

**STRATEGY: Core Concepts and Analytical Approaches**  
Arthur A. Thompson, The University of Alabama

2nd Edition

CHAPTER  
**1** **What Is Strategy and Why Is It Important?**

Copyright © 2012 Glo-Bus Software, Inc. PowerPoint Presentation by Charlie Cook

**Chapter 1 Learning Objectives**

1. Understand the concept of "strategy," how to identify a company's strategy, and the tight connection between a company's strategy and its quest for sustainable competitive advantage.
2. Learn why a company's strategy evolves over time and why a company's strategy is partly proactive and partly reactive.
3. Understand why a company's strategy needs to pass ethical scrutiny.
4. Understand the concept of a "business model," how a company's business model connects to its strategy, and why a company's business model is important.
5. Learn the three tests that distinguish a winning strategy from a so-so or flawed strategy and why good strategy and good strategy execution are the most trustworthy signs of good management.

Copyright © 2012 Glo-Bus Software, Inc. 1-5

**Chapter 1 Roadmap**

- What Do We Mean by "Strategy?"
- Strategy and the Quest for Competitive Advantage
- Identifying a Company's Strategy
- Why a Company's Strategy Evolves Over Time
- A Company's Strategy Is Partly Proactive and Partly Reactive
- Strategy and Ethics: Passing the Test of Moral Scrutiny
- The Relationship Between a Company's Strategy and Its Business Model
- What Makes a Strategy a Winner?
- Why Crafting and Executing Strategy Are Important Tasks

Copyright © 2012 Glo-Bus Software, Inc. 1-6

**The Three Big Strategic Questions Every Company Faces**

- What's the company's present situation?
  - ▶ Industry conditions? Competitive pressures? The company's current market standing? Competitive strengths? Competitive weaknesses?
- What should the company's future direction be and what performance targets should we set?
  - ▶ What emerging buyer needs to try to satisfy? Which growth opportunities to emphasize? Which existing markets to deemphasize or even abandon? Where should the company be headed? How should the company's success be measured?
- What's our plan for running the company and producing good results?
  - ▶ A company's plan for heading the company in the intended direction, staking out a market position, attracting customers, and achieving the targeted financial and market performance is its **strategy**.

Copyright © 2012 Glo-Bus Software, Inc. 1-7

**Core Concept: Strategy**

A company's **strategy** consists of the competitive moves and business approaches that managers employ to attract and please customers, compete successfully, capitalize on opportunities to grow the business, respond to changing market conditions, conduct operations, and achieve the targeted financial and market performance.

*A strategy represents managerial commitment to undertake one set of actions rather than another.*

Copyright © 2012 Glo-Bus Software, Inc. 1-8

**The Hows That Define a Firm's Strategy**

- A company's strategy requires making numerous choices or decisions about **How**:
  - ▶ **How** to attract and please customers.
  - ▶ **How** to compete against rivals.
  - ▶ **How** to position the company in the marketplace and capitalize on attractive growth opportunities.
  - ▶ **How** to best respond to changing economic and market conditions.
  - ▶ **How** to manage the functional pieces of the business.
  - ▶ **How** to achieve the company's performance targets.

Copyright © 2012 Glo-Bus Software, Inc. 1-9

### Choosing the "Hows" of Strategy

- Strategic choices about "how" are based on
  - ▶ Trial-and-error organizational learning about what has worked and what has not worked
  - ▶ Management's appetite for taking risks
  - ▶ Managerial analysis and strategic thinking about how best to proceed, given market conditions and a company's circumstances
- In choosing a strategy, management is in effect saying, **"Among all the many different ways of competing we could have chosen, we have decided to employ this combination of competitive and operating approaches to move the company in the intended direction, strengthen its market position and competitiveness, and boost performance."**

Copyright © 2012 Glo-Bus Software, Inc. 1-10

### Why Bother with Crafting a *Strategy*?

- Company managers need a clear, specific, and deliberate action plan to:
  - ▶ Avoid conflicting or inconsistent or uncoordinated strategic actions and decisions
  - ▶ Strengthen the company's competitive position.
  - ▶ Win a competitive edge over rivals.
  - ▶ Improve the company's financial performance.
- A creative, distinctive strategy:
  - ▶ Sets a company apart from rivals
  - ▶ Helps draw an attractive numbers of buyers to purchase a company's product/service **despite the efforts of competitors to erode this appeal**
  - ▶ Can be a reliable ticket to **above average profitability**

Copyright © 2012 Glo-Bus Software, Inc. 1-11

### The Essence of Good Strategy-Making

- Good strategy-making is about making choices to compete *differently* from rivals. This means:
  - ▶ Appealing to buyers in a way that delivers added value to buyers in ways that rivals don't do or can't do
  - ▶ Carving out the company's own market position
  - ▶ Developing a **distinctive "aha" element** to attract customers

***Copying the competitive moves of other successful companies rarely works!***

Copyright © 2012 Glo-Bus Software, Inc. 1-12

### Strategy and the Quest for Competitive Advantage

- A firm achieves **competitive advantage** when an attractive number of buyers are drawn to purchase its products or services rather than those of competitors.

*But a lasting or durable or sustainable competitive advantage is even better!*

Copyright © 2012 Glo-Bus Software, Inc. 1-13

### Core Concept

A company achieves **sustainable competitive advantage** when an attractive number of buyers are drawn to purchase its products or services rather than those of competitors and **when the basis for such purchases is durable**, despite the efforts of competitors to overcome or otherwise erode the appeal of its offering.

Copyright © 2012 Glo-Bus Software, Inc. 1-14

### Strategic Approaches That Set a Company Apart and Lead to Competitive Advantage

```

    graph TD
      A[Four Dependable Routes to Competitive Advantage] --> B[Low-cost provider]
      A --> C[Differentiating features]
      A --> D[Focus on market niche]
      A --> E[Specialized Expertise]
    
```

Copyright © 2012 Glo-Bus Software, Inc. 1-15

### Strategic Approaches to Building Sustainable Competitive Advantage

- Four dependable approaches to achieving a competitive edge over rivals:
  - Striving to become the industry's low-cost provider (being more cost efficient than rivals).
  - Outcompeting rivals on important differentiating features (having a more appealing product/service).
  - Doing a better job than rivals of serving the special needs and tastes of buyers comprising a certain market niche.
  - Developing expertise and resource strengths that rivals cannot easily imitate or trump with capabilities of their own.

Copyright © 2012 GLO-BUS Software, Inc. 1-16

### Why Winning a Sustainable Competitive Advantage Matters

- A company is almost certain to earn significantly higher profits when it enjoys a competitive advantage as opposed to when it competes with no advantage or is hamstrung by competitive disadvantage.
- Without a strategy that leads to competitive advantage, a company risks being outcompeted by stronger rivals and/or locked into mediocre financial performance.

**Consequently, the quest for sustainable competitive advantage should always rank center stage in a crafting a strategy!**

Copyright © 2012 GLO-BUS Software, Inc. 1-17



### Why a Firm's Strategy Evolves over Time

- There are times when managers find it advisable or necessary to modify strategy in response to:
  - Changing market conditions
  - Advancing technology
  - Fresh moves of competitors
  - Shifting buyer needs and preferences
  - Emerging market opportunities
  - New ideas for improving the strategy
  - Mounting evidence that the current strategy is not working well

Copyright © 2012 GLO-BUS Software, Inc. 1-19

### Core Concept

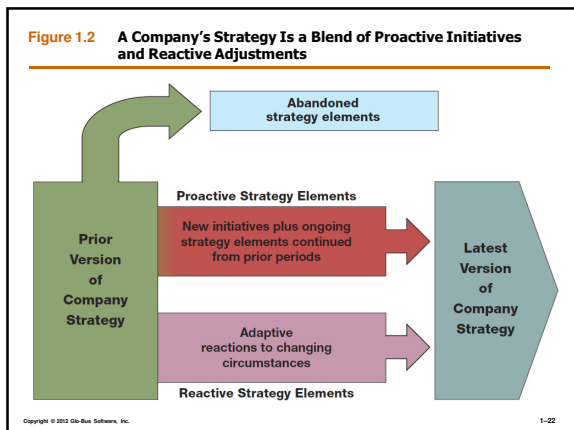
Changing circumstances and ongoing management efforts to improve the strategy cause a company's strategy to **evolve over time**—a condition that makes the task of crafting a strategy a **work in progress**, not a one-time event.

Copyright © 2012 GLO-BUS Software, Inc. 1-20

### A Company's Strategy Is Partly Proactive and Partly Reactive

- The typical company's strategy is a blend of:
  - Proactive and deliberate actions to compete more successfully, secure a competitive edge, and improve the company's financial performance. This part of strategy consists of new initiatives plus ongoing strategy elements continued from prior periods.
  - As-needed reactions to unanticipated developments and fresh market conditions—this part of strategy is developed on the fly.

Copyright © 2012 GLO-BUS Software, Inc. 1-21



**Core Concept**

A strategy cannot be considered ethical just because it involves actions that are legal. 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.

Copyright © 2012 Glo-Bus Software, Inc. 1-23

**Strategy and What is Legal versus What Is Ethical**

- Just because a strategic actions is legal does not necessarily make it ethical or morally acceptable.
  - The standards of what constitutes legal behavior are different from the standards of what is ethical and what is not.
- Ethical standards are about "right" vs. "wrong" and *a company's duty* to conduct itself honorably and in a manner that reflects credit upon the actions and decisions of company personnel.

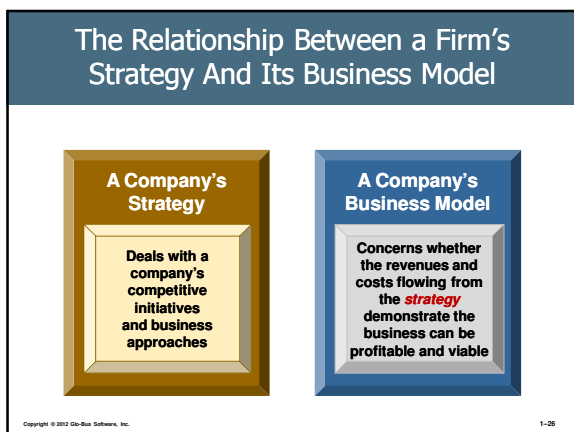
**What company behaviors can you identify that may be legal but not ethical or morally acceptable?**

Copyright © 2012 Glo-Bus Software, Inc. 1-24

**Strategy, Ethics, and the Test of Moral Scrutiny**

- A strategy is ethical only if it can pass **the test of moral scrutiny**:
  - Requirement 1:** The strategy cannot entail actions and behaviors that cross the line from "should do" to "should not do" (because such actions are unsavory, shady, unconscionable, injurious to others, or harmful to the environment)
  - Requirement 2:** The strategy must allow management to fulfill its ethical duties in a manner that takes into account the legitimate interests of all stakeholders.

Copyright © 2012 Glo-Bus Software, Inc. 1-25



**Core Concept**

- A firm's **business model** is a blueprint for how its strategy and operating approaches will create value for customers while at the same time generating ample revenues to cover costs and realize a profit.
- Absent the ability to earn good profits, a firm's strategy and operating blueprint are flawed, its business model is not viable, and its ability to survive is questionable.

Copyright © 2012 Glo-Bus Software, Inc. 1-27

### The Two Crucial Elements of a Company's Business Model

- Its Customer Value Proposition
  - ▶ How it will go about satisfying customer needs and requirements at a price customers will consider to be a good value.
  - The greater the value delivered to customers and the lower the price, the more attractive the value proposition is to customers.*
- Its Profit Proposition (or "Profit Formula")
  - ▶ How it will go about creating and delivering customer value in a cost-efficient manner at a price that produces enough revenues to cover costs and enable attractive profits.
  - The lower a company's costs are in relation to the revenues generated, the more appealing is its profit proposition or "profit formula."*

Copyright © 2012 Glo-Bus Software, Inc. 1-28

### The Business Model of Network TV and Radio Broadcasters

- The Customer Value Proposition
  - ▶ Provide audiences with free and appealing programming content.
- The Profit Proposition
  - ▶ Charge advertising fees based on audience size that more than cover the full costs of providing the program content.

Copyright © 2012 by Glo-Bus Software, Inc. 1-29

### The Business Model of Newspapers and Magazines

- The Customer Value Proposition
  - ▶ Delivering valuable or interesting information and entertainment to readers.
- The Profit Proposition
  - ▶ Securing sufficient revenues from advertising fees and subscriptions to more than cover the costs of producing and delivering their products to readers.

Copyright © 2012 by Glo-Bus Software, Inc. 1-30

### Gillette's Business Model in Razor Blades

- The Customer Value Proposition
  - ▶ To provide a close comfortable shave using a razor (a one-time purchase) and razor blades (purchased repeatedly).
- The Profit Proposition
  - ▶ To sell a "master product"—the razor—at an attractively low price and then make money on repeat purchases of inexpensively-produced razor blades priced to yield high profit margins.
  - ▶ Printer manufacturers like Hewlett-Packard, Lexmark, and Epson pursue much the same business model as Gillette—selling printers at a low (virtually breakeven) price and making large profit margins on the repeat purchases of printer supplies, especially ink cartridges.

Copyright © 2012 by Glo-Bus Software, Inc. 1-31

### Why Does a Company's Business Model Matter?

- The strategy that company managers craft for competing successfully and running various parts of the business *may or may not lead to profitability.*
- Thus the role of a company's business model is to provide **convincing rationale** for why the resources and business processes needed to execute the strategy **will generate revenues sufficient to cover costs and produce attractive profits and return on investment.**
  - ▶ Companies that have been in business for a while and are making acceptable profits have a "proven" business model—because there is hard revenue-cost-profit evidence that their strategies and approaches to operating are capable of profitability.
  - ▶ Companies that are in a start-up mode or that are losing money have "questionable" or unproven business models.

Copyright © 2012 by Glo-Bus Software, Inc. 1-32



### What Makes a Strategy a Winner?

- Three questions can be used to test the merits of one strategy versus another and to distinguish a winning strategy from a flawed or so-so strategy:
  - How well does the strategy fit the firm's situation?
  - Is the strategy helping the firm achieve a sustainable competitive advantage?
  - Is the strategy resulting in better firm performance?

Copyright © 2012 GLO-BUS Software, Inc.

1-34

### Two Reasons Why Crafting and Executing Strategy Are Core Management Tasks

- There's a compelling need for *managers* to *proactively shape how* a firm's *business* will be *conducted*.
  - A clear and reasoned strategy is management's prescription for doing business, its road map to competitive advantage, and its game plan for pleasing customers and improving financial performance.
- 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.
  - Pursues what needs to be done internally to produce good day-in/day-out strategy execution and operating excellence.

Copyright © 2012 GLO-BUS Software, Inc.

1-35

### Good Strategy + Good Strategy Execution = Good Management

- The better conceived a company's strategy and the more competently it is executed, the more likely that the company will be a standout performer both financially and in the marketplace.
- A company that lacks clear-cut direction, has vague or undemanding performance targets, has a muddled or flawed strategy, or can't seem to execute its strategy competently is a company whose financial performance is probably suffering, whose business is at long-term risk, and whose management is sorely lacking.

Copyright © 2012 GLO-BUS Software, Inc.

1-36

### Core Concept

How well a company performs and the degree of market success it achieves are directly attributable to the caliber of its strategy and the proficiency with which the strategy is executed.

*Excellent execution of an excellent strategy is the best test of managerial excellence.*

Copyright © 2012 GLO-BUS Software, Inc.

1-37

### The Road Ahead

- Every business student and every aspiring manager needs to know the answer to the following question:
  - What must managers do, and do well, to give a company its best shot for being attractively profitable and successful in the marketplace?
- The answer that emerges time and again and that becomes the biggest lesson of the course you are taking is that **doing a good job of managing requires good strategic thinking, good strategy-making, and good strategy execution.**
- Welcome and best wishes for your success!**

Copyright © 2012 GLO-BUS Software, Inc.

1-38

### The Road Ahead (cont'd)

- In the coming chapters, we will explore what good strategic thinking entails, describe the core concepts and tools of strategic analysis, and examine the ins and outs of crafting and executing strategy.
- Then, in the accompanying strategy simulation exercise where you will run a company in head-to-head competition with companies run by your classmates, you will have a golden *learn-by-doing* opportunity to
  - Apply what you have read about in the chapters
  - Gain some firsthand experience in actually crafting and executing a strategy for your company and being held accountable for how well your company performs.

Copyright © 2012 GLO-BUS Software, Inc.

1-39

What You Can Expect to Learn

- **Lesson 1:** First-rate capabilities in crafting and executing strategy are basic to managing successfully and are skills every manager needs to possess.
- **Lesson 2:** Company managers don't deserve any applause for coming up with a ho-hum strategy that results in ho-hum (or worse) financial performance and a ho-hum (or worse) industry standing.

Copyright © 2012 Glo-Bus Software, Inc.

1-40

*"Commerce is a game of skill which many people play, but which few play well."*

*Ralph Waldo Emerson, poet and essayist*

If the chapters, the experience of running your firm, and the other course-related assignments help you become a savvy player and better equip you to succeed in business, then the time and energy you spend in this course will indeed prove worthwhile.

Copyright © 2012 Glo-Bus Software, Inc.

1-41