CHAPTER 1
What Is Strategy and Why Is It Important?

“Strategy means making clear-cut choices about how to compete.”
Jack Welch
Former CEO, General Electric

“Without a strategy the organization is like a ship without a rudder.”
Joel Ross and Michael Kami
Authors and Consultants

“If your firm’s strategy can be applied to any other firm, you don’t have a very good one.”
David J. Collis and Michael G. Rukstad

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

Chapter 1 Roadmap
- What Do We Mean by “Strategy?”
- Strategy and the Quest for Competitive Advantage
- Identifying a Firm’s Strategy
- Why a Firm’s Strategy Evolves Over Time
- A Firm’s Strategy Is Partly Proactive and Partly Reactive
- Strategy and Ethics: Passing the Test of Moral Scrutiny
- The Relationship Between a Firm’s Strategy and Its Business Model
- What Makes a Strategy a Winner?
- Why Crafting and Executing Strategy Are Important Tasks
Three Strategic Questions All Firms Must Answer

<table>
<thead>
<tr>
<th>What's the company's present situation?</th>
<th>What's the company's future direction to be, and what are our performance targets?</th>
<th>What is our plan for running the company and achieving the targeted results?</th>
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<tbody>
<tr>
<td>Industry conditions?</td>
<td>Emerging buyer needs to serve?</td>
<td>Actions to move the firm in the intended direction</td>
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<td>Competitive pressures?</td>
<td>Growth opportunities to pursue?</td>
<td>Actions to compete against rivals</td>
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<td>Current market standing?</td>
<td>Markets to deemphasize or even abandon?</td>
<td>Actions to attract customers</td>
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<td>Competitive strengths and weaknesses?</td>
<td>Choosing a strategic path for the company to pursue</td>
<td>Actions to achieve the targeted financial and market performance</td>
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<td>Profitability?</td>
<td>Deciding how to measure the firm's success</td>
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<td>Financial strength and credit rating?</td>
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What Do We Mean by “Strategy”?

- A company's strategy is defined by the specific market positioning, competitive moves, and business approaches that form management's answer to “What's our plan for running the company and producing good results?”

How Are Important Strategic Choices Made?

- Ways to Arrive at Strategic Choices
  - Trial-and-error organizational learning
  - Strategic thinking on the part of key executives and their appetite for risk-taking
  - Decisions based on analysis of the company’s situation

Choosing the Strategy

- In choosing among all the “hows” and crafting a strategy for the company to pursue, management is saying,
  “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 to move the firm in the intended direction, strengthen its market position and competitiveness, and meet or beat our performance targets.”
Good strategy-making is making choices to compete differently from rivals by:

- Appealing to buyers in ways that set a company apart from rivals—particularly when it comes to doing what rivals don’t do or can’t do
- Staking out a market position that is not crowded with other strong competitors

Really successful strategies contain a distinctive “aha” element that:

- Sets a company apart from rivals
- Attracts buyer attention
- Delivers what buyers perceive as superior value compared to the offerings of rivals
- This superior value is what converts buyers into loyal customers

Copycat strategies rarely work!!!
Why Winning a Sustainable Competitive Advantage Matters

- A firm will earn significantly higher profits when it has a competitive advantage than when competing with no advantage or at a competitive disadvantage.
- Without a strategy leading to competitive advantage, a firm 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 crafting a strategy!**

Why Bother with Crafting a Strategy?

- A clear, specific, and deliberate action plan:
  - Helps avoid conflicting or inconsistent or uncoordinated strategic actions and decisions on the part of different managers in different parts of the organization
  - Helps clarify what to do to strengthen the firm’s competitive position and try to build a competitive edge over rivals
  - Lays out a path for improving the firm’s performance
- A creative, distinctive strategy:
  - Sets the firm apart from rivals and deliver superior value to customers
  - Attracts buyers to a firm’s product/service despite the efforts of competitors to erode this appeal
  - Can be a reliable pathway to above average profitability

Why a Firm’s Strategy Evolves over Time

- Occasions often arise when it becomes 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 some parts of the strategy are no longer working well
  - All of which can impair company performance

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.

Strategy Is Partly Proactive and Partly Reactive

- The typical firm’s strategy is a blend of:
  - Current strategy elements that seem to be working well enough to be continued
  - New proactive actions that managers believe have good potential for improving the strategy and boosting the firm’s performance
  - As-needed strategic reactions developed in response to unanticipated developments and fresh market conditions
A Company's Strategy Is a Blend of Proactive Initiatives and Reactive Adjustments

Figure 1.2

1.2

A Company's Strategy
Deals with a company's competitive initiatives and business approaches.

A Company's Business Model
Concerns whether the revenues and costs flowing from the strategy demonstrate that the business can be profitable and viable.

Strategy—Distinguishing Between What Is Legal and What Is Ethical

- Just because a strategic action or business approach is legal does not necessarily mean it is ethical or morally acceptable.
- Ethical standards are about "right" vs. "wrong", "moral" versus "immoral", and not crossing the line from "should do" (or "okay to do") to "should not do".

What business behaviors can you identify that are legal but not ethical or morally acceptable?

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A firm’s **business model** is a blueprint for how its strategy and operating approaches will create value for customers **while also generating ample revenues to cover costs and realize a profit**.

Without the ability to earn adequate profits, a firm’s strategy and operating blueprint are flawed, its business model is not viable, and its ability to survive is questionable.

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**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 an audience size that more than covers the full costs of providing the program content.

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**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.

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**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 pursue much the same business model as Gillette—selling printers at low (virtually breakeven) prices and making large profit margins on repeat purchases of printer supplies, especially ink cartridges.

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**Why a Firm’s Business Model Has to Be Carefully Evaluated**

- The strategy managers craft to execute the company’s business model **may or may not result in attractive profitability**.
- Having a customer value proposition that actually satisfies buyer needs and requirements at a price buyers will consider a good value is **necessary but not sufficient** to determine the merits of a company’s business model.
- The **sufficient condition** that validates a company’s business model is whether the price being charged generates revenues big enough to
  - Cover the costs of delivering the value to customers and also
  - Yield a big enough profit margin to produce attractive profits and return on investment.

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**Core Concept**

The nitty-gritty issue surrounding a company’s business model is whether it can execute its customer value proposition **profitably**:

- The revenues that a company’s business model generates are a function of the volume of customers attracted at the price being charged.
- The costs of a company’s business model approach are dependent on the resources and business processes it utilizes and the cost-efficiency of its operating systems.
- The lower a firm’s costs are in relation to its revenues, the greater the profitability of its business model.
Companies that have been in business for a while and are making sufficiently appealing profits have a “proven” business model.

- A track record of good bottom-line profitability and return on investment provides credible evidence that a company’s business model approach is working and has promising long-term viability.

Firms in a start-up mode or that are losing money have “questionable” or “unproven” business models—it remains to be seen how good their business model is.

To qualify as a winning strategy, a strategy has to pass all three tests:

1. How well does the strategy fit the company’s situation?
2. Is the strategy helping the company achieve a sustainable competitive advantage?
3. Is the strategy producing good company performance?

Testing the merits of one strategy versus another requires getting satisfactory answers to three questions:

1. How well does the strategy fit the company’s situation?
2. Is the strategy helping the company achieve a sustainable competitive advantage?
3. Is the strategy producing good company performance?

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.

In stark contrast, 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.

What Makes a Strategy a Winner?

Because it is management’s responsibility to proactively shape how the firm will conduct business, 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.

Because nothing affects a company’s ultimate success or failure more fundamentally than how well its management team:

- Charts the firm’s direction
- Develops competitively effective strategic moves and business approaches
- Pursues what must be done internally to produce good day-in/day-out strategy execution and operating excellence

Good Strategy + Good Strategy Execution = Good Management

Excellent execution of an excellent strategy is the best test of managerial excellence.
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 firm its best shot for being attractively profitable and successful in the marketplace?

► The answer that emerges—and becomes the biggest lesson of this course—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!*

In the coming chapters, we will explore strategic thinking, the core concepts and tools of strategic analysis, and the processes of crafting and executing strategy.

Then, in the strategy simulation exercise you will manage a firm in competition with firms managed by classmates, and have an excellent **learn-by-doing** opportunity to:

► Apply what you have read about in the chapters.
► Gain experience in crafting and executing strategy for your firm and being held accountable for how well your firm performs.

**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:**

► Managers don’t deserve applause for coming up with a weak strategy that results in weak (or worse) financial performance and a weak (or worse) industry standing.

"**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 competitor and better equip you to succeed in business, then the time and energy you spend in this course will prove worthwhile.