunities that were favored by various constituencies within the company included expanding retail sales within Victoria and British Columbia, expanding retail sales outside of British Columbia, developing an updated image for the company, expanding the company’s online sales and/or expanding the company’s sales in the corporate gift market. Regardless of the growth strategy chosen it was obvious that the new president would have to address some significant issues regarding internal operations and get buy-in from other top managers, the board and employees.

SUGGESTIONS FOR USING THE CASE

The Rogers’ Chocolates case provides students with an excellent opportunity to assess the merits of a variety of strategic options intended to produce growth in revenues and earnings for a small- to medium-sized company. There is sufficient information in the case to allow students to evaluate competition in the market for specialty chocolates in Canada, consider how the industry is changing, and identify the industry’s key success factors. In addition, students will be able to conduct a SWOT analysis and examine the company’s recent financial performance in order to recommend a course of action that provides a solid strategy-situational fit. The relatively modest length of the case will please students, and students will easily grasp the nature of Rogers’ Chocolates business and competitive strategy. Because the analysis of the Rogers’ Chocolates case is not as demanding as several other cases, it is highly suitable for an early case assignment. We suggest assigning Rogers’ Chocolates anytime after coverage of Chapters 1-5. However, the case is also well suited for use in your module on strategy implementation and can be assigned after your lectures on Chapters 10, 11, and 12.

The assignment questions and teaching outline presented below reflect our thinking and suggestions about how to conduct the class discussion and what aspects to emphasize.

To give students guidance in what to think about and what analytical tools to utilize in preparing the Rogers’ Chocolates case for class discussion, we strongly recommend providing class members with a set of study questions and insisting that they prepare good notes/answers to these questions in preparing for class discussion of the case.

*This teaching note reflects the thinking and analysis of the case author, Professor Charlene Zietsma of the Richard Ivey School of Business, University of Western Ontario. We are most grateful for her insight, analysis and contributions to how the case can be taught successfully.
To facilitate your use of study questions and making them available to students, there is a file of suggested study questions for the Rogers’ Chocolates case that is posted on the student section of the publisher’s Online Learning Center for the 17th edition (www.mhhe.com/thompson); these study questions correspond to the assignment questions that appear in the next section of this TN. (As a point of information, there is a set of study questions posted in the student section of the OLC for each of the 26 cases included in the 17th edition.)

It is really very difficult to have an insightful and constructive class discussion of the Rogers’ Chocolates case unless students have conscientiously made use of pertinent core concepts and analytical tools in preparing substantive answers to a set of well-conceived study questions before they come to class. In our classes, we expect students to bring their notes to the study questions to use/refer to in responding to the questions that we pose. Moreover, students often find having a set of study questions is useful in helping them prepare oral team presentations and written case assignments—in addition to whatever directive questions you supply for these assignments. Hence, we urge that you have students make full use of study questions—either those we have provided or a set of your own questions—in preparing each and every case assignment.

The case can be used effectively for written assignments and oral team presentations. We recommend the following questions for written assignments:

1. You have recently been hired by Steve Parkhill, the new president and general manager of Rogers’ Chocolates, to help devise a growth strategy for the company. Parkhill has requested that you prepare an industry and competitive analysis of the premium chocolate industry as well as an internal situation analysis for Rogers’ Chocolates to determine which avenue(s) of growth appear to be the most promising. In response to Parkhill’s request, please prepare a 5-6 page report that identifies a specific growth strategy based on your internal and external analyses. Your report should include specific, actionable strategy recommendations that will allow Rogers’ to achieve 200-300% growth over the next decade while maintaining the company’s culture.

2. As part of your internship with Rogers’ Chocolates, Mr. Steve Parkhill has asked that you evaluate strategic growth options available to the company and make recommendations that will allow the company to achieve 200% - 300% growth within the next 10 years. Your recommendations should be based upon the results of an industry and competitive analysis of the premium chocolate industry and an analysis of Rogers’ Chocolates internal situation. Please prepare a 2 – 3 page executive summary of recommendations that weighs the pros and cons of each avenue of growth and sets forth an action plan for the most viable option. Your executive summary of recommendations should be supported with specific statements linked to your analysis. Exhibits such as a Five Forces model, key success factors, driving forces, SWOT analysis, and financial analysis should be attached to your report. Your supporting exhibits and executive summary of recommendations will be given equal weighting in your grade for the written assignment.

ASSIGNMENT QUESTIONS

1. What is competition like in the premium chocolate industry? Which of the five competitive forces is strongest? Which is weakest? What competitive forces seem to have the greatest effect on industry attractiveness and the potential profitability of new entrants?

2. How is the premium chocolate industry changing? What are the underlying drivers of change and how might those driving forces individually or collectively change competition in the industry?

3. What key factors determine success for producers of premium chocolates?

4. What does a SWOT analysis of Rogers’ Chocolates reveal about the prospects for company’s future success? What are its key resource strengths and competitive capabilities? its resource weaknesses and competitive liabilities? its external opportunities and threats?
5. How would you describe Rogers’ Chocolates’ competitive strategy? How is it positioned in the industry? What specific steps has management taken to implement this strategy? Do the company’s functional strategies and tactics appear to be consistent with its competitive strategy?

6. How well is Rogers’ Chocolates’ strategy working in terms of the financial performance it is delivering? What is your assessment of its level of profitability, its degree of liquidity, and the extent of its leverage?

7. Which of the strategic options available to Rogers’ Chocolates should be given the highest priority? Which of the growth options is the most attractive? Why?

8. What specific actions should Steve Parkhill undertake to improve Rogers’ competitiveness in the Canadian Premium Chocolate Industry? How will the culture of the organization impact Parkhill’s decision? As a relatively new CEO, how would you suggest that Parkhill reconcile the competing growth suggestions championed by various members of the Board of Directors?

TEACHING OUTLINE AND ANALYSIS

1. What is competition like in the premium chocolate industry? Which of the five competitive forces is strongest? Which is weakest? What competitive forces seem to have the greatest effect on industry attractiveness and the potential profitability of new entrants?

![Diagram of competitive forces]

- **Suppliers of Ingredients used in the Manufacturing of Premium Chocolates**: Competitive pressures stemming from supplier-seller collaboration and bargaining.
- **Rivalry among Competing Suppliers of Premium Chocolates**: Competitive pressures created by the jockeying of rival sellers for better market position and competitive advantage.
- **Substitutes for Premium Chocolates**: Competitive pressures coming from the market attempts of outsiders to win buyers over to their products.
- **Buyers of Premium Chocolates**: Competitive pressures stemming from seller-buyer collaboration and bargaining.
- **Potential New Entrants into the Premium Chocolates Industry**: Competitive pressures coming from the threat of entry of new rivals.
Students should have little trouble understanding the competitive forces at play in the premium chocolate industry. In completing this analysis we encourage students to identify specific factors underlying each force and to indicate whether the factor strengthens (+) or weakens (-) the competitive force.

**Rivalry Among Competing Premium Chocolate Producers—a Moderately Strong Competitive Force**

In the discussion of the five competitive forces that follows, we use a + sign to indicate factors acting to strengthen rivalry and a – sign to indicate factors acting to weaken rivalry. The +/- signs are shown in parentheses.

- The Canadian premium chocolate industry has been growing by about 20% annually while the chocolate industry as a whole has been relatively stagnant or falling. (–)

- The gap between the growth of the premium and lower quality markets has spurred a movement by large, traditionally low quality, manufacturers into the premium market through acquisitions and upmarket launches. (+)

- Product differentiation is moderate among makers of premium chocolates. While there is some differentiation with respect to the quality of the chocolate produced, the main differentiating feature is the packaging of the product which helps draw first time users to one premium brand over another. (+)

- Competitors consistently pursue premium placement and packaging changes that make their product more attractive to the consumer. (+)

- With large percentages of annual sales being seasonal, advertising and competitive jockeying for retail sales intensifies during the most profitable periods of the year. (+)

- Switching costs to consumers is low. While the costs of switching from one brand to another are low, consumers of premium chocolates tend to be brand loyal. (–)

- The industry is mostly regional with only a few large players. (neutral)

- Most competitors have similar strategies, offering some customization on wholesale and online purchases and maintaining standardized retail operations. (+)

**Threat of Entry—A Strong Competitive Force**

- With the industry currently composed primarily of regional players there are not significant economies of scale in production that would prohibit entry. (+)

- Significant learning curve effects and lower fixed costs independent of scale, such as favorable long-term leases in retail locations, for incumbents exist that could discourage new entrants. (–)

- Strong brand loyalty and preferences for existing brands would make it difficult for new entrants to take market share. (–)

- There are high capital requirements in the form of manufacturing facilities, machinery, retail space, and distribution channels to launch large scale operations but low capital requirements for local and some regional operations. (neutral)

- With the industry growing at 20% annually potential entrants may see room to flourish in an underserved market. (+)

- This high growth has caused large, well known, low quality manufacturers with large resources to begin positioning themselves to enter this market. (+)

- With a large portion of the market consisting of baby boomers, there is potential for market growth for decades to come. (+)


**Competition from Substitutes—Barriers Depending on the Taste Preferences of Consumers**

- The primary consumers of premium chocolates appreciate high product quality and have a high level of brand awareness. Traditional off-the-shelf candy and chocolates do not compare in the minds of these consumers. This leaves very few substitutes that include upscale, premium candies, cakes, and ice creams. (−)

- Switching costs to the few substitutes are low. (+)

- Average consumers that may purchase premium chocolates on special occasions or as gifts have a wide array of readily available substitutes. The substitutes to these consumers are traditional candy bars, flowers, stuffed animals, hard candy, etc., etc. (+)

- Substitutes are readily available and are sold at lower price points. (+)

- Switching costs for these consumers are also low. (+)

**The Bargaining Power and Leverage of Suppliers—Weak to Moderate for Packaging Inputs; Moderate to Strong for Product Inputs**

- Packaging inputs for the industry can be procured from a multitude of suppliers located around the world. (−)

- There are some costs to switching packaging suppliers for industry members but these costs are not so extreme that they prevent switching. (neutral)

- Packaging inputs are readily available from most suppliers. (−)

- Suppliers of packaging inputs are heavily relied upon to deliver inputs on time and in conjunction with production runs. These inputs are also a large portion of overall product costs. (+)

- It is not economically viable for industry members to backward integrate into production of packaging inputs. (+)

- It is not likely that suppliers will integrate forward. (−)

- Consumer concerns for human rights and environmentally safe packaging increases the pressure on industry members to procure packaging inputs from what are considered responsible suppliers or to pressure suppliers into producing packaging inputs under set terms and conditions. (neutral)

- Production inputs to the industry, such as cocoa beans, are a commodity but can only be grown in certain climates restricting the number of suppliers. (+)

- Switching suppliers of production inputs can be costly if they come from regions or continents other than what the industry member is currently using. This may require new procurement channels and transportation methods. (+)

- Production inputs can be in short supply or abundant depending on the climate that year. (neutral)

- Production inputs are basically standard across the industry. (−)

- Suppliers provide inputs that account for a large portion of the product cost. (+)

- It is neither feasible nor economically viable for market participants to integrate into the production of these inputs. (+)

- It is not likely that suppliers will integrate forward. (−)
Consumer concerns for human rights increases the pressure on industry members to procure production inputs from what are considered responsible suppliers or to pressure suppliers into producing inputs under set terms and conditions. (neutral)

The Bargaining Power and Leverage of Buyers—Weak for Consumers; Moderate for Wholesale Buyers

- Cost of switching brands for retail/online buyers is low, and despite high brand loyalty, many buyers may switch to another brand if they perceive the brand to be equivalent in quality at a lower price. (+)
- Number of buyers is large and the individual buyer is a small portion of the total business. (–)
- Retail/Online buyer purchases are infrequent and small. (–)
- Retail/Online buyers can postpone purchases. (+)
- There are equivalent products from competitors available. (+)
- Cost of switching brands for wholesale buyers, such as large retail chains, is low when there are no contracts in place; however, if contracts are in place the switching costs are high. (neutral)
- Wholesale buyers purchase in larger quantities and on a more regular basis. (+)
- Wholesale buyers can easily compare prices, costs and product quality. (+)
- There is a moderate threat of wholesale buyers, such as food retailers, integrating into this industry. (neutral)
- There are equivalent products from competitors available. (+)
- Wholesale buyers are not able to postpone purchases as easily as individual buyers. (–)

Conclusions concerning the overall strength of competitive forces. Students should conclude that the overall competitive pressures on the premium chocolates industry are moderate and that industry conditions are favorable to above average profit margins. However, class discussion should reveal that when considering the threat of new entrants, the growth potential and the resources that some potential entrants control, this industry is likely to see an increase in the number and/or size of industry participants in the near future. This will inevitably result in an increase in the rivalry among industry participants. An increase in supplier power could result if large manufacturers arrange strategic alliances and/or sole provider contracts with suppliers that restrict the inputs available to other industry participants.

2. How is the premium chocolate industry changing? What are the underlying drivers of change and how might those driving forces individually or collectively change competition in the industry?

If you have time in your class, a useful teaching methodology is to help students differentiate between forces that are impacting the industry and the 3-5 primary drivers of change in an industry.

You may begin by having the class list potential driving forces. Of the 14 most common driving forces described in the text, at least nine of them have some impact on the Canadian premium chocolate industry.

- Emerging Internet capabilities and applications – Thirty percent of Canadian men and 18% of Canadian women shopped online in 2006. This number is likely to increase consistently for many years to come as infrastructure is added to remote areas of Canada, current users increase number of purchases made online, younger users come of age, and older consumers are made familiar with the capabilities and convenience of online shopping. Communications between suppliers, industry participants and customers, large and small, have been improved across many industries due to the Internet, and there is no reason the Canadian Premium Chocolate Industry should be any different.
Changes in the industry’s long-term growth rate – The Canadian Chocolate Industry is projected to grow at 2% annually but has actually fallen in recent years. The Canadian Premium Chocolate Industry, however, has been growing at 20%. This is due to the increase in purchases by aging baby boomers and their preferences for quality and brand. As more and more baby boomers come into the market buyer demand will increase. This will have an effect on the long-term growth rate and could result in projections of high growth for decades to come. If these projections prove accurate, the industry will continue to see interest from potential entrants and actual increases in entry resulting in increasing competition.

Product innovation – For the Canadian Premium Chocolate Industry this driver of change is closely related to marketing innovation. It is clear in the case that packaging and customizability are major factors in what brands consumers like and what brands they decide to try. The companies that have changed their product packaging to appeal to different market segments and those that are innovative in the shapes, sizes, assortments, and customizability options they offer are attracting consumers and will continue to do so. Another aspect of this driver is the change in consumer preferences for organic, healthy chocolate produced by socially responsible corporations. The industry participants that can incorporate these preferences into their product offering stand to gain new and loyal customers.

Marketing innovation – With market growth comes an increased awareness of the product. The larger the buyer pool, the more people there are talking about the product. This along with Canada’s tourism, tourists’ ability to shop online once they return home, and the Olympics coming to Vancouver in 2010 will give industry participants many opportunities to reach new and different consumer segments through traditional and innovative marketing practices. The effects of marketing innovations can also be seen in the wide array of packaging offered by some industry participants.

Entry and exit of major firms – It is stated in the case that major firms have been attracted to and are looking at entering this market. Hershey’s and Cadburys are both named as potential entrants that are already looking for or in the process of acquiring small industry participants or conducting upmarket launches into the industry. Some of the retail chains that were customers of industry participants have also launched their own brands. As stated in the changes in growth rate section, this will result in increased competitive pressures.

Changes in cost and efficiency – Some industry participants have very high overhead and production costs. Unless these companies upgrade their production capabilities or find some way of cutting costs, a gap in costs and efficiency of production is likely to emerge between large manufacturers (Hershey’s and Cadburys) and smaller, established companies (Rogers’).

Growing preferences for differentiated products – This has long been an influence in this market as purchases are driven by preferences for quality and unique, custom gifts and souvenirs. There is also the potential to gain a loyal following by being the first company to differentiate its product to appeal to the consumer preferences for organic, healthy chocolates.

Regulatory influences and policy changes – If manufacturers are able to sway the USFDA into changing the definition of chocolate this could cause a spillover effect into the equivalent Canadian regulatory authority. This change would make it cheaper to produce chocolate and give those companies that are willing to sacrifice quality a cost advantage over rivals.

Changing societal concerns, attitudes, and lifestyles – This driver of change is related to some of the previously mentioned aspects of the industry. Namely, this is connected to the concern for human rights and environmental concerns with respect to production inputs and the growing demand for healthier chocolates. A discussion of this driver may also bring up the topic of the recent economic downturn which will affect the lifestyles of consumers of luxury goods.

The next step is to have students identify the 3-5 primary drivers of change in the industry and discuss how those forces individually and collectively will impact (a) the intensity of competition in the years ahead and (b) future industry profitability.
In the discussion of the primary driving forces marketing and product innovation may be used in conjunction or combined. The primary driving forces in this industry should include a discussion of Internet capabilities, long-term growth, the aforementioned combination, entry and exit of major firms, and cost and efficiency (note: cost and efficiency may not be as pertinent to the industry as a whole as it is to Rogers’).

- **Emerging Internet capabilities and applications** – Individually, this driving force can significantly affect an industry participant’s competitive position. Those companies that can successfully develop, promote, and nurture these capabilities to capture a growing population of online shoppers can capture market share from other companies as well as gain loyal customers in rural and local markets and global markets that are either untapped or underserved. Well designed, easy-to-navigate sites coupled with premium placement by search engines will help to position these companies for future success. These capabilities will increase the intensity of future competition by allowing companies to compete in global markets controlled by firms that are outside of the Canadian market, compete with rivals within the Canadian market that do not offer this service or that have inferior sites, and compete in rural Canadian markets where they have no physical presence. These capabilities will also facilitate faster, easier communication between suppliers, production facilities, retail stores and wholesale customers, thereby cutting production costs and resources wasted by less timely communication alternatives. The effects on future industry profitability are an increased reach and potential customer base and lower costs resulting in higher sales volume, increasing margins, and higher net profits.

- **Changes in the industry’s long-term growth rate** – Individually, a high long-term growth rate signals continued industry profitability. Since the growth rate is so much higher in premium chocolates than in the industry as a whole, entry into this industry will occur resulting in increased rivalry. If, in fact, baby boomers continue to be drawn to this industry, then the growth rate will continue to be very high. The result on competition from a high long-term growth rate and increasing demand from a growing population of potential buyers will be further entry into the market by large broad coverage firms as well as small niche players. Another result will be increases in production capacity by existing industry participants. The impact of increased capacity is that firms will drive down their unit costs. This could affect competition in one of two ways: either the larger players will enjoy higher per-unit profits or they will decrease their prices in an effort to capture more market share causing rivalry to increase further. Ultimately, a high long-term growth rate in this industry will increase competition while future industry profitability should remain relatively unaffected.

- **Marketing and product innovation** – As industry participants begin to offer organic products and continue to differentiate their products through customization and attractive packaging competition will increase to win over the consumer. Companies that combine new, innovative products with effective marketing innovations will capture more of the industry growth than others. The constant jockeying and changes that companies make to their products and marketing campaigns will cause an increase in competitive rivalry, while those that do not focus on this aspect will fall by the wayside and see minimal or no growth. The tactics that work will bring increased awareness to the industry and potentially lead to growth opportunities in new markets which can lead to higher future industry profitability. This is a short term occurrence, however, and as the industry begins to reach maturation and decline in the life cycle the profitability may decline as intense competition forces companies to spend money on marketing innovations that no longer attract as many new first-time customers but instead serve to keep existing customers or capture other industry participants’ customers.

- **Entry and exit of major firms** – The entry of Hershey’s and Cadburys will cause an immediate increase in rivalry among industry participants. The brand recognition and the resources these two companies have at their disposal will allow them to compete on a high, broad level immediately. These two firms have the potential to consume all of the growth in the industry for at least their first year. This will have a dramatic effect on competition and future industry profitability. In a large industry this would not initially have a significant impact as growth may be faster on the demand side than the supply side. But, since the Canadian Premium Chocolate Industry is relatively small at $167 million U.S., both new firm entry and any increases in production capacity that may occur will facilitate an increase in rivalry among competitors since the yearly growth in demand can be met by industry participants quickly. Industry
profitability could be affected in one of several ways. If capacity outruns demand due to competitors’ efforts to gain market share, this will have a negative affect on future industry profitability as it will drive down price and margins. It is more likely, however, that industry participants will plan production accordingly and the result will be continued competition through product and marketing innovations. Another effect entry may have on profitability is an almost immediate increase. If entrants bring with them innovation in production techniques, this could decrease costs and redefine the way premium chocolates are made thereby increasing margins, albeit only in the short run.

- **Changes in costs and efficiency** – This driving force has far different effects on competition and profitability than the others. If some industry participants can achieve cost advantages and/or better efficiency, those companies will experience a decrease in industry rivalry. They will put increased pressure on their competitors that cannot achieve equivalent costs and efficiency causing them to either die or focus on a small niche. This driving force can significantly improve the future industry profitability of those firms that can achieve a wide gap between their costs and efficiency and those of rival firms. Alternatively, if a gap exists and a company or companies can shrink this gap the effects will be reversed.

Collectively, these driving forces act to increase the competitive rivalry while having varying effects on future industry profitability. The Internet offers an alternative venue to increase sales in an already growing market and allows more options to implement innovative marketing techniques while attracting loyal customers and increasing brand awareness. The Internet also provides an additional area for entry by large and small manufacturers, especially small, niche players since it circumvents the need for retail space and staff thereby decreasing costs allowing smaller operations to continue to compete. As long as the market is growing rapidly and industry participants are forced to compete on quality and brand image rather than price, then future industry profitability should remain favorable.

**3. What key factors determine success for producers of premium chocolates?**

Industry key success factors likely to be identified by students include:

- A marketing mix that is supportive of the company’s premium strategy. This would include a **strong brand name and reputation** that customers associate with superior quality. The mix should also include luxury packaging and in-store displays.

- An **appealing product mix** that features standard customer favorites as well as seasonally appropriate products and new product introductions.

- **Extensive distribution channels** in locations and with partners that are consistent with and dedicated to the company’s image and reputation.

- **Superior production capabilities** that enable the company to consistently produce high quality chocolates at competitive prices.

- **Superior inventory management skills** to ensure that chocolates are available to consumers at peak demand times in the necessary quantity and sufficient quality.

**4. What does a SWOT analysis of Rogers’ Chocolates reveal about the prospects for company’s future success? What are its key resources strengths and competitive capabilities? Its resource weaknesses and competitive liabilities? Its external opportunities and threats?**

**Resource Strengths and Competitive Capabilities**

- One of Rogers’ key capabilities is making high quality chocolates. In fact, Rogers has won awards for the quality of its chocolate.
The company has many repeat customers

Rogers’ enjoys having a knowledgeable, dedicated workforce

Most of the top management team appears to be committed to the company’s success

Rogers’ has secured a number of prime retail locations

Superior Internet site and ranking

Favorable image and strong brand loyalty and among core customers especially in the Victoria area

Customer contact information for web, mail, and phone customers

Award winning service and a distinctive in-store experience

Good margins

Resource Weaknesses and Competitive Liabilities

Poor production planning. Ray Won, vice president of production, has not implemented (introduce him somewhere?) any meaningful metrics in his 17 years on the job.

Inconsistent product packaging, some of which is viewed as dated by key consumer groups

The company has serious issues in production including no measures of productivity or efficiency, low production capacity, costly operating procedures including long change-over times and outdated technology

Poor supplier and dealer network. Many of the dealers do not appear to be either sufficiently trained in and/or dedicated to the Rogers’ brand.

The Rogers’ brand is unknown in many areas of Canada

The main customer base is aging

Low on cash and equivalents

External Opportunities

The 2010 Olympics provide a potential avenue for increasing brand name recognition

The premium chocolate industry is still a rapidly growing market

Online sales are growing

Potential new buyer segments and demographics arising from Internet capabilities and tourism

Changing customer demands in terms of environmental sound products

Attractive acquisition targets are available in regional markets

NAFTA (expansion into other markets)

External Threats

Entry of large global firms into Canada in general and into the premium chocolate market in specific

Slowdown in market due to economic hardship may lead customers to go to lower quality brands

Shift in consumer demands toward healthier snack alternatives
Aging existing customer segment

Political turmoil in countries that supply cocoa beans

Current rivals may be acquired by larger companies and/or new entrants may target the premium market

Students should conclude that Rogers’ Chocolates has a number of serious weaknesses that must be addressed by the company’s new president. While the company has a superior product offering and a highly skilled workforce, its weaknesses are likely to prevent it from being able to take advantage of many lucrative opportunities. It will be very difficult for Rogers’ to capitalize on any of the opportunities with its low capacity, poor production and operating procedures, weak dealer network, and very little cash to grow the company. Its future prospects could be extremely lucrative but for Rogers’ to be in a position to take advantage of those prospects it must be willing to change a great deal of its operations and be willing to take on debt. They must focus first on their ability to accurately plan for production. Beyond this they should invest in technology that will assist in production and allow them to accurately tell what their productivity is and if their operations are efficient. Rogers’ should simultaneously be coming up with new, more attractive product packaging and technologies to package the products. There is no reason a handmade chocolate must be hand packaged. If they can afford to do so, Rogers’ should be doing something to increase awareness of the company and its distinguished history. Marketing should play a huge role in the new strategic direction Rogers’ takes. Once some of these major weaknesses are addressed Rogers’ can begin to take advantage of the many opportunities before it. The Olympics, online sales, and changing consumer demands are three opportunities that Rogers’ can easily take advantage of and capture market share once they position themselves properly internally.

5. How would you describe Rogers' Chocolates' competitive strategy? How is it positioned in the industry? What specific steps has management taken to implement this strategy? Do the company's functional strategies and tactics appear to be consistent with its competitive strategy?

Students should have little trouble identifying that Rogers’ is pursuing a focused differentiation strategy based on quality. The company’s products are handmade and highly customizable and are offered at the highest price points. In addition, Rogers’ operates old fashioned service oriented chocolate operated in high traffic tourist areas and maintains wholesale accounts with upscale retail chains through a small dealer network. Almost everything Rogers’ does emphasizes quality and process over price. The company’s functional strategies and tactics complement this strategy as well. Production is stopped when special orders arrive, products are recalled from retail stores to fill wholesale orders despite lower margins, and affluent consumers are targeted through upscale sponsorships and advertising. The company does not rely heavily on radio, print, and TV advertising that targets a more broad range of consumers than usual.

6. How well is Rogers' Chocolates' strategy working in terms of the financial performance it is delivering? What is your assessment of its level of profitability, its degree of liquidity, and the extent of its leverage?

Rogers’ Chocolates strategy has worked well for decades, but has allowed the company’s performance to decline in recent years. The company’s sales and earnings both declined between 2005 and 2006, while the industry grew 20% annually. Students who make calculations similar to what is shown in Table 1 should recognize that the company’s profitability has decreased over the last year, while liquidity and leverage have improved. Students should also note that the company’s financial statements look a little unusual with wide variations in direct material and overhead cost allocations between the two years. These discrepancies certainly warrant further analysis.
Table 1  Selected Financial Ratios for Rogers’ Chocolates, 2005 – 2006

<table>
<thead>
<tr>
<th>Profitability</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Profit Margin</td>
<td>54.6%</td>
<td>55.2%</td>
</tr>
<tr>
<td>Operating Profit Margin</td>
<td>55.9%</td>
<td>58.2%</td>
</tr>
<tr>
<td>Net Profit Margin</td>
<td>7.5%</td>
<td>8.9%</td>
</tr>
<tr>
<td>Return on Total Assets</td>
<td>11.7%</td>
<td>13.6%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Liquidity</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Ratio</td>
<td>1.36</td>
<td>1.24</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Leverage</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt to Assets Ratio</td>
<td>32.4%</td>
<td>43.9%</td>
</tr>
<tr>
<td>Debt to Equity Ratio</td>
<td>48.0%</td>
<td>78.2%</td>
</tr>
</tbody>
</table>

Calculated from case Exhibits 5 and 6.

7. Which of the strategic options available to Rogers’ Chocolates should be given the highest priority? Which of the growth options is the most attractive? Why?

In planning for the future, students may recommend that Parkhill focus on improving internal operations before expanding. If he does not do this, then expansion is likely to exacerbate some of the challenges the company is currently facing. The highest priority should be given to production problems. Without any reliable measure of productivity and efficiency, the company has little control over the business. It is basically akin to driving blind. The company should also be encouraged to examine which of its production techniques are adding value and which are inefficient. One prime candidate for analysis would be the company’s policy of hand wrapping candies.

Growth Options

Expand Chocolate Retail in British Columbia

This option takes advantage of the growing market for premium chocolate and builds on the company’s retail capabilities, strong chocolate products and its current brand recognition. Furthermore, if store capacity can be built prior to the 2010 winter Olympics on the lower mainland, the increased traffic could contribute to windfall gains during the Olympic season, in addition to significantly broader brand awareness among tourists which, in the past, has contributed to growing Rogers’ online and mail-order business.

Some gaps need to be overcome, however. Rogers’ must take a serious look at its brand positioning and test new positions in the Vancouver and Whistler market. If Victoria is truly different, a classic Victoria line should be maintained, but a more contemporary packaging or product line may be required for expansion outside of Victoria. The biggest key success factor in this business appears to be marketing including upscale packaging, and the best-selling packaging today is sleek and modern.

Specialize in Victoria Retail

This option involves developing and owning new retail locations in downtown Victoria that may or may not be associated with the Rogers’ name. Similar to the acquisition of Sam’s Deli, Rogers’ could focus on the acquisition of other retailers, preferably high-end retailers in Victoria, and use its retail capabilities to create strong retail experiences.

However, this option does not leverage Rogers’ strong brand or strong product quality. Rogers’ experience with Sam’s Deli should suggest that acquiring other retail operations has the potential to dilute the company’s focus.
**Grow Outside of BC**

This option might involve a combined wholesale, acquisition and retail strategy. For example, wholesale penetration can be built more strongly in Ontario (a promising market), with select Rogers’-owned retail locations in downtown Toronto, Oakville, Niagara-on-the-Lake and other similar locations. The company stores and the wholesale sales could together reinforce the brand image in a new market. Furthermore, if Rogers’ were to acquire a strong premium Ontario chocolate brand, the company could potentially market both brands together and use the manufacturing facilities of the acquired company. Thus, both revenue and cost synergies could be developed. Furthermore, the brand awareness of the acquired company can help to build Rogers’ own brand awareness if the two brands are paired. This strategy would require significant efforts on multiple fronts simultaneously, and thus requires a very complex implementation. It has significant potential, but does not leverage the brand awareness in BC.

Although this option does leverage product quality and retail capabilities, the retail capabilities reside far away in Victoria, and may be difficult to transfer. This strategy is a higher-risk strategy than the first strategy, although the benefits may be realized in the long run.

**Internet Growth**

Growing the company’s Internet presence can be combined with any of the other growth strategies. It requires very little overhead, achieves the best possible margins, and has been proven in other industries to be a viable, reliable source of revenue. It also allows them to compete in a wider market with a more broadly defined and younger consumer. The biggest obstacle to this growth strategy is getting the word out, but with a little effort by the marketing personnel they should be able to take further advantage of their history, user-friendly site, and high search engine ranking to attract people to their site.

The most attractive growth options appear to be expanding the chocolate retail segment in BC while growing online sales. This strategy represents the safest (because it leverages the most existing capabilities) and potentially most lucrative option in the short run because of the increased tourism attracted by the 2010 Olympic Games and the spin-off benefits that can be expected to the mail-order business. The geographic proximity of the BC market will also enable closer supervision and better learning as the company determines how to grow the brand without as much access to its historical brand strength (yet still more than in Ontario).

8. **What specific actions should Steve Parkhill undertake to improve Rogers’ competitiveness in the Canadian Premium Chocolate Industry? How will the culture of the organization impact Parkhill’s decision? As a relatively new CEO, how would you suggest that Parkhill reconcile the competing growth suggestions championed by various members of the Board of Directors?**

Students should recommend that Steve Parkhill address the production and operating techniques that are causing problems and that new production planning and production control systems need to be implemented. This may, unfortunately, require replacing Wong and/or Bjornson, Vice President of Finance and CFO, who seem unwilling, or unable to make the production and accounting systems more efficient.

Beyond this, Parkhill should start developing new brand concepts, products and packaging that are attractive to more diverse customer groups. Additionally, new products should be featured in the Tastes of Canada promotion and the rebranding initiative should include a new Internet strategy that features advertising campaigns on high traffic sites such as Amazon.com and iTunes.com.

Parkhill should continue to strive to achieve high search engine rankings and have the best site compared to his competitors. They should continue to send out reminders to their current online customers and maybe start offering bonuses or discounts for large orders or new customer orders. Another possibility would be to start a rewards program that allows repeat customers to reduce shipping charges over time or earn free chocolates after some predetermined threshold.
The culture of the organization will likely react negatively to changes in production and operating techniques. Parkhill must use everything in his power to prove to the employees and other stakeholders that these changes are not an attempt to get rid of people or change the image of the company but simply an effort to gain more control over what the company is actually doing and what it is doing well. This will be the biggest obstacle to any strategy Steve Parkhill adopts since any strategy change is going to require better production and operating techniques.

Appeasing the board may actually prove to be the easiest part of adapting a new strategy. As long as he starts slowly with a growth strategy that involves better production and increasing online sales or focusing on the Olympics, he can inform the board that these are simple things that must be done before any drastic changes are necessary. There is no immediate need for Steve Parkhill to dismiss any board member’s ideas. All of the ideas can be pursued by gradually adapting and adopting the strategy. If the time comes that one strategy is shown to be the best or the worst idea then he can approach that when necessary. In the short run he will likely see more adversity from the board if he attempts to adopt one of the more radical growth ideas. For instance, if Parkhill set out to start franchising the company immediately he would see a large backlash from employees, board members, and existing customers alike. As long as he keeps it slow and simple to begin with the board should remain supportive.

EPILOGUE

There was no important company news to report at the time this teaching note went to press. The company's press releases can be found at [www.rogerschocolates.com](http://www.rogerschocolates.com).
OVERVIEW

At the end of 2006, Nucor was solidly entrenched as the second largest steel producer in North America based on total production capacity, with 18 plants having the capacity to produce 25 million tons of steel annually, 2006 revenues of $14.8 billion, and net profits of $1.8 billion. It was the most profitable steel producer in North America in both 2005 and 2006. The company was regarded as the low-cost steel producer in the U.S. and one of the most efficient and technologically innovative steel producers in the world. Nucor had earned a profit in every quarter and every year since 1966—a truly remarkable accomplishment in a mature and cyclical industry where it was common for companies to post losses when demand for steel sagged. Going into 2007, Nucor had paid a dividend for 135 consecutive quarters.

Ken Iverson, the architect of Nucor’s climb from obscurity to prominence in the steel industry, was regarded by many as a “model company president.” In 1972 Iverson initiated a long-term strategy to grow Nucor into a major player in the U.S. steel industry. Under Iverson, who served as Nucor’s CEO until late 1998, Nucor was known for its aggressive pursuit of innovation and technical excellence, rigorous quality systems, strong emphasis on employee relations and work force productivity, cost-conscious corporate culture, and ability to achieve low costs per ton produced. The company had a very streamlined organizational structure, incentive-based compensation systems, and steel mills that were among the most modern and efficient in the U.S. Iverson proved himself as a master in crafting and executing a low-cost leadership strategy, and he made a point of making sure that he practiced what he preached when it came to holding down costs. The offices of executives and division general managers were simply furnished. There were no company planes and no company cars, and executives were not provided with company-paid country club memberships, reserved parking spaces, executive dining facilities, or other perks. To save money on his own business expenses and set an example for other Nucor managers, Iverson flew coach class and took the subway when he was in New York City.

When Iverson left the company in 1998 following disagreements with the board of directors, he was succeeded briefly by John Correnti and then Dave Aycock, both of whom had worked in various roles under Iverson for a number of years. In 2000, Daniel R. DiMicco, who had joined Nucor in 1982 and risen up through the ranks to executive vice president, was named president and CEO. Under DiMicco, Nucor continued to pursue a rapid-growth strategy, expanding capacity via both acquisition and new plant construction and boosting tons sold from 11.2 million in 2000 to 22.1 million in 2006. Following in the tradition of Ken Iverson, two other key elements of DiMicco’s strategy were continuous upgrading of steel plants and always ongoing cost reduction efforts.

But during 2000-2006, acquisitions were center stage in DiMicco’s strategy to grow Nucor’s business. Dimicco saw opportunities to make strategic acquisitions when the economic recession which hit Asia and Europe in the late 1990’s reached the United States in full force in 2000-2001. The September 11, 2001 terrorist attacks further weakened steel purchases by such major steel-consuming industries as construction, automobiles, and farm equipment. Many steel companies in the U.S. and other parts of the world were operating in the red. Market conditions in the U.S. steel industry were particularly grim. Between October 2000 and October 2001, 29 steel companies in the U.S., including Bethlehem Steel Corp. and LTV Corp., the nation’s third and fourth largest steel producers respectively, filed for bankruptcy protection. Bankrupt steel companies accounted for about 25
percent of U.S. capacity. *The Economist* noted that of the 14 steel companies tracked by Standard & Poor’s, only Nucor was indisputably healthy. Some experts believed that close to half of the U.S. steel industry’s production capacity might be forced to close before conditions improved; about 47,000 jobs in the U.S. steel industry had vanished since 1997.

One of the principal reasons for the distressed market conditions in the U.S. was a surge in imports of low-priced steel from foreign countries. Outside the U.S., weak demand and a glut of capacity had driven commodity steel prices to 20-year lows in 1998. Globally, the industry had about 1 billion tons of annual capacity, but puny demand had kept production levels 750 to 800 million tons per year during 1998-2000. A number of foreign steel producers, anxious to keep their mills running and finding few good market opportunities elsewhere, had begun selling steel in the U.S. market at cut-rate prices in 1997-1999. Nucor and other U.S. companies reduced prices to better compete and several filed unfair trade complaints against foreign steelmakers. The U.S. Department of Commerce concluded in March 1999 that steel companies in six countries (Canada, South Korea, Taiwan, Italy, Belgium, and South Africa) had illegally dumped stainless steel in the United States, and the governments of Belgium, Italy, and South Africa further facilitated the dumping by giving their steel producers unfair subsidies that at least partially made up for the revenues losses of selling at below-market prices. Congress and the Clinton Administration opted to not impose tariffs or quotas on imported steel, which helped precipitate the number of bankruptcy filings. However, the Bush Administration was more receptive to protecting the U.S. steel industry from the dumping practices of foreign steel companies. In October 2001, the U.S. International Trade Commission (ITC) ruled that increased steel imports of semi-finished steel, plate, hot-rolled sheet, strip and coils, cold-rolled sheet and strip, and corrosion-resistant and coated sheet and strip were a substantial cause of serious injury, or threat of serious injury, to the U.S. industry. In March 2002, the Bush Administration imposed tariffs of up to 30 percent on imports of selected steel products to help provide relief from Asian and European companies dumping steel in the U.S. at ultra-low prices.

Even though market conditions were tough for Nucor in 2001-2003, management concluded that oversupplied steel industry conditions and the number of beleaguered U.S. companies made it attractive to expand Nucor’s production capacity via acquisition. The company proceeded to make a series of acquisitions:

- In 2001, Nucor paid $115 million to acquire substantially all of the assets of Auburn Steel Company’s 400,000-ton steel bar facility in Auburn, New York. This acquisition gave Nucor expanded market presence in the Northeast and was seen as a good source of supply for a new Vulcraft joist plant being constructed in Chemung, New York.

- In November 2001, Nucor announced the acquisition of ITEC Steel Inc. for a purchase price of $9 million. ITEC Steel had annual revenues of $10 million and produced load bearing light gauge steel framing for the residential and commercial market at facilities in Texas and Georgia. Nucor was impressed with ITEC’s dedication to continuous improvement and intended to grow ITEC’s business via geographic and product line expansion. ITEC Steel’s name was changed to Nucon Steel Commercial Corporation in 2002.

- In July 2002, Nucor paid $120 million to purchase Trico Steel Company, which had a 2.2 million ton sheet steel mill in Decatur, Alabama. Trico Steel was a joint venture of LTV (which owned a 50 percent interest), and two leading international steel companies—Sumitomo Metal Industries and British Steel. The joint venture partners had built the mill in 1997 at a cost of $465 million, but Trico was in Chapter 11 bankruptcy proceedings at the time of the acquisition and the mill was shut down. The Trico mill’s capability to make thin sheet steel with a superior surface quality added competitive strength to Nucor’s strategy to gain sales and market share in the flat-rolled sheet segment. By October 2002, two months ahead of schedule, Nucor had restarted operations at the Decatur mill and was shipping products to customers.

- In December 2002, Nucor paid $615 million to purchase substantially all of the assets of Birmingham Steel Corporation, which included four bar mills in Alabama, Illinois, Washington, and Mississippi. The four plants had capacity of approximately 2 million tons annually. The purchase price also included approximately $120 million in inventory and receivables, the assets of Port Everglade Steel Corp.,
assets of Klean Steel, Birmingham Steel’s ownership interest in Richmond Steel Recycling, and a mill in Memphis, Tennessee, that was not currently in operation. Top executives believed the Birmingham Steel acquisition would broaden Nucor’s customer base and build profitable market share in bar steel products.

- In August 2004, Nucor acquired a cold rolling mill in Decatur, Alabama, from Worthington Industries for $80 million. This 1 million-ton mill, which opened in 1998, was located adjacent to the previously-acquired Trico mill and gave Nucor added ability to service the needs of sheet steel buyers located in the southeastern U.S.

- In June 2004, Nucor paid a cash price of $80 million to acquire a plate mill owned by Britain-based Corus Steel that was located in Tuscaloosa, Alabama. The Tuscaloosa mill, which currently had capacity of 700,000 tons that Nucor management believed was expandable to 1 million tons, was the first U.S. mill to employ a special technology that enabled high quality wide steel plate to be produced from coiled steel plate. The mill produced coiled steel plate and plate products that were cut to customer-specified lengths. Nucor intended to offer these niche products to its commodity plate and coiled sheet customers.

- In February 2005, Nucor completed the purchase of Fort Howard Steel’s operations in Oak Creek, Wisconsin; the Oak Creek facility produced cold finished bars in size ranges up to 6-inch rounds and had approximately 140,000 tons of annual capacity.

- In June 2005, Nucor purchased Marion Steel Company located in Marion, Ohio, for a cash price of $110 million. Marion operated a bar mill with annual capacity of about 400,000 tons; the Marion location was within close proximity to 60 percent of the steel consumption in the United States.

- In May 2006, Nucor acquired Connecticut Steel Corporation for $43 million in cash. Connecticut Steel’s bar products mill in Wallingford had annual capacity to make 300,000 tons of wire rod and rebar and approximately 85,000 tons of wire mesh fabrication and structural mesh fabrication, products that complemented Nucor’s present line-up of steel bar products provided to construction customers.

- In late 2006, Nucor purchased Verco Manufacturing Co for approximately $180 million; Verco produced steel floor and roof decking at one location in Arizona and two locations in California. The Verco acquisition further solidified Vulcraft’s market leading position in steel decking, giving it total annual capacity of over 500,000 tons.

- In January 2007, Nucor announced plans to acquire all of the shares of Canada-based Harris Steel for a total of about $1.07 billion. Harris Steel had 2005 sales of Cdn$1.0 billion and earnings of Cdn$64 million. The company’s operations consisted of (1) Harris Rebar which was involved in the fabrication and placing of concrete reinforcing steel and the design and installation of concrete post-tensioning systems; (2) Laurel Steel which manufactured and distributed wire and wire products, welded wire mesh, and cold finished bar; and (3) Fisher & Ludlow which manufactured and distributed of heavy industrial steel grating, aluminum grating, and expanded metal. In Canada Harris Steel had 24 reinforcing steel fabricating plants, two steel grating distribution center, and one cold finished bar and wire processing plant; in the U.S., it had 10 reinforcing steel fabricating plants, two steel grating manufacturing plants, and three steel grating manufacturing plants. Harris had customers throughout Canada and the United States and employed about 3,000 people. For the past three years, Harris had purchased a big percentage of its steel requirements from Nucor. Nucor planned to operate Harris Steel as an independent subsidiary.

By 2005-2006, steel industry conditions worldwide had improved markedly. Prices in the U.S. were about 50 percent higher than in 2000 and Nucor’s sales and earnings were at all-time highs (see Exhibits 1 and 3). But dumping of foreign-made steel into the U.S. market at below-market prices was still a problem. In April 2005, the U.S. International Trade Commission extended the antidumping and countervailing duty orders and suspension agreement covering imports of hot-rolled steel from Brazil, Japan and the Russian Federation for an additional five years.
The breadth of Nucor’s product line made it the most diversified steel producer in North America. The company had market leadership in several product categories—it was the largest U.S. producer of steel bars, structural steel, steel joist, steel deck, and cold-rolled bars. Nucor had an overall market share of shipments to U.S.-based steel customers (including imports) of about 17 percent in both 2005 and 2006.

**SUGGESTIONS FOR USING THE CASE**

We strongly recommend use of this case in your group of case assignments relating to the material covered in Chapters 3-7. The case is versatile enough to convey a number of strategic management lessons. We’ve not seen a better case for illustrating how to craft and implement a low-cost leadership strategy successfully and why such a strategy can be very powerful from a competitive standpoint. Nucor is a fascinating success story and one of the world’s most adept manufacturers in crafting and executing a low-cost leadership strategy. The case also illustrates the role of technological innovation in driving down costs and transforming a company into a low-cost provider. Nucor’s growth forcefully makes the point that a company can grow and prosper despite highly adverse industry conditions—if the company has a well-conceived and competitively astute strategy. Even though Nucor is a Fortune 500 company, it behaves like a small entrepreneurial enterprise that is trying to carve out a stronger competitive position for itself against industry giants. Nucor is very much a company on the move, and it is employing some very shrewd operating practices to achieve low-cost leadership. The company has a very innovative and successful incentive compensation program that helps it achieve low labor costs. It also has an exceptionally lean corporate structure and a distinctive corporate culture.

The “comprehensive” nature of the case and the rich data it contains on both the industry and on Nucor make the case best-suited for use in the middle or second half of your business strategy module and for testing student capabilities to correctly apply the tools of strategic analysis covered in Chapters 3-7. Because of the somewhat global nature of the case, it makes sense for students to have been exposed to the material in Chapter 7 (Competing in Foreign Markets) prior to being assigned the case.

The Nucor case is a particularly good vehicle for illustrating the power of a low-cost leadership strategy, for drilling the class in industry and competitive analysis and company situation analysis, and for demonstrating to class members how a U.S. manufacturer can compete successfully against low-cost foreign importers. There’s scarcely a better case for drilling students in sizing up a company’s overall competitive position and evaluating its strategic direction and strategy.

We like to ask the class what Nucor does well that accounts for its success and industry standing. After the drivers of its success have been thoroughly explored, then you can probe for where Nucor’s best strategic opportunities lie and what the company should do next.

We suggest teaching the case in straightforward, analytical fashion—using the tools of industry and competitive analysis to diagnose the industry situation, identifying the key elements of Nucor’s low-cost leadership strategy, doing a first-rate SWOT analysis, comparing the value chains of integrated producers versus minimills, identifying the strategic issues that Nucor management needs to address, and having students recommend what Nucor needs to do to remain competitively and financially successful.

However, the Nucor case contains some good detail on how Nucor has gone about implementing and executing its strategy—its use of decentralized decision-making, its incentive compensation systems for both workers and managers, and its corporate culture. Hence, we think the Nucor case can also be assigned as part of a module on strategy implementation or as a “comprehensive case” following your coverage of Chapters 10-12. Nucor should be viewed as a strong candidate for a “final exam” case or a comprehensive written case (or oral team presentation) assigned near the end of the course.

Students have access to a file of study questions for this case that is posted on the student section of the Web site for the text (www.mhhe.com/thompson). These questions are identical to those that appear in the next section of this TN.
The Nucor case merits very strong consideration for a written case assignment or oral team presentation. Our suggested assignment questions, in the event you opt to use the case for a written assignment or an oral team presentation, are as follows:

1. Dan DiMicco, aware of your emerging expertise in strategic analysis, has employed you as an intern to assist him in evaluating Nucor’s situation and future prospects. Mr. DiMicco has asked you to provide him with a 4-6 page report detailing (1) the strength of competitive forces in the steel industry as of late 2006, (2) industry key success factors, (3) the pros and cons of Nucor’s competitive strategy, (4) a SWOT analysis—preferably in the form of an accompanying exhibit, (5) how attractive Nucor’s value chain is compared to the value chains of the integrated steel mills, (6) the strategic issues that Nucor management needs to address, and (7) your recommendations as to what actions he should take to enhance Nucor’s position and future performance particularly as concern competing effectively against low-cost foreign steel imports into the U.S.

2. Dan DiMicco, impressed with your knowledge of strategic analysis, has employed you to assist him and Nucor’s senior executive team in evaluating the company’s growth prospects and determining the wisdom of pursuing a rapid growth strategy via both additional acquisitions and new plant construction. Prepare a 2-3 page executive summary to Dan DiMicco giving him your appraisal of the competitive forces facing Nucor, the attractiveness of making further investments in steel-making capacity in the U.S., and of the company’s ability to compete successfully against both domestic and foreign rivals. He is particularly interested in your recommendations concerning what strategic course the company should follow over the next five years and whether Nucor should continue expanding its steel-making capacity.

**ASSIGNMENT QUESTIONS**

1. What are the primary competitive forces impacting U.S. steel producers in general and the producers like Nucor that make new steel products via recycling scrap steel in particular? Please do a five-forces analysis to support your answer.

2. What driving forces do you see at work in this industry? Are they likely to impact the industry’s competitive structure favorably or unfavorably?

3. How attractive are the prospects for future profitability of U.S. steelmakers? Should Nucor consider expanding in this type of industry environment? Why or why not?

4. What type of strategy has Nucor followed? Which of the five generic strategies discussed in Chapter 5 is Nucor employing? Is there any reason to believe that Nucor has achieved a sustainable competitive advantage over many of its steel industry rivals? If so, what type of competitive advantage does Nucor enjoy?

5. What are the specific policies and operating practices that Nucor has employed to implement and execute its chosen strategy?

6. What specific factors account for why Nucor has been so successful over the past several decades? Do these factors have more to do with great strategy, great strategy execution, or great leadership?

7. What does a SWOT analysis reveal about Nucor’s situation? Does Nucor have any core or distinctive competencies?

8. What is your assessment of Nucor’s financial performance the past several years? How strong is the company’s financial condition?

9. What issues does Nucor management need to address?

10. What recommendations would you make to Dan DiMicco?
Teaching Outline and Analysis

1. What are the primary competitive forces impacting U.S. steel producers in general and the producers like Nucor that make new steel products via recycling scrap steel in particular? What does a five-forces analysis reveal about competition in the U.S. steel industry?

It is worth spending 5-10 minutes of class time establishing just why competitive conditions in the steel industry are currently very tough. A five forces model for the steel industry is depicted below.

Rivalry among Steel Producers—a fierce competitive force

Rivalry revolves heavily around price competition because most steel products are commodities. Producing steel of satisfactory quality is something most producers have mastered. In a commodity market like steel where it is hard to tell the steel products of one steel-maker from those of another, buyers shop heavily for the lowest/best price. However, given the recent strong demand for steel in the U.S. (and also worldwide), meeting customers' delivery schedule requirements is also a competitively relevant consideration for buyers when it comes to selecting whose steel to purchase—this is particularly true when rivals sellers are charging identical or very similar prices.
Another competitive factor of significance is that producers like Nucor are figuring out how use low-cost scrap steel recycling technology to make a wider and wider range of steel products. They are using their newly-developed technological capabilities to enter product segments that used to be the province of the integrated producers, thus precipitating a fierce battle for market share in the newly-entered product categories.

**Competition from Substitutes**—a moderately strong competitive force

Aluminum, plastics and perhaps other materials can be used in place of steel in some products.

**The Threat of Entry**—a moderately strong competitive force

While it is quite unlikely that new start-up firms will enter the steel industry, it is clear from information in the case that existing steel producers anxious to operate their plant at or very near full capacity will seek out customers in geographic markets where they do not currently have a presence. This accounts for why some low-cost foreign producers are thought to be “dumping” their products in the U.S. Moreover, it is clear that “new entry” is occurring when companies like Nucor and Mittal Steel acquire less successful steel producers and try to turn the operations of the newly-acquired companies into strong contenders in the marketplace.

Nucor’s recent acquisitions, for example, represent entry of a potent and competitively successful steel company into either product categories or geographic areas where its presence heretofore may have been fairly minimal. Similarly, Mittal Steel’s growth via acquisition strategy has turned it into a major competitive force worldwide—a new acquisition by Mittal is certain to put added competitive pressure of those rivals that formerly competed head-to-head against the company that Mittal acquired.

Students may also point out here that the growing technological capability of mini-mill producers to use electric arc furnaces to recycle scrap steel and turn it into new types of steel products that heretofore could not be produced by minimill companies like Nucor represents competitively important entry by a new player into these new product categories.

**Bargaining Power of Suppliers**—a moderate competitive force in the case of scrap steel suppliers and union labor (in the case of unionized steel companies) but a weak competitive force otherwise

There’s little in the case to indicate that suppliers are a major competitive factor. However, the price of scrap steel is a key input for mini-mills and rising scrap prices can put them at a competitive disadvantage. But scrap steel prices appear to be a function of overall market demand-market supply conditions rather than a function of the power of individual suppliers of scrap steel.

The power of unions could be a factor in affecting labor costs for steel producers having unionized labor forces, putting such producers at a cost disadvantage vis-à-vis firms with nonunion labor.

**Bargaining Power of Customers**—a moderate to weak competitive force when demand is strong and in short supply but a potent competitive force when demand is weak and steel suppliers are anxious to win a customer’s business

Slack demand conditions allow customers, especially those who buy in large quantities, to bargain for price discounts. Buyer switching costs are relatively low and alternative suppliers are readily available.

Conversely, if strong demand creates a “sellers” market, then the bargaining power of all but the largest buyers is negated—and even large buyers may be able to wrangle only a small concession from sellers of steel products.

**Conclusions:** Students should have little difficulty concluding the competitive conditions can be tough in steel (especially when the available supply outstrips demand) and that price competition tends to dominate the competitive environment because of the commodity-like nature of steel products.
2. What driving forces do you see at work in this industry? Are they likely to impact the industry's competitive intensity and profitability favorably or unfavorably?

Three factors qualify as driving forces here:

- Technological innovation in steel-making via electric arc furnace technology, thin-slab casting, direct casting of carbon steel (Nucor’s Castrip technology) that has allowed companies (like Nucor) to enter product segments formerly dominated by the integrated mills of producers using older, more traditional steel-making technology. This driving force is acting to greatly increase the competitive pressures that mini-mills are putting on the integrated producers—an unfavorable result from the standpoint of integrated producers but a highly favorable result from the standpoint of the producers like Nucor that are leading the charge to use new low-cost steel-making technology.

- Steel-making capacity worldwide exceeds the demand for steel, such that companies anxious to operate their plants at full capacity are seeking to find foreign customers for their output. Thus a number of foreign steel suppliers are shipping some of their output to the U.S. which puts them in head-to-head competition with domestic steel suppliers. High-cost domestic steel suppliers are the hard hit by imported foreign steel.

- Industry consolidation to a smaller number of larger and more competitively successful steel companies (lead in part by the acquisitions of Mittal Steel and Nucor) is acting to heighten competitive pressures. Aggressive companies in reasonably good financial condition (like Nucor) may be able to acquire efficient and perhaps state-of-the-art plants at bargain basement prices, thus enhancing their long-term competitive market position.

The important point for students to grasp at this point is that while industry conditions are tough for high-cost steel producers (who are currently being bailed out by historically high market prices and strong demand—which is unlikely to last), the industry outlook and competitive structure is much brighter for a low-cost producer like Nucor that is in good financial shape and that can benefit from or exploit the weak competitiveness of high-cost steel producers.

In other words, tough industry conditions do not hit all competitors equally hard. As one of the industry’s low-cost producers, Nucor is in good position to gain sales and market share at the expense of the high-cost producers and the financially troubled firms that may be forced to exit the marketplace. Thus while an industry’s market environment may be unattractive to some rivals, it does not follow that the environment is unattractive to all rivals—tough conditions for some may mean opportunities for others. Students need to recognize this.

3. How attractive are the prospects for future profitability of U.S. steelmakers? Should Nucor consider expanding in this type of industry environment? Why or why not?

The point of this line of questioning is to get students to recognize that all U.S. steelmakers are not necessarily in the same boat. High-cost steelmakers are in a precarious position, earning profits in 2005-2006 because of short supplies and historically high market prices, but facing a dimmer future when demand weakens and the market prices for steel products slip. A low-cost producer like Nucor is poised to succeed—gain sales and market share—at the expense of high-cost producers, although it must certainly fight off low-cost foreign suppliers opting to sell in the U.S. to achieve this result.

Hence, we think Nucor should certainly consider expanding its capacity via both additional acquisitions and the construction of new plant capacity. And Nucor should probably be somewhat aggressive in doing so, since it has proven expertise in operating plants efficiently and profitably.
But we suspect that many domestic steel producers will be cautious about expanding in the present environment—unless they have the skills and expertise to be a low-cost operator of any new facilities that are constructed. There may be some tendency for domestic steel producers desirous of expanding to acquire existing steel mills rather than to construct new ones, so as to avoid overcapacity and the price-cutting that occurs in times of excess supply.

4. **What type of strategy has Nucor followed? Which of the five generic strategies discussed in Chapter 5 is Nucor employing? Is there any reason to believe that Nucor has achieved a sustainable competitive advantage over many of its steel industry rivals? If so, what type of competitive advantage does Nucor enjoy?**

Very clearly, Nucor is pursuing a low-cost leadership strategy. Such a competitive approach often is the best strategy in a commodity product industry.

Just as clearly, Nucor has been successful in achieving relatively low production costs. Nucor builds plants inexpensively and operates them efficiently. Nucor’s record of profitability—even during hard times in the domestic steel industry—is strong evidence that Nucor has low costs relative to most other domestic steel producers and probably is quite cost competitive with many foreign steel producers selling products in the U.S.

Furthermore, Nucor’s cost competitiveness is longstanding, not something that it achieved just recently or temporarily. No domestic competitors appear to have costs as low as Nucor—and this has been the case for many, many years. Nucor management seems to miss no opportunities to drive costs out of its business. As a consequence, it is fair to say that Nucor has a sustainable low-cost advantage over domestic steel producers and that it seems able to hold its own in competing against low-cost foreign steelmakers that are selling steel products to customers in the U.S.

5. **What are the specific policies and operating practices that Nucor has employed to implement and execute its chosen strategy?**

The class will undoubtedly see Nucor’s low-cost leadership strategy clearly enough but they may not be as clear about all the things that Nucor has done to achieve its low-cost status. It is one thing for a company to aspire to low-cost leadership and profess its pursuit of a low-cost producer strategy; it is another thing to display the managerial creativity and skills to do the kinds of things needed to become the low-cost leader.

Some of the key operating practices, policies, and approaches that Nucor has employed in pursuit of low-cost leadership status include:

- The aggressive pursuit and implementation of cost-saving technological improvements at its plants.
- Nucor’s incentive compensation system for both plant employees and senior managers—the compensation scheme is highly effective in generating continuous gains in labor productivity and motivating employees to seek out and implement cost-saving ways of operating (see case Exhibit 4).
- Nucor’s HR practices and policies (apart from its incentive compensation)—such as its no-layoff policy and its empowerment of plant employees to implement efficiency improvements
- The company’s low-cost culture and cost-conscious operating practices.
- The company’s pursuit of innovative technologies to enable low costs and Nucor’s profitable entry into new market segments
The emphasis on decentralized decision-making and a very lean corporate staff. Nucor had a simple, streamlined organizational structure to allow employees to innovate and make quick decisions. The company was highly decentralized, with most day-to-day operating decisions made by division or plant-level general managers and their staff. The three building systems plants and the four cold-rolled products plants were headed by a group manager, but otherwise each plant operated independently as a profit center. The group manager or plant general manager had control of the day-to-day decisions that affected the group or plant’s profitability.

Employees were kept informed about company and division performance. Charts showing the division’s results in return-on-assets and bonus payoff were posted in prominent places in the plant. Most all employees were quite aware of the level of profits in their plant or division.

Nucor plants were linked electronically to each other’s production schedules, and each plant strived to operate in a just-in-time inventory mode. Virtually all tons produced were shipped out very quickly to customers and, consequently, finished goods inventories at Nucor plants were relatively small.

6. What specific factors account for why Nucor has been so successful over the past several decades? Do these factors have more to do with great strategy, great strategy execution, or great leadership?

Students ought to single out several factors that account for Nucor’s rather spectacular success over the years:

1. The company’s aggressive pursuit of a low-cost leadership strategy. Nucor is an excellent example of a company with a winning strategy (a clear reason for the company’s success).

2. All of the operating practices, policies, and procedures identified in the answer to question 5 above—not only has Nucor chosen a great strategy for competing, but it has implanted and executed this strategy with considerable proficiency.

3. Nucor has had great strategic leadership, especially in the case of Ken Iverson and Dan DiMicco. There can be little doubt that Nucor’s astute senior executive team is a big reason for the company’s success over the long-term.

All three, taken together, go far towards explaining why Nucor is a standout company in an industry that is highly competitive and often marginally profitable for many steel producers.

Key Teaching Point. Nucor provides a classic example of why great strategy + great strategy execution = great management and great bottom-line performance.

7. What does a SWOT analysis reveal about Nucor’s situation? Does Nucor have any core or distinctive competencies?

Nucor’s Resource Strengths and Competitive Assets

Nucor’s technological expertise and innovative capabilities in steel-making (it is willing to step out and pioneer new advances in mini-mill technology that allow the company to expand into attractive new product categories)—the company has an excellent reputation as a company that aggressively pursues innovation and technical excellence. Nucor is very diligent in monitoring R&D activities in steel production processes worldwide—and then aggressively implementing those innovations that prove worthy. So proficient is Nucor at identifying and implementing innovative and cost-saving technologies that its capabilities here qualify as a core competence if not a distinctive competence.
State-of-the-art plants which are kept in tip-top shape with regard to production efficiency and the latest equipment—the company’s mills are among the most modern and most efficient in the U.S. The company had recently implemented a three-year bar mill modernization program and added vacuum degassers to its four sheet steel mills. The addition of the vacuum degassers not only improved Nucor’s ability to produce some of the highest quality sheet steel available but also resulted in expanded capacity at low incremental cost. All of Nucor’s plants were expected to have ISO 14001 certified Environmental Management Systems in place by the end of 2007.

Nucor’s strong top management—this is a very well managed company that has avoided making strategic mistakes of any significance

Proven skills and expertise in keeping costs low (via lean corporate management, excellent use of incentives, a cost-conscious corporate culture)—the company is the low-cost leader and has been profitable every quarter of every year since 1966, despite industry downturns and sometimes low industry prices for steel products. Nucor management stressed continual improvement in product quality and cost at each one of its production facilities. The company had a “BESTmarking” program aimed at being the industrywide best performer on a variety of production and efficiency measures. Managers at all Nucor plants were accountable for demonstrating that their operations were competitive on both product quality and cost vis-à-vis the plants of rival companies.

A productive, motivated, and well-compensated labor force—strong emphasis on continuous improvements in labor, strong reliance on production incentives (which appear to be highly effective!!), and a no-layoff policy. The company’s HR practices are very well-matched to the company’s low-cost provider strategy. Executives at Nucor had a longstanding commitment to provide the company’s work force with the best technology available to get the job done right in a safe working environment.

A broad line of steel products

Nucor’s proven ability to gain sales and market share in the product categories it has entered—see the data in case Exhibit 3 showing how fast Nucor had boosted tons sold during the 1990-2006 period in each of the product categories where it competes.

The stress that Nucor management placed on continual improvement in product quality and cost at each one of its production facilities. The company had a “BESTmarking” program aimed at being the industrywide best performer on a variety of production and efficiency measures. Managers at all Nucor plants were accountable for demonstrating that their operations were competitive on both product quality and cost vis-à-vis the plants of rival companies

A thrifty, no-nonsense, stripped-down organization; few corporate perks, Spartan corporate facilities; a very cost-conscious corporate culture

Good information systems to monitor/track operations; and employees are kept well-informed about plant performance, division performance, and company performance (plant personnel know what the profit performance of their division is!). In addition, Nucor plants were linked electronically to each other’s production schedules, and each plant strived to operate in a just-in-time inventory mode. Virtually all tons produced were shipped out very quickly to customers and, consequently, finished goods inventories at Nucor plants were relatively small.

The new plant in Trinidad which helped Nucor curtail its dependence on scrap steel as a raw material input. (Nucor acquired an idled direct reduced iron plant in Louisiana in September 2004, relocated its operation to Trinidad (an island off the coast of South America near Venezuela), and expanded the project to a capacity of 1.8 million metric tons. Nucor was currently purchasing 6 to 7 millions tons of iron annually to use in making higher quality grades of sheet steel. Integrating backward into supplying 25 to 30 percent of its own iron requirements held promise of raw material savings and less reliance on
outside iron suppliers. The Trinidad site was chosen because it had a long-term and very cost-attractive supply of natural gas, along with favorable logistics for receiving iron ore and shipping direct reduced iron to Nucor’s sheet steel mills in the U.S.)

- Nucor’s part ownership of the new HIsmelt® technology. Nucor had recently partnered with The Rio Tinto Group, Mitsubishi Corporation, and Chinese steel maker Shougang Corporation to pioneer Rio Tinto’s HIsmelt technology at a new plant located in Kwinana, Western Australia. The HIsmelt plant converted iron ore to liquid metal or pig iron and was both a replacement for traditional blast furnace technology and a hot metal source for electric arc furnaces. Rio Tinto had been developing the HIsmelt technology for ten years and believed the technology had the potential to revolutionize iron-making and provide low-cost, high quality iron for making steel. Nucor had a 25 percent ownership in the venture and had a joint global marketing agreement with Rio Tinto to license the technology to other interested steel companies. The Australian plant represented the world’s first commercial application of the HIsmelt technology. Production started in January 2006, the plant had a capacity of over 800,000 metric tons and was expandable to 1.5 million metric tons at an attractive capital cost per incremental ton. Nucor viewed the Australian plant as a future royalty stream and raw material source. The technology had also been licensed to a Chinese steelmaker that planned to construct an 800,000-ton steel plant in China using the HIsmelt process for its iron source.

- Due to Nucor’s low-cost leadership status, its prices were customarily the lowest or close to the lowest in the U.S. market for steel—this put Nucor in a competitively strong position to fully utilize its production capacity.

- Nucor’s contracts to supply customers and its pricing strategy. Nucor’s status as a low-cost producer with reliably low prices had resulted in numerous customers entering into non-cancelable 6 to 12-month contracts to purchase steel mill products from Nucor. These contracts contained a pricing formula tied to raw material costs (with the cost of scrap steel being the primary driver of price adjustments during the contact period). In 2005-2006, about 45 percent of Nucor’s steel mill production was committed to contract customers. All of Nucor’s steel mills planned to pursue profitable contract business in the future. Nucor’s pricing strategy was to quote the same price and sales terms to all customers, with the customer paying all shipping charges.

- All recently constructed mills were built on big enough tracts of land to accommodate expansion and collaborating businesses

- Heavy reliance on an empowered plant workforce to identify and implement efficiency-increasing ideas.

- A relatively strong financial condition that enabled Nucor to make acquisition and finance new plant construction without taking on burdensome and costly levels of debt.

- Many of the above resource strengths combine to give Nucor a sizable cost advantage over many rivals—a very, very powerful competitive asset in a commodity marketplace like steel

**Nucor’s Resource Weaknesses and Competitive Liabilities**

- The economics at Nucor’s mini-mills is dependent on favorable scrap steel prices and adequate supplies of scrap steel (all steel producers cannot be mini-mills that recycle scrap steel—some producers must make steel from scratch); without recent declines in scrap steel prices of about $18-23 per ton (see case Exhibit 10), the company’s profit margins would likely be negative rather than positive (see the last column of case Exhibit 1 where Nucor’s profit per ton of steel sold averaged about $16 per in 2001). As the market for steel begins to improve and prices for steel products hopefully head higher, rising prices for scrap steel would erode some of the gains in profit margins which Nucor could otherwise expect to realize.
Limited reliance on having a strategic vision and a strategic plan for the whole company (until recently)—in years past, “growth engine” has been to simply build more plants.

Currently depressed prices for steel products have cut deeply into Nucor’s profit margins (see case Exhibits 1 and 9), thus weakening company cash flows and working capital and limiting the funds available to finance new acquisitions. As can be seen from case Exhibit 2, the company’s long-term debt has been rising in the past several years (to 15.9% of total capital from 6 to 7% of total capital in the mid-1990s). While the company’s debt level is by no means alarmingly high and the company would seem to have adequate working capital and additional debt capacity, efforts to make new acquisitions with the aid of debt could put some strains on Nucor’s balance sheet.

Nucor’s Market Opportunities

- Growing the company’s sales and market share in those product categories where it already competes
- Expansion into additional product categories
- Acquiring the plants of other steel industry participants in North America and operating these plants more cost-effectively than prior management
- Exporting steel products to foreign countries
- Buying ownership rights in innovative new technologies (allows Nucor to be one of the first users of such technologies in its own plants and perhaps be in a position to delay the use of such technology by rivals)

Threats to Nucor's Well-Being

- Rising prices for scrap steel (could cut deep into Nucor’s profit margins)
- More low-cost foreign producers of steel opt to sell their products in the U.S.
- Continued excess capacity worldwide, which acts to depress the prices of steel products and encourage foreign steel producers to “dump” their products into the U.S. market at ultra low prices.
- Aggressive rivals (like Mittal Steel) become much more proficient in cutting their costs at existing steel mills and/or acquire cost-efficient steel-making assets that improve their competitiveness vis-à-vis Nucor.

Conclusions: Nucor is a superbly managed company that is in a terrific competitive position because of its effective execution of a low-cost leadership strategy in a commodity business where low-price/low-cost is the predominant key success factor.

Nucor has proven competencies in

- implementing new innovative and highly cost effective steel-making technologies,
- lean, cost effective management of steel plants, and
- achieving high levels of worker productivity in a cost-effective fashion (such that it has low labor costs per ton produced).

There should be no doubt in students’ minds after reviewing the SWOT lists and Nucor’s performance (as presented in case Exhibits 1 and 2) that Nucor is a pretty impressive company, that it is a strong competitor, and that its future prospects are quite promising. Making steel is a tough business with cyclical demand and fierce competition for market share, and Nucor is the standout performer in the U.S. steel industry during the past 35+ years—no other company in the U.S. industry can come close to matching Nucor’s achievements (but certainly the rapid climb of Mittal Steel in the past 5 years is also a very impressive feat).
8. What is your assessment of Nucor’s financial performance the past several years? How strong is the company’s financial condition?

Students should critically review the numbers in case Exhibits 1, 2, and 3 as a basis for evaluating Nucor’s performance and financial condition. Case Exhibit 1 clearly indicates that Nucor has been able to grow its business very consistently over the years. Eager beaver students may run the numbers and come up with the following compound annual growth rates (CAGR):

- CAGR in tons sold to outside customers 1970-2006: 13.86%
- CAGR in net sales 1970-2006: 17.06%
- CAGR in earnings before taxes 1970-2006: 21.84%
- CAGR in net earnings 1970-2006: 22.74%

The data in Case Exhibit 2 indicates that Nucor is in good financial shape and that its financial performance has been particularly strong the past three years (2004-2006). Using the financial ratio information provided in Table 4.1 in Chapter 4 along with calculations of CAGRs, students can determine the following:

- Nucor’s net sales grew from $4.76 billion in 2000 to $14.75 billion in 2006, a very healthy CAGR of 20.7%. The strong increase is due both to rising unit sales volume and rising selling prices per ton (which students should see in columns 2 and 3 in case Exhibit 1 and also the data in case Exhibit 5).
- Nucor’s net earnings grew from $310.9 million in 2000 to $1.76 billion in 2006, equal to a robust CAGR of 33.4%. However the big gains came primarily in the 2004-2006 period.
- Nucor’s diluted net earnings per share of common stock jumped from $0.95 in 2000 to $5.68 in 2006, a strong CAGR of 34.7%. Again, the big gains came in the past three years—EPS was below the 2000 level in 2001, 2002, and 2003.
- The big gains in earnings per share in 2004-2006 have permitted Nucor to boost its dividends quite significantly.
- Nucor’s expense ratios during the lean years of 2001-2003 and the boom years of 2004-2006 were as follows:

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<tr>
<td>Cost of products sold as a % of net sales</td>
<td>76.48%</td>
<td>79.41%</td>
<td>80.24%</td>
<td>95.70</td>
<td>90.02%</td>
<td>90.32%</td>
<td>82.61%</td>
</tr>
<tr>
<td>Marketing, administrative and other expenses as a % of net sales</td>
<td>4.02%</td>
<td>3.89%</td>
<td>3.65%</td>
<td>2.64%</td>
<td>3.66%</td>
<td>3.48%</td>
<td>3.85%</td>
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The rise in Nucor’s cost of goods sold percentages during 2001-2003 is more a reflection of depressed sales prices for steel products than of costs running out of control (as students should be able to see by inspecting the trend of the net sales and cost of products sold numbers in case Exhibit 2 and the steady rise in tons sold numbers in the last column of case Exhibit 3).

During the lean years of 2001-2003, Nucor actually cut marketing, administrative, and other expenses below 2000 levels.

- Nucor’s working capital (defined as current assets minus current liabilities) has increased from $821.5 million in 2000 to $3.23 billion in 2006, giving it substantially more money to conduct business operations and more financial flexibility. The company’s current ratio (shown in the bottom of case exhibit 2) has climbed steadily during the 2000-2006 period.
Nucor’s cash flows from operating activities climbed from $820.8 million in 2000 to $2.25 billion in 2006. These cash flows have been more than sufficient to cover annual capital expenditure (Nucor’s capital expenditures are shown just below the middle of case Exhibit 2).

Even though Nucor’s long-term debt climbed from $460.5 million in 2000 to $922.3 million in 2006, Nucor’s long-term debt as a % of stockholders’ equity dropped from 21.6% to 19.1%; the company clearly has the ability to handle the higher level of debt (much of which is the result of having made so many new acquisitions).

All things considered, Nucor is in very good financial shape as of 2006 and its financial performance during 2004-2006 has been quite strong.

The data in case Exhibit 3 indicates that Nucor has considerable competitive ability to gain sales and market share in the product categories it has entered. The data in case Exhibit 3 tell an impressive story about how fast Nucor had boosted tons sold during the 1990-2006 period in each of the product categories where it competes.

9. Based on your analysis and assessment of Nucor's situation, what issues does Nucor management need to address?

We think it is always wise to push the class to sum up its analysis and assessment of a company’s situation by identifying and precisely stating what issues need to be on top management’s “worry list.” Zeroing in on exactly what strategic issues that company managers need to address—and resolve—for the company to be more financially and competitively successful in the years ahead forces students to think strategically about the results of their industry and competitive analysis and their evaluations of the company’s situation, competitiveness, and performance. The challenge here for students is to get a clear fix on exactly what strategic and competitive challenges confront the company, which of the company’s competitive shortcomings need fixing, what obstacles stand in the way of improving the company’s competitive position in the marketplace, and what specific problems merit front-burner attention by company managers. Pinpointing the precise things that management needs to worry about sets the agenda for deciding what actions to take next to improve the company’s performance and business outlook.

In our classes, we stress the importance of stating the issues and problems clearly and in precise terms. The worry list thus always centers on such concerns as “how to…”, “what to do about…….”, and “whether to…….”—it is not about making recommendations as to what actions to take.

In Nucor’s case, we see the following issues that students ought to single out:

- Whether to continue to expand the company’s steel-making capacity and, if so, what balance to strike between making additional acquisitions versus building new plants.

- How best to deal with the threat posed by the growing volume of low-priced foreign imports in Nucor’s core U.S. market? Or, to put it another way, how to combat competition from foreign steel producers?

- Whether to invest additional resources in trying to develop a low-cost substitute for scrap steel (as a way of combating the company’s dependence on scrap steel and its vulnerability to rising scrap steel prices)?

- Whether to continue to focus on the market for steel in the U.S. or to begin to expand into select foreign markets?
10. What recommendations would you make to Dan DiMicco?

The actions that students recommend should probably involve the following:

- Continue to aggressively pursue a low-cost leadership strategy—it is clearly the best strategy for Nucor and is well-suited for competing in the steel industry. No major changes in competitive strategy are thus called for.

- Continue to seek out profitable opportunities to expand the company’s production capacity. Nucor has done a great job of taking sales and market share away from higher cost steel-making competitors. It should be able to continue to do so. Whether to expand via acquisition or by new plant construction should be driven by opportunity. If interesting acquisition opportunities appear, then pursue them and make additional acquisitions. If building additional plant capacity appears promising (and perhaps lower cost than making additional acquisitions in a particular product category or geographic market segment), then by all means go ahead with new plant construction. Nucor has proven it can be successful via both new acquisition and new plant construction—there is no reason to just go with one avenue for expanding production capacity. The balance between acquisition and new plant construction should be governed by whichever presents the best (least cost) option in a given product category or geographic where growth opportunities are identified.

The numbers in case Exhibit 3 are powerful testimony to the growth that Nucor has been able to achieve in competing in the U.S. market for steel products. There is nothing in the case that would lead one to conclude that Nucor has run out of growth opportunities in the U.S.—the company ought to be successful in growing its sales over time in most or all of the steel products categories where it now competes. An economic slowdown could, of course, slow or delay Nucor’s ability to continue to increase tons shipped—the steel industry is definitely a cyclical industry. Yet, Nucor boosted its sales volume during the lean years of 2001-2003.

- There are really only two primary ways to deal with the threat of low-cost foreign imports: (1) continue to be aggressive in seeking out and implementing ways to lower the company’s cost of making steel products and (2) work to persuade the U.S. government to protect U.S. steel companies from dumping and other unfair competitive practices via either tariffs or import quotas on the steel products of offending companies and/or nations. Nucor’s best defense is definitely having low costs on a par with those of companies in foreign countries. Depending on the U.S. government for protection is unreliable and uncertain of success.

- It is probably a bit premature to commit to making big additional investments in trying to develop a low-cost substitute for scrap steel (as a way of combating the company’s dependence on scrap steel and its vulnerability to rising scrap steel prices). Nucor needs to gain a bit more experience with the recent investments it has made to learn how well they are working, to master the process of producing scrap steel substitutes, and to make sure that its techniques for producing these substitutes are as cost efficient as possible. If over the next year or two, it becomes clear that substantial cost savings are possible in producing its own scrap steel substitutes (or sourcing these substitutes from suppliers), then it can commit additional funds to such endeavors.

- Expanding into the markets of foreign countries needs to be pursued cautiously, if at all. There would seem to be ample opportunities in the U.S. market for Nucor to grow, since the U.S. has a number of high-cost steel producers which Nucor can probably outcompete. Wading into foreign markets would seem more perilous, unless Nucor can do so with a cost advantage over rivals (perhaps because of its exclusive access to lower-cost steel-making technologies or maybe because of its low-cost operating practices).
EPILOGUE

In 2007, Nucor had record revenues of $16.6 billion (compared to $14.8 billion in 2006). Net income in 2007 was $1.47 billion (down 16.3% from the all-time record of $1.76 billion in 2006).

For the first 3 quarters of 2008, Nucor reported record revenues of $19.51 billion (up 60% over the $12.2 billion in revenues for the first 9 months of 2007) and record earnings (for just 3 quarters) of $1.73 billion.

The strong increases in sales and net earnings for the first 9 months of 2008 were attributable in part to the significant acquisitions made by Nucor in the last 21 months, including Harris Steel in March 2007 and The David J. Joseph Company in February 2008. Nucor had also used these two companies as platforms for additional acquisitions to grow its rebar fabrication and scrap businesses.

In August 2008, Nucor’s Harris Steel subsidiary acquired all of the common shares of Ambassador Steel Corporation for a cash purchase price of approximately $185 million. At closing, Harris Steel also repaid Ambassador’s bank debt of approximately $136 million. Based in Auburn, Indiana, Ambassador was a fabricator and distributor of concrete reinforcing steel and related products.

Also in August 2008, Nucor’s subsidiary, The David J. Joseph Company, completed the acquisition of substantially all the assets of the American Compressed Steel operations of Secondary Resources, Inc. American Compressed Steel had facilities in Kansas City, St. Joseph, and Sedalia, Missouri, and processed nearly 180,000 tons annually. DJJ is now operating these facilities under the Advantage Metals Recycling, LLC name.

In July 2008, Nucor completed the acquisition of 50% of the stock of Duferdofin - Nucor S.r.l., for the purchase price of approximately $667.0 million. Duferdofin - Nucor S.r.l. operates a steel melting and bloom/billet caster in San Zeno, Italy as well as rolling mills in Pallanzeno and Giammoro, Italy. Total production in 2007 was approximately one million tons. A new merchant bar mill, which is expected to produce approximately 450,000 tons, was under construction at the Giammoro plant and was expected to be fully operational in late 2008.

In July 2008, Nucor announced plans to install a plate heat treating facility at its plate mill in Hertford County, North Carolina. The heat treat line will have an estimated annual capacity of 120,000 tons the ability to produce heat treated plate from 3/16” through 2” thick. Total cost of the project was expected to be approximately $110 million.

Looking past the first 9 months of 2008, Nucor management said:

Entering the fourth quarter, the global economy has been negatively impacted by the crisis in the financial markets. What started out as a seasonal slowdown -- due to temporary global market disruptions such as the six-month China Olympics effect and the Middle Eastern religious holidays -- has now been overwhelmed by a worldwide financial crisis that is unique in both size and scope in our lifetime. The business environment has obviously become significantly more challenging for everyone including Nucor. There is little forward visibility on either the economy or our industry, even for the fourth quarter. These conditions are such that financial projections are not practical. Therefore, we will not be providing numerical or qualitative guidance at this time. We will give an update of our business at the normal time midway between our quarterly earnings releases.

What we can say is that 2008 will be another record year for Nucor and today our competitive position is stronger than ever, both here and globally. If recent initiatives by the world’s governments to stabilize financial markets are successful, then businesses should see significantly improved access to credit and resulting improved business conditions beginning early in 2009. We are still strong believers in the long-term strength of the global infrastructure build and the associated bull market for steel. It is this global growth in steel demand that will help drive Nucor’s growth and profitability.
As of the end of 2008, Nucor made more steel in the United States than any other company. As of mid-December 2008, Nucor’s stock price was trading at about $43-45, with a 52-week high of $83.56 and a 52-week low of $25.25. During 2008, Nucor paid its shareholders a quarterly base dividend of $0.32 and a quarterly supplemental dividend of $0.20—equal to a total of $1.56 for the first three quarters of 2008.

For the very latest information on developments at Nucor, we urge that you check the press releases and the investor relations sections at www.nucor.com.
OVERVIEW

The video game industry, which grew in prominence with the 1985 introduction of the Nintendo Entertainment System (NES), was well into the battle for supremacy among third generation consoles in 2008. Whereas, the first generation NES console had limited processing capabilities and offered rudimentary graphics, the latest generation of game consoles that were launched by Microsoft in November 2005 and by Nintendo and Sony in November 2006 were equipped with powerful microprocessors, hard drives, Internet connectivity, and offered high definition graphics resolution. Video game industry analysts and consumers alike were quite impressed by the capabilities of third generation video games. Both Microsoft’s Xbox 360 and Sony’s PlayStation 3 allowed users to play highly sophisticated and lifelike games with others in their homes or with gamers located anywhere in the world who had Internet connectivity. The Nintendo Wii also allowed users to play games online, but its unique wand controller was the key to its success in the marketplace. The Wii controller took over one year to develop and was able to respond to hand motions that were used in throwing a ball, casting a fishing line, swinging a baseball bat, pointing a gun, or playing a musical instrument.

The Sony PlayStation 3, Microsoft Xbox 360, and the Nintendo Wii proved to be “must have” gifts during the 2006 and 2007 holiday retail seasons, with production at none of the three companies being able to keep up with demand. When January 2008 arrived, Nintendo had proven to be the early winner of the next generation console war with Wii sales exceeding 20 million units. Microsoft’s Xbox 360 installed base had grown to more than 17 million units, while Sony’s installed base in January 2008 stood at just over 10 million. In addition, Nintendo had captured a solid lead in the handheld game category with the Nintendo DS selling more than 8.5 million units in the United States alone during 2007. Sony’s PlayStation Portable (PSP) was a distant runner up in the handheld game segment with 2007 U.S. sales of 3.8 million units. To make matters worse, Sony was said to have lost as much as $300 on the sale of each PlayStation 3 (PS3) and its older generation PlayStation 2 outsold the PS3 by nearly 400,000 units during the 2007 holiday shopping period.

Going into the 2008 holiday retail season, industry analysts were awaiting signs that the PlayStation 3 would match the success of the PlayStation 2 (PS2), which had sold nearly 120 million units since its October 2000 launch. It has been assumed that PS2 users would migrate to the PS3, but so far, the Microsoft Xbox 360 seemed to be the preferred console for graphics-oriented gamers. Analysts had predicted since its November 2006 launch that gamers would tire of the Wii’s wand controller and Nintendo’s reliance on the youth and adult market for both the Wii and handheld DS would fail to attract avid gamers who purchased the largest percentage of the industry’s game software. Year-end 2008 sales data that was set for release in January 2009 would provide an indication of the relative competitive positions of Microsoft, Nintendo, and Sony in the market for video game consoles.
SUGGESTIONS FOR USING THE CASE

Students should find Competition in the Video Game Console Industry an interesting case since all but a few grew up playing video games. Most of your students probably received Nintendo 64, Sega Genesis, or PlayStation consoles or Nintendo GameBoy handheld games as gifts when they were children. It’s also likely a majority of your students currently own a handheld game or console mentioned in the case.

We recommend using the case immediately following your coverage of Chapter 3. Competition in the Golf Equipment Industry in 2008 and Competition in the Movie Rental Industry in 2008 are other cases that are ideally positioned immediately after your lecture on Chapter 3. All three cases are excellent leadoff cases for drilling students in industry and competitive analysis and were included specifically for this purpose. The video game console industry case is ideal for demonstrating use of the five-forces model and analyzing the impact of the five competitive forces on overall industry attractiveness. In addition, the driving forces analysis is quite important as it demonstrates that the dynamics of competition in the industry are in the midst of dramatic change. There is ample material in the case to allow students to go beyond five-forces analysis and determine the dominant industry economic characteristics, examine strategic positioning through the use of a strategic group map, and evaluate industry key success factors. The decision focus of the case centers on what strategies industry rivals might consider to ultimately win the battle among next generation video game consoles.

The Student Edition of the Online Learning Center (OLC) provides students with copies of the assignment questions contained in this note. The list of assignment questions leads students through a thorough industry analysis and prepares them to make strategy recommendations for selected companies. We suggest that you always direct students to the assignment questions posted on the Crafting & Executing OLC and instruct them to use the assignment questions to prepare for the class discussion of the case. We always instruct our students to read the case once to gain a general understanding of the issues presented in the case and then return to the case to prepare written responses to each of the assignment cases. We’ve found that our students who follow this approach are well-prepared to make a meaningful contribution to the class discussion.

There is a 2:48 second video that accompanies this case that discusses how the Wii has expanded the market for video games by appealing to non-traditional gamers. It is best to show the video at the very beginning of the class discussion.

The case can be used effectively for a written assignment. Our recommended questions for written assignments are as follows:

1. You have recently been hired by Microsoft’s Entertainment and Devices Division as an analyst and have been assigned to its Xbox 360 strategy group. During your first meeting with the strategy group, the team leader asked that you prepare an analysis of the video game console industry for distribution at the next meeting. Please prepare a 5-6 page report that includes a description of the industry’s dominant business and economic characteristics, evaluates competition in the industry, assesses industry driving forces, and lists industry key success factors. Your report should also include a strategic group map of the entire video game industry and specific strategy recommendations that will allow the Xbox 360 to become the leading next generation console.

2. As a new member of Nintendo of America’s brand management team, you have been asked to prepare an analysis of the video game console industry. Your 2-3 page executive summary should specify recommendations that will solidify the Nintendo Wii and the Nintendo DS the industry’s leading next generation game systems. The executive summary should be supported by your analysis of the industry. Exhibits such as a Five Forces model, dominant industry characteristics, key success factors, driving forces, and a strategic group map should be attached to your report. Your supporting exhibits and executive summary of recommendations will be given equal weighting in your grade for the written assignment.
ASSIGNMENT QUESTIONS

1. What are the strategy-shaping business and economic characteristics of the console segment of the video game industry? What is the industry like?

2. What is competition like in the video game system industry? Which of the five competitive forces is strongest? Which is weakest? What competitive forces seem to have the greatest effect on industry attractiveness and the potential profitability of new entrants?

3. How is the video game system industry changing? What are the underlying drivers of change and how might those driving forces individually or collectively change competition in the industry?

4. What does your strategic group map of the video game industry (all segments) look like? Which strategic groups do you think are in the best positions? The worst positions?

5. What key factors determine the success for video game console producers?

6. Which console makers seem to be best able to perform the industry’s key success factors and other measures of competitive strength? What ratings do Microsoft, Sony, and Nintendo merit in a competitive strength assessment?

7. What recommendations would you make to Microsoft to win the next generation battle in the video game console industry? to Sony? to Nintendo?

TEACHING OUTLINE AND ANALYSIS

1. **What are the strategy-shaping business and economic characteristics of the console segment of the video game industry? What is the industry like?**

   Students should be able to identify the following business and economic characteristics of the console segment of the video game industry.

   - **Segmentation:** The industry was segmented into console hardware, console software, handheld hardware, handheld software, PC software, online games, interactive TV, and mobile phone games. Case Exhibit 3 presents the sizes of each segment of the industry for 2000, 2003, 2005, and projections for 2010.

   - **Market size.** The total size of the global video game industry exceeded $35 billion in 2005. The video game console industry totaled nearly $3.9 billion in 2005.

   - **Market growth rate.** The video game industry had grown at a 7.7% compounded annual growth rate between 2000 and 2005 and was projected to grow at 7.8% between 2005 and 2010. Students should note that growth rates for segments within the industry varied substantially and were typically a function of next generation launches. Table 1 presents compounded annual growth rates for all segments of the video game for 2000 – 2005 and projected growth rates for 2005 – 2010.
Table 1 Compounded Annual Growth Rates For The Video Game Industry, 2000 – 2005 and 2005 – 2010 (projected)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Console Hardware</td>
<td>-4.1%</td>
<td>8.2%</td>
</tr>
<tr>
<td>Console Software</td>
<td>6.7%</td>
<td>5.6%</td>
</tr>
<tr>
<td>Handheld Hardware</td>
<td>14.7%</td>
<td>-15.0%</td>
</tr>
<tr>
<td>Handheld Software</td>
<td>11.0%</td>
<td>-8.4%</td>
</tr>
<tr>
<td>PC Software</td>
<td>-3.2%</td>
<td>-7.3%</td>
</tr>
<tr>
<td>Broadband</td>
<td>94.4%</td>
<td>26.7%</td>
</tr>
<tr>
<td>Interactive TV</td>
<td>57.5%</td>
<td>31.0%</td>
</tr>
<tr>
<td>Mobile</td>
<td>108.7%</td>
<td>34.2%</td>
</tr>
<tr>
<td>Total</td>
<td>7.7%</td>
<td>7.8%</td>
</tr>
</tbody>
</table>

Calculated from case Exhibit 3.

- **Entry/Exit barriers.** Barriers to entry were all but insurmountable. Successful new entrants were required to have sufficient capital and technological capabilities to develop sophisticated game hardware systems capable of performing highly complex calculations. Other barriers to entry included the establishment of an installed base of sufficient size to provide an adequate incentive for independent software developers to create games for a new game system. With game development costs for next generation systems approximating as much as $20 million, game developers were unwilling to make such an investment unless there was some certainty that millions of software units would be sold. Additionally, gamers would not purchase game systems that did not have a large inventory of game titles available. Another barrier to entry was access to retailers. Electronics retailers and discounters had limited shelf space to allocate to multiple game systems and game software titles.

- **Scope of rivalry.** Rivalry in the industry could be considered global, with the three largest sellers of game systems competing against each other in all world markets.

- **Scale economies.** Economies of scale were necessary to keep game system and component development expenses at acceptable per unit levels. Next generation game system and component development costs were so high that analysts believed Sony would lose as much as $300 per PlayStation 3 unit sold until its cumulative production volume approached 20 million units.

- **Consumer characteristics.** Case Exhibit 2 presents an extensive list of characteristics of video game enthusiasts in the United States. The average player spent about 6.8 hours per week playing video games in 2005. In 2005, 31% of gamers were under age 18, but the percentage of gamers over 50 had increased to 25% from 13% in 2000. Also in 2005, 62% of gamers were male.
2. **What is competition like in the video game system industry? Which of the five competitive forces is strongest? Which is weakest? What competitive forces seem to have the greatest effect on industry attractiveness and the potential profitability of new entrants?**

*Substitutes for Video Game Systems*
- Competitive pressures coming from the market attempts of outsiders to win buyers over to their products

*Suppliers of Raw Materials and other inputs used in the Manufacturing of Video Game Consoles*
- Competitive pressures stemming from supplier-seller collaboration and bargaining

*Rivalry among Competing Video Game System Sellers*
- Competitive pressures stemming from the jockeying of rival sellers for better market position and competitive advantage

*Buyers of Video Game Systems*
- Competitive pressures stemming from seller-buyer collaboration and bargaining

*Potential New Entrants into the Video Game Console Industry*
- Competitive pressures coming from the threat of entry of new rivals

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**The bargaining power and leverage of buyers**—a weak competitive force

Big box electronics store and discount store buyers had relatively little leverage in negotiations with sellers of video game consoles. Consumers expected retailers to carry the three leading brands of consoles and the top-two brands of handheld games. A decision by retailers not to carry the leading brands of game consoles would negatively impact the retailer’s image with consumers. Students may suspect that manufacturers had uniform pricing for retailers, regardless of size, because of the standardized retail prices of game consoles.

**The bargaining power and leverage of suppliers**—a moderately strong competitive force

Students will easily conclude that suppliers of microprocessors and graphics processing units (GPUs) had a moderate degree of leverage with console manufacturers because of the collaborative development process utilized in the industry. Console makers were unable to negotiate between sellers of core components, since microprocessors and GPUs were specifically designed for a system. There was no opportunity to take competing bids for core components once the system was designed. Students can rightfully argue that video
game console producers did have the ability to negotiate terms with components manufacturers prior to the development of a next generation system. Students might also correctly suggest that console producers had more leverage in negotiations with suppliers of memory chips and components used in the production of peripherals such as cables and wired controllers. The suppliers of key components used in motion sensing wireless controllers likely had supplier-seller relationships similar to those existing between the suppliers of microprocessors or GPUs.

**Competition from substitutes**—a moderately strong competitive force

There were many recreation and entertainment substitutes to video games. Video gamers could engage in outdoor sports or other activities or find entertainment indoors by watching television, reading, listening to music, surfing the Internet, playing board games, or playing a musical instrument. However, the interactive nature of video games was very intriguing for many young people and older gamers. Students should point out that other gaming platforms such as PC games, handheld games, and mobile phone games were also substitutes for console-based video games.

**Threat of entry**—a weak competitive force

Entry barriers that include considerable console development costs, advanced technological skills, a sizeable installed base of game consoles, game software development costs, volume guarantees to suppliers of key components, and access to retailers make the threat of entry weak. The most likely new entrants would be established computer technology companies such as Apple. However, students may recognize the development of future entertainment/information appliances such as set-top boxes as the most likely form of entry into the video game industry. Some students may suggest that both Microsoft and Sony are undertaking actions to gain a first mover advantage in interactive TV. The capabilities of the PlayStation 3 and the Xbox 360, coupled with Microsoft’s IPTV operations, should help students to understand that Microsoft and Sony are independently working to prevent entry into the video game industry by outsiders.

**Rivalry among competing video game console producers**—a fierce competitive force

Students should conclude that rivalry among competing sellers is fierce. Competition between Nintendo, Sony, and Microsoft centers primarily on the technological capabilities of the consoles and having a wide variety of appealing game titles developed either internally or through partnerships with independent game developers. The intensity of competition had driven console development and production costs to more than $800 per unit for the PlayStation 3. A third competitive weapon utilized by console makers was aggressive pricing, which resulted in a loss of more than $300 per unit on every PlayStation 3 sold at the time of its November 2006 launch. Microsoft’s Xbox 360 pricing was initially below its production costs as well. Nintendo had chosen not to compete aggressively on technological capabilities when developing the Wii and was presumed to earn profits on the sales of Wii units upon the product’s launch. However, the success of the $250 Wii in the marketplace has put additional pricing pressure on Microsoft and Sony.

**Overall Assessment:** Students should conclude that the video game industry is only modestly attractive when looking at the console segment. The greatest percentage of industry profits seemed to generate from the sale of game software and peripherals. Students may compare the video game business to the razor/razor blade industry, whereby razors are sold at a loss or breakeven and blades carry high margins. The development of a large installed base of console systems is essential to earning substantial profits from the sale of game software over the lifespan of a console. Therefore, students should recognize that the video game industry requires patience on the part of participants to see profits from their investments in next generation technology.
3. How is the video game system industry changing? What are the underlying drivers of change and how might those driving forces individually or collectively change competition in the industry?

Driving forces that students will be able to identify include:

- **Product innovation.** Students will note that since the beginning of the video game industry, each new generation of video game consoles have been dramatically more technologically advanced than prior generations. Case Exhibit 1 presents the key features of the industry’s most important game systems launched since 1972. The extent of production innovation is likely to become even more pronounced as computing capabilities advance. Students will point to the comments of Nvidia’s CEO in the case that the industry aspires to deliver graphics rendering that meets the “Toy Story standard.” The CEO suggested that future next generation consoles and game software would offer improved motion, blur, and depth of field. The CEO noted that reproducing the subtleties of humans and nature were long-term goals of developers.

- **Emergence of new video game devices.** Students will comment on the emergence of new video game devices such as mobile phones, iPods, and other handheld devices. The market for mobile gaming on wireless devices was projected to increase from $2.6 billion in 2005 to $11.2 billion in 2010.

- **Emergence of Internet-based video games.** Beginning with the Xbox and PlayStation 2, game consoles were capable of connecting to the Internet to play Internet-based game software or multiplayer games. The Internet capabilities of next generation consoles launched in 2005 and 2006 offered more extensive online content. All three consoles offered Internet connectivity and provided online games and other content for registered users. The market for online games was projected to increase from $1.9 billion in 2005 to $6.4 billion in 2010.

Students should conclude that the individual and collective effect of industry driving forces will drive development costs higher—making the industry less attractive for new entrants and increasing the number of unit sales necessary for current console makers to achieve breakeven. Students could make the argument that, as development and production costs continue to climb, consoles must evolve into central entertainment hubs that all consumers would like to have in their homes to achieve sales volumes necessary to support profitability. In addition, students may suggest that cost of developing handheld systems will likely rise as features are added to defend against game features included on wireless telephones and iPod-type devices.

4. What does your strategic group map of the video game industry (all segments) look like? Which strategic groups do you think are in the best positions? The worst positions?

Students can choose a variety of factors to categorize the video game industry into strategic groups. We have chosen to look at the technological capabilities of the products and the scope of vertical integration of the producer. Students who construct strategic group maps similar to what is depicted in Figure 1 should suggest that industry participants offering technologically advanced products are positioned most favorably in the industry. Also, students might suggest that companies producing software are in a favorable strategic group since software carries much higher profit margins than hardware. Although Sony earns royalties from the sale of software produced by independent software developers, it’s likely that such royalties are smaller than the profit margins earned by Nintendo and Microsoft on internally developed software. Students may also suggest that the producers of devices primarily intended for another purpose (e.g. mobile phones, iPods) have the weakest position in the industry since such devices are unable to play complex or graphics intensive games.
5. What key factors determine the success for video game console producers?

Factors that are necessary for competitive success in the console segment of the video game industry include:

- **Large installed base.** Students should be able to argue successfully that the development of a large installed base is the most important factor related to success in the console segment of the video game industry. Sony’s installed base for the PlayStation 2 of nearly 120 million units reduced console development cost to a small per unit amount, which allowed it to eventually earn profits on the sale of game consoles. Also, a large installed base allowed Sony to earn substantial royalties from the sale of game software by independent developers. Not only were royalties or profits from the sale of software limited if the installed base of consoles was small, but it was also unlikely that game developers would create games for consoles with a small installed base. A limited selection of game titles reduced consumer interest in the console—regardless of its technological capabilities.

- **Technological capabilities.** Video game console makers were required to develop next generation consoles that could fully exploit the capabilities of the latest microprocessors and GPUs. Traditional gamers seemed most interested in games with realistic graphics. Nintendo’s Wii did not have the graphics rendering capabilities of the PlayStation 3 or Xbox 360, but did include a highly innovative and technologically advanced wireless game controller.
Partnerships with independent software developers. The availability of intriguing game titles was essential to building an installed base and earning residual profits from game sales. Game operating profit margins that approximated 35% - 40% might represent the majority of profits from video game system manufacturers. Even though Sony’s video game division did not develop game software, it received royalties from the sale of software compatible with its PlayStation consoles and therefore relied on royalties paid by independent software developers for a large percentage of its profits.

Acceptable development and production costs. Development costs and production costs increased as each new generation of game console became more technologically advanced. The cost to develop microprocessors and GPUs capable of performing increasingly complex instruction sets and the cost of innovative components such as Sony’s Blu-Ray HD optical drive had caused the cost of each PlayStation 3 unit to range from $805 to $840. The PlayStation 3’s retail price caused Sony to lose as much as $305 per unit at the time of its November 2006 launch, which increased the volume of game software that must be sold to make the business unit profitable.

Access to distribution. Students should determine without much difficulty that access to retail distribution through big box electronics stores and large discount stores such as Wal-Mart and Target are essential to building an installed base.

6. Which console makers seem to be best able to perform the industry’s key success factors and other measures of competitive strength? What ratings do Microsoft, Sony, and Nintendo merit in a competitive strength assessment?

Based upon the identification of the industry’s key success factors and consideration of other measures of competitive strength, students should conclude that all three console makers hold relatively strong positions in the industry. Prior to the launch of next generation consoles in 2006 and 2007, Sony would have been properly judged as the industry’s strongest rival because of the success of the PlayStation and PlayStation 2. However, as the installed base of the Nintendo Wii, Nintendo DS, and Microsoft Xbox 360 continue to grow, students should recognize that Sony’s competitive strength has been quite diminished since year-end 2006. Students should note that Sony’s game division has not earned an operating profit since the launch of the PlayStation 3 in late 2007. Microsoft’s growing competitiveness is reflected in the first ever annual operating profit for its Entertainment and Devices Division in fiscal 2008. Although there’s room for subjective judgments about the competitive strength of each of the industry’s key participants, students’ evaluations of competitive strength shouldn’t differ too greatly from what is shown in Table 2.

Table 2  Weighted Competitive Strength Assessment for the Console Segment of The Video Game Industry

<table>
<thead>
<tr>
<th>Key Success Factor/Competitive Strength Measure</th>
<th>Importance Weight</th>
<th>Sony Strength</th>
<th>Rating</th>
<th>Score</th>
<th>Microsoft Strength</th>
<th>Rating</th>
<th>Score</th>
<th>Nintendo Strength</th>
<th>Rating</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large installed base</td>
<td>0.25</td>
<td>6</td>
<td>1.50</td>
<td>6</td>
<td>1.50</td>
<td>9</td>
<td>2.25</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Technological capabilities</td>
<td>0.20</td>
<td>10</td>
<td>2.00</td>
<td>10</td>
<td>2.00</td>
<td>7</td>
<td>1.40</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Partnerships with independent software developers</td>
<td>0.20</td>
<td>8</td>
<td>1.60</td>
<td>8</td>
<td>1.60</td>
<td>9</td>
<td>1.80</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Development and production costs</td>
<td>0.20</td>
<td>3</td>
<td>0.60</td>
<td>8</td>
<td>1.20</td>
<td>10</td>
<td>2.00</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Access to distribution</td>
<td>0.05</td>
<td>10</td>
<td>0.50</td>
<td>6</td>
<td>1.20</td>
<td>10</td>
<td>0.50</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial resources</td>
<td>0.10</td>
<td>8</td>
<td>0.80</td>
<td>10</td>
<td>1.00</td>
<td>7</td>
<td>0.70</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1.00</strong></td>
<td><strong>7.00</strong></td>
<td><strong>7.80</strong></td>
<td><strong>8.65</strong></td>
<td></td>
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</tr>
</tbody>
</table>
7. **What recommendations would you make to Microsoft to win the next generation battle in the video game console industry? to Sony? to Nintendo?**

Students recommendations to strengthen each company’s competitive position in the video game industry should include the following points.

**Microsoft**

- Students should recommend that Microsoft expand its initial efforts to integrate the content of its Mediaroom Internet Protocol Television (IPTV) venture into the features of the Xbox 360. Widespread adoption of game consoles by consumers of all types hinges on console manufacturers’ ability to make the game console the central component of a home entertainment center. Downloadable television programming, movies, music and other digital content could turn game consoles into an on-demand entertainment hub. Also, students will likely recommend that Microsoft push forward with its streaming IPTV venture with Netflix. Microsoft clearly has the lead in making the game console a full-feature entertainment system and should make this a top strategic priority.

- Students who recommend that Microsoft make the Xbox 360 an interface for IPTV downloads might also suggest that the Xbox 360 be upgraded with a larger hard drive. Hard drive prices are not mentioned in the case, but students who are familiar with computer components prices may comment that the cost of a 250 GB hard drive is only fractionally higher than the cost of a 60 GB hard drive.

- Regardless of Microsoft’s efforts to make the Xbox 360 an entertainment hub, it must ensure that it maintains its current advantage in HD game titles. There is little reason to purchase an Xbox 360 or PlayStation 3 if gamers don’t have an HDTV and HD games. Students will recommend that Microsoft internally develop new HD game titles for gamers of all ages. Similarly, students should suggest that Microsoft offer incentives to independent software developers to develop HD games for players of all ages.

- Students may also recommend that Microsoft replace the Xbox’s 12X DVD with a Blu-Ray drive as a standard feature. However, it is difficult to support such a recommendation at the time of the case because of the high cost of the Blu-Ray drive. The fact that Microsoft utilized a standard DVD drive rather than an HD device has allowed it to keep its production costs for the Xbox 360 low and reach breakeven on unit manufacturing costs. The case notes that Sony’s Blu-Ray drive and other components have pushed the production cost of the PlayStation 3 to as much as $840 per unit.

- Students may also suggest that Microsoft develop an innovative motion sensing controller that could be sold as an accessory for the Xbox 360. The development of such a product would eliminate the key advantage held by the Nintendo Wii.

**Sony**

- The pricing of the PS3 seemed to be among the greatest barriers to increasing the installed base of Sony’s next generation console. Just as students should be hesitant to recommend that Microsoft add a Blu-Ray drive to the Xbox 360 as a standard feature, students should consider the appeal of dropping the Blu-Ray drive from the PlayStation 3 as a standard feature. The case doesn’t make the exact cost of the Blu-Ray drive known, but it does mention that in 2007 a stand-alone Blu-Ray player carried a retail price of approximately $1,000. The cost of Blu-Ray players will undoubtedly decline as consumer demand and manufacturing volume increase, but even in 2008, the Blu-Ray drive was likely the most expensive component used in the production of PS3 consoles. Students may recommend that Sony offer a base version of the PS3 that would be equipped with a standard DVD drive and a smaller sized hard drive. This would allow Sony to drop the price of the entry-level PlayStation 3 to a price point comparable to that of the base Xbox 360 or Nintendo Wii.
Students recommending that Sony not abandon the Blu-Ray drive may suggest that Sony aggressively promote the PlayStation 2 as the least costly game system for those who don’t have an HDTV or for those who don’t care to play HD games. At $129, the PlayStation 2 was about one-half the price of a Nintendo Wii. However, students will note that Sony would need to develop a wireless motion sensing controller to allow the PlayStation 2 to match all of the Wii’s unique features.

Students will also recommend that Sony encourage independent software developers to launch new HD versions of popular games and create new HD game titles as soon as possible. At the close of the case, there were far fewer game titles available for the PlayStation 3 that what were available for the Xbox 360 or Wii.

Students may also suggest that Sony encourage independent software developers to launch PlayStation Portable titles that would appeal to younger children and adults. The PSP has achieved a respectably sized installed base, but at the close of the case, was falling behind Nintendo DS at an alarming rate. The success of the DS is attributable to its innovative titles directed at non-traditional gamers. There is no evidence in the case that game titles developed for adults were available for the PSP.

Students are also likely to recommend that Sony improve the content offered by the PlayStation Network. Most industry analysts found the free online games, weather updates, social networking, voice, and chat capabilities of the PlayStation Network to be no match for Xbox Live’s features. A robust PlayStation Network could lay the groundwork for Sony to offer IPTV programming.

**Nintendo**

Most students will recommend that Nintendo’s software division expand game titles for adults and other non-traditional gamers. Its recent Nintendo Wii and DS game introductions such as *Wii Fit*, *Brainboost*, and *Brain Academy* expanded the market for video games by appealing to those who had never before played video games.

Students are also likely to recommend that Nintendo continue to develop new Wii accessories such as the $90 wireless Balance Board needed to play *Wii Fit* games. New types of controllers or accessories increase sales to existing customers and create opportunities for new types of software titles.

Students may also suggest that Nintendo improve the capabilities of its Wii Connect24 gaming site. Students will applaud its decision to make all games developed for previous generation consoles available for purchase at the site, but are likely to suggest that the company should develop new online games as well. There may also be recommendations among the class for Nintendo to create a strategic alliance with a media company to make archived television programming and movies available through the Wii Connect24 network. However, any such recommendation would require that Nintendo either add a hard drive to the Wii or have the capability to offer streaming programming at Wii Connect24.

Students should also comment on Nintendo’s inability to meet demand during the 2007 and 2008 holiday retail season. Therefore, you should expect that some students will recommend that the company improve its production capabilities to ramp up production during periods of peak demand.
EPILOGUE

Sales of video game hardware and software in the United States increased from $18 billion in 2007 to $21.3 billion during 2008. Software sales in the United States approached $11 billion with the three best selling software titles all developed exclusively for the Wii. Video game console sales in the United States reached $7.8 billion during 2008. The Wii continued to build upon its lead in the industry with 2008 sales of 10.2 million units. During December 2008, the Nintendo DS was the best selling console with sales of 3 million units during the month. More than 2.2 million Nintendo Wii consoles were sold in December 2008. Nintendo increased production of the Wii by 50% during late 2008 but remained unable to meet consumer demand for the console.

The Microsoft Xbox 360 sold 4.7 million units during 2008, which was 58 percent greater than Xbox 360 sales in 2007. The console’s sales during 2008 increased the installed base for the Xbox 360 to 28 million units. Also, Xbox Live membership grew by 70 percent during 2008 to reach 17 million members. Microsoft announced in late-2008 that Xbox Live had generated more than $1 billion in revenue since the launch of the Xbox 360. Its online revenue from downloadable content sold at Xbox Live (game add-ons, television programming, and movies) increased by 84 percent during 2008.

Sony’s PlayStation 3 was the fourth best-selling console during 2008 with 3.5 million units sold during the year. The high price of the PS3 console remained an obstacle to its success with its December 2008 sales of 726,000 representing a 7% decline from December 2007. The PlayStation 2 remained a popular alternative to next generation consoles for price sensitive buyers with the PS2 selling 410,000 units in the United States during December 2008. Sony executives stated in January 2009 that the company had no plans to discontinue the PS2 and would continue to introduce new game titles for the PS2 in 2009.
OVERVIEW

Nintendo’s Wii, which was launched in November 2006, was developed to appeal to people who generally did not play video games. Nintendo’s development of a game system targeted to non-gamers enabled the company to expand the market for video game consoles and create opportunities to achieve rapid growth in revenues and earnings. Nintendo’s developers simplified the design of the Wii, focused less on hyper-realistic graphics and more on artistic elements. Simplifying the design and use of the Wii system allowed the developers to create the perfect entry strategy for their new target market with great success. In the first half of 2007, the Nintendo Wii sold more units in the United States than the Xbox 360 and PlayStation 3 (PS3). In the first quarter of 2008, Nintendo’s net sales were up over 20% from the same quarter the previous year and Wii was outselling its seventh generation home system rivals the Sony PlayStation 3 and the Xbox 360. Nintendo’s net income in the same quarter was up over 30% from the same quarter the previous year due to the continued strength of Wii and Nintendo DS hardware and software sales. Finally, most believe that both Sony and Microsoft had been traditionally operating at a loss with anticipated gains in software and game sales while Nintendo enjoyed operating profits.

Although initially surprised by Wii’s resounding broad appeal, Sony and Xbox were prepared for a series of competitive counter moves designed to attack Wii’s popularity going into the 2008 holiday season. For instance, Wii’s competitors designed software for casual gamers, offered new controllers that allowed gamers to play in ways similar to Nintendo’s controllers and cut price to be more competitive. These moves have raised questions about Nintendo’s strategy for Wii moving forward.

SUGGESTIONS FOR USING THE CASE

Students should find Nintendo’s Strategy for the Wii – Good Enough to Beat Xbox 360 and PlayStation 3 an interesting case since many of them have probably had experience playing video games. Some of your students may have received early versions of game consoles such as Nintendo 64, Sega Genesis, or PlayStation or handheld games such as Nintendo GameBoy as gifts when they were children. Given the increasing popularity, sophistication and complexity of consoles, it’s also likely that a majority of your students currently own one of the handheld game or consoles mentioned in the case.

The case will allow you to illustrate concepts from Chapters 3 – 6 if used as a stand alone case or can be paired with Case 11—Competition in the Video Game Console Industry if you prefer to use the case to focus on the strategy options presented in Chapters 5 and 6. The case provides sufficient information to allow students to prepare a review of the industry’s dominant economic characteristics, fully examine the competitive forces at play in the video game industry, consider the industry’s driving forces and key success factors, and examine Nintendo’s internal situation and recent financial performance. The case also allows students to understand how focused differentiation strategies are capable of yielding above-average profit margins without a reliance on premium pricing. The case also allows students to understand the appeal of Nintendo’s Blue Ocean strategy and observe how the company has turned a first mover advantage into what appears to be a sustainable advantage.
Finally, the case’s strong decision focus allows students to consider what Nintendo must do next to ultimately win the battle among next generation video game consoles.

To give students guidance in what to do and think about in preparing the Nintendo case for class discussion, we strongly recommend providing class members with a set of study questions and insisting that they prepare good notes/answers to these questions in preparing for class discussion of the case.

To facilitate your use of study questions and making them available to students, we have posted a file of the Assignment Questions contained in this teaching note for Nintendo on the publisher’s Online Learning Center for the 17th edition (www.mhhe.com/thompson). (You should be aware that there is a set of study questions posted in the student OLC for each of the 26 cases included in the 17th edition.)

In our experience, it is quite difficult to have an insightful and constructive class discussion of an assigned case unless students have conscientiously have made use of pertinent core concepts and analytical tools in preparing substantive answers to a set of well-conceived study questions before they come to class. In our classes, we expect students to bring their notes to the study questions to use/refer to in responding to the questions that we pose. Moreover, students often find having a set of study questions is useful in helping them prepare oral team presentations and written case assignments—in addition to whatever directive questions you supply for these assignments. Hence, we urge that you insist students spend quality time preparing answers to study questions—either those we have provided or a set of your own questions.

There is a 2:48 second video that accompanies this case that discusses how the Wii has expanded the market for video games by appealing to non-traditional gamers. It is best to show the video at the very beginning of the class discussion.

The case can be used effectively for a written assignment or oral presentation. Our recommended questions for written assignments are as follows:

1. You have recently been hired by Nintendo of America as an analyst and have been assigned to its Wii strategy group. During your first meeting with the strategy group, the team leader asked that you prepare an analysis of the video game console industry for distribution at the next meeting. Please prepare a 5-6 page report that includes a description of the industry’s dominant business and economic characteristics, evaluates competition in the industry, assesses industry driving forces, and lists industry key success factors. Your report should also include a strategic group map of the entire video game industry and specific strategy recommendations that will allow the Wii to remain the leading next generation console.

2. As a newly hired Nintendo of America retail representative, you have been asked to join a cross functional strategy group. The group’s charge from upper level management is to make a set of recommendations designed to further solidify the company’s number-one ranking in the industry. Your recommendations to upper management should be in the form of a 2 – 3 page executive summary and must be supported with a complete industry analysis, company situation analysis, and financial analysis. Each recommendation should be supported by your analyses and must clearly specify what elements of your analysis led to your conclusions. The exhibits, tables and figures used in your analysis should be attached to your executive summary and carry an equal weight in determining your grade for the assignment.

ASSIGNMENT QUESTIONS

1. What are the defining business and economic characteristics of the video game console industry? What is the industry like?

2. What is competition like in the video game console industry? Do a five-forces analysis to support your answer. Which of the five competitive forces is strongest? Which is weakest? Would you characterize the overall strength of competition in video game consoles as fierce, strong, moderate to normal or weak? Why?
3. What forces are driving changes in the video game console industry? Are these driving forces acting to make the industry more or less competitively intense? Are the driving forces acting to make the industry more or less profitable in future years?

4. What 3-5 key factors determine the success of video game console developers like Nintendo?

5. What is Nintendo’s strategy? Which of the five generic strategies discussed in Chapter 5 is Nintendo using? What are some of the recent offensive and/or defensive strategies that Nintendo has employed? Have these tactics been successful?

6. Is it fair to characterize Nintendo’s introduction of the Wii as a blue ocean strategy? Why or why not?

7. How well is Nintendo’s strategy working in terms of the financial performance it is delivering? Should shareholders be pleased? Why or why not? What 2-3 weaknesses do you see in Nintendo’s financial performance?

8. What does a SWOT analysis reveal about the attractiveness of Nintendo’s overall situation? Is the company’s competitive position as solid as top management seems to believe? Does the company have a competitive advantage? If so, what is the basis for this competitive advantage and is the advantage sustainable?

9. What does a competitive strength assessment (as per the methodology in Table 4.4 of Chapter 4) reveal about whether Nintendo has a competitive advantage?

10. What recommendations would you make to Nintendo to improve its competitiveness in the video game console industry and to maintain its favorable positioning vis-à-vis Microsoft and Sony?

TEACHING OUTLINE AND ANALYSIS

1. What are the defining business and economic characteristics of the video game console industry? What is the industry like?

Students should be able to identify the following business and economic characteristics of the console segment of the video game industry:

- **Economies of scale**: Competitors in the industry are large and achieve cost advantages by producing large quantities. However, both Sony and Microsoft have traditionally operated at a loss in part due to heavy investments into research and development.

- **Product innovation**: Competitors win market share from rivals by developing products that are technologically superior and more powerful than the products offered by rivals. New products often contain technological breakthroughs such as advanced graphics or interactive motion-sensitive controllers as the basis for competition.

- **Degree of product differentiation**: Products in the market are becoming increasingly more differentiated. Some products offer high definition graphics and play DVDs while others offer controllers with motion sensors to fundamentally change the way gamers play and interact with the game.

- **Scope of competitive rivalry**: Competition occurs on a global scale to help spread research and development costs while driving revenues. For the largest competitors, non-American sales account for the majority of worldwide sales with the exception of Xbox.

- **Segmentation**: The industry was segmented into console hardware, console software, handheld hardware, handheld software, PC software, online games, interactive TV, and mobile phone games.

- **Market size**: The total size of the global video game industry exceeded 69 million units sold in 2008.
Students should further identify the following as important attributes of the industry:

- **Entry/Exit barriers.** Barriers to entry were all but insurmountable. Successful new entrants were required to have sufficient capital and technological capabilities to develop sophisticated game hardware systems capable of performing highly complex calculations. Other barriers to entry included the establishment of an installed base of sufficient size to provide an adequate incentive for independent software developers to create games for a new game system.

- **Scope of rivalry.** Rivalry in the industry could be considered global, with the three largest sellers of game systems competing against each other in all world markets. Competition exists on the basis of technologically-advanced and unique game consoles.

- **Scale economies.** Economies of scale were necessary to keep game system and component development expenses at acceptable per unit levels. Next generation game system and component development costs were so high that analysts believed Sony and Microsoft consistently operated at a loss.

- **Consumer characteristics.** While typical gamers could be thought to have demographic characteristics of being young and male, a new trend is emerging whereby traditional non-gamers are now potential consumers. This has expanded consumer characteristics to include a wider array of ages along with male and female consumers.

2. **What is competition like in the video game console industry?** Do a five-forces analysis to support your answer. Which of the five competitive forces is strongest? Which is weakest? Would you characterize the overall strength of competition in video game consoles as fierce, strong, moderate to normal or weak? Why?

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**Substitutes for Video Game Systems**

Competitive pressures coming from the market attempts of outsiders to win buyers over to their products

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**Suppliers of Raw Materials and other inputs used in the Manufacturing of Video Game Consoles**

Competitive pressures stemming from supplier-seller collaboration and bargaining

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**Rivalry among Competing Video Game System Sellers**

Competitive pressures created by the jockeying of rival sellers for better market position and competitive advantage

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**Buyers of Video Game Systems**

Competitive pressures stemming from seller-buyer collaboration and bargaining

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**Potential New Entrants into the Video Game Console Industry**

Competitive pressures coming from the threat of entry of new rivals
The bargaining power and leverage of buyers - a weak competitive force

Big box electronics store and discount store buyers had relatively little leverage in negotiations with sellers of video game consoles. Consumers expected retailers to carry the three leading brands of consoles and the top two brands of handheld games. A decision by retailers not to carry the leading brands of game consoles would negatively impact the retailer’s image with consumers. Students may suspect that manufacturers had uniform pricing for retailers, regardless of size, because of the standardized retail prices of game consoles.

The bargaining power and leverage of suppliers - a moderately strong competitive force

Students will easily conclude that suppliers of microprocessors and graphics processing units (GPUs) had a moderate degree of leverage with console manufacturers because of the collaborative development process utilized in the industry. Console makers were unable to negotiate between sellers of core components, since microprocessors and GPUs were specifically designed for a system. Students can rightfully argue that video game console producers did have the ability to negotiate terms with components manufacturers prior to the development of a next generation system.

Competition from substitutes - a moderately strong competitive force

There were many recreation and entertainment substitutes to video games. Video gamers could engage in outdoor sports or other activities or find entertainment indoors by watching television, reading, listening to music, surfing the Internet, playing board games, or playing a musical instrument. However, the interactive nature of video games was very intriguing for many young people and older gamers. Students should point out that other gaming platforms such as PC games, handheld games and mobile phone games were also substitutes for console-based video games.

Threat of entry - a weak competitive force

Entry barriers that include considerable console development costs, advanced technological skills, a sizeable installed base of game consoles, game software development costs, volume guarantees to suppliers of key components and access to retailers make the threat of entry weak. The most likely new entrants would be established computer technology companies such as Apple.

Rivalry among competing video game console producers - a fierce competitive force

Students should conclude that rivalry among competing sellers is fierce. Competition between Nintendo, Sony and Microsoft centers primarily on the technological capabilities of the consoles and having a wide variety of appealing game titles developed either internally or through partnerships with independent game developers. The intensity of competition had driven console development and production costs to more than $800 per unit for the PlayStation 3. A third competitive weapon utilized by console makers was aggressive pricing, which resulted in a loss of more than $300 per unit on every PlayStation 3 sold. Microsoft’s Xbox 360 pricing was also believed to be below its production costs. Nintendo had chosen not to compete aggressively on technological capabilities when developing the Wii and has earned profits on the sales of Wii units.

Overall Assessment: Students should conclude that the video game industry is only modestly attractive when looking at the console segment. The greatest percentage of industry profits seemed to generate from the sale of game software and peripherals. Students may compare the video game business to the razor/razor blade industry, whereby razors are sold at a loss or breakeven and blades carry high margins. The development of a large installed base of console systems is essential to earning substantial profits from the sale of game software over the lifespan of a console. Therefore, students should recognize that the video game industry requires patience on the part of participants to see profits from their investments in next generation technology.
3. **What forces are driving changes in the video game console industry? Are these driving forces acting to make the industry more or less competitively intense? Are the driving forces acting to make the industry more or less profitable in future years?**

Driving forces that students should be able to identify include:

- **Product innovation.** Students should note that since the beginning of the video game industry, each new generation of video game consoles has been dramatically more technologically advanced than prior generations. Technological advancements have included better graphics (i.e., high definition) and motion sensor controllers.

- **Emergence of new video game devices.** Students will comment on the emergence of new video game devices such as mobile phones, iPods, and other handheld devices.

- **Emergence of Internet-based video games.** Beginning with the Xbox and PlayStation 2, game consoles were capable of connecting to the Internet to play Internet-based game software or multiplayer games.

- **Societal trends.** Changes in societal trends influence the disposable income of consumers to buy consoles. The industry is said to be resilient to recession. Changes in demographic groups present an opportunity in untapped market segments.

- **Changing consumers.** There has been a change in the target audience for video game console industry competitors with the introduction of Nintendo’s Wii. Incumbents are likely to take note of this new segment.

Students should conclude that the individual and collective effect of industry driving forces will drive development costs higher—making the industry less attractive for new entrants and increasing the number of unit sales necessary for current console makers to achieve breakeven. Students could make the argument that, as development and production costs continue to climb, consoles must evolve into central entertainment hubs that all consumers would like to have in their homes to achieve sales volumes necessary to support profitability. In addition, students may suggest that the cost of developing handheld systems will likely rise as features are added to defend against game features included on wireless telephones and iPod-type devices.

4. **What 3-5 key factors determine the success of video game console developers like Nintendo?**

Students should identify several factors that are necessary for competitive success in the console segment of the video game industry to include the following:

- **Large installed base.** Students should be able to argue successfully that the development of a large installed base is the most important factor related to success in the console segment of the video game industry. A limited selection of game titles reduced consumer interest in the console—regardless of its technological capabilities.

- **Technological capabilities.** Video game console makers were required to develop next generation consoles that could fully exploit the capabilities of the latest microprocessors and GPUs. Traditional gamers seemed most interested in games with realistic graphics. Nintendo’s Wii did not have the graphics rendering capabilities of the PlayStation 3 or Xbox 360, but did include a highly innovative and technologically advanced wireless game controller.

- **Partnerships with independent software developers.** The availability of intriguing game titles was essential to building an installed base and earning residual profits from game sales.
Acceptable development and production costs. Development costs and production costs increased as each new generation of game console became more technologically advanced. The cost to develop microprocessors and GPUs capable of performing increasingly complex instruction sets and the cost of innovative components such as Sony’s Blu-Ray HD optical drive had caused the cost of each PlayStation 3 unit to range from $805 to $840. The PlayStation 3’s retail price caused Sony to lose as much as $305 per unit, which increased the volume of game software that must be sold to make the business unit profitable.

Access to distribution. Students should determine without much difficulty that access to retail distribution through big box electronics stores and large discount stores such as Wal-Mart and Target are essential to building an installed base.

5. What is Nintendo’s strategy? Which of the five generic strategies discussed in Chapter 5 is Nintendo using? What are some of the recent offensive and/or defensive strategies that Nintendo has employed? Have these tactics been successful?

Students should identify a firm’s competitive strategy as being concerned with the specific game plan management uses to compete successfully and to secure a competitive advantage over its rivals. This requires that a firm out-compete its rivals by doing a better job of satisfying buyer needs and preferences.

Companies can employ one of five generic strategies or some combination thereof to beat its rivals. Those generic strategies include the following: overall low-cost provider strategy, broad differentiation strategy, focused low-cost strategy, focused differentiation strategy and best-cost provider strategy.

Students may find that Nintendo is using a broad differentiation strategy, which involves competing by being unique in ways that are valuable to a wide range of customers. Nintendo’s Wii utilizes a game controller that is highly interactive by incorporating motion sensors. As such, Nintendo has successfully built a competitive advantage by incorporating features that enhance buyer satisfaction in noneconomic or intangible ways, which is one of the four ways to build a competitive advantage with a broad differentiation strategy.

Nintendo’s broad differentiation strategic approach has been successful since technological breakthroughs are a critical success factor in the industry. Additionally, Nintendo’s recent offensive and defensive strategies have helped the company successfully implement its strategy. A core element of Nintendo’s offensive strategy involved changing the market’s perception of Wii by offering a very different gaming experience that was less intimidating for casual gamers who had not previously played video games. The goal of the strategy that Nintendo used to re-enter the video game console market was to target a wider demographic than typical gamers. The marketing strategy involved commercials displaying grandparents, teens, urban families, etc. as users. Nintendo’s design strategy of developing a Bluetooth wireless remote that required the player to “act out” the character’s desired action allowed it to pursue a pricing strategy that did not place it at the center of an ongoing pricing war with market leaders. Furthermore, this strategy encouraged Nintendo to focus on the artistic elements of the game rather than focusing on hyper-realistic graphics that would drive up costs. Hence, Nintendo was able to keep its production and development costs relatively low.

The success of Nintendo’s strategy is evident in its performance. Its net sales in the first quarter of 2008 were up over 20% from the same quarter the previous year. During this quarter, its net income was up over 30% from the same quarter the previous year. By mid-2008, its cumulative sales for the Wii had surpassed that of Sony’s PlayStation 3 (PS3) and of Microsoft’s Xbox 360. Moreover, while Sony and Microsoft had been operating at a loss, Nintendo was operating at a profit. Finally, Nintendo’s various strategic moves have allowed it to enjoy a commanding market share over its strong, more resource-rich rivals.
6. Is it fair to characterize Nintendo’s introduction of the Wii as a blue ocean strategy? Why or why not?

Students should first identify what a blue ocean strategy is. It seeks to gain a dramatic and sustainable competitive advantage by deserting attempts to out-compete rivals in existing markets. Instead, firms that pursue a blue ocean strategy seek to create a new industry or unique market segment that makes the existing competition in existing markets relatively irrelevant resulting in the creation and capture of new demand.

Given this definition, it is fair for students to characterize Nintendo’s introduction of the Wii as a blue ocean strategy for the following reasons:

**Abandoning existing markets.** Nintendo’s introduction of the Wii did not rely on competing in an existing market with strong rivals. While being developed, Nintendo’s CEO Satoru Iwata did not position the Wii as a “next-generation” video console since that would imply that it had to compete with the likes of Sony’s PS3 and Microsoft’s Xbox 360. Instead, he sought to create an entirely different video game playing experience for its players. Competing in the existing markets successfully would have required Wii to build a console with hyper graphics and technological capabilities, which they did not. Such competition would have been very expensive; however, targeting a wider demographic was considered to be very risky and many believed the Nintendo would not be successful. Nintendo abandoned the existing market and opted to create a new one.

**Creating new demand.** Nintendo sought to create new demand from nontraditional game players with the introduction of the Wii. Instead of pursuing traditional video console players, Wii’s target audience was relatively non-existent prior to its introduction since they were, in part, comprised of people who had not previously played video games. Other members of Nintendo Wii’s target audience included casual gamers. Key to this effort of attracting a new group was the successful development of a pioneering video game controller. The development of a controller that allowed for a more interactive gaming experience that relied more on artistic elements rather then hyper graphics meant that Nintendo could appeal to grandparents, teens, urban families, females, etc. Nintendo’s marketing strategy ensured the development of new demand by depicting these new users in its promotional efforts. Hence, Nintendo was able to create demand where it had not previously existed.

7. How well is Nintendo’s strategy working in terms of the financial performance it is delivering? Should shareholders be pleased? Why or why not? What 2-3 weaknesses do you see in Nintendo’s financial performance?

Students should identify that Nintendo’s strategy has been working very well in terms of its financial performance. Its revenues were generated primarily through the sales and distribution of hardware, which includes the Nintendo DS and the Nintendo Wii. Revenues from software stemmed from licensing agreements with third party game developers for Nintendo gaming systems. Nintendo saw a slight drop in unit sales of its Nintendo DS units in 2007, when compared to the first quarter of the fiscal year which ended June 30, 2008. During that same period it enjoyed an increase of 2.33 million units in sales of Nintendo DS software. Sales of Wii hardware increased 1.74 million from the previous year during the same quarter. Software sales for the Wii increased even more by 24.42 million units from the same quarter in 2007. Nintendo’s net sales were up over 20% in the first quarter of 2008, from the same quarter the previous year. Nintendo’s net income in the same quarter was up over 30% from the same quarter the previous year due to the continued strength of Wii and Nintendo DS hardware and software sales. Finally, while most video console manufacturers were operating at a loss, Nintendo was able to produce its products at a profit and Wii was outselling its seventh generation home system rivals, the Sony PlayStation 3 and the Xbox 360. Nintendo’s financial performance as shown in Table 1 suggests that it is doing well.
Table 1  Selected Financial Statistics and Ratios for Nintendo, 2005 – 2008

<table>
<thead>
<tr>
<th>Performance Ratios</th>
<th>2008</th>
<th>2007</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue Growth</td>
<td>73.03%</td>
<td>89.79%</td>
<td>-1.11%</td>
<td>N/A</td>
</tr>
<tr>
<td>Gross Profit Margin</td>
<td>41.9%</td>
<td>41.2%</td>
<td>42.2%</td>
<td>42.2%</td>
</tr>
<tr>
<td>Operating Profit Margin</td>
<td>16.4%</td>
<td>5.7%</td>
<td>-6.4%</td>
<td>N/A</td>
</tr>
<tr>
<td>R&amp;D as % of Sales</td>
<td>2.2%</td>
<td>3.9%</td>
<td>6.0%</td>
<td></td>
</tr>
<tr>
<td>Return on Assets (ROA)</td>
<td>14.3%</td>
<td>11.1%</td>
<td>8.5%</td>
<td>7.7%</td>
</tr>
<tr>
<td>Return on Equity (ROE)</td>
<td>20.9%</td>
<td>15.8%</td>
<td>10.1%</td>
<td>9.5%</td>
</tr>
<tr>
<td>Current Ratio</td>
<td>2.4</td>
<td>1.9</td>
<td>3.8</td>
<td>4.3</td>
</tr>
<tr>
<td>Inventory Turns</td>
<td>16.0</td>
<td>10.9</td>
<td>16.5</td>
<td>10.4</td>
</tr>
<tr>
<td>Debt-to-Equity</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.01</td>
</tr>
</tbody>
</table>

Sources: Calculated from case Exhibits 2 and 3

Student should also note that in recent years, revenue growth has generally increased with the greatest increase of 89.79% in 2007. This is most impressive and reflects very strong financial performance. However, gross profit margin has decreased slightly, which might be cause for concern, particularly if the margin’s overall range wasn’t so high and variability so low (i.e., 41.86% - 42.24%). While students may identify this minor glitch, it is offset by Nintendo’s steady and strong increase in its operating profit margins suggesting that they are in control of their operations and everyday operating expenses have been reduced.

Nintendo's ROA and ROE are most impressive based upon this financial analysis. Both have increased and nearly doubled within the period covered (i.e., 2005 – 2007). ROA improved from 7.72% to 14.28% and ROE improved from 9.49% to 20.92%. This positive change indicates that Nintendo is making excellent use of its assets and equity to enhance the business’ efficient growth. In other words, they are making more money with fewer assets and not as much equity. The impressiveness of this is made even more remarkable since they are making all this money with the use of very low long-term debt for the last four years as indicated by the low debt-to-equity ratio.

While there is not enough information in the case to establish an industry average of inventory turns, students can assume that the current 16 days is a reasonably good number. Moreover, it is clear that Nintendo has improved its inventory management over the last four years due to an increasing inventory turns ratio.

8. What does a SWOT analysis reveal about the attractiveness of Nintendo’s overall situation? Is the company’s competitive position as solid as top management seems to believe? Does the company have a competitive advantage? If so, what is the basis for this competitive advantage and is the advantage sustainable?

Nintendo’s Resource Strengths and Competitive Capabilities

- Dominates the video game console industry
- Clear financial objectives
- Motion-sensing wireless handheld controller technology
- Financial resources available to fund growth
- Solid operating profits
- Broad user appeal to a larger nontraditional market
Case 12  Nintendo’s Strategy for the Wii—Good Enough to Beat Xbox 360 and PlayStation 3?

- Strong hardware sales, which surpassed Sony and Microsoft
- Strong software sales (i.e., over 150 million units sold by October 2008)
- Popular game titles with great name recognition
- Artistic image appeal
- Strong international presence

**Nintendo’s Internal Resource Weaknesses and Competitive Liabilities**

- Inability to keep up with global demand of Wii consoles
- Low technological capabilities in consoles
- Lack of adequate on-board memory
- Lack of appeal to hardcore game players and traditional users

**Nintendo’s External Opportunities**

- Expand its appeal to traditional gamers
- Increase revenues through broader global appeal and reach
- Increase license agreements with software developers based upon current popularity

**Nintendo’s External Threats**

- Weaknesses in key economies across the globe
- Patent infringement lawsuit in the U.S. on core technology Nintendo used
- Potential attacks and increased competition from Sony and/or Microsoft
- Projected weaknesses in the global economy
- Customer concerns regarding limited game titles

Students should find that this SWOT analysis supports the management’s perception that Nintendo has a solid competitive position; however, the extent to which that position is sustainable is questionable. Nintendo’s competitive advantage is built largely on Nintendo’s decision to offer a product that appeals to a nontraditional group of gamers with an artistic appeal and a more interactive experience. Central to this strategic approach is the use of a wireless motion-sensing controller. Students will recognize that given the likes of Sony and Microsoft who have abundant financial, technological and marketing capabilities, there should be concern as to whether Nintendo can sustain its competitive advantage over an extended period of time. The identification of these new very attractive nontraditional user and casual game user segments has, surely, not gone unnoticed by Sony and Microsoft. As a result, Nintendo will likely have to fiercely defend its current dominant competitive position.

9. **What does a competitive strength assessment (as per the methodology in Table 4.4 of Chapter 4) reveal about whether Nintendo has a competitive advantage?**

The competitive strength assessment (CSA) for this question can be found below. Although the students’ strength measures, respective weightings, and ratings may vary, the CSA that is presented is a good indication of the relative position of each competitor.
Table 2  Competitive Strength Assessment for Rivals in the Video Game Console Industry

Rating Scale: 1 = very weak; 10 = very strong

<table>
<thead>
<tr>
<th>Key Success Factors/Strength Measures</th>
<th>Importance Weight</th>
<th>Nintendo Rating</th>
<th>Score</th>
<th>Sony Rating</th>
<th>Score</th>
<th>Microsoft Rating</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Technological capabilities</td>
<td>0.20</td>
<td>6</td>
<td>1.2</td>
<td>10</td>
<td>2.0</td>
<td>10</td>
<td>2.0</td>
</tr>
<tr>
<td>Product features</td>
<td>0.20</td>
<td>9</td>
<td>1.8</td>
<td>9</td>
<td>1.8</td>
<td>8</td>
<td>1.6</td>
</tr>
<tr>
<td>New product innovation capabilities</td>
<td>0.20</td>
<td>10</td>
<td>2</td>
<td>9</td>
<td>1.8</td>
<td>8</td>
<td>1.6</td>
</tr>
<tr>
<td>Financial resources</td>
<td>0.10</td>
<td>7</td>
<td>0.7</td>
<td>9</td>
<td>0.9</td>
<td>9</td>
<td>0.9</td>
</tr>
<tr>
<td>Broad demographic appeal</td>
<td>0.15</td>
<td>10</td>
<td>1.5</td>
<td>8</td>
<td>1.2</td>
<td>7</td>
<td>1.05</td>
</tr>
<tr>
<td>Development and production costs</td>
<td>0.15</td>
<td>8</td>
<td>1.2</td>
<td>3</td>
<td>0.45</td>
<td>5</td>
<td>0.75</td>
</tr>
<tr>
<td>Total Weight</td>
<td>1.00</td>
<td>50</td>
<td>8.4</td>
<td>48</td>
<td>8.15</td>
<td>47</td>
<td>7.9</td>
</tr>
</tbody>
</table>

Based upon the identification of the industry’s key success factors and consideration of other measures of competitive strength, students should conclude that all three console makers hold relatively strong positions in the industry. However, based upon the success of the Nintendo Wii, Nintendo should be judged as the industry’s strongest rival. Students should recognize that Nintendo’s competitive strength would fall significantly if its strategy regarding the use of a motion-sensing controller, development of more artistic elements in its hardware and software, and ability to have broad appeal to a wider demographic is duplicated. Although there’s room for subjective judgments about the competitive strength of each of the industry’s key participants, students’ evaluations of competitive strength shouldn’t differ too greatly from what is shown in Table 2.

10. What recommendations would you make to Nintendo to improve its competitiveness in the video game console industry and to maintain its favorable positioning vis-à-vis Microsoft and Sony?

Nintendo entered the video game console industry and by all accounts has dominated a group of capable incumbents with extensive resources such as Sony and Microsoft. Nintendo’s competitive advantage exists primarily due to its ability to appeal to a large group of new consumers who traditionally were not targeted as gamers and by introducing a more interactive and engaging experience for game players with their motion-sensing controllers. However, it is unclear whether this competitive advantage is sustainable, which means that Nintendo must take steps to improve its competitiveness and to continue innovating. Below are some recommendations:

- Most students will recommend that Nintendo’s software division expand game titles for adults and other nontraditional gamers. Nintendo has developed a competitive advantage in a new market space based largely upon nontraditional gamers. Game titles should be developed for the Wii to appeal to this wide existing consumer base of nontraditional gamers. However, in doing this Nintendo must be wary of diluting its brand with weak game titles, or in allowing games to be sold that are too far away from the family image that the company is trying to build.
Students will also suggest that Nintendo encourage independent software producers to develop new games that integrate the Wii and Nintendo DS. The company has an opportunity to maintain and enhance its lead over Sony and Microsoft since its cumulative sales as of mid-2008 have surpassed those of PS3 and Xbox 360.

(Lou, check this whole paragraph for duplication with the first bullet above) Students may also suggest that Nintendo improve the capabilities of its Wii by adding more on-board memory and more technological capabilities. Students might encourage Nintendo to improve its competitive advantage with nontraditional gamers by including capabilities and games that appeal to nontraditional gamers. They may suggest that Nintendo’s broad appeal and massive popularity along with relatively low production costs be used to also compete in more nontraditional markets. The appeal of a high definition player in its console may be too much to resist, particularly since Blu-Ray technology has emerged as the industry standard for high definition video. Hence, Nintendo may want to add an HD optical drive.

Students may suggest that Nintendo develop a second console to appeal to a more traditional group of gamers while maintaining the loyalty of its existing base of nontraditional gamers. Video game manufacturers have developed games with high technological capabilities and different on-board memory storage capabilities. Nintendo may further differentiate itself by offering the original video console with its relatively low inclusion of technological capabilities along with a more technologically advanced console. While appealing, this recommendation will likely drive up production costs and position the second console in more direct competition with the PS3 and Xbox 360.

**EPILOGUE**

Sales of video game hardware and software in the United States increased from $18 billion in 2007 to $21.3 billion during 2008. Software sales in the United States approached $11 billion with the three best selling software titles all developed exclusively for the Wii. Video game console sales in the United States reached $7.8 billion during 2008. The Wii continued to build upon its lead in the industry with 2008 sales of 10.2 million units. During December 2008, the Nintendo DS was the best selling console with sales of 3 million units during the month. More than 2.2 million Nintendo Wii consoles were sold in December 2008. Nintendo increased production of the Wii by 50% during late 2008 but remained unable to meet consumer demand for the console.

The Microsoft Xbox 360 sold 4.7 million units during 2008, which was 58 percent greater than Xbox 360 sales in 2007. The console’s sales during 2008 increased the installed base for the Xbox 360 to 28 million units. Also, Xbox Live membership grew by 70 percent during 2008 to reach 17 million members. Microsoft announced in late-2008 that Xbox Live had generated more than $1 billion in revenue since the launch of the Xbox 360. Its online revenue from downloadable content sold at Xbox Live (game add-ons, television programming, and movies) increased by 84 percent during 2008.

Sony’s PlayStation 3 was the fourth best-selling console during 2008 with 3.5 million units sold during the year. The high price of the PS3 console remained an obstacle to its success with its December 2008 sales of 726,000 representing a 7% decline from December 2007. The PlayStation 2 remained a popular alternative to next generation consoles for price sensitive buyers with the PS2 selling 410,000 units in the United States during December 2008. Sony executives stated in January 2009 that the company had no plans to discontinue the PS2 and would continue to introduce new game titles for the PS2 in 2009.

For the latest information on developments at Nintendo, please check the company’s latest financial results and press releases at [www.nintendo.com](http://www.nintendo.com).
OVERVIEW

Grupo Modelo was Mexico’s largest beer producer and distributor and the world’s fourth largest brand of beer in 2007. The company first began exporting its Corona Extra beer to the United States in 1979 and had become the number-one selling imported beer in the U.S. by 1997. In 2007, Grupo Modelo was exporting five kinds of beer to the United States: Corona Extra, Corona Light, Modelo Especial, Pacifico Clara, and Negra Modelo. These exports represented 131 million cases in 2005 and three Grupo Modelo brands ranked among the ten best-selling imports in the United States. Corona’s ascent to stardom could be attributed to its brilliant and unique marketing campaign which was a direct result of the international strategy undertaken by Grupo Modelo when it expanded into the United States. While continuing to produce the beer domestically, Modelo entered into distribution contracts with companies that had local knowledge of the market and gave them autonomy to market the product fittingly, yet maintained an active involvement in the decision making. Modelo’s agreement with its distributors was that each importer would be responsible for essentially all activities involving the sale of the beer, except its production, which took place in Modelo factories in Mexico. Everything—including transportation of the beer, insurance, customs clearance, pricing strategy, and creativity of the advertising campaigns—was the importers’ responsibility. Although the importers were essentially autonomous to make these decisions, Modelo always took an active role in the decision making and maintained the final say on anything involving the brand image of its beers. In order to oversee all operations in the United States, Modelo set up Procermex Inc., a subsidiary whose purpose was to coordinate, support, and supervise the two distributors.

In 2007, Grupo Modelo faced increasing competition domestically and internationally as other top international brands gained momentum through mergers and stronger marketing efforts. The intensifying competitive rivalry had affected Grupo Modelo with Corona’s sales decreasing domestically and in the United States. As Corona’s position as the world’s most recognizable Mexican beer became threatened, its top management team confronted by the following strategic issues:

- How concerned should Grupo Modelo be about the potential merger between InBev and Anheuser-Busch?
- What actions would Carlos Fernandez need to do to help Grupo Modelo sustain or improve its competitive position, especially its international operations, and its long-term financial performance?

SUGGESTIONS FOR USING THE CASE

Many students are likely to find the case interesting because of their familiarity with the Corona brand. Some members of the class may even have a strong preference, favorable or unfavorable, about Grupo Modelo’s products. The Corona Beer case will fit especially well in later half of your module on business strategy or in your module on strategies for competing in foreign markets. The case is particularly well-suited to drill students in the application of such Chapter 7 concept—for instance, students will be able to wrestle with and address cross-country differences in the beer market, strategy options for entering and competing in international markets, and multi-country versus global competition. The case also provides an opportunity to further refine their mastery of the analytic tools presented in Chapter 3 and 4.
The case provides ample information for students to examine issues such as:

- Evaluating whether an industry is best characterized as having global or multinational competition
- Evaluating the nature of a firm’s international strategy
- Completing an industry and competitive analysis of a firm competing internationally

The Student Edition of the Online Learning Center (OLC) provides students with copies of the assignment questions contained in this note. The list of assignment questions leads students through a thorough industry analysis and prepares them to make strategy recommendations for selected companies. We suggest that you always direct students to the assignment questions posted on the Crafting & Executing OLC and instruct them to use the assignment questions to prepare for the class discussion of the case. We always instruct our students to read the case once to gain a general understanding of the issues presented in the case and then return to the case to prepare written responses to each of the assignment cases. We’ve found that our students who follow this approach are well-prepared to make a meaningful contribution to the class discussion.

This case is suitable for either an in-class presentation or a written assignment. Our recommended questions for written assignments are as follows:

1. Impressed with your work as a new member of the Corona brand management team, executives at Grupo Modelo have asked that you assist in an evaluation of the company’s situation and growth prospects. Grupo Modelo’s management has asked you to prepare a 5-6 page report detailing (1) the defining economic characteristics of the brewing industry, (2) the key success factors in the industry, (3) a SWOT analysis for Grupo Modelo, (4) an assessment of the Group’s recent financial performance, (5) an examination of the Grupo Modelo’s approach to competing in foreign markets, (6) the strategic issues that Grupo Modelo’s management needs to address, and (7) your recommendations as to what actions management should undertake to enhance the company’s global leadership position and future performance.

2. As a requirement of your internship with Grupo Modelo USA, you have been asked to evaluate the company’s competitive position in the brewing industry and recommend strategy changes necessary to enable the company to improve its global market position and future performance. Specifically, you should provide a set of recommendations to build global market share and improve financial performance in the form of a 2-3 page executive summary. Your recommendations must show clear linkage to the results of a thorough analysis of the global brewing industry and Grupo Modelo’s competitive position in the industry. All analyses relied upon in identifying strategic issues confronting the company should be included as exhibits accompanying your report. Appropriate exhibits include (1) a list of the dominant economic characteristics of the brewing industry, (2) a list of key success factors in the industry, (3) a SWOT analysis for Grupo Modelo, (4) an assessment of the Group’s recent financial performance, and (5) an examination of the Grupo Modelo’s approach to competing in foreign markets. Your supporting exhibits and executive summary of recommendations will be given equal weighting in your grade for the written assignment.

**ASSIGNMENT QUESTIONS**

1. What are the dominant business and economic characteristics of the global beer industry?

2. What do you see as the key success factors for firms in the global beer industry?

3. What does a strategic group map of the global beer industry look like? How strongly is Grupo Modelo positioned in the industry? How favorably does it compare with its closest Mexican rival FEMSA? How favorably does Grupo Modelo’s position compare to that of Heineken?

4. What are the resource strengths and weaknesses of Grupo Modelo? What competencies and capabilities does it have that its chief rivals don’t have? What market opportunities does Grupo Modelo have? What threats
do you see to the company’s future well being? What conclusions can we draw from the SWOT analysis for Grupo Modelo?

5. What is your assessment of Grupo Modelo’s financial performance and financial condition from Exhibit 6 in the case? Is the company in good financial shape? Why or why not? Please use the financial ratios in Table 4.1 in Chapter 4 to develop calculations in support of your assessment of the company’s financial performance.

6. Is competition in the global beer industry best characterized as global or multi-country? Why? Which type of international strategy discussed in Chapter 7 is Grupo Modelo using in its international operations? How does this compare to the strategies of FEMSA and Heineken? What are the strengths and weaknesses of Grupo Modelo’s international strategy versus those of its main rivals?

7. Based on your analysis of the global beer industry and Grupo Modelo’s situation, what problems and issues does the company’s top management need to address? Which ones are top priorities? Which are low priorities? How concerned should Grupo Modelo be about the potential merger between InBev and Anheuser-Busch?

8. What actions would you recommend to Carlos Fernandez to help Grupo Modelo sustain or improve its competitive position, especially its international operations, and its long-term financial performance?

TEACHING OUTLINE AND ANALYSIS

1. What are the dominant business and economic characteristics of the global beer industry?

   Market Size and Growth Rate
   - The size of the global beer industry approximated $385.5 in 2005 and $376.7 in 2004. This is a growth rate of 2.3% during the year 2005.
   - This is a mature industry with slowing growth, but it will continue to grow at a small rate.

   Number of Rivals
   - During its early development and rapid growth stage, there were many rivals and the industry was very fragmented.
   - The lack of a transportation network made exportation impossible for centuries and brewing was a local, then a national domain.
   - Mergers and acquisitions are beginning to increase in frequency and the industry is experiencing a period of consolidation.
   - A determining factor of beer is that it has different national tastes based on different countries. Specialty beer-makers can find niche markets to sustain themselves without economies of scale.

   Scope of Competitive Rivalry
   - The largest producers compete on global levels with strategic alliances set up to distribute the beer in other countries.
   - Most companies started out on a local or regional level, and then changed the company’s focus to incorporate a multinational or global perspective.
   - While many companies have exported products, most companies still use the production capabilities in their native country.
Having a presence in foreign country markets is becoming more important to a company’s long-term competitive success because of currency risk.

**Number of Buyers**

- The market demand of buyers is spread out across the globe, with China and the United States demanding the most beer by volume annually.
- The market is very fragmented because there are many consumers who drink beer worldwide.
- It is culturally unique because some countries favor other alcoholic beverages such as wine or liquor.
- Most buyers do not have any bargaining power because they do not need to buy in bulk. Suppliers and distributors are able to pick and choose who they supply.

**Degree of Product Differentiation**

- Most of the products by various companies do not differentiate by many degrees. Instead, the only differentiating factors would be taste, color, and thickness.
- The large producers cover most types of beer with their product lines.
- Buyers can get fixated on new types of beer which leads to suppliers focusing on new products to gain popularity.

**Product Innovation**

- The industry is characterized by long product life cycles and slow product innovation.
- Corona Extra was first produced in 1925 and has not gone under many changes for over the last 80 years.
- Research and development is not that important to the beer industry because any person or small company can produce beer.
- Marketing techniques are the most important aspect of selling beer because it creates a personality associated with each brand of beer.
- Not many opportunities exist to overtake rivals by being the first-to-market with next-generation products because most producers are large corporations with prominent brands of beer to use as their backbone.

**Supply/Demand Conditions**

- A surplus of capacity does not exist in the industry, especially for Grupo Modelo, because they are trying to increase capacity to fulfill buyer demands.
- There are many competitors in the industry but buyer demand is increasing to counter the abundance of suppliers.

**Pace of Technological Change**

- Advancing technology does not play a huge role in this industry. Beer has been produced the same way for centuries.
- Producers increase the size of their facilities to accommodate large buyer demands.
- Not too many technological advances are in the actual production of beer; instead, new ways to keep beer cool might affect the participants in the industry.
**Vertical Integration**

- Most companies in the industry operate only in the beer production component of the industry.
- They do not produce the bottles for the beer, and most of them use outside distributing companies to get the beer to the buyers.
- It would not be beneficial for the producers to distribute the beer themselves because the distributors are working for many other producers and use the same routes.

**Economies of Scale**

- The industry is characterized by economies of scale in order to become a global brand. Smaller companies can produce in niche markets in order to encompass regional areas.
- Larger companies can use economies of scale to gain a competitive advantage in low cost production capabilities over small firms.

**Learning/Experience Curve Effects**

- Any person or small company can start brewing their own beer, but a learning curve exists in order to accurately get the right taste.
- Large companies have the ability to develop new brands of beer while smaller more local breweries can only focus on a few brands.

2. What do you see as the key success factors for firms in the global beer industry?

**A strong network of wholesale distributors/dealers (Distribution-related KSFs)**

Firms must create a strong network of distributors in order to compete on a global scale. In Corona’s case, they have created a strong network of distributors, especially with Barton Beers Ltd. and Gambrinus Inc. in the United States. The company chose Barton because it was the largest beer importer in the 25 western states and was experienced in the marketing and sales of imported, premium beers. Barton was the company who coined the “fun in the sun” marketing campaign. Gambrinus Inc. was chosen because of the success of Barton and the fact that it was headed by a former Modelo executive. Each of the distributors is responsible for 25 states, Barton in the west and Gambrinus in the east. Modelo’s made agreements with each company that the importers would be responsible almost all activities involving the sale of the beer. Additionally, Modelo created Procermex Inc. which coordinated, supported, and supervised the two distributors.

**Clever advertising (Marketing-related KSFs)**

Firms must be able to have very productive marketing campaigns as evident by the amount of money spent on advertising in the industry. For Corona, the “fun in the sun” marketing philosophy has been very successful. Since being launched, it quickly saw Corona in an ever-increasing number of bars and restaurants in the United States. The unique feature of the campaign was that it did not focus on the classical target market for beer drinkers (males between the ages of 25 and 45). Instead, it focused on minimalist and often humorous scenes of escape in the form of relaxing on the beach with a Corona bottle always in the center of the screen and no soundtrack other than the sounds of the sea and surrounding nature. The result was that Corona was able to get the non-beer-drinking population to drink beer, specifically, females. More importantly, the campaign has resulted in Corona becoming a well-known and well-respected brand name.

**Quality Products**

Firms need to be able to produce a quality product. While individual tastes and personal preferences may vary, the most successful beer companies produce quality products with a distinctive taste.
A strong balance sheet and access to financial capital (Other types of KSFs)

With the need for constant expansion and acquisitions, firms must have or at least have access to large amounts of capital. Grupo Modelo has very good financials which have been important in the continued rise of the organization. The company just spent more than $300 million to renovate and expand one of its main breweries. Also, the company has bought other companies including Toluca y México Brewery.

3. What does a strategic group map of the global beer industry look like? How strongly is Grupo Modelo positioned in the industry? How favorably does it compare with its closest Mexican rival FEMSA? How favorably does Grupo Modelo’s position compare to that of Heineken?

Students’ strategic group maps of the global beer industry will vary, depending on the variables that they have chosen to categorize the strategic approaches of the industry’s major participant. We have selected 1) the scope of geographic coverage and 2) uniqueness of product offerings. Figure 1 presents our strategic group map based upon the use of these two variables. The size of each entity’s circle is dependent upon the total sales revenue for that particular company. Students who have developed strategic group maps using these variables should conclude that strategic groups that have a moderate level of internationalization are in a better position than others that operate only domestically. In addition, strategic groups that offer a diverse product lineup are in a more favorable position than strategic groups whose product selections lack uniqueness.
Grupo Modelo has placed itself in a moderately favorable position as compared to its rivals. While it has more than moderate internationalization, Modelo lacks the unique product offerings of its larger rivals. On the other hand, Modelo and its chief rival, FEMSA, are nearly identical on the strategic group map. Students should note that FEMSA could be a prime candidate for merger because of the similarity. While the company is very close to FEMSA, it lacks similarities when compared to Heineken. The companies are nearly identical in their geographic coverage but a large discrepancy exists in their product offering with Heineken being much more diverse, making it a more favorable company.

We think students should easily see that InBev has positioned itself as a global leader based on the acquisitions it has made on a global scale. Also, students should note that Anheuser-Busch and Heineken are similar in size and geographic coverage but one (Heineken) offers a large product mix.

4. What are the resource strengths and weaknesses of Grupo Modelo? What competencies and capabilities does it have that its chief rivals don't have? What market opportunities does Grupo Modelo have? What threats do you see to the company’s future well being? What conclusions can we draw from the SWOT analysis for Grupo Modelo?

Students should be able develop a SWOT analysis including the points we have listed below.

**Grupo Modelo’s Resource Strengths and Competitive Capabilities**

- Grupo Modelo made a $300 million investment to renovate its facilities in order to increase production in the face of growing international demand.
- Corona has had increasing U.S. sales since 1992 and, since 1997, Grupo Modelo has been the number one selling import in the United States, instead of Heineken.
- Grupo Modelo has the ability to utilize strengths of partial owner Anheuser-Busch.
- Grupo Modelo has experience at top positions including chairman of the board and CEO Carlos Fernandez.
- Grupo Modelo has multiple brands that are successful including Corona Extra, Corona Light, Modelo Especial, Pacifico Clara, and Negra Modelo. These exports represented 131 million cases in 2005 and three Grupo Modelo brands ranked among eight firsts in the United States.
- Corona’s domestic market, Mexico, where the company has captured 62.8 percent (as of 2007), was the world’s 11th most populated country and one of the largest beer markets in the world.
- Corona Extra is the fourth best-selling beer in the world (by quantity).
- Grupo Modelo is one of the top 10 biggest breweries in the world.
- Corona’s “Fun in the Sun” U.S. marketing campaign has been highly successful.
- Grupo Modelo’s products have established, international images.
- Corona’s local knowledge of the U.S. markets is due to the distribution contracts between Modelo and the U.S. distributors of Barton Beers Ltd. and Gambrinus Inc.
- Grupo Modelo stays actively involved in the decision making process of their U.S. distributors.
- Grupo Modelo’s distributors were willing to change their pricing strategies without affecting their customers.
Grupo Modelo own Procermex Inc., a subsidiary whose purpose is to coordinate, support, and supervise Modelo’s two distributors in the United States.

Corona has risen to a dependable second choice for beer drinkers who are frustrated with not having their favorite beers sold at certain locations.

Grupo Modelo’s net sales have risen 7.8 percent on a compounded basis over the last 10 years.

Grupo Modelo’s total volume of beer sold in 2005 was 45.5 million hectoliters, an increase of 6.4 percent compared with the previous year.

Grupo Modelo has 4 percent growth in the domestic market and 12.3 percent in the export market.

Grupo Modelo’s export sales comprised 30.2 percent of total volume for 2005, compared to 28.6 percent in 2004.

Grupo Modelo’s Resource Weaknesses and Competitive Deficiencies

- Grupo Modelo’s voting rights are held by the Diez family which could lead to conflicts of interest in the future.
- Grupo Modelo’s domestic market is the birthplace and home of the most affluent tequila market in the world which takes away from their market share.
- Grupo Modelo has given autonomy to the U.S. distributors which could result in decreasing sales if bad decisions are made.
- Grupo Modelo does not have a product amongst the top seven best-tasting beers in Mexico.
- Grupo Modelo is geographically concentrated only in North America.
- Grupo Modelo’s domestic sales are currently decreasing.

Grupo Modelo’s External Opportunities

- Increase strategic alliances with major distributors due to the introduction of the North American Free Trade Agreement (NAFTA).
- Expand brands into large beer markets throughout the world including China, the United States, and Mexico, instead of reliance on domestic markets, due to competition in the industry.
- Acquire, consolidate, and merge with other brewers, due to competition in the industry.
- The barriers to entry have been increased due to high initial startup costs for breweries, the need for a constant cash flow for maintenance, and the fluctuating price of resources.
- Obtain U.S. market share from the top three breweries (Anheuser- Busch, Miller Brew, and Adolph Coors), who control almost 80 percent of the market and the 300 smaller U.S. breweries who struggle to find profitability due to vertical integration and economies of scale.

External Threats to Grupo Modelo’s Future Well-Being

- Establishment and threat of an increasing federal excise tax on beer in the United States.
- Decreasing growth expectations in the United States.
- Operations of 300 breweries in the United States due to a dense network of regional craft brewing.
- Creation of opportunities including NAFTA for opposition to take market share from the Mexican duopoly.
- Reluctance of customers to pay high costs for imported, premium beers.
- Rising costs of advertising throughout the industry.
- Shifting consumer trends and preferences can cause industry players to have to drastically alter their product offerings.
- Vertical integration moves by companies such as FEMSA who owns Oxxo, Central America’s largest chain of convenience stores (and one of the biggest in North America).
- Movement of industry leaders into areas other than beer including FEMSA who is the exclusive distributor of Coca-Cola products in Mexico and Central America.
- The volatility of the Mexican economy including the devaluation of the Mexican peso.
- Further consolidation by industry leaders will increase the market share by industry leaders.

We can draw from the SWOT analysis that Grupo Modelo is an attractive company. While it lacks in areas such as geographic coverage, it has many strengths compared to its rivals. Also, many opportunities have arisen that making the chances of future success likely. Additionally, the company has some competencies and capabilities that its chief rivals do not have including strong advertising and favorable market share.

5. What is your assessment of Grupo Model's financial performance and financial condition from Exhibit 6 in the case? Is the company in good financial shape? Why or why not? Please use the financial ratios in Table 4.1 in Chapter 4 to develop calculations in support of your assessment of the company's financial performance.

Due to the success of Corona Extra, Grupo Modelo has consistently been ranked among the top 10 beer producers in the world. The effects of these accomplishments are evident in the financial statements of the company which bolster its overall financial condition. The liquid volume sale of beer in both the domestic and export markets for Grupo Modelo has increased by 6.4% to over 45 million hectoliters during the course of 2005. This demonstrates the ever-increasing demand for the brands of beer that the company produces. Financially, sales revenue has increased 7% throughout the course of 2004-2005 with continued growth prospects. Focusing on some key financial ratios in Table 1, it is evident that Grupo Modelo is performing very well financially. For example, the net profit margin, which shows the after-tax profits per dollar of sales, has increased 6.6% during 2005. This means that Grupo Modelo is keeping more money per dollar of sales than it was in 2004. The return on stockholders’ equity has increased 5.2% during the fiscal year 2005. This ratio shows the return the stockholders are earning on their investment in the company.

Another way of valuating Grupo Modelo’s financial condition focuses on its leverage ratios. Even during the year 2005, when total assets and stockholders’ equity have increased by 5.8% and 8.5%, respectively; the debt-to-assets ratio and the debt-to-equity ratio of the company have decreased 12.0% and 14.2%. These ratios measure the extent to which borrowed funds have been used to finance the firm’s operations. The reductions in these numbers show that Grupo Modelo is paying off some of its debt and will have much lower risks of bankruptcy, thereby pointing toward a more favorable financial condition. With the financial stability of the company under control, Grupo Modelo made a $300 million investment to renovate its facilities with the hope of increasing production to continue its favorable financial performance.
### Table 1  Selected Financial Ratios for Grupo Modelo, 2004 – 2005

<table>
<thead>
<tr>
<th>Profitability ratios</th>
<th>2005</th>
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<tr>
<td>Gross Profit Margin</td>
<td>54.0%</td>
<td>56.3%</td>
</tr>
<tr>
<td>Operating Profit Margin</td>
<td>27.8%</td>
<td>29.3%</td>
</tr>
<tr>
<td>Net profit margin (or net return on sales)</td>
<td>14.7%</td>
<td>13.8%</td>
</tr>
<tr>
<td>Return on stockholders’ equity</td>
<td>13.9%</td>
<td>13.2%</td>
</tr>
<tr>
<td>Leverage ratios</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total liabilities-to-assets ratio</td>
<td>15.2%</td>
<td>17.2%</td>
</tr>
<tr>
<td>Total liabilities-to-equity ratio</td>
<td>23.2%</td>
<td>27.1%</td>
</tr>
<tr>
<td>Other Measures</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dividend yield on common stock</td>
<td>2.8%</td>
<td>3.0%</td>
</tr>
<tr>
<td>Price/earnings ratio</td>
<td>17.2</td>
<td>15.6</td>
</tr>
<tr>
<td>Dividend payout ratio</td>
<td>47.8%</td>
<td>46.4%</td>
</tr>
</tbody>
</table>

Calculated from case Exhibit 6.

6. Is competition in the global beer industry best characterized as global or multi-country? Why? Which type of international strategy discussed in Chapter 7 is Grupo Modelo using in its international operations? How does this compare to the strategies of FEMSA and Heineken? What are the strengths and weaknesses of Grupo Modelo’s international strategy versus those of its main rivals?

The beer industry can best be characterized as having global markets. Almost every country in the world consumes beer, with China and the United States holding the top two positions. With some countries having cultural tastes of different alcoholic beverages such as wine, large producers must effectively use strategies to gain market share in these countries. Beer producers such as Interbrew and AmBev must merge to incorporate these markets and to gain vital understanding of the preferences of each country.

Companies must decide what strategy to use when deciding to enter foreign markets. Grupo Modelo uses the “Think Global, Act Global” strategy in its international operations. It pursues the same basic competitive strategy because its products do not change from country to country, even if local tastes change. The marketing approach appears to be the same as well. For instance, the Corona Extra marketing campaign continues to revolve around the idea of relaxation in a coastal atmosphere. The distribution companies that Grupo Modelo uses coordinate all the channels and even take most of the risks such as insurance, pricing strategies, and tax increases. Grupo Modelo also uses a strategic alliance with Anheuser-Busch to broaden its international impact.

Rival companies such as FEMSA and Heineken have also developed strategic alliances. In order to compete in the U.S. market, FEMSA developed a partnership with Heineken to take some market share from Grupo Modelo. FEMSA also opened up a partnership with Coca-Cola to arrive in the non-alcoholic beverage industry. This strategy is a “Think Global, Act Local” strategy because the Coca-Cola products vary among every country.

Grupo Modelo’s strategy has some significant strengths as well as weaknesses compared to its rivals’ strategies. The main strength of Grupo Modelo’s strategy is that the company never has to produce a broad variety of its brands. For example, Corona Extra is the same beer throughout the world and does not change from country to country. Also, the company does not take full responsibility for the beer when it is transferred to its distributors, which means that its work is finished when the distributors deliver the product. Another
 Cra 

strength for Grupo Modelo is that its marketing campaign does not change throughout the various companies. This made for a relatively small advertising budget of $5.1 million for the United States in 1996 compared to Heineken’s advertising budget of $15.1 million for the U.S. in the same year. However, this strategy does have its weaknesses. Thinking globally instead of locally, Grupo Modelo’s brands do not tailor to each country’s specific tastes, whereas other producers create new brands that can be sold in specific countries. Also, with smaller advertising campaigns the brand recognition for Grupo Modelo can be relatively weak in regard to the higher-budgeted campaigns of other beer producers. Even with these weaknesses, the strategy that Grupo Modelo has employed propelled the Corona Extra brand to new heights throughout the early 21st century.

7. Based on your analysis of the global beer industry and Grupo Modelo’s situation, what problems and issues does the company’s top management need to address? Which ones are top priorities? Which are low priorities? How concerned should Grupo Modelo be about the potential merger between InBev and Anheuser-Busch?

There are many problems and issues that plague Grupo Modelo. First of all, Grupo Modelo is lacking the ability to keep up with consumer demand. Corona Extra just became the number one imported beer in the United States and Grupo Modelo just approved a $300 million facility expansion project. The company must be able to foresee the growth rates of its brands and adjust them accordingly. This is definitely a high-priority because the global demand of its brands will cause shortages in the product and a loss in potential revenues. Also, the governments of certain countries such as the United States have imposed significant tax increases on the sale of alcohol. Since Grupo Modelo absorbs only a portion of the tax while their distributors absorb the other portions, its priority is relatively low.

As for other companies, FEMSA is differentiating its beer brands based on the quality of the beer in Mexico. According to Exhibit 5 in the case, the brands produced by FEMSA are rated much higher than the brands produced by Grupo Modelo. Especially in a mature market, the quality of the products plays a significant role in the consumer buying process. This is the leading reason why FEMSA is beginning to steal market share from Grupo Modelo. This is another top priority because Grupo Modelo is losing revenues to its domestic competitor. Additionally, Grupo Modelo must be concerned with the competitive advantage that FEMSA has attained by owning its distribution channel, OXXO. This creates a cost advantage to FEMSA since its profits are not split among distributors. Grupo Modelo also faces problems with its advertising campaigns. With other companies spending enormous budgets on marketing for their product, Grupo Modelo will be exposed to these other companies stealing market share from them through brand recognition. Without a sufficient marketing strategy, Grupo Modelo’s market share will decrease throughout the future years. This should be a high-priority aspect in order to stay at the top in this extremely competitive environment.

The potential merger between InBev and Anheuser-Busch would certainly change the competitive dynamics of the industry. Essentially, the merger would create a dominant player in the industry that was 2/3 larger than any other competitor. This company would have a market share that was twice that of the nearest competitor. With this type of market power the combined company could gain production and distribution efficiencies, and leverage its position with major distributors.

8. What actions would you recommend to Carlos Fernandez to help Grupo Modelo sustain or improve its competitive position, especially its international operations, and its long-term financial performance?

Students will need to be familiar with Chapter 7’s discussion of strategy options for competing globally and internationally. The following recommendations should address strategic issues presented in the introduction of the case and rely on concepts presented in Chapter 7 of the text.

- First, there is considerable consolidation occurring in the industry. Students should recognize that Grupo Modelo will need to continue to expand the company offerings in more foreign markets though mergers, acquisitions, or formations of strategic alliances.
Grupo Modelo is relatively smaller in size as compared to other global conglomerates such as InBev and Anheuser-Busch. However, students should recommend that Grupo Modelo grow organically as well as through acquisitions. This organic growth should be focused on expanding production capabilities to keep pace with global demand which is needed given the company’s position as Mexico’s best-selling beer, the top-selling imported beer in the U.S., and the world’s fourth best-selling beer, as of 2007.

Grupo Modelo must vigorously defend its profit sanctuary in Mexico against FEMSA. FEMSA has begun to overtake Grupo Modelo’s large lead in domestic market share partly because of the taste of FEMSA’s product as well as FEMSA’s line of convenience stores. Students should recommend Modelo to increase their product offering to provide a better tasting product and/or create their convenience stores to compete with FEMSA. It is not completely unreasonable for students to consider an acquisition of FEMSA by Grupo Modelo. FEMSA has a number of highly rated beers that could help fuel Modelo’s continued international expansion.

The larger organizations have considerably larger advertising budgets. Students should recommend that Grupo Modelo increase its marketing budgets to maintain its U.S. brand recognition and overall market share. The expanded advertising budgets should also be extended to other foreign markets. In designing these campaigns, Modelo should ensure that it maintains its currency marketing strategy and tactics which have been so successful.

EPILOGUE

There have been many important developments occurring between the close of the case in early 2006 and late 2008:

- In June 2006, Anheuser-Busch secured exclusive advertising rights with NBC of the Super Bowl XLIII and Super Bowl XLVI as part of a comprehensive six-year agreement.
- In November 2006, Anheuser-Busch became the exclusive U.S. importer of numerous InBev products including Stella Artois, Beck’s, Hoegaarden, and other select brands.
- In January 2007, Grupo Modelo signed an agreement with Anheuser-Busch to import Modelo’s beers into China, thereby, moving Grupo Modelo into the world’s largest market.
- In May 2007, Grupo Modelo announced an agreement with Carlsberg A/S to import Carlsberg beer into Mexico to secure more financial stability.
- In June 2007, Heineken launched its new advertising campaign, “Continental Shift,” for the Rugby World Cup. As a result, the market share of Heineken in the Czech Republic, the country with the highest consumption per capita, increased 8% and improved its position to number three in the market.
- In January 2008, Grupo Modelo established a joint venture with Molson Coors Brewing Company entitled Modelo Molson Imports L.P. to distribute beer in all Canadian provinces and territories.
- Grupo Modelo Chief Executive, Carlos Fernandez, resigned from the board of Anheuser-Busch in June 2008.
- Also in June 2008, InBev made a $46.3 billion bid to acquire Anheuser-Busch at $70 per share. With the approval of the shareholders, this acquisition made InBev the world’s largest global brewer.

You can review the company’s latest financial results and press releases at www.gmodelo.com.mx.
OVERVIEW

The number of people worldwide accessing the Internet to read breaking news, conduct library research, make consumer e-commerce transactions, use web-based business applications, and perform other online tasks had grown at an astronomic rate since the 1994 introduction of the Netscape Navigator browser. The number of Internet users worldwide had increased from about 360 million in 2000 to nearly 1.5 billion in 2008. North America had the world’s highest Internet penetration rate with 73.6 percent of North America’s population having Internet access. About 220 million of the 248 million Internet users in North America resided in the United States. Even though only 15.3 percent of Asians had Internet access in 2008, Asia’s 578.5 million Internet users made it the world’s largest and fastest growing geographic region for Internet usage.

The growth in the number of Internet users worldwide and in the United States had caused a shift in how advertisers communicated with consumers and had allowed Internet advertising to become the second most common form of advertising used in the United States in 2007. Only newspaper, with 2007 advertising revenues of $48.6 billion, controlled a larger share of United States advertising dollars. Cable television, radio, and network television each accounted for about $20 billion each in advertising revenues during 2007. The prospects for Internet advertisers looked strong in 2008 with Internet advertising expected to grow from $21 billion in 2007 to $36.5 billion in 2011. Search-based ads accounted for the largest portion of Internet advertisements in the United States during 2007—amounting to nearly $9 billion in industry revenues. Video ads shown on YouTube and other web sites accounted for only $505 million in 2007, but were expected to grow to a $5.8 billion market by 2013. Mobile search was another rapidly growing advertising media format, which was projected to increase from worldwide revenues of $813 million in 2007 to $5 billion by 2013.

Advertisers believed search-based ads were particularly effective because they were highly targeted to what Internet users were immediately searching for. In 2008, Google was the worldwide leader in Internet and mobile search advertising because of consumers’ faith in the search engine. Internet users trusted Google’s results because its paid search results were not interspersed with other search results and were clearly marked as Sponsor Links. Perhaps Google’s most important feature was its capability to retrieve highly relevant results to search queries that was made possible by its innovative text-matching techniques and PageRank technology.

Internet users’ preference for Google’s search results produced 2007 revenues of nearly $16.5 billion and profits of more than $4.2 billion. The highly scaleable business model added relatively little additional fixed cost as volume increased, which helped boost the company’s cash, cash equivalents and marketable securities to $14.2 billion at the end of 2007. Google’s stellar growth rate in revenues and net income was destined to continue into 2008, since its revenues and net income for the first nine months of the fiscal year stood at $16.1 billion and $3.8 billion, respectively. Neither Microsoft’s Live Search nor Yahoo, which were the industry’s second and third most used search engines, seemed capable of slowing Google’s growth in 2008.
With Google controlling the market for search based ads, much of the company’s attention was focused on new initiatives that might allow the company to sustain its extraordinary growth in revenues, earnings, and net cash provided by operations. Google launched its Android operating system for mobile phones in 2008, which would allow wireless phone manufacturers such as LG and Nokia to produce Internet enabled phones boasting features similar to what were available on Apple’s iPhone. Widespread use of the Internet-enabled Android phones would not only help Google solidify its 2008 mobile search market share of 63 percent, but would also allow it to increase its share of banner ads and video ads displayed on mobile phones. Perhaps the company’s most ambitious strategic initiative in 2008 was its desire to change the market for commonly used business productivity applications such as word processing, spreadsheets, and presentation software from the desktop to the Internet. The company’s Google Apps “cloud computing” software would allow corporate software users to access Google’s data centers to run software applications and store files that might be needed by other users engaged in collaborative projects. Information technology analysts believed that the market for cloud computing applications could grow to $95 billion by 2013. Other strategic issues confronting Google’s chief managers in 2008 included how to best capitalize on such recent acquisitions as its DoubleClick banner ad management program, dMark media auctioning system, and YouTube video sharing network and how to increase its share of search based ads in emerging markets.

**SUGGESTIONS FOR USING THE CASE**

Students will likely look forward to discussing Google’s Strategy in 2008 because of their frequent use of Google and other search engines. Also, Google is a high-profile company, one that is regularly in the business headlines when it makes new strategic moves or reports its latest financial performance. It is clearly one of the most important and influential companies of the early 21st century.

We think the case is best positioned in the middle or second half of your module on business strategy. The case analysis calls for students to wrestle with an assessment of the five competitive forces, industry driving forces and industry key success factors. There’s also an opportunity for you to have students evaluate Google’s business model and competitive strategy along with specific elements of its strategy. So far, Google’s strategy and business model have generated outstanding financial performance (the case contains financial data back to 2001), but there are all kinds of questions students should ask about the company’s recent strategic initiatives such as its launch of the Android mobile phone operating system and its decision to take on Microsoft in business productivity software. Other issues students must assess include Google’s move into banner ads through its DoubleClick acquisition and how much success it might achieve with its new auctioning system for traditional media ads.

The Student Edition of the Online Learning Center (OLC) provides students with copies of the assignment questions contained in this note. The list of assignment questions leads students through a thorough industry analysis and prepares them to make strategy recommendations for selected companies. We suggest that you always direct students to the assignment questions posted on the Crafting & Executing OLC and instruct them to use the assignment questions to prepare for the class discussion of the case. We always instruct our students to read the case once to gain a general understanding of the issues presented in the case and then return to the case to prepare written responses to each of the assignment cases. We’ve found that our students who follow this approach are well-prepared to make a meaningful contribution to the class discussion.

There is a video accompanying the Google case, which we suggest showing at the beginning of class. The video is a 19:55 minute interview with Google CEO Eric Schmidt. The McKinsey Quarterly interview should help set the stage for the class discussion.

The Google case is ideal for drilling the class in doing SWOT analysis—students really need to have a strong grasp of Google’s key resource strengths and competitive capabilities and its weaknesses, opportunities, and threats before attempting to make strategic recommendations.
Because of the number-crunching possibilities and the wide ranging strategic issues confronting the company, the case is an excellent choice for oral team presentations or a written case assignment. Our suggested assignment questions are:

- Google’s top managers have heard of your budding skills of analysis as a new project manager with the company. You have been assigned to a strategic planning committee where your charge is to analyze the search industry and Google’s competitive position. Your report should include a 2-3 page executive summary of recommendations necessary to allow Google to strengthen its lead in the industry and to make a success of its mobile search, cloud computing, and other recent ventures. Your recommendations should be specific and supported with facts from your industry analysis, company situation analysis, and financial analysis. Please attach whatever tables, figures, or other exhibits you believe necessary to support your conclusions. (You should utilize the financial ratios presented in Table 1 of Chapter 4 as a guide in doing your financial analysis of the company.) Your supporting exhibits and executive summary of recommendations will be given equal weighting in your grade for the written assignment.

- Please prepare a 5-6 page report that analyzes the search engine industry and Google’s competitive position in the industry. Your report should include a Five Forces analysis, list of industry driving forces and key success factors, a SWOT analysis and financial analysis for Google’s performance between 2001 and 2007. Also, please recommend strategies necessary to allow Google to strengthen its lead in the search industry and to make a success of its mobile search, cloud computing, and other recent ventures. Your recommendations should be specific and supported with facts from your analysis. (You should utilize the financial ratios presented in Table 1 of Chapter 4 as a guide in doing your financial analysis of the company.)

ASSIGNMENT QUESTIONS

1. Discuss competition in the search industry. Which of the five competitive forces seem strongest? weakest? What is your assessment of overall industry attractiveness?

2. How is the search industry changing? What forces seem most likely to bring about major change to the industry within the next three to five years?

3. What are the key factors that define success in the industry? What are the key competencies, capabilities, and resources of successful search engine companies?

4. Describe Google’s business model. What are the company’s revenue-cost-profit relationships? What strategies has Google relied upon to build competitive advantage in the industry?

5. Have Google’s business model and strategy proven to be successful? Should investors be impressed with the company’s financial performance? How does the company’s financial performance compare to that of Microsoft and Yahoo? Please conduct a financial analysis to support your position—you may wish to use the financial ratios presented in Table 1 of Chapter 4 as a guide in doing your financial analysis of the company.

6. What are the company’s key resource strengths and competitive capabilities? What competitive liabilities and resource weaknesses does it have? What opportunities exist? What threats to its continued success are present?

7. What recommendations would you make to Google’s top-management team to sustain its competitive advantage in the search industry? How should it best capitalize on its strategic initiatives in mobile search, cloud computing, and its auctioning system for traditional media ads?
1. Discuss competition in the search industry. Which of the five competitive forces seem strongest? weakest? What is your assessment of overall industry attractiveness?

The bargaining power and leverage of buyers—a moderate competitive force

Students should not confuse search engine users with buyers of search engine services. The buyer-seller relationship is between the search engine company and the companies that pay for its search-based ads. A second category of buyers includes companies that purchase search appliances to offer search functionality to intranets or corporate websites. Most students will find both types of buyers had a moderate amount of leverage in their negotiations with search engine sellers. The search engine companies have standard fees that are charged for both search appliances and search-based ads. However, there are no meaningful switching costs for buyers, which puts poor sellers with poor performing search technology at a considerable disadvantage in the marketplace.
The bargaining power and leverage of suppliers—a weak competitive force

Most of the technology that powers search engines is either developed internally or acquired, so students will likely conclude suppliers to the industry are very weak in their relationships with search engine companies. Computer hardware and telecommunications equipment are the major purchased inputs into delivering search results and students will universally agree that these products are readily available from a number of suppliers. It should be assumed that search engine companies are able to negotiate for low prices when purchasing large numbers of servers and accepting bids on telecommunications services.

Competition from substitutes—a weak competitive force

Memorization of URLs, using a favorites list, or perusing wiki sites are among the few substitutes for search engines. Students will readily comment that search engines are a critical application for Internet use and have no substitutes.

Threat of entry—a moderate competitive force

Entry into the industry seems restricted to only those with considerable technological capabilities and access to capital. Students will conclude that entry into the industry is limited to a select group of technology and Internet companies, but it is likely new search engines will emerge. Some students may also note that Google was developed on a very limited budget by two creative computer science graduate students. It’s possible that the development of a viable semantic search engine might originate in a similar fashion.

Rivalry among competing sellers of search engine services—a strong competitive force

The ability to attract buyers of search based ads was a function of a search engine’s ability to deliver highly-relevant search results and then attract vast numbers of Internet users to its site. The search engine industry was highly consolidated with three sites accounting for more than 90% of all searches in April 2008. Competition among rival search engines is best characterized as strong, since each search engine attempted to create the best technology to search billions of websites and develop a following among millions of Internet users. Internet advertisers were unlikely to utilize the services of search engine companies with inferior technology, limited results, or small numbers of Internet users.

Overall attractiveness of search engine industry

Students are likely to conclude that the search engine industry is highly attractive for a company with Google’s capabilities. Buyers have little ability to bargain for lower ad rates from Google, substitutes and suppliers have very little impact on industry profits, and the company’s technology protects it from interfirm rivalry. However, the potential entry of a firm having mastered semantic search technology could quickly erode Google’s competitive position and cause it to lose Internet users and advertising clients. Therefore, students will also agree the ability of consumers (and advertisers) to switch allegiances to better search technologies makes the industry very unattractive for companies offering inferior search technology. Search engines with inferior technology and small numbers of users will find it very difficult to attract sufficient advertising revenues to earn profits and recover development costs.

2. How is the search industry changing? What forces seem most likely to bring about major change to the industry within the next three to five years?

Students are likely to identify the following driving forces.

- Development of semantic search technology

  The developing capability of search technology to consider the context of words entered into a search query offered an opportunity to radically improve search results. Common language and contextual search is likely to bring about changes in how consumers use search and improve the ability of advertisers to target ads to Internet users. Any company able to develop and deploy viable semantic search has the potential to challenge Google for industry dominance.
Expansion of Internet capabilities on wireless devices

Students will note that Internet search functionality on wireless devices is becoming more important as a larger percentage of mobile phones and PDAs develop full browser capabilities. Therefore, search engine compatibility with operating systems used by wireless telephones and PDAs is becoming increasingly important.

Migration of software applications from local computers to the Internet

The development of cloud computing applications has the potential to radically change the revenue-cost-profit dynamics of the computer software industry and create new opportunities for Internet advertisers. Microsoft has begun the migration to web-based applications with the launch of Azure—an operating program and data file hosting service for businesses. Google Apps is Google’s web-based productivity software package intended to compete with Microsoft Office. Such applications have different pricing models and cost structures than disk-based software applications and have the potential to create new sources of revenue for Google and other Internet sites. Also, web-based software applications would allow advertisers to reach computer users during all types of activity, not just while browsing the Internet or conducting Internet searches.

3. What are the key factors that define success in the industry? What are the key competencies, capabilities, and resources of successful search engine companies?

The industry key success factors are easy to understand and should involve very little debate. Students should be able to list the following industry key success factors from information provided in the case and from personal experience using search engines.

- **Quick search retrieval**—Internet users expect quick results to search requests.
- **Accuracy of search results**—Internet users expect accurate results that can be retrieved from plain language queries.
- **Search index that includes billions of websites**—Internet users expect results to include all known websites of significance. In addition, search engines that are able to provide maps, phone numbers, driving directions, and local information are at an advantage in attracting Internet users looking for a single site to answer questions.
- **Sufficient site traffic to gain the interest of Internet advertisers**—Advertisers are free to contract for search-based ads with any commercial search engine. Advertisers are unlikely to enter into agreements with search engines not heavily used by consumers.
- **Extension of search results to mobile devices**—Students should understand the growing importance of proving search results to those connecting to the Internet via mobile phones and PDAs. Worldwide revenues generated from mobile search results were expected to increase from $813 million in 2007 to $5 billion by 2013.

4. Describe Google’s business model. What are the company’s revenue-cost-profit relationships? What strategies has Google relied upon to build competitive advantage in the industry?

Google’s business model has evolved from one keyed to licensing its search engine technology for use on corporate intranets or web sites to revenue generation through search-based advertising. In 2008, the company continued to license its Google Search Appliance to commercial users, but the vast majority of its revenues were derived from its AdWords and AdSense programs. The AdWords program provided
discreet text-based ads to Internet advertisers, while AdSense allowed various websites to share in Google’s advertising revenues by hosting its text-based ads. The business model requires substantial fixed investments in research and development, but the revenues from Google’s advertising programs have yielded hefty profits so far. Students should easily recognize the appeal of the revenue-cost-profit relationships provided by Google’s business model.

Google has expanded its business model further to include revenues from an online auctioning service for ads placed in traditional media and from the licensing of cloud computing software applications. So far, these additions to the business model have made only a negligible contribution to corporate revenues.

Specific components of Google’s strategy that students will identify include:

- The company pursues competitive advantage through differentiation with its text-matching techniques and PageRank technology that returns search results by examining the underlying links to websites across the Internet.
- The company also creates value for its advertising customers by providing consumers with highly relevant ads. Also, the wide usage of Google ensures advertisers that their ads will be seen by the largest possible number of consumers accessing the Internet through either a computer or mobile device.
- The company has expanded its product and services offering to consumers beyond search results to Gmail, Blogger, Mobile, Maps, Book Search, images, news, and many other features (See case Exhibit 3).
- The strategy was unique to eBusiness since there was no fulfillment activities and the company was able to direct traffic to its site primarily by word of mouth.

5. Have Google's business model and strategy proven to be successful? Should investors be impressed with the company's financial performance? How does the company's financial performance compare to that of Microsoft and Yahoo? Please conduct a financial analysis to support your position.

Students will be impressed with Google’s remarkable revenue growth and outstanding profit margins. Table 1 presents compound annual growth rates for items included in Google’s Consolidated Statement of Operations. Case Exhibit 4 presents Income Statement data from 2001 through 2007, but we’ve excluded 2001 and 2002 from our calculations because evaluation of the 2003 - 2007 period gives a better picture of Google’s sustainable growth rate.

Students should overwhelmingly approve of the company’s 83% annual growth in revenues between 2003 and 2007 and make note that Google’s Cost of Revenues and Total Costs and Expenses have grown slightly more slowly than revenues. The result of Google management’s efforts to control the growth in expenses has allowed Income from Operations and Net Income to grow more rapidly than Revenues. Students who calculate compounded annual growth rates for Google’s sources of revenues shown on page C-271 of the case should note that the company’s fastest growth has occurred in additional revenue from search based ads provided at Google web sites. Table 2 lists compounded annual growth rates for Google’s revenues categories between 2003 and 2007.

The ratios in Table 3 show that operating profit margins and net profit margins grew dramatically between 2003 and 2005, but seem to have leveled off since 2007. Students should also be quite impressed with Google’s balance sheet. The company has no long-term debt and its current ratio was 8.5 in 2007 and 10.0 in 2006.

Students who make calculations such as what is shown in Tables 4 and 5 will note that Microsoft is an equally profitable company, while Yahoo’s performance began a rather rapid decline in 2006. Students should note that even though Microsoft is a highly profitable company, its Online Services business has struggled.
### Table 1  Compound Annual Growth Rates For Items Included In Google’s Consolidated Statement Of Operations, Fiscal 2003-2007

<table>
<thead>
<tr>
<th>Item</th>
<th>CAGR (2003 - 2007)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues</td>
<td>83%</td>
</tr>
<tr>
<td>Costs and expenses:</td>
<td></td>
</tr>
<tr>
<td>Cost of revenues</td>
<td>81%</td>
</tr>
<tr>
<td>Research and development</td>
<td>120%</td>
</tr>
<tr>
<td>Sales and marketing</td>
<td>87%</td>
</tr>
<tr>
<td>General and administrative</td>
<td>64%</td>
</tr>
<tr>
<td>Stock-based compensation</td>
<td>40%</td>
</tr>
<tr>
<td>Non-recurring portion of settlement of disputes with Yahoo</td>
<td>--</td>
</tr>
<tr>
<td>Total costs and expenses</td>
<td>79%</td>
</tr>
<tr>
<td>Income (loss) from operations</td>
<td>96%</td>
</tr>
<tr>
<td>Interest income (expense) and other, net</td>
<td>244%</td>
</tr>
<tr>
<td>Income (loss) before income taxes</td>
<td>101%</td>
</tr>
<tr>
<td>Provision for income taxes</td>
<td>57%</td>
</tr>
<tr>
<td>Net income (loss)</td>
<td>151%</td>
</tr>
<tr>
<td>Net income (loss) per share:</td>
<td></td>
</tr>
<tr>
<td>Basic</td>
<td>105%</td>
</tr>
<tr>
<td>Diluted</td>
<td>139%</td>
</tr>
</tbody>
</table>

Source: Calculated from case Exhibit 4.

### Table 2  Compound Annual Growth Rates For Google’s Revenue Categories, Fiscal 2003-2007

<table>
<thead>
<tr>
<th>Advertising revenues</th>
<th>CAGR (2003 - 2007)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Google web sites</td>
<td>91%</td>
</tr>
<tr>
<td>Google Network web sites</td>
<td>74%</td>
</tr>
<tr>
<td>Total advertising revenues</td>
<td>84%</td>
</tr>
<tr>
<td>Licensing and other revenues</td>
<td>41%</td>
</tr>
<tr>
<td>Net revenues</td>
<td>83%</td>
</tr>
</tbody>
</table>

Source: Calculated from case exhibit shown on page C-271.

### Table 3  Selected Financial Ratios For Google Inc., Fiscal 2003 –2007

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating profit margin</td>
<td>30.6%</td>
<td>33.5%</td>
<td>32.9%</td>
<td>20.1%</td>
<td>23.4%</td>
</tr>
<tr>
<td>Net profit margin</td>
<td>25.3%</td>
<td>29.0%</td>
<td>23.9%</td>
<td>12.5%</td>
<td>7.2%</td>
</tr>
<tr>
<td>Return on assets</td>
<td>16.6%</td>
<td>16.7%</td>
<td>14.3%</td>
<td>12.0%</td>
<td>12.1%</td>
</tr>
<tr>
<td>Return on equity</td>
<td>18.5%</td>
<td>18.1%</td>
<td>15.6%</td>
<td>13.6%</td>
<td>17.9%</td>
</tr>
<tr>
<td>Current ratio</td>
<td>8.5</td>
<td>10.0</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
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Source: Calculated from case Exhibits 4 and 5.
Table 4  Selected Financial Ratios For Microsoft Corporation, Fiscal 2004 –2008

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<tbody>
<tr>
<td>Operating profit margin</td>
<td>37.2%</td>
<td>36.2%</td>
<td>37.2%</td>
<td>36.6%</td>
<td>24.5%</td>
</tr>
<tr>
<td>Net profit margin</td>
<td>29.3%</td>
<td>27.5%</td>
<td>28.5%</td>
<td>30.8%</td>
<td>22.2%</td>
</tr>
<tr>
<td>Return on assets</td>
<td>24.3%</td>
<td>22.3%</td>
<td>18.1%</td>
<td>17.3%</td>
<td>8.7%</td>
</tr>
<tr>
<td>Return on equity</td>
<td>48.7%</td>
<td>45.2%</td>
<td>31.4%</td>
<td>25.5%</td>
<td>10.9%</td>
</tr>
<tr>
<td>Operating profit margin (Online Services)</td>
<td>-38.4%</td>
<td>-25.3%</td>
<td>0.2%</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
</tbody>
</table>

Source: Calculated from case Exhibit 7.


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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating profit margin</td>
<td>10.0%</td>
<td>14.6%</td>
<td>21.1%</td>
<td>19.3%</td>
<td>18.2%</td>
</tr>
<tr>
<td>Net profit margin</td>
<td>9.5%</td>
<td>11.7%</td>
<td>36.1%</td>
<td>23.5%</td>
<td>14.6%</td>
</tr>
<tr>
<td>Return on assets</td>
<td>5.4%</td>
<td>6.5%</td>
<td>17.5%</td>
<td>9.1%</td>
<td>4.0%</td>
</tr>
<tr>
<td>Return on equity</td>
<td>6.9%</td>
<td>8.2%</td>
<td>22.1%</td>
<td>11.8%</td>
<td>5.5%</td>
</tr>
</tbody>
</table>

Source: Calculated from case Exhibit 6.

6. **What are the company’s key resource strengths and competitive capabilities?**

**What competitive liabilities and resource weaknesses does it have? What opportunities exist? What threats to its continued success are present?**

**Resource strengths and competitive capabilities**

- Google’s text-matching techniques and PageRank technology provides highly relevant search results by searching billions of web pages to examine how many sites point to other sites
- Google’s search functionality allows users to search stock quotes, street maps, telephone numbers, flight information, perform web page translations, and track overnight parcels
- Extensive list of services and tools listed in case Exhibit 3
- Liquid assets of more than $6 billion as of December 31, 2007
- 61.6% market share in Internet searches from computers
- 63% market share in mobile search
- More than 150 international domains
- More than one-half of Google’s traffic was generated from United States
- 72.6% increase in revenues from outside the United States between 2006 and 2007—see case exhibit shown on page C-271.
- Policy of separating paid ads from search results is admired by consumers
- Cost-per-click (CPC) sales model is appealing to advertisers
- Bidding process allows advertisers with high click-through rates to offer lower minimum bids
Case 14  Google’s Strategy in 2008

- CPC bidding process that ensured advertisers paid only 1 cent more than the next highest bid, regardless of the actual amount of the bid
- Wide network of AdSense partners has allowed revenue from Google Network web sites to increase from $628.6 million in 2003 to nearly $5.8 billion in 2007
- Google Checkout provided revenues from sales at participating e-retailer websites
- Specialized marketing services for large advertisers
- Network of more than 650 traditional media partners that participated in its online media auctioning service
- Google’s acquisition of DoubleClick allowed it to provide advertisers with banner ads in addition to search ads
- Google’s Android operating system allowed it to shape how mobile phones and PDAs would access Internet content
- Google Apps provides businesses with a low-cost productivity software alternative to Microsoft Office
- Google’s Chrome browser helped the company defend against attempts by Microsoft to limit Google’s ability to deliver relevant search based ads to Internet users.

Resource weaknesses and competitive liabilities

- Only $181.3 million of Google’s 2007 revenues of approximately $16.6 billion were generated Search Appliance licensing fees
- Google’s site was not as diversified as those of web portals such as Yahoo
- Google generated no revenues from auctions

External opportunities

- Development of relationships with content providers that would allow Google to provide links to proprietary information sources
- Development of relationships with paid-access content providers such as Lexis-Nexis or The Wall Street Journal Online that would allow users to access information on a fee per visit basis
- Development of semantic search capabilities
- Further development cloud computing software applications that would extend Google’s revenues beyond advertising
- Development of Wi-Fi service that utilizes unused television frequencies
- Increased presence in country markets experiencing rapid growth in Internet usage (e.g., China, India, and other countries experiencing rapid economic growth)

External threats

- Prominent Internet companies will make acquisitions or develop technology that allows them to avoid use of Google’s search engine
Microsoft’s Live Search could be integrated into Microsoft Windows, Explorer, Outlook, and Office products and would eliminate the need to visit www.google.com or use a Google browser-based search tool.

Integration of search functionality into cloud computing applications could eliminate the need for a stand-alone search tool.

Microsoft may again pursue the acquisition of Yahoo to increase its market share in search based ads.

Entrepreneurial computer programmers may develop a semantic search engine superior to Google’s text matching techniques and PageRank.

Wireless device manufacturers may internally develop search capabilities for their products.

7. **What recommendations would you make to Google’s top-management team to sustain its competitive advantage in the search industry? How should it best capitalize on its strategic initiatives in mobile search, cloud computing, and its auctioning system for traditional media ads?**

Students are likely to suggest that Google’s current strategic course is sufficient to sustain its competitive advantage in the search industry, but that it should place a greater emphasis on improving its search technology with the addition of semantic search capabilities. Its ongoing addition of features will likely appeal to many of its dedicated users, but the development of a fast and accurate semantic search engine would best solidify its advantage in the marketplace. The development of a viable semantic search engine by Microsoft or a new entrant poses a serious threat to Google’s dominance and continued growth.

Students should also recommend that Google find ways to better integrate search based ads and banner ads into YouTube, develop an advertising auctioning program that allows advertisers to bid for both search-based ads and banner ads served by DoubleClick, and refine its traditional media advertising auctioning system. As of 2008, none of these acquisitions had provided Google with a noteworthy source of additional revenues.

Students will suggest that Google should collaborate with wireless phone providers to make its Android mobile phone operating system available on a wider range of phones provided by a larger number of wireless providers. Android’s Internet capabilities will allow Google to further increase its share of mobile searches and create opportunities to serve search ads, banner ads, or YouTube video ads to Internet-enabled mobile phones.

You may find student recommendations concerning Google’s cloud computing venture mixed. Some may suggest that cloud computing is a distraction from Google’s core business. Also, some students may consider the employee training cost and the temporary loss of productivity that would accompany a change from Microsoft Office to Google Apps as an unacceptable switching costs for many organizations. However, examination of Microsoft’s profit margins shown in Table 4 discloses the attractiveness of the business productivity software industry. Entry into the software segment would give Google a substantial source of new revenue. In addition, students may suggest that Google’s cloud computing venture is a critical defensive strategy necessary thwart attempts by Microsoft to integrate Live Search into productivity software applications. Google’s top management should also pursue regulatory remedies to prevent Microsoft from integrating Live Search into its emerging cloud computing applications or other Microsoft software products. Search functionality embedded into software applications would reduce the necessity for computer users to use a browser or a Google tool bar to perform Internet searches.
EPILOGUE

Google continued its impressive growth in 2008 with revenues increasing by 31% over 2007 to reach $21.8 billion. Even though the company’s net income grew by just 0.6% to reach $4.22 billion in 2008, its net cash provided by operations increased from $5.8 billion in 2007 to nearly $7.9 billion in 2008. Google’s current assets grew to $20.2 billion in 2008, while its current liabilities stood at just $2.3 billion at year-end 2008. Google’s income statements for 2007 and 2008 are provided at the end of this epilogue.

Google further extended its cloud computing initiative in early-2009 with the announcement of its GDrive service that would allow Internet users to store all files on Google’s servers. GDrive was expected to launch in mid-2009. PC manufacturers feared that GDrive and Google’s other cloud computing applications might reduce the need for powerful PCs and allow Internet users to run applications from Android-equipped mobile phones or similar devices.

In January 2009, Google announced that it would end its efforts to sell ads appearing in newspapers. The company continued to exit traditional media advertising with an announcement in February 2009 that it would discontinue its online system for radio advertisers as well. A Google executive commented in a February 2009 blog post that the company would continue to invest in its TV advertising business.

Yahoo ended 2008 with a 3% increase in revenues and a 35.7% decline in net earnings. Yahoo’s recorded revenues of $7.2 billion and net income of $424.3 million in 2008. With sales and earnings declining through the year, Yahoo co-founder and CEO Jerry Yang resigned from his position in November 2008. The company replaced Yang with Carol Bartz, the former CEO of Autodesk, Inc. Autodesk generated revenues of $2.2 billion in 2007 through the design and sale of engineering software. It was speculated that Ms. Bartz would initiate discussions with Microsoft to enter into a search agreement or perhaps execute an acquisition.

You can also check the company’s latest financial results and press releases at www.google.com.

(In thousands, except per share amounts)

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2008 (unaudited)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues</td>
<td>$16,593,986</td>
<td>$21,795,550</td>
</tr>
<tr>
<td>Costs and expenses:</td>
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<td></td>
</tr>
<tr>
<td>Cost of revenues</td>
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<td>8,621,506</td>
</tr>
<tr>
<td>Research and development</td>
<td>2,119,985</td>
<td>2,793,192</td>
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<tr>
<td>Sales and marketing</td>
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<td>1,946,244</td>
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<tr>
<td>General and administrative</td>
<td>1,279,250</td>
<td>1,802,639</td>
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<tr>
<td>Total costs and expenses</td>
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<td>15,163,581</td>
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<tr>
<td>Income from operations</td>
<td>5,084,400</td>
<td>6,631,969</td>
</tr>
<tr>
<td>Impairment on equity investments</td>
<td>--</td>
<td>(1,094,757)</td>
</tr>
<tr>
<td>Interest income and other, net</td>
<td>589,580</td>
<td>316,384</td>
</tr>
<tr>
<td>Income before income taxes</td>
<td>5,673,980</td>
<td>5,835,596</td>
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<tr>
<td>Provision for income taxes</td>
<td>1,470,260</td>
<td>1,626,738</td>
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<tr>
<td>Net income</td>
<td>$4,203,720</td>
<td>$4,226,858</td>
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<tr>
<td>Net income per share - basic</td>
<td>$13.53</td>
<td>$13.46</td>
</tr>
<tr>
<td>Net income per share - diluted</td>
<td>$13.29</td>
<td>$13.31</td>
</tr>
<tr>
<td>Shares used in per share calculation - basic</td>
<td>310,806</td>
<td>313,959</td>
</tr>
<tr>
<td>Shares used in per share calculation - diluted</td>
<td>316,210</td>
<td>317,514</td>
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eBay is an online auction company that was founded by Pierre Omidyar in 1995 as Auctionwatch at the domain name of www.eBay.com. As business grew for the small business run out of his home, Pierre Omidyar’s Internet service provider explained that he had to update his service, which led to his charging a fee for auctions in 1996. Pierre Omidyar asked Jeff Skoll, a Stanford MBA graduate, to join his firm. Pierre provided the vision while Jeff was the strategist. In 1997, both Omidyar and Skoll agreed that a professional manager was needed for their growing business. Meg Whitman joined the team as CEO and president. Her background included a BA in economics from Princeton, an MBA from Harvard Business School, brand management experience from Procter & Gamble, president and CEO of FTD, president of Stride Rite Corporation’s Stride Rite division and senior vice president of marketing for Walt Disney Company’s consumer products division. John Donahoe joined the company in 2005.

eBay’s business model involved its acting as a value-added facilitator by providing a supportive online infrastructure for global trading of goods and services among buyers and sellers. This entails three operating segments – Marketplaces (69.91% of total revenues), Payments (25.11% of total revenues) and Communications (6.78% of total revenues). Three types of online auctions included business-to-business, business-to-consumer and person-to-person auctions. Auction users are categorized into six categories: (1) bargain hunters, (2) hobbyists/collectors, (3) professional buyers, (4) casual sellers, (5) hobbyists/collectors sellers and (6) corporate and power sellers. Buyers incurred no fees to bid on items. Sellers paid insertion fees and a “final value” fee along with optional fees to promote their listings.

As eBay grew in popularity, so did its rivals. Its more direct competitors included Amazon.com, Overstock.com and uBid.com. eBay originally focused solely on online auctions and many buyers and sellers flocked to eBay for the deals available on this site and its broad selection. Many customers came to view traditional brick and mortar competitors as inefficient and at a competitive disadvantage relative to eBay’s online auction format. As eBay’s business model evolved to offer a greater variety of transaction types (e.g., Buy it Now, Fixed Price sales, eBay Stores, etc.), the company came into more direct competition with other online retailers (or e-tailers) like Amazon.com, Wal-Mart, Kmart, Target, Sears, JC Penney, and Office Depot and specialty retailers to include Christie’s (antiques), KB Toys (toys), Blockbuster (movies), Dell (computers), Foot Locker (sporting goods), Ticketmaster (tickets), and Home Depot (tools).

Much has changed for eBay since 2005 when it was considered the unchallenged leader in the online auction industry. Meg Whitman, president and CEO until January 23, 2008, had ushered the company into significant growth in revenues and employees through well-executed international and acquisition strategies. Despite these successes, the new president and CEO, John Donahoe, faced several significant challenges:

1. eBay’s core business, online auction, was experiencing slowing growth. The percentage of total revenues from this division fell from 72% to 56% with a declining growth rate in the number of active users relative to registered users.

*This teaching note reflects the thinking and analysis of the case authors, Professor Lou Marino, University of Alabama, and Professor Patrick Kreiser, Ohio University. We are most grateful for their insight, analysis and contributions to how the case can be taught successfully.
Case 15 The Challenges Facing eBay in 2008 – Time for Changes in Strategy?

2. The acquisition of Skype, an online communications service, was riddled with strategic concerns regarding its inability to produce intended results. For instance, Skype was not successfully integrated into eBay’s business model and the company had to take a $900 million write down in the value of Skype.

3. A lack of financial and strategic performance heading into the fourth quarter of 2008 raised concerns about eBay. An erosion of its core customer base, a loss of its innovative capabilities, stifling bureaucracy, weaknesses in key economies across the globe, declining market share of the U.S. e-commerce market from 19% to 17% between 2006 and 2008, increasing competition from Amazon.com as its market share grew from 3.7% to 5.3% during the same period, a 50% drop in eBay’s stock price to $15.01 in November 2008, from its 52 week high, and speculation about Donahoe’s suitability as CEO of eBay were contributing to growing concerns about eBay’s ability to recover its dominance.

CEO Donahoe was charged with the responsibility of ushering eBay into a new era of competition while holding true to that which helped propel eBay’s success. Omidyar, who served on the company’s board of directors, was careful to remind all that eBay’s customers are critical to its long-term success. “Our success is really based on our members’ success. They’re the ones who have created this, and they’re the ones who will create it in the future. If we lose sight of that, then we’re in big trouble.” Omidyar also expressed the need for eBay to maintain its culture even in the midst of its growth and product line evolution. “If we lose that [culture], we’ve pretty much lost everything.” Notwithstanding Omidyar’s expressed sentiments, there was some doubt among analysts as to whether Donahoe shared these values. This was of particular concern as eBay headed into the 2008 holiday season and wrestled with two fundamental questions:

1. As eBay’s business model evolved to include more fixed price sales in an effort to combat the saturation of its domestic market, how could the company transfer its competitive advantage in the online auction industry into the more general area of online retail?

2. How could the company reinvigorate its core market, especially in the face of a global economic slowdown and growing dissatisfaction among smaller eBay sellers? Given the slowing growth in the company’s core market should the company be concerned with the growing dissatisfaction among smaller eBay sellers? If so, what could they do to remedy this without alienating the larger sellers?

SUGGESTIONS FOR USING THE CASE

This case has been extensively rewritten since the last version to reflect the changes in eBay, to focus the case on the evolution of eBay’s business model, and to reflect the challenges faced by the new CEO of a successful firm that is facing considerable challenges. You can use the eBay case to serve any of several pedagogical purposes including:

- To drill students in using and applying the concepts and tools of industry and competitive analysis and help them understand how different segments of the same market can offer different challenges and opportunities.
- To give students practice in doing SWOT analysis and competitive strength analysis.
- To probe and assess a company’s financial and strategic condition.
- To illustrate the strategy-making challenge of an industry leader whose once established sustainable competitive advantage in its core market is being tested even as it expands into new, related markets both in terms of geographic markets and product lines.
- To help students analyze the international strategy of an industry leading firm that is expanding into multiple geographic markets, but that has stumbled in a market that has significant strategic value.
To help students understand the role corporate culture plays in successfully executing strategies.

To have students gain an understanding of the challenge of sustaining historical growth rates for successful entrepreneurial start-ups.

To help students learn to translate good analysis into good recommendations for action.

Because the issues and topics in the eBay case cut broadly across the business strategy landscape and embrace material in Chapters 3, 4, 5, 6, and 7, we recommend positioning the eBay case in the latter third of your business strategy module. However, the eBay case can also serve to provide students with an excellent opportunity to conduct a thorough industry analysis and company situation analysis, using the concepts and analytical tools discussed in Chapters 3 and 4.

The Student Edition of the Online Learning Center (OLC) provides students with copies of the assignment questions contained in this note. The list of assignment questions leads students through a thorough industry analysis and prepares them to make strategy recommendations for selected companies. We suggest that you always direct students to the assignment questions posted on the Crafting & Executing OLC and instruct them to use the assignment questions to prepare for the class discussion of the case. We always instruct our students to read the case once to gain a general understanding of the issues presented in the case and then return to the case to prepare written responses to each of the assignment cases. We’ve found that our students who follow this approach are well-prepared to make a meaningful contribution to the class discussion.

This case functions well as an oral presentation, a written analysis, or a comprehensive exam for your strategy course. A good assignment question is the following:

John Donahoe has noted your skills in strategic management and has retained your services to help assess eBay’s situation and to make recommendations for improving the company’s strategy and sustaining the company’s growth and business performance. Specifically, you have been asked to provide Mr. Donahoe with a 4-6 page (double-spaced) report, along with whatever charts and supporting exhibits you deem appropriate, that covers the following points:

1. An assessment of the competitive forces operating in the online auction industry.
2. A brief identification and evaluation of the forces driving change in this industry.
3. A strategic group map showing the positions of the leading competitors.
4. A concise discussion of the key success factors for competing in the online auction market.
5. A SWOT analysis of eBay (a supporting exhibit containing your bullet points would be appropriate).
6. An assessment of eBay’s competitive strength vis-à-vis its major competitors (a supporting exhibit showing your ratings and calculations is definitely appropriate here).
7. The issues that you think Omidyar, Whitman and Donahoe should focus their attention on.
8. A set of recommended actions that address which avenues for future growth eBay should pursue and how to strengthen eBay’s competitiveness while maintaining its historical growth rates in revenues and earnings. Each recommendation should be accompanied by persuasive supporting arguments.

You are expected to provide eBay’s senior executives with a report that is thorough and thoughtfully prepared, that reflects strong grasp and application of the tools and concepts of industry and competitive analysis and company situation analysis, and that is professionally presented in every respect.
ASSIGNMENT QUESTIONS

1. What does a five-forces analysis reveal about the nature and strength of the various competitive pressures eBay faces? Are the competitive pressures facing eBay and other online auction companies conducive to earning good profits? Why or why not?

2. What driving forces are operating in the online auction macro-environment? Is the combined impact of the driving forces likely to cause competitive pressures to strengthen or weaken? Are the driving forces acting to make the industry more or less attractive from the standpoint of future profitability?

3. What do you see as the key success factors for firms in the online auction industry? What differences do you see between the KSFs for online auction members and the KSFs for online retailers?

4. What does a strategic group map reveal about the positions of the major players in the online auction industry? Is eBay in a good position on the map? Why or why not? Who are eBay’s closest competitors?

5. What does a SWOT analysis reveal about eBay’s situation? Just how attractive is the company’s situation and position?

6. What is your assessment of eBay’s financial performance and financial condition? Is the company in good financial shape? Why or why not? Please use the summary of financial ratios in Table 4.1 in Chapter 4 to guide your calculations and support your assessment of the company’s financial performance.

7. Does your weighted competitive strength assessment (as per the methodology in Table 4.4 in Chapter 4) for eBay and its rivals reveal that eBay has a competitive advantage or a disadvantage in the online auction industry? What are the sources of the advantage or disadvantage? Does eBay have a sustainable competitive advantage in the online auction industry?

8. How has eBay’s competitive strategy evolved throughout the company’s history? How have these changes impacted the nature of eBay’s core business and its customer base?

9. What challenges does John Donahoe, eBay’s new CEO, face in taking over from Meg Whitman? What strengths does he bring to the table?

10. Based on your analysis of the industry and eBay’s situation, what problems and issues does eBay’s top management need to address? Which ones are top priorities?

11. What actions would you recommend to Mr. Donahoe to improve eBay’s competitive position, especially its market position vis-à-vis key rivals, its long-term financial performance, and its relationships with key customers?
OUTLINE AND ANALYSIS

1. What does a five-forces analysis reveal about the nature and strength of the various competitive pressures eBay faces? Are the competitive pressures facing eBay and other online auction companies conducive to earning good profits? Why or why not?

In the discussion of the five competitive forces that follows, we use a + sign to indicate factors acting to strengthen rivalry and a – sign to indicate factors acting to weaken rivalry. The +/- signs are shown in parentheses.

**Rivalry among competing online auction services—a weak to moderate competitive force**

If student’s focus on the online auction industry they should conclude that competition from rivals is weak to moderate, leaning more toward weak. However, if they include general e-tailers such as Amazon.com in the evaluation of rivals, they will conclude rivalry is strong. However, for the purposes of this case, students should be encouraged to focus on the online auction industry as the focus of this analysis and should recognize that in this context, general e-tailers would fall into the category of Substitutes. Specific factors students should note in concluding that rivalry is weak to moderate include:

- Rapid industry growth both domestically and internationally weakens rivalry in the online auctions segment. (–)
A decrease in the number of online auction companies decreases rivalry. (–)

There is one large competitor which dominates the industry weakening rivalry. (–)

eBay’s dominant position domestically has reduced the jockeying for position among rivals (–)

However, rivalry centers around

- Image, reputation, brand awareness
- Numbers and type of auctions
- Website functionality and features
- Fees/commissions charged to sellers of items listed
- Caliber and breadth of information resources
- Customer confidence in using the site (security, safety, fraud protection)

Relatively low switching costs for users, except for the eBay reputation scores, increases rivalry. (+)

Only moderate product differentiation exists among rival auction sites. (+)

The bargaining power and leverage of suppliers—a weak competitive force

Students may have some difficulty with this section as there is not a significant amount of material in the case for them to complete a full supplier analysis. However, they should be able to conclude that:

- The broad availability of key suppliers such as software, servers and website hosting services from multiple sources at competitive prices reduces the bargaining power of suppliers. (–)

- Seller-supplier collaboration does not appear to be a competitive factor. (–)

- The only “suppliers” with bargaining clout are other high traffic websites that may be a source for attracting Internet users to auction sites (we see these more as marketing-related alliances for which cash payments may be made). But such alliances/partnerships do create a “supply” relationship of sorts, and some students may include this competitive force here (rather than in the rivalry portion where we put it).

Competition from substitutes—a strong competitive force

If the students focus on the online auction industry rather than general e-tailing for analyzing rivalry, they should include online retailers under substitutes and are likely to conclude that:

- There are many substitutes for eBay’s online auction segment such as online retailers, classified ads, garage sales, flea markets and live auctions. Online retailers such as Amazon.com pose a very serious and credible threat to eBay due to:

  - The ready availability of substitutes
  - Customers’ comfort level with using substitutes
  - The potential for customers to obtain better deals from substitutes on some categories of goods

- However, substitutes such as classified ads, garage sales, flea markets and live auctions pose little threat given their deficiencies vis-à-vis online auctions because of: (–)

  - Limited variety and breadth of selection
• High transaction costs (time, convenience)
• Information inefficiencies resulting in a lack of reliability and convenience in setting prices

**Threat of Entry—a moderately strong competitive force**

It is once again worth cautioning students to focus on the online auction industry in this section rather than online retailing as a whole. Given this students are likely to note that:

- There are relatively low capital requirements for new entrants except for those associated with building brand recognition and loyalty such as marketing/advertising costs of attracting site users. (+)
- Launching a website for online auctions entails costs that many entry candidates can easily surmount.
- However, luring customers away from more easily recognized online auction websites involves higher costs.
- Entrenched large incumbents can do little directly in the way of retaliation to prevent new entrants from seeking to exploit market opportunities and gain market share. (+)
- The industry is growing both domestically and globally and appears to offer attractive profit opportunity leading to a stronger likelihood of entry as new competitors are lured into the market. (+)
- Likely entry candidates include other Internet portals, existing online auctions looking to enter new geographic arenas where they do not have a presence, and start-ups looking to establish a niche auction for a particular product category. Start-ups are likely to be most successful entering country markets where online auctions are just starting to become popular. (+)
- Notwithstanding the attractive profit potential, network effects can prove to be a substantial barrier to entry as there is a significant need to have a broad network of sellers and buyers. (–)
- The learning curve effect is also very strong, providing another entry barrier. (–)
- Customers in the online auction industry tend to have strong brand preferences and loyalty. Additionally, brand recognition for new users acts as a source of credibility. (–)

**The bargaining power and leverage of buyers—a weak to moderate competitive force**

Students may have a little difficulty with recognizing that the buyers in the online auction industry are actually those individuals and businesses who purchase auction services from companies such as eBay rather than individuals who purchase goods from online auctions. Once this differentiation is made students should recognize that:

- Individual users have little to no opportunity to bargain for better terms since there are millions of individual users with each representing a very small percentage of total revenues. However, eBay values its users’ opinions and often introduces new features and policies based upon their feedback. Hence, students have a valid point when they argue that individuals have some ability to express their opinion in an effort to influence the practices of online auction rivals. (–)
- Collectively, Power Sellers have greater influence given that they contribute a significant portion of eBay’s revenues. Individually, the large corporate Power Sellers who list hundreds or thousands of items or big-ticket items probably have some bargaining leverage given their ongoing business transactions with eBay: (+)
  - Power Sellers are likely to gather information about the fees/commissions/services of rival online auction sites to make informed decisions about where they list their items.
Commissions/fees charged by an online auction site can represent a significant dollar cost to power sellers who sell more items or items at higher costs.

Power Sellers may be enticed to switch sites due to differences in fees/commissions from site to site. This may be used to negotiate better terms or influence practices of online auction companies.

Alternative sites offer products that are largely undifferentiated (unless a Power Seller’s items, for whatever reason, sell better on one site than another), which lowers switching costs.

There are usually low switching costs for both individuals and Power Sellers except for the feedback rating that eBay members build, which represents a source of quality and credibility. (+)

Site users express their satisfaction with online auction sites by the number of items listed and the number bids generated. Each listing and bid can be considered a “vote” whereby an overall decrease in “votes” by their volume of items listed and by the number of bids entered may result in “bargaining power,” but individually they are likely to count for little (except in the case of power sellers). (–)

Buyer demand in the online auction segment is growing which reduces the bargaining power of buyers. (–)

**Overall Assessment:** Students should take note of eBay’s dominant position in the online auction industry, which is a source of stability in this profitable segment. However, the increased popularity of fixed price selling and Amazon’s strong position in that segment coupled with eBay’s desire to move in that direction are noteworthy. The lack of strength of competitive forces such as the bargaining power of suppliers and buyers and the threat of substitutes makes this industry increasing more attractive to incumbents and also to new entrants. The ease of entering the market coupled with low switching costs makes this industry attractive for large Internet-related companies, which can bring brand recognition. This is, particularly, true given the expected growth of Internet users in new very large markets such as Asia and Europe and because the use of sophisticated Internet capable mobile devices should increase future industry revenues. Hence, this industry is moderately attractive although that may change in the foreseeable future.

**2. What driving forces are operating in the online auction macro-environment? Is the combined impact of the driving forces likely to cause competitive pressures to strengthen or weaken? Are the driving forces acting to make the industry more or less attractive from the standpoint of future profitability?**

Students should identify at least three of the following as candidates for driving forces including:

- Anticipated growth of Internet users globally and particularly in regions such as Asia, Latin America and Eastern Europe as the industry leaders maneuver and position themselves to contend for global market leadership
- Slowing growth rate of online retail sales in the United States from 17% in 2008 to 11% in 2012
- Estimation of business-to-business e-commerce growth by ten times in 2012 with revenues reaching $12.4 trillion
- Expectation that more Internet users will access the Internet from mobile devices than from the PC by 2012
- Increasing popularity of fixed price selling where users may be open to higher fees for higher quality service and features

In total these driving forces are likely to continue to push companies such as eBay to expand geographically and to continue expanding into new sales formats as the line between the online auction industry and general online retailing continues to become blurred and rivalry becomes increasingly intense.
3. **What do you see as the key success factors for firms in the online auction industry? What differences do you see between the KSFs for online auction members and the KSFs for online retailers?**

There are several key success factors that students should identify when considering the online auction and the general e-commerce industries:

- The ability to attract a large number of users (generate traffic) and an appealing number and variety of items (broad product mix) auctioned in growing numbers to leverage network effects
- Strong brand recognition and favorable image/reputation/awareness among Internet users
- Appealing website features and functionality along with perceived security of personal information to entertain customers while enhancing selling experiences for both sellers and buyers thereby increasing customer confidence
- Customer service skills to satisfy customer needs and preferences leading to increased retention of registered and active users (repeat visitors or “stickiness”)  
- Competitive fees and commissions relative to services rendered
- Cost-effective website operations to keep costs low

4. **What does a strategic group map reveal about the positions of the major players in the online auction industry? Is eBay in a good position on the map? Why or why not? Who are eBay’s closest competitors?**

This strategic group map is based on the dimensions of geographic presence and product breadth availability. These two variables were chosen since they are key to the success of online auction companies. Students may choose to draw strategic group maps with different key variables depending upon the availability of relevant information.

**Figure 1**  
**eBay’s Strategic Group Map**
This map shows that eBay continues to occupy a dominant position in the market. However, this position of dominance may change as Amazon.com’s fixed pricing approach becomes increasingly popular and as eBay pursues opportunities in that market space. Additionally, recent reports show slowing growth in the number of active users relative to registered users on eBay. A lack of strategic focus or stronger interest in strategic change in the future may also affect eBay’s position on this map. Amazon.com is positioned as eBay’s closest competitor with relatively wide product breadth and a strong geographic presence. Overstock.com and uBid.com are positioned as lesser competitors due to their lack of wide product availability and a weak geographical presence. It appears that their ability to expand to newer markets constrains their ability to offer a wide variety of products and services online. This, subsequently, moves them into a weaker position on the strategic group map. Hence, eBay currently occupies a position of competitive strength relative to its competitors with Amazon.com being its closest rival.

5. **What does a SWOT analysis reveal about eBay’s situation? Just how attractive is the company's situation and position?**

**Resource Strengths and Competitive Capabilities**
- Ownership of PayPal provides a powerful diversification strategy
- Best image/reputation in the online auction industry
- Responsive to customer needs and has the flexibility to respond to changing demand
- Dominates the online auction industry
- Clear financial objectives
- More than 2 billion items listed for sale in auction format as of September 2008
- Financial resources available to fund growth
- Broad strategic alliance portfolio
- Broad user base (370.2 million registered users — see Case Exhibit 1)
- Very functional website that is relatively easy to navigate
- eBay Motors automobile auctions have grown substantially
- eBay Real Estate auctions have also grown
- Strong sense of community among eBay customers
- Integration of Half.com
- Strong international presence

**Resource Weaknesses and Competitive Liabilities**
- Active users are a relatively low percentage of total users (only 23.2%—see Case Exhibit 1).
- Declining growth rate in the number of active users relative to registered users.
- Erosion of eBay’s core customer base due to poor perceptions of the company by its customers.
- Ebay’s first mover advantage is fading.
- Marketplaces division revenues fell from 72% to 56% since 2005.
1% decrease in gross merchandise volume in eBay’s core business in the third quarter of 2008.

Acquisition of Skype failed to lead expected synergistic advantages and was followed by a $900 million write down.

Net transaction revenues in eBay’s core Marketplaces division was down 6% from the second quarter in 2007.

The fourth quarter in 2008 was expected to be the weakest quarter of the year.

eBay’s recent declining stock performance

The innovative culture of the company, one of the keys to its early success, was being lost and overcome by perceived stifling bureaucracy.

eBay’s stock fell more than 50% from its fifty-two week high of $35.98 to $15.01 on November 3, 2008.

There was an announcement that eBay would lay off 10% of its workforce.

John Donahoe’s CEO approval rating on Glassdoor.com, a website that allows employees to rate their CEOs, fell to 22% compared to the previous CEO, Meg Whitman, who was at 75% when she retired.

**Market Opportunities**

Internet users worldwide would grow from 1.4 billion in 2008 to 1.9 billion by 2012 with half expected to make online purchases in 2008.

The global regions with the highest amount of Internet users in 2008 were: Asia with 550 million; Europe with 380 million and North America with 250 million whereby the United States contributed 220 million users to the total number of North American Internet users.

The greatest anticipated Internet usage growth was to be in Asia, Latin America and Eastern Europe.

By 2012, the number of users accessing the Internet from mobile devices such as phones would surpass the number of PC users.

Business-to-business e-commerce would be ten times larger in 2012, up to $12.4 trillion.

**External Threats**

There were weaknesses in key economies across the globe. (Lou, aren’t these two the same?)

The growth rate in online retail sales in the United States would slow from 17% in 2008 to 11% in 2012.

eBay’s share of the U.S. e-commerce market had fallen from 19% to 17% between 2006 and 2008.

Amazon.com’s market share of the U.S. e-commerce market had grown from 3.7% to 5.3% between 2006 and 2008.

Customers expressed concerns about entering credit card numbers online and personal information because it might later be sold to marketing firms.

Limitations concerning those customers who wanted to see goods and/or services in person to verify quality.

Growing competition by direct competitors such as Amazon.com, Overstock.com and uBid.com along with their growing revenues.
6. What is your assessment of eBay’s financial performance and financial condition? Is the company in good financial shape? Why or why not? Please use the summary of financial ratios in Table 4.1 in Chapter 4 to guide your calculations and support your assessment of the company’s financial performance.

A quick look at eBay’s financial figures suggests that its financial condition is moderately strong. Its figures indicate that net revenues have been steadily increasing. However, operating expenses have also been increasing resulting in a sharp drop in the 2007 fiscal year. Notwithstanding this sharp drop, eBay appears to be in solid financial condition. Students should express concern for what this sharp drop in the most recent year might indicate about eBay’s future financial condition, particularly, as competitive forces increase and general economic global conditions decline. Students should attempt to use financial ratios to better understand eBay’s financial condition as indicated in Table 1 below.

<table>
<thead>
<tr>
<th>Table 1</th>
<th>Selected Financial Ratios for eBay, 2000 - 2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profitability Ratios</td>
<td></td>
</tr>
<tr>
<td>Gross profit margin</td>
<td>0.77</td>
</tr>
<tr>
<td>Operating profit margin</td>
<td>0.08</td>
</tr>
<tr>
<td>Net profit margin</td>
<td>0.05</td>
</tr>
<tr>
<td>Return on total assets</td>
<td>0.02</td>
</tr>
<tr>
<td>Return on stockholders’ equity</td>
<td>0.03</td>
</tr>
<tr>
<td>Liquidity Ratios</td>
<td></td>
</tr>
<tr>
<td>Current ratio</td>
<td>2.30</td>
</tr>
<tr>
<td>Working capital*</td>
<td>$4,023</td>
</tr>
<tr>
<td>Leverage Ratios</td>
<td></td>
</tr>
<tr>
<td>Debt-to-asset ratio</td>
<td>0.24</td>
</tr>
<tr>
<td>Debt-to-equity ratio</td>
<td>0.31</td>
</tr>
<tr>
<td>Long-term debt-to-equity ratio</td>
<td>0.05</td>
</tr>
<tr>
<td>Times-interest-earned</td>
<td>36.94</td>
</tr>
</tbody>
</table>

(* in thousands)

Based on the financial analysis students should conclude that while eBay’s financial condition is still solid, the deteriorating ratios should give both managers and investors some cause for concern. Some students may argue that the 2007 numbers reflect the beginning of the recession the U.S. economy entered in 2008. However, a careful analysis of the trends within the ratios reveals that the company’s profitability ratios have been declining since 2005 and leverage ratios have been increasing. Given the current level of the leverage ratios this is not necessarily a significant problem, but if these trends continue unabated, and there is reason to believe they will not significantly improve, the company could face significant challenges in the future.

The state of the ratios should give students some incentive to dig a bit deeper into eBay’s financial position. They should at least be encouraged to examine the income statement to try to diagnose the cause for the company’s deteriorating position. By breaking down each category of expense as a % of revenue students should recognize that one of the main drivers of eBay’s weak profitability ratios (OPM, NPM, ROA and ROE) in 2007 was the write down they took when they revalued Skype that is reflected in the “Impairment to Goodwill.” However, excluding this onetime charge, these ratios are still declining, albeit at a much slower rate. One of the main categories of expense that appears to be creeping steadily up, despite a decline in 2007, is “General and Administrative” expenses. Astute students should recognize that this could be a symptom of the culture at eBay that some employees are describing as increasingly bureaucratic.
Table 2  eBay’s Income Statement Expressed as a Percentage of Net Revenues, 2000-2007

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net revenues</td>
<td>100.00%</td>
<td>100.00%</td>
<td>100.00%</td>
<td>100.00%</td>
<td>100.00%</td>
<td>100.00%</td>
<td>100.00%</td>
<td>100.00%</td>
</tr>
<tr>
<td>Cost of net revenues</td>
<td>22.13%</td>
<td>18.00%</td>
<td>17.62%</td>
<td>19.22%</td>
<td>18.78%</td>
<td>17.97%</td>
<td>21.05%</td>
<td>22.98%</td>
</tr>
<tr>
<td>Gross profit</td>
<td>77.87%</td>
<td>82.00%</td>
<td>82.38%</td>
<td>80.78%</td>
<td>81.22%</td>
<td>82.03%</td>
<td>78.95%</td>
<td>77.02%</td>
</tr>
</tbody>
</table>

Operating expenses

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales and marketing</td>
<td>38.66%</td>
<td>33.85%</td>
<td>28.80%</td>
<td>26.21%</td>
<td>26.22%</td>
<td>26.05%</td>
<td>27.13%</td>
<td>25.10%</td>
</tr>
<tr>
<td>Product development</td>
<td>12.95%</td>
<td>10.05%</td>
<td>8.62%</td>
<td>7.36%</td>
<td>7.36%</td>
<td>7.21%</td>
<td>8.29%</td>
<td>8.08%</td>
</tr>
<tr>
<td>General and administrative</td>
<td>16.93%</td>
<td>14.13%</td>
<td>14.15%</td>
<td>14.07%</td>
<td>12.71%</td>
<td>14.27%</td>
<td>16.39%</td>
<td>15.07%</td>
</tr>
<tr>
<td>Amortization of acquired intangibles</td>
<td>0.33%</td>
<td>4.89%</td>
<td>1.31%</td>
<td>2.34%</td>
<td>2.02%</td>
<td>2.83%</td>
<td>3.30%</td>
<td>2.66%</td>
</tr>
<tr>
<td>Impairment of Goodwill</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>18.13%</td>
</tr>
<tr>
<td>Total operating expenses</td>
<td>69.76%</td>
<td>63.24%</td>
<td>53.21%</td>
<td>51.72%</td>
<td>48.84%</td>
<td>50.36%</td>
<td>55.11%</td>
<td>69.03%</td>
</tr>
<tr>
<td>Income (loss) from operations</td>
<td>8.11%</td>
<td>18.75%</td>
<td>29.17%</td>
<td>29.06%</td>
<td>32.38%</td>
<td>31.67%</td>
<td>23.84%</td>
<td>7.99%</td>
</tr>
<tr>
<td>Interest and other income (expense), net</td>
<td>10.74%</td>
<td>5.56%</td>
<td>4.05%</td>
<td>1.75%</td>
<td>2.38%</td>
<td>2.44%</td>
<td>2.18%</td>
<td>2.01%</td>
</tr>
<tr>
<td>Interest expense</td>
<td>-0.78%</td>
<td>-0.38%</td>
<td>-0.12%</td>
<td>-0.20%</td>
<td>-0.27%</td>
<td>-0.08%</td>
<td>-0.10%</td>
<td>-0.22%</td>
</tr>
<tr>
<td>Impairment of certain equity investments</td>
<td>0.00%</td>
<td>-2.17%</td>
<td>-0.31%</td>
<td>-0.06%</td>
<td>0.00%</td>
<td>0.00%</td>
<td>0.00%</td>
<td>0.00%</td>
</tr>
<tr>
<td>Income before income taxes and minority interest</td>
<td>18.07%</td>
<td>21.76%</td>
<td>32.79%</td>
<td>30.55%</td>
<td>34.49%</td>
<td>34.03%</td>
<td>25.91%</td>
<td>9.79%</td>
</tr>
<tr>
<td>Provision for income taxes</td>
<td>-7.59%</td>
<td>-10.68%</td>
<td>-12.02%</td>
<td>-9.55%</td>
<td>-10.51%</td>
<td>-10.26%</td>
<td>-7.06%</td>
<td>-5.25%</td>
</tr>
<tr>
<td>Minority interests in consolidated companies</td>
<td>0.71%</td>
<td>1.00%</td>
<td>-0.19%</td>
<td>-0.35%</td>
<td>-0.19%</td>
<td>0.00%</td>
<td>0.00%</td>
<td>0.00%</td>
</tr>
<tr>
<td>Net income</td>
<td>11.19%</td>
<td>12.08%</td>
<td>20.58%</td>
<td>20.65%</td>
<td>23.79%</td>
<td>23.77%</td>
<td>18.86%</td>
<td>4.54%</td>
</tr>
</tbody>
</table>

7. Does your weighted competitive strength assessment (as per the methodology in Table 4.4 in Chapter 4) for eBay and its rivals reveal that eBay has a competitive advantage or a disadvantage in the online auction industry? What are the sources of the advantage or disadvantage? Does eBay have a sustainable competitive advantage in the online auction industry?

Students should be informed that the dimensions of this Competitive Strength Assessment (CSA) were chosen based upon those factors that mattered most to the online auction industry and based upon eBay’s closest competitors. The competitive strength measures were selected and weighted according to their importance to online auction companies. Those measures with greater importance were then weighted according their relative importance. There is sufficient data in the case to estimate and compare the relative strengths of eBay, Amazon.com, Overstock.com and uBid.com. These measures, weights and rivals are based upon inferences from the competitive portion of the case.

Table 3 reflects the competitive strength assessments of eBay’s closest rivals. eBay is considered to be relatively stronger than its closest competitor. However, its position of relative strength is diminishing. Although eBay is dominant in key areas such the size of its customer base, the number/types of auctions and its financial resources, it should be concerned with Amazon’s relative strength in key areas that help to facilitate domestic and international growth – reputation/image, relative fees/commissions and customer service. These strengths can help Amazon compete more effectively with eBay, thereby, siphoning market share from eBay and increasing its competitive strength associated with financial resources. This is important as eBay seeks to continue expanding beyond its core online auction business. The CSA further illustrates the relatively weak competitive strengths of Overstock and uBid.
Table 3  Competitive Strength Assessment of eBay and Selected Rivals

Rating Scale: 1 = very weak; 10 = very strong

<table>
<thead>
<tr>
<th>Competitive Strength Measures</th>
<th>Weight</th>
<th>eBay Rating</th>
<th>eBay Score</th>
<th>Amazon Rating</th>
<th>Amazon Score</th>
<th>Overstock Rating</th>
<th>Overstock Score</th>
<th>uBid Rating</th>
<th>uBid Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reputation/Image</td>
<td>0.15</td>
<td>9</td>
<td>1.35</td>
<td>9</td>
<td>1.35</td>
<td>6</td>
<td>0.9</td>
<td>5</td>
<td>0.75</td>
</tr>
<tr>
<td>Size of customer base</td>
<td>0.2</td>
<td>9</td>
<td>1.8</td>
<td>7</td>
<td>1.4</td>
<td>5</td>
<td>1</td>
<td>4</td>
<td>0.8</td>
</tr>
<tr>
<td>Number/types of auctions</td>
<td>0.15</td>
<td>9</td>
<td>1.35</td>
<td>6</td>
<td>1.05</td>
<td>5</td>
<td>0.75</td>
<td>3</td>
<td>0.45</td>
</tr>
<tr>
<td>Website functionality and resources</td>
<td>0.05</td>
<td>8</td>
<td>0.4</td>
<td>8</td>
<td>0.4</td>
<td>6</td>
<td>0.3</td>
<td>4</td>
<td>0.2</td>
</tr>
<tr>
<td>Relative fees/commissions</td>
<td>0.1</td>
<td>6</td>
<td>0.6</td>
<td>8</td>
<td>0.8</td>
<td>7</td>
<td>0.7</td>
<td>7</td>
<td>0.7</td>
</tr>
<tr>
<td>Relative cost position</td>
<td>0.05</td>
<td>8</td>
<td>0.4</td>
<td>6</td>
<td>0.3</td>
<td>6</td>
<td>0.3</td>
<td>7</td>
<td>0.35</td>
</tr>
<tr>
<td>Global success</td>
<td>0.1</td>
<td>8</td>
<td>0.7</td>
<td>6</td>
<td>0.6</td>
<td>1</td>
<td>0.3</td>
<td>5</td>
<td>0.5</td>
</tr>
<tr>
<td>Customer services</td>
<td>0.05</td>
<td>7</td>
<td>0.35</td>
<td>8</td>
<td>0.4</td>
<td>5</td>
<td>0.25</td>
<td>5</td>
<td>0.25</td>
</tr>
<tr>
<td>Financial Resources</td>
<td>0.05</td>
<td>9</td>
<td>0.45</td>
<td>7</td>
<td>0.35</td>
<td>1</td>
<td>0.05</td>
<td>2</td>
<td>0.1</td>
</tr>
<tr>
<td>User confidence</td>
<td>0.1</td>
<td>8</td>
<td>0.8</td>
<td>8</td>
<td>0.8</td>
<td>7</td>
<td>0.7</td>
<td>7</td>
<td>0.7</td>
</tr>
<tr>
<td>Total Rating/Score</td>
<td>1</td>
<td>81</td>
<td>8.3</td>
<td>73</td>
<td>7.3</td>
<td>49</td>
<td>5.05</td>
<td>48</td>
<td>4.7</td>
</tr>
</tbody>
</table>

Students should be encouraged to justify their selection of competitive strength measures along with their assigned weights. Factors which are most likely to attract customers typically receive greater weights. Students should also explain the absence of factors which can reasonably be considered critical to the success of online auction companies.

It is worthwhile to ask students if they believe eBay has achieved a sustainable competitive advantage in the online auction industry based on the SWOT analysis and the competitor analysis. Students should remember that to have a sustainable competitive advantage a firm must have resources that are valuable, rare, imperfectly imitable and unsubstitutable.

Students are likely to conclude that eBay does have a sustainable competitive advantage but they should be pushed to identify the specific resources that underlie this position. They will tend to list resources such as brand name, image, reputation, wide variety of auctions, etc. While all of these are important, most can be summarized as eBay’s ability to leverage the network effects in its business model to enhance its value proposition for both buyers and sellers. Students should explore the relative strengths of both eBay and Amazon to determine Amazon’s threat to eBay’s ability to sustain its competitive advantage and to expand it to the fixed price format.

Although eBay capitalized on its first mover advantage and achieved a critical mass in the online auction industry, has Amazon begun to more effectively realize second mover advantages at lower costs? Will competitors be able to build a similar resource due to eBay’s path dependencies, causal ambiguity and social complexity? Moreover, it is less certain that this competitive advantage is sustainable in the fixed pricing segment where eBay hopes to compete effectively with Amazon.
8. How has eBay’s competitive strategy evolved throughout the company’s history? How have these changes impacted the nature of eBay’s core business and its customer base?

eBay was founded in 1995 by Pierre Omidyar as Auctionwatch at the domain name of www.eBay.com. In 1996, Jeffrey Skoll contributed to Omidyar’s vision with a more strategic perspective. The company began charging a fee to offset its costs. The goal from a strategic and visionary perspective was to “create a place where people could do business just like in the old days—when everyone got to know each other personally, and we all felt we were dealing on a one-to-one basis with individuals we could trust.”

In 1997, both agreed that the company had reached a size sufficient to warrant a professional manager/strategist at which time Margaret Whitman joined the company when it had fewer than forty employees and less than $6 million in revenues. Whitman’s focus was on creating a great experience for its consumers by growing without sacrificing the quality and personal touch that helped grow the business. The focus had been on the core online auction portion of the business.

The next major evolutions in eBay’s business model and its customer base came through eBay’s international expansion, through both internal growth acquisition, and diversification. eBay diversified through acquisitions of Stubhub, the launch of eBay Express and the introduction of online partnerships with Yahoo and Google. The company further diversified in 2006 with the acquisition of Skype, an online communication company. The company was also moving towards fixed price selling and general e-commerce as Amazon’s business model grew in popularity. Over the life of the company, eBay moved from offering collectibles in the San Francisco Bay area to offer a wide product mix to a global community.

In 2008, with slowing growth in its core auction business segment, John Donahoe took the helm as Whitman stepped down. Interestingly, Donahoe joined the company in 2005, which might later be reflected in his attitude towards efficiency of culture. Donahoe introduced some controversial changes such as a change in fee structure and a fundamental change in eBay’s feedback system suggesting an increasing focus on buyers.

This evolution in strategy and leadership has affected eBay’s core business in several ways. First, its core business grew as eBay leverage first mover advantages under the “personal touch” of Whitman at the CEO position in the late 1990’s. However, growth began to slow in the 2000’s and Donahoe who had little problem with rapid change replaced Whitman. As the company continued to grow, greater emphasis was placed on large sellers. Additionally, the company appeared to lose some of its advantages previously associated with an innovative and flexible culture as bureaucracy grew. This, along with a declining global economy, increasing diversification, and competing business models have had an adverse impact on eBay’s core business – online auctions.

9. What challenges does John Donahoe, eBay’s new CEO, face in taking over from Meg Whitman? What strengths does he bring to the table?

Students should point out that John Donahoe faces several challenges:

- A decline in the growth rate in the number of active users relative to registered users
- The potentially failed acquisition of Skype which was expected to produce synergistic advantages but was followed by a $900 million write down
- A decline in transaction revenues in eBay’s core Marketplaces division and recent declining stock performance
- The erosion of eBay’s core customer base due to poor perceptions of the company by its customers
- The innovative culture of the company, one of the keys to its early success, was being lost and overcome by perceived stifling bureaucracy.
Increasing competition in the general e-commerce arena from competitors with sufficient resources and capabilities to successfully increase their market share

Students will recognize that Donahoe’s value and skills are a departure from Meg Whitman, the company’s previous CEO. They are likely to correctly note that some employees and analysts do not believe he is being perceived as a slight liability. He brings certain strengths that students should identify including:

A strong consulting background reflecting solid analytical skills and previous experience with eBay. It is likely that Whitman chose Donahoe to take her place and has been grooming him for the position. Additionally these skills might be increasingly useful as eBay may need to find internal efficiencies to help combat falling profit margins

Donahoe had experience with bringing about organizational change and this was a skill that was likely to be needed in the near future at eBay as the company faced increasing competition

It was likely that the management of eBay would have to make some difficult decisions in the near future and it appeared that Donahoe was willing to make hard decisions to propel the company forward

10. Based on your analysis of the industry and eBay’s situation, what problems and issues does eBay’s top management need to address? Which ones are top priorities?

The case lays out the most pressing issues that eBay needs to address. Students should have little difficulty identifying the top issues that eBay’s top management should address, in order of priority:

- How should eBay address the slowing growth regarding its core business? What role does customer service play? How should they expand successfully into the fixed prices market?

- What role does John Donahoe’s leadership play in eBay’s ability to successfully formulate and implement a sound strategy? How can culture help facilitate or hinder these efforts?

- What strategic direction should the company take regarding its various segments? What are the expansion opportunities in the Payments segment? How should the acquisition of Skype be handled? Can it be successfully integrated into eBay’s existing business model?

11. What actions would you recommend to Mr. Donahoe to improve eBay’s competitive position, especially its market position vis-à-vis key rivals, its long-term financial performance, and its relationships with key customers?

The most critical issue eBay needs to address is the slowing growth in its core business of online auctions.

The following recommendations are appropriate given eBay’s situation:

- Addressing the core business – eBay’s core business is declining amidst increasing competition and a global economic slowdown requiring that they refocus their efforts to rebuild a competitive advantage in this area while expanding into the fixed prices market.
  - eBay’s core business, Marketplaces, is down 6% from the end of the second quarter in 2007. Additionally, the percentage of eBay’s total revenues fell from 72% to 56%.
  - From 2006 to 2008 eBay’s market share in the U.S. e-commerce market fell from 19% to 17% as Amazon.com’s market share rose from 3.7% to 5.3%. This trend can be problematic as the number of total online users is expected to grow to 1.9 billion users in 2012.
Finally, eBay’s stock price reflects a lack of investor confidence in its current business model. Questions continue about whether it should sell its online auction business, particularly in lieu of an announcement to lay off 1,000 employees in 2008.

To help rebuild its core business, eBay needs to first address customer satisfaction because:

- eBay’s Customer Service Rankings are marginally below the average for Internet retail and well below Amazon.com.
- eBay’s number of active users relative to registered users is declining while its competition continues to experience growth.
- eBay’s declining number of active users relative to registered users may inhibit expansion opportunities in fast growing markets such as Asia, Europe and America.
- eBay’s smaller sellers are dissatisfied with changes to the feedback system whereby sellers cannot leave feedback about buyers.

In addressing customer satisfaction eBay should improve its ability to effectively communicate its values to its customers and to have its existing customers communicate those personal values to its new customers. Additionally, it appears that some of the customer dissatisfaction is coming from smaller sellers who feel that they are not being heard or appreciated by eBay. While eBay is moving towards favoring larger sellers, it needs to realize that many of the small sellers on eBay are also buyers. If these individuals stop selling on eBay, they are also likely to stop buying on eBay as well. One possible solution is for eBay to formalize a panel of small sellers who will act as representatives on behalf of the smaller sellers on eBay. In doing this, eBay must make sure that the small sellers on the panel remain independent and not perceived as having been “captured” by eBay.

Additionally, eBay needs to take a hard look at the revision of its feedback forum. Many small sellers felt that they have been damaged by eBay’s removal of their ability to leave feedback for buyers. There does seem to be some merit to this argument and eBay should consider reinstating buyer feedback, or some sort of “verified buyer” program which can reduce the impact of fraudulent buyers on small sellers.

eBay should continue to expand fixed price sales. Recent trends indicate that the fixed price method of selling is growing in popularity and, thus, provides a viable means for continuing growth. Expanding the fixed price segment of online transactions moves eBay in a better position to become an online retailer and not merely an online auction company. Hence, they are more capable of competing with other online retailers like Wal-Mart and Target. Expanding into the fixed price transactions, like big-ticket item auctions, may also help eBay generate larger fees.

In implementing this recommendation, there are at least four potential pitfalls. First, eBay clearly has a competitive advantage in the online auction industry. However, it is questionable as to whether this competitive advantage, and their business model, can directly translate to compete effectively in general online retailing. While there are a number of potential issues, one of the most significant is that eBay never takes possession of the goods and thus is not able to guarantee that the goods arrive on time, and in the desired condition. While they do offer protection to buyers and sellers, it is not the same as buying directly from a company like Amazon.com who warranties their goods. Second, there are a number of eBay users who purchase on eBay for the thrill of winning an auction. These buyers are likely to turn to other venues if eBay neglects its auction format in favor of fixed price selling. Third, a number of eBay buyers are bargain hunters, while the fixed price sales can certainly be cost competitive, bargain hunters tend to prefer auctions since they have the opportunity to buy below fixed prices available from other outlets. Finally, eBay was originally created to provide an efficient market place for the buying and selling of goods over the Internet. The auction format allows the market to dynamically determine the optimal pricing for a good. By going to a fixed price format, buyers of in-demand goods may receive less profit that than would in an auction format and may turn to competitors’ venues.
Second, eBay should address growing concerns regarding its CEO, John Donahoe. When Donahoe was chosen, the board had to realize that his views on managing and the future of eBay were somewhat divergent from Whitman’s. However, they may very well have felt that as eBay’s business model evolved, the company needed a different type of CEO to lead eBay into the future. However, it has become apparent that Donahoe’s willingness to “break patterns” may be too disruptive to eBay’s organizational culture. Employees have openly expressed concern for eBay’s culture since Meg Whitman stepped down and John Donahoe took control of the company. They also alluded to Meg Whitman’s pride in shopping online with eBay. Alternatively, they have witnessed a growing number of packages from Amazon.com in their mailroom under the leadership of John Donahoe. Perhaps most troubling is that eBay’s employees expressed a lack of confidence in Donahoe with an approval rating of 22% compared to that of Whitman whose approval rating was at 75% when she stepped down. This lack of confidence is likely to have a significant negative impact on his ability to successfully implement strategic change. Further, Donahoe’s efforts to leverage internal customer data, to shift the fee structure and to fundamentally change eBay’s feedback system along with rapid growth may further erode the culture of the eBay community which Omidyar considers to be critical to its long-term success.

Students should recognize that there is likely to be a certain amount of dissatisfaction with any significant leadership change. However, it appears that the concerns surrounding Donahoe’s leadership go beyond simply “grumbling” and may be indicative of a poor cultural fit between the new CEO and the company. eBay’s Board of Directors needs to take a hard look at this situation and determine whether Donahoe is the right fit for the position. If they determine he is, then he needs to be pressed to develop a plan to improve the internal culture.

Third, eBay should address its future strategic focus. The segment with the highest growth potential is the Payments segment. Revenues in the Payments segment grew 40% from 2005 to 2006 and an additional 34% from 2006 to 2007. The president of this segment believes that it will generate more revenues than eBay transactions. In 2008, Bill Me Later was purchased in 2008 to complement growth opportunities in this segment. eBay should continue to grow this segment by aggressively expanding the availability of PayPal to reputable merchants across the Internet and promoting it as an alternative for small merchants who do not want to operate their own payment processing services. Additionally, eBay should add to its portfolio of payment processing companies by acquiring additional payment processing companies, especially those in key international markets.

Finally, eBay should closely examine its inability to successfully integrate Skype into its business model. The acquisition of Skype has failed to leverage the synergies that justified its acquisition; in late 2007, eBay had to take a $900 million write down in the value of Skype, which further questions the acquisition. eBay should seek to sell Skype to a more suitable purchaser such as Google or Microsoft which may help eBay to function on its more profitable, potentially high growth and core businesses. However, in choosing the purchaser, eBay needs to ensure that it is not directly improving the competitive capabilities of a key rival.

EPILOGUE

eBay recorded revenues of $8.54 billion and net income of $2.25 billion for the full-year 2008. Revenues for the company’s marketplaces business unit declined by 16% during the fourth quarter of 2008, while its payments business unit experienced an 11% year-over-year increase and its Skype business unit experienced 26% year-over-year revenue increase during the fourth quarter of 2008. Its complete annual reports were not available at the time this teaching note went to press. You can find the company’s latest financial results and press releases at www.ebay.com.
OVERVIEW

In 2007 Loblaw Companies Limited (Loblaw), the largest family-owned supermarket chain in Canada, was facing significant challenges including increasing customer dissatisfaction, a subpar logistics system, and the threat of increasing competition with the impending entry of Wal-Mart into the Canadian supermarket industry. Loblaw’s top management team, headed up by Galen Weston Jr., Executive Chairman and the fourth-generation leader of the family-owned company, had begun preparing for Wal-Mart’s entry into the market as early as 2004, when the company decided to focus its efforts on The Real Canadian Superstores. In 2004 Loblaw operated 670 corporate stores under at least 12 different corporate banners, but their best known chain was Loblaws. However, under the guidance of Weston, in 2004 Loblaw made the decision to no longer invest in conventional Loblaws supermarkets, but rather to focus its efforts on The Real Canadian Superstores (TRCS) and to reposition this chain with a deep discount strategy. TRCS carried many nonfood categories and groceries, and marketed them at everyday low prices rather than running weekly and seasonal specials as was the norm in the industry. Over the next three years the company undertook a major reorganization of its distribution system and replaced a number of top executives.

Similar to the strategy it used in the United States, Wal-Mart entered the Canadian grocery industry in the fall of 2006 using its large general merchandise discount stores as a base for its expansion as a food retailer. As expected, the entry of this formidable competitor had an impact on markets in which it competed. In response to Wal-Mart’s entry, other rivals had improved their product offerings focusing on fresh produce and enhancing their quality-based images with their customers. Thus, Loblaw was facing increased competitive pressure at both the higher and lower ends of the market.

Unfortunately for the company, Loblaw’s repositioning of its brand did not go as expected and by 2007 the company was in the unenviable position of having a weak distribution system, customers who were confused as to the company’s brand position and value proposition, questionable leadership and a falling stock price. The company’s troubles were most evident in the customers’ perceptions of the brand and the distribution system. Before the company began its repositioning it had a reputation among consumers for offering a large assortment of high quality fresh food. However, between 2004 and 2007, in an effort to compete with the superstores, the company had experimented with offering a large variety of nonfood merchandise ranging from electronics to kitchen goods to clothing. However, the company’s distribution system was not sufficient to support such a broad array of merchandise and both quality and customer service suffered. By 2007 customers were confused by the assortment of general merchandise carried by The Real Canadian Superstores and unhappy with its offering of fresh food. Further, inventory had leapt out of control and attempts to manage inventory were resulting in shortages and stale-dated products in both food and nonfood categories. These difficulties were especially troubling as Loblaw’s Canada based competitors sharpened their skills and competencies and there was no reason to believe that Wal-Mart would slow its expansion. It was evident to many observers that Loblaw needed to regain its focus and sharpen its competitive capabilities. However, there was some question as to whether the Weston family would retain its controlling stake in Loblaw or divest itself of this asset.

*This teaching note reflects the thinking and analysis of the case authors, Professor Kenneth G. Hardy, the Richard Ivey School of Business, University of Western Ontario and Veronika Papyrina, San Francisco State University. We are most grateful for her insight, analysis and contributions to how the case can be taught successfully.
SUGGESTIONS FOR USING THE CASE

Students should find it relatively easy to understand the issues in the Loblaw Companies case because of the detailed information provided in the case and through their experiences as retail grocery customers. Also, most students in your class will have shopped in Wal-Mart Supercenters and will understand the threat that Wal-Mart poses to regional grocery chains. The central issues for students to consider are: (1) what must Loblaw do to restore its competitiveness in the Canadian retail grocery industry and improve its overall financial performance and (2) how should Loblaw best prepare for Wal-Mart’s entry into Canada as a new rival supermarket chain. We suggest making the case a component of your international module to have students apply Chapter 7 concepts. Specifically, students should refer to Chapter 7’s discussion of strategy options available to local companies intent on defending their positions against resource-rich multinational companies. In addition, the case also allows you to further drill students in the tools of industry analysis, with an examination of the industry’s dominant economic characteristics, the underlying forces causing change in the industry, and the industry’s key success factors. You can also ask that students utilize the analytic tools described in Chapter 4—SWOT analysis, strategic group mapping, and financial analysis.

The Student Edition of the Online Learning Center (OLC) provides students with copies of the assignment questions contained in this note. The list of assignment questions leads students through a thorough industry analysis and prepares them to make strategy recommendations for selected companies. We suggest that you always direct students to the assignment questions posted on the Crafting & Executing OLC and instruct them to use the assignment questions to prepare for the class discussion of the case. We always instruct our students to read the case once to gain a general understanding of the issues presented in the case and then return to the case to prepare written responses to each of the assignment cases. We’ve found that our students who follow this approach are well-prepared to make a meaningful contribution to the class discussion.

The case allows for a modest degree of number-crunching, and may be a good choice for oral team presentations or a written case assignment because of its decision focus. However, the case involves more complex issues and should not be assigned as a first written assignment or oral presentation in the course. Our suggested assignment questions are:

The case is well suited for both oral team presentations and written assignments. A good assignment question is:

1. Galen Weston Jr., the Executive Chairman of Loblaw Companies Limited, has employed you as a consultant to evaluate the company’s approaches to executing its strategy and to make recommendations for improvement. Please prepare a 4-6 page report evaluating the Canadian supermarket industry and Loblaw’s current situation. Offer specific, actionable recommendations to Weston as to how he can improve the company’s competitive position and position Loblaw to compete with Wal-Mart. Your analysis should include an examination of the industry’s dominant economic characteristics, the driving forces impacting the industry, and the industry’s key success factors. In addition, your analysis should include an assessment and identification of the company’s current strategy, an examination of its recent financial performance, and a SWOT analysis. Your recommendations should clearly identify a specific course of action that Loblaw should pursue and be well supported with arguments and justifications from your analyses for each.

2. As a component of Loblaw Companies’ new employee selection process, you have been asked prepare an analysis of the Canadian supermarket industry and recommend strategic approaches to improving the company’s competitiveness and performance and defending against Wal-Mart’s entry into the market. Your recommendations to restore the company’s competitiveness, improve financial performance, and defend against Wal-Mart should be in the form of a 2-3 page executive summary. Your recommendations should be specific and defended with findings from your analysis. Please use whatever analytic tools discussed in Chapters 3 and 4 you believe appropriate. All analyses should be labeled as exhibits and attached to your executive summary. Your supporting exhibits and executive summary of recommendations will be given equal weighting in your grade for the written assignment.
ASSIGNMENT QUESTIONS

1. What are the defining business and economic characteristics of the Canadian supermarket industry? What is the industry like?

2. How is the Canadian supermarket industry changing? Identify the 3-5 primary underlying drivers of change in the industry and discuss how those forces individually and collectively are changing competition in the industry.

3. Identify the 3-5 factors that determine success for supermarket operators such as Loblaw.

4. What does a SWOT analysis for Loblaw Companies reveal? Does the company have any identifiable core and/or distinctive competencies?

5. Assess the effectiveness of the actions taken by John Lederer and his executive group to prepare Loblaw and The Real Canadian Superstore for coping successfully with the added competitive pressures posed by Wal-Mart Supercenters. Are these actions likely to prove sufficient for Loblaw to maintain its market position and financial performance?

6. How well is Loblaw’s strategy working? What is your assessment of Loblaw’s recent financial performance?

7. What does a strategic group map reveal about Loblaw’s position vis-à-vis Wal-Mart’s position in the industry? How are Loblaws, Fortino, and The Real Canadian Supercenter store formats positioned to compete with Wal-Mart? Which format is likely to be the most direct competitor?

8. What issues should Galen Weston Jr. be most concerned about? Which should have the highest priority? Why?

9. What specific actions should Loblaw take to improve its competitiveness? How might Lowlaw exploit its local knowledge of the Canadian supermarket industry to defend against Wal-Mart’s entry?

TEACHING OUTLINE AND ANALYSIS

1. What are the defining business and economic characteristics of the Canadian supermarket industry? What is the industry like?

Market Size and Growth Rate: This industry is approximately $74 billion in sales during 2006 and is growing at a rate of 2.49%, which is slower than the American industry to which it is compared in the case. However, there has been some minor shrinkage in the number of stores in the industry, having reduced in number from 2005 by 0.81%.

Number of Rivals: There are three main competitors for Loblaw identified in the case, but this is almost a negligible factor since Loblaw held a commanding, if not dominant lead in industry market share (34.9%, more than double its closest competitor and nearly three times its next closest competitor).

Scope of Rivalry: Loblaw operates nationally, but its principal interests are in the urban centers of Canada, with particular concentration in the Eastern Provinces.

Number of Buyers: As a retail grocer, Loblaw’s customer base is the consumer making individual purchases, and is therefore fragmented and with no appreciable power. However, it should be noted that the case mentions that 50% of Loblaw’s income is from discount format stores, suggesting that consumers have driven the industry toward lower prices.
**Degree of Product Differentiation:** The product is grocery goods, and therefore, a commodity with some minor differentiation available on price, selection and quality. However, Loblaw introduced a means of achieving differentiation by wedding the concepts of private label goods with a premium image.

**Product Innovation:** As noted, Loblaw has pioneered the use of differentiation among private labels. They have also branched out, employing unrelated diversification to bring such goods and services as banking into their stores. Although the case does not suggest this is a prominent feature of the industry, having succeeded in doing it Loblaw should expect it to become a common feature as rivals attempt to copy their success.

**Supply/Demand Conditions:** Loblaw deals with suppliers, but the case gives no indication that those suppliers have any cohesion or power in the relationship.

**Pace of Technological Change:** More sophisticated means of managing the supply chain, to include EDI systems mentioned in the case, suggest that new means of reducing costs are presenting opportunities for grocers to obtain an advantage over one another.

**Vertical Integration:** The presence of suppliers indicates that the industry is not perfectly integrated. However, Loblaw and Wal-Mart each maintain extensive warehousing and transportation assets, suggesting that there is a considerable degree of integration in the industry.

**Economies of Scale:** Given that the product is a commodity provided by suppliers, economies of scale would be essential in this industry.

**Learning/Experience Curve Effects:** Developing the competencies required to accurately forecast and supply demand for perishable grocery goods, coordinate with suppliers, identify local market interests, and execute successful promotions would imply a substantial amount of institutional knowledge and skill that would be difficult to acquire (note: as the case demonstrates, simply hiring an executive from a rival with a distinct competency in these areas is not sufficient to acquire such abilities).

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2. **How is the Canadian supermarket industry changing? Identify the 3-5 primary underlying drivers of change in the industry and discuss how those forces individually and collectively are changing competition in the industry.**

Students should have relatively little difficulty identifying five forces that are driving change in the Canadian retail grocery industry including:

- **Changes in the industry growth rate.** As previously noted, the growth rate for the industry is slowing. The growth rate is only 2.49% and there has been a minor reduction, 0.81%, in the number of stores in the industry. This slowing growth rate is acting to increase the intensity of rivalry in the industry.

- **Changes in customer expectations.** The industry’s customer, the consumer, is demanding lower priced goods, as indicated in the case by the fact that the discount formats were beginning to contribute 50% of Loblaw’s income.

- **Entry of new competition.** A major, powerful competitor with a reputation for entering and dominating markets (Wal-Mart) has entered the Canadian arena and is doing so in Ontario, a concentrated center of Loblaw’s business. The case describes the potential impact of Wal-Mart’s entry predicting that other stores would lose between 5% and 10% of their business.

- **Application of new technologies.** Technologies, such as EDI, are playing a more important role in managing cost for the firm and improving operational efficiencies.

- **Increasing pressure for efficiency.** There is a drive for efficiency, reducing the number of warehouses, which reduces inventory costs, while at the same time maintaining service levels.
3. **Identify the 3-5 factors that determine success for supermarket operators such as Loblaw.**

The case provides ample information to address this question, but students should be able to draw on their own experiences as well to identify five factors that are important to achieving success in this industry:

- **Affordability for the Value Delivered.** As competition increases, customers are becoming increasingly value conscious. However, they still appear to be willing to pay a fair price for a quality product.

- **Quality of Product: within the constraints of affordability.** The case makes it clear that Canadian grocery customers are very demanding of quality in their food and Loblaw had built a good reputation in this area.

- **Customer Service and Product Availability.** It is crucial for a firm such as Loblaw to ensure that they can provide the goods their customers want, and to ensure that customers can find those goods.

- **Breadth of Selection.** Customers will have a significant range of brand preferences for any given product and it is important that the grocer knows what those are and provides a good supply of those that are demanded in sufficient volume.

- **Logistics Management.** Given the perishable nature of the goods in the industry and the impact of seasonality on sales, grocery stores need to have a logistics system that delivers the necessary products at the proper time.

4. **How has the competitive strength of the Loblaw Companies changed in the past five years? How would a SWOT analyses for the company in 2007 compare to a SWOT analysis based on its competitive capabilities in 2003? Did the company have any identifiable core and/or distinctive competencies in 2007?**

There is value in having students examine the company’s competitive positioning both 2003 and 2007 to better understand its eroding competitiveness and capability to defend against attacks from powerful new rivals. In 2003 the SWOT analysis included:

**Loblaw Companies’ Internal Resource Strengths and Competitive Capabilities in 2003**

- Innovative business model including unrelated diversification into banks, etc. within their stores
- Loblaw owned its own real estate which helped lower facility costs
- The company owned a range of grocery store chains
- Private label brands had a high profit margin and were popular with customers
- The company had successfully implanted a differentiation strategy in what is typically a low cost product by successfully marking private label foods as a premium product.
- They enjoyed a reputation for delivering quality and customer service
- The company arguably had core and distinctive competencies in operational efficiency and customer service abilities
- From Case Exhibit 1, the company had been experiencing increased profitability with growing profit margins, ROA and cash flow.
Loblaw Companies' Internal Resource Weaknesses and Competitive Liabilities in 2003

- Company growth has slowed
- Management believes that the Loblaw’s brand might be stagnating

External Opportunities in 2003

- Entering new segments (demonstrated the ability by unrelated diversification into banking)
- Geographic Expansion: There are urban areas in Western Canada that can be serviced.
- Acquiring Rivals: Although Loblaw’s two main competitors might be resistant to acquisition, many of the smaller grocers might be open to such approaches

External Threats in 2003

- New Entrants: as indicated by the case, large, competent, and well-funded firms could enter the market
- Growing Supplier Power: It is possible that Loblaw could face fewer numbers of suppliers, with more bargaining power as the growth in the industry slows, prompting suppliers to compete more intensely and acquire or eliminate one another.
- Shifts in taste or demand: Loblaw could lose one of its key advantages, the premium private label good, if customers become more conservative.

Students should recognize that by 2006 the SWOT analysis of Loblaw had changed significantly. Many of the company’s key strengths had eroded or, worse yet, changed to weaknesses.

Loblaw Companies' Internal Resource Strengths and Competitive Capabilities in 2007

- Loblaw owned its own real estate which helped lower facility costs.
- The company owned a range of grocery store chains.
- Private label brands had a high profit margin and were popular with customers.

Loblaw Companies' Internal Resource Weaknesses and Competitive Liabilities in 2007

- Appears to lack any distinct competencies
- Weak balance sheet. It appears that resources were drained by mismanagement of the supply chain and misreading of customer preferences.
- Product service failures are common including the inability to place product in the stores and delivering poor quality in the product that does arrive.
- The company appears to be attempting to compete directly with Wal-Mart and trying to use the same tools Wal-Mart has mastered in doing so. Effectively they have matched their weakness on logistics against Wal-Mart’s strength in this area.
- The company is losing market share in several of its chains.
- Drain of Intellectual Capital (lost or temporarily neutralized key employees during the relocation/consolidation of the purchasing groups)
- The company’s image is suffering badly with customers and suppliers.
External Opportunities in 2007

- Refocusing on differentiation by concentrating on the more upscale markets rather than competing in the costs arena
- Developing Alliances: partner with suppliers to ensure better service and quality and preferential treatment
- Geographic Expansion: There are urban areas in Western Canada that can be serviced.
- Acquiring Rivals: Although Loblaw’s two main competitors might be resistant to acquisition, many of the smaller grocers might be open to such approaches

External Threats in 2007

- New Entrants: as indicated by the case, large, competent, and well-funded firms could enter the market
- Growing Supplier Power: It is possible that Loblaw could face fewer numbers of suppliers with more bargaining power as the growth in the industry slows, prompting suppliers to compete more intensely and acquire or eliminate one another.
- Shifts in taste or demand: Loblaw could lose one its key advantages, the premium private label good, if customers become more conservative.

5. Assess the effectiveness of the actions taken by John Lederer and his executive group to prepare Loblaw and The Real Canadian Superstore for coping successfully with the added competitive pressures posed by Wal-Mart Supercenters. Are these actions likely to prove sufficient for Loblaw to maintain its market position and financial performance?

Some students may argue that Lederer was on the right track and that his basic strategy was sound; he just needed more time to make it work. After all, many of the strategic changes he was implementing in The Real Canadian Superstore chain were proven to work in Wal-Mart’s business model. However, other students are likely to be very critical and to describe Loblaw’s attempt to change strategy as both unwise and inept.

The firm correctly identified Wal-Mart as not being a low-cost general merchandise retailer that also offers groceries, but rather a supply chain company that happens to deal in general merchandise and groceries. To preempt competition from Wal-Mart, Loblaw attempted to become a supply chain company as well, consolidating distribution centers and forcing cost-cutting efficiency demands on suppliers. However, Loblaw underestimated the how difficult it would be to build competencies and capabilities in supply chain management that would be on par with that of Wal-Mart.

Students need to recognize that it is easy to be critical with perfect hindsight and it is important to acknowledge that Lederer’s team was aware of Wal-Mart’s plans and was taking action. Clearly, Lederer and his team made mistakes in executing the strategy but this can be at least partially excused by the significant changes in management that occurred during the transition. Perhaps the single largest mistake was the decision to enter into categories of merchandising in which the company had zero experience, namely the non-food categories, especially appliances. The Real Canadian Superstores name was new in Ontario, and customers did not expect to find appliances and pajamas when they went to buy groceries. Moreover, Loblaw was apparently not very good at promoting and managing these categories.

Students should have little trouble realizing that by choosing to enter direct competition with Wal-Mart, Loblaw placed itself at disadvantage in terms of resources. As noted in the table below, at no point during the period of the study did Loblaw comes within $5 billion of Wal-Mart’s earnings, thus it is unlikely that they would possess the resources to engage in a direct contest in the low cost arena with Wal-Mart, and unlikely that they could withstand a lengthy “war of attrition” if their hope was to make the market sufficiently unprofitable for Wal-Mart to abandon its efforts.
Evidence of the poor execution of the strategy’s implementation can be seen in the fact that Loblaw experienced such overstock that it was required to liquidate nearly $140 million of excess inventory in the system at the time that the retail sites had empty shelves. Adjustments to make the organization more streamlined were executed in a similar poor fashion, such as relocating 2,000 employees to the new consolidated offices, disrupting the firm’s ability to employ its personnel resources while staff sought new homes, in addition to the staff that chose not to relocate, depriving the company of needed expertise.

6. How well is Loblaw’s strategy working? What is your assessment of Loblaw’s recent financial performance?

The case provides students with a detailed ratio analysis in case Exhibit 1 reproduced below so this provides an excellent opportunity for you to help them understand what these numbers actually mean.

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<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Adjusted EBITDA margin</td>
<td>6.7%</td>
<td>7.8%</td>
<td>8.2%</td>
<td>7.5%</td>
<td>7.3%</td>
</tr>
<tr>
<td>Operating margin</td>
<td>1.0%</td>
<td>5.1%</td>
<td>6.3%</td>
<td>5.9%</td>
<td>5.7%</td>
</tr>
<tr>
<td>Adjusted operating margin</td>
<td>4.7%</td>
<td>5.9%</td>
<td>6.3%</td>
<td>5.9%</td>
<td>5.7%</td>
</tr>
<tr>
<td>Return on average total assets</td>
<td>2.3%</td>
<td>11.2%</td>
<td>14.2%</td>
<td>13.9%</td>
<td>13.8%</td>
</tr>
<tr>
<td>Return on average shareholders’ equity</td>
<td>(3.9)%</td>
<td>13.2%</td>
<td>19.2%</td>
<td>19.3%</td>
<td>19.0%</td>
</tr>
<tr>
<td>Interest coverage</td>
<td>1.0</td>
<td>5.1</td>
<td>6.4</td>
<td>6.4</td>
<td>6.8</td>
</tr>
<tr>
<td>Net debt to equity</td>
<td>0.72</td>
<td>0.66</td>
<td>0.71</td>
<td>0.79</td>
<td>0.72</td>
</tr>
<tr>
<td>Cash flows from operating activities to net debt</td>
<td>0.30</td>
<td>0.38</td>
<td>0.38</td>
<td>0.28</td>
<td>0.34</td>
</tr>
<tr>
<td>Price/net earnings ratio at year end</td>
<td>(61.0)</td>
<td>20.7</td>
<td>20.4</td>
<td>22.1</td>
<td>20.5</td>
</tr>
<tr>
<td>Market/book ratio at year end</td>
<td>2.5</td>
<td>2.6</td>
<td>3.6</td>
<td>4.0</td>
<td>3.7</td>
</tr>
</tbody>
</table>

The ratios provided above allow students to get a solid picture of the company’s profitability and its leverage. Students should note that since 2004, when the repositioning began, virtually all of the company’s key ratios have been deteriorating. The decline in the profitability ratio can be traced back to multiple issues including the company’s new low priced format in The Real Canadian Superstores, the increased inventory holding costs the company is experiencing, and the loss of sales due to poor supply chain management and customer dissatisfaction. The reduction in profitability is forcing the company to increase its reliance on debt funding, although the debt level is far from a critical level. However, with a little encouragement, students should be able to forecast where these trends will take Loblaw if the situation is not corrected.

Ultimately, the story of Loblaw’s performance is told by the trend of the firm’s change in earnings over time. From a healthy 20% growth of earnings in 2003, Loblaw was earning barely more than 1/3 of its previous year’s earnings by 2006.
8. What does a strategic group map reveal about Loblaw’s position vis-à-vis Wal-Mart’s position in the industry? How are Loblaws, Fortino, and The Real Canadian Supercenter store formats positioned to compete with Wal-Mart? Which format is likely to be the most direct competitor?

Students can use a variety of axes for their strategic group maps. We have used price and level of service as the axes for the strategic group map shown in Figure 1 since these variables are closely tied to the industry’s key success factors. The map we have created shows that the Loblaws and Fortino brands compose a separate strategic group from The Real Canadian Superstores and Wal-Mart which are in head-to-head competition. For students familiar with retailing in the United States, some may identify the space in the middle of the map between Real Canadian and Loblaws as potentially fertile space that is occupied by Target Supercenters. This opens up the intriguing possibility that if Loblaws can address some of its other concerns, it may be able to occupy this space successfully in Canada.

Figure 1  Strategic Group Map of The Canadian Supermarket Industry

9. What issues should Galen Weston Jr. be most concerned about? Which should have the highest priority? Why?

Loblaw’s most serious issue is the loss of its ability to provide quality products, or even products in some cases, to its customers. Customers are losing faith in the brand. This deterioration of the company’s market position can be attributed to the poor quality of the groceries it is selling and its inability to properly manage its supply chain. These challenges can be attributed, at least partially, to the loss of much of the company’s
intellectual capital in the fields of suppliers and demand planning. The firm has adopted a strategy that abandoned all other viable grocery formats to focus on the low-cost market. This has placed the company in direct competition with the most capable low-cost company in the world and has put Loblaw in an adversarial relationship with its suppliers. Additionally, Weston needs to be concerned with the company’s loss of managerial talent. It appears that there is no real succession, or contingency, plan in place for key leadership roles.

The most threatening issue is supplying quality goods to its customers is reliability. However, the issue demanding the most immediate attention is the loss of the intellectual capital. It is the absence of these key players that is causing the issues with the customers.

10. What specific actions should Loblaw take to improve its competitiveness? How might Lowlaw exploit its local knowledge of the Canadian supermarket industry to defend against Wal-Mart’s entry?

In broad terms, one of the first things Loblaw needs to do is to reposition The Real Canadian Superstores to a position that is superior to the Wal-Mart Supercenters, and not in direct competition with them. Trying to compete directly with Wal-Mart and matching one of Loblaw’s weaknesses to their strength is ill-advised. More specifically, the company needs to immediately resolve its supply chain problems. If it is not able to get the products to the stores in time and in the desired quality, no amount of marketing is going to help in repositioning the company. To resolve these problems, the company should

■ Rebuild its intellectual capital by rehiring as many of its purchasing experts as possible in order to repair its relationship with suppliers and “right-its-ship” in terms of identifying and meeting demand at the stores. Use tele-commuting to get those employees who did not want to move back on board if necessary, but they have to address this immediately.

■ Simplify the amount of merchandise it carries, perhaps going so far as to return almost exclusively to groceries.

Concurrent with this, Loblaw needs to return to its higher quality strategy of offering a broad portfolio of grocery services, rather than only focusing on low cost. The company has built a reputation and competencies around fresh, high quality groceries and it needs to strengthen and deepen this competence if it is going to successfully compete with Wal-Mart. If the customers don’t like the supercenters, reopen or buy stores that serve the more focused grocery need. As part of this, it may be necessary to rebrand several of the Loblaw banners in order to distance the firms’ locations from past failures in the minds of the customers.

Loblaw must also examine their restricted supply chain closely, employing consultants if necessary. They have already set the structures (warehouse locations, distribution networks, etc.) in place, and it is essential that they make sure these are working efficiently and halt the cash bleeding their poor operations have imposed.

There may be students who suggest that Loblaw Companies consider abandoning the supercenter concept in locations where they cannot compete and concentrate on customers who prefer higher quality products and better atmospherics in their grocery shopping.

An alternative to abandoning the concept would be to focus on its local knowledge of the Canadian supermarket industry to appeal to consumers in ways that would be difficult for Wal-Mart to match. In pursuing such a defensive international strategy, Loblaw Companies could:

■ Utilize its keen understanding of local customer needs and preferences to create products or services that are not offered by Wal-Mart, but that Canadian consumers would find appealing.

■ The company might also consider a merger with other Canadian grocery chains such as Metro or Sobeys to develop the scale necessary to better defend against Wal-Mart’s entry into the market.
EPILOGUE

Heading into 2009 the company had made some significant changes in its strategy. According to a company press release highlighting the results from the fourth quarter of 2008 the company had develop a “five-point plan to drive profitable sales momentum. The five-point plan includes focus on a “Back-to-Best” great food renewal in Ontario, a Western Canada refurbishment, local market merchandising, improvements in foundational infrastructure and private label innovation.”

Sales and profit margins were improving as well. According to the report:

- “Total sales were $7,745 million in the fourth quarter of 2008 compared to $6,967 million in 2007, an increase of 11.2%. Same-store sales in the quarter increased by 10.6%. Sales and same-store sales growth in the fourth quarter of 2008 were positively impacted by approximately 7.9% as a result of an additional selling week. Sales and same-store sales growth were positively impacted by 0.8% as a result of a shift of the Thanksgiving holiday into the fourth quarter. Sales and same-store sales growth were also negatively impacted by approximately 1.0% as a result of a strike in certain Maxi stores in Quebec.

- Operating income increased by $183 million, or 136.6%, to $317 million in the fourth quarter of 2008, compared with $134 million in the fourth quarter of 2007. Operating margin was 4.1% for the fourth quarter of 2008 compared to 1.9% in 2007. Included in operating income is a charge of $29 million (2007 - $33 million) for fixed impairments related to asset carrying values in excess of fair values for specific store locations. Operating income and operating margin were positively influenced by lower restructuring and net stock-based compensation costs, higher sales and the company’s cost reduction initiatives.

- EBITDA(1) for the quarter was $441 million, representing an increase of 64.6% compared to $268 million in the fourth quarter of 2007. EBITDA margin(1) increased to 5.7% in the quarter from 3.8% in 2007.

- Basic net earnings per common share increased $0.55 or 392.9% to $0.69 for the fourth quarter of 2008, compared to $0.14 in the same quarter last year.”

In looking forward Loblaw stated

“The Company remains confident in its approach and will continue to focus on making measured progress on its key transformation priorities, including food renewal, store enhancements, product innovation, infrastructure, and customer value. During 2009 the Company will step up investments in information technology and supply chain which will increase the associated expense by approximately $100 million. This investment, coupled with the continuing economic challenges and competitive pressures are expected to challenge results in 2009.”

You can find the company’s latest financial results and press releases at www.loblaw.ca.

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1http://micro.newswire.ca/release.cgi?rkey=1702188699&view=62151-0&Start
2Ibid
3Ibid
OVERVIEW

Research and development (R&D) had been the core of the BlackBerry’s remarkable success through 2007 and although Research in Motion (RIM) spent almost $360 million in R&D during the year, this number represented a smaller percentage of sales than in 2006. Also, RIM’s R&D expenditures were low compared to its largest competitors in both absolute numbers and as a percentage of sales. Explosive growth and increased competition were creating pressures on RIM’s R&D team to develop new solutions to keep up with changes in the global smartphone market. With 2007 revenue up 98 percent from the previous year, the team of approximately 1,400 software engineers should have doubled—but both talent and space were getting increasingly scarce. The current model of “organic” growth was not keeping pace and the company’s engineers were feeling the strain.

The company’s chief technology officer for software, David Yach, was considering a number of alternative paths to managing the expansion and exploiting various geographic advantages. Yach’s options for the company presented in the case include: (1) doing what it is doing now, only more of it, (2) building on its existing and satellite R&D locations, (3) growing through acquisition or (4) going global.

SUGGESTIONS FOR USING THE CASE

Students should find the case’s discussion of Research in Motion’s growth in the wireless communications industry interesting because of their familiarity and daily use of mobile phones and smartphones. You’re likely to find that many in the class are dedicated users of BlackBerry devices. The case also allows students to consider the effectiveness of RIM’s think global, act global approach to strategy making and its ability to use location to build competitive advantage. The central issue for students to debate is whether RIM should continue to concentrate its R&D activities in a few locations or to disperse such activities more widely as its need for software engineers grows. We suggest assigning the case later in your international module to illustrate how firms are able to use location to lower costs or achieve greater product differentiation. In addition, the case forces students to consider the importance of cross-border coordination of competitively valuable activities. The case also allows you to further drill students in the tools of industry analysis, with an examination of the industry’s dominant economic characteristics, the strength of its competitive forces, and underlying forces causing change in the industry.

Students who are not familiar with Chapter 7’s discussion of localized multicountry and global strategies and approaches to using location to build competitive advantage will struggle with recommendations. The Research in Motion case also allows you to reinforce material from Chapters 3, while illustrating important concepts from Chapter 7.

The Student Edition of the Online Learning Center (OLC) provides students with copies of the assignment questions contained in this note. The list of assignment questions leads students through a thorough industry analysis and prepares them to make strategy recommendations for selected companies. We suggest that you always direct students to the assignment questions posted on the Crafting & Executing OLC and instruct them to use the assignment questions to prepare for the class discussion of the case. We always instruct our students

*This teaching note reflects the thinking and analysis of the case authors, Diane Mazuits, Professor Rod White, and Professor Paul Beamish, all of the Richard Ivey School of Business, University of Western Ontario. We are most grateful for their insight, analysis and contributions to how the case can be taught successfully.
to read the case once to gain a general understanding of the issues presented in the case and then return to the case to prepare written responses to each of the assignment cases. We’ve found that our students who follow this approach are well-prepared to make a meaningful contribution to the class discussion.

The case allows for a modest degree of number-crunching, and may be a good choice for oral team presentations or a written case assignment because of its decision focus. However, the case involves more complex issues and should not be assigned as a first written assignment or oral presentation in the course. Our suggested assignment questions are:

1. David Yach of Research in Motion has heard of your emerging skills of analysis and has asked that you assist the company in evaluating options to sustain its innovation-based competitive advantage. The specific options for managing its growth and expanding its research and development staff include: (1) Do what we do now, only more of it; (2) Grow and expand existing geographies; (3) Increase acquisitions; and (4) Go global. In arriving at a recommendation you should first examine the economic characteristics of the mobile communications industry, the strength of the industry’s competitive forces, and identify and evaluate the industry’s driving forces of change. Your review should also examine Research in Motion’s strategic approach in international markets. Your recommendations should be in the form of a 2-3 page executive summary that assesses the merit of each option for increasing the company’s engineering staff and suggest to what extent the company should expand the geographic scope of its research and development activities. Your supporting exhibits and executive summary of recommendations will be given equal weighting in your grade for the written assignment.

2. Research in Motion (RIM) has employed you as an analyst in its corporate offices in Waterloo, Ontario. Your first assignment is to assist senior management in developing a plan to sustain its innovation-based competitive advantage. The specific options for managing its growth and expanding its research and development staff include: (1) Do what we do now, only more of it; (2) Grow and expand existing geographies; (3) Increase acquisitions; and (4) Go global. In arriving at a recommendation you should first examine the economic characteristics of the mobile communications industry, the strength of the industry’s competitive forces, and identify and evaluate the industry’s driving forces of change. Your review should also examine RIM’s strategic approach in international markets. Your 5-6 page report should assess the merit of each option for increasing the company’s engineering staff and suggest to what extent the company should expand the geographic scope of its research and development activities. The report should also include exhibits providing the details of your industry analysis and review of RIM’s strategy in international markets.

**ASSIGNMENT QUESTIONS**

1. What are the dominant economic characteristics of the wireless communications industry? What are the distinguishing features of the market for smartphones?

2. What is competition like in the wireless phone industry? Which of the five competitive forces is strongest? Which is weakest? What competitive forces seem to have the greatest effect on industry attractiveness?

3. How is the wireless phone industry changing? What are the underlying drivers of change and how might those driving forces change the industry?

4. What strategic approach has Research in Motion chosen to employ in international markets? Would you characterize its strategy as a global strategy or a localized multicountry strategy? How has it utilized location to build competitive advantage?

5. How important is it for Research in Motion to increase the size of its pool of software developers? What are the different options for substantially increasing its R&D staff?

6. Which option for increasing the number of software developers should Research in Motion pursue? Explain how your recommended course of action is consistent with Research in Motion’s resources, organizational capabilities, and management preferences.
TEACHING OUTLINE AND ANALYSIS

1. What are the dominant economic characteristics of the wireless communications industry? What are the distinguishing features of the market for smartphones?

Students should be able to identify the following dominant economic characteristics of the wireless communications industry and the smartphone market segment of the industry.

- **Market size and growth rate:** The number of wireless subscribers worldwide had reached 3 billion by year-end 2007. China was the world’s largest market for wireless phones with more than 524 million subscribers, followed by the United States with 254 million subscribers and India with 237 million subscribers. Growth in the number of subscribers by country was dependent, to a great extent, on penetration rates. In 2007, India was the world’s fastest growing market with 60 percent annual growth in subscribers between 2006 and 2007. The wireless telephone penetration rate in India was 21 percent. China’s wireless telephone growth rate and penetration rate in 2007 were 18.3 percent and 21 percent, respectively. The wireless penetration rate in the United States was 87 percent in 2007, while its subscriber growth rate was 9.5 percent.

- **Segmentation:** The market was segmented by type of wireless phone. While most wireless phones included features such as calendars, cameras, music players, appointment reminders, and text messaging, smartphones integrated e-mail, voice, instant messaging, short message service (SMS), internet, music, cameras, organizers, and global positioning systems (GPS) and other features into a single device. In 2007, smartphones represented only 10 percent of the global mobile phone market in units. However, smartphones were expected to account for 30 percent of worldwide mobile phone sales by 2012. The number of smartphone subscribers doubled in 2007 to about 14.6 million, while worldwide shipments increased by 53 percent in 2007 to reach 118 million.

- **Scope of rivalry:** Students will easily recognize that competitive rivalry in the wireless communications industry was global. However, there were some differences between countries in wireless technology and, in some cases, loyalty to domestic brands.

- **Presence of forward/backward vertical integration:** The manufacturers of wireless phones had not vertically integrated into the development of wireless networks or the operation of retail stores. However, some phone manufacturers such as Research in Motion and Apple produced the operating systems used on smartphones. Nokia, Ericsson, Sony Ericsson, Panasonic, Siemens, and Samsung jointly created and utilized the Symbian operating system. Microsoft also produced an operating system for smartphones that could be adopted by phone manufacturers.

- **Technology/innovation:** Industry growth was spurred primarily by technological innovations in wireless phone and smartphone capabilities. Innovation in the industry was directed toward capitalizing on the convergence of internet and wireless capabilities.

2. What is competition like in the wireless phone industry? Which of the five competitive forces is strongest? Which is weakest? What competitive forces seem to have the greatest effect on industry attractiveness?

- **Rivalry among competing sellers:** A very strong competitive force

Competition among rival makers of wireless phones centered on innovations that would allow phone providers to offer a variety of voice and data services to consumers. The industry was moving toward convergence among devices and the latest versions of wireless phones, and specifically, smartphones offered much of the functionality of an internet-enabled PC. New versions of phones were expected to be easier to use and offer expanded communication and productivity capabilities.
The bargaining power and leverage of buyers: A strong competitive force

Wireless providers such as AT&T, Sprint, Verizon, and T-Mobile had considerable leverage in their negotiations with wireless phone manufacturers. Wireless providers carried a broad line of phones for consumers to choose from, but were not required to carry all brands and models of phones. This ability to carry a small number of phones at each price point increased the ability of each wireless provider to bargain for good prices.

However, students will probably recognize that wireless providers had far less ability to negotiate for low prices and other favorable terms with the producers of smartphones. Business users (and to a growing extent consumers) were likely to choose a wireless provider based upon the availability of a preferred model of a smartphone. For example, many business users and consumers were highly attached to their BlackBerry, Palm, or iPhone and chose a carrier based upon the availability of such a phone.

Bargaining power and leverage of suppliers: A weak to moderately strong competitive force, but bargaining strength varies by type of component

Suppliers of commodities such as resins, fasteners, and memory chips used in the assembly of wireless phones had little leverage with their negotiations with manufacturers. However, the providers of operating systems likely had more negotiating power in their dealings with wireless phone manufacturers. Manufacturers who were not part of the Symbian alliance had few choices in operating systems other than Microsoft’s Windows Mobile OS or Google’s Android operating system.
- **Competition from Substitutes**: a weak competitive force

Students are likely to be avid users of wireless phones and text messaging and suggest that consumers have few good substitute choices for wireless telephones. Such a conclusion is subject to debate, but it is important to recognize that this analysis focuses on the wireless handset market and that wireless providers are the buyer of such devices. There are no substitute devices for wireless handsets that wireless providers might consider.

- **Threat of Entry**: a weak competitive force (a moderate to strong force for the smartphone segment)

Entry into the industry is limited to those possessing strong technological capabilities and an established brand name in consumer electronics. Apple was able to enter into the market for smartphones because of its technological skills and its success in the digital music player industry. Students will use their own personal knowledge of the wireless telephone market to suggest most of the companies possessing necessary capabilities to hurdle the industry’s barrier to entry have already entered the industry. However, many producers of wireless telephones do not offer smartphone models. It is very likely that all manufacturers will offer smartphone models as convergence among devices continues and the market for smartphones grows.

**Overall Assessment**: Students should conclude that the wireless phone industry is an attractive industry for incumbents with strong competitive capabilities. The smartphone segment of the industry is particularly attractive and presents good opportunities to earn above-average profits. However, students should anticipate that profitability in the smartphone segment will decline as others enter the market and competitive rivalry grows stronger among the makers of smartphones.

3. **How is the wireless phone industry changing? What are the underlying drivers of change and how might those driving forces change the industry?**

Students should be able to identify the following driving forces of change in the wireless communication industry.

- **Technological innovation.** Rapid advancements in the capabilities of wireless telephones were quickly bringing about the convergence of communications, media, business software applications, and entertainment. Smartphones allowed users to connect to the Internet via wireless networks to securely access e-mail, instant messaging services, and web, database, and other computer applications—see case Exhibit 3. As the capabilities of smartphones advanced, business users were less tethered to their desktop computers and laptop computers. Smartphones could also access the Internet for non-business purposes such as checking the weather, bidding on an item at eBay, or checking sports scores.

- **Growth in demand for smartphones.** Demand for smartphones was not only driven by business users, but consumers who wished to access secure e-mail, text messaging, and the Internet via a wireless device. The growth in demand for smartphones was prevalent in countries throughout the world.

- **Apple’s entry into the markets for smartphones.** Apple’s launch of the iPhone in June 2007 had ratcheted up the race for technological leadership in the wireless communications industry. The iPhone was rated very highly for its functionality and was an instant hit with many consumers because of the popularity of the iPod. By year-end 2007, Apple held a 27 percent market share in the North American smartphone market.

Students should conclude that the driving forces in the wireless communications industry will aid leaders in the smartphone segment since demand in that segment is expected to grow rapidly. However, competitiveness in the segment is dependent on a relentless pursuit of innovations keyed to improving functionality and further enabling the convergence of voice, data, and media. Apple’s entry into the segment also requires that smartphone manufacturers be concerned with product styling and marketing tactics designed to appeal to consumers.
4. What strategic approach has Research in Motion chosen to employ in international markets? Would you characterize its strategy as a global strategy or a localized multicountry strategy? How has it utilized location to build competitive advantage?

Students should be able to easily classify Research in Motion’s competitive strategy as a focused differentiation strategy. The company does not produce a broad line of electronics or wireless communications devices, but has focused on converged smartphones that include the features such as voice, e-mail, instant messaging (IM), short message service (SMS), camera, recorder, and a QWERTY keyboard. Even though a growing number of consumers have begun to abandon traditional cell phones for BlackBerry models and other smartphones, it is important to note that BlackBerry’s success was built on a focus on business users.

The company’s differentiation was built upon its push e-mail architecture, ease of use, and security and reliability. The company had over 100,000 BlackBerry enterprise solution, which would incur substantial costs and inconvenience of switching to another provider. These enterprise users are likely to become brand loyal and adopt newer BlackBerry models for both personal and business communications.

The company’s strategy does not vary by geographic region and should be recognized as a global strategy. Research in Motion has pursued a Think Global, Act Global strategy whereby BlackBerry devices were standardized to the extent possible between geographic regions. The company has concentrated its R&D activities in a few locations to exploit collaboration among engineers working on projects related to radio frequency, hardware and software design, audio and display improvement, antenna design, circuit board design, power management, industrial design, and manufacturing engineering. Most of its engineers were located in Waterloo, Ontario. The company expanded its reach for highly capable engineers by adding two more locations in Canada (Ottawa and Mississauga), several in the United States (Dallas, Chicago, Atlanta, Seattle, and Palo Alto) and one in England. However Waterloo remained its principle location and the focal point of its recruiting efforts. Table 1 below provides an overview of what activities have been concentrated in Waterloo and those that are dispersed across various geographic regions.

<table>
<thead>
<tr>
<th>R&amp;D Related Activities</th>
<th>Waterloo Ontario</th>
<th>Other Canada</th>
<th>United States</th>
<th>Western Europe</th>
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<tbody>
<tr>
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<td>Major CE</td>
<td>Minor CE</td>
<td>Minor CE</td>
<td></td>
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<tr>
<td>Non-core OS Research in Satellite Design Offices/Secondary Design Hubs</td>
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<td>Minor CE</td>
<td>Minor CE</td>
<td>Minor FE</td>
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<tr>
<td>Core OS Development in Satellite Design Offices/Secondary Design Hubs</td>
<td>Major CE</td>
<td>Minor FE</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Major Acquisition Candidates</td>
<td></td>
<td></td>
<td>Major FE</td>
<td>Major FE</td>
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</tbody>
</table>

Major CE = Major current emphasis  
Minor CE = Minor current emphasis  
Major FE = Major future emphasis  
Minor FE = Minor future emphasis
5. How important is it for Research in Motion to increase the size of its pool of software developers? What are the different options for substantially increasing its R&D staff?

It is possible that not all among the class will have the same understanding of the urgency of the situation. You might wish to challenge students to consider the implications of the problem by asking “What are the implications for RIM if it does not ramp up its R&D quickly?” or “How big is the competitive threat of rivals surpassing RIM’s innovation-based advantage?” Students should bring up details from case Exhibit 6—RIM is being outspent not only in terms of percentage of R&D/sales, but in absolute dollars as well. Nokia, Microsoft, Motorola and other competitors are poised to outspend RIM on innovation. What kind of threat does this pose for RIM? The students’ understanding of the urgency will shape the strategy that they select moving forward.

List the options on the board and take a quick vote to see how many teams have chosen which strategy. Alternately, the instructor could also select a class member to come forward and present their option to the class, noting the pros and cons on the board.

Either way, have the representative for each option explain their rationale for selecting a particular course of action. Make sure they also articulate why they didn’t choose a particular option. If no groups have selected one of the options, solicit feedback as to why no one chose to pursue this strategy. You may have several groups that decide to pursue all options simultaneously. Have these groups discuss how they foresee RIM would implement all of these programs. What are the risks of pursuing everything?

Once all of the pros/cons are on the board have the class debate why their preferred course of action is the “right” solution. A partial list of pros/cons that you may expect students to offer is listed below.

**Option 1: Do what they are doing now, only more of it**

**Pros:**

- RIM is currently successful in its local recruiting strategy. They have the best and brightest from the nearby University of Waterloo, many of whom come in as part of a co-op program.
- Organic growth has contributed to RIM’s young, entrepreneurial engineering culture
- RIM could expand recruitment activities to other universities in Canada and increase frequency and intensity of recruitment efforts domestically
- RIM could recruit at technical universities around the world; establish research network from which to draw new talent
- Expanding existing recruiting efforts would be the easiest option to implement
- Relatively low cost alternative
- Fits with existing mentality and culture at RIM
- Maintains strong alignment with elements of RIM’s existing strategy: value proposition and core activities

**Cons:**

- Slow way to grow (one employee at a time); this approach will not generate 1,400 new hires quickly
- Insular; recruiting only from University of Waterloo might eventually stifle innovation
- Current software engineers already feeling the strain; need immediate solution
Organizational development department does not have in-house expertise; will have to ramp up to recruit from other universities and geographies

Local talent pool is running dry; competitors are sweeping in to snatch talent

Relatively low cost of recruitment efforts could be offset by need to bring new recruits to Waterloo and offer competitive perks

Especially complex if they are going to offer immigration services

Does not align with RIM’s stated goals of expanding consumer base and global reach of BlackBerry platform or RIM’s stated product/market focus

**Option 2: Grow and expand existing geographies**

**Pros:**

- Current North American facilities are located in areas with ample talent and quality technical universities
- Lower cost than setting up brand new research centers
- Slightly easier to retain culture

**Cons:**

- Satellite locations (e.g. Ottawa, California) are not fully integrated into RIM culture; communication patterns and practices would need to be adjusted
- “If you are not here, you are not visible” mentality
- Engineers in other locations also feel “less important” as they are not working on the core product, but rather product enhancements or adaptations
- Trade-off in cost of engineering talent in Waterloo vs. California or elsewhere in North America
- Need to ensure that they have an overarching strategic R&D plan that divides what location will be responsible for what product or what process
- Keeping software developers all in one location helps foster innovation and protect intellectual property; decentralization contributes to bureaucracy, which is the antithesis of RIM’s successful start
- Not sure if RIM is “following the talent” — are there smarter places to go? Other Waterloo’s out there?

**Option 3: Increase acquisitions**

**Pros:**

- Faster way to acquire talent; if you buy the company, you buy its people (e.g. could be 200 to 2,000 people all in one shot)
- Can bring new technology and new ideas into the organization
- Depressed economic climate in the United States has left several smaller firms and competitors vulnerable for takeover; could get “bargain”
- May make some markets more open to RIM products/services (e.g. Europeans favor home-grown solutions. Establishing an R&D location in Europe may help penetrate this market)
Cons:

- Acquisitions take a long time to negotiate, often a year or more: may not meet immediate need
- Great potential for a culture clash (e.g. if you buy ex-PALM employees, you also buy their existing corporate culture, which is likely to clash with RIM’s culture given their competitive start)
- Acquisitions are very expensive both in terms of upfront capital, as well as training and on-boarding costs; most do not create value
- RIM has no experience integrating large numbers of employees after an acquisition

Option 4: Go global

Pros:

- India, China and other countries are an available and ready source of qualified, lower cost, highly skilled labor
- Proximity to market allows for faster and easier adaptation of products to local market needs; gateway to markets with highest growth in smartphone subscribers
- Foreign R&D labs can be a source of new ideas and innovations
- Foreign governments are offering incentives for investors to set up in R&D parks
- RIM has the available cash flows that could be invested in going global

Cons:

- United States government laws against exporting encryption codes; U.S. government is RIM’s largest client – RIM cannot afford to take any action that might endanger this relationship
- Intellectual property protection concerns are a critical barrier: RIM cannot afford to lose its competitive advantage that comes from its proprietary source code
- No first mover advantage; not in market leader position moving into emerging markets
- No infrastructure to access foreign business customers
- High internal resistance to off-shoring
- No experience in managing global research network; no internal infrastructure to do so, no internal expertise
- No plan for how to go global: What kind of R&D site/network/structure should RIM set up?
- Large potential for culture clash — at both national and organizational levels
- Expensive both in terms of upfront capital, as well as training and onboarding costs both abroad and at home
- Won’t solve the problem in the near term

At this point, it should become clear that as the options progress from 1 to 4, so do the complexities, trade-offs and the risks. However, so do the potential rewards — continued explosive growth, sales and subscriptions of the BlackBerry. As it stands, RIM has 41 per cent of the North American smartphone market, but it only has 11 per cent of the global market. The global market for smartphones was approximately $120 million in 2007 but expected to grow to $1 billion devices by 2012. In the end, RIM essentially has only one decision to make: (1) stay a local Canadian success story or (2) take on the challenges inherent in competing in a global marketplace.
6. Which option for increasing the number of software developers should Research in Motion pursue? Explain how your recommended course of action is consistent with Research in Motion’s resources, organizational capabilities, and management preferences.

Students may be divided on the best approach to increasing the number of software developers at Research in Motion, but regardless of their recommended approach, they must demonstrate that their recommendations are consistent with RIM’s resources, capabilities, and management preferences. An overview of considerations that should accompany student recommendations is as follows:

**Resources.** The company is in good financial health. Students who have examined case Exhibit 2 and prepared an analysis similar to what is shown in Table 2 will see that net income, in particular, has seen very healthy growth and that RIM has also been able to reduce its cost of sales as it expands. They may also point to the doubling of revenues projected for 2008 or that revenues have grown more than 10-fold since fiscal 2004.

### Table 2  
**Research In Motion’s Common Size Consolidated Statements of Operations, 2004 - 2008**

<table>
<thead>
<tr>
<th></th>
<th>For the year ended</th>
<th>March 2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>100.0%</td>
<td>100.0%</td>
</tr>
<tr>
<td>Cost of sales</td>
<td>48.7</td>
<td>45.4</td>
</tr>
<tr>
<td><strong>Expenses</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Research and development</td>
<td>6.0</td>
<td>7.8</td>
</tr>
<tr>
<td>Selling, marketing &amp; admin.</td>
<td>14.7</td>
<td>17.0</td>
</tr>
<tr>
<td>Amortization</td>
<td>1.8</td>
<td>2.5</td>
</tr>
<tr>
<td>Litigation</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Expenses Subtotal</td>
<td>22.5</td>
<td>28.0</td>
</tr>
<tr>
<td>Income before income taxes</td>
<td>30.1</td>
<td>28.3</td>
</tr>
<tr>
<td>Net Income</td>
<td>21.5</td>
<td>20.8</td>
</tr>
</tbody>
</table>

Calculated from case Exhibit 2.

However, analysis of case Exhibit 6 discloses that RIM’s R&D spending for the year ending March 1, 2008, which was almost $360 million, dropped to 6 per cent of sales and is down from a high of 10.5 per cent in 2004. This is less than half of what some of RIM’s largest competitors are spending on R&D as a percentage of sales (e.g. Microsoft spends 14 per cent, Motorola 12 per cent, etc.). More importantly, RIM’s R&D budget is very small in absolute numbers when compared to Nokia’s $8.2 billion, Microsoft’s $7.1 billion and Motorola’s $4.4 billion. While RIM is showing tremendous growth and profitability, it is up against some industry heavyweights that are poised to outspend RIM on product/service innovations. RIM is also currently short 2,100 R&D engineers of which 1,400 are in Yach’s software group, threatening to put the company even further behind.

The case stresses that R&D is the heart and soul of the organization and a key driver of internal growth. RIM’s intellectual property, patents, source codes and designers are all important resources. Other resources include RIM’s relationships with enterprise clients (over 100,000) and major network carriers (over 270 carrier partnerships in more than 110 countries). RIM also has deep partnerships with competitors through the BlackBerry Connect Licensing program and a strong ecosystem of program developers (e.g. Facebook and Guitar Hero III).
**Organization Capabilities.** The case also discusses how the R&D function at RIM is geographically concentrated, with Waterloo as a hub for core development activity and satellite offices, primarily in North America, working on product and technology customizations to the core platform. The organization is not currently structured to take on global expansion. The case alludes to some of the types of R&D expansions that RIM may consider, from simple “market-seeking” expansion of production (e.g. outsource the design and manufacturing of non-critical components) or processes (e.g. testing or documentation) to more complex international technology centers that collaborate with local universities and public research centers. If students have recommended that RIM should expand its locations in North America or globally, they should also discuss how the company should ensure cross-border coordination of its R&D activities.

If RIM goes global, they also need to consider whether they should build their own facilities abroad and hire their own people, or if they should acquire existing firms. The decision about if and how to go global will depend on the students’ understanding of the following:

- The significance of R&D relative to RIM’s success thus far; can RIM loosen its hold on BlackBerry’s source codes? What will this mean in terms of RIM’s value proposition? Its ability to remain competitive in the long run?
- The degree to which RIM may have areas of weakness in its home-based innovation system that can only be acquired by seeking complementary strengths outside of Waterloo.
- The extent of coordination needed to transfer the knowledge from the home base to the satellite locations; the potential threat of technology leakage, copyright infringement, etc.
- The trade-offs between the different types of R&D collaborations from satellite laboratories to contract R&D sites to more equal partnerships

**Management Preferences.** How ready is RIM to implement the strategic change required to compete in the global smartphone marketplace? The case provides several clues that management is reticent to expand outside of Waterloo and would prefer to keep all R&D in one central location. In terms of mindset, management is only now gaining an awareness of the need to change existing strategies.

**EPILOGUE**

As of April 2008, RIM had announced that it planned to maintain most of its core R&D in Ontario—Waterloo, Ottawa and Mississauga. Yach suggested that R&D are really two separate issues—research and development—and that RIM remained committed that the research should stay close to home, but is willing to look at moving the development to other locations. In parallel, RIM also announced the creation of a $45 million R&D center in Bochum, Germany, as a first step to penetrating the European market. In reality, Yach admitted that he will likely be pursuing all four options simultaneously and that he will be facing the same situation in January 2009.1

Continued growth factors at RIM include (as released in RIM’s Fiscal 2008 Annual Financial Information investor report, May 2008, and other press releases):

- In December 2007, RIM announced it was opening its U.S. headquarters in Irving, Texas
- In 2007, RIM added 80 new carrier and distribution channel relationships, increasing its partnerships to 350 carriers in 135 countries
- As of March 1, 2008, RIM’s R&D team consisted of approximately 2,900 employees; total employees had grown to 8,387

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1Canadian Business Leader Hall of Fame/Ivey Learning Summit, May 6, 2008, Toronto, Ontario
On May 12, 2008, RIM launched its new BlackBerry Bold Smartphone (its first in the 9000 series)

In December 2008, RIM’s total BlackBerry subscriber accounts had increased to 21 million. The company expected to add an additional 3.5 million subscribers by the end of its fiscal year in March 2009.

You can visit Research in Motion’s investor relations site at www.rim.com/investors to access its latest financial reports and press releases.
OVERVIEW

For more than a decade, adidas AG’s corporate strategy had been focused on making acquisitions that would allow it to surpass Nike as the leader of the global sporting goods industry. The company’s 1998 acquisition of French sporting goods manufacturer and marketer Salomon SA diversified it beyond footwear and apparel and into ski equipment, golf clubs, bicycle components, and winter sports apparel. The €1.5 billion acquisition allowed adidas to surpass Reebok to become the world's second largest sporting goods company with 1998 sales of nearly €5.1 billion. However, almost as soon as the deal was consummated, it looked doubtful that the acquisition would help adidas achieve its strategic intent of becoming the world’s largest seller of sporting goods. Chief concerns with the acquisition were the declining attractiveness of the winter sports industry and integration problems between the adidas footwear and apparel business and Salomon’s business units. Not until 2003, five years after the acquisition, had adidas’ earnings per share returned to the level that shareholders enjoyed in 1997. In addition, the company’s stock price failed to return to its 1998 trading range until 2004.

Adidas management divested all of Salomon’s winter sports and bicycle components brands in 2005 to Amer Sports Corporation for €485 million. The divestiture of Salomon’s winter sports and bicycle components business made TaylorMade Golf the lone business retained from the company’s 1998 acquisition of Salomon SA. Adidas management followed the divestiture of Salomon business units with the €3.1 billion acquisition of Reebok International Ltd. in 2006. In addition to Reebok branded athletic footwear and apparel, Reebok International also designed, marketed, and sold Rockport footwear, Greg Norman apparel, and CCM hockey equipment.

The Reebok acquisition increased the company’s revenues from €5.8 billion in 2005 to €10.1 (approximately $13.3 billion) in 2006 and brought it closer to Nike, which ended fiscal 2006 with total revenues of $14.9 billion. Adidas revenues had grown to €10.3 billion by year-end 2007 and adidas management expected that the Reebok acquisition would boost 2008 revenues by an additional €250 million. The integration of adidas and Reebok supply chain activities was expected to result in cost savings of €105 million by year-end 2008 and contribute to improvements in both the company’s gross margins and bottom line. However, Nike’s continued to hold a substantial lead over adidas in the United States athletic footwear market with a 36 percent market share compared to a combined 21 percent market share for adidas and Reebok branded footwear in 2008. Evidence seemed to mounting to support the thesis of New Balance CEO, Jim Davis, who upon hearing of adidas management’s latest round of corporate restructuring in 2005 and 2006 concluded “You can try to take on Nike, but…Nike is Nike and will continue to be Nike.”

SUGGESTIONS FOR USING THE CASE

This case can be used as either a first or second case in your module on corporate diversification strategies. The case teaches well because students have undoubtedly purchased adidas, Reebok, or Nike shoes or sportswear and may also own Salomon winter sports equipment or TaylorMade golf equipment. Class debate should center on why the Salomon SA acquisition failed to make adidas a stronger competitor to Nike and why the Reebok acquisition may or may not prove to be more successful. There is ample opportunity for students to consider
the competitive strength of adidas’ core athletic footwear and apparel business and evaluate the merit of its diversification strategy. The case provides adequate financial data for students to calculate the profitability and cash flow requirements for each of adidas’ business units. Students also have sufficient information to determine what type of strategic fit benefits existed within the business lineup in 2008. The strategic fit between adidas branded footwear and apparel and Reebok should be obvious to students. At the conclusion of their analyses, students should be able to relatively easily determine why the Salomon SA acquisition failed at providing greater returns to shareholders and why the Reebok acquisition may or may not prove to be more successful in building shareholder value. In addition, students should be able to propose recommendations to allow adidas to capitalize on its restructured portfolio and finally draw closer to Nike in terms of revenues and market share.

The assignment questions provided in the Student Edition of the Online Learning Center (OLC) are designed to introduce students to use of the tools and concepts in Chapter 8. The assignment questions lead students through the analysis provided in this teaching note. If you are requiring students use the assignment questions provided in the OLC to prepare for the discussion of the case, then you’ll want to remind them to bring the printout of their work to class to refer to in giving substantive, supportable answers to the questions you pose and shining in the class discussion.

You may also find the case suitable for use as a written assignment. Our suggestions for assignment questions are as follows:

1. Please evaluate adidas’ restructured line-up of sporting goods businesses. Your analysis should identify adidas’ corporate strategy, evaluate the attractiveness of the industries it has diversified into and the strength of each of its business units, and assess the degree to which strategic fit and resource fit exists in the portfolio. Also, please recommend an investment priority and strategic moves to improve overall corporate performance and increase shareholder value. Please limit your report to 5 – 6 pages.

2. Please prepare a 2–3 page executive summary of strategic recommendations to boost overall corporate performance and improve shareholder value at adidas. Your recommendations should include an investment priority for the businesses in the company’s portfolio as of 2008 and strategic actions to fully capture the benefits of its recent acquisition of Reebok. Please attach any analyses relied upon to reach your conclusions to your report. Please refer to Chapter 8 for a description of analytic tools utilized to evaluate diversified companies. Your supporting exhibits and executive summary of recommendations will be given equal weighting in your grade for the written assignment.

ASSIGNMENT QUESTIONS

1. What is adidas’ corporate strategy? Was there a common strategic approach utilized in managing the company’s lineup of sporting goods businesses prior to its 2005-2006 restructuring? Has the corporate strategy changed with restructuring?

2. What is your evaluation of adidas’ line-up of businesses in 2008? What does a 9-cell industry attractiveness/business strength matrix displaying adidas’ business units look like?

3. Does adidas’ business line-up exhibit good strategic fit? What value-chain match-ups exists? What opportunities for skills transfer, cost sharing, or brand sharing are evident? Prior to its divestiture, what kind of strategic fits existed between adidas’ core business and its Salomon business unit?

4. Has adidas’ business line-up exhibited good resource fit between 1998 and 2007? What have been the financial characteristics of its major business segments during that time period? Which businesses might have been considered cash hogs and cash cows?

5. Based on your analysis of adidas businesses, did the restructuring undertaken in 2005 and 2006 make sense? Does it appear the acquisition of Reebok International will produce higher returns for shareholders? What strategic actions should adidas’ top management initiate to improve the company’s financial and market performance now that restructuring is complete?
TEACHING OUTLINE AND ANALYSIS

1. **What is adidas' corporate strategy? Was there a common strategic approach utilized in managing the company's lineup of sporting goods businesses prior to its 2005 – 2006 restructuring? Has the corporate strategy changed with restructuring?**

   - **Adidas-Salomon’s corporate strategy (1998 – 2004):** Adidas had diversified into a mix of sporting goods businesses, most of which had branded apparel among the product line. The apparel and footwear businesses of adidas, Salomon and TaylorMade are clearly related businesses. However, students should conclude the product development, manufacturing and assembly, and distribution activities for Salomon and TaylorMade sporting goods equipment were unrelated to the value chain activities of the athletic footwear and apparel business. Also, the value chains for each equipment business (winter sports, bicycle rims, and golf clubs) were very dissimilar. Students should suggest the company pursued mostly unrelated diversification outside the apparel and footwear operations of each business.

   - **Adidas’ post-restructuring corporate strategy (Since 2005):** Students should be able to clearly see adidas’ restructured business lineup has focused the product line on athletic footwear and apparel and golf equipment. The acquisition of Reebok also added hockey equipment and Rockport footwear, but these businesses make up a relatively minor part of Reebok International’s revenues. Students might conclude that even though the value chains of TaylorMade and CCM hockey equipment are dissimilar to that of adidas’ footwear and apparel businesses, the company’s corporate strategy after 2008 is best described as primarily related diversification.

2. **What is your evaluation of adidas' line-up of businesses in 2008? What does a 9-cell industry attractiveness/business strength matrix displaying adidas' business units look like?**

To draw a 9-cell industry attractiveness/business strength matrix for adidas using rigorous methodology, students really need to do industry attractiveness ratings for each of the industries in which adidas competes and do competitive strength ratings for each of its business units. These ratings should then be used to plot the location of the bubbles on the 9-cell grid. Otherwise, students end up locating the bubbles on the basis of “judgment,” which may or may not match up well with a well-done set of ratings. To encourage students to practice applying the tools and concepts in Chapter 8 when preparing a case, we suggest spending class time here to go through the development of industry attractiveness ratings and business strength ratings and then using these ratings to draw the 9-cell matrix. However, if time is tight you can resort to the judgment approach. Table 1 of this note shows our industry attractiveness ratings and Table 2 presents our business strength ratings. Figure 1 shows a 9-cell GE-style matrix where the location of the bubbles is based on the industry attractiveness and business strength ratings shown in Tables 1 and 2.

There’s ample room for judgmental differences regarding selection of the factors, the weights, and the ratings used to draw a 9-cell GE matrix depicting adidas’ portfolio. So you should expect that student opinions will vary and the matrices they come up with will vary. Students will be required to use judgment in evaluating the attractiveness of some of the industries in which adidas participates, but there should be little disagreement that athletic footwear and apparel and golf equipment rank as its most attractive industries. Students should conclude from case data that hockey equipment and casual men’s footwear have only a modest level of attractiveness because of small market size and slow growth, low profitability, few emerging opportunities, and limited potential for product innovation.

It’s quite clear from the case that adidas possessed considerable strength in its core athletic footwear and apparel business in every market outside North America, but neither adidas nor Reebok were serious challengers to Nike in the United States or other markets in North America. Students should note that in 2008 the combined market shares of Reebok and adidas were 15 points less than Nike’s 36% market share.
in North America. However, adidas was quite strong in Europe, Latin America, and Asia—making it a respectable worldwide runner-up to Nike. Similarly, students should find that TaylorMade-adidas Golf had a great deal of business strength, which was also the case for CCM/Rbk hockey. Students should recognize that Rockport held only a moderate amount of competitive strength in the casual men’s footwear industry.

Students should be able to prepare a 9-cell matrix similar to what is presented in Figure 1 after making appropriate industry attractiveness and business strength calculations. Students who have developed ratings similar to those shown in Tables 1 and 2 should agree the company’s core adidas athletic footwear and apparel business and its TaylorMade-adidas Golf business unmistakably fall into the “grow and build” category and calls for high investment priorities. The CCM/Rbk hockey business also falls into the “grow and build” category, but most likely requires little additional investment because of the limited opportunities for innovation in the industry and the slow growth nature of the industry. The placement of Reebok will vary on students’ industry attractiveness/business strength matrices, with some students categorizing the business as a “grow and build” business, while others have it placed as a business warranting a medium investment priority. There should be a little disagreement among the class that Rockport merits no better than a medium investment priority.

### Table 1  Industry Attractiveness Assessment for adidas’ Businesses

*(Scale 1 = very low attractiveness, 5 = average attractiveness, 10 = very strong attractiveness)*

<table>
<thead>
<tr>
<th>Attractiveness Measure</th>
<th>Weight</th>
<th>Athletic Footwear &amp; Apparel</th>
<th>Golf Equipment</th>
<th>Casual Men’s Footwear</th>
<th>Hockey Equipment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market size and growth rate</td>
<td>0.20</td>
<td>7/1.4</td>
<td>4/0.8</td>
<td>4/0.8</td>
<td>2/0.8</td>
</tr>
<tr>
<td>Industry profitability</td>
<td>0.25</td>
<td>5/1.25</td>
<td>5/1.25</td>
<td>5/1.25</td>
<td>5/1.25</td>
</tr>
<tr>
<td>Intensity of competition</td>
<td>0.15</td>
<td>5/0.75</td>
<td>6/0.9</td>
<td>4/0.6</td>
<td>10/1.5</td>
</tr>
<tr>
<td>Emerging opportunities and threats</td>
<td>0.05</td>
<td>6/0.3</td>
<td>7/0.35</td>
<td>4/0.2</td>
<td>4/0.2</td>
</tr>
<tr>
<td>Resource requirements</td>
<td>0.10</td>
<td>8/0.8</td>
<td>7/0.7</td>
<td>8/0.8</td>
<td>6/0.6</td>
</tr>
<tr>
<td>Product innovation</td>
<td>0.20</td>
<td>9/1.8</td>
<td>10/2.0</td>
<td>5/1.0</td>
<td>4/0.8</td>
</tr>
<tr>
<td>Social, political, environmental, factors</td>
<td>0.05</td>
<td>9/0.45</td>
<td>9/0.45</td>
<td>9/0.45</td>
<td>9/0.45</td>
</tr>
<tr>
<td>Totals</td>
<td>1.00</td>
<td>6.75</td>
<td>6.45</td>
<td>5.1</td>
<td>5.6</td>
</tr>
</tbody>
</table>

### Table 2  Competitive Position/Business Strength Calculations for adidas’ Business Units

*(Scale 1 = very weak, 5 = average, 10 = very strong)*

<table>
<thead>
<tr>
<th>Strength Measures</th>
<th>Weight</th>
<th>adidas</th>
<th>Reebok</th>
<th>TaylorMade-adidas Golf</th>
<th>Rockport</th>
<th>CCM/Rbk Hockey</th>
</tr>
</thead>
<tbody>
<tr>
<td>Relative market share</td>
<td>0.20</td>
<td>6/1.2</td>
<td>4/0.8</td>
<td>8/1.6</td>
<td>2/0.4</td>
<td>10/2.0</td>
</tr>
<tr>
<td>Marketing and promotion</td>
<td>0.25</td>
<td>8/2.0</td>
<td>6/1.5</td>
<td>10/2.5</td>
<td>2/5</td>
<td>6/1.5</td>
</tr>
<tr>
<td>Product innovation capabilities</td>
<td>0.15</td>
<td>9/1.35</td>
<td>7/1.05</td>
<td>9/1.35</td>
<td>7/1.05</td>
<td>6/9</td>
</tr>
<tr>
<td>Distribution capabilities</td>
<td>0.10</td>
<td>9/0.9</td>
<td>7/0.7</td>
<td>10/1.0</td>
<td>6/6</td>
<td>6/6</td>
</tr>
<tr>
<td>How well resources are matched to industry KSFs</td>
<td>0.10</td>
<td>10/1.0</td>
<td>10/1.0</td>
<td>10/1.0</td>
<td>8/0.8</td>
<td>10/1.0</td>
</tr>
<tr>
<td>Brand name recognition/image</td>
<td>0.20</td>
<td>8/1.6</td>
<td>6/1.2</td>
<td>10/2.0</td>
<td>7/1.4</td>
<td>10/2.0</td>
</tr>
<tr>
<td>Totals</td>
<td>1.00</td>
<td>8.05</td>
<td>6.25</td>
<td>9.45</td>
<td>4.75</td>
<td>8.0</td>
</tr>
</tbody>
</table>
3. Does adidas’ business line-up exhibit good strategic fit? What value-chain match-ups exists? What opportunities for skills transfer, cost sharing, or brand sharing are evident? Prior to its divestiture, what kind of strategic fits existed between adidas’ core business and its Salomon business unit?

Students will have little trouble understanding the strategic fit opportunities between adidas and Reebok branded athletic footwear and apparel. The two brands have opportunities to share product development activities, contract manufacturing relationships, and international distribution channels. Students should also note strategic fit opportunities existing between Rockport and adidas’ athletic footwear in product design, production, and distribution. Similar types of strategic fits exists between all of adidas’ apparel businesses—adidas, Rbk, adidas Golf, and Ashworth. The image building, sales, and marketing activities of all businesses are very similar and offered considerable skills transfer benefits across the company.

Students should also note there were few strategic fit opportunities in purchasing, product development, or manufacturing between adidas’ apparel and footwear businesses and its sports equipment businesses (golf clubs and hockey equipment). In addition, there seems was little opportunity to capture synergistic benefits between these sports hardware businesses. The purchasing, product design, and production activities for hockey equipment and golf equipment are undoubtedly very dissimilar. There does seem to be good strategic fit in distribution and sales and marketing between golf equipment and golf apparel and between hockey equipment, hockey skates, and hockey apparel. Students will agree brand sharing opportunities existed for TaylorMade golf equipment, adidas branded golf apparel and footwear, and Ashworth golf apparel. Similarly, the customer service activities of these business groups could respond to retailer queries concerning equipment or apparel. However, it seems adidas would have great difficulty combining customer service activities for businesses with no common retailers (i.e. men’s casual footwear, hockey equipment retailers, golf equipment retailers, and traditional sporting goods retailers). Figure 2 presents a matrix of potential strategic fit benefits existing within the portfolio.

Regarding strategic fit between adidas’ core athletic apparel and footwear business and the divested Salomon winter sports business, students should note that few potential strategic fits existed. The greatest opportunities...
to share costs or transfer skills between the business units were related to apparel design and manufacturing. It’s likely that many of the technological innovations developed in adidas’ athletic apparel business might benefit its ski apparel business. Similarly, adidas was likely able to use common contract manufacturers to produce both athletic apparel and ski apparel. There’s little evidence of strategic fits in other segments of the adidas and Salomon value chains.

**Figure 2** Assessment of Strategic Fit Potentials Between Adidas’ Business Units

<table>
<thead>
<tr>
<th>Business Unit</th>
<th>Purchasing</th>
<th>Manufacturing</th>
<th>Distribution</th>
<th>Sales &amp; Marketing</th>
<th>Customer Service</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sports Footwear</td>
<td>CS and economies of scope in purchases of all footwear materials</td>
<td>Shared contract manufacturing and ST with all footwear brands</td>
<td>CS/ST with sports apparel and hockey, apparel, skates, and equipment/ST with golf equipment</td>
<td>Image building ST with all businesses/ Potential brand sharing with all businesses except Rockport and TaylorMade golf equipment</td>
<td>CS/ST with all apparel and footwear business using common retailers</td>
</tr>
<tr>
<td>Sports Apparel</td>
<td>CS and economies of scope in purchases of all apparel materials</td>
<td>Shared contract manufacturing and ST all apparel brands</td>
<td>CS/ST with sports apparel and hockey apparel, skates, and equipment/ST with golf equipment</td>
<td>Image building ST with all businesses/ Potential brand sharing with all businesses except Rockport and TaylorMade golf equipment</td>
<td>CS/ST with all apparel and footwear business using common retailers</td>
</tr>
<tr>
<td>Golf Equipment</td>
<td>None</td>
<td>None</td>
<td>CS/ST with golf apparel and footwear/ST with other businesses</td>
<td>Image building ST with all businesses</td>
<td>CS/ST with golf apparel &amp; footwear business</td>
</tr>
<tr>
<td>Golf Apparel &amp; Footwear</td>
<td>CS and economies of scope in purchases of all footwear and apparel materials</td>
<td>Shared contract manufacturing and ST with all footwear and apparel brands</td>
<td>CS/ST with golf equipment/ST with other businesses</td>
<td>Image building ST with all businesses/ Brand sharing with adidas apparel &amp; footwear</td>
<td>CS/ST with all apparel and footwear business using common retailers</td>
</tr>
<tr>
<td>Hockey equipment, skates, and apparel</td>
<td>CS and economies of scope in purchases of footwear and apparel materials No CS between hockey equipment and other adidas product categories</td>
<td>CS between Rbk hockey apparel and other adidas apparel brands Limited CS between CCM skates and other footwear brands No CS between hockey equipment and other adidas product categories</td>
<td>CS/ST with sports apparel, and footwear/ST with golf equipment</td>
<td>Image building ST with all businesses/ Brand sharing with Reebok apparel and footwear</td>
<td>CS/ST with all apparel and footwear business using common retailers</td>
</tr>
<tr>
<td>Men’s Casual Footwear</td>
<td>CS and economies of scope in purchases of all footwear materials</td>
<td>Shared contract manufacturing and ST with all footwear brands</td>
<td>ST with all footwear brands/ Some cost sharing where Reebok, adidas, and Rockport utilize common retailers</td>
<td>Image building ST with all businesses</td>
<td>CS/ST with all apparel and footwear business using common retailers</td>
</tr>
</tbody>
</table>
4. Has adidas’ business line-up exhibited good resource fit between 1998 and 2007? What have been the financial characteristics of its major business segments during that time period? Which businesses might have been considered cash hogs and cash cows?

Students who have made calculations similar to those shown in Table 3 will note that adidas’ gross margins, operating profit margins, and net profit margins have all declined since its restructuring began in 2005. The company’s current ratios for 2006 and 2007 seem to indicate that adidas has ample liquidity, but students should note that accounts receivable and inventories made up 77% and 74.6% of its current assets in 2006 and 2007, respectively. Students should also comment on the company’s rather unimpressive inventory turns of 3.5 and 3.3 in 2006 and 2007, respectively.

Students should have little trouble determining that the adidas athletic footwear and apparel and TaylorMade Golf are the financial strength of the portfolio. The operating profit margins of both business units during 1998 - 2004 exceeded that of the Salomon business unit in each year except 2000 and 2001—see Table 4. In addition, the operating profits as a percentage of operating assets for the adidas unit and TaylorMade unit were much better than that of Salomon in all years between 1998 and 2004. You should expect for students to note that with the exception of Salomon’s performance in 2004, Reebok’s operating profit margins are no more attractive than those recorded by Salomon. The financial ratios shown in Table 5 provide further evidence that neither Salomon nor Reebok are strong resource contributors to adidas. In fact, students may likely suggest that Reebok’s poor performance is largely responsible for the company’s overall decline in profit margins since 2005.

Students who make calculations such as those shown in Table 6 will note that adidas’ core athletic footwear and apparel business is a cash cow with estimated cash flows €874 million in 2007 and €744 million in 2006. The division’s cash flows have been quite impressive in every year between 1998 and 2007. TaylorMade also had a positive estimated cash flow each year, but its operating profits and cash flows are quite small relative to the core business. Like TaylorMade, the operating profits and estimated cash flows of the Salomon business unit were weak in comparison to the core business. In addition, the Salomon unit had an estimated cash flow shortfall €18 million in 2004. Reebok provides much more acceptable cash flows than what was provided by Salomon, but similarly fails to match the adidas business unit in terms of operating cash flows.

After reviewing adidas’ financial performance, students should find it difficult to argue that adidas’ acquisition of Salomon and its subsequent restructuring and acquisition of Reebok have improved the company’s capability to deliver increases in shareholder value.

Table 3  Selected Financial Ratios for Adidas, 1998 – 2007

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</thead>
<tbody>
<tr>
<td>Gross Profit Margin</td>
<td>47.4%</td>
<td>44.6%</td>
<td>48.2%</td>
<td>48.0%</td>
<td>44.9%</td>
<td>43.2%</td>
<td>42.6%</td>
<td>43.3%</td>
<td>43.9%</td>
<td>41.9%</td>
</tr>
<tr>
<td>Operating Profit Margin</td>
<td>9.2%</td>
<td>8.7%</td>
<td>10.7%</td>
<td>10.0%</td>
<td>7.8%</td>
<td>7.3%</td>
<td>7.8%</td>
<td>7.5%</td>
<td>9.0%</td>
<td>8.2%</td>
</tr>
<tr>
<td>Net Profit Margin</td>
<td>5.4%</td>
<td>4.8%</td>
<td>6.4%</td>
<td>5.6%</td>
<td>4.1%</td>
<td>3.5%</td>
<td>3.4%</td>
<td>3.1%</td>
<td>4.2%</td>
<td>4.0%</td>
</tr>
<tr>
<td>Return on Assets</td>
<td>6.6%</td>
<td>5.8%</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Return on Equity</td>
<td>18.2%</td>
<td>17.1%</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Debt to Assets</td>
<td>25.8%</td>
<td>30.8%</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Current Ratio</td>
<td>1.7</td>
<td>1.8</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Inventory Turnover</td>
<td>3.3</td>
<td>3.5</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
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N/A Not available.
Calculated from case Exhibits 1 and 3.
### Table 4 Operating Profit Margins by Adidas Business Segment, 1998 – 2007

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</tr>
</thead>
<tbody>
<tr>
<td>Adidas</td>
<td>12.9%</td>
<td>11.9%</td>
<td>11.8%</td>
<td>10.9%</td>
<td>7.4%</td>
<td>6.7%</td>
<td>7.3%</td>
<td>8.4%</td>
<td>9.7%</td>
<td>9.5%</td>
</tr>
<tr>
<td>Reebok</td>
<td>4.7%</td>
<td>3.5%</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>TaylorMade-adidas Golf</td>
<td>8.1%</td>
<td>8.5%</td>
<td>7.1%</td>
<td>7.6%</td>
<td>10.5%</td>
<td>10.5%</td>
<td>11.6%</td>
<td>10.0%</td>
<td>9.2%</td>
<td>7.6%</td>
</tr>
<tr>
<td>Salomon</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>1.4%</td>
<td>5.3%</td>
<td>5.7%</td>
<td>8.8%</td>
<td>8.7%</td>
<td>5.5%</td>
<td>1.2%</td>
</tr>
</tbody>
</table>

Calculated from case Exhibit 5.

### Table 5 Operating Profit as a Percentage of Operating Assets for Adidas’ Business Segments, 1998 – 2007

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</thead>
<tbody>
<tr>
<td>Adidas</td>
<td>27.6%</td>
<td>24.5%</td>
<td>27.4%</td>
<td>27.0%</td>
<td>16.8%</td>
<td>15.0%</td>
<td>18.0%</td>
<td>17.1%</td>
<td>21.7%</td>
<td>23.8%</td>
</tr>
<tr>
<td>Reebok</td>
<td>3.7%</td>
<td>2.7%</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>TaylorMade-adidas Golf</td>
<td>10.3%</td>
<td>11.1%</td>
<td>7.2%</td>
<td>7.8%</td>
<td>17.1%</td>
<td>17.1%</td>
<td>19.9%</td>
<td>20.1%</td>
<td>19.2%</td>
<td>20.2%</td>
</tr>
<tr>
<td>Salomon</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>1.8%</td>
<td>6.7%</td>
<td>6.7%</td>
<td>9.3%</td>
<td>10.8%</td>
<td>6.0%</td>
<td>1.0%</td>
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Calculated from case Exhibit 5.

### Table 6 Estimated Cash Flow For Adidas’ Business Units, 1998 - 2007

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</thead>
<tbody>
<tr>
<td>Adidas</td>
<td>€ 920</td>
<td>€ 788</td>
<td>€ 693</td>
<td>€ 564</td>
<td>€ 365</td>
<td>€ 343</td>
<td>€ 352</td>
<td>€ 391</td>
<td>€ 431</td>
<td>€ 412</td>
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<tr>
<td>+ Amortization and depreciation</td>
<td>104</td>
<td>91</td>
<td>69</td>
<td>56</td>
<td>56</td>
<td>63</td>
<td>57</td>
<td>52</td>
<td>45</td>
<td>48</td>
</tr>
<tr>
<td>- Capital expenditures</td>
<td>150</td>
<td>135</td>
<td>138</td>
<td>85</td>
<td>63</td>
<td>84</td>
<td>113</td>
<td>93</td>
<td>105</td>
<td>102</td>
</tr>
<tr>
<td>Estimated Cash Flow</td>
<td>€ 874</td>
<td>€ 744</td>
<td>€ 624</td>
<td>€ 535</td>
<td>€ 358</td>
<td>€ 322</td>
<td>€ 296</td>
<td>€ 350</td>
<td>€ 371</td>
<td>€ 358</td>
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</thead>
<tbody>
<tr>
<td>Reebok</td>
<td>€ 109</td>
<td>€ 86</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>+ Amortization and depreciation</td>
<td>60</td>
<td>53</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
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</tr>
<tr>
<td>- Capital expenditures</td>
<td>57</td>
<td>72</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
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</tr>
<tr>
<td>Estimated Cash Flow</td>
<td>€ 112</td>
<td>€ 67</td>
<td>--</td>
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</thead>
<tbody>
<tr>
<td>TaylorMade-adidas Golf</td>
<td>€ 65</td>
<td>€ 73</td>
<td>€ 50</td>
<td>€ 48</td>
<td>€ 67</td>
<td>€ 74</td>
<td>€ 63</td>
<td>€ 44</td>
<td>€ 30</td>
<td>€ 20</td>
</tr>
<tr>
<td>+ Amortization and depreciation</td>
<td>12</td>
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<td>13</td>
<td>11</td>
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<td>7</td>
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<td>4</td>
<td>2</td>
</tr>
<tr>
<td>- Capital expenditures</td>
<td>12</td>
<td>13</td>
<td>17</td>
<td>9</td>
<td>12</td>
<td>49</td>
<td>16</td>
<td>12</td>
<td>10</td>
<td>16</td>
</tr>
<tr>
<td>Estimated Cash Flow</td>
<td>€ 65</td>
<td>€ 73</td>
<td>€ 46</td>
<td>€ 50</td>
<td>€ 64</td>
<td>€ 32</td>
<td>€ 53</td>
<td>€ 36</td>
<td>€ 24</td>
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</thead>
<tbody>
<tr>
<td>Salomon</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>€ 9</td>
<td>€ 35</td>
<td>€ 39</td>
<td>€ 63</td>
<td>€ 61</td>
<td>€ 32</td>
<td>€ 6</td>
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<tr>
<td>+ Amortization and depreciation</td>
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<td>7</td>
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<td>7</td>
<td>7</td>
<td>5</td>
<td>7</td>
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</tr>
<tr>
<td>- Capital expenditures</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>34</td>
<td>34</td>
<td>34</td>
<td>34</td>
<td>34</td>
<td>34</td>
<td>34</td>
</tr>
<tr>
<td>Estimated Cash Flow</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>(€ 18)</td>
<td>€ 8</td>
<td>€ 12</td>
<td>€ 36</td>
<td>€ 34</td>
<td>€ 3</td>
<td>(€ 21)</td>
</tr>
</tbody>
</table>

Calculated from case Exhibit 5.
5. Based on your analysis of adidas businesses, did the restructuring undertaken in 2005 and 2006 make sense? Does it appear the acquisition of Reebok International will produce higher returns for shareholders? What strategic actions should adidas' top management initiate to improve the company's financial and market performance now that restructuring is complete?

Students will likely applaud the divestiture of the Salomon winter sports and Mavic bicycle components businesses from adidas’ business line-up. The two businesses offered little strategic fit beyond what was possible in apparel and was a drag on earnings. There may be doubts among members of the class concerning the ability of the Reebok International acquisition to improve the company’s poor performance in the North American marketplace for athletic footwear. Even though the addition of Reebok branded footwear gave the company a combined market share of approximately 21% in North America, there was little evidence that the acquisition helped adidas close the competitive gap with Nike. The Reebok acquisition was intended to address the company’s weakness in the men’s basketball category of the North American athletic footwear market, but students should note that Reebok was no stronger in the basketball category than adidas. Some students will suggest that Reebok’s strength in footwear markets focused on beginning runners and women’s casual shoes contributed to its low profit margins because of the likely strong price competition in those segments.

Students may struggle with recommendations to allow adidas/Reebok to match Nike’s 36% market share in North America. Some students will suggest that the company’s intended strategy of positioning adidas as a technology leader and Reebok at lower price points seems to be on the mark, but most will understand that strategies to increased sales in international markets are more likely to produce overall sales gains. To support growth in international markets, student should argue forcefully for the expansion of company-owned retail stores in Latin America, Eastern Europe, and Asia.

Students should also recommend that the company work diligently to capture expected cost-sharing benefits between adidas and Reebok operations of €105 million. Integration efforts should also apply to Rockport, CCM/Rbk Hockey, and Ashworth business units. Also, attention must be paid to blending the two companies’ distinctly different cultures and leadership styles. Some students will suggest there is merit to beginning a search for a buyer for Rockport and Reebok’s hockey businesses.

The company must also give TaylorMade Golf adequate investments to maintain technological leadership in the golf equipment industry. Innovation is a strength of the business and must remain a central element of its strategic approach to competition. The company must also move to capture strategic fit opportunities existing between adidas Golf apparel and Ashworth apparel operations. Students may recommend that adidas management continue its exit from the golf ball segment of the golf equipment industry with the divestiture of Noodle and Maxfli TP Red and TP Black golf balls.

Students should also recommend that adidas strengthen its balance sheet by reducing outstanding long-term net borrowings and inventory. A reduction in inventory would free up additional capital to make strategic investments necessary to close the gap with industry leader Nike.

EPILOGUE

There was no new company news or financial results available at the time this note went to press. You can visit adidas’ investor relations site at www.adidas-group.com to access its latest financial reports and press releases.

OVERVIEW

PepsiCo was the world’s largest snack and beverage company with 2007 net revenues of approximately $39.5 billion. The company’s portfolio of businesses in 2008 included Frito-Lay salty snacks, Quaker Chewy granola bars, Pepsi soft drink products, Tropicana orange juice, Lipton Brisk tea, Gatorade, Propel, SoBe, Quaker Oatmeal, Cap’n Crunch, Aquafina, Rice-A-Roni, Aunt Jemima pancake mix, and many other regularly consumed products. Gatorade, Propel, Rice-A-Roni, Aunt Jemima, and Quaker Oats products were added to PepsiCo’s arsenal of brands through the $13.9 billion acquisition of Quaker Oats in 2001. The acquisition was the final component of a major portfolio restructuring initiative that began in 1997. Since the restructuring, the company had increased revenues and net income at annual rates of 7 percent and 12 percent respectively.

Through 2007, the company’s top managers were focused on sustaining the impressive performance that had been achieved since its restructuring through strategies keyed to product innovation, close relationships with distribution allies, international expansion, and strategic acquisitions. Newly introduced products such as Gatorade G2, Tiger Woods signature sports drinks, and Quaker Simple Harvest Multigrain Hot Cereal had accounted for 15%-20% of all new growth in recent years. New product innovations that addressed consumer health and wellness concerns were the greatest contributors to the company’s growth with PepsiCo’s better-for-you and good-for-you products accounting for 16 percent of its 2007 snack sales in North America, 70 percent of net beverage revenues in North America during 2007, and more than 50 percent of its 2007 sales of Quaker Oats products in North America. The company also increased the percentage of healthy snacks in markets outside North America since consumers in most developed countries wished to reduce their consumption of saturated fats, cholesterol, trans fats, and simple carbohydrates.

The company’s Power of One retailer alliance strategy had been in effect for more than 10 years and was continuing to help boost PepsiCo’s volume and identify new product formulations desired by consumers. Under the Power of One strategy, PepsiCo marketers and retailers collaborated in stores and during offsite summits to devise tactics to increase consumers’ tendency to purchase more than one product offered by PepsiCo during a store visit. In addition, some of PepsiCo’s most successful new products had been recommended by retailers.

PepsiCo’s international sales had grown by 22 percent during 2007, but the company had many additional opportunities to increase sales in markets outside North America. The company held large market shares in many international markets for beverages and salty snacks, but it had been relatively unsuccessful in making Quaker branded products available outside the United States. In 2006, 75% of Quaker Oats’ international sales of $500 million was accounted for by just six countries. In addition, PepsiCo’s international operations were much less profitable than its businesses operating in North America. While, the operating profit margins of PepsiCo’s international division had ranged from 13.4 percent to 15.6 percent between 2004 and 2007, operating profit margins for its Frito-Lay and North American beverage business ranged from 21.3 percent to 25 percent during the same time period. Quaker Foods’ sales of Cap’n Crunch, Life cereal, Quaker oatmeal, Chewy granola bars, Aunt Jemima, and Rice-A-Roni produced the highest profit margins among all PepsiCo brands with operating profits exceeding 30 percent each year between 2004 and 2007.
PepsiCo management developed a new organizational structure in 2008 to address the low relative profitability of its international operations and to produce even faster growth in international markets. The new structure that would place all brands sold in the United Kingdom, Europe, Asia, the Middle East and Africa into a common division was expected to aid the company in its ability to capture strategic fits between its various brands and products. It was also quite possible that PepsiCo management needed to consider restructuring its lineup of snack and beverage businesses to improve overall profitability and reverse the downturn in its stock price which began in 2008.

**SUGGESTIONS FOR USING THE CASE**

This case is ideal for opening the module on corporate diversification strategies. The case teaches well because students likely purchase the company’s products on a regular basis. Class debate should center on whether PepsiCo’s diversification strategy has contributed to increased shareholder value. Analysis of the case data will lead students to conclude that PepsiCo’s top managers have built a fine collection of businesses capable of delivering impressive earnings and cash flows. Students will be recognize the success PepsiCo management has achieved in exploiting strategic fit opportunities across business units, acquiring new businesses to strengthen the overall quality of its business line up, and increasing revenues and earnings in international markets. The issue in 2008 is how PepsiCo management should best deploy the company’s operating cash flows to support further growth in revenues, earnings, and shareholder value. An additional issue for students to consider is whether the addition of all the Quaker brands has enhanced PepsiCo’s competitive strength, proven to have good strategic and resource fit, and helped boost PepsiCo’s overall performance.

The case contains ample data for students to prepare a 9-cell industry attractiveness/business strength matrix and to go through the steps of analyzing a diversified company’s business portfolio that are described in Chapter 8. Following their analysis of industry attractiveness and business strengths, students are able to analyze opportunities for economies of scope, cost-sharing and skills transfer across businesses, and examine the cash flow requirements of the businesses included in the portfolio. Students will need to make recommendations regarding what actions PepsiCo management should take to sustain the company’s growth and how it should best utilize its free cash flows. Student recommendations should also include actions to improve strategic fit, improve the overall healthiness of PepsiCo’s snacks and beverages, and further internationalize Gatorade and Quaker Oats brands.

The assignment questions provided in the Student Edition of the Online Learning Center (OLC) are designed to introduce students to use of the tools and concepts in Chapter 8. Students are called on to assess the attractiveness of such food and beverage industries as soft drinks, bottled water, ready to drink teas and coffees, snack foods, chilled juices, isotonic beverages, grain based snacks, flavored grains, ready to eat and hot cereals, and other breakfast foods. Students will also be required to evaluate the competitive strength of PepsiCo’s various business units. The assignment questions require students to construct an attractiveness/strength matrix and consider the strategic fits and resource fits among its businesses. These analytical steps, along with their assessment of PepsiCo’s financial performance, puts students in good position to develop solid recommendations of what PepsiCo’s new top management team should do to sustain the company’s stellar corporate performance.

You’ll find that this case works well for oral team presentations and for a written assignment outside of class. Our suggested assignment questions are

1. Indra Nooyi has employed you as a consultant to assess PepsiCo’s diversified business portfolio in 2008 and to make recommendations as to what actions PepsiCo’s top management team should now take to increase shareholder value to new highs. Your report should contain a 2-3 page executive summary of your recommendations, which are fully supported by the use the concepts and analytical tools presented in Chapter 8. Supplement your executive summary with additional charts and tables as needed to support your analysis and recommendations. It is strongly suggested that you follow the analytical steps covered in Chapter 8 in developing your paper. Your supporting exhibits and executive summary of recommendations will be given equal weighting in your grade for the written assignment.
2. What is your evaluation of PepsiCo’s lineup of businesses? Has the company diversified into attractive industries? What is the competitive strength of its business units? Do they have adequate strategic and resource fit to contribute to increases in shareholder value? How should PepsiCo management best allocate management operating cash flows? Should the company consider new acquisitions? Do some of the Quaker brands need to be divested? What other corporate strategies would you recommend to PepsiCo management? Please develop a 5-6 page report to PepsiCo management detailing your analysis and action recommendations.

ASSIGNMENT QUESTIONS

1. What is PepsiCo’s corporate strategy? Briefly identify the business strategies that PepsiCo is using in each of its consumer business segments in 2008.

2. What is your assessment of the long-term attractiveness of the industries represented in PepsiCo’s business portfolio?

3. What is your assessment of the competitive strength of PepsiCo’s different business units?

4. What does a 9-cell industry attractiveness/business strength matrix displaying PepsiCo’s business units look like?

5. Does PepsiCo’s portfolio exhibit good strategic fit? What value-chain match-ups do you see? What opportunities for skills transfer, cost sharing, or brand sharing do you see?

6. Does PepsiCo’s portfolio exhibit good resource fit? What are the cash flow characteristics of each of PepsiCo’s four segments? Which businesses are the strongest contributors to PepsiCo’s free cash flows?

7. Based on the preceding analysis, what is your overall evaluation of PepsiCo’s business portfolio in 2008? Does the portfolio provide the company’s shareholders with an opportunity for above-average market returns?

8. What strategic actions should Indra Nooyi take to sustain the corporation’s impressive financial and market performance? Should its free cash flows be used to fund additional share repurchase plans, pay higher dividends, make acquisitions, expand internationally, or for other purposes? What other strategic actions should be pursued by corporate level management?

TEACHING OUTLINE AND ANALYSIS

1. What is PepsiCo’s corporate strategy? Briefly identify the business strategies that PepsiCo is using in each of its consumer business segments in 2008.

PepsiCo’s corporate strategy.

- Basic approach: related diversification

- The businesses are all concerned with consumer foods and beverages and share key success factors: branding, importance of advertising, new product development, operating efficiencies, and strong distribution.

- Capture cost-sharing benefits among the business units where possible.

- Power of One strategy that enlists retail partners in developing new products, identifying inefficiencies, and creating promotions.
Common Aspects of Business Strategy among PepsiCo’s Divisions. All of PepsiCo’s businesses compete on the basis of product differentiation and are attempting to build a differentiation-based competitive advantage. For the most part, the differentiation is keyed to product features, image and reputation, heavy advertising and promotion, and new product development. Key among PepsiCo’s product development efforts in all of its business units in 2008 was the development of better-for-you (BFY) and good-for-you (GFY) products.

2. What is your assessment of the long-term attractiveness of the industries represented in PepsiCo’s business portfolio?

It is important to recognize that, with the exception of a few Quaker products, PepsiCo has diversified into convenience food and beverage industries rather than the broader processed foods industry. Students may suggest that snacks and beverages offer more growth potential and are more profitable than the overall food and beverage industry based upon the case discussion of the snack food and beverage industries. Students will comment that some food and beverage categories that are represented in PepsiCo’s portfolio have outstanding growth rates. Students can calculate the growth rates of the various segments of the U.S. beverage industry by examining the volume data provided in case Exhibit 8. Food and beverage categories students are most likely to rate as highly attractive include almost all snack categories, carbonated soft drinks (because of the industry’s size), bottled water, ready to drink tea, chilled juices, and isotonic beverages. Product categories likely to be rated as moderately attractive include flavored grains, ready to drink coffees, hot cereals, and other breakfast products. Some students may rate flavored grains, ready-to-eat cereals, other breakfast products, and hot cereals as unattractive because of industry maturity, but these categories have some appealing characteristics—strategic fit with other PepsiCo/Quaker products and exceptionally high profit margins. Table 1 presents our industry attractiveness ratings for each industry that PepsiCo has diversified into.

3. What is your assessment of the competitive strength of PepsiCo’s different business units?

Students will have little trouble determining that PepsiCo has done an exceptional job of building a lineup of businesses with strong competitive positions in their respective industries. The company holds number one market shares in almost every convenience food and beverage category while Pepsi Cola trails only Coca-Cola in soft drink market share.

You may wish to point out that all businesses have built much of their strength on their product innovation skills and marketing and promotion expertise and that PepsiCo’s marketing-related success has provided the company with worldwide name recognition for most of its businesses and products. The company has added to its competitive strength by developing better-for-you (BFY) and good-for-you (GFY) snacks and beverages. In almost every business unit, PepsiCo’s BFY and GFY products were growing at faster than industry average rates and were accounting for a growing percentage of division sales. PepsiCo also has very good worldwide distribution capabilities in all of its businesses even though its Quaker brands have yet to expand outside the U.S. and Canada to a meaningful degree. Table 2 presents our competitive strength calculations for PepsiCo’s major business units.
### Table 1  Industry Attractiveness Assessment for PepsiCo’s Businesses

(Scale 1 = very low attractiveness, 5 = average attractiveness, 10 = very strong attractiveness)

<table>
<thead>
<tr>
<th>Attractiveness Measure</th>
<th>Unweighted/Weighted Ratings for Industries Represented in PepsiCo’s Portfolio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market size and growth rate</td>
<td>Unweighted/Weighted Ratings for Industries Represented in PepsiCo’s Portfolio</td>
</tr>
<tr>
<td>Industry profitability</td>
<td>Unweighted/Weighted Ratings for Industries Represented in PepsiCo’s Portfolio</td>
</tr>
<tr>
<td>Intensity of competition</td>
<td>Unweighted/Weighted Ratings for Industries Represented in PepsiCo’s Portfolio</td>
</tr>
<tr>
<td>Emerging opportunities and threats</td>
<td>Unweighted/Weighted Ratings for Industries Represented in PepsiCo’s Portfolio</td>
</tr>
<tr>
<td>Resource requirements</td>
<td>Unweighted/Weighted Ratings for Industries Represented in PepsiCo’s Portfolio</td>
</tr>
<tr>
<td>Product innovation</td>
<td>Unweighted/Weighted Ratings for Industries Represented in PepsiCo’s Portfolio</td>
</tr>
<tr>
<td>Social, political, environmental, factors</td>
<td>Unweighted/Weighted Ratings for Industries Represented in PepsiCo’s Portfolio</td>
</tr>
<tr>
<td>TOTALS</td>
<td>Unweighted/Weighted Ratings for Industries Represented in PepsiCo’s Portfolio</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Soft Drinks</th>
<th>Bottled Water</th>
<th>Chilled Juices</th>
<th>Isotonic Beverages</th>
<th>RTD Tea</th>
<th>RTD Coffee</th>
<th>Salty Snacks</th>
<th>Hot Cereals</th>
<th>RTE Cereals</th>
<th>Flavored Grains</th>
<th>Other Breakfast</th>
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<tbody>
<tr>
<td>Market size and</td>
<td>.20</td>
<td>8/1.6</td>
<td>7/1.4</td>
<td>6/1.2</td>
<td>7/1.4</td>
<td>5/1.0</td>
<td>2/4</td>
<td>8/1.6</td>
<td>4/8</td>
<td>4/8</td>
<td>2/6</td>
</tr>
<tr>
<td>growth rate</td>
<td></td>
<td></td>
<td></td>
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<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industry</td>
<td>.20</td>
<td>8/1.6</td>
<td>8/1.6</td>
<td>6/1.2</td>
<td>6/1.2</td>
<td>8/1.6</td>
<td>9/1.8</td>
<td>8/1.6</td>
<td>8/1.6</td>
<td>8/1.6</td>
<td>8/1.6</td>
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<tr>
<td>profitability</td>
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<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Intensity of</td>
<td>.25</td>
<td>3/7.5</td>
<td>7/1.75</td>
<td>8/2.0</td>
<td>10/2.5</td>
<td>9/2.25</td>
<td>9/2.25</td>
<td>9/2.25</td>
<td>9/2.25</td>
<td>9/2.25</td>
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<tr>
<td>competition</td>
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<td></td>
<td></td>
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</tr>
<tr>
<td>Resource</td>
<td>.15</td>
<td>8/1.2</td>
<td>7/1.05</td>
<td>7/1.05</td>
<td>5/7.5</td>
<td>5/7.5</td>
<td>8/1.2</td>
<td>6/9</td>
<td>6/9</td>
<td>6/9</td>
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<td>requirements</td>
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<tr>
<td>Product</td>
<td>.10</td>
<td>8/8</td>
<td>5/5</td>
<td>8/8</td>
<td>9/9</td>
<td>7/7</td>
<td>8/8</td>
<td>5/5</td>
<td>3/3</td>
<td>1/1</td>
<td>7/1</td>
</tr>
<tr>
<td>innovation</td>
<td></td>
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<td>environmental,</td>
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<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>TOTALS</td>
<td>1.00</td>
<td>6.8</td>
<td>7.25</td>
<td>7.00</td>
<td>7.8</td>
<td>6.10</td>
<td>5.95</td>
<td>8.5</td>
<td>6.85</td>
<td>5.5</td>
<td>6.1</td>
</tr>
</tbody>
</table>

### Table 2  Competitive Position/Business Strength Calculations for PepsiCo’s Business Units

(Scale 1 = very weak, 5 = average, 10 = very strong)

<table>
<thead>
<tr>
<th>Strength Measures</th>
<th>Unweighted/weighted Strength Ratings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Relative market share</td>
<td>Pepsi-Cola</td>
</tr>
<tr>
<td>Marketing and promotion</td>
<td>.20</td>
</tr>
<tr>
<td>Product innovation capabilities</td>
<td>.20</td>
</tr>
<tr>
<td>Distribution capabilities</td>
<td>.15</td>
</tr>
<tr>
<td>How well resources are matched to</td>
<td>.15</td>
</tr>
<tr>
<td>industry KSFs</td>
<td></td>
</tr>
<tr>
<td>Brand name recognition/image</td>
<td>.15</td>
</tr>
<tr>
<td>TOTALS</td>
<td>1.00</td>
</tr>
</tbody>
</table>

### 4. What does a 9-cell industry attractiveness/business strength matrix displaying PepsiCo’s business units look like?

To draw a 9-cell industry attractiveness/business strength matrix for PepsiCo using rigorous methodology, students really need to do industry attractiveness ratings for each of the industries in which PepsiCo competes and do competitive strength ratings for each of PepsiCo’s business units. These ratings should then be used to plot the location of the bubbles on the 9-cell grid. Otherwise, students end up locating the bubbles on the basis of “judgment,” which may or may not match up well with a well-done set of ratings. To encourage students to practice applying the tools and concepts in Chapter 8 when they prepare a case, we suggest spending class time here to go through the development of industry attractiveness ratings and business strength ratings and then using these ratings to draw the 9-cell matrix. However, if time is tight you can resort to the judgment approach. Table 1 of this note shows our industry attractiveness ratings and Table 2 presents our business strength ratings. Figure 1 shows a 9-cell GE-style matrix where the location of the bubbles is based on the industry attractiveness and business strength ratings shown in Tables 1 and 2.
There’s ample room for judgmental differences regarding selection of the factors, the weights, and the ratings used to draw a 9-cell GE matrix depicting PepsiCo’s portfolio. So you should expect that student opinions will vary and the matrices they come up with will vary. In this instance, however, the variations should not be very great since it is clear that the industries represented in PepsiCo’s portfolio are all relatively attractive. It is also clear from the case that all of PepsiCo’s businesses except Quaker RTE cereals have strong competitive positions. Hence, most bubbles on the 9-cell matrix representing PepsiCo’s businesses cluster in the top left of the grid.

The 9-cell GE-style matrix analysis (Figure 1) indicates that PepsiCo’s portfolio consists chiefly of “grow and build” businesses that should be given a high priority for investment. Students should conclude that RTE cereals should be given a medium investment priority. None of PepsiCo’s business units need to be considered for divestiture based on industry attractiveness. Students may be able to argue that RTE cereals should be considered for divestiture based upon its relatively weak competitive position in the cereal industry. However, once students prepare cash flow estimates for PepsiCo’s business units, they will determine that Quaker Oats is a cash cow that doesn’t currently require investments beyond what is supported by internal cash flows.

**Figure 1** Sample Industry Attractiveness/Competitive Strength Matrix of PepsiCo’s Domestic Businesses
5. **Does PepsiCo’s portfolio exhibit good strategic fit? What value-chain match-ups do you see? What opportunities for skills transfer, cost sharing, or brand sharing do you see?**

Substantial cost sharing and skills transfer opportunities exist between PepsiCo’s beverage brands and between its various snack brands, but there appear to be less strategic fit opportunities across business platforms. The operating processes vary greatly between hot fill beverage bottling, soft drink concentrate production, grain-based food products production, and snack food production. Students may suggest that beyond PepsiCo’s corporate-wide purchases for ingredients and packaging materials, it is unlikely that PepsiCo managers could find ways to share costs or transfer skills between these businesses. It should also be noted, however, that there are ample opportunities to share costs and transfer skills within broad product categories. The company’s research and development activities directed at creating BFY and GFY products can likely benefit all businesses within a division. PepsiCo’s transfer of best practices between 230 plants, 3,600 distribution systems, and 120,000 service routes around the world is another example of such strategic fit. Students should also note that marketing innovation plays a major role in PepsiCo’s competitive strategy in each of its lines of business. PepsiCo management relies heavily on marketing innovations to position their brands in each market in which it competes. Consumers in each of these markets have much in common and it should be expected that PepsiCo managers share skills and information in crafting and implementing the strategies of each of the businesses. Some students may point to the company’s Power of One strategy that allows its products to be cross-marketed in retail locations as an example of marketing-related strategic fit. However, students should recognize that important joint distribution opportunities existing between Gatorade and Pepsi soft drinks have been prohibited by the FTC for a 10-year period—thus impeding/delaying the capture of potentially large strategic fits benefits (one of the major attractions of the Quaker acquisition).

The operations, sales and marketing, and advertising/promotion of Quaker’s hot and RTE cereals, flavored grains, and other breakfast products have little in common with value chain activities of PepsiCo’s convenience foods and beverages, but do offer cost sharing and skills transfer opportunities among themselves. Figure 4 provides a list of cost sharing, skills transfer, and brand sharing opportunities along the value chains of PepsiCo’s business units with the value chain of its core beverage business.
### Figure 2  
Assessment of Strategic Fit Potentials Between Pepsico’s Business Units

CS = cost sharing benefits    ST = skills transfer opportunities

<table>
<thead>
<tr>
<th>Business Unit</th>
<th>Purchasing</th>
<th>Operations</th>
<th>Distribution</th>
<th>Sales &amp; Marketing</th>
<th>Advertising/Promotion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pepsi Cola</td>
<td>None</td>
<td>None</td>
<td>None</td>
<td>Cross-selling with Frito-Lay products/ST with all convenience products</td>
<td>ST/CS with all convenience products</td>
</tr>
<tr>
<td>Frito-Lay</td>
<td>Some potential cost sharing with Quaker Snacks</td>
<td>None</td>
<td>Cost sharing with all convenience snacks/ST with convenience beverages</td>
<td>Cross-selling with Pepsi products/ST with all convenience products</td>
<td>ST/CS with all convenience products</td>
</tr>
<tr>
<td>Tropicana/DoLe/SoBe</td>
<td>Some potential cost sharing with hot fill beverages</td>
<td>Cost sharing among hot fill operations</td>
<td>Cost sharing with all convenience beverages/ST with convenience snacks</td>
<td>ST with all convenience products</td>
<td>ST/CS with all convenience products</td>
</tr>
<tr>
<td>Aquafina</td>
<td>None</td>
<td>Cost sharing among hot fill operations</td>
<td>Cost sharing with all convenience beverages/ST with convenience snacks</td>
<td>ST with all convenience products</td>
<td>ST/CS with all convenience products</td>
</tr>
<tr>
<td>Starbucks Frappucino</td>
<td>None</td>
<td>Cost sharing among hot fill operations</td>
<td>Cost sharing with all convenience beverages/ST with convenience snacks</td>
<td>ST with all convenience products</td>
<td>ST/CS with all convenience products</td>
</tr>
<tr>
<td>Lipton/SoBe teas</td>
<td>Some potential cost sharing with hot fill beverages</td>
<td>Cost sharing among hot fill operations</td>
<td>Cost sharing with all convenience beverages/ST with convenience snacks</td>
<td>ST with all convenience products</td>
<td>ST/CS with all convenience products</td>
</tr>
<tr>
<td>Gatorade</td>
<td>Some potential cost sharing with hot fill beverages</td>
<td>Cost sharing among hot fill operations</td>
<td>Cost sharing with all convenience beverages/ST with convenience snacks</td>
<td>ST with all convenience products</td>
<td>ST/CS with all convenience products</td>
</tr>
<tr>
<td>Quaker snacks</td>
<td>Some potential cost sharing with Frito-Lay</td>
<td>Possible ST with RTE and hot cereals</td>
<td>Cost sharing with all convenience snacks/ST with convenience beverages</td>
<td>ST with all convenience products</td>
<td>ST/CS with all convenience products</td>
</tr>
<tr>
<td>Quaker hot cereals</td>
<td>CS with RTE cereals, Quaker snacks</td>
<td>Possible ST with RTE cereals, Quaker snacks</td>
<td>CS with RTE cereals, flavored grains, and other breakfast</td>
<td>ST/CS with RTE cereals, flavored grains, Quaker snacks, and other breakfast products</td>
<td>ST/CS with Quaker branded products</td>
</tr>
<tr>
<td>Quaker RTE cereals</td>
<td>CS with hot cereals, Quaker snacks</td>
<td>Possible ST with RTE cereals, Quaker snacks</td>
<td>CS with hot cereals, flavored grains, and other breakfast</td>
<td>ST/CS with hot cereals, flavored grains, Quaker snacks, and other breakfast products</td>
<td>ST/CS with Quaker branded products</td>
</tr>
<tr>
<td>Quaker flavored grains</td>
<td>None</td>
<td>None</td>
<td>CS with RTE and hot cereals and other breakfast</td>
<td>ST/CS with RTE and hot cereals, Quaker snacks, and other breakfast products</td>
<td>ST/CS with Quaker branded products</td>
</tr>
<tr>
<td>Quaker other breakfast</td>
<td>None</td>
<td>None</td>
<td>CS with RTE cereals, flavored grains, and hot cereals</td>
<td>ST/CS with RTE cereals, flavored grains, Quaker snacks, and hot cereals</td>
<td>ST/CS with Quaker branded products</td>
</tr>
</tbody>
</table>
6. **Does PepsiCo’s portfolio exhibit good resource fit? What are the cash flow characteristics of each of PepsiCo’s four segments? Which businesses are the strongest contributors to PepsiCo’s free cash flows?**

Students who have completed the assignment questions posted on the Student Edition of the OLC should recognize that the portfolio has very good resource fit, with all of the company’s businesses offering ample cash flows to fund internal investments. The cash flow estimates in Table 3 indicate that all business units generated free cash flows each year between 2004 and 2007. Even with large annual capital expenditures, PepsiCo International has been able to generate positive cash flows during the 2004 - 2007 timeframe. Clearly, Frito-Lay North America and PepsiCo Beverages North America are tremendous cash cows capable of funding further expansion in those businesses plus providing excess cash flows to fund PepsiCo’s share repurchase plans and future acquisitions. Quaker Foods cash flows are equally impressive, given the relatively minor revenue contribution of the business unit.

In addition, students should approve of the operating profit margins of the company’s North American businesses presented in Table 4. Even though Quaker Oats’ brands compete in mature processed food categories that offer little growth potential, the brands offer hefty operating profit margins. PepsiCo International has the smallest profit margins, but most students will find the operating profit margins that approximate 15% acceptable.

**Table 3  Estimated Cash Flow for PepsiCo’s Business Units, 2004 - 2007**

<table>
<thead>
<tr>
<th></th>
<th>Frito-Lay North America</th>
<th>PepsiCo Beverages North America</th>
<th>PepsiCo International</th>
<th>Quaker Foods North America</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007 Operating profit</td>
<td>$2,845.0</td>
<td>$2,188.0</td>
<td>$2,322.0</td>
<td>$568.0</td>
</tr>
<tr>
<td>+ Depreciation/other amortization</td>
<td>437.0</td>
<td>302.0</td>
<td>564.0</td>
<td>34.0</td>
</tr>
<tr>
<td>+ amortization of intangible assets</td>
<td>9.0</td>
<td>11.0</td>
<td>38.0</td>
<td>0.0</td>
</tr>
<tr>
<td>− Interest expense</td>
<td>29.1</td>
<td>25.6</td>
<td>39.6</td>
<td>4.7</td>
</tr>
<tr>
<td>− Income taxes</td>
<td>580.1</td>
<td>511.0</td>
<td>789.2</td>
<td>92.7</td>
</tr>
<tr>
<td>− Capital expenditures</td>
<td>624.0</td>
<td>430.0</td>
<td>1,108.0</td>
<td>41.0</td>
</tr>
<tr>
<td>− Dividend payments</td>
<td>691.5</td>
<td>609.2</td>
<td>940.8</td>
<td>110.5</td>
</tr>
<tr>
<td>Estimated free cash flow</td>
<td>$1,366.3</td>
<td>$925.2</td>
<td>$46.4</td>
<td>$353.1</td>
</tr>
</tbody>
</table>

Revenue Contribution:

- Frito-Lay North America: 29.4%
- PepsiCo Beverages North America: 25.9%
- PepsiCo International: 40.0%
- Quaker Foods North America: 4.7%

continued
### Table 3  Estimated Cash Flow for Pepsico’s Business Units, 2004 - 2007

<table>
<thead>
<tr>
<th></th>
<th>Frito-Lay North America</th>
<th>PepsiCo Beverages North America</th>
<th>PepsiCo International</th>
<th>Quaker Foods North America</th>
</tr>
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<tr>
<td><strong>2006</strong></td>
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<td>Operating profit</td>
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<td>+ Depreciation/other amortization</td>
<td>432.0</td>
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<td>478.0</td>
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</tr>
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<td>+ amortization of intangible assets</td>
<td>9.0</td>
<td>77.0</td>
<td>76.0</td>
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<tr>
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<td>− Income taxes²</td>
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<td>67.8</td>
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<td>492.0</td>
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</tr>
<tr>
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<td>521.0</td>
<td>705.9</td>
<td>96.4</td>
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<tr>
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<td>$1,530.2</td>
<td>$1,016.3</td>
<td>$440.0</td>
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<th>Revenue Contribution⁴</th>
<th>Frito-Lay North America</th>
<th>PepsiCo Beverages North America</th>
<th>PepsiCo International</th>
<th>Quaker Foods North America</th>
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<tbody>
<tr>
<td></td>
<td>30.9%</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>PepsiCo Beverages North America</td>
<td>27.2%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>PepsiCo International</td>
<td>36.9%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Quaker Foods North America</td>
<td>5.0%</td>
<td></td>
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<table>
<thead>
<tr>
<th></th>
<th>Frito-Lay North America</th>
<th>PepsiCo Beverages North America</th>
<th>PepsiCo International</th>
<th>Quaker Foods North America</th>
</tr>
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<tbody>
<tr>
<td><strong>2005</strong></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Operating profit</td>
<td>$2,529.0</td>
<td>$2,037.0</td>
<td>$1,661.0</td>
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</tr>
<tr>
<td>+ Depreciation/other amortization</td>
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<td>264.0</td>
<td>420.0</td>
<td>34.0</td>
</tr>
<tr>
<td>+ amortization of intangible assets</td>
<td>3.0</td>
<td>76.0</td>
<td>71.0</td>
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</tr>
<tr>
<td>− Interest expense¹</td>
<td>30.7</td>
<td>27.2</td>
<td>33.9</td>
<td>5.1</td>
</tr>
<tr>
<td>− Income taxes²</td>
<td>730.4</td>
<td>647.1</td>
<td>804.9</td>
<td>121.6</td>
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<tr>
<td>− Capital expenditures</td>
<td>512.0</td>
<td>320.0</td>
<td>667.0</td>
<td>31.0</td>
</tr>
<tr>
<td>− Dividend payments³</td>
<td>537.3</td>
<td>476.1</td>
<td>592.2</td>
<td>89.4</td>
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<tr>
<td>Estimated free cash flow</td>
<td>$1,140.6</td>
<td>$906.5</td>
<td>$54.0</td>
<td>$323.9</td>
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<table>
<thead>
<tr>
<th>Revenue Contribution⁴</th>
<th>Frito-Lay North America</th>
<th>PepsiCo Beverages North America</th>
<th>PepsiCo International</th>
<th>Quaker Foods North America</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>31.7%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>PepsiCo Beverages North America</td>
<td>28.1%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>PepsiCo International</td>
<td>34.9%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Quaker Foods North America</td>
<td>5.3%</td>
<td></td>
<td></td>
</tr>
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Table 3  Estimated Cash Flow for Pepsico’s Business Units, 2004 - 2007

<table>
<thead>
<tr>
<th></th>
<th>Frito-Lay North America</th>
<th>PepsiCo Beverages North America</th>
<th>PepsiCo International</th>
<th>Quaker Foods North America</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>2004</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operating profit</td>
<td>$2,389.0</td>
<td>$1,911.0</td>
<td>$1,323.0</td>
<td>$475.0</td>
</tr>
<tr>
<td>+ Depreciation/other amortization</td>
<td>420.0</td>
<td>258.0</td>
<td>382.0</td>
<td>36.0</td>
</tr>
<tr>
<td>+ Amortization of intangible assets</td>
<td>3.0</td>
<td>75.0</td>
<td>68.0</td>
<td>1.0</td>
</tr>
<tr>
<td>− Interest expense</td>
<td>30.4</td>
<td>26.4</td>
<td>31.3</td>
<td>4.9</td>
</tr>
<tr>
<td>− Income taxes 2</td>
<td>435.8</td>
<td>379.0</td>
<td>449.6</td>
<td>69.6</td>
</tr>
<tr>
<td>− Capital expenditures</td>
<td>469.0</td>
<td>265.0</td>
<td>537.0</td>
<td>33.0</td>
</tr>
<tr>
<td>− Dividend payments 3</td>
<td>477.3</td>
<td>415.1</td>
<td>492.4</td>
<td>76.1</td>
</tr>
<tr>
<td>Estimated free cash flow</td>
<td>$1,399.4</td>
<td>$1,158.5</td>
<td>$262.6</td>
<td>$328.4</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Revenue Contribution 4</th>
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</thead>
<tbody>
<tr>
<td>Frito-Lay North America</td>
<td>32.7%</td>
</tr>
<tr>
<td>PepsiCo Beverages North America</td>
<td>28.4%</td>
</tr>
<tr>
<td>PepsiCo International</td>
<td>33.7%</td>
</tr>
<tr>
<td>Quaker Foods North America</td>
<td>5.2%</td>
</tr>
</tbody>
</table>

1Interest expense estimated by multiplying total interest expense listed in case Exhibit 3 by revenue contribution for business segment.
2Income tax expense estimated by multiplying total income tax expense listed in case Exhibit 3 by revenue contribution for business segment.
3Dividend expense estimated by first determining the total number of shares by dividing net income by EPS listed in case Exhibit 1. The resulting total number of shares was multiplied by cash dividends per share. The total cash dividend figure was then multiplied by revenue contribution for business segment.
4Revenue contribution calculated by dividing business segment revenues by total revenues.

Table 4  Operating Profit Margins by Pepsico Business Segment, 2004 - 2007

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Frito-Lay North America</td>
<td>24.6%</td>
<td>24.1%</td>
<td>24.5%</td>
<td>25.0%</td>
</tr>
<tr>
<td>PepsiCo Beverages North America</td>
<td>21.4%</td>
<td>21.5%</td>
<td>22.3%</td>
<td>23.0%</td>
</tr>
<tr>
<td>PepsiCo International</td>
<td>14.7%</td>
<td>15.6%</td>
<td>14.6%</td>
<td>13.4%</td>
</tr>
<tr>
<td>Quaker Foods North America</td>
<td>30.5%</td>
<td>31.3%</td>
<td>31.3%</td>
<td>31.1%</td>
</tr>
</tbody>
</table>

7. Based on the preceding analysis, what is your overall evaluation of PepsiCo’s business portfolio in 2008? Does the portfolio provide the company’s shareholders with an opportunity for above-average market returns?

Students will likely commend Roger Enrico, Steve Reinemund, and Indra Nooyi for their efforts as CEO to build shareholder value. Enrico’s spin-off of the company’s restaurants, IPO of its bottling operations, and acquisitions of Tropicana, Cracker Jack, and Quaker Oats have contributed to more than a 100% increase in the company’s share price between 1997 and late 2008—see case Exhibit 2. With the exception of Quaker RTE cereals, the company’s businesses all hold impressive positions in their respective industries and some have outstanding potential for growth. It is unlikely that the domestic sales of soft drinks or
snack foods will grow much more quickly than current annual growth rates, but Gatorade, Propel, Aquafina, and SoBe offer considerable growth opportunities in North America. Also, PepsiCo has the potential to increase Gatorade’s sales outside of the U.S. In addition, Frito-Lay’s focus on developing BFY and GFY snacks is likely to contribute to revenue and volume gains in developed countries where health and fitness are growing concerns of consumers. Recently acquired GFY brands such as Flat Earth fruit and vegetable snacks, Stacey’s bagel and pita chips, and Naked Juice also offer opportunities for growth in attractive snack and beverage categories.

There is some question concerning the ability to gain synergistic benefits between some of Quaker’s food businesses and PepsiCo’s convenience food and beverage businesses, but the cash flow analysis and operating profit margins presented in Tables 3 and 4 suggest that these businesses do have the ability to contribute to increased shareholder value through their impressive cash flows and stellar profit margins. The company’s RTE cereal business competes in a fierce competitive environment and its flavored grains and other breakfast products lack the sparkle of Gatorade, but appear to be solid businesses capable of delivering above-average profits and free cash flows.

8. What strategic actions should Indra Nooyi take to sustain the corporation’s impressive financial and market performance? Should its free cash flows be used to fund additional share repurchase plans, pay higher dividends, make acquisitions, expand internationally, or for other purposes? What other strategic actions should be pursued by corporate level management?

Students may struggle with what moves are needed next at PepsiCo, but should be able to recommend most of the following:

- The company should capitalize on its recent reorganization to further internationalize Quaker Oats’ brands. The new organizational structure creating the PepsiCo Americas Foods division should make it easier to bring Quaker brands to the Latin American market for grain-based snacks. Students should also recommend that PepsiCo undertake more aggressive efforts to expand Quaker snacks to the United Kingdom and Europe.

- Similarly, students should recognize the importance of exploiting PepsiCo’s new organizational structure to further internationalize Gatorade. Gatorade’s sales outside the United States should benefit from inclusion in the new PepsiCo Americas Beverages division. However, there are likely many attractive markets for Gatorade outside North America and Latin America. The company should not neglect making Gatorade a more important brand for PepsiCo International.

- Students are also likely to suggest that PepsiCo push Propel and Aquafina into additional markets outside the U.S.

- Students may recommend that the company divest its Quaker RTE cereals, flavored grains, and other breakfast products because of low industry growth rates. However, students should not be too forceful in arguing for a rapid liquidation of these business since analysis of Quaker’s financials suggest these businesses have handsome operating profit margins and free cash flows.

- Students should suggest that the company should utilize its free cash flows to support the ongoing $8 billion share repurchase program and make additional acquisitions of producers of GFY snacks and beverages.

- There doesn’t seem to be a strong reason for students to recommend that PepsiCo undertake a major acquisition since the case doesn’t make mention of attractive, large snack and beverage sellers that are acquisition candidates.

- Students will likely recommend that the company continue to develop BFY and GFY snacks and beverages.
Students should also recommend that PepsiCo International management pursue more aggressive efforts to capture strategic fit opportunities within the division. The division’s operating profit margins have ranged from 13.4% to 15.6% between 2004 and 2007, which is considerably lower than operating profit margins in the company’s other divisions.

PepsiCo International should also make greater use of the company’s Power of One strategy in international markets and increase the percentage of GFY and BFY products offered in international markets.

**EPILOGUE**

There was no new financial information or other important company news to report at the time this teaching note was to press. You can check for the company’s latest financial reports and press releases at its investor web site ([www.pepsico.com](http://www.pepsico.com)).
OVERVIEW

This 2-page case is a classic that works great in the classroom. It forces students to think outside the box, challenging them to analyze Robin Hood’s crusade against the Sheriff of Nottingham in business terms. As the case unfolds, Robin Hood’s problems are multiplying. His main source of revenue is declining as travelers are beginning to avoid coming through the forest (The market is in decline! The present strategy has run out of gas. Does Robin Hood need to expand into new geographic markets to maintain and grow revenues?). Yet, because the fame of his Merrymen is spreading, new recruits are pouring in. The size of his band is beginning to exceed the food capacity of the forest and the band’s camp, because of its increasing size, is easier to detect. Discipline is becoming harder to enforce. (In other words, costs are rising and diseconomies of scale have set in—Robin Hood is caught in a classic profit squeeze! Moreover, the culture is being eroded because all the newcomers do not have the same values and beliefs as the original members who had a common bond of opposing the evil Sheriff and trying to redress grievances of the downtrodden at the hands of the ruling class.) Furthermore, the Sheriff’s forces are growing stronger (i.e., competition is intensifying!). Robin needs an action plan to deal with the deteriorating situation, and he needs to implement it quickly.

SUGGESTIONS FOR USING THE CASE

We positioned this case as the lead off case for the strategy execution section (Chapters 10-12) for three reasons. One, the case is short—something that students always appreciate. Two, and more importantly, it is an excellent transition case—there are elements of both crafting strategy and executing the chosen strategy for students to consider in arriving at their action recommendations. The implementation/execution issues lurking in this case cut across a wide front—organization, culture, motivation and commitment, policies, control, and leadership. Some kind of action on Robin Hood’s part is urgently needed—indeed, some pretty big decisions are needed. The twin issues of “what to do” and “how to achieve good results quickly” are pervasive. Three, in teaching this case over the years, we’ve seen time and again that the Robin Hood case has all of the ingredients for producing an exceptionally lively, entertaining class discussion. It’s a case that is virtually certain to be popular with students, and it’s a fun case to teach.

However, you can also use the Robin Hood case as a leadoff case for the course. The case involves issues relating to mission, objectives, strategy, and decisive strategic leadership; the need for an action plan is obvious—these are the very things one looks for in a good leadoff case. And the nature of the case virtually guarantees the stimulating kind of class discussion one needs to get the course off on the right foot.

There’s a file of the suggested Assignment Questions in this TN that is posted on the Student section of the Web site; you may wish to have class members access this file in preparing the case.
Case 20  Robin Hood

The length of the case makes it ideal for an in-class written case or a final exam case. Our suggested written assignment questions are as follows:

1. As Robin Hood’s most trusted advisor (and as someone knowledgeable in the ways of crafting and executing effective strategies), please prepare an action plan for Robin Hood’s consideration. It is your job to convince him to pursue your proposed plan; hence your report should include full justification and arguments to support your recommended course of action.

2. Since you are Robin Hood’s most trusted advisor and are most knowledgeable about crafting and implementing effective strategies, he has called upon you to advise him on how to proceed in light of the situation. Within the next few hours, Robin Hood expects you to provide him with:
   
   (a) A rundown of the issues he needs to address
   
   (b) An appropriate action plan that includes
       
       ■ a mission,
       ■ a set of performance objectives,
       ■ a strategy for dealing with the issues/problems he confronts, and
       ■ the action steps that will need to be taken to implement the strategy effectively.

Please provide supporting analysis and persuasive argument for your recommended course of action (you must convince him to do what you suggest!) and you need to be specific about what to do and how to do it.

ASSIGNMENT QUESTIONS

1. What problems does Robin Hood have? What issues need to be addressed?

2. Do Robin Hood and the Merrymen need a new mission? new objectives? a new strategy?

3. What strategic options does Robin Hood have? Is continuing with the present strategy an option or is the present strategy obsolete?

4. Why not try to end the campaign by killing the Sheriff?

5. What are the pros and cons of accepting the offer of the barons to assist in securing King Richard’s release from prison?

6. What action plan would you recommend to Robin?

7. How should Robin implement the recommended plan? What action steps will need to be taken to make the recommended strategy work successfully?
TEACHING OUTLINE AND ANALYSIS

1. What problems does Robin Hood have? What issues need to be addressed?

Robin Hood and his Merrymen are caught in a classic “profit” squeeze. Revenues are down because travelers are avoiding routes through Sherwood Forest. Costs are rising as new recruits pour in and as foraging for food supplies must reach out farther and farther from the main encampment. Students ought to see that diseconomies of scale are becoming a serious problem. As a consequence, Robin has to be concerned about the Merrymen’s ability to continue to succeed at its mission of “rob from the rich and give to the poor.” There are fewer “customers” to rob. Falling revenues combined with rising costs means there is less “profit” (or dividends) to distribute to the poor (or “shareholders”).

Moreover, there are cracks appearing in the culture. Robin Hood and his original small close-knit band of Merrymen shared a common bond and set of values: oppose the evil Sheriff and try to redress grievances of the downtrodden at the hands of the ruling class. However, do all the new recruits who are showing up voluntarily in droves have these same values? Are perhaps they being attracted to join up for less noble reasons — the excitement, the prospects of sharing in the spoils, ambitions to become a thief (as opposed to engaging in honest, hard work), or not having anything better to do (being unemployed). Discipline is suffering. Will the new recruits be loyal to Robin Hood or will they look out for their own personal interests? As Robin noted, “Why, I don’t know half the men I run into these days.”

Several issues have to be addressed:

- Whether to institute the fixed transit tax (and shift to a new business purpose or mission).
- How to avoid detection (given the growing size of the encampment) and ensure the security of the organization.
- Whether to accept the offer of several barons to join in a move to secure King Richard’s release from jail in Austria.
- What to do about the growing strength of the Sheriff’s forces.

2. Do Robin Hood and the Merrymen need a new mission? new performance targets? a new strategy?

The issue of whether a whole new strategic direction (mission, objectives, and strategy) is needed should be explored fairly early in the class discussion because the conclusions reached will drive the action plan that emerges. You can attack the issue of strategic direction by asking the class whether the band’s traditional mission of robbing the rich and giving to the poor is fast becoming obsolete in light of events.

- Will there soon be any bounty to distribute to the poor? With revenues on the decline and costs on the rise, won’t “profits” dry up?
- Can Robin Hood and his Merrymen continue to count on support from their constituency (the poor, the downtrodden, and the townspeople) if the distribution of the “profits” slows to a trickle? Will Robin Hood’s popularity and “hero” image suffer as he becomes less and less able to redistribute income from the rich to the poor.
The Merrymen’s common bond and shared values involve their mutual desire to oppose the Sheriff and his administration. Robin Hood forged his original band from men who were united in enmity against the Sheriff, had a deep sense of justice, and were willing to live outside the law to accomplish their goals. Their motto of “rob from the rich and give to the poor” was viewed as noble and, in their eyes, gave them legitimacy. But do the new recruits share these same values? Are they coming to join up because of grievances against the Sheriff and a desire to serve the Merrymen’s original purpose or because of other attractions—the desire to take up professional thievery as an occupation (because they are unemployed and have no attractive job prospects), because they are enamored with the excitement of provincial banditry, or because they want to share in Robin Hood’s glory by being associated with his band of Merrymen? What is the strength of their commitment to the organization’s original purpose and mission? Why is discipline becoming harder to enforce?

As the class considers these points, there is likely to be a growing realization that Robin Hood needs to consider whether the organization’s purpose and mission needs to be expanded or changed.

You can shed further light on whether there is a need for a new strategic direction by getting the class to contemplate the organization’s objectives and current strategy.

If the mission-purpose-motto is “rob from the rich and give to the poor,” then what are the appropriate objectives or performance targets?

- From a business standpoint, an argument can be made that to achieve the purpose and mission to the fullest, the organization must try to maximize its profits—which requires low operating costs so that most of the revenues gained from robbing the rich can then be redistributed to the poor in the form of 100% “dividends.” The greater the amount there is to distribute to the poor, the more the mission is fulfilled.

What is the most appropriate strategy for achieving this objective?

- The basic strategic approach would be to try to maximize revenues (rob as many rich travelers as is feasible), minimize operating costs (i.e., employ a classic low-cost provider strategy), and have a 100% dividend payout of profits. To contain costs, the band should be large enough to function effectively, yet not so overstaffed that scale diseconomies are encountered. Yes, there is strength in numbers, but only up to the point where profits can be maximized.

- So far, Robin Hood has pursued a focus strategy. The target market is only rich merchants and abbots traveling through Sherwood Forest. The problem Robin now faces is that the target market is drying up and that his organization has grown too big for a focus strategy tied solely to Sherwood Forest.

As these aspects become more apparent to the class, students should begin to understand that Robin cannot “stay the course” and stick with the ways and methods that have made the organization successful to date. The current strategy has run its course. Strategic changes are definitely needed. Once the class reaches these conclusions, you are ready to tackle the question of what to do and can call upon students for recommendations.

3. **What strategic options does Robin Hood have?**

Continuing with the present strategy is not a viable option. A SWOT analysis can help sort out the alternative courses of action Robin Hood needs to consider:

**Strengths**

- The increasing size of the band
- The fame of the Merrymen is spreading
So far, the organization has operated with success

**Weaknesses**

- The increasing size of the band (raises costs and increases the chances of detection by the Sheriff’s forces)
- Discipline is becoming harder to enforce—the culture has some disturbing cracks
- Game is becoming scarce
- Food has to be transported from greater distances
- The encampment is so large that it can be detected from miles away
- Diseconomies of scale are setting in, causing costs to rise

**Opportunities**

- Impose a fixed transit tax
- Expand operations to geographic areas outside Sherwood Forest (to escape declining market opportunities in Sherwood Forest)
- Accept the offer of the barons to help in securing King Richard’s release

**Threats**

- The Sheriff is growing stronger in terms of money, men, and facilities
- Travelers are avoiding routes through Sherwood Forest; the target market is drying up
- Prince John may decide to reinforce the Sheriff

4. **Does it make sense to impose a fixed transit tax to counter the decline in revenues?**

The fixed transit tax would entail an altogether new business definition and business purpose. While it might rejuvenate revenues if the tax is viewed by travelers as an acceptable price to pay for safe passage through the forest, a fixed transit tax is a questionable alternative. The Merrymen will resist such a radical redefinition of the band’s purpose; they are proud of their motto: “Rob from the rich and give to the poor.” A transit tax, imposed uniformly on rich and poor travelers alike, would antagonize the band’s main source of support and information (the poor and the townspeople) in addition to its lack of cultural fit or temperamental fit. Besides the transit tax is not a legitimate function for “provincial bandits”—levying and collecting taxes is a governmental function. For the Merrymen to try to horn in on the government’s tax collection function could attract the ire of Prince John and cause him to reinforce the Sheriff. Prince John might choose to ignore the actions of a provincial bandit (even a successful one like Robin Hood) since he has more important matters to concern his attention. But a bandit who tries to set up a rival tax collection function and divert taxes away from the royal treasury cannot be tolerated since it represents treason against the Crown and the potential budding of a revolution.

In short, the option of a fixed transit tax is unappealing. The cons outweigh the pros by a hefty margin.
5. What about expanding the band’s operations to geographical areas to the north, south, east, and west of Sherwood Forest as a way of rejuvenating revenues and cash flows?

At first blush, this option has some appeal. Expanding into new geographic areas could provide a much needed revenue boost and thwart the efforts of rich travelers and abbots to use routes around Sherwood Forest. It would also capitalize on the increasing size of the band and provide jobs for the new recruits pouring in.

But geographic expansion would pose serious problems for Robin Hood and his functional organization structure. With the present organization, Robin Hood can maintain tight personal control over all operations and supervise his key lieutenants (Will Scarlett, Little John, Scarlock, and Much the Miller’s Son). Shifting to a strategy of geographic expansion to the north, south, east, and west of Sherwood Forest would probably require shifting to a geographical organization structure.

- Who would be put in charge of the geographical units? Are Will Scarlett, Little John, Scarlock, or Much the Miller’s Son ready to assume general management responsibility—their skills and experiences are limited to a single functional areas? Could anyone other than a loyal lieutenant be trusted with the job of heading up a geographic unit?

- Would not each band need to operate on a decentralized basis and assume responsibility for handling its own intelligence-gathering, security, discipline, provisioning, and financial controls? If each band handles its own intelligence-gathering, for example, then what is Will Scarlett’s role? Does he provide advice, counsel, and staff support from headquarters? Should the intelligence-gatherers for each band report to Will Scarlett or to the geographical head? Similar issues arise for the appropriate roles for Scarlock, Little John, and Much the Miller’s Son in their respective areas of responsibility.

- How would the operations of the geographical units be coordinated?

- How would Robin Hood and/or his chief financial officer maintain proper financial controls? What would prevent some of the geographic units from not reporting all of the take?

- Should the geographic units be operated as profit centers? How would Robin Hood measure the performance of each geographic unit?

- Would geographic decentralization tend over time to weaken Robin Hood’s position as a strong leader? Should Robin Hood be willing to move to decentralized geographic decision-making? Does this really make sense in light of his personal campaign against the Sheriff and the growing strength of the Sheriff’s forces? Which decisions would it make sense for Robin to decentralize; for instance should he be willing to delegate authority for specific “raids” to his geographic heads or should all plans for raids be cleared with Robin first? Should he simply set policies and guidelines and concern himself mainly with supervising the geographic heads? How often should he expect reports from them—daily, weekly, monthly?

You should raise as many of the above questions with the class as seems necessary to get the class to see the range of managerial and organizational issues that a geographic expansion strategy entails. This phase of the discussion gives you a golden opportunity to stress the fundamental point that structure follows strategy—in other words, a new strategy typically creates a need for changes in organizational structure, competencies, and capabilities.

It will not be a simple matter for Robin Hood to pursue a strategy of geographic expansion from an organizational standpoint. It would cause a major upheaval in the way Robin Hood and his band currently function. Just as important, though, is the question of whether geographic expansion makes good strategic sense. Expanding operations over a wider area could accelerate the strengthening of the Sheriff’s forces since Robin Hood’s activities would pose a bigger threat. To the extent that Robin Hood succeeded in expanding his activities beyond the boundaries of Sherwood Forest, his exploits could attract increasing
attention from Prince John and prompt Prince John to take an active interest in seeing that the Sheriff was ampley reinforced. Robin should not risk activities that would encourage a strategic alliance between the Sheriff and the Prince. He has a big enough problem with the growing strength of the Sheriff’s forces without getting Prince John involved.

6. Why not try to end the campaign by killing the Sheriff?

While the case states that killing the Sheriff would “not solve the basic problem,” some members of the class may not see why this option holds out no solution for Robin. Or, they may disagree with the statement in the case. So this is an issue you may want to explore briefly.

Killing the Sheriff has numerous problems as a solution. To begin with, should “murder” or “assassination” be countenanced? Is this a legitimate purpose of the organization? Is it compatible with the band’s mission/motto of “rob from the rich and give to the poor” (which, it might be argued, is a “nobler purpose”)? Is killing the sheriff ethical or socially responsible? How would it affect Robin’s image? Would engaging in premeditated murder necessarily make Robin a “bad guy” as opposed to a “good guy”?

Second, even if the hated Sheriff is killed, would not the next Sheriff, probably someone appointed by Prince John, simply continue to pursue Robin Hood and his band? Is there any reason to believe that the next Sheriff would not be from the same mold as the current Sheriff? Might the next Sheriff come after Robin with equal or greater vengeance? Might not killing the Sheriff trigger a move to strengthen the forces of the next Sheriff against Robin?

Given these considerations, the class should see that killing the Sheriff is, at best, no more than a short term solution and in the long term would produce no fundamental change in Robin Hood’s deteriorating strategic position.

7. What are the pros and cons of accepting the offer of the barons to assist in securing King Richard’s release from prison?

While this option may not have seemed appealing at the outset, by this point in the class discussion it starts to loom as something that must be considered very seriously. None of the other options have stood up under careful scrutiny. We like to dig into this option by asking the class why the barons have approached Robin for his assistance. The obvious reason, it seems to us, is because Robin Hood’s activities put him in a position to provide some of the ransom. He might also serve as an emissary to deliver the ransom and some expertise from members of his organization could prove valuable as well. But, Robin’s primary value to the barons is likely the assist he could provide in collecting the necessary monies for the ransom. There’s likely to be no disagreement from the class on this point.

The benefit of Robin joining with the barons is the promise of amnesty for himself. Amnesty gives Robin a way out of his dilemma and offers a way to successfully end his campaign against the Sheriff. Yes, there are risks but they seem no greater than are posed by the other options he has.

But there are some difficulties that some class members may not have thought about.

- If Robin gets amnesty, then he has his golden parachute. But what about the rest of the Merrymen? Is Robin to abandon them to fend for themselves?
- What loyalty does Robin owe the other stakeholders — the Merrymen and the poor people he has benefitted through his efforts at income redistribution?
- Can Robin Hood, as leader, just up and walk away because he has been offered a better deal? Even if he can, should he?
Is Robin ethically and morally obligated to look out for the well-being of his organization as best he can before he departs? Should he try to get the organization in good shape before he departs? Should he be the first to bail out and try to save only himself?

Should he try to arrange amnesty for his chief lieutenants? for all the Merrymen? even the new recruits whom he doesn’t know?

The point of this discussion is to highlight the leader’s role and responsibility for looking out for the best interests of the organization’s stakeholders and also to indicate the need for a plan to implement whatever course of action is chosen.

8. What action plan would you recommend to Robin?

Very likely, the majority will see the merits of joining with the barons to secure King Richard’s release. A few may argue for other courses of action.

9. How should Robin implement the recommended plan? What action steps will need to be taken to make the recommended strategy work successfully?

Assuming that the choice is to pursue negotiations with the barons and participate in their efforts to restore King Richard to the throne, there are several actions that Robin should take:

- Have a meeting with the Merrymen and explain fully the strategic dilemma that the organization finds itself in for the long term and the tough choices that have to be made. Let everyone know that the future does not look promising, that things cannot continue going as they have been, and that the time has come to chart a new course.

- Stop accepting recruits immediately and begin a program to downsize the organization.

- Encourage people to leave the organization voluntarily. Perhaps Little John should come down hard on those who are not inclined to observe strict discipline as a way of making some people unhappy enough to leave.

- Employ a harvest strategy to maximize short-term cash flow. Perhaps make scattered raids outside Sherwood Forest to shore up sagging revenues.

- Pursue negotiations with the barons to secure amnesty for all the remaining Merrymen, the justification being that their efforts have helped generate the monies that Robin Hood can contribute to the ransom for King Richard.

- Avoid further conflict with the Sheriff and lessen the urgency for the Sheriff to secure reinforcements. Try to buy enough time in the campaign against the Sheriff for the efforts to secure the King’s release to bear fruit.

- Prepare to cease operations as soon as circumstances permit. Help the Merrymen find alternative career occupations. Try to bring the organization to a graceful end. Have key lieutenants develop an orderly exit strategy.

- Robin should personally devote most of his time and effort to assisting the barons gain King Richard’s release and making sure that the promise of amnesty is honored.
OVERVIEW

Dilemma at Devil’s Den records the observations of unethical behavior and general poor strategy execution at a university snack bar by a part-time student employee. At the time of the case, the student employee was a 21 year old junior with a concentration in finance. She originally started working at the Den in order to earn some extra spending money and had been working there for one semester when she became upset with some of the happenings. The Den was managed by contract with an external company, College Food Services (CFS). What bothered her was that many employees were allowing their friends to take free food, and the employees themselves were also taking food in large quantities when leaving their shifts. The policy was that employees could eat whatever they liked free of charge while they were working, but it had become common for employees to leave with food and not to be charged for their snacks while off duty as well.

The student employee felt these problems were occurring for several reasons. For example, employee wages were low, there was easy access to the unlocked storage room door, and inventory was poorly controlled. Also, there was weak supervision by the student managers and no written rules or strict guidelines. It seemed that most of the employees were enjoying “freebies,” and it had been going on for so long that it was taken for granted. The problem got so far out of hand that customers who had seen others do it felt free to do it whether they knew the workers or not. The employees who witnessed this never challenged anyone because, in her opinion, they did not care and they feared the loss of friendship or being frowned upon by others. Apparently, speaking up was more costly to the employees than the loss of money to CFS for the unpaid food items. It seemed obvious to her that the employees felt too secure in their jobs and did not feel that their jobs were in jeopardy.

SUGGESTIONS FOR USING THE CASE

This 2-1/2 page case is a sure winner that will fit nicely almost anywhere else in your case series on strategy execution. Almost all students will be able to identify with the first person account of the sloppy management of the campus snack bar. The case also involves personal ethics issues related to the rampant employee theft at Devil’s Den, which some students may have experienced in part-time jobs. Also, students may identify with Susan’s struggle between idealism (a wish to make a better world) and her principles, virtue and conscience on one hand and pragmatism on the other; cynicism (because of “the way the world is”); or a need to fit in or be liked. In one way or another almost all students are facing, or have recently faced, peer pressure to do things that violate their value systems. The Devil’s Den case will help them to understand why they feel so much ambivalence, sometimes go along, and sometimes draw a line beyond which they will not go.

The case also raises questions of a business-level ethics and management’s responsibility for creating or allowing a climate that tolerates at best, and encourages at worst, illegal, criminal or unethical behavior. It is the view of the case writer and the authors that organizations which encourage, or tolerate, behavior that is generally considered illegal or unethical are themselves unethical and such seems to be the case for the College Food Service.

*Substantial portions of this teaching note were developed by Professor Allan R. Cohen, Babson College. We are most grateful for his insight, analysis, and contributions to how the case can be taught successfully.
This case, along with the Robin Hood case, is an excellent candidate for a leadoff case for your strategy execution module, following your coverage of Chapters 10-12. It is a particularly good first case to assign as a follow-on to the material in Chapter 12. But, in truth, the Devil’s Den case will fit most anywhere in your case assignment grouping where strategy execution and corporate culture are highlighted—the short length of the case makes it ideal for use in the last 45-50 minutes of a class where you have scheduled a mini-lecture or want to cover aspects of an accompanying simulation.

Your discussion of the case can follow the general outline of strategy execution in Chapters 10-12 and investigate such components of the strategy execution process as organization building, shaping the culture, instituting policies and procedures that facilitate strategy execution, installing control systems, tying rewards to the achievement of strategic and financial targets, and ethical leadership. But the extensive ethical content of the case also makes it suitable for use as part of your ethics module — this case is definitely suitable for use with Chapter 9.

There’s a file of the suggested Assignment Questions in this TN that is posted on the Student section of the Web site; you may wish to have class members access this file in preparing the case.

Because of students’ easy identification with the circumstances portrayed in the case, its simplicity, and its illustration of multiple strategy implementation and business ethics issues, we’ve found it’s also a good choice for a short written assignment; since the case is quite short, it is particularly suitable for an in-class written assignment. Our recommended assignment question is:

Your close friend, Susan, has asked that you help her analyze the various problems at the Devil’s Den and come to a conclusion about her course of action. She would like for you to use your business knowledge to examine the snack bar’s strategy execution process and her ethical dilemma. Please prepare a 3-4 page report that lists examples of poor or superior competency building, culture elements, policies and procedures, control systems, reward and discipline systems, and ethical leadership at Devil’s Den. You should also provide guidance about how to resolve her dilemma.

ASSIGNMENT QUESTIONS

1. What problems has Susan identified with the night shift operations of the Devil’s Den? How well does the management team perform such strategy execution processes as competency building, shaping the culture, instituting policies and procedures, establishing control systems, developing reward and discipline systems, and exhibiting ethical leadership?

2. What is Susan’s dilemma? What seems to influence her perceptions and behavior? What seems to influence the perceptions and behaviors of other Devil’s Den employees?

3. What should Susan do about her dilemma?

TEACHING OUTLINE AND ANALYSIS

1. What problems has Susan identified with the night shift operations of the Devil’s Den? How well does the management team perform such strategy execution processes as competency building, shaping the culture, instituting policies and procedures, establishing control systems, developing reward and discipline systems, and exhibiting ethical leadership?

You may wish to categorize the problems Susan has observed under the headings used in Chapter 10’s introduction of the components of the strategy execution process. We have categorized the problems using the following categories.
Organization building

- The work that is to be done in the cafeteria is low skilled, tedious and not challenging.
- The persons who tend to get hired are either freshmen or sophomores who want to earn some spending money.
- As a consequence it is seen by the prospective employees, students who work on a part-time basis, and probably by the College Food Service (CFS) management as undesirable work.
- It is difficult to recruit and to hold part-time student employees.
- CFS provides no formal training to part-time student employees or student managers.
- Student managers are not provided with guidelines concerning their authority and responsibilities.

Organizational culture

- The employees have regularly taken food off the premises, both for their own purposes and to give to friends. They continue to do so.
- Friends and customers frequently take food from Devil’s Den without paying for it.
- Student employees and student managers know that customers take food without paying for it and do not interfere with the practice.

Policies and procedures

- Employees of CFS who work in Devil’s Den are allowed to eat on the job without charge.
- There are no written rules or policies stating what behavior are permissible and what is not.

Installing control systems

- Food in the storage area, as elsewhere, is easily accessible to everybody since the storage area is not locked.
- Inventory is poorly controlled.
- The day manager has no controls in place to limit the independence of night managers.
- There seems to be no method for evaluating theft on the night shift.

Rewards and discipline

- The Devil’s Den requires night work and weekend work.
- Pay at the Devil’s Den for student workers and student managers is low.
- It is known by the student employees and managers, and by the CFS day manager, that an employee was caught pocketing cash from the cash register and was only told to stay away from the register. There was no other punishment, and the event was never mentioned again.
- There is no history of punishment for taking food off the premises without paying for it by anybody, whether employee or customer.
**Exercising strong leadership**

- Supervision on all shifts is inattentive although there is no evidence of food being taken off the premises without payment for it either by student employees, student managers, customers or friends on the day shift, when the CFS manager is present.

- The employees on the night shift do not finish the work that is assigned to them and the day shift manager employees complete this work without comment.

- Student employees are supervised by student managers, who earn a little bit more money than the persons that they supervise.

2. **What is Susan's dilemma? What seems to influence her perceptions and behavior? What seems to influence the perceptions and behaviors of other Devil's Den employees?**

**What is Susan's dilemma?**

Susan is caught between a wish to do what she thinks is right, that is, take some steps to stop food being taken off the premises without payment for it, and the fear of negative consequences if she takes some action to prevent it. There are corollaries to Susan’s dilemma; namely that she would also like to see students work harder, and finish what is assigned to them on the night shift, and be punished for stealing from the cash register.

Students should see that Susan does not fit the culture at Devil’s Den—and she really is not in a position to change the culture on her own efforts. Culture change must come from the top—not from a part-time reform-minded employee (or even a student manager, should she decide to stay on and get promoted to this position). Sharp students will propose that Susan’s dilemma is one of accepting the situation at Devil’s Den or quitting and finding a job elsewhere—she is not likely to be happy at Devil’s Den, given that her values and ethical standards clash with the culture.

**What influences Susan's perceptions and behavior?**

Susan’s values are that it is wrong to take food off the premises without paying for it when this is not stated company policy, or to allow friends and customers to do so. Her value is that stealing money from a cash register also deserves some clear punishment rather than a minimal instruction of staying away from the cash register. Her values also are that you should work hard and finish what is assigned to you.

Her beliefs are that other employees do not share her values, that a clearer outline of the limits, enforced by negative consequences, will deter behavior that she thinks is unacceptable, and that it is management’s responsibility to see that there is compliance with these limits.

She has other values and beliefs that feed her dilemma. She values the positive regard of her fellow employees and, in contrast, wants to avoid their negative regard. She values promotion and achievement. She believes that if she tattles on her fellow students she will receive their disapproval. She also fears that management will not approve of her tattling, because it is less costly to allow the practices to which she objects than to run the risk of not being able to hire employees.

The consequences for her would be that she would not be promoted to the position of student manager. The balance between doing what she believes is right, and pursuing her self-interest, is about even, therefore, leaving her unsure about what to do. Nor does she see a choice that will tip the balance in one direction of another.
What influences the perceptions and behavior of the others in the case?

The practices have apparently been going on for some time. Why do they persist? They persist because: there is easy access to the food stuffs, there is poor inventory control, the practice is widely known because people see others doing it, and they see that it is allowed even to the extent of the failure to punish stealing from the cash register. Nor are there any written rules that clearly identify the limits.

It is, therefore, fair to assume that employees believe that the practice is known to the CFS management and allowed by them in order to compensate employees for their low wages and poor working conditions. Employees also see nothing to indicate that management intends to stop the practice, or punish anyone for engaging in it. This acquiescence can be interpreted as implicit approval of the practice.

3. What should Susan do about her dilemma?

Of course Susan may not be alone in the dilemma that she has. Others may feel the same way. One way of looking at it is to examine Susan’s belief that tattling will indeed have negative consequences. Some research on whistleblowers supports this belief. For instance, in the New York Times (February 22, 1987) Donald R. Soeken, a psychiatric social worker, and his wife, Karen L. Soeken, a statistician, “found that whistleblowers win little more than increased self-respect.” The Soekens’ study of 100 whistleblowers, with the average being a 47-year-old family man employed seven years before exposing wrongdoing, found that they suffered considerably and for many years.

Some of them, as a matter of fact, have never recovered from the adverse consequences of having exposed wrongdoing. Yet it is interesting to note that the Soeken’s report that the whistleblowers would do it again. They acted on the belief that the best society could be achieved by following universal moral codes, and this belief guided their judgments. “One engineer said: ‘Do what is right. Lost income can be replaced. Lost self-esteem is more difficult to retrieve.’”

Therefore, Susan is probably correct in her belief that there is an overwhelmingly negative reaction to tattling; apparently no matter how wrong the act may be that would be reported. Very likely the manager of Devil’s Den knows about some (most?) of the behavior that is going on—and has taken no steps to stop it. So Susan’s “tattling” to the Devil’s Den manager is not likely to work to Susan’s advantage or lead to corrective action.

Here, you might ask the class if Susan should go above the head of the manager of Devil’s Den and report the goings on to higher-ups at College Food Services (CFS).

- Should Susan write a letter? Send an e-mail? Make an anonymous phone call?
- Will Susan come off looking good to the people at CFS if she brings the issue of all the misdeeds to their attention, assuming she identifies herself as the whistleblower?
- What are the folks at CFS to whom Susan complains or “tattles” likely to do? Will they contact the manager at Devil’s Den? Will the manager appreciate what Susan has done?

Of course, the Devil’s Den manager and the student shift managers are largely responsible for placing Devil’s Den employees in a position where they have to wrestle with their conscience. Some students may, however, say that taking food off the premises in modest amounts in the Devil’s Den case is hardly something to get very upset about and that Susan is making a mountain out of a molehill. It could be argued that, from a financial point of view, management is wiser to allow the practice, rather than crack down on it, with the potential of not being able to staff the food facility.

On the other hand, this is not simply a question of ethics; it is also a matter of doing something illegal. In our system of private property, taking food off the premises without paying for it is at the least a misdemeanor.
and possibly a felony. It is a crime and punishable accordingly. Almost all students recognize that stealing is frowned upon in our culture. Therefore, even if accepted as a practice, they are likely to face a conflict of conscience. Failure to enforce ordinary expectations about such legal conventions can only erode respect for the law.

Under these circumstances, what is it that a person can do who is as bothered as Susan seems to be by what she sees is going on? Talking with one’s fellow employees, even if they feel the same way, is not likely to produce any change. Indication of this is the fact that Susan did talk to Mac, and there was little that happened as a consequence. Perhaps she could organize the rest of the employees, but given their weak motivation for taking this employment, and their propensity to leave by the time they are juniors, there is little likelihood that they will be willing to suffer the fate of those who try to organize.

The costs could be high and the reward small. Nor is there any indication that the CFS management will be pleased to be informed. To the contrary, its representative on the first shift did not even punish or object strenuously to stealing from the cash register.

Susan feels that there are better chances of doing something constructive as a student manager. Why should this be the case? She may be misguided in her hopes, but her conclusion lies in some sound reasoning, whether intuitive or conscious. As a manager one has some assigned responsibility, authority to go with it, and therefore legitimacy in insisting that certain expectations be met. As an employee one does not have that legitimacy. Neither responsibility nor authority is assigned and, therefore, she would be violating expectations if she made an effort to exercise influence that was not conferred upon her by the required system. Even as a manager she might find that the practice is so well entrenched that she would jeopardize her future, and relationships with other students, if she did not go along with the practice.

There is no easy way out for Susan and certainly no way to both avoid risk and assuage her conscience. An anonymous phone call or letter might do it. If that didn’t, she would really have to decide how much of a price she was willing to pay to be true to herself. Susan’s best option might be to find employment in an organization where the culture more closely matches her values.

**EPILOGUE**

We have nothing to report about the outcome of Susan’s decision regarding her dilemma or an update on the management practices at the Devil’s Den.
OVERVIEW

In June 2008, Wal-Mart CEO Lee Scott presented a glowing report to the estimated 16,000 shareholders attending the company’s annual shareholder meeting held at the 19,000-seat Bud Walton Arena on the University of Arkansas campus located a few miles from Wal-Mart’s headquarters in Bentonville, Arkansas. In the tradition of prior annual meetings of Wal-Mart shareholders, the 2008 meeting was an elaborate event lasting most of the day; not only did the meeting include a series of presentations by company executives but it also featured entertainment by Tim McGraw, David Cook (who had been named the 2008 American Idol a few weeks earlier), British-singer Joss Stone, and Oscar winner and Idol finalist Jennifer Hudson. Lee Scott said he was quite pleased with the results of the transformation process that top management had initiated in 2006 to provide customers with a more satisfying shopping experience, better fulfill the company’s new mission of “Saving People Money So They Can Live Better”, and do a better job of getting Wal-Mart’s 2.1 million employees worldwide to understand and practice the cultural values and business principles espoused by the company’s esteemed founder, Sam Walton.

Lee Scott explained to shareholders why transformation of Wal-Mart had become essential to the company’s continued growth and success even though in 2006 Wal-Mart’s traditional business model of driving costs out of its supply chain, constantly implementing ways to operate more cost efficiently, offering customers worldwide a wide range of merchandise at appealingly low prices, and opening stores in more and more places to serve an ever-growing customer base had served the company well:

It would be easy to take comfort in the success we have had in our business…..If you know that something works, why not just replicate it and replicate it and replicate it? Well, we have done that before. For several years, we did what we knew worked. And we did it very well. We grew beyond expectations. Our stock price went up. And we felt good about it. And we had every right to.

But, in time, the world changed. People’s expectations of us—and of corporations in general—changed. And we found ourselves playing catch up. We can never let that happen again. Not only must we never fall behind….we must always push ourselves to stay ahead.

We must continue to ask fundamental questions that alter perspectives and ultimately behavior. Questions like: How do you persuade someone in a successful organization that real change is needed and can be achieved in a way that is consistent with their core beliefs? How do you get a leadership team to step back and ask what success means not just in their own business, but in the larger context of the company as a whole? How do you take the trends of the future and put them into the business, so a company is relevant to today’s consumers and well positioned for tomorrow’s consumers?

These are not easy questions to ask. They are not easy questions to answer. But we have to keep asking them. And when necessary make difficult decisions.

Your Wal-Mart has an opportunity to be a leader in the retail industry for more ethical and environmentally friendly sourcing. Your Wal-Mart can play a role in reducing the world’s dependence on oil and other high-
carbon sources of energy. Your Wal-Mart can bring even greater value to customers who need and deserve to save on everyday needs.

And there are things we need to do inside our company—such as making your Wal-Mart more diverse and creating a more inclusive environment. I am confident that if we put diversity and inclusion into our business and really commit to it, we can make real progress. I am determined Wal-Mart will do this.

But I also urge you to think about what we can do—and what the world will expect us to do in the future. There are very clear trends that the retail industry and the world will have to confront—the aging of the global population, a multi-polar balance of power, income inequality, the disruptive power of technology, increased demand for energy, to name a few.

Think about these trends, the strengths of your Wal-Mart and our model of “Saving Money” and “Living Better.” We have the best global footprint to serve millions worldwide who will want the opportunity to lift themselves up into the middle class. Our leadership in sustainability will give customers and suppliers everywhere the ability to be more energy efficient and therefore more energy independent. An older global population will need us to help them stretch their money and maintain their quality of life while living on a fixed income. Here’s the bottom line for our business and the larger role we can play….your Wal-Mart is uniquely positioned to succeed not just in this economy, but in these times. And among retailers, we are the best positioned to lead in the world of tomorrow.

So how do we continue to turn our position of strength into leadership for the future? I want to repeat a quote from Sam [Walton] that I shared on this stage two years ago: “You can’t just keep doing what works one time. Everything around you is always changing. To succeed, stay out in front of that change.”

We have a culture, a mission and core values that are timeless and universal. But we have to constantly look at how we apply those things to the changing world around us. The challenge ahead is that we must continue to challenge ourselves.

Scott’s leadership of the transformation process underway at Wal-Mart included a number of initiatives:

- Recasting the company’s mission as one of “Saving people money so they can live better.”
- Revising Wal-Mart’s logo to better mirror the company’s shift in emphasis away from “Always low prices. Always.” and “We sell for less” to the broader mission of “Saving people money so they can live better.”
- Making a special effort to convince Wal-Mart’s 2.1 million associates why the company’s new mission of “Saving people money so they can live better” was more than a hollow statement and a reflection of the company’s new marketing campaign tied to the theme “Save money. Live better.” Scott and Wal-Mart’s other senior executives believed the new mission would not have the desired transformational effect unless it led to better operating practices and a cultural energy that actually delivered added value to customers and touched the communities in which Wal-Mart operated.
- Broadening Wal-Mart’s appeal to existing customers and attracting new customers to shop at Wal-Mart, updating merchandise offerings, instituting faster checkout procedures, and revising the layout and decor of Wal-Mart stores to enhance store ambience and better present merchandise offerings in a manner calculated to spur sales.
- Initiating a flat $4 price for the generic versions of some 200 common prescription drugs.
- Increasing “green” merchandise offerings and promoting their use to customers.
- Launching a multi-faceted “Zero Waste” campaign.
- Instituting ways to make Wal-Mart stores both more energy efficient and supplied by 100 percent renewable energy.
- Making Wal-Mart an even better place to work.
- Driving growth in the company’s international operations via both acquisitions of foreign retailers (whose operations could later be converted to Wal-Mart stores) and opening newly-constructed stores. This strategic thrust was aimed at transforming Wal-Mart into an increasingly global retailer with more and more stores in more and more countries.
- Making a positive contribution to the quality of life in every community in which the company conducted business.

Lee Scott’s sweeping effort to transform Wal-Mart was, to a large degree, a thoughtfully and carefully crafted response to a loud and growing chorus of Wal-Mart critics and a series of embarrassing incidents. During the 2003-2005 period, numerous journalists, union leaders, community activists, and so-called cultural progressives had united in a campaign to publicize assorted Wal-Mart sins and misdeeds, generate anti-Wal-Mart sentiment, stymie the company’s growth, and turn public opinion against Wal-Mart and its seemingly virtuous business model of relentlessly wringing cost efficiencies out of its supply chain and providing customers with everyday low prices. The biggest complaint of critics was that Wal-Mart’s zealous pursuit of low costs had resulted in substandard wages and insufficient medical benefits for Wal-Mart’s U.S. employees. Others complained that Wal-Mart sourced too much of its merchandise from Chinese suppliers, thus costing jobs for American workers and hastening the decline of the U.S. manufacturing sector. Some said the “Beast of Bentonville” was too big and too powerful. Community activists in California, New York, Vermont, Massachusetts, and several other areas were vigorously opposing the company’s attempts to open “big box” stores in their locales, claiming that they were unsightly and detracted from the small merchant atmosphere that they wanted to preserve.

Wal-Mart’s journey from humble beginnings in the 1960s as a folksy discount retailer in the boondocks of Arkansas to a global retailing juggernaut in 2008 was unprecedented among the companies of the world:

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Sales</th>
<th>Profits</th>
<th>Stores</th>
</tr>
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<tr>
<td>1962</td>
<td>$1.4 million</td>
<td>$112,000</td>
<td>9</td>
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<tr>
<td>1970</td>
<td>$31 million</td>
<td>$1.2 million</td>
<td>32</td>
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<tr>
<td>1980</td>
<td>$1.2 billion</td>
<td>$41 million</td>
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<td>1990</td>
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<td>2000</td>
<td>$153 billion</td>
<td>$5.3 billion</td>
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<tr>
<td>2008</td>
<td>$375 billion</td>
<td>$12.7 billion</td>
<td>7,262</td>
</tr>
</tbody>
</table>

Sales were expected to exceed $400 billion in fiscal 2009. Wal-Mart was the largest retailer in the U.S., Canada, and Mexico, as well as the world as a whole.

Just as unprecedented was Wal-Mart’s impact on general merchandise retailing and the attraction its stores had to shoppers in locations where it had stores. In 2008, nearly 180 million people per week shopped Wal-Mart’s stores in 14 countries; in the U.S., the numbers averaged 127 million per week. Since the early 1990s, the company had gone from dabbling in supermarket sales to No. 1 in grocery retailing worldwide. In the U.S., Wal-Mart was the biggest employer in 21 states. As of June 2008, the company employed about 2.1 million people worldwide and was expanding its work force by about 120,000 jobs annually.

Lee Scott, Wal-Mart’s third CEO, had the challenge of sustaining the company’s growth, globalizing Wal-Mart operations, continuing the long-term process of saturating the U.S. market with Supercenters, overseeing Wal-Mart’s ever-larger business operations, and most recently, figuring out how to counteract the anti-Wal-Mart campaign being orchestrated by the company’s critics and adversaries.
To profitably execute its everyday low price strategy, Wal-Mart put heavy emphasis on getting the lowest possible prices from its suppliers, forging close working relationships with key suppliers in order to capture win-win cost savings throughout its supply chain, keeping its internal operations lean and efficient, paying attention to even the tiniest details in store layouts and merchandising, making efficient use of state-of-the-art technology, and nurturing a culture that thrived on pleasing customers, hard work, constant improvement, and passing cost-savings on to customers in the form of low prices.

The hallmarks of Wal-Mart's strategy were a deeply ingrained dedication to being a low-cost provider and charging everyday low prices, multiple store formats, wide selection, a mix of both name-brand and private-label merchandise, a customer-friendly store environment, astute merchandising, limited advertising, a strong emphasis on customer satisfaction, disciplined expansion into new geographic markets, the use of acquisitions to enter foreign country markets.

In 2008 Lee Scott had reason to believe like his transformation plan was producing the desired results. Company morale was decidedly improved, partly because Wal-Mart's far-reaching efforts to adopt business practices that were better for the environment had energized company personnel, triggered a burst of innovative thinking, and made associates feel good about their jobs and the company. There had been a noticeable falloff in the Wal-Mart bashing that had taken place in 2004-2006. Time would tell whether Scott’s transformation initiatives would eventually restore the luster to Wal-Mart’s image, spur the company’s sales revenues, and reduce community resistance to opening new Supercenters.

But heading into 2009, there continued to be occasional stories in the media that were critical of Wal-Mart’s operating practices and of the company in general. It was unclear whether the company’s transformation initiatives were having the desired impact on public opinion and whether Wal-Mart’s growth and profitability would be adversely affected by its critics and adversaries.

Nonetheless, the economic slowdown that began in early 2008, followed by the global financial crisis and even sharper economic downturn that transpired in Fall 2008, had resulted in significant increases in customer traffic and purchases at Wal-Mart’s stores. Many consumers—already feeling the pinch of recessionary forces or else anxious about the prospects of being laid off—were shopping at Wal-Mart more frequently and Wal-Mart’s average sales per customer checkout were above prior-year levels, due in part to steep declines in gasoline prices in September-November 2008 which made a trip to Wal-Mart cheaper and gave consumers more discretionary income to spend at Wal-Mart. Sales at Wal-Mart stores open at least a year rose a robust 3.4 percent for the 43-week period ending November 28, 2008 (versus just 1.4 percent for the same period in 2007). Wal-Mart executives believed that in tough economic times Wal-Mart was the best destination for shoppers to save money.

SUGGESTIONS FOR USING THE CASE

This is a superb case for helping students comes to grips with all that needs to be done to successfully execute a low-cost leadership strategy and to make needed changes in company operations when confronted with widespread criticism of how the company handles some aspects of its business.

The case lays out Wal-Mart’s corporate history and phenomenal growth record, its strategy to become the largest discount retailer in the world via a low-cost leadership strategy, the company’s approaches to strategy execution, and the transformative initiatives that CEO Lee Scott launched to curtail media bashing of Wal-Mart. There’s a detailed rundown of all the things that Wal-Mart has done to implement its strategy in near-perfect textbook fashion. And there’s a portrayal of Sam Walton’s leadership style, why he was the driving force behind Wal-Mart’s success, and how his beliefs, philosophies, and values were instrumental in creating a strategy-supportive corporate culture at Wal-Mart. Information at the beginning and end of the case.

The Wal-Mart case is a good vehicle for illustrating what it takes to implement and execute a low-cost leadership strategy in top notch fashion and for driving home the relevance of what was covered in Chapters 10-12. The issues in the Wal-Mart case cut across all three strategy-execution chapters, making it an ideal case to assign once you have finished your lectures on these chapters. As long as students have been exposed to the material
in Chapters 10-12, you can position the Wal-Mart case most anywhere in your strategy execution module. It is a relatively easy case for students to analyze. Having students critique Lee Scott’s transformation program and make further recommendations for change is a very good way to conclude the class discussion.

One of the things that makes the Wal-Mart case such a good assignment is that students will likely have some strong opinions about the company based on their own experiences as a customer. They may or may not be familiar with how sophisticated a retailer that Wal-Mart is, what a solid job of strategy execution the company has done, and Lee Scott’s recent transformation initiatives, but they will almost certainly have strong opinions based on their own shopping experiences and the merits of the arguments made by Wal-Mart’s critics.

The case contains a raft of issues that students can debate, ranging from what has made the company so successful to just how good a job that Wal-Mart has done in executing its strategy to what Wal-Mart should do about the obstacles that are being thrown in the company’s path as management tries to carry out its strategy for growing the business to whether Wal-Mart is a “good” company from a societal perspective.

The Wal-Mart case has a brief 1½-minute accompanying video concerning the 2008 campaigns of Wal-Mart and CVS (a leading drug chain) to cut the costs of generic drugs for their customers. We suggest showing this as part of your discussion of the transformation initiatives that Lee Scott has recently launched.

There is probably enough material here for a two-day class discussion. The first day could be devoted to exploring Wal-Mart’s approaches to strategy execution and getting students to see the power and sophistication with which Wal-Mart executes its big-box discount retailing strategy. The central issue during day one can be: “What is the single biggest factor that accounts for Wal-Mart’s success—its first-rate strategy, its first-rate leadership, or its first-rate strategy execution?” The second day can be used to address all of Wal-Mart’s alleged sins and misdeeds; have the class evaluate Lee Scott’s transformation initiatives, debate whether these initiatives are “sincere” or just a PR campaign to dress up Wal-Mart’s image, raise questions about whether Wal-Mart is a “good” or “bad” company, and push the class to recommend what else Wal-Mart management should be doing to enhance the company’s reputation and prospects for continued growth and profitability.

There’s a file of the suggested Assignment Questions in this TN that is posted on the Student section of the Web site; we always urge having class members prepare thoughtful notes to the study questions (either those we have provided or a set of your own choosing) prior to coming to class. In our experience, class discussions of assigned cases are far more productive when class members have been prodded by study questions to “think about the right things” and to make use of the pertinent core concepts and analytical tools covered in the text chapters before they come to class. Moreover, class members often find that a set of study questions is useful in helping them prepare oral team presentations and written case assignments—in addition to whatever directive questions you you want them to zero in on in preparing these assignments. Thus, there’s much to be gained by insisting that your students spend quality time preparing answers to study questions for each and every case assignment.

We believe the Wal-Mart case is a good candidate for oral team presentations and a written case analysis. Our recommended assignment questions for a written case assignment or oral team presentation are as follows:

- Wal-Mart’s CEO Lee Scott has asked you to critique his efforts to transform Wal-Mart and combat Wal-Mart bashing and to make recommendations for further improving the way the company conducts its business. Please prepare a 2-4 page report (or a 30-minute presentation) to Lee Scott and Wal-Mart management detailing your thoughts and analysis. Your critique and recommendations should be thoroughly supported and forcefully argued, and you should demonstrate command and use of the material in Chapters 10-12.

- What grade would you give Lee Scott for the job he has done as Wal-Mart’s CEO? Your grade should be thoroughly supported and forcefully argued in a 2-4 page report (or a 20-minute presentation). It is essential that you make use of and demonstrate command of the pertinent core concepts and methods of analysis presented in the text chapters in evaluating Lee Scott’s strategic leadership during his tenure as Wal-Mart’s CEO.
ASSIGNMENT QUESTIONS

1. What impresses you about this company? What accounts for Wal-Mart’s success over the past 25+ years? Is it a great strategy, superb strategy implementation and execution, or great leadership? What aspects of Wal-Mart do you find unimpressive?

2. Which of the five generic strategies is Wal-Mart employing? What are the chief elements of its strategy?

3. Is Wal-Mart’s strategy working well? What does the information in case Exhibit 1 reveal about the company’s strategic and financial performance during 2000-2008? Please use the financial ratios presented in Table 4.1 of Chapter 4 to guide your calculations and reach conclusions about the caliber of Wal-Mart’s financial performance.

4. What policies, practices, support systems, and management approaches underlie Wal-Mart’s efforts to execute the company’s strategy?

5. What are its chief elements and characteristics of Wal-Mart’s culture? Why does the culture seem to be so much stronger in Bentonville than out in the stores?

6. What is your assessment of Lee Scott’s transformation initiatives? Are the initiatives “sincere” or just calculated to garner better PR for Wal-Mart? Are more transformational initiatives needed? Why or why not?

7. What issues do Lee Scott and Wal-Mart management need to address?

8. What recommendations would you make to Lee Scott?

TEACHING OUTLINE AND ANALYSIS

1. What impresses you about this company—why has this company been so successful over the past 25+ years? Is it a great strategy, superb strategy implementation and execution, or great leadership? What aspects of Wal-Mart do you find unimpressive?

In our view, easily the 3 most impressive things about Wal-Mart are:

- Its spectacular growth (as shown below):

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Sales</th>
<th>Profits</th>
<th>Stores</th>
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</thead>
<tbody>
<tr>
<td>1962</td>
<td>$1.4 million</td>
<td>$112,000</td>
<td>9</td>
</tr>
<tr>
<td>1970</td>
<td>$31 million</td>
<td>$1.2 million</td>
<td>32</td>
</tr>
<tr>
<td>1980</td>
<td>$1.2 billion</td>
<td>$41 million</td>
<td>276</td>
</tr>
<tr>
<td>1990</td>
<td>$26 billion</td>
<td>$1 billion</td>
<td>1,528</td>
</tr>
<tr>
<td>2000</td>
<td>$153 billion</td>
<td>$5.3 billion</td>
<td>3,884</td>
</tr>
<tr>
<td>2008</td>
<td>$375 billion</td>
<td>$12.7 billion</td>
<td>7,262</td>
</tr>
</tbody>
</table>

- Its 45-year climb from humble beginnings in rural Arkansas (a rather unlikely place) to become the world’s premier discount retailer (more accurately, the world’s biggest, most sophisticated, and best-managed retailer—despite its shortcomings!).
Sam Walton’s visionary leadership (the best retailing entrepreneur of the past 50 years, and arguably of all time).

Astute class members will attribute Wal-Mart’s success to a combination of good strategy, competent strategy execution, and sound leadership on the part of Sam Walton, David Glass, and Lee Scott.

Strategy surely has been important at Wal-Mart, especially the part of locating stores in medium and small towns first (as opposed to starting in metro areas and then expanding outward). Wal-Mart has faced much less competition in small communities than it would have encountered if it concentrated only on larger towns where other discount operations and name brand retailers also had stores. Other important strategy elements have been the transition to Supercenters (which has resulted in Wal-Mart becoming the biggest supermarket retailer in the U.S.) and, more recently, Wal-Mart’s drive to expand into foreign countries. The company’s cost-conscious operating culture has also been crucial to making a profit selling mostly name-brand merchandise at discounted prices.

But when you get right down to it, the only part of the Wal-Mart strategy that stands out from what other discounters do (or could try to do) is the “backwards expansion” approach. This could have been copied by other discounters (once Wal-Mart proved it could work)—but it never was (and now, of course, it is too late since Wal-Mart stores are a shopping fixture in rural areas across the U.S. and for another retailer discounter to enter these markets and compete head-to-head against Wal-Mart would likely prove disastrous).

Wal-Mart’s strategy is good, actually excellent, but it doesn’t really account for Wal-Mart’s success. There’s nothing proprietary about Wal-Mart’s strategy, nor is there any really great genius underlying Wal-Mart’s strategy except for the backwards expansion component (selling brand name merchandise at low prices was not an idea invented by Sam Walton).

Moreover, there’s nothing to prevent other retailers from essentially imitating Wal-Mart’s “big-box” stores that sell name-brand merchandise at attractively low prices. Kmart has been remarkably unsuccessful with a strategy not greatly different from Wal-Mart’s. Target, which also has a strategy fairly similar to Wal-Mart’s is not as successful as Wal-Mart either.

Once you develop the point that there really is nothing all that unique about Wal-Mart’s strategy that rivals could not copy or imitate, you should ask how good Wal-Mart is at day-to-day execution of its retailing approach.

Implementation and execution of the strategy devised by Sam Walton has plainly been a huge contributor to Wal-Mart’s success.

By all indications, the strategy has been smoothly put in place and rapid expansion has been accommodated without much evidence of growing pains.

No big operating problems are evident.

Continuous fine tuning and seeking ways to improve strategy and strategy execution have been institutionalized all the way down to the departments within stores.

There shouldn’t be too much controversy over the caliber of Wal-Mart’s strategy execution—we would rate it as a textbook A+ example of how to do things. Wal-Mart is very, very well-managed from top to bottom from an operational standpoint.

Students should have little trouble recognizing that Sam Walton had a big influence on Wal-Mart’s success. He did a masterful job of orchestrating the implementation and execution of the strategy, functioning as leader, cheerleader, motivator, culture-builder, and avid supporter of innovation and change. His successor, David Glass, while lacking the charisma of Sam Walton, was nonetheless enormously successful in engineering Wal-Mart’s continued climb to the top of the world retailing industry. During Glass’s tenure, the company
did not appear to miss a beat. Lee Scott has continued in the steps of his predecessors (though with perhaps more and bigger problems to deal with). It should be clear that Wal-Mart has had exceptionally strong leadership so far.

It is hard to make a case that “luck” has had anything to do with Wal-Mart’s success.

Our favorite way to bring out the above points is to begin the class with the question “what do you find really impressive about this company?” We go to the blackboard, write a heading “Impressive things about Wal-Mart,” and tally the responses from the class. Usually the list gets lengthy—some 12-15 items, at which point we stand back and ask whether all the items can be synthesized into 3 categories:

- Good strategy
- Good strategy execution
- Good strategic leadership

Usually, all the items fall into one of these categories. Then you can ask which one most explains Wal-Mart’s success, which has been second most important, and which is third in importance. Our vote is:

1. Good strategy execution
2. Good leadership
3. Good strategy

But none of the three can be minimized and all have definitely played a factor. It’s a close call whether good strategy execution should outweigh good leadership.

Once these points have been brought out you can turn to what students find lacking at Wal-Mart. There are several questions that you can pose to spur class debate:

- What do you dislike about the company’s strategy or operating approaches? What concerns you?
- What do you dislike about the company?
- Is Wal-Mart’s wage scale “too low?” Is it skimping too much on paying good health care benefits?
- Is there a problem with ethics at Wal-Mart?
- Are Wal-Mart’s prices “too low?” Should the company up the wages and benefits paid to associates and cover the added costs with price increases? Are the majority of jobs at Wal-Mart’s stores entry-level jobs that require minimal skills and know-how? Where else could Wal-Mart’s store associates expect to get jobs making more money and paying better benefits than they make at Wal-Mart?
- Is Wal-Mart a “bad” company? Has it engaged in too many “misdeeds?”
- Is Wal-Mart “good” for low-income consumers?
- Is Wal-Mart a socially responsible company? Why or why not?

2. Which of the five generic competitive strategies is Wal-Mart employing? What are the chief elements of its strategy?

The company is plainly employing an overall low-cost leadership strategy. Wal-Mart’s big appeal is its low prices for name-brand merchandise; it can’t execute this strategy profitably without being low cost in virtually every aspect of its operations.
The class should have little difficulty singling out the chief elements of Wal-Mart’s strategy:

- Everyday low prices—often the lowest prices for a given item
- Name-brand merchandise (but with some house or private-label merchandise throw in)
- Wide selection—Wal-Mart’s Supercenter stores have a bigger variety of items to choose from than its older and smaller Discount stores and a full supermarket.
- Multiple store formats—Discount City stores, Supercenters, neighborhood markets, and Sam Clubs
- A customer-friendly store environment
- Innovative and astute merchandising
- Use its enormous buying power to obtain goods from suppliers at the lowest possible prices
- Limited advertising—Wal-Mart relied less on advertising than most other discount chains (understandable because most consumers know about Wal-Mart, know about its low prices and good selection, and know what to expect when shopping at Wal-Mart). The only thing Wal-Mart needs to advertise is its “specials.” The company distributed only one or two circulars per month and ran occasional TV ads, relying primarily on word-of-mouth to communicate its marketing message. Wal-Mart’s advertising expenditures ran about 0.3 percent of sales revenues, versus 1.5 percent for Kmart and 2.3 percent for Target.
- Disciplined expansion into new geographic markets
- The use of acquisitions to expand into foreign markets

If you haven’t already done so, you should make sure at this juncture that students understand that Wal-Mart’s strategy is easily copied. There are no secrets about what Wal-Mart’s strategy is, and there’s no proprietary element to its strategy. There’s nothing to prevent Sears or Kmart or Target or any other discount retailer from imitating most all elements of Wal-Mart’s strategy.

- **Whether rivals can execute such a strategy as efficiently and effectively as Wal-Mart is quite another matter.**

Once the main elements of the strategy are identified and the point about the readily copy-able nature of the strategy has been made, then you should move immediately to the main focus of the case: **How has Wal-Mart implemented its strategy and how good is the company at day-to-day strategy execution? What has Wal-Mart management done to achieve low-cost leader status in retailing?**

**3. Is Wal-Mart’s strategy working well?** What does the information in case Exhibit 1 reveal about the company’s strategic and financial performance during fiscal years 2000-2008? Please use the financial ratios presented in Table 4.1 of Chapter 4 to guide your calculations and reach conclusions about the caliber of Wal-Mart’s financial performance.

The financial information provided in case Exhibit 1 is revealing in several respects:

- Wal-Mart’s sales revenues grew from $156.2 billion in FY 2000 to $374.5 billion in FY 2008, equal to a compound average growth rate (CAGR) of 11.6%—which is very respectable for a company of Wal-Mart’s size. On average, Wal-Mart’s revenues have risen $27.3 billion annually since 2000 (pretty impressive!!).
But it is clear from the annual sales increase percentages in case Exhibit 1 that Wal-Mart’s revenue growth is slowing down (which is probably normal and expected for a company of Wal-Mart’s size).

Net income rose from $5.3 billion in FY 2000 to $12.7 billion in FY 2008, equal to a respectable compound average growth rate (CAGR) of 11.5%.

EPS rose from $1.19 in FY 2000 to $3.13 in FY 2008, equal to a compound average growth rate (CAGR) of 12.8%.

Wal-Mart’s comparable store sales growth is slowing—from 8% in fiscal 2000 to 4% in fiscal 2004 to 2% in fiscal 2007 and 2008.

Operating costs and profit margins have trended thusly:

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<tr>
<td>Cost of sales as a %</td>
<td>76.5%</td>
<td>76.6%</td>
<td>76.9%</td>
<td>77.5%</td>
<td>77.5%</td>
<td>76.5%</td>
</tr>
<tr>
<td>% of net sales</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Operating, selling,</td>
<td>18.8%</td>
<td>18.6%</td>
<td>18.0%</td>
<td>17.4%</td>
<td>17.0%</td>
<td>16.1%</td>
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<td>general, and admin</td>
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<td>expenses as a % of</td>
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<tr>
<td>net sales</td>
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<tr>
<td>Net income as a %</td>
<td>3.4%</td>
<td>3.3%</td>
<td>3.6%</td>
<td>3.6%</td>
<td>3.3%</td>
<td>3.4%</td>
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<td>% of net sales</td>
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Although cost of sales as a % of net sales at Wal-Mart has steadily improved since FY2004, the gain has been more than offset by a persistent upward creep in operating, selling, general, and administrative expenses. However, the company’s net profit margin has held steady.

Wal-Mart’s current ratio has hovered in the 0.8 to 1.0 range, surprisingly low for a “blue-chip” company.

Wal-Mart’s return on assets and return on shareholders’ equity have eroded somewhat since FY2000.

Long-term debt and long-term obligations under capital leases are steadily rising—no doubt due to the financing needed to support opening so many new stores and to fund new acquisitions.

**Conclusions:** While the company is doing well, there’s certainly no reason to get excited about the company’s financial performance. Yet, there are no red flags of much size to indicate that Wal-Mart’s strategy or its execution are faltering. Revenue growth has exceeded $30 billion each of the past two years. Net income is rising, albeit more in some years than others. Operating, general, selling, and admin expenses are rising as a percent of revenues, which definitely is something that needs to be halted. But the company is growing its revenues $25 to $30 billion annually (which is, after all, an impressively large amount of new business to secure each year).

**4. What policies, practices, support systems, and management approaches underlie Wal-Mart’s efforts to execute the company’s strategy?**

The class should identify the following as central elements in Wal-Mart’s drive to implement and execute its low-cost leader strategy:

- **Build highly efficient and effective distribution centers and have a world-class distribution system.** To improve the delivery of merchandise to its stores, Wal-Mart in 1980 began to build its own centralized distribution centers and to supply stores from these centers with daily deliveries by its own truck fleet. Wal-Mart added new distribution centers when new, outlying stores could no longer be reliably and economically supported from an existing center.
Throughout the 1980s and 1990s, Wal-Mart had pursued a host of efficiency-increasing actions at its distribution centers. The company had been a global leader in automating its distribution centers and expediting the transfer of incoming shipments from manufacturers to its fleet of delivery trucks that made daily deliveries to surrounding stores. Prior to automation, bulk cases received from manufacturers had to be opened by distribution center employees and perhaps stored in bins, then picked and repacked in quantities needed for specific stores, and loaded onto trucks for delivery to Wal-Mart stores—a manual process that was error-prone and sometimes slow to fill store orders turn. Using state-of-the-art technology, Wal-Mart had automated many of the labor-intensive tasks, gradually creating an ever-more sophisticated and cost-efficient system of conveyors, bar-coding, and handheld computers, and other devices with the capability to quickly sort incoming shipments from manufacturers into smaller, store-specific quantities and route them to waiting trucks to be sent to stores to replenish sold merchandise. Oftentimes, incoming goods from manufacturers being unloaded at one section of the warehouse were immediately sorted into store-specific amounts and conveyed directly onto waiting Wal-Mart trucks headed for those particular stores—a large portion of the incoming inventory was in a Wal-Mart distribution center an average of only 12 hours. Distribution center employees had access to real-time information regarding the inventory levels of all items in the center and used the different barcodes for pallets, bins, shelves and items to pick up items for store orders. Handheld computers also enabled the packaging department to get accurate information about which items to pack for which store and what loading dock to have packages conveyed.

In instances where it was economical, Wal-Mart trucks were dispatched direct to a manufacturer’s facilities, picked up goods for one or more stores and delivered them directly, bypassing the distribution center entirely. Manufacturers that supplied certain high-volume items or even a number of different items sometimes delivered their products in truckload lots directly to some or many of Wal-Mart’s stores.

- **Emphasize continuous improvement.** Continuous improvement and the willingness to try out new ideas has lowered the barriers to doing things better and created a climate receptive to change, innovation, and experimentation. Wal-Mart has a low threshold for change.

- **Be willing to try new ideas and employee suggestions and to experiment with different store formats.**

- **Work hard at creating a customer-friendly store environment—make a point of emphasizing that “the customer is number one” and practice “aggressive hospitality.”** Management strived to find ways to keep these two themes in front of store associates and to keep the attitudes and actions of store employees “customer-oriented.” The goal was to make shopping at Wal-Mart a satisfying experience.

Wal-Mart tried to put some organization muscle behind its pledge of “Satisfaction Guaranteed” and do things that would make customers’ shopping experience at Wal-Mart pleasant. Store managers challenged store associates to practice what Sam Walton called “aggressive hospitality.” A “greeter” was stationed at store entrances to welcome customers with a smile, thank them for shopping at Wal-Mart, assist them in getting a shopping cart, and answer questions about where items were located. Clerks and check-out workers were trained to be courteous and helpful and to exhibit a “friendly, folksy attitude.” All store associates were urged to display the “10-foot attitude” and commit to a pledge of friendliness: “I solemnly promise and declare that every customer that comes within ten feet of me, I will smile, look them in the eye, and greet them.”

- **Be quick to adopt new technology that offers cost-saving benefits.** Wal-Mart’s aggressive adoption and use of state-of-the-art retailing technology. Wal-Mart’s approach to technology was to be on the offense—probing, testing, and then deploying the newest equipment, retailing techniques, computer software programs, and related technological advances to increase productivity and drive costs down. The company’s technological goal was to provide employees with the tools to do their jobs more efficiently and to make better decisions.
The latest example of pioneering leadership in state-of-the-art technology came in mid-2003 Wal-Mart informed its suppliers that they had to convert to electronic product code (EPC) technology based on radio frequency identification (RFID) systems by 2005. Electronic product codes involved a new product numbering standard that went beyond identifying products. EPC technology entailed embedding every single item that rolled off a manufacturing line with an electronic tag containing a unique number assigning a unique number to every single item that rolled off a manufacturing line. The ability to read EPC’s via RFID (which did not require direct line-of-sight) offered users significant time-savings and enhanced ability to update online databases -- identifying where and when a case or pallet of goods arrived, for example -- in supply chain logistics applications. EPC tags could be read by radio frequency scanners when brought into range of a tag reader. Wal-Mart management expected the ability to scan the codes would eventually be built into warehouse bin locations and store shelves, providing the ability to locate and track items throughout the supply chain in real-time. With EPC and RFID capability, every single can of soup or DVD or screwdriver in Wal-Mart’s supply chain network or on its store shelves could then be traced back to when it was made, where and when a case or pallet of goods arrived, and where and when an item was sold or turned up missing.

- **Use an assortment of compensation and human resource management practices to incentivize Wal-Mart associates** via above-minimum wage scale, a profit-sharing plan, a stock purchase plan, sales contests, bonuses for good ideas and suggestions, praise and recognition, dress up days. The sales contests are a means of boosting sales productivity per square foot of floor space.

- **Use participatory decision making, encourage employees to use their own inventiveness to accomplish the tasks at hand.**

- **Avidly practice “management-by-walking-around.”** Wal-Mart executives have been expert practitioners of MBWA over the years and stayed in touch with what’s going on in the stores and distribution centers—they are very involved in day-to-day operations and very much on top of what’s happening in the field. Senior Wal-Mart executives regularly spent time talking to vendors, employees, and customers to get ideas for how Wal-Mart could improve and then they followed-up with actions to try the new ideas out.

- **Build a strong, strategy-supportive culture**—Wal-Mart culture and values are strongest in the Bentonville headquarters and in the distribution centers (less so in the stores because of rapid employee turnover and rapid expansion in the number of stores).

The company has kept its small-town flavor as it has grown. Being headquartered in Bentonville (a small, rural-Arkansas town) has probably helped Wal-Mart remain true to its strategy of low-cost-operation, low discount prices, and a merchandise mix that appeals to its small-town, budget-conscious customers.

- **Have unusually productive and effective meetings and make them an integral part of the Wal-Mart culture.** Wal-Mart used meetings both as a communication device and as a culture-building exercise. Store managers had several regularly scheduled meetings with store associates daily. In Bentonville, there were Thursday afternoon meetings dealing with store operations, Friday morning management meetings, noon Friday merchandising meetings, and Saturday morning meetings covering a range of topics. The meetings in Bentonville nearly always making decisions and keeping in step with the very latest happenings in the stores. Most every meeting began and ended with the Wal-Mart cheer.

- **Pay attention to detail in the store environment and in its merchandising practices.** In all stores, efforts were made to present merchandise in easy-to-shop shelving and displays. Floors in the apparel section were carpeted to make the department feel homier and to make shopping seem easier on customers’ feet. Store layouts were constantly scrutinized to improve shopping convenience and make it easier for customers to find items. Store employees wore blue vests to make it easier for customers to pick out from a distance. Fluorescent lighting was recessed into the ceiling to create a softer impression than exposed fluorescent lighting strips. Yet, nothing about the decor conflicted with Wal-Mart’s low price
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image; retailing consultants considered Wal-Mart as being very adept at sending out an effective mix of vibes and signals concerning customer service, low prices, quality merchandise, and friendly shopping environment. Wal-Mart’s management believed that the attention paid to all the details of making the stores more user-friendly and inviting caused shoppers to view Wal-Mart in a more positive light.

- **Leverage the Supercenter concept.** The speed and power with which Wal-Mart has executed the Supercenter concept and taken over the lead in supermarket retailing is an especially impressive operating achievement—made possible by the distribution capabilities and core competences that the company had, over the years, built in its core discount retailing business.

- **Bargain hard with suppliers and get their bottom prices.** Wal-Mart’s purchasing agents were dedicated to getting the lowest prices they could, and they did not accept invitations to be wined or dined by suppliers. **Procurement personnel spent a lot of time meeting with vendors and understanding their cost structure.** By making the negotiation process transparent, Wal-Mart buyers soon learned whether a vendor was doing all it could to cut down its costs and quote Wal-Mart an attractively low price.

Wal-Mart looked for suppliers who were dominant in their category (thus providing strong brand-name recognition), who could grow with the company, who had full product lines (so that Wal-Mart buyers could both cherry-pick and get some sort of limited exclusivity on the products it chose to carry), who had the long-term commitment to R&D to bring new and better products to retail shelves, and who had the ability to become more efficient in producing and delivering what it supplied. **Even though Wal-Mart was tough in negotiating for absolute rock-bottom prices, the price quotes it got were still typically high enough to allow suppliers to earn a profit.** Being a Wal-Mart supplier generally meant having a stable, dependable sales base that allowed the supplier to operate production facilities in a cost effective manner. Moreover, **once it decided to source from a vendor, then Wal-Mart worked closely with the vendor to find mutually beneficial ways to squeeze costs out of the supply chain.** Every aspect of a supplier’s operation got scrutinized—how products got developed, what they were made of, how costs might be reduced, what data Wal-Mart could supply that would be useful, how sharing of data online could prove beneficial, and so on. Nearly always, as they went through the process with Wal-Mart personnel, suppliers saw ways to prune costs or otherwise streamline operations in ways that enhanced their profit margins.

Many suppliers viewed Wal-Mart’s single bottom-line price policy and its expectation of close coordination as a win-win proposition, not only because of the benefits of cutting out all the funny money costs and solidifying their relationship with a major customer but also because what they learned from the collaborative efforts and mutual data-sharing often had considerable benefit in the rest of their operations. Many suppliers, including Procter & Gamble, liked Wal-Mart’s supply chain business model so well that they had pushed their other customers to adopt similar practices.

**As the biggest and most important customer of its suppliers, Wal-Mart got first-class attention, service, and treatment from its suppliers.** Some 200 vendors had established offices in Bentonville to work closely with Wal-Mart on a continuing basis.

- **Get the biggest bag for the buck out of capital expenditures for new stores, store renovations, and store fixtures.** Ideas and suggestions were solicited from vendors regarding store layout, the design of fixtures, and space needed for effective displays. Wal-Mart’s store designs had open-air fixtures for management personnel that could be furnished economically and featured a maximum of display space that could be rearranged and refurbished easily. Wal-Mart claimed that the design and aisle width at its new Supercenters would accommodate 100 million shoppers per week. Because Wal-Mart insisted on a high degree of uniformity in the new stores it built, the architectural firm Wal-Mart employed was able to use computer modeling techniques to turn out complete specifications for 12 or more new stores a week. Moreover, the stores were designed to permit quick, inexpensive construction as well as to allow for low-cost maintenance and renovation.
In keeping with the low-cost theme for facilities, Wal-Mart’s distribution centers and corporate offices were also built economically and furnished simply. The offices of top executives were modest and unpretentious. The lighting, heating and air-conditioning controls at all Wal-Mart stores were connected via computer to Bentonville headquarters, allowing cost-saving energy management practices to be implemented centrally and freeing store managers from the time and worry of trying to hold down utility costs.

Wal-Mart mass-produced a lot of its displays in-house, not only saving money but also cutting the time to roll out a new display concept to as little as 30 days. It also had a group that disposed of used fixtures and equipment that could not be used at other store via auctions at the store sites where the surplus existed—a calendar of upcoming auctions was posted on the company’s web site.

Most recently, push to implement and execute Lee Scott’s transformation initiatives—especially those related to environmental sustainability and making Wal-Mart a “green” company.

Class members should see that Wal-Mart management has been very, very successful in finding ways to keep operating costs low. Indeed, for the past 40+ years, management has been relentless in driving costs out of the business—no stone has been left unturned.

In researching and writing the case, we made a special effort to detail the array of things Wal-Mart management does to enhance day-to-day execution of its retailing strategy. This has made the case somewhat longer than is optimal but we think the richness of detail we’ve provided in the case allows you to drive home a very key strategic management principle:

When a company cannot realistically expect to out-compete rivals with a decidedly superior strategy, then its best chance for sustainable competitive advantage is to beat them with superior strategy execution.

Few companies illustrate this principle any better than Wal-Mart. A solid case can be made that the key to Wal-Mart’s success is the thoroughness with which Wal-Mart management does things. Operating details simply don’t slip through the cracks. No bases are left uncovered. There’s no complacency; instead, the company exhibits a strong drive to be innovative, to experiment with new ideas, and to improve.

As you bring out these points, the class should begin to understand what good strategy implementation and execution entails and why Wal-Mart’s management team over the years has done such a good job of running the company.

5. What are its chief elements and characteristics of Wal-Mart’s culture? Why does the culture seem to be so much stronger in Bentonville than out in the stores?

The defining components of Wal-Mart’s culture are:

- An emphasis on frugality, penny-pinching efficiency, and austerity—this is a company that thrives on driving costs out of the business.

- Dedication to customer satisfaction, meeting or exceeding customer expectations, and good customer service. Much emphasis was placed on going all out to exceed customers’ expectations and make sure that customers had a good time shopping at Wal-Mart. Every associate repeatedly heard “The customer is boss and the future depends on you.”

- The change-oriented work environment and entrepreneurial atmosphere—there’s a strong tradition of innovation and continuous improvement.

- Senior executives’ practice of spending much of their time in stores, listening and talking to customers and associates, soliciting suggestions and ideas, gathering information, and staying in touch with daily operations.
The emphasis being placed on practicing Sam Walton’s 10 rules for building a business and Sam Walton’s three basic beliefs—Management had distilled much of Sam Walton’s business philosophy into 10 rules (see case Exhibit 4); these were reiterated to associates and used at meetings to guide decision-making and the crafting and executing of Wal-Mart’s strategy. In addition, Wal-Mart top management stressed the three basic beliefs that Sam Walton had preached since 1962—the idea was to ingrain all three in the culture.

The manner and extent to which Wal-Mart executives cultivate employee empowerment and involvement and treat employees as partners/associates.

The rah-rah spirit (the Wal-Mart cheer), the cheerleading by management, and the positive motivational practices.

The strong bias for action as displayed in the meetings in Bentonville.

As these elements of the culture are brought out, you may wish to observe that Wal-Mart’s culture is closely akin to that of an adaptive culture (as described in Chapter 12). There is a pervasive emphasis on change, innovation, continuous improvement, and problem-solving. Resistance to change appears minimal.

The culture in Bentonville is stronger than out in the stores for several reasons:

Sam Walton’s values, beliefs, and business principles are firmly rooted in the way headquarters operates. Many of the people in headquarters knew Sam Walton personally and were deeply influenced by his leadership during the company’s early years and up until his death in 1992. His spirit lives on in Bentonville and the roots of the Wal-Mart culture are very deeply planted.

Out in the stores the culture is much weaker due to high rates of employee turnover and to rapid increases in the number of stores. It is virtually impossible to have a strong culture when a company has 1.8 million employees and when so many of these employees are relatively new (both because of turnover and the addition of some 100,000+ employees to staff the company’s growing store and distribution operations. No other company in all of business history had been confronted with cultural indoctrination of so many new employees in so many locations in such a relatively short time. One can expect, therefore, that Wal-Mart will have a hard time doing more than struggling to maintain a weak corporate culture in its retail stores. We see little chance of creating a strong culture in the retail stores (except at those relatively few stores where the store managers are exceptionally good culture-builders) unless the store-level turnover rate can be brought down to close to 10% (so that there is considerable stability in the work force at the store-level).

We see the culture in Bentonville as strong and the culture in the stores as comparatively weak (compared to the 1980-1990 period when the company was smaller and Sam Walton was personally orchestrating the culture in the stores). Very likely, the culture in the distribution centers is moderately strong, less strong than in Bentonville but probably much stronger than in the stores. Wage rates are higher in the distribution centers, making for lower turnover of associates and opportunities to implant the culture in employees the longer that they stay with the company. Store turnover and the thousands of new hires each year makes it tough to maintain a strong culture in the retail stores.
6. What is your assessment of Lee Scott’s transformation initiatives? Are the initiatives “sincere” or just calculated to garner better PR for Wal-Mart? Are more transformational initiatives needed? Why or why not?

We would give Lee Scott a grade of A for his efforts to transform Wal-Mart and for the wisdom and timeliness of the initiatives themselves. We like everything he is doing and we think his motives are genuine.

But class members may see things differently and their views may range broadly. There are a number of questions you can pose to stimulate debate, both pro and con:

- What grade would you give Lee Scott for his efforts to transform Wal-Mart?
- What is your assessment of Wal-Mart’s environmental sustainability initiatives? On target or cosmetic or just tokenism?
- Was a transformation effort needed at Wal-Mart to respond to the bashing by critics?
- Which transformation initiatives do you think were inappropriate or unwise or ill-conceived?
- Which transformation initiatives were just cosmetic and intended to secure better publicity for Wal-Mart?
- Which transformation initiatives were, in your view, appropriate?
- Is Lee Scott’s transformation effort “genuine” or is it a stunt to gain better PR for Wal-Mart? How do you tell the difference between a “genuine” effort to “reform” a company and an effort that is “all talk” and cosmetic, intended mainly to make the company “look good” in the eyes of the public and to counter the company’s critics.
- Should the company’s critics view Lee Scott’s transformational efforts favorably or unfavorably?
- Do Lee Scott’s transformation initiatives go far enough—should he be pushing for even more transformational changes at Wal-Mart?
- Is Wal-Mart a socially responsible company? Is the company doing its part to promote environmental sustainability and to be a leader in promoting environmentally friendly operating practices in its own operations and those of its suppliers?

7. What issues do Lee Scott and Wal-Mart management need to address?

- Should the company increase the wages paid to employees?
- Should the company be doing more to improve its package of health care benefits?
- What more can Wal-Mart do to combat the hostility of local citizens towards the opening of new Wal-Mart stores (especially the large-scale Supercenters), particularly in metropolitan areas, California, and other locations where Supercenters are few and far between.
- Should Wal-Mart begin to place more emphasis on foreign expansion and prepare for slower rates of store growth in the U.S.?
- Whether and how to deflect the efforts of unions, such as the United Food & Commercial Workers Union, to try to unionize Wal-Mart stores in the U.S. and perhaps Canada. Unionization of Wal-Mart’s work force would deal a major blow to the company’s low-cost structure.
- What more to do to try to minimize the number of “embarrassing incidents” that have occurred at Wal-Mart since 2003-2004.
8. What recommendations would you make to Lee Scott?

The class needs to be pushed to propose ways to deal with the issues identified above. Several action recommendations ought to be forthcoming:

- The company needs to continue to address, and ideally remedy, the concerns of local citizens towards the opening of new Wal-Mart Supercenter stores—although the need for such action is clearly recognized by top management. The “green” store initiatives should help and modified store and parking lot designs (nicer store fronts, better landscaping) might help also. Doing a better job of promoting and explaining the company’s new mission of “Saving People Money So They Can Live Better” to Wal-Mart’s critics could help, too. Scott’s transformation initiatives seem clearly aimed at making Wal-Mart a “good” company that is actively engaged in a number of socially responsible activities. Local citizens that are anti-Wal-Mart may be mollified somewhat by the many things that Wal-Mart is doing to “reform” its operating practices in ways that directly address the concerns of the company’s critics.

- The rollout of Supercenters to more and more areas where Supercenters have not yet been built is crucial to the achieving higher sales in the U.S. The company has got to be public relations savvy and perhaps even more responsive to the concerns of those who oppose the entry of Supercenters into their neighborhoods and jurisdictions. To succeed here, Wal-Mart has to win over opponents and take actions to overcome and rectify the arguments of its critics.

- Continue to be aggressive in promoting the many good things that Wal-Mart is doing and to counter the efforts of anti-Wal-Mart critics. The Wal-Mart Fact web site is a good idea and can play an important role in “setting the record straight” and making sure that Wal-Mart’s side of the story is better told.

- Consideration of paying higher wages and providing even better health care benefits has to be looked at closely. Wal-Mart’s wages probably are pretty good in many of the rural areas where it has stores but they are probably sub-par by the standards of many of the locations that it is now trying to enter. Top management needs to look at this and see what the impact would be of upping pay scales in certain locations—even if it means that prices in these stores might have to be a bit higher to cover the higher labor costs. The goodwill generated by instituting higher wage scales and better health care benefits may be worth the 1-2% or so price increases which might be necessary. Moreover, such moves could be pivotal in forestalling unionization of the company’s work force—and such actions need to be taken before efforts to unionize Wal-Mart’s work force spread (as may well occur under the current administration in Washington). A strong case can be made that remaining non-union must be a very high priority at Wal-Mart (convincing Wal-Mart management of this is a non-issue—the company’s management reached this conclusion long ago).

- If the company is discriminating against women in pay, promotions, training, and job assignments, then it must quietly but forcefully cease such practices and begin to take clear and unequivocal steps to ensure that female employees receive equal pay for equal work and that more females are promoted to managerial positions.

- Wal-Mart is going to need to work hard at instilling the company’s values and culture to whatever extent possible in the years to come. More emphasis on values and culture is probably going to have to be included in employee training programs—especially management training and training for newly-hired store employees. Store managers are going to have to become more skilled in culture building—since they are going to have to play the lead role in implanting and nurturing the culture in Wal-Mart’s stores.

- Foreign expansion should be Wal-Mart’s top priority for growing the business. There are now more international growth opportunities than domestic opportunities at Wal-Mart. We would suggest that the senior executives at Bentonville headquarters go through each of Wal-Mart’s policies, procedures, and operating practices to be sure that they are each defensible and that there is nothing in them that is potentially embarrassing.
Lee Scott’s transformation initiatives—especially the “green” ones—need to remain on the front burner and expanded where new opportunities are identified. Scott is on the right track here—and class members should be generally pleased with what Scott and Wal-Mart have done so far.

Otherwise, we think Wal-Mart’s strategy and strategy execution efforts are very much on track. The company appears to have the management talent and resources to execute its strategy of rolling out more Supercenters and Neighborhood Markets to drive increases in domestic sales and to accelerate efforts to grow Wal-Mart’s presence in the retail markets of select foreign countries. As best as we can see, customers like to shop at Wal-Mart and they benefit considerably from the company’s ability to keep its prices low.

EPILOGUE

In Fall 2008, Lee Scott announced that he would retire as CEO, effective February 1, 2009. Wal-Mart’s board elected Mike Duke, 58, to succeed Lee Scott as president and CEO; Duke was also appointed as a member of Wal-Mart’s Board of Directors. Duke was the head of Wal-Mart’s International operation prior to being selected as Wal-Mart’s fourth CEO; earlier, he had been head of Wal-Mart’s U.S. operations, and Wal-Mart’s Logistics Division.

Wal-Mart posted sales of $398.3 billion for the year ended January 30, 2009, an increase of 6.2% increase over the $375.0 recorded in fiscal 2008. Comparable store sales were up a fairly strong 3.0%. Full financial results for FY 2009 were not available at the time this TN went to press.

In February 2009, Wal-Mart announced that the efficiency of its truck fleets had increased 25% since the company began its environmental campaign in 2005.

For information on the latest developments at Wal-Mart, we suggest that you go to www.walmart.com and check out the company’s most recent press releases and sales and earnings numbers.
OVERVIEW

In 2008 more people were flying Southwest Airlines than any other U.S. airline, and Southwest had the enviable distinction of being the only major air carrier in the U.S. that was consistently profitable. After losing over $35 billion during 2001-2005, U.S. commercial airlines earned a combined $3.1 billion in 2006 and $5.0 billion in 2007; but sharply higher costs for jet fuel in 2008 were expected to result in another money-losing year for most major airlines in the U.S., with the notable exception of Southwest. In August 2008, analysts were projecting combined 2008 losses of $5 to $8 billion for the U.S. airline industry as a whole, depending on what happened to crude oil prices and jet fuel prices for the remainder of the year. However, the U.S. airline industry’s profit outlook brightened considerably when crude oil prices dropped below $100 per barrel in September, prompting revised 2008 profit projections for the industry somewhere near breakeven—the difference between buying jet fuel when crude oil was $147 per barrel (as it was in portions of July 2008) versus when crude oil was $100 per barrel (as in a portion of September 2008) equated to a fuel cost savings industrywide of $15 billion.

The U.S. airline industry had lost money in 14 of the 28 years during the period 1980 through 2007, with combined annual losses exceeding combined annual profits by $15 billion. Yet, in July 2008, Southwest reported record quarterly revenues, its 69th consecutive quarter of profitability, rising passenger traffic on its flights, and a record load factor (percentage of available seats sold). The company had reported a profit every year since 1973. During 1990-1994—when the airline industry had five straight money-losing years, laid off 120,000 employees, and lost a cumulative $13 billion, Southwest earned a profit every quarter of every year. It had weathered industry downturns, economy-wide recessions, fare wars and other attempts by rivals to undercut its business, energy crises, and cataclysmic falloffs in airline traffic due to terrorist attacks. It had contended successfully with a series of industry problems and business pressures—air-traffic congestion, mergers of rivals, stricter government regulations regarding aircraft safety and maintenance, and mounting customer dissatisfaction with airline service.

Once regarded as little more than a scrappy underdog with quirky practices that flew mainly to “secondary” airports (rather than high traffic airports like Chicago O’Hare, Dallas Fort Worth, Atlanta Hartsfield, and New York’s LaGuardia and Kennedy airports), Southwest had proved it was a major competitive force in the U.S. airline industry. It had the lowest operating cost structure in the domestic airline industry and consistently offered the lowest and simplest fares. Not only was it the market share leader in terms of passengers carried, but its market share was climbing at a time when passenger traffic on other major U.S. airlines was stagnant.

This case sets forth Southwest’s strategy, then describes in some detail all the various policies, practices and operating approaches that management has employed to implement and execute the strategy. Southwest’s values and culture are also covered in some depth.
SUGGESTIONS FOR USING THE CASE

The Southwest Airlines case is an exceptionally good case to assign in conjunction with your module on implementing and executing strategy. It can be assigned at any time following your lectures and coverage of the material in Chapters 10-12. You’ll find the Southwest to be a terrific vehicle for exposing students to the hows of implementing and executing a low-cost leadership strategy and how core values and a strategy-supportive corporate culture can be deeply planted. As an added element of interest, a number of students in your class will likely have flown on Southwest and thus be in a good position to testify how flying Southwest compares to other airlines they have flown and to express their opinions about the positive/negative aspects of their Southwest experiences. But Southwest’s new CEO Gary Kelly has some challenges, and toward the end of class there’s considerable opportunity to press class members for their recommendations on what actions are needed at Southwest to sustain the company’s market success and profitability.

There is a 3:40 minute accompanying video that consists of an interview with Southwest CEO Gary Kelly. We suggest showing this video at either of two points in the class period: (1) at the beginning of the class or (2) about midway in the period when time comes to evaluate the CEOs that followed in the footsteps of Southwest’s co-founder Herb Kelleher. Kelly is the company’s current CEO.

The Southwest Airlines case merits consideration for either a written case assignment or an oral team presentation. Our suggested assignment questions are as follows:

- What grade would you give Southwest management for the job it has done over the years in implementing and executing Southwest’s strategy? Please prepare a 2-3 page report detailing and fully supporting your evaluation. Your report must absolutely reflect command of and use of the material covered in Chapters 10-12.

- What 2-3 policies, procedures, and operating practices have been the most important in accounting for the success that Southwest has enjoyed in executing its low-cost, low fare strategy? Prepare a 3-4 page report that identifies the factors you deem to be pivotal and that presents convincing and forceful support for why they have mattered so much?

- Southwest CEO Gary Kelly has asked you to advise him on what policies, procedures, and operating practices at Southwest are working particularly well and what changes might be needed to improve Southwest’s performance in 2009-2010 and beyond. Please present Mr. Kelly with a 3-5 page report detailing the things that Southwest does right, the problems that you see and the areas where it needs to improve, and your recommendations to improve Southwest’s performance prospects. It is imperative that your report demonstrate command of the material in Chapters 10-12 and that each of your action recommendations be supported with reasoned arguments and factual evidence.

ASSIGNMENT QUESTIONS

1. Is there anything that you find particularly impressive about Southwest Airlines?

2. What grade would you give Southwest management for the job it has done in crafting the company’s strategy? What is it that you like or dislike about the strategy? Does Southwest have a winning strategy?

3. What are the key policies, procedures, operating practices, and core values underlying Southwest’s efforts to implement and execute its low-cost/no frills strategy?

4. What are the key elements of Southwest’s culture? Is Southwest a strong culture company? Why or why not? What problems do you foresee that Gary Kelly has in sustaining the culture now that Herb Kelleher, the company’s spiritual leader, has departed?
5. What grade would you give Southwest management for the job it has done in implementing and executing the company’s strategy? Which of Southwest’s strategy execution approaches and operating practices do you believe have been most crucial in accounting for the success that Southwest has enjoyed in executing its strategy? Are the any policies, procedures, and operating approaches at Southwest that you disapprove of or that are not working well?

6. What weaknesses or problems do you see at Southwest Airlines?

7. What recommendations would you make to Gary Kelly?

TEACHING OUTLINE AND ANALYSIS

1. **Is there anything that you find particularly impressive about Southwest Airlines?**

   Well-prepared students should have little trouble coming up with some impressive things about Southwest Airlines. Any of the following would seem to qualify:

   - *Southwest’s low fares.*
   
   - *The Southwest spirit and fun company culture*—The esprit de corps among Southwest employees is pretty impressive. Southwest’s employees seem unusually committed and engaged in doing their part to deliver very good customer service and to make the company successful. Southwest has done a first-rate job of employee selection, training, and motivation; company employees really know how to create customer satisfaction and they seem to have a fun time doing it. The work environment at Southwest is very attractive—one can understand why Southwest attracts so many job applicants.
   
   - *The competitive power of the company’s strategy and the tight fits among the pieces of the strategy*—Southwest’s strategy is quite well-crafted and well-conceived, having been thought through down to the last detail. And it has produced a low-cost competitive advantage based. In virtually every market where Southwest has presence, it has emerged as the market share leader and often has a high share of the passenger traffic at the airports it serves. It is very, very tough for rival airlines to compete against Southwest, and there are few instances where Southwest has gone head-to-head against its rivals and lost out.
   
   - *Southwest’s very capable top management team*—this is a very well-managed company any way you look at it, with few missteps and bumps in the road over the years. Herb Kelleher’s leadership was exemplary and instrumental in the company’s success.
   
   - *The approaches to low-cost operations the company has put in place*—it is one thing to espouse low-cost leadership and quite another to figure out how to pull it off. Southwest has done a terrific job of keeping its costs low, as is documented in case Exhibit 10.
   
   - *Southwest’s execution of its strategy has been superb.*

   Southwest has crafted a competitively powerful strategy and executed it beautifully—why shouldn’t it be the most admired airline in the world?
2. What grade would you give Southwest management for the job it has done in crafting the company’s strategy? What is it that you like or dislike about the strategy? Does Southwest have a winning strategy?

Most likely, there will be a very strong class consensus that Southwest deserves an A or an A+ on crafting the company’s strategy. But the important teaching lesson here is for class members to understand what is so good about the strategy. Just why is the strategy a winner? What is there to like? What is the justification for an A or an A+?

Several points need to be emphasized here:

- Southwest’s low-cost/low-fare strategy strikes a chord with fare-conscious flyers. Southwest has grown over the years to become the number 1 airline in terms of passengers carried—more people now fly Southwest than any other airline. This is testimony to the market effectiveness of Southwest’s strategy. Class members should recognize that while Southwest carries more passengers than rivals as of 2007 (case Exhibit 1) its revenues are considerably lower (case Exhibit 5) because of its lower fare structure and because so many of its flights are short-haul flights.

- Southwest has put some muscle behind its desire to be a low-cost airline, having come up with a host of strategic moves to actually create and sustain a low-cost advantage. This is a good time to call attention to the figures in case Exhibit 10 and to have students identify all of the cost areas where Southwest has a low-cost advantage over all or most of its rivals—specifically, fuel, employee salaries and fringe benefits (even though Southwest employees are well paid!!), maintenance, and other operating expenses.

- Southwest’s cost advantage gives it pricing power—Southwest can charge low fares and make money; rivals, if they choose to match Southwest’s low fares for competitive reasons, will lose money on these routes. This is indeed a potent competitive edge.

- Southwest’s fuel hedging strategy has been spectacularly successful during the recent period of rising prices for crude oil and jet fuel.

- It is no accident that Southwest has been profitable while rivals have lost billions of dollars. This is powerful testimony to just how astute and on target Southwest’s strategy is and has been. In some very real sense, Southwest has a recession-proof strategy—when times are tough, it is likely to gain business and market share at the expense of rivals. Yes, its profit may not be as large as in good years, but it almost certainly will not gush red ink like what has happened to rivals.

- There can be no doubt that Southwest has prospered with its low-cost provider strategy. The company has enjoyed steady, though not spectacularly rapid, growth. It has been profitable every year since 1973. A good case can be made that Southwest’s strategy is producing a company that is “built to last.”

- There does not appear to be any competitor that can duplicate or imitate Southwest’s strategy—profitably matching Southwest’s low-fare structure appears out of reach of United, Delta, American, Continental, US Airways, and Northwest, although in recent years they have made headway in closing the gap.

We believe—and the evidence in the case confirms—that Southwest does have a winning strategy. The strategy is very much in tune with the marketplace. The strategy has delivered competitive advantage. Southwest’s financial performance has been the best in the U.S. airline industry over the long-term and short-term. We see very little of substance to criticize as concerns Southwest’s strategy.
3. What are the key policies, procedures, operating practices, and core values underlying Southwest's efforts to implement and execute its low-cost/no frills strategy?

Southwest’s execution of its low-cost/no frills/low fares strategy is underpinned by some critically important policies, procedures, operating practices, and core values that students should be called upon to identify (making a list on the board is useful here because it will facilitate connecting Southwest’s strategy implementing approaches tightly to the material covered in Chapters 10-12).

The following policies, procedures, operating practices, and core values stand out:

- **Southwest management’s strong conviction and operative principle that “employees come first and customers come second”** has been a crucial factor in achieving high levels of customer satisfaction and high employee productivity. The importance placed on employees reflected management’s belief that delivering superior service required employees who not only were passionate about their jobs but who also knew the company was genuinely concerned for their well-being and committed to providing them with job security. Southwest’s thesis was simple: Keep employees happy—then they will keep customers happy.

- **Management’s beliefs that employees were the company’s most important asset** were visibly symbolized by designating the personnel department as the People Department (and, most recently the People and Leadership Department) and titling the head of the department as the vice president of people. The message Herb Kelleher penned in 1990 that was prominently displayed in the lobby of Southwest’s headquarters in Dallas is particularly telling:

> The people of Southwest Airlines are “the creators” of what we have become—and of what we will be.

> Our people transformed an idea into a legend. That legend will continue to grow only so long as it is nourished—by our people’s indomitable spirit, boundless energy, immense goodwill, and burning desire to excel.

> Our thanks—and our love—to the people of Southwest Airlines for creating a marvelous family and a wondrous airline.

- **The strength and depth of management’s commitment to deliver high quality customer service**—as stated in the company’s mission statement (which company management gives every appearance of having lived up to and tried to achieve):

> The mission of Southwest Airlines is dedication to the highest quality of Customer Service delivered with a sense of warmth, friendliness, individual pride, and Company Spirit.

CEO Gary Kelly was continuing to stress the importance of top-rate customer service, as evidenced by the four factors he saw as being keys to Southwest’s recipe for success:

- Hire great people, treat ‘em like family.
- Care for our Customers warmly and personally, like they’re guests in our home.
- Keep fares and operating costs lower than anybody else by being safe, efficient, and operationally excellent.
- Stay prepared for bad times with a strong balance sheet, lots of cash, and a stout fuel hedge.
Southwest management’s zealous pursuit of low operating costs, which had led to a number of practices to achieve lower costs than rival carriers:

- The company operated only one type of aircraft—Boeing 737s—to minimize the size of spare parts inventories, simplify the training of maintenance and repair personnel, improve the proficiency and speed with which maintenance routines could be done, and simplify the task of scheduling planes for particular flights.

- Southwest was the first major airline to introduce ticketless travel (eliminating the need to print and process paper tickets) and also the first to allow customers to make reservations and purchase tickets at the company’s website (thus bypassing the need to pay commissions to travel agents for handling the ticketing process and reducing staffing requirements at Southwest’s reservation centers). Selling a ticket on its Web site cost Southwest roughly $1, versus $3-4 for a ticket booked through its own internal reservation system and as much as $15 for tickets for business travelers purchased through travel agents and professional business travel partners. Ticketless travel accounted for more than 95 percent of all sales in 2007 and nearly 74 percent of Southwest’s revenues were generated through sales at its website.

- The company deemphasized flights to congested airports, stressing instead serving airports near major metropolitan areas and in medium-sized cities. This helped produce better-than-average on-time performance and reduce the fuel costs associated with planes sitting in line on crowded taxiways or circling airports waiting for clearance to land, plus it allowed the company to avoid paying the higher landing fees and terminal gate costs at such high-traffic airports like Atlanta’s Hartsfield International, Chicago’s O’Hare, and Dallas-Fort Worth (DFW) where landing-slots were controlled and rationed to those airlines willing to pay the high fees.

- Southwest’s point-to-point scheduling of flights was more cost-efficient than the hub-and-spoke systems used by rival airlines.

- To economize on the amount of time it took terminal personnel to check passengers in and to simplify the whole task of making reservations, Southwest had never adopted the practice of assigning each passenger a reserved seat. All passengers could check in online up to 24 hours before departure time and print out a boarding pass, thus bypassing counter check-in (unless they wished to check baggage).

- Southwest flight attendants were responsible for cleaning up trash left by deplaning passengers and otherwise getting the plane presentable for passengers to board for the next flight (until recently, other carriers had cleaning crews come on board to perform this function; however, recurring losses at many airlines in 2001-2005 forced stringent cost-cutting measures, prompting most all airlines to cut out the use of cleaning crews and copy Southwest’s practice).

- Southwest did not have a first-class section in any of its planes and had no fancy clubs for its frequent flyers to relax in at terminals. No meals had ever been served on Southwest flights; passengers were offered beverages and snacks (a practice that made re-provisioning planes simple and quick). During 2001-2005, virtually all airlines discontinued meal service on domestic flights (except for first-class passengers) as a way to cut expenses; a few of Southwest’s rivals had begun charging passengers $2 for coffee, soft drinks, and bottled water served during flights.

- Southwest offered passengers no baggage transfer services to other carriers—passengers with checked baggage who were connecting to other carriers to reach their destination were responsible for picking up their luggage at Southwest’s baggage claim and then getting it to the check-in facilities of the connecting carrier.

- In mid-2001 Southwest implemented use of new software that significantly decreased the time required to generate optimal crew schedules and help improve on-time performance.
• Starting in 2001, Southwest began converting from cloth to leather seats; the team of Southwest employees that investigated the economics of the conversion concluded that an all-leather interior would be more durable and easier to maintain, more than justifying the higher initial costs.

• Southwest was a first-mover among major U.S. airlines in employing fuel hedging and derivative contracts to counteract rising prices for crude oil and jet fuel. Since 1998, the company’s aggressive fuel hedging strategy had produced fuel savings of about $3.5 billion over what it would have spent had it paid the industry’s average price for jet fuel.

• The addition of vertical winglets on the wing tips of the existing aircraft fleet and ordering new planes equipped with winglets. These winglets reduced lift drag, allowed aircraft to climb more steeply and reach higher flight levels quicker, improved cruising performance, helped extend engine life and reduce maintenance costs, and reduced fuel burn. In 2007, Southwest partnered with Naverus, an aviation consulting firm, to develop new flight systems and procedures that would result in its planes being able to reduce fuel consumption, lower emissions, and curtail noise while simultaneously taking better advantage of the high performance characteristics of its aircraft.

• In 2007-2008, Southwest began investing in technology and software to replace its ticketless system and its back office accounting, payroll, and human resource information systems, so as to enhance data flow, operational efficiency, and customer service capability.

Southwest management’s conviction that delivering superior service required employees who not only were passionate about their jobs but who also knew the company was genuinely concerned for their well-being and committed to providing them with job security. Management’s thesis was simple: Keep employees happy—then they will keep customers happy. The excerpt from the company’s 2000 annual report cited in the case lays out the benefit of Southwest’s employees first, customers second policy—pursuing such a provides further evidence:

Our people are warm, caring and compassionate and willing to do whatever it takes to bring the Freedom to Fly to their fellow Americans. They take pride in doing well for themselves by doing good for others. They have built a unique and powerful culture that demonstrates that the only way to accomplish our mission to make air travel affordable for others, while ensuring ample profitability, job security, and plentiful Profitsharing for ourselves, is to keep our costs low and Customer Service quality high.

At Southwest, our People are our greatest assets, which is why we devote so much time and energy to hiring great People with winning attitudes. Because we are well known as an excellent place to work with great career opportunities and a secure future, lots of People want to work for Southwest……. Once hired, we provide a nurturing and supportive work environment that gives our Employees the freedom to be creative, have fun, and make a positive difference. Although we offer competitive compensation packages, it’s our Employees’ sense of ownership, pride in team accomplishments, and enhanced job satisfaction that keep our Culture and Southwest Spirit alive and why we continue to produce winning seasons.

What needs to be emphasized about the two above statements by Herb Kelleher is that they do not just represent a bunch of nice high-sounding words and managerial pontification. Rather, they words seem to truly reflect what management believes and the people management principles and approaches that executives employ in their relationships and dealings with the company’s workforce.

As a test of how strongly students agree, you may poll the class for answers to the following question:

On a scale of 1 to 10 (where 1 = low and 10 = high), to what extent has Southwest’s approach to people management been a major contributor to the company’s success in implementing and executing its strategy?

In our view, the best answer is a 9 or 10.
- **The careful attention paid to recruiting, screening, and hiring new employees.** Southwest hired employees for attitude and trained for skills. In 2007, Southwest received 329,200 resumes and hired 4,200 new employees.

- **Management’s success in involving and engaging employees in seeking out and implementing ways to save on costs.** Employee-led initiatives to cut costs and streamline operations were common. Southwest’s pilots had been instrumental in developing new protocols for takeoffs and landings that conserved fuel. Another frontline employee had suggested not putting the company logos on trash bags, saving an estimated $250,000 annually. It was Southwest clerks that came up with the idea of doing away with paper tickets and shifting to e-tickets.

- **The company’s no layoff policy**—important because employees did not have to fear for their jobs in pursuing cost-saving initiatives. Southwest Airlines had never laid off or furloughed any of its employees since the company began operations in 1971. Southwest had built up considerable goodwill with its unions over the years by avoiding layoffs.

- **Southwest’s compensation policies and practices.** Southwest’s pay scales tended to be above the industry average—sometimes even at or near the top of the industry, and it offered good benefit packages relative to other airlines. Southwest also had an attractive profit-sharing plan.

- **Southwest’s employees enjoyed substantial authority and decision-making power.** The company relies heavily upon empowerment of employees and decentralized decision-making. According to Kelleher:

  > We’ve tried to create an environment where people are able to, in effect, bypass even the fairly lean structures that we have so that they don’t have to convene a meeting of the sages in order to get something done. In many cases, they can just go ahead and do it on their own. They can take individual responsibility for it and know they will not be crucified if it doesn’t work out. Our leanness requires people to be comfortable in making their own decisions and undertaking their own efforts.

- **Southwest’s supervisory positions were filled internally,** reflecting management’s belief that people who had “been there and done that” would be more likely to appreciate and understand the demands that people under them were experiencing and, also, more likely to enjoy the respect of their peers and higher-level managers.

- **Management’s strong commitment to and skills in building a strong strategy-supportive culture, accompanied by efforts to ingrain core values that were equally strategy supportive.** Southwest management has done a very, very commendable job over the years in creating and nurturing core values and a culture that has promoted good strategy execution and operating excellence.

- **Southwest managers were expected to spend at least one-third of their time out of the office, walking around the facilities under their supervision, observing firsthand what was going on, listening to employees and being responsive to their concerns.** This helped keep managers well-informed about employee concerns and promoted effective employee-management relationships. Company managers were very approachable. Managers and executives had an open door policy, actively listening to employee concerns, opinions, and suggestions for reducing costs and improving efficiency. Informal problem avoidance and rapid problem resolution were seen as managerial virtues.

  From time to time, there were candid and sometimes heated meetings of frontline employees and managers where operating problems and issues between/among workers and departments were acknowledged, openly discussed, and resolved.
Management encouraged union members and negotiators to research their pressing issues and to conduct employee surveys before each contract negotiation. This helped focus both union leaders and company managers on those issues of concern to employees and helped foster an “employee-friendly” work environment.

Management wanted Southwest employees to be proud of the company they worked for and its workforce practices.

4. What are the key elements of Southwest's culture? Is Southwest a strong culture company? Why or why not? What problems do you foresee that Gary Kelly has in sustaining the culture now that Herb Kelleher, the company’s spiritual leader, has departed?

Students certainly ought to be able to point to a number of features that characterize and define Southwest’s corporate culture. The “spirit of Southwest” has a number of important elements:

- **A fun atmosphere and work environment**—Fun at Southwest was exactly what the word implies and it occurred throughout the company in the form of the generally entertaining behavior of employees in performing their jobs, the ongoing pranks and jokes, and frequent company-sponsored parties and celebrations.

- **A pep rally atmosphere and “can do” attitude**—this is a company where people willingly pitch it to make things happen, to solve problems, to overcome adversity, and to celebrate the company’s successes.

- **LUV**—evidence of the Golden Rule and a caring, supportive environment abounds in many places. The company has done a superb job with using LUV (and all that this means at Southwest) to create a strategy supportive culture and to nurture achievement of the company’s customer satisfaction objectives.

- **The culture is combative and feisty and a “warrior mentality” prevails**—a carryover from the company’s battle to survive in its early years and something that is reflected in its ads.

- **A cost-conscious and thrifty approach to operating**—both management and employees are attentive to keeping costs down and to operating in a lean fashion. Everyone at the company understands that the company’s profitability and success, giving its low-cost provider strategy, requires constant diligence to eliminate wasteful or unnecessary costs and ongoing efforts to identify new and better ways of operating. Cost reduction initiatives are a frequent occurrence and not something that employees fear (because of the no layoff policy—which can endure as long as the company is steadily expanding and growing, thus creating a need for even more employees). This is a company where jobs are growing in number, despite high and growing levels of employee productivity. Thus the no layoff policy is “cost-free” and Southwest’s ongoing search for greater operating efficiencies does not undermine employee job security or create employee insecurities that erode the search for cost-saving opportunities.

All of this is a way of saying that employees cooperate fully in the companywide effort to trim costs and maintain a lean approach to operations. In this sense, the culture is very strongly supportive of Southwest’s low-cost strategy. This is a major reason for Southwest’s success in implementing and executing its strategy.

- **The tradition of employee empowerment and decentralized decision-making**—this aspect of the culture is likewise strategy supportive, as well as being a positive motivational factor for employees and a contributor to making Southwest a good company to work for.

Students should have no trouble seeing that Southwest Airlines is very much a “strong culture” company. There is plenty of evidence in the case indicating the lengths to which Southwest management has gone to nurture and ingrain the culture and to create a work environment where core values are widely shared and deeply entrenched:
Southwest formed a Culture Committee in 1990 to promote “Positively outrageous Service” and devise tributes, contests, and celebrations intended to nurture and perpetuate the Southwest Spirit. Members, chosen for their zeal in exhibiting the Southwest Spirit and their commitment to Southwest’s mission and values, functioned as cultural ambassadors, missionaries, and storytellers.

Over the years, Southwest had come up with a wide variety of ways to nurture its core values and perpetuate its unique culture. There was an annual “Heros of the Heart Award,” a CoHearts mentoring program, a Day in the Field program where employees spent time working in another area of the company’s operations, a Helping Hands program where volunteers from around the system traveled to work two weekend shifts at other Southwest facilities that were temporarily shorthanded or experiencing heavy workloads, and periodic Culture Exchange meetings to celebrate the Southwest Spirit and company milestones. Almost every event at Southwest was videotaped, which provided footage for creating such multipurpose videos as *Keepin’ the Spirit Alive* that could be shown at company events all over the system and used in training courses. The concepts of LUV and fun were spotlighted in all of the company’s training manuals and videos.

Southwest’s monthly newsletter, LUV Lines, often spotlighted the experiences and deeds of particular employees, reprinted letters of praise from customers, and reported company celebrations of milestones. A quarterly news video, *As the Plane Turns*, was sent to all facilities to keep employees up to date on company happenings, provide clips of special events, and share messages from customers, employees, and executives. The company had published a book for employees describing “outrageous” acts of service. Sometimes important information was circulated to employees in “fun” packages such as Cracker Jack boxes.

The big issue at Southwest now is whether relatively new CEO Gary Kelly can continue to do an effective job of nurturing the culture, now that Herb Kelleher and Colleen Barrett have retired. We see no hints or clues in the case that suggests Gary Kelly does not appreciate the need to put considerable personal time and energy into the task of nurturing Southwest’s culture. He will likely continue the Culture Committee and continue all the other culture-nurturing programs mentioned above. He has been around Southwest long enough to know the importance of keeping the Southwest Spirit alive and well. But the proof of his commitment and culture-building capabilities is in the events yet to come and his ability to visibly and effectively lead the culture-nurturing effort at Southwest Airlines. It is unreasonable to expect Kelly to fill Kelleher’s and Barrett’s shoes precisely. He will have to make his own footprints and put his own stamp on how things are to be done.

5. **What grade would you give Southwest management for the job it has done in implementing and executing the company’s strategy? Which of Southwest’s strategy execution approaches and operating practices do you believe have been most crucial in accounting for the success that Southwest has enjoyed in executing its strategy? Are the any policies, procedures, and operating approaches at Southwest that you disapprove of or that are not working well?**

Our vote for a grade is an A+. It is hard to see what Southwest could have done much better. Nor do we see much for students to dislike.

Indeed, the pedagogical value/purpose of this case is to give students a solid benchmark for judging what a good job of strategy execution involves and recognizing a job well done when they see it.

To us, the 2-3 most important strategy-executing approaches and operating practices are:

- The company’s array of people management practices.
- The company’s strong commitment to identifying and implementing ways to keep its costs low.
Management’s efforts to instill and deeply plant strategy-supportive core values and a strategy-supportive culture.

We don’t see any reason to dislike or object to virtually any of Southwest’s policies, procedures, operating practices, and core values. There isn’t much evidence to support criticism. Nonetheless, there’s merit in giving class members an opportunity to voice their dislikes if they see any. If few are forthcoming, that speaks volumes.

6. What weaknesses or problems do you see at Southwest Airlines?

Southwest is a company with no glaring weaknesses or critical operating problems. But there are indeed areas of legitimate concern:

- Southwest has lost some of its cost advantage in recent years because:
  - Rival airlines have been slashing costs in order to survive, particularly in the areas of pilot salaries and employee salaries. Southwest, which once had lower labor costs now finds itself confronted with somewhat higher labor costs (its employees have more longevity—and thus higher salaries—whereas many employees at rival airlines are relatively new and have not yet gotten in-grade pay raises to the extent as has occurred at Southwest).
  - Southwest has been moving into airports with higher landing fees (Denver, Philadelphia, for example).
  - Other airlines have slashed their food costs—all airlines now just provide peanuts and beverages (formerly, just Southwest served no meals and offered only snacks).
  - However, Southwest’s cost trends in case Exhibit 11 are encouraging—they indicate that Southwest is doing a pretty good job of cost control, as compared to the data for Southwest in case Exhibit 10.

- Southwest’s gains on fuel hedging have been directly responsible for the company remaining profitable in the last several quarters/years. Without these gains, Southwest may, in fact, have reported net losses rather than net profits.

- Much of Southwest’s future growth would seem to hinge on moving into major hub airports where its rivals have big market shares—Southwest will have to successfully attack these rivals in major airports that are crucial to the revenues and profitability of these rivals. In times past, Southwest has prospered by focusing on less congested airports and avoiding those airports that have been the province of its major rivals—American, United, Delta, Northwest, US Airways, and Continental—Delta and Northwest merged effective October 29, 2008.

- Southwest’s recent embarrassing safety lapse in inspecting its planes is a bit disconcerting, but we suspect that Gary Kelly learned an important lesson here and that it won’t happen again at Southwest.

- It is open to question whether CEO Gary Kelly can sustain the culture that has been created and nurtured by Herb Kellerher and Colleen Barrett. His task will be challenging to say the least. Kelleher was something of a charismatic leader, and Barrett has devoted much of her time and effort to sustaining the culture—their culture-building and culture-nurturing efforts will be hard to replace.

- Southwest’s operating performance in case Exhibit 13 is not unduly impressive or that much better than several rival airlines on at least two of the four measures in the exhibit—mishandled baggage and involuntary denied boardings.
7. What recommendations would you make to Gary Kelly?

Class members may struggle to come up with much of substance to recommend. But there are several actions that ought to be proposed:

- **Continue to expand the number of airports it serves**—perhaps by 1-3 new airports annually. New airports would be a source of new customers, new revenues, and jobs for employees. It will be hard for Southwest to prosper without growing the business as fast as seems prudent. But Southwest needs to do a do job of picking the airports to enter—its track record in doing this has been excellent in years past!!!! A low-cost leader is always in the strongest position to woo passengers, especially fare-conscious ones, away from higher-cost/higher-fare rivals. This is particularly true in tough economic times.

- **Renew efforts to reduce costs and encourage employees to identify further cost-saving actions.** This may or may not prove to generate much in the way of cost-savings and we suspect this avenue is already been pursued internally in one way or another.

- Pay considerable attention to leading the task of nurturing Southwest’s culture—this is critical now that Kelleher and Barrett have retired. The ball is now in CEO Gary Kelly’s court—he has to perform well in this arena.

- Make sure there are no more safety and maintenance lapses.

**EPILOGUE**

In January 2009, Southwest Airlines announced its financial highlights for the 4th quarter of 2008:

- 71st consecutive quarter of profitability, excluding special items
- Record fourth quarter revenues of $2.7 billion, up 9.7 percent from the fourth quarter of 2007
- Net income, excluding special items, of $61 million, down 30 percent
- Net income per diluted share, excluding special items, of $.08, down 33 percent
- Cash settlement gains of $32 million from fuel contracts
- Raised approximately $1.1 billion in cash through financing activities

Southwest reported operating revenues for the year ended December 31, 2008, of $11.0 billion, up 11.8% from 2007. Operating expenses increased 16.6 percent to $10.6 billion, resulting in operating income of $449 million, a decrease of $342 million or 43.2 percent. Full-year 2008 net income was $178 million, or $.24 per diluted share, compared to $645 million, or $.84 per diluted share, for full year 2007. The results for 2008 represented Southwest’s 36th consecutive year of profitability and included $1.3 billion of fuel hedging cash settlement gains.

In commenting on the company’s performance in 2008, CEO Gary Kelly said:

We are very proud to report another profitable year in one of the most difficult years in aviation’s 100-year-plus history. We certainly had our challenges in 2008, but thanks to the extraordinary efforts and Warrior Spirit of our People, we persevered to report our 36th consecutive year of profitability.

With one full year of our new boarding system and Business Select product offering, the Customer response has been overwhelmingly favorable. We’ve made significant advancements in our revenue management and network optimization capabilities. And, we’ve made great progress on the technology side to lay the foundation for improved Customer Service, a new southwest.com, a new Rapid Rewards program, and international codeshare agreements with WestJet to Canada and Volaris to Mexico.
Despite the difficult credit markets, we were able to boost our liquidity by $1.1 billion during fourth quarter 2008 through several financing transactions to end the year with $1.8 billion in unrestricted cash and short-term investments.

Due to the rapid collapse in energy prices during fourth quarter 2008, we substantially reduced our net fuel hedge position to approximately ten percent of our estimated fuel gallons in each year from 2009 through 2013. Based on this current 2009 portfolio and future market prices for energy (as of January 20, 2009), we estimate our economic fuel costs per gallon, including fuel taxes, to be approximately $1.80 and under $1.90, for first quarter and full year 2009, respectively. This current full year 2009 projection is more than $1 billion lower than we were projecting last summer for 2009.

The current market value (as of January 20, 2009) of our net fuel derivative contracts for 2009 through 2013 reflects a net liability of approximately $1.0 billion. Based on this market value (which reflects forward market prices and assumes no change to our current fuel hedge portfolio), we currently estimate our economic jet fuel costs per gallon could exceed market (or unhedged) prices by approximately $.16 to $.17 in each year from 2009 to 2011, $.10 in 2012, and $.08 in 2013. Even so, we currently expect our 2009 economic jet fuel costs per gallon to substantially decline from 2008 based on current market prices.

Although we ended the year with a superb revenue performance and fuel hedging cash settlement gains, fourth quarter 2008 net income, excluding special items, declined 30 percent year-over-year due primarily to higher fuel costs. Despite the onset of a deep economic recession, we produced record fourth quarter 2008 operating revenues, up almost ten percent, or 8.8 percent per available seat mile. We were especially pleased with our revenue performance over the holidays, with revenue per available seat mile (RASM) up year-over-year approximately seven percent for November/December 2008, combined. Based on booking and revenue trends thus far, we estimate a similar growth rate for the month of January. Although it is too early to accurately predict first quarter 2009 traffic and revenues, we have seen notable softness in post-January bookings. Based on the current booking and revenue trends and taking into consideration the Easter shift to April this year (versus March last year), we are not confident January’s strong run-rate will continue throughout first quarter 2009.

We remain intensely focused on maximizing the efficiency and profitability of each published flight schedule. Through our optimization efforts in 2008, we were able to grow key markets like Denver and San Francisco, while simultaneously pruning unpopular, and thus unproductive, flights. While we remain cautious about our 2009 growth and currently plan to reduce our available seat miles by approximately four percent versus 2008, we remain well-positioned to respond quickly to favorable market opportunities, such as our launch into Minneapolis-St. Paul beginning March 2009 and our bid to acquire rights to 14 slots at New York’s LaGuardia airport.

Our current 2009 fleet plan includes taking delivery of 13 new Boeing 737-700 aircraft, including three aircraft originally scheduled for delivery in 2008 that were delayed to 2009 due to Boeing machinists’ 2008 strike. Two 737-300 lease returns that were planned for fourth quarter 2008 were deferred to first quarter 2009. Including these two lease returns, we currently plan to return or retire fifteen aircraft, to end the year with 535 aircraft.

We have reduced our 2010 aircraft deliveries to ten firm orders from 22 (16 firm, 6 options) and have made adjustments to our schedule beyond 2010. The revised Boeing 737-700 Delivery Schedule is included in the accompanying tables. Since the beginning of 2008, we have reduced our aircraft capital spending requirements by almost $700 million in 2009 and by the same amount in 2010.

Despite a roller coaster year, our Employees’ Warrior Spirits prevailed, and I could not be more proud of their accomplishments. Our People continue to deliver exceptional Customer Service and were recognized throughout 2008 for it.

For additional information on important developments at Southwest Airlines, please check the company’s latest press releases and financial results at [www.southwest.com](http://www.southwest.com).
OVERVIEW

In November 2006, Symon Bridle, the newly appointed chief operating officer of Shangri-La Hotels and Resorts, was reviewing the progress the Hong Kong–based company had made over the previous 10 years as it grew from a regionally focused business into a rapidly expanding international deluxe hotel group. With 18,400 employees, 50 hotels, and $842 million in revenues, Shangri-La Hotels and Resorts (Shangri-La) was a leading player in the luxury hotel industry. The company was growing rapidly to satisfy increased demand for deluxe hotels and resorts in Asia, Europe, and North America and Bridle was in charge of ensuring that Shangri-La’s signature standards of “Shangri-La Hospitality,” a service model based on traditional Asian hospitality, were maintained during this expansion.

For the past two weeks, Bridle and a task force of his top managers had been discussing a number of organizational issues that presented challenges to Shangri-La’s rapid expansion strategy. There were three major issues at hand that required management attention: (1) the company was expanding into high-wage economies in Europe and North America; (2) the company was expanding its presence in China—a country where front-line employees were not used to exercising decision-making authority; and (3) newcomers in the Chinese hotel market were poaching Shangri-La’s staff and driving up wages in historically low-wage markets.

SUGGESTIONS FOR USING THE CASE

Students should find the Shangri-La Hotels case quite interesting because of its impressive successes and because of its exemplary approach to strategy execution. The case should also be of interest to students because of relevance of the Chinese market for most any good or service. The case can help students realize that while the opportunities associated with entering the Chinese market are very attractive, they are not without obstacles. Although the case can be used in your module on competing in international markets, the Shangri-La Hotels case is best-suited for use in your strategy execution module and should be positioned in the course after your lectures on Chapters 10-12. The case illustrates how Shangri-La’s corporate culture, policies and procedures, delegation of authority, and internal leadership support key aspects of its business strategy. Students will also be able to examine the effectiveness of the company’s human resource management strategy that includes issues related to selection, compensation, and career development. There is also an opportunity to require students to perform a modest amount of “number-crunching” to fully understand the company’s financial capabilities to pursue further international expansion.

The Student Edition of the Online Learning Center (OLC) provides students with copies of the assignment questions contained in this note. The list of assignment questions leads students through a thorough industry analysis and prepares them to make strategy recommendations for selected companies. We suggest that you always direct students to the assignment questions posted on the Crafting & Executing OLC and instruct them to use the assignment questions to prepare for the class discussion of the case. We always instruct our students to read the case once to gain a general understanding of the issues presented in the case and then return to the case to prepare written responses to each of the assignment cases. We’ve found that our students who follow this approach are well-prepared to make a meaningful contribution to the class discussion.
The case can be used effectively for a written assignment. We recommend the following question for written assignments:

As a newly-hired member of Shangri-La Hotels corporate human resource department, you have been asked to prepare an analysis of the company’s key business practices that support its ability to offer superior value to hotel guests. Knowing that you have recently completed a course in strategic management, your supervisor has asked that you prepare a 5-6 page report evaluating the company’s ability to perform each of the 8 components of the strategy execution process described in Chapter 10 of your strategic management textbook. Your report should conclude with a set of specific, actionable strategy recommendations that will allow Shangri-La Hotels to further improve the execution of its service model as it continues its quest to become the leading international luxury hotel provider.

**ASSIGNMENT QUESTIONS**

1. What are the key elements of Shangri-La Hotel’s strategy? Which of the five generic competitive strategies described in Chapter 5 is the company employing? What is Shangri-La’s strategy for competing internationally?

2. What policies, practices, support systems, and management approaches underlie Shangri-La’s efforts to execute its strategy?

3. How important are the company’s training and Shangri-La Care program to its success? What is your assessment of Shangri-La’s compensation policies and career growth effort? What pluses and minuses do you see?

4. What are the key features of the culture at Shangri-La Hotels? How important is the culture in the company’s success? Explain. What impact do the company’s mission statement and the Shangri-La Care program have on the company’s culture?

5. What core/distinctive competencies has management at Shangri-La tried to build and nurture? What challenges does the company face as it attempts to transfer its core and distinctive competencies to other cultures? How has the company attempted to resolve these challenges? Has it been successful in doing so?

6. What does the company’s financial and operational performance reveal about how successful its strategy and strategy implementation efforts have been? Should shareholders be pleased with the company’s financial performance? Why or why not? What financial and operating performance pluses and minuses do you see?

7. What challenges does Shangri-La face in expanding into Eastern China? Do you believe the company’s current policies and operating procedures will be sufficient in addressing these challenges? If so, why? If not, what else may need to be done?

8. How do the challenges associated with Shangri-La’s expansion into Europe, Australia, and North America compare with the company’s expansion in China? Do you believe the company’s current policies and operating procedures will be sufficient in addressing these challenges? If so, why? If not, what else may need to be done?

9. How big a threat does the expansion of other hotel chains into China pose for Shangri-La Hotels? What specific challenges are likely to arise as a result of this expansion? How should Shangri-La address these challenges?

10. What recommendations would you make to Symon Bridle to improve Shangri-La’s prospects for continued success?
TEACHING OUTLINE AND ANALYSIS

1. What are the key elements of Shangri-La Hotel’s strategy? Which of the five generic competitive strategies described in Chapter 5 is the company employing? What is Shangri-La’s strategy for competing internationally?

Students should have relatively little trouble identifying the following elements of Shangri-La’s business-level strategy:

- Operating in four main business segments including:
  - Hotel ownership and operations,
  - Property development including commercial buildings and serviced apartments,
  - Hotel management services to group-owned and third-party hotels, and
  - Spas.

- The company is a deluxe Asian hotel chain which has followed an aggressive growth strategy. It operates under two brands: the five-star Shangri-La and the four-star Traders. It owns or manages resorts in Asia, the Middle East, North America and Europe for a total of over 23,000 rooms in 29 locations. As of 2006, the company had over 40 additional projects in development.

- Shangri-La based its competitive advantage on outstanding customer service. The service model was based on the core principles of respect, humility, courtesy, helpfulness and sincerity. The service model was supported by extensive training, an organizational structure that decentralized decision making, and a compensation structure that was designed to align individual goals with the company’s mission.

- To meet the expectations of excellence, Shangri-La developed local talent to world class expectations through culture training. The importance of Shangri-La’s employees as central to its successful execution of its strategy was further reinforced by its three-tier compensation system and transparent and well-defined career path.

Students should recognize that Shangri-La competed on the basis of a differentiation strategy which involves being unique in ways that are valuable to a wide range of customers. Students will recognize that the differentiation is based on providing distinct standards of hospitality and service by offering a luxurious atmosphere and outstanding service for its clients. These efforts led to the establishment of a world-class reputation and prestigious awards and recognition to include the following: “Best Business Hotel Chain in Asia Pacific” by Business Traveler (U.K. and Germany) and “Best Hotel Chain” by Chinese Hurun Report (China)—along the way. While some students may want to conclude that the company is employing a niche strategy, we feel that a broader differentiation strategy is more appropriate as the company offers both five-star and four-star properties under its two brands – Shangri-La and Traders. Additionally, the company has been pursuing aggressive international growth to expand its geographic base of operations.

To compete internationally, Shangri-La expanded beyond its core Asian markets through management contracts and owner/operator developments in the luxury segment. The company launched its rapid expansion by building a foundation of 35 hotels in some of Asia’s most sought after locations. This was followed by Shangri-La’s becoming the largest Asian-based deluxe hotel in Southeast Asia. The deluxe hotel company had expanded to Dubai in the United Arab Emirates and then to Muscat, Oman. Its expansion efforts took it to Australia and included plans to expand to North America and Europe. Despite these diversifying interests, Shangri-La remained focused on investments in the Asia-Pacific area with plans to expand rapidly in China. Shangri-La funded its expansion by incorporating its various subsidiaries and listing with local stock exchanges under Shangri-La Asia.
2. What policies, practices, support systems, and management approaches underlie Shangri-La’s efforts to execute its strategy?

This case provides students with an excellent example of how a firm has built competencies and capabilities that are supportive of its business level strategy. Specifically, Shangri-La has done an outstanding job of aligning its culture, compensation system, career path and its human resources training to more effectively execute its differentiation strategy. Students should discuss the importance of these key organizational activities relative to Shangri-La’s ability to implement its strategy. Shangri-La is a prime example of a company that has developed practices and policies that facilitate good strategy execution and ties rewards and incentives to those desired goals. Additionally, the company has supported its strategy execution by developing a corporate culture that encourages the achievement of good results and operating excellence.

**Training**

Shangri-La focused its training programs on instilling a sense of confidence among employees to offer a personalized luxury hotel experience by improving individual decision-making. It helped employees to avoid common mistakes and focused on best practices to be adopted. It gave employees a greater sense of direction and unity regarding offering a world class service.

**Culture Training**

The managers of Shangri-La believed that superior service was a key to their differentiation strategy and they worked to build a strong, service-based culture to ensure that each employee delivered service the “Shangri-La Way.” This culture encouraged employees to go the extra mile and emphasized the importance of acknowledging and fixing mistakes when made. The culture also encouraged employees to take responsibility for customers’ satisfaction.

**Compensation System**

The three-tier compensation structure was designed to support organizational goals at various levels. At the first level, which included hotel general managers and division heads, compensation included a salary and a bonus. The bonus was tied to financial results (i.e., gross operating profit and gross operating revenue attainment) to help hotels reach goals. Compensation for the second tier, which included level two and three employees, was linked to financial results and, more specifically, to customer satisfaction and customer loyalty scores, which were key indicators of how well Shangri-La executed its strategy. In the third tier, which included level four and five employees, there was a common bonus pool that linked compensation not to individual performance, but to overall property performance.

**Career Path**

The company’s career path was designed to retain Shangri-La’s well-trained workforce by offering well-defined career paths. These career paths offered upward mobility driven by rapid international expansion as well as lateral mobility by moving from hotel to hotel. The company’s policy of promoting from within helped enhance the value of the career paths.

**Organizational Structure**

Shangri-La’s five-level organizational structure was also supportive of its strategy execution as it empowered them, within limits, to directly address guests concerns. At each level in the organization employees had a specific dollar amount that could be used to address customer requests that might fall outside of normal operations.
3. **How important are the company's training and Shangri-La Care program to its success? What is your assessment of Shangri-La's compensation policies and career growth effort? What pluses and minuses do you see?**

It is important that students recognize the critical role policies play in helping organizations facilitate the execution of their strategy. From the text, students should be able to identify three ways policies encourage good strategy implementation. First, these policies provide guidance from the top regarding the manner in which things need to be done. Second, they enforce consistency in how activities critical to a firm’s strategy are conducted among geographically dispersed locations. Finally, policies help to build a work climate that facilitates good strategy execution.

Shangri-La’s training and Care program were critical to its success as the successful execution of its strategy to offer a unique Asian luxury hotel experience depended on maintaining a capable workforce. More specifically, Shangri-La developed a competitive advantage based upon personalized guest service that required a capable workforce. Its training program ensured that employees had the confidence to make decisions to improve each customer’s experience. The training program also sought to overcome cultural challenges that might inhibit employees taking initiative, as was the case in China. The company’s structure and culture was based on empowering employees through the delegation of authority. To help instill employees’ confidence to take this initiative, the training program highlighted common mistakes to avoid while emphasizing best practices to pursue, thereby encouraging standard delivery of worldwide excellence. Equally important, Shangri-La’s Care program sought to develop local talent to world-class expectations. Subsequent modules of the Care program were launched to improve retention and guest loyalty and to emphasize the importance of recovery when a mistake was made. Students should recognize that these programs were the cornerstones of Shangri-La’s successful strategy implementation.

A well-designed reward structure based upon monetary and nonmonetary rewards is the most powerful tool to build commitment and to sustain employees’ commitment to organizational goals. Hence, companies have to be creative in developing and using motivational incentives to align and build commitment. Students may find that Shangri-La has used its compensation policies and career growth efforts well to motivate employees and align their interests with its strategic efforts. The incentive structure was previously discussed and the benefits are relatively obvious. However, while the program is based upon sound logic, this compensation system inadequately addressed the challenges Shangri-La faces with competitors who were paying their employees salaries that were 35% to 50% more than Shangri-La. Clearly, this system does not go far enough in addressing this challenge.

Shangri-La’s well-defined career path sought to improve retention efforts by promoting from within and by allowing lateral moves from property to property. Opportunities were provided to move up within properties and to move across to other properties. The career path coupled with rapid expansion provided significant and enticing opportunities for its loyal employees. This can be seen as a plus.

4. **What are the key features of the culture at Shangri-La Hotels? How important is the culture in the company’s success? Explain. What impact do the company’s mission statement and the Shangri-La Care program have on the company’s culture?**

Students should recall from the text that corporate culture reflects the character of a company’s internal work climate and personality. This culture is shaped by its core values, beliefs, business principles, traditions, ingrained behaviors, work practices and styles of operating. As such, corporate culture affects how organizations conduct business. In this case the corporate culture is critical to the company’s success, especially since the company differentiates itself based on service. If the employees do not share the corporate culture it would be difficult, if not impossible, for the company to live up to its Shangri-La Care standards.
Students should readily recognize that the culture at Shangri-La Hotels can best be described as a strong, high-performance culture from the material in Chapter 12. The culture is strongly rooted throughout the company and is reflected in its values, behavioral norms, policies and compensation structure. Key elements of this strong culture include the company’s guiding philosophy and its mission statement, as shown in case Exhibit 6, and the five core values of the Shangri-La brand of hospitality (respect, humility, courtesy, helpfulness and sincerity. Students should also note how these values are closely aligned with the Care Modules, as reflected in case Exhibit 7, and how they are tied with compensation. Overall, it is a very impressive alignment of the values, policies and compensation structure to support the company’s core values and the culture. Additionally, the students should note that the alignment of these elements creates a high performance culture with a bias to being proactive in which problems and issues are promptly addressed.

5. **What core/distinctive competencies has management at Shangri-La tried to build and nurture? What challenges does the company face as it attempts to transfer its core and distinctive competencies to other cultures? How has the company attempted to resolve these challenges? Has it been successful in doing so?**

Shangri-La has competed on the basis of a differentiation strategy by attempting to build a competence in the fine Asian luxury hotel experience. They wanted to create a distinctively unique hotel experience based upon Asian standards of hospitality and service. Shangri-La’s brand of hospitality was built around five core principals – respect, humility, courtesy, helpfulness and sincerity. A high standard of service excellence stemmed from its mission to “delight customers each and every time.” Both its hospitality and service relied on Shangri-La’s ability to blend local cultures, exotic art and lively ambience. The cornerstone to offering an experience with which few other hotels could compete depended largely on Shangri-La’s competitive advantage of offering personalized guest service. This competitive advantage relied on a well-trained and well-compensated workforce that could consistently deliver high levels of service across a variety of cultural norms and preferences. Each hotel was expected to serve its clients in the way their society deemed acceptable. Hence, employees were expected to adapt to the local requirements and expectations of each country and were given personal decision-making authority to accommodate guest requests. To accomplish these goals Shangri-La developed core and distinctive competencies in human resources management, especially in employee training.

Given that its goal was to offer personalized service based upon the norms and preferences of each country and its culture, Shangri-La faced challenges transporting these competences across diverse cultures. For example, the decentralization of decision-making authority to accommodate guests was resisted by employees in China. Employees in Shangri-La’s hotels in China were not always comfortable making decisions, especially those involving small monetary issues. Moreover, they were not accustomed to taking initiative and acting independently but rather they preferred to follow instructions from superiors. To further complicate matters, managers were reluctant to give up their perceived authority by delegating.

To address the culture challenges, including the growing number of employees in China hesitating to take the initiative to meet guest needs, Shangri-La developed the Shangri-La Academy in 2004 and engaged in ongoing communications to instill a higher level of confidence in its employees. The academy was designed to address the challenges of growing from a workforce of nearly 10,000 employees to 19,000 without losing sight of Shangri-La’s standard of excellence through personal service and decentralized decision-making. In general, it does appear that the Academy has been successful in addressing these issues, although they are not completely resolved.
6. **What does the company’s financial and operational performance reveal about how successful its strategy and strategy implementation efforts have been? Should shareholders be pleased with the company’s financial performance? Why or why not? What financial and operating performance pluses and minuses do you see?**

Shangri-La’s strategy in terms of planning and implementation appears to have yielded solid performance. Shangri-La has recorded impressive growth, with total revenues increasing by 67% between 2002 and 2006. Students should recognize that the company’s total expenses grew at a slower rate of 53% during the same 4-year timeframe. Students should also notice that operating income grew by 123% and net income grew by 219% between 2002 and 2006.

Even though the company has achieved commendable growth in revenues and earnings, students who make calculations similar to what are shown in Table 1 may find elements of the company’s financial performance that are less than stellar.

### Table 1  Selected Financial Statistics and Ratios for Shangri-La Hotels, 2002 – 2006

<table>
<thead>
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<tbody>
<tr>
<td>Revenue Growth</td>
<td>19.11%</td>
<td>16.06%</td>
<td>34.25%</td>
<td>-10.01%</td>
<td>N/A</td>
</tr>
<tr>
<td>Gross Profit Margin</td>
<td>59.24%</td>
<td>58.95%</td>
<td>57.48%</td>
<td>56.62%</td>
<td>58.57%</td>
</tr>
<tr>
<td>Operating Profit Margin</td>
<td>27.25%</td>
<td>22.38%</td>
<td>19.67%</td>
<td>25.17%</td>
<td>20.45%</td>
</tr>
<tr>
<td>Return on Assets (ROA)</td>
<td>3.98%</td>
<td>3.54%</td>
<td>3.05%</td>
<td>1.53%</td>
<td>1.39%</td>
</tr>
<tr>
<td>Return on Equity (ROE)</td>
<td>7.49%</td>
<td>6.34%</td>
<td>5.74%</td>
<td>2.77%</td>
<td>2.48%</td>
</tr>
<tr>
<td>Current Ratio</td>
<td>1.77%</td>
<td>1.18%</td>
<td>1.30%</td>
<td>1.11%</td>
<td>1.28%</td>
</tr>
<tr>
<td>Inventory Turns</td>
<td>45.59</td>
<td>40.68</td>
<td>38.39</td>
<td>31.06</td>
<td>38.25</td>
</tr>
<tr>
<td>Debt-to-Equity</td>
<td>0.56</td>
<td>0.42</td>
<td>0.48</td>
<td>0.40</td>
<td>0.40</td>
</tr>
</tbody>
</table>

A close analysis of various financial ratios reveals the following:

- Shangri-La’s recent revenue growth has been somewhat sporadic. For instance, students should point out that in 2003 its revenue growth was -10%; however, in 2004 it was up to 34%. While this might be seen as favorable, revenue growth fell to 16% in 2005 and increased to 19% in 2006. The unpredictable nature of revenue growth should be cause for some concern.

- Gross profit margins have hovered around 57% and 59%. The absolute value of the gross profit margins is solid; however, the lack of growth in gross profit margins suggests that the company has failed to make significant strides in operational efficiency.

- Operating profit margins have only increased twice in a five year period from 22% to 27%. These numbers may suggest that Shangri-La is not in control of its operations since everyday operating expenses have not been steadily reduced.

- Shangri-La’s ROA and ROE offer little support for a superficial analysis that might suggest their operational and financial performances are strong. In fact, they strongly suggest otherwise. Its ROA has gone from 1% in 2002 to 4% in 2006, which is nothing short of abysmal. Its ROE has not done much better with an increase from 2% to 7% in the same period. Some students may find that the upward trend in these areas is favorable. However, the percentage values of ROA and ROE suggest that Shangri-La is not making excellent use of its assets and equity to enhance the business’ efficient growth. In other words, they are not making more money with fewer assets and not as much equity. This is especially true when students realize that Shangri-La’s long-term debt has increased by 49% from 2002 to 2006 while its total assets have only increased by 11% in the same period.
The inventory turns ratio has decreased, indicating that Shangri-La has not improved its inventory management over the last four years.

On the upside, however, its debt-to-equity ratio is solidly below 1 making them more creditworthy and is evidence that they are not heavily leveraged.

7. **What challenges does Shangri-La face in expanding into Eastern China? Do you believe the company's current policies and operating procedures will be sufficient in addressing these challenges? If so, why? If not, what else may need to be done?**

Shangri-La faces several challenges in its efforts to expand to Eastern China including competition from international hotel chains, competition from local hotels, and wage pressures. By 2006, China had become the world’s fourth largest economy and a very attractive destination for tourists. Hence, resource-rich international hotel chains such as the U.K-based InterContinental Hotel Group (IHG), the U.S.-based Marriott chain, and French-based Accor targeted China for new growth. The announcement of Beijing as the site for the 2008 Olympics brought an onslaught of new competition. Although local hotels did not quickly adopt higher standards as might have been expected, they did begin to consider strategic alliances with more widely internationally recognized brands in which they would provide the funding and their partners would provide the management skills. Finally, increasing completion elevated the demand for skilled workers. The training the Shangri-La employees had received made them attractive targets for poachers.

Students may find that Shangri-La’s strategic approach is sufficient to overcome some but not all of the challenges identified. For instance, Shangri-La’s strategy of differentiation based upon a personalized local experience is well-suited for China’s markets. However, the cultural differences in China relative to their model of taking the initiative and delegated authority may be difficult to overcome. Challenges associated with the local hotels entering into alliances with internationally recognized brand hotels is not insurmountable since Shangri-La has a reputation for world class service and since their financial performance seems to be able to support their future growth. Moreover, Shangri-La has continued to improve upon their model of expansion by offering operational and culture training. The pressure of increasing wages and threats of poachers may be more difficult to overcome with Shangri-La’s existing policies and procedures. They may need to consider increasing the wages of their employees in addition to the career paths offered in the face of steep competition for well-trained staff, particularly since the successful implementation of their strategy depends on maintaining a well-trained workforce.

8. **How do the challenges associated with Shangri-La’s expansion into Europe, Australia, and North America compare with the company’s expansion in China? Do you believe the company’s current policies and operating procedures will be sufficient in addressing these challenges? If so, why? If not, what else may need to be done?**

The challenges that Shangri-La faces in its effort to expand to Europe, Australia and North America are different than those encountered in China. Students should note that the most critical challenge confronting Shangri-La in expanding into these areas has to do with maintaining an adequate ratio of staff-to-guests in light of relatively more expensive labor markets where trained hotel staff was in short supply. In low wage and developing markets such as China, Shangri-La could maintain a ratio of staff-to-customer ratio of 2.5 to 3.0 staff per guest. However, in more mature markets where trained staff was in greater demand and lower availability (such as Sydney, Chicago and Vancouver), the ratio might be closer to 0.8. Paris was the only exception with a ratio of 2.1 staff per guest. Such a low ratio raised challenges for Shangri-La to offer better service and greater attention to details. Additionally, there were concerns about the inability to raise room rates that were dictated by the market.
Students may recognize that Shangri-La’s current policies and operating procedures may not be sufficient to overcome the challenges associated with a high wage market where limited potential employees are available. Nonetheless, Shangri-La can take several steps to help overcome these challenges. For instance, Shangri-La may seek to import talent from other locations for extended periods of time. Although wages may have to be increased, visa regulations may offer some protection from poaching and may help relieve the shortage of a well-trained labor market. Alternatively, Shangri-La could attempt to bring over employees from remote locations on a more short-term basis under a visiting program. While such programs may be difficult given regulatory stipulations, they do help Shangri-La leverage a large pool of its trained workforce by mobilizing them for the long and short terms in a way that may be attractive to its employees.

9. How big a threat does the expansion of other hotel chains into China pose for Shangri-La Hotels? What specific challenges are likely to arise as a result of this expansion? How should Shangri-La address these challenges?

The expansion of other hotels is a significant threat given the attractiveness of the Chinese market. The announcement of the 2008 Beijing Olympics brought competitors such as Regent, Ritz-Carlton, Hyatt, and Sheraton who invested billions of dollars into their expansion. Major hotels such as the U.K-based InterContinental Hotel Group (IHG), which operated the Crowne Plaza, Holiday Inn chains and had a portfolio of 51 hotels in China and planned to develop an additional 74 by 2008, the U.S.-based Marriott chain, which operated the Ritz-Carlton, Renaissance, and Courtyard brands, had 26 hotels in China and planned to expand its portfolio to 100 by 2010 and France’s Accor, which had 30 hotels under development in China, all scheduled to open before 2008. Wyndham Hotel Group, which also owned the Ramada and Wingate Inn brands, had a portfolio of 60 hotels in China in 2006 and planned to expand at an annual rate of 40% leading up to the 2008 Beijing Olympics.

This type of expansion is likely to lead to increasing rivalry for both customers and suppliers. Although the Chinese market represents a lucrative and growing market, a hypercompetitive market is likely to result in the erosion of profits as hotels utilize competitive weapons to out compete their rivals and build market share. Profits are likely to be further eroded as demand for trained employees drives up wages. Additionally, the quality of training that Shangri-La offers to its employees makes it attractive for poaching, which can be minimized by increasing fringe benefits, non-monetary recognition, or salaries. As Shangri-La enters hypercompetitive markets, it must focus on not only training its workforce to implement a strategy that emphasizes a unique experience, but they must work hard to retain that workforce through both financial and non-financial forms of compensation. The company should design the compensation structure in a manner that is sensitive to the diverse cultures in which they operate.

10. What recommendations would you make to Symon Bridle to improve Shangri-La’s prospects for continued success?

Shangri-La has competed in the luxury hotel market with a strategy that differentiates it from its competitors by offering world class service and hospitality. Shangri-La’s competitive advantage exists primarily due to its ability to offer guests personalized service based upon local requirements. However, given its continued expansion and increasing global competition, it is unclear whether this competitive advantage is sustainable, which means that Shangri-La must seek to improve its competitiveness. Below are some recommendations:

- Students may suggest that Shangri-La offer a more competitive compensation package to help retain its trained employees. That package might include a higher salary or greater incentive-based pay to better align the goals and efforts of employees with that of the company. An important component is to offer a compensation package that is sufficient to retain employees but not so high as to eliminate operating profits.
While the case provides ample material on training and compensation, it does not provide an equal amount of material on the company’s selection process. Attentive students will tend to pick this up and make recommendations focusing on this issue. While we have no reason to believe that the company is not making hires that are supportive if its culture, it would be worthwhile for them to explore developing a selection process that focuses on identifying key characteristics in their applicants.

Students may also suggest that Shangri-La pursue creative methods to mobilize its workforce around the globe for the short and long terms. Travel visit and visa programs might provide Shangri-La with an innovative way to meet its staff-to-guest ratios in markets where demand for well-trained hotel employees is high without eliminating profits. It is important that Shangri-La maintain its excellence regarding hospitality and service as it expands globally to markets where demand in labor markets for highly trained employees is high.

Students may recognize that the pressures of wages in developing countries as well as in mature countries require that Shangri-La improve its operating efficiency. Its financial performance suggests that while Shangri-La has increased its overall revenues, it has failed to improve operating efficiency. Improvements in this area may allow Shangri-La to marginally increase compensation without eliminating profits.

Finally, students may find that Shangri-La will have to engage in more aggressive training to ensure that their way of doing things is perpetuated as they expand internationally. Expansion of operations without retention of the organization’s culture is likely to produce inconsistent service across countries. Shangri-La should expand their operational training and cultural training efforts to maintain a high quality of service and decision-making.

**EPILOGUE**

Shangri-La Hotels received numerous recognitions and awards for its customer service and hotel amenities through 2009. Shangri-La was also named by the American Society for Training & Development as one of the “Best 40” companies worldwide for effective training and development in 2008. Between 2007 and 2009, Shangri-La opened new luxury hotels in China, Japan, and the Philippines to bring its total number of hotels to 62.

Mr. Symon Bridle became Shangri-La’s group director of development in 2008. He was replaced as chief operating officer by Mr. Greg Dogan. There was no important company news to report at the time this teaching note went to press. You can find the company’s latest financial results and press releases at [http://www.shangri-la.com/](http://www.shangri-la.com/).

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OVERVIEW

The E. & J. Gallo Winery was the world’s largest wine producer and distributor with some 75 brands, including Turning Leaf, Gallo of Sonoma, Carlos Rossi, Livingston Cellars, and André. The company’s products had received numerous awards for quality and had achieved notable market success. Gallo produced the top-selling red and white table wines in the U.S. based on unit volume, its Blush Chablis became the best-selling blush-style wine within the first year of its national introduction, André was the leading brand of sparkling wine in the U.S., and E & J Brandy outsold the numbers two and three brands combined. The company’s Gallo of Sonoma winery was named the Winery of the Year in 1996, 1998, and 2001 and its Bartles and Jaymes wine cooler brand had led the wine cooler category every year since its introduction in the 1980s. Gallo Winery was far and away the biggest U.S. exporter of wines.

Gallo’s major competitive weakness over the years had always been its reputation as a maker of low-end wines in screw top bottles—an image that flowed partly from its Thunderbird and Night Train brands. This was not so much a liability in the early days when wine sales in the U.S. were heavily concentrated in the low end of the market, but Gallo’s low-end image became an increasing liability in the 1980s as wine consumers began to purchase better-quality table wines in increasing numbers and as wine became a favored beverage at cocktail parties. As the company grew over the years, first becoming the largest winemaker in the U.S. and then the largest in the world, the Gallo brothers initiated a series of moves to shed the winery’s image as a maker of low-end wines sold in screw-top bottles and jugs. Gallo’s new strategy was to distance itself from the Thunderbird and Night Train brands and begin the long-range task of repositioning itself as a maker of better quality, moderately-priced table wines and then later as a maker of truly fine wines.

Nonetheless, in 2001, Gallo’s Thunderbird and Night Train brands were still among the best-selling low-priced fortified dessert wines. Dessert wines were highly controversial because of their alcohol content that could be as high as 20% (natural wines contained 8% to 12% alcohol by volume) and low prices (less than $3 per 750 ml bottle and $1 to $2 per 375 ml bottle) that were favored by skid row alcoholics, people with low incomes, and budget-constrained teenagers and college students. Critics of cheap fortified wines had tagged them “the most seriously abused drug in the country” and suggested that manufacturing and selling cheap, fortified wine was unethical, even bordering on criminal. The publisher of Wine Investor said, “Makers of skid-row wines are the dope-pushers of the wine industry. And these companies are the largest producers and appear to be the most successful wineries.” Defenders of dessert wines suggested that many consumers who purchased brands like Thunderbird and Night Train did so because they liked the flavor and couldn’t afford expensive varietals and reserves. Business ethicists, such as The Darden School’s Professor Edward Freeman, defended the products by stating, “There is a long tradition of freedom of contract in our country. People are free to make their own mistakes.” The root issue, he claimed, was the underlying social conditions that helped push alcoholics into their disease, “Not selling this stuff is like moving the deck chairs on the Titanic. The question is, do you really want to be a company associated with these products that are so abused? In our system, we let the companies decide.”
In April 2001, Ernest Gallo received the Lifetime Achievement Award from the prestigious James Beard Foundation; in presenting the award, Charles Osgood spoke about “the power and persistence of the Gallo mission to make not just the most, but the best wines possible.” John Deluca, Chairman of the Wine Institute, further elaborated on Ernest Gallo and the Gallo legacy, “he has really created the modern wine industry in America….The Gallo brothers have been the most important force in the positive transformation of the California wine industry this last century.” Marvin Shanken, publisher of Wine Spectator, said, “All Americans who drink wine at their dinner table today are in his debt.” But what always seemed to go unsaid was that, despite the company’s industry prominence and the growing market success and quality of Gallo table wines, the cheap bottles of Thunderbird and Night Train still continued to be among the best-selling and most notorious wines that E&J Gallo Winery produced and marketed. In 2001, E&J Gallo’s website featured many of its award-winning wines and highlighted the care and attention paid by the company’s winemakers to making quality wines but there was no mention on the Gallo website of Thunderbird or any of the company’s other low-end fortified and jug wines.

SUGGESTIONS FOR USING THE CASE

The E&J Gallo Winery case is a thoroughly updated version of an extremely popular case that appeared in an earlier edition of the text. You can expect spirited debate over whether a company as prominent as Gallo should continue to produce and market brands like Thunderbird and Night Train and whether Gallo is a willing contributor to alcohol abuse. The product reviews of the leading fortified wine brands presented in the case are highly entertaining, as well as scathing—students will find it very hard to argue that these products have any redeeming value.

You can teach the E&J Gallo case as a standalone ethics case as part of your strategy and ethics module as it ties in very well with Chapter 9. In structuring your discussion of the E. & J. Gallo Winery case, we suggest launching the class discussion by cutting straight to the chase and asking what responsibility Gallo Winery has to society in combating alcohol abuse. We’ve found classes will leap at the opportunity to discuss the question and, generally, will be split into two factions: one group will argue that if such wines did not exist, there would be fewer alcoholics on the street; a second group will contend that alcoholics are going to be alcoholics anyway, and if they don’t abuse wine, they will simply switch to other alcoholic beverages (cheap liquors or malt liquor) or abuse products containing alcohol (chafing dish fuel or mouthwash). The latter group will see little problem with Gallo continuing to produce and market Thunderbird and Night Train.

Next you can explore the strategic importance of dessert wines to wine producers. Is it a key product for a company like Gallo? Do dessert wines have any redeeming qualities? Then you can explore the impact of withdrawing from the dessert wine market. Considerations here include the probable impact on individuals who abuse the product, on Gallo’s sales and profits, and on Gallo employees who work in the company’s dessert wine operations. Is dessert wine an important component of Gallo’s strategy?

Since Gallo is a privately held company, there were no financials to include in the case beyond those provided by “industry watchers.” But there is plenty of meat in the case to (1) provoke a heated and stimulating discussion of a company’s ethical responsibilities and the consequences of doing what is ethical and (2) scrutinize the pros and cons of Gallo’s strategy.

The Student Edition of the Online Learning Center (OLC) provides students with copies of the assignment questions contained in this note. The list of assignment questions leads students through a thorough industry analysis and prepares them to make strategy recommendations for selected companies. We suggest that you always direct students to the assignment questions posted on the Crafting & Executing OLC and instruct them to use the assignment questions to prepare for the class discussion of the case. We always instruct our students to read the case once to gain a general understanding of the issues presented in the case and then return to the case to prepare written responses to each of the assignment cases. We’ve found that our students who follow this approach are well-prepared to make a meaningful contribution to the class discussion.
This case is appropriate for an oral presentation, a debate, or a written assignment. A potential assignment question would be:

Gallo’s co-presidents Joseph Gallo, Robert Gallo and James Coleman have recently engaged your consulting services to examine the company’s position in the fortified wine industry. Specifically, they want to know whether the company should continue to produce and distribute fortified wines. In addressing this question the co-presidents would like you to lay out the pros and cons of remaining in the industry from both the economic and social responsibility perspectives. In addition, be sure to address the potential ramifications of your recommendation on the company’s employees and customers regardless of which course of action you suggest. Please limit your report to 5-6 pages, including any exhibits you believe are appropriate.

ASSIGNMENT QUESTIONS

1. How important is the dessert wine segment to the industry? to E&J Gallo Winery? How do these products fit with Gallo’s stated position on the quality of its products? Do brands like Thunderbird and Night Train have any redeeming features as a product, even if they are in demand by a segment of the population?

2. What are the key success factors in the dessert wine segment? Is there strategic fit between Gallo’s fortified wines and its other wines?

3. Is Gallo being socially responsible by supplying dessert wines? What responsibility does Gallo have to consumers in furnishing dessert wines? Does the Gallo family have any personal responsibility to speak out against alcohol abuse? Should they be doing more than speaking out? Should production and sale of Thunderbird and Night Train be discontinued?

4. Which approach to managing a company’s ethical conduct (see Table 9.2 on p. 308 of Chapter 9) would you say Gallo seems to be applying? What are the challenges associated with this approach?

5. If Gallo Winery decides to abandon the Thunderbird and Night Train brands, what will be the impact on those individuals who abuse the dessert wine products?

6. What responsibility does Gallo have to the employees in its dessert wine operations should the company elect to abandon the production of Thunderbird and Night Train?

7. What actions would you recommend the company take, especially with regard to its cheap fortified wine product offerings?

TEACHING OUTLINE AND ANALYSIS

1. How important is the dessert wine segment to the industry? to E&J Gallo Winery? How do these products fit with Gallo’s stated position on the quality of its products? Do brands like Thunderbird and Night Train have any redeeming features as a product, even if they are in demand by a segment of the population?

In 2005, dessert wines represented a 47 million gallon business in the United States, representing only 7.03% of the total wine sold in the U.S. according to case Exhibit 6, which represents a growth from 2000 when these wines accounted for only 5.7% of total volume. In addition, case Exhibit 7 indicates that wines in the under $6.00 category represented 37.1% of consumer wine purchases by price in 2006. Finally, the case estimates that the profit margins on these low end wines were as much as 10% higher than those on ordinary table wines, and local wine distributors were anxious to handle these low-end dessert and fortified wines since they had relatively large margins, needed little or no advertising or sales promotion, and had sizable sales volumes.
Students should recognize that the dessert wine category appears to be a profitable venture for Gallo and other wineries because dessert/fortified wines were made with less expensive, low quality grapes and required little advertising support. Cheap fortified wines were low-margin, high-volume products that filled both a production niche and a sales niche.

Based on this information, students can be encouraged to examine the importance of these products to Gallo by examining both the value chain fits and the resource fits between Gallo’s fortified wines and its better quality table wines. Based on the value chain analysis, a good case can be made that there is good strategic fit between dessert wines and other wines since there are ample opportunities for cost-sharing and joint use of production facilities and bottling operations, plus there can be shared distribution opportunities. There is both market/distributor fit (many distributors and retailers carry multiple Gallo brands) and production/operating fit (fortified wines provide a use for low-end grapes that are not good enough for use in making better table wines, and production of such wines helps achieve full utilization of both Gallo’s wine-making capacity and Gallo’s container-making/packaging facilities). Perhaps one of the few areas of the value chain where there does not seem to be a valuable strategic fit is in marketing. Indeed, it appears that Gallo appears to be distancing itself from these products by forgoing the use of a common brand name. However, given the low quality of the fortified wines, and their relatively poor image, students will realize that Gallo probably does not want the image of the fortified wines to “taint” their higher end wines.

From a resource fit perspective, the fortified wines can best be viewed as a cash cow, and the margins over variable cost of dessert wines almost assuredly provide a meaningful contribution to Gallo’s fixed costs and total profit. Based on both of these types of fits, students should recognize that these fortified wines play a valuable role in Gallo’s portfolio. However, this role is clearly declining as the case states: “In 1993 Gallo was selling roughly 3 million cases of Thunderbird a year. By 2003 the company had quit advertising the product altogether and sold only 300,000 cases.”

In examining whether dessert wines have any redeeming qualities, students should differentiate between true dessert wines, which may well represent an acceptable wine product, and cheap fortified wines like Thunderbird and Night Train that do not appear to be anything other than questionable products. You will likely get little argument among class members from asking if Gallo should be proud of its Thunderbird and Night Train brands. Early in the company’s history Gallo made its name selling cheap fortified wines. However, recognizing the competitive liability this image represented, between 1985 and 2000 Gallo invested hundreds of millions of dollars to reposition the products and the brand. The company’s focus on quality is evident from the statements of Matt and Gina Gallo presented in the case. Therefore, it appears that the production of fortified wines is no longer consistent with Gallo’s philosophy. Indeed, the case notes that there is no mention on Thunderbird on the company’s website.

This can lead to you to ask the students directly whether these products are “sleazy.” The product reviews of these products are pretty scathing and are pretty close to the mark, we think. But there is likely to be more disagreement and debate among class members about whether they should be discontinued. To provoke discussion, you can pose several questions:

- If these products are sleazy, then why wouldn’t a respectable winery like E&J Gallo simply stop producing them? (Because they are profitable?)
- Should Gallo be proud that it is earning what is probably a nice profit from such products?
- Why doesn’t Gallo proudly promote the products? Why is there no mention of Night Train or Thunderbird on Gallo’s website? Because it is, indeed, not proud of these products?
- Can you imagine that members of the Gallo family would ever consider serving Thunderbird or Night Train to their guests?
2. **What are the key success factors in the dessert wine segment?**

Students should have little trouble identifying the following factors as insuring market success in the dessert wine segment:

- Low price
- High alcohol content (as much as 18%)
- Effective distribution system and an ability to gain shelf space in liquor stores and convenience stores in low-income areas
- Brand name appeal

3. **Is Gallo being socially responsible by supplying dessert wines? What responsibility does Gallo have to consumers in furnishing dessert wines? Does the Gallo family have any personal responsibility to speak out against alcohol abuse? Should they be doing more than speaking out? Should production and sale of Thunderbird and Night Train be discontinued?**

In discussing the social responsibility issue with our classes, we like to begin by discussing what it means to be socially responsible. If you have assigned Chapter 9 prior to discussing this case in class, you should focus on the ethical nature of Gallo’s strategy and if the production and sale of fortified wines has a positive impact on society. You will likely find that two points of view will emerge as you lead the class discussion of this assignment question.

- Some students will insist that corporations should not be concerned about the adverse effects their products have on society or on particular consumers so long as the company’s actions stay within the letter of the law and what is legally permissible.

- Others will argue that a company’s actions must be both ethical and in tune with societal expectations and public opinion and that Gallo’s actions violate the two components of socially responsible business behavior listed above.

In fostering debate over whether Gallo’s cheap fortified wine products “violate the canons of social responsibility” you can pose the following questions:

- Do a company’s customers determine whether the product is acceptable and worthwhile when they make the decision to buy the product or not?

- Is Gallo not obligated to do its part to try to prevent alcohol abuse?

- Doesn’t consumption of Thunderbird and Night Train by skid-row alcoholics impose costs on society? Shouldn’t Gallo exercise some degree of social responsibility in trying to discourage use of its products by skid-row alcoholics? Should it raise the prices of such products?

- Is Gallo doing consumers a service by providing them with a cheap way to get drunk? Is this a “legitimate” way of earning a profit?

- Would sales of Gallo’s higher-priced, more prestigious wines be damaged if the general public knew that Gallo was the market leader in the dessert wine segment?

- Is it important to Gallo that the Thunderbird and Night Train brands not be connected with the Gallo brands? Would a significant number of people care? Would Gallo’s image be tarnished?

- Is it fair to say that Gallo is socially unconcerned about the adverse impacts on skid-row alcoholics and society that its Thunderbird and Night Train brands have?
4. Which approach to managing a company’s ethical conduct (see Table 9.2 on p. 308 of Chapter 9) would you say Gallo seems to be applying? What are the challenges associated with this approach?

Students who are familiar with Chapter 9 concepts should be able to recall that the four approaches to managing business ethics are:

1. The Unconcerned or Nonissue Approach
2. The Damage Control Approach
3. The Compliance Approach
4. The Ethical Culture Approach

This is likely to be a relatively difficult question for students to address. There is little evidence in the case to support a position that the company takes anything other than an unconcerned or nonissue approach to managing business ethics. Students who argue that the company engaged in philanthropic activities such as donating to political campaigns should note the political boons the company received. Additionally, students should note that it appears that Gallo uses distribution tactics that appear to prey on some of the most vulnerable elements of the population (i.e., homeless alcoholics and the poor) by changing the size and therefore price ranges of the bottles of alcohol available at various times of the month to make the product more accessible to these customers.

Students should realize that while the company appears to have been able to dodge the potential financial consequences that can be associated with this approach, despite disassociating itself from the fortified wines, the company has suffered alienation from some stakeholders, as well as credibility problems with other stakeholders. Additionally, the company appears to have a subpar ethical reputation. If you wish to extend this discussion, you can show the slide with Figure 10.1 that shows the Business Costs of Ethical Failures, and you can discuss which of these Gallo has incurred, or is likely to incur if it continues its commitment to the cheap fortified wines.

Students who do a little extra digging can go to the company’s website and find information on their position on environmental conservation and their statement on community involvement. That statement on community involvement reads:

“At E. & J. Gallo Winery, we understand that family and community go hand-in-hand, which is why we are committed to making a difference in the communities where we live, work and play.

We proudly support a variety of nonprofits, charitable foundations, community events, mentoring and scholarship programs, and the arts.

Our approach is simple: we look for innovative programs that solve problems and improve people’s lives.

Our impact is even greater thanks to our generous employees who, year in and year out, give the gift of their time and energy to a variety of organizations meaningful to them.”


However, there is not a specific statement on ethics or ethical behavior on the site. Therefore, students who find this information may be able to argue that the company has adopted a Compliance approach at the best. However, they will still have a hard time making the case that available evidence supports the position that the company is following the Ethical Culture Approach to managing business ethics.
5. **If Gallo Winery decides to abandon the Thunderbird and Night Train brands, what will be the impact on those individuals who abuse the low-end dessert wine/fortified wine products?**

Since low price and high alcohol content are the primary appeal of cheap fortified wines and since the commodity nature of the product makes it easy to produce and supply them, if Gallo elects to pull out of the dessert wine segment, then in all probability another opportunistic (unethical? or socially unconcerned?) winemaker would move quickly to absorb Gallo’s market share. In fact, buyers of these wines would likely simply switch to whatever fortified wine brands are available, without wine producers having to do anything to pick up extra sales. If this is the case, the impact on Gallo’s dessert wine customers would be minimal. Gallo, of course, might gain a clear conscience as well as some points with knowledgeable segments of the public. It would also avoid potential embarrassment should public interest groups decide to arouse public opinion against the producers of dessert wines for their “uncaring, irresponsible” actions in supplying an undesirable product to “addicted” drinkers and thus contributing to alcoholism. More importantly, Gallo would avoid exposure to class action lawsuits charging that the makers of dessert wines have contributed to unreimbursed medical expenses paid by states and Medicaid. The litigation against the tobacco industry could establish a legal precedent against producers of other products contributing to public health issues.

Students can make a good case that Gallo’s abandoning the Thunderbird and Night Train brands will probably have only modest, if any, bearing on the level of alcoholism. The company’s experiment in San Francisco’s Tenderloin District and the Portland ban on dessert wines support such a position. (Salt Lake City did find its ban on dessert wines contributed to a decline in public drunkenness.) Opportunistic winemakers with excess capacity will likely increase their production and the situation will stay the same. Of course, Gallo could lobby heavily (as it has in other matters affecting the wine industry) to ban cheap dessert wines or make them more costly through higher taxation. In this case, alcohol abusers would find it more difficult to locate an inexpensive product to satisfy their needs.

6. **What responsibility does Gallo have to the employees in its dessert wine operations should the company elect to abandon the production of Thunderbird and Night Train?**

Assuming the class majority is solidly in favor of abandoning the dessert wine segment, then the issue of social responsibility can be raised once again regarding Gallo’s responsibility to the employees in the dessert wine segment. If a company changes its strategy because of an ethical change of heart, does the company have any responsibility to those employees affected by the “tightening” of ethical principles? It would seem reasonable that Gallo could protect the jobs of employees engaged in making Thunderbird and Night Train by introducing other low-end table wine brands and growing its business sufficiently to keep all such employees engaged in productive activities?

7. **What actions would you recommend the company take, especially with regard to its cheap fortified wine product offerings?**

Students will likely suggest that Gallo could gradually abandon the fortified wine segment (this is the perfect place for a harvest strategy!) and take up the slack by re-deploying these resources to focus on other opportunities in low end table wines. Indeed, students should note that Gallo has already scaled back production in this area and cutting the remaining production should not be especially damaging to the company’s bottom line. Astute students may note that although the company does not promote its association with the fortified wine brands, in a family business such as Gallo there may be some sentimental reasons, in addition to economic reasons, to want to retain these brands. After all, these brands were key to the company’s early rise to prominence. However, from an ethical and socially responsible perspective, there seems to be relatively little reason to retain the cheap fortified wine product offerings. Indeed, abandoning these brands would be a bold statement not only on the company’s position on ethics and social responsibility, but also on the company’s commitment to quality.
We would also recommend that the company take additional steps to institute the ethical culture approach to managing business ethics. If the company does not have specific strategies to ingrain ethical behaviors as part of its culture, it needs to begin doing so immediately. At the very least the company should begin by developing an ethical code of conduct and publicly promoting the code on the company’s website. Additionally, it should begin promoting stories of its “ethics heroes.” Currently it seems that most of the stories related in the case focus on ethically questionable actions and it would benefit the company to promote values that are more squarely based on an ethical culture.

EPILOGUE

There was nothing new to report about Gallo’s fortified wine business at the time this teaching note went to press. You may wish to review the company’s latest press releases at www.gallo.com to determine if it has altered its product lineup to address the societal impact of its fortified wines.
OVERVIEW

Importers of goods from China, Indonesia, Cambodia, Vietnam, Malaysia, Korea, Pakistan, Bangladesh, Sri Lanka, India, the Philippines, Peru, Honduras, the Dominican Republic, Tunisia, and several other countries in Latin America, Eastern Europe, the Middle East, and Africa have long had to contend with accusations by human rights activists that they sourced goods from “sweatshop” manufacturers who paid substandard wages, required unusually long work hours, used child labor, exposed workers to toxic chemicals and other safety hazards, failed to provide even minimal fringe benefits, and habitually engaged in assorted other unsavory and abusive workplace practices. Factories in China were particularly in the spotlight because of China’s prominence as the largest single source of goods imported into both the U.S. and the 25 countries comprising the European Union; U.S. imports from Chinese manufacturers amounted to about $320 billion in 2007. Political support in many countries for growing trade ties with countries where low-cost manufacturers were located, especially China, often hinged on the ability of companies with global sourcing strategies to convince domestic governmental officials, human rights groups, and concerned citizens that they were doing all they could do to police working conditions in the plants of suppliers in low-wage, poverty-stricken countries where sweatshop practices were concentrated.

Starting in the 1990s, companies began countering these criticisms by instituting elaborate codes of conduct for suppliers and by periodically inspecting supplier facilities to try to eliminate abuses and promote improved working conditions. A strong program of auditing labor practices and working conditions in supplier factories was a way for a company to cover itself and negate accusations that it was unfairly exploiting workers in less developed countries. By 2008, hundreds of companies that sourced goods from factories in less developed parts of the world had instituted strict codes for suppliers and either had an internal staff to conduct audits of supplier factories or utilized the services of recognized third parties with auditing expertise to inspect supplier factories. Most companies focused their efforts on improving working conditions at supplier factories, preferring to help suppliers comply with the expected standards rather than to impose penalties for violations and perhaps abruptly or permanently cutting off purchases.

But a number of unscrupulous foreign manufacturers had recently gotten much better at concealing human rights abuses and substandard working conditions. In November 2006, Business Week ran a cover story detailing how shady foreign manufacturers were deceiving inspection teams and escaping detection. According to the Business Week special report, Ningbo Beifa Group, a top Chinese supplier of pens, mechanical pens, and highlighters to Wal-Mart, Staples, Woolworth, and some 400 other retailers in 100 countries, was alerted in late 2005 that a Wal-Mart inspection team would soon be visiting the company’s factory in the coastal city of Ningbo. Wal-Mart was Beifa’s largest customer and on three previous occasions had caught Beifa paying its 3,000 workers less than the Chinese minimum wage and violating overtime rules; a fourth offense would end Wal-Mart’s purchases from Beifa. But weeks prior to the audit, an administrator at Beifa’s factory in Ningbo got a call from representatives of Shanghai Corporate Responsibility Management & Consulting Company offering to help the Beifa factory pass the Wal-Mart inspection. The Beifa administrator agreed to pay the requested fee of $5,000. The consultant advised management at the Beifa factory in Ningbo to create fake but authentic-looking records regarding pay scales and overtime work and make sure to get any workers with grievances out of the plant on the day of the
audit. Beifa managers at the factory were also coached on how to answer questions that the auditors would likely ask. Beifa’s Ningbo factory reportedly passed the Wal-Mart inspection in early 2006 without altering any of its practices. A lawyer for Beifa confirmed that the company had indeed employed the Shanghai consulting firm but said that factory personnel engaged in no dishonest actions to pass the audit; the lawyer indicated that the factory passed the audit because it had taken steps to correct the problems found in Wal-Mart’s prior audits.

The efforts of unscrupulous manufacturers in China and other parts of the world to game the plant monitoring system and use whatever deceptive practices it took to successfully pass plant audits had four chief elements:

1. *Maintaining two sets of books*—Factories generated a set of bogus payroll records and time sheets to show audit teams that their workers were properly paid and received the appropriate overtime pay; the genuine records were kept secret.

2. *Hiding the use of underage workers and unsafe work practices*—In some instances, factories in China, parts of Africa, and select other countries in Asia, Eastern Europe, and the Middle East employed underage workers. This was disguised either by falsifying the personnel records of underage employees, by adeptly getting underage employees off the premises when audit teams arrived, or by putting underage employees in back rooms concealed from auditors.

3. *Meeting requirements by secretly shifting production to subcontractors*—On occasions, suppliers met the standards set by customers by secretly shifting some production to subcontractors who failed to observe pay standards, skirted worker safety procedures, or otherwise engaged in abuses of various kinds.

4. *Coaching managers and employees on answering questions posed by audit team members*—Both managers and workers were tutored on what to tell inspectors should they be interviewed. Scripting responses about wages and overtime pay, hours worked, safety procedures, training, and other aspects related to working conditions was a common tactic for thwarting what inspectors could learn from interviews.

In many less-developed countries struggling to build a manufacturing base and provide jobs for their citizens, factory managers considered deceptive practices a necessary evil to survive, principally because improving wages and working conditions to comply with labor codes and customers’ codes of conduct for suppliers raised costs and imperiled already thin profit margins. Violations were said to be most prevalent at factories making apparel, but more violations were surfacing in factories making furniture, appliances, toys, and electronics. There was a growing awareness among companies attempting to enforce supplier codes of conduct that all factories across the world with substandard working conditions and reasons to hide their practices from outside view played cat-and-mouse games with plant inspectors.

Nike and Wal-Mart were two companies with supplier codes of conduct and rather extensive programs to monitor whether suppliers in low-wage, low-cost manufacturing locations across the world are complying with their codes of conduct. Both companies initiated such efforts in the 1990s because they came under fire from human rights activist groups for allegedly sourcing goods from sweatshop factories in China and elsewhere. This case lays out in some detail how Nike and Wal-Mart have gone about monitoring foreign supplier factories and trying to secure compliance with their codes of conduct for suppliers, thus allowing students to evaluate which company has the “better” monitoring and compliance program.

The case also includes information about such organizations as the Fair Labor Organization and the Fair Factories Clearinghouse that perform audits of foreign plants on behalf of their members (many of which are large corporations that source goods from plants located in countries where substandard workplace practices existed).
SUGGESTIONS FOR USING THE CASE

This 16-page case (which is an extensively updated and revised version of one which appeared in the 16th edition) poses a host of timely and relevant issues for students to wrestle with. Is it appropriate, indeed necessary, for companies like Wal-Mart and Nike, to monitor the working conditions and workforce practices of their foreign suppliers? Why should companies “police” the workplace practices of foreign suppliers’ factories as opposed to letting local government set and enforce standards for working conditions at factories within their jurisdictions? Monitoring supplier compliance is a costly activity—how far should companies go to try to detect and prevent human rights abuses and sweatshop working conditions in supplier factories? What constitutes a reasonable level of effort to detect and prevent sweatshop practices on the part of unscrupulous foreign manufacturers? Who has the stronger supplier monitoring program—Nike or Wal-Mart? What can concerned companies do to detect foreign manufacturers who are deliberately deceiving inspection teams?

The case will work nicely as a leadoff case for your strategy and ethics module taught either after your coverage of the material in Chapter 9 or towards the end of the course. The key teaching points can be gotten across adequately in a 45-60 minute time frame, making it an excellent case for class periods when you need to spend 10-15 minutes of class time on other matters. But there is ample substance in the case for a full 60-75 minute discussion as well.

The whole issue of monitoring foreign suppliers in developing nations where wages are low and factory working conditions are often substandard is a thorny one. There are no easy cut-and-dried solutions or approaches to detecting sweatshop practices and enforcing supplier codes of conduct. We’ve filled this TN with a host of questions you can pose to the class to stimulate a heated debate of the issues.

We do strongly suggest having students prepare note to the assignment questions for this case that are posted on in the Student Section of the Online Learning Center at www.mhhe.com/thompson. These questions match those in the Assignment Questions section of this TN. The caliber of your class discussion will be much higher if class members have spent some quality time thinking about and preparing thoughtful answers to the assignment questions prior to coming to class.

The rather extensive data this case has on the supplier monitoring programs at both Nike and Wal-Mart make it suitable for a short written assignment (either in or out of class). Our suggested assignment question is as follows:

Which company has the strongest supplier monitoring program—Nike or Wal-Mart? Explain and justify your answer in some detail.

ASSIGNMENT QUESTIONS

1. How important is it for companies such as Nike and Wal-Mart that source extensively from foreign suppliers located in countries where wages are low and substandard working conditions are common to institute supplier codes of conduct and undertake programs to monitor and ensure supplier compliance with these codes of conduct?

2. Which company has the strongest supplier monitoring and compliance program—Nike or Wal-Mart? Why?

3. Would you recommend that a company join the Fair Labor Association and use FLA’s standards and program of factory audits instead of trying to set up its own supplier monitoring and compliance effort?

4. What can a company do to detect and combat the efforts of unscrupulous foreign suppliers to deceive inspection/compliance teams?
TEACHING OUTLINE AND ANALYSIS

1. How important is it for companies such as Nike and Wal-Mart that source extensively from foreign suppliers located in countries where wages are low and substandard working conditions are common to institute supplier codes of conduct and undertake programs to monitor and ensure supplier compliance with these codes of conduct?

Ethically-minded students will take the position that it is very important—even essential—for companies like Wal-Mart and Nike to have a supplier code of conduct and to strictly enforce this code. There are at least two important reasons why compliance monitoring has merit for companies that outsource a high percentage of their products from foreign manufacturers:

1. The big hit to a company’s reputation and image that can flow from media coverage of accusations by human rights activists that the company is sourcing its goods from “sweatshop” manufacturers who pay substandard wages, require unusually long work hours, use child labor, operate unsafe workplaces, and habitually engage in assorted other substandard practices. Such adverse and negative publicity can not only do long-term damage to a company’s reputation but also erode its sales and customer loyalty.

2. Because it is unethical and socially irresponsible for a company to do business with suppliers who operate unsafe factories, use child labor, pay substandard wages, or otherwise engage in unsavory practices. A company that knowingly and as a matter of course does business with such suppliers (usually in the name of obtaining its supplies at the lowest possible price) cannot morally and ethically justify such sourcing practices.

Amoral students are likely to view supplier codes of conduct as a useful public relations tool but be tolerant of token or lax enforcement of such codes. They will tend to disclaim responsibility for policing the actions and practices of suppliers, arguing that such is the province of governmental authorities.

To stimulate debate of the issues pro and con, you can pose the following questions:

- What reasons can you give for why a company that sources extensively from foreign suppliers located in countries where wages are low and substandard working conditions are common should definitely institute a supplier code of conduct and monitor supplier compliance with this code?

- Why should a company concern itself with how suppliers operate their businesses?

- Are human rights abuses on the part of suppliers something that a company should legitimately be concerned about and actively try to prevent? If a supplier factory habitually engages in human rights abuses, should a company cease doing business with that supplier?

- Are substandard pay and working conditions in suppliers’ factories something that a company should legitimately be concerned about? If a supplier factory habitually operates a sweatshop, should a company cease doing business with that supplier?

- Is supplier use of child labor something that a company should legitimately be concerned about? If a supplier factory habitually utilizes child labor, should a company cease doing business with that supplier?

- Is supplier abuse of the environment something that a company should legitimately be concerned about? If a supplier factory refuses to operate in a manner that constitutes rape of the environment, should a company cease doing business with that supplier?
Why is it a company’s ethical or social responsibility to monitor the workforce practices of its foreign suppliers? Why is concern about working conditions in foreign factories and the payment of adequate wages and fringe benefits in these factories not the sole responsibility of governmental authorities in the country where the supplier is located?

Can a company that overlooks how its suppliers operate their factories (as concerns wages, work hours, use of child labor, worker safety, environmental stewardship, and so on) stand on high moral ground when it comes to judging how it conducts its business?

On what grounds can a company justify doing business with suppliers who operate unsafe factories, use child labor, pay substandard wages, or otherwise engage in unsavory practices?

2. Which company has the strongest supplier monitoring and compliance program—Nike or Wal-Mart? Why?

In all probability students will conclude that Wal-Mart has a stronger and more thorough supplier monitoring program than Nike—and by a significant margin.

Evaluation of Nike’s Compliance Monitoring Program

In 2004, Nike’s compliance team consisted on 90 people based in 24 offices in 21 countries. The typical Nike compliance team in each country spent about one-third of their time on monitoring and auditing activities, about half their time assisting and tracking factory remediation activities, and the remainder of their time on trouble-shooting and collaboration/outreach work. But Nike had only 46 employees in 2004 who conducted in-depth M-Audits in contract factories, most auditors were women under 30 years old (perhaps indicating a lack of savvy, experienced plant auditors).

Nike’s factory audits were announced rather than unannounced because “much of the information we require in our evaluation of a factory is dependent upon access to relevant records and individuals within factory management.” It is hard to believe that announced audits are as effective as unannounced audits in detecting noncompliance.

During 2003-2006, Nike utilized 4 types of factory audits:

1. Basic monitoring or SHAPE inspections: SHAPE inspections, used since 1997, sought to gauge a factory’s overall compliance performance, including environment, safety and health. They were typically performed by Nike’s field-based production staff and could be completed in one day or less. Nike’s stated goal was to conduct two SHAPE audits on each active factory each year, but the actual number of such audits had fallen short of that target.

2. In-depth M-Audits: The M-Audit was designed to provide a deeper measure of the working conditions within contract factories. As a general rule, Nike focused its plant inspection efforts on factories where non-compliance was most likely to occur. In 2003, Nike focused its M-audits on factories presumed to have the highest risk of non-compliance and the greatest size (as measured by worker population). In 2004 M-audits were focused on factories believed to be of medium risk for non-compliance. Nike’s stated goal was to conduct M-audits for approximately 25-33 percent of its active factory base each year. The M-Audit included four major categories of inquiry (hiring practices, worker treatment, worker-management communications, and compensation) and covered more than 80 labor-management issues.

3. MAV Audits: Starting in fiscal year 2006, Nike introduced a new audit focused on finding root causes of non-compliance issues that most impacted workers, specifically work hours, wages/benefits, grievance systems, and freedom of associations. Prior audit experience had led Nike’s staff to believe that root cause identification would help supplier factories remediate the problems that were identified. Nike conducted 42 MAV audits through fiscal year 2006.
4. **Independent external monitoring:** Beginning in 2003, Nike became a member of the Fair Labor Association, an organization that conducted independent audits of factories that provided goods to members. The FLA applied a common set of compliance standards in all of its factory audits.

- In 2004 Nike had 46 employees who regularly conducted M-Audits. The typical M-Auditor was under the age of 30 and 74 percent were women. Nike tried to hire auditors who were local nationals and understood the local language and culture. In 2003-2004, over 9,200 factory workers were individually interviewed as part of the M-Audit process. Each interview took approximately 30 minutes. The typical M-Audit took an average of 48 hours to complete, including travel to and from the factory—travel hours accounted for between 25 and 30 percent of total M-Audit time.

> It is hard to believe that M-Audits could be done in a very thorough manner in this amount of time.

- M-Audits were conducted for only 25-33% of Nike factory base annually, meaning that on average each factory was audited only once every 3-4 years. In 2007, Nike reported that it had almost 700 factories in 52 countries actively engaged in manufacturing its products—this number was smaller than in earlier years.

- To facilitate factory compliance with Nike’s Code of Conduct for suppliers, the company conducted or sponsored training and education programs for factory personnel. In 2004, over 16,500 factory managers and workers attended programs relating to labor issues, worker health and safety, and environmental protection.

- While Nike’s compliance ratings of its contract suppliers in 2003-2004 resulted in 15% of the factories earning very commendable A ratings and another 44% earning B ratings, there were still some pretty low scores—25% involved grades of C and D, the average scores in Asia were only 58, and the scores in some factories ranged as low as 20 (see the data in case Exhibit 3).


- Nike’s efforts to correct problems in factories found to be out of compliance seem weak in comparison to Wal-Mart. In its 2004 Corporate Responsibility Report, Nike admitted, “With an average of one compliance staff for more than 10 factories—some of which are remote and some of which are large and complex businesses with 10,000 or more employees—tracking and assisting factory remediation is at times an overwhelming and incomplete body of work.”

- When a factory was found to be out of compliance with the Nike Code of Conduct, Nike’s compliance team worked with factory management and the Nike business unit for which products were being manufactured to develop a Master Action Plan (MAP) that specified the factory’s needed remediation efforts. The Nike production manager responsible for the business relationship with the contract factory monitored MAP progress and exchanged information about progress or obstacles with Nike’s country compliance team. The Nike general manager for production monitored the progress of all factories within his or her purview, and weighed in when factory remediation progress was too slow. One wonders if the Nike plant inspection teams should also have been much more deeply involved in working with the factory to achieve compliance; managers from Nike’s business units may not be highly motivated to push non-complying suppliers hard to get in compliance—their priorities may lie in making sure Nike receives the needed products on time.

Some questions you may want to pose to class members here:

- Does Nike’s general manager for production have strong incentive to push non-complying factories into compliance or to cut off orders to factories with chronically poor ratings?

- Would not the general manager for production be primarily concerned about getting deliveries on orders from such plants and making sure that the plant’s product quality was good?
Does Nike put responsibility for factory compliance in the hands of the general manager for production (as opposed having the plant audit teams responsible for monitoring compliance) in order to “ensure” soft pressures for compliance, especially if the violations involve a plant with low costs or if cutting off orders from the plant would disrupt Nike’s deliveries to its customers?

A factory was cut from Nike’s supplier base when, over a period of time, Nike management determined that factory management lacked the capacity or the will to correct serious issues of non-compliance. The compliance team established action plans, which three different Nike business units worked with the factory to implement. After six months of continuous efforts, and no improvement, the factory was dropped. More typically, Nike’s decisions to end a business relationship with problem suppliers was based on a “balanced scorecard” of factory performance that took into account labor code compliance along with such measures such as price, quality, and delivery time. Thus non-compliance might be overlooked if a supplier’s scores on the other measures were high—a circumstance not calculated to induce suppliers to get into compliance quickly.

To supplement its own compliance monitoring efforts, in 2003 Nike joined the Fair Labor Association, an organization that conducted independent audits of factories that supplied products to FLA members. The FLA applied a common set of compliance standards in all of its factory audits. In 2006, FLA’s teams of independent plant monitors conducted inspections at 147 factories in 18 countries, the results of which were published in FLA’s 2007 Annual Public Report. The audits, all of which involved factories that were supplying goods to one or more FLA members, revealed 2,511 instances of noncompliance with FLA’s Workplace Code of Conduct, an average of 18.2 violations per factory (versus averages of 15.1 per factory in 2003 and 18.2 per factory in 2004). The violations included excessive work hours, underpayment of wages and overtime, failure to observe legal holidays and grant vacations (27.5 percent); health and safety problems (44 percent); and worker harassment (5.1 percent). The FLA concluded that the actual violations relating to underpayment of wages, hours of work, and overtime compensation were probably higher than those discovered because “factory personnel have become sophisticated in concealing noncompliance relating to wages. They often hide original documents and show monitors falsified books.”

In its 2006 Public Report, the FLA said that accredited independent monitors conducted unannounced audits of 99 factories in 18 countries in 2005; the audited factories employed some 77,800 workers. The audited factories were but a small sample of the 3,753 factories employing some 2.9 million people from which the FLA’s 35 affiliated companies sourced goods in 2005; however, 34 of the 99 audited factories involved facilities providing goods to 2 or more of FLA’s 35 affiliated companies. The 99 audits during 2005 revealed 1,587 violations, an average of 15.9 per audit. The greatest incidence of violations was found in Southeast Asia (chiefly factories located in China, Indonesia, Thailand, and India) where violations averaged about 22 violations per factory audit. As was the case with the audits conducted in 2004, most of the violations related to health and safety (45 percent); wages, benefits, hours of work, and overtime compensation (28 percent); and worker harassment and abuse (7 percent). The FLA stated in its 2006 report that the violations relating to compensation and benefits were likely higher than those detected in its 2005 audits because “Factory personnel have become accustomed to concealing real wage documentation and providing falsified records at the time of compliance audits, making any noncompliances difficult to detect.”

In its 2007 Public Report, the FLA said that accredited independent monitors conducted unannounced audits of 147 factories in 30 countries in 2006; the audited factories employed some 110,000 workers. The audited factories were but a small sample of the 5,178 factories employing some 3.8 million people from which the FLA’s affiliated companies sourced goods in 2006; however, 24 of the audited factories involved facilities providing goods to 2 or more of FLA’s affiliated companies. The 147 audits during 2006 revealed 2,511 violations, an average of 17.1 per audit.
While Nike’s membership in the FLA seems to be a positive thing on the surface, is it really?
There are several questions you can pose to class members to arrive at an evaluation of whether Nike’s reliance on FLA audits is good:

Does the FLA audit enough Nike factories to matter?

Does the FLA have any leverage to secure compliance?

What should we make of the FLA’s statement that “Factory personnel have become accustomed to concealing real wage documentation and providing falsified records at the time of compliance audits, making any noncompliances difficult to detect.”?

Does Nike’s membership (or that of any other company) in the FLA just provide nice public relations cover in case of an embarrassing incident that comes into the public spotlight?

Evaluation of Wal-Mart’s Compliance Monitoring Program

- In 2005-2007, Wal-Mart purchased goods from close to 9,000 factories in some 60 countries; about 2,500 of the 9,000 factories had recently come into Wal-Mart’s compliance and factory audit system due to mergers, acquisitions, and new factory construction. About 200 Wal-Mart personnel scattered across GPSG’s offices in all 25 countries were engaged in monitoring suppliers for compliance with Wal-Mart’s Standards for Suppliers. Suppliers covered by Wal-Mart Ethical Standards program had to disclose the factory (or factories) used to fulfill each order placed by Wal-Mart.

- During 2006, Wal-Mart audited more factories than any other company in the world, performing 16,700 initial and follow-up audits of 8,873 factories. In 2005, Wal-Mart conducted 13,700 initial and follow-up audits of 7,200 supplier factories; in 2004, Wal-Mart conducted 12,561 initial and follow-up audits at 7,600 factories.

- Wal-Mart’s audit methodology and factory rating system is described in Exhibit 5. Most class members are likely to conclude (we think correctly) that Wal-Mart’s factory rating system seems to be significantly more stringent than Nike’s.

- A higher percentage of Wal-Mart’s factory ratings revealed significant compliance issues as compared to Nike—35.6% in 2004 and 52.3% in 2005 received Orange ratings (factories were rated Green, Yellow, Orange, or Red). A Green assessment was assigned for no or minor violations; a Yellow rating signified medium-risk violations; an Orange rating entailed high-risk violations (and was an automatic rating for factories where the use of one or two underage workers was discovered); and a Red rating indicated failure to pass the audit). Wal-Mart’s high percentage of Orange ratings was perhaps due to stricter ratings than Nike’s and/or because Wal-Mart’s suppliers were more prone to operate substandard facilities. Wal-Mart management said the greater incidence of Orange violations in 2005 compared to 2004, was primarily due to a 100 percent increase in unannounced audits, increased rigor of supplier standards, a reclassification of violations to strengthen and reinforce their severity, the implementation of team audits, and greater auditor familiarity with the factories and their workers.
A summary of Wal-Mart’s audit findings for 2004-2006 is contained in case Exhibit 6 on page C-475 of the textbook (for convenience, the data in this exhibit are shown below):

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total number of factory audits</td>
<td>12,561 (8% were unannounced)</td>
<td>13,600 (20% were unannounced)</td>
<td>16,700 (26% were unannounced)</td>
</tr>
<tr>
<td>Number of factories audited</td>
<td>7,600</td>
<td>7,200</td>
<td>8,873</td>
</tr>
<tr>
<td>Audits resulting in Green ratings (re-audited after 2 years)</td>
<td>19.1%</td>
<td>9.6%</td>
<td>5.4%</td>
</tr>
<tr>
<td>Audits resulting in Yellow ratings (re-audited after 120 days*)</td>
<td>38.8%</td>
<td>37.0%</td>
<td>51.6%</td>
</tr>
<tr>
<td>Audits resulting in Orange ratings (re-audited after 120 days)</td>
<td>32.5%</td>
<td>52.3%</td>
<td>40.3%</td>
</tr>
<tr>
<td>Audits resulting in Orange ratings due to child labor violations (re-audited after 30 days)</td>
<td>---</td>
<td>0.8%</td>
<td>0.4%</td>
</tr>
<tr>
<td>Factories disapproved for producing for one year—four orange assessments in a two-year period</td>
<td>8.8% (668 factories)</td>
<td>0.1% (7 factories)</td>
<td>2.1% (186 factories)</td>
</tr>
<tr>
<td>Audits resulting in Red ratings—factories permanently banned from receiving orders</td>
<td>0.8% (-61 factories)</td>
<td>2.3% (164 factories of which 141 related to the use of underage labor)</td>
<td>0.2% (-33 factories)</td>
</tr>
</tbody>
</table>

*In 2007, the re-audit period for Yellow-rated factories was changed to 180 days.

According to Wal-Mart management, the lower number of disapproved factories in 2005 and 2006 relative to 2004 was chiefly due to extending the disapproval period from 90 days to one year for factories receiving 4 orange ratings within a two-year period; other contributing factors were a revision of the ratings and Wal-Mart’s public announcement that it was expanding the percentage of unannounced audits to 20 percent in 2005 and as many as 30 percent in 2006. Also, starting in 2004, more rigorous supplier standards were instituted, certain types of violations were reclassified to increase their severity, and audits were conducted by 2-person teams instead of just a single individual. Increases in the number of audits had also resulted in Wal-Mart’s auditors becoming more familiar with the factories and their workers. About 52 percent of the supplier factories audited in 2005 were not included in the 2006 audit program because of supplier turnover, disapproved factories, permanently banned factories receiving Red ratings, and the two-year re-audit cycle for supplier factories receiving a Green Rating.

Red-rated factories were permanently banned from producing merchandise for Wal-Mart. Wal-Mart permanently banned orders from a surprisingly large number of suppliers (including those factories receiving 4 Orange ratings within 2 years)—729 in 2004, 171 in 2005, and 219 in 2006; this signals an arguably tough and serious compliance monitoring effort.

Factories rated Orange with underage labor violations for only one or two workers were re-audited within 30 days. If the follow-up audit indicated that the use of underage labor had been corrected, the factory could continue production for Wal-Mart; a failure on the follow-up 30-day audit resulted in a Red rating and a permanent order ban. A factory receiving an Orange assessment four times in a two-year period was banned from producing for Wal-Mart for up to one year (the ban on orders for such factories was extended from 90 days to one year starting January 1, 2005, in order to strengthen the seriousness of program non-compliance). During 2004-2006, 861 factories were banned from supplying Wal-Mart due to 4 Orange rating within a 2-year period.

At supplier factories receiving Yellow and Orange ratings, Wal-Mart’s policy was to work with supplier factories to reduce violations and achieve steady improvement of workplace conditions. Wal-Mart’s policy of striving first to achieve compliance rather than immediately imposing harsh penalties was a practice widely endorsed by most human rights activists, concerned citizens groups, and non-governmental agencies striving for better factory conditions for low-wage workers.
To help promote higher levels of supplier compliance, Wal-Mart trained more than 8,000 supplier personnel in 2004, 11,000 suppliers and members of factory management in 2005, and 5,000 supplier personnel in 2006. The training focused on increasing supplier familiarity with Wal-Mart’s Standards for Suppliers and encouraging an exchange of information about factory operating practices. Wal-Mart also actively worked with its foreign suppliers on ways to do better production planning, enhance plant efficiency, better educate and train workers, make supply chain improvements, and adopt better factory operating practices. Wal-Mart also consulted with knowledgeable outside experts and organizations on ways to accelerate ethical compliance and the achievement of better working conditions in supplier factories.

When Wal-Mart sourced goods for its foreign stores from suppliers in the same country in which Wal-Mart’s foreign stores were located, it used outside auditors to check supplier compliance. In 2005-2007, the outside auditing firms performing audits for some supplier factories included Accordia, Bureau Veritas, Cal Safety Compliance Corporation (CSCC), Global Social Compliance, Intertek Testing Services, and Société Générale de Surveillance.

Wal-Mart was addressing what to do about “audit fatigue.” It was not uncommon for the audit teams of different companies to be in some supplier factories as often as 10 times each month, not only leading to duplication of audit efforts but also audit fatigue and frustration on the part of factory managers. Wal-Mart recognized that multiple audits by multiple companies with varying standards and interpretations needed to be addressed. Its response had been to increase its collaboration with other companies and organizations that were engaged in monitoring to work toward a convergence of supplier codes of conduct and common interpretation of standards and local laws; Wal-Mart’s goal was to develop a unified and credible certification program for factories that would both facilitate compliance and reduce audit fatigue.

Toward this end, Wal-Mart had begun working closely with the International Council of Toy Industries (ICTI) CARE Process and the Global Social Compliance Program. ICTI consisted of toy trade associations from 21 countries and was engaged in promoting toy safety standards, fair labor treatment and safe working conditions in toy factories, and a responsible approach in advertising and marketing toys to children.

In July 2008, Wal-Mart announced that Intertek Group, plc, an independent supplier monitoring organization with 25 offices in China, would begin conducting audits of Wal-Mart’s supplier factories in China.

Drawing Some Conclusions about Which Company is Doing the Best Job of Compliance Monitoring and Enforcement

To help catalyze the debate among class members as to whether Nike or Wal-Mart is doing the “best” job of compliance monitoring, you may want to pose some of the following questions:

- Why do you think Nike does mainly announced audits?
- Is Nike auditing the factories of its contract suppliers frequently enough? Should it be doing more M-Audits?
- Is Nike’s compliance monitoring program adequately staffed?
- Does Nike appear to grade its supplier factories as tough as Wal-Mart’s grades its supplier factories?
- What evidence indicates that Nike is aggressive in pressuring its suppliers to achieve compliance, particularly when a supplier receives a below average score on its M-Audit (see the data in case Exhibit 3)?
- Is Nike lax (too lax?) in pushing suppliers with violations to achieve compliance?
- Is Wal-Mart’s compliance monitoring program adequately staffed?
- Who has the best factory auditing methodology—Nike or Wal-Mart?
- Do Nike’s factory audits appear to be more or less thorough than those done by Wal-Mart? Why?
- What do you think accounts for why Wal-Mart has given so many supplier factories Red ratings and permanently banned orders from these factories?
- Do all the Red and Orange ratings given to Wal-Mart’s supplier factories signal that Wal-Mart may be picking its foreign suppliers chiefly on the basis of low price and then finding out that many of these suppliers are out of compliance with its Supplier Code of Conduct?

3. Would you recommend that a company join the Fair Labor Association and use FLA’s standards and program of factory audits to monitor supplier compliance instead of trying to set up its own supplier monitoring and compliance effort?

Students can argue this pro or con. The FLA has what is likely to be appropriate standards of conduct for suppliers—as least as far as most candidate members are concerned. It already has experience in monitoring suppliers and conducting plant audits. It is a prominent and apparently well organized coalition whose members and affiliates include 194 colleges and universities, a number of concerned non-governmental organizations, and a group of 35 companies. FLA’s membership fees are likely to be substantially smaller than the amount of money a company would have to spend to conduct its own full-scale audit and compliance program.

But on the con side, the FLA conducts a relatively small number of plant audits annually:

- The FLA conducted unannounced audits of 99 factories in 18 countries in 2005; the audited factories employed some 77,800 workers. The audited factories were but a small sample of the 3,753 factories employing some 2.9 million people from which the FLA’s 35 affiliated companies sourced goods in 2005.
- In 2006, FLA’s teams of independent plant monitors conducted inspections at just 147 factories in 18 countries).

Moreover, FLA representatives are unlikely to have much clout in getting violators to correct their practices unless the affected member companies put real pressure on such suppliers to bring their factory operations into compliance.

The FLA has also admitted that violations at the plants it has audited are very likely higher than those it detected because of supplier efforts to deceive inspectors and conceal violations. The FLA concluded that the actual violations relating to underpayment of wages, hours of work, and overtime compensation were probably higher than those discovered because “factory personnel have become sophisticated in concealing noncompliance relating to wages. They often hide original documents and show monitors falsified books.”

It seems clear that the FLA’s plant inspection methodology definitely needs to be strengthened.

Astute class members might argue that membership in the FLA just provides nice public relations cover in the event of highly publicized allegations about substandard working conditions at the foreign plants of one or more of a company’s suppliers.

4. What can a company do to detect and combat the efforts of unscrupulous foreign suppliers to deceive inspection/compliance teams?

There are several ways for a company to combat supplier actions to deceive its inspection/compliance teams:

- Conduct unannounced inspections.
- Inspect supplier premises and records several times a year, especially when there are reasons to suspect that a supplier may be cheating on compliance.
Insist on interviewing a sizable number of employees, chosen at random (and certainly not chosen by the supplier); try to make sure that those employees who are interviewed are not subsequently punished by the supplier if they reveal information unfavorable to the supplier (ideally, the supplier should not know which employees are interviewed).

Make sure the members of inspection/compliance teams are experienced and savvy.

Conduct thorough, not superficial or perfunctory, inspections of supplier factories and records. A company must amply staff its inspection/compliance program and allow teams enough time to do a good job of conducting plant inspections.

Make it clear to suppliers in no uncertain terms that premeditated actions to deceive inspection/compliance teams will be dealt with harshly, including being permanently banned as a supplier (if the deception involves two or more separate instances).

Work closely with problem suppliers to achieve compliance—achieving compliance is far more important and of long-lasting benefit to all concerned that is administering swift and harsh punishment for violators (unless the violations are deliberate and repeated).

Recognize that compliance with the company’s code of supplier conduct imposes costs on suppliers (perhaps sizable costs) and thus may be a basis for agreeing to pay the suppliers a somewhat higher price for the product/service being supplied (unless a supplier’s operations are inefficient and the added compliance costs can be offset by working with the supplier to eliminate such inefficiencies).

Recognize that it is burdensome for suppliers to have to comply with a whole host of different codes of conduct. When a foreign supplier is supplying goods to several (or many) companies, those companies should strive to have compatible codes of supplier conduct (as opposed to widely differing requirements and expectations of suppliers). Moreover, they might want to join forces in conducting plant inspections of common suppliers—both to save on their own costs of monitoring suppliers and to economize on the time that suppliers spend dealing with compliance/inspection teams. In such instances, joining the Fair Labor Association, adopting the FLA’s Workplace Code of Conduct, and utilizing the FLA’s accredited independent plant monitors may be a useful way to go. But the FLA would have to significantly step up the number of unannounced plant audits that it conducts annually for this to be workable; moreover, the FLA or its members would have to take strong and decisive action to enforce compliance at those factories where code violations were found.

There is considerable merit in companies banding together to conduct plant audits and sharing audit results. Allied companies sourcing goods from the same factories would have considerable clout in jointly applying pressure on a supplier to improve its working conditions and comply with buyers’ codes of supplier conduct. Furthermore, allied companies could pool their audit information on off-shore factories, creating a database on thousands of manufacturing plants. Once a plant was certified by a coalition company or organization, other coalition members could accept the results without having to do an audit of their own.

EPILOGUE

We have nothing further to report on the developments in monitoring foreign suppliers at the time this teaching note went to press in February 2009. For the latest developments at Nike, you can check Nike’s Web site (www.nike.com) and review the contents of its latest Corporate Responsibility Report. Wal-Mart has considerable information posted on its Web site (www.walmart.com) regarding its supplier monitoring program; there are regular updates of new developments.