PART 1

Concepts and Techniques for Crafting and Executing Strategy

CHAPTER

1

What is Strategy and Why is it Important?

Learning Objectives

LO 1 Learn what we mean by a company's *strategy.*

LO 2 Grasp the concept of a *sustainable competitive advantage.*

LO 3 Develop an awareness of the four most basic strategic approaches for winning a sustainable competitive advantage.

LO 4 Understand that a company's strategy tends to evolve over time because of changing circumstances and ongoing management efforts to improve the company's strategy.

LO 5 Learn why it is important for a company to have a viable business model that outlines the company's customer value proposition and its profit formula.

LO 6 Learn the three tests of a winning strategy.

Strategy means making clear-cut choices about how to compete.

Jack Welch – Former CEO of General Electric

One must have strategies to execute dreams.

Azim Premji – CEO Wipro Technologies and one of the world's richest people

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 – Consultants and professors

In any given year, a group of companies will stand out as the top performers, in terms of metrics such as profitability, sales growth, or growth in shareholder value. Some of these companies will find that their star status fades quickly, due to little more than a fortuitous constellation of circumstances, such as being in the right business at the right time. But other companies somehow manage to rise to the top and stay there, year after year, pleasing their customers, shareholders, and other stakeholders alike in the process. Companies such as Apple, Google, Coca-Cola, Procter & Gamble, McDonald's, Berkshire Hathaway, and General Electric come to mind—but long-lived success is not just the province of U.S. companies. Diverse kinds of companies, both large and small, from many different countries have been able to sustain strong performance records, including Singapore Airlines, Sweden's IKEA (in home furnishings), Korea's Hyundai Heavy Industries (in shipbuilding and construction), Mexico's America Movil (in telecommunications), and Japan's Nintendo (in video game systems).

What can explain the ability of companies like these to beat the odds and experience prolonged periods of profitability and growth? Why is it that some companies, like Southwest Airlines and Walmart, continue to do well even when others in their industry are faltering? Why can some companies survive and prosper even through economic downturns and industry turbulence?

Many factors enter into a full explanation of a company's performance, of course. Some come from the external environment; others are internal to the firm. But only one thing can account for the kind of long-lived success records that we see in the world's greatest companies—and that is a cleverly crafted and well executed *strategy,* one that facilitates the capture of emerging opportunities, produces enduringly good performance, is adaptable to changing business conditions, and can withstand the competitive challenges from rival firms.

In this opening chapter, we define the concept of strategy and describe its many facets. We will explain what is meant by a competitive advantage, discuss the relationship between a company's strategy and its business model, and introduce you to the kinds of competitive strategies that can give a company an advantage over rivals in attracting customers and earning above-average profits. We will look at what sets a winning strategy apart from others and why the caliber of a company's strategy determines whether it will enjoy a competitive advantage over other firms or be burdened by competitive disadvantage. By the end of this chapter, you will have a clear idea of why the tasks of crafting and executing strategy are core management functions and why excellent execution of an excellent strategy is the most reliable recipe for turning a company into a standout performer over the long term.

WHAT DO WE MEAN BY *STRATEGY?*

A company's **strategy** is its action plan for outperforming its competitors and achieving superior profitability. In effect, it represents a managerial commitment to an integrated array of considered choices about how to compete.[1] These include choices about:

- *How* to attract and please customers.
- *How* to compete against rivals.
- *How* to position the company in the marketplace.
- *How* best to respond to changing economic and market conditions.
- *How* to capitalize on attractive opportunities to grow the business.
- *How* to achieve the company's performance targets.

> **CORE CONCEPT**
>
> A company's **strategy** is its action plan for outperforming its competitors and achieving superior profitability.

The objective of a well-crafted strategy is not merely temporary competitive success and profits in the short run, but rather the sort of lasting success that can support growth and secure the company's future over the long term. In most industries, there are many different avenues for outcompeting rivals and boosting

> **LO 1**
>
> Learn what we mean by a company's *strategy.*

company performance.[2] Consequently, some companies strive to improve their performance by employing strategies aimed at achieving lower costs than rivals, while others pursue strategies aimed at achieving product superiority or personalized customer service or quality dimensions that rivals cannot match. Some companies opt for wide product lines, while others concentrate their energies on a narrow product lineup. Some competitors deliberately confine their operations to local or regional markets; others opt to compete nationally, internationally (several countries), or globally (all or most of the major country markets worldwide).

Strategy Is about Competing Differently Every strategy needs a distinctive element that attracts customers and produces a competitive edge. But there is no shortage of opportunity to fashion a strategy that both tightly fits a company's own particular situation and is discernibly different from the strategies of rivals. In fact, competitive success requires a company's managers to make strategic choices about the key building blocks of its strategy that differ from the choices made by competitors—not 100 percent different, but at least different in several important respects. A strategy only stands a chance of succeeding when it is predicated on actions, business approaches, and competitive moves aimed at appealing to buyers *in ways that set a company apart from rivals.* Simply trying to mimic the strategies of the industry's successful companies never works. Rather, every company's strategy needs to have some distinctive element that draws in customers and produces a competitive edge. Strategy, at its essence, is about competing differently—doing what rival firms *don't* do or what rival firms *can't* do.[3]

Strategy is about competing differently from rivals—doing what competitors *don't* do or, even better, doing what they *can't* do!

A company's strategy provides direction and guidance, in terms of not only what the company *should* do but also what it *should not* do. Knowing what not to do can be as important as knowing what to do, strategically. At best, making the wrong strategic moves will prove a distraction and a waste of company resources. At worst, it can bring about unintended long-term consequences that put the company's very survival at risk.

Figure 1.1 illustrates the broad types of actions and approaches that often characterize a company's strategy in a particular business or industry. For a more concrete example of the specific actions constituting a firm's strategy, see Illustration Capsule 1.1, describing McDonald's strategy in the quick-service restaurant industry.

Strategy and the Quest for Competitive Advantage

LO 2

Grasp the concept of a *sustainable competitive advantage*.

The heart and soul of any strategy are the actions and moves in the marketplace that managers are taking to gain a competitive advantage over rivals. A company achieves a competitive advantage whenever it has some type of edge over rivals in attracting buyers and coping with competitive forces. There are many routes to competitive advantage, but they all involve either giving buyers what they perceive as superior value compared to the offerings of rival sellers or giving buyers the same value as others at a lower cost to the firm. Superior value can mean a good product at a lower price, a superior product that is worth paying more for, or a best-value offering that represents an attractive combination of price, features, quality, service, and other appealing attributes. Delivering superior value or delivering value more efficiently—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. In Illustration Capsule 1.1, it's evident that McDonald's has gained a competitive advantage over its rivals in the fast-food industry through its efforts to minimize costs, ensure fast and consistent delivery of foods with wide appeal, and keep

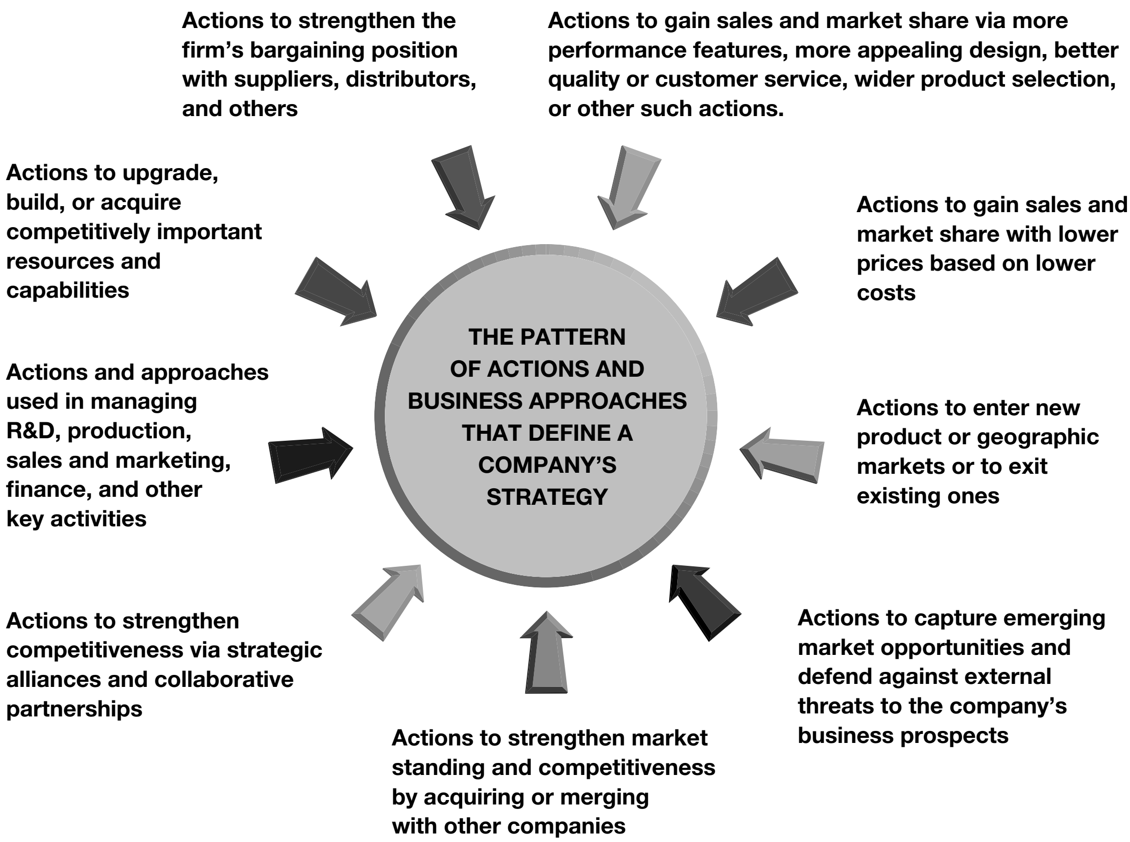

FIGURE 1.1 *Identifying a Company's Strategy—What to Look For*

its prices low, thereby driving sales volume. A creative *distinctive* strategy such as that used by McDonald's is a company's most reliable ticket for developing a competitive advantage over its rivals. If a strategy is not distinctive, then there can be no competitive advantage, since no firm would be meeting customer needs better or operating more efficiently than any other.

If a company's competitive edge holds promise for being *sustainable* (as opposed to just temporary), then so much the better for both the strategy and the company's future profitability. What makes a competitive advantage **sustainable** (or durable), as opposed to temporary, are elements of the strategy that give buyers lasting reasons to prefer a company's products or services over those of competitors—*reasons that competitors are unable to nullify or overcome despite their best efforts.* In the case of McDonald's, the company's unparalleled name recognition, reputation for tasty, quick-service food, and formidable volume advantage make it difficult for competitors to weaken or overcome McDonald's competitive advantage. Not only has their strategy provided them with a sustainable competitive advantage, it has made them one of the most admired companies on the planet.

CORE CONCEPT

A company achieves a **competitive advantage** when it provides buyers with superior value compared to rival sellers or offers the same value at a lower cost to the firm. The advantage is **sustainable** if it persists despite the best efforts of competitors to match or surpass this advantage.

ILLUSTRATION CAPSULE 1.1

McDonald's Strategy in the Quick-Service Restaurant Industry

In 2011, McDonald's was setting new sales records despite a global economic slowdown and declining consumer confidence in the United States. More than 64 million customers visited one of McDonald's 33,000 restaurants in 119 countries each day, which allowed the company to record 2011 revenues and earnings of more than $27 billion and $5.5 billion, respectively. McDonald's performance in the marketplace made it the top performing company on the Dow Jones Stock Market Index for 2011, with a 35 percent return to investors. The company's sales were holding up well amid the ongoing economic uncertainty in early 2012, with global sales as measured in constant currencies increasing by more than 4 percent in the first quarter. The company's success was a result of its well-conceived and executed Plan-to-Win strategy that focused on "being better, not just bigger." Key initiatives of the Plan-to-Win strategy included:

- *Improved restaurant operations.* McDonald's global restaurant operations improvement process involved employee training programs ranging from on-the-job training for new crew members to college-level management courses offered at the company's Hamburger University. The company sends nearly 200 high-potential employees annually to its McDonald's Leadership Institute to build leadership skills. The company trains its store managers to closely monitor labor, food, and utility costs. McDonald's excellence earned the company 10th place on *Fortune*'s list of the World's Most Admired Companies in 2011.
- *Affordable pricing.* McDonald's kept its prices low by scrutinizing restaurant operating costs, administrative costs, and other corporate expenses. McDonald's saw the poor economy in the United States as an opportunity to renegotiate its advertising contracts with newspapers and television networks. The company also began to replace its company-owned vehicles with more fuel-efficient models when gasoline prices escalated dramatically. However, McDonald's did not sacrifice product quality in order to offer lower prices. The company implemented extensive supplier monitoring programs to ensure that its suppliers did not change product specifications to lower costs.
- *Wide menu variety and beverage choices.* McDonald's has expanded its menu beyond the popular-selling Big Mac and Quarter Pounder to include new, healthy quick-service items. The company has also added an extensive line of premium coffees that include espressos, cappuccinos, and lattes sold in its McCafé restaurant locations in the United States, Europe, and the Asia/Pacific region.
- *Convenience and expansion of dining opportunities.* The addition of McCafés helped McDonald's increase same store sales by extending traditional dining hours. Customers wanting a midmorning coffee or an afternoon snack helped keep store traffic high after McDonald's had sold its last Egg McMuffin and before the lunch crowd arrived to order Big Macs. The company also extended its drive-thru hours to 24 hours in many cities where consumers tend to eat at all hours of the day and night.
- *Ongoing restaurant reinvestment and international expansion.* With more than 14,000 restaurants in the United States, the focus of McDonald's expansion of units was in rapidly growing emerging markets such as China. The company also intends to refurbish 90 percent of the interiors and 50 percent of the exteriors of its restaurants by the end of 2012 to make its restaurants a pleasant place for both customers and employees.

Developed with Jenna P. Pfeffer. *Sources:* Janet Adamy, "McDonald's Seeks Way to Keep Sizzling," *Wall Street Journal Online,* March 10, 2009; various annual reports; various company press releases.

Four of the most frequently used and dependable strategic approaches to setting a company apart from rivals, building strong customer loyalty, and winning a competitive advantage are:

LO 3

Develop an awareness of the four most dependable strategic approaches for setting a company apart from rivals and winning a sustainable competitive advantage.

1. *Striving to be the industry's low-cost provider, thereby aiming for a cost-based competitive advantage over rivals.* Walmart and Southwest Airlines have earned strong market positions because of the low-cost advantages they have achieved over their rivals and their consequent ability to underprice competitors. These advantages in meeting customer needs *efficiently* have translated into volume advantages, with Walmart as the world's largest discount retailer and Southwest as the largest U.S. air carrier, based on the number of domestic passengers.[4]
2. *Outcompeting rivals on the basis of differentiating features, such as higher quality, wider product selection, added performance, value-added services, more attractive styling, and technological superiority.* Successful adopters of differentiation strategies include Apple (innovative products), Johnson & Johnson in baby products (product reliability), Chanel and Rolex (luxury and prestige), and Mercedes and BMW (engineering design and performance). These companies have achieved a competitive advantage because of their ability to meet customer needs more effectively than rivals can, thus driving up their customers' willingness to pay higher prices. One way to sustain this type of competitive advantage is to be sufficiently innovative to thwart the efforts of clever rivals to copy or closely imitate the product offering.
3. *Developing an advantage based on offering more value for the money.* Giving customers more value for their money by satisfying buyers' expectations on key quality/features/performance/service attributes while beating their price expectations is known as a *best-cost provider strategy.* This approach is a hybrid strategy that blends elements of the previous approaches. Target is an example of a company that is known for its hip product design (a reputation it built by featuring cheap-chic designers such as Isaac Mizrahi), as well as a more appealing shopping ambience for discount store shoppers. It offers the perfect illustration of a best-cost provider strategy.
4. *Focusing on a narrow market niche within an industry.* There are two types of strategies based on focus. The first aims to achieve an advantage through greater efficiency in serving a niche; the goal of the second is greater effectiveness in meeting the niche's special needs. Prominent companies that enjoy competitive success in a specialized market niche include eBay in online auctions, Jiffy Lube International in quick oil changes, McAfee in virus protection software, and The Weather Channel in cable TV.

Winning a *sustainable* competitive edge over rivals with any of the preceding four strategies generally hinges as much on building competitively valuable expertise and capabilities that rivals cannot readily match as it does on having a distinctive product offering. Clever rivals can nearly always copy the attributes of a popular product or service, but for rivals to match the experience, know-how, and specialized capabilities that a company has developed and perfected over a long period of time is substantially harder to do and takes much longer. FedEx, for example, has superior capabilities in next-day delivery of small packages. Apple has demonstrated impressive product innovation capabilities in digital music players, smartphones, and e-readers. Hyundai has become the world's fastest-growing automaker as a result of its advanced manufacturing processes and unparalleled quality control system. Each of these capabilities has proved hard for competitors to imitate or best.

LO 4

Understand that a company's strategy tends to evolve over time because of changing circumstances and ongoing management efforts to improve the company's strategy.

Why a Company's Strategy Evolves over Time

The appeal of a strategy that yields a sustainable competitive advantage is that it offers the potential for an enduring edge over rivals. However, managers of every company must be willing and ready to modify the strategy in response to changing market conditions, advancing technology, unexpected moves by competitors, shifting buyer needs, emerging market opportunities, and mounting evidence that the strategy is not working well. Most of the time, a company's strategy evolves incrementally from management's ongoing efforts to fine-tune the strategy and to adjust certain strategy elements in response to new learning and unfolding events.[5] But in industries where industry and competitive conditions change frequently and in sometimes dramatic ways, the life cycle of a given strategy is short. Industry environments characterized by high-velocity change require companies to repeatedly adapt their strategies.[6] For example, companies in industries with rapid-fire advances in technology like medical equipment, electronics, and wireless devices often find it essential to adjust key elements of their strategies several times a year, sometimes even finding it necessary to "reinvent" their approach to providing value to their customers.

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 strategy *a work in progress,* not a one-time event.

A company's strategy is shaped partly by management analysis and choice and partly by the necessity of adapting and learning by doing.

Regardless of whether a company's strategy changes gradually or swiftly, the important point is that the task of crafting strategy is not a one-time event but always a work in progress. Adapting to new conditions and constantly evaluating what is working well enough to continue and what needs to be improved are normal parts of the strategy-making process, resulting in an *evolving strategy.*[7]

A Company's Strategy Is Partly Proactive and Partly Reactive

The evolving nature of a company's strategy means that the typical company strategy is a blend of (1) *proactive,* planned initiatives to improve the company's financial performance and secure a competitive edge, and (2) *reactive* responses to unanticipated developments and fresh market conditions. The biggest portion of a company's current strategy flows from ongoing actions that have proven themselves in the marketplace and newly launched initiatives aimed at building a larger lead over rivals and further boosting financial performance. This part of management's action plan for running the company is its **deliberate strategy,** consisting of proactive strategy elements that are both planned and realized as planned (while other planned strategy elements may not work out)—see Figure 1.2.[8]

CORE CONCEPT

A company's **deliberate strategy** consists of *proactive* strategy elements that are both planned and realized as planned; its **emergent strategy** consists of *reactive* strategy elements that emerge as changing conditions warrant.

But managers must always be willing to supplement or modify the proactive strategy elements with as-needed reactions to unanticipated conditions. Inevitably, there will be occasions when market and competitive conditions take an unexpected turn that calls for some kind of strategic reaction. Hence, *a portion of a company's strategy is always developed on the fly,* coming as a response to fresh strategic maneuvers on the part of rival firms, unexpected shifts in customer requirements, fast-changing technological developments, newly appearing market opportunities, a changing political or economic climate, or other unanticipated happenings in the surrounding environment. These unplanned,

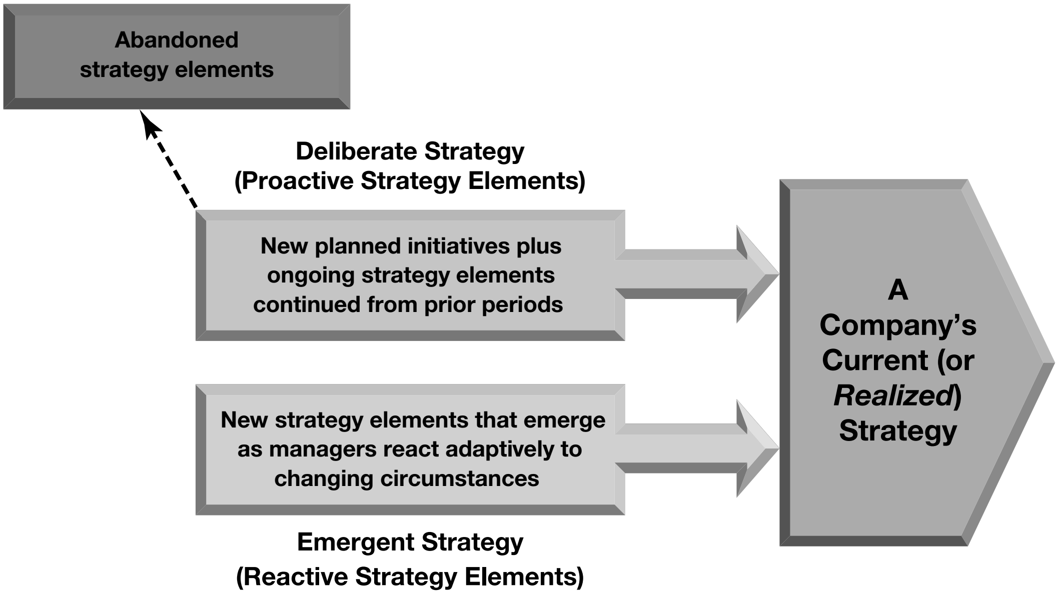

FIGURE 1.2 *A Company's Strategy is a Blend of Proactive Initiatives and Reactive Adjustments*

reactive, and adaptive strategy adjustments make up the firm's **emergent strategy.** A company's strategy *in toto* (its **realized strategy**) thus tends to be a *combination* of proactive and reactive elements, with certain strategy elements being *abandoned* because they have become obsolete or ineffective. A company's realized strategy can be observed in the pattern of its actions over time, which is a far better indicator than any of its strategic plans on paper or any public pronouncements about its strategy.

A COMPANY'S STRATEGY AND ITS BUSINESS MODEL

LO 5

Learn why it is important for a company to have a viable business model that outlines the company's customer value proposition and its profit formula.

At the center of a company's strategy is the company's **business model.** A business model is management's blueprint for delivering a valuable product or service to customers in a manner that will generate revenues sufficient to cover costs and yield an attractive profit.[9] The two elements of a company's business model are (1) its *customer value proposition* and (2) its *profit formula.* The customer value proposition lays out the company's approach to satisfying buyer wants and needs at a price customers will consider a good value. Plainly, from a customer perspective, the greater the value delivered *(V)* and the lower the price *(P)*, the more attractive is the company's value proposition. The profit formula describes the company's approach to determining a cost structure that will allow for acceptable profits, given the pricing tied to its customer value proposition. The lower the costs *(C)*, given the customer value proposition *(V – P)*, the greater the ability of the business model to be a moneymaker. Thus the profit formula reveals how efficiently a company can meet customer wants and needs and deliver on the value proposition. The nitty-gritty issue surrounding a company's business model is whether it can execute its customer value proposition profitably. Just because company managers have crafted a strategy for competing and running the business, this does not automatically mean that the strategy will lead to profitability—it may or it may not.

Magazines and newspapers employ a business model keyed to delivering information and entertainment they believe readers will find valuable and a profit formula aimed at securing sufficient revenues from subscriptions and advertising to more than cover the costs of producing and delivering their products to readers. Mobile phone providers, satellite radio companies, and broadband providers also employ a subscription-based business model. The business model of network TV and radio broadcasters entails providing free programming to audiences but charging advertising fees based on audience size. Gillette's business model in razor blades involves selling a "master product"—the razor—at an attractively low price and then making money on repeat purchases of razor blades that can be produced very cheaply and sold at 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 break-even) price and making large profit margins on the repeat purchases of printer supplies, especially ink cartridges. McDonald's invented the business model for fast food—providing value to customers in the form of economical quick-service meals at clean convenient locations. Its profit formula involves such elements as standardized cost-efficient store design, stringent specifications for ingredients, detailed operating procedures for each unit, and heavy reliance on advertising and in-store promotions to drive volume. Illustration Capsule 1.2 describes two contrasting business models in radio broadcasting.

CORE CONCEPT

A company's **business model** sets forth the logic for how its strategy will create value for customers, while at the same time generate revenues sufficient to cover costs and realize a profit.

WHAT MAKES A STRATEGY A WINNER?

Three tests can be applied to determine whether a strategy is a *winning strategy:*

LO 6

Learn the three tests of a winning strategy.

1. ***The Fit Test:*** *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 pertinent aspects of the business environment in which the company operates. No strategy can work well unless it exhibits good *external fit* and is in sync with prevailing market conditions. At the same time, a winning strategy must be tailored to the company's resources and competitive capabilities and be supported by a complementary set of functional activities (i.e., activities in the realms of supply chain management, operations, sales and marketing, and so on). That is, it must also exhibit *internal fit* and be compatible with a company's ability to execute the strategy in a competent manner. Unless a strategy exhibits good fit with both the external and internal aspects of a company's overall situation, it is likely to be an underperformer and fall short of producing winning results. Winning strategies also exhibit *dynamic fit* in the sense that they evolve over time in a manner that maintains close and effective alignment with the company's situation even as external and internal conditions change.[10]
2. ***The Competitive Advantage Test:*** *Can the strategy help the company achieve a sustainable competitive advantage?* Strategies that fail to achieve a durable competitive advantage over rivals are unlikely to produce superior performance for more than a brief period of time. Winning strategies enable a company to achieve a competitive advantage over key rivals that is long-lasting. The bigger and more durable the competitive advantage, the more powerful it is.

A **winning strategy** must pass three tests:

1. The Fit Test
2. The Competitive Advantage Test
3. The Performance Test

ILLUSTRATION CAPSULE 1.2

Sirius XM and Over-the-Air Broadcast Radio: Two Contrasting Business Models

	Sirius XM	Over-the-Air Radio Broadcasters
Customer value proposition	Digital music, news, national and regional weather, traffic reports in limited areas, and talk radio programming provided for a monthly subscription fee. Programming is interrupted only by brief occasional ads.	Free-of-charge music, national and local news, local traffic reports, national and local weather, and talk radio programming. Listeners can expect frequent programming interruption for ads.
Profit formula	***Revenue generation:*** Monthly subscription fees, sales of satellite radio equipment, and advertising revenues. ***Cost structure:*** Fixed costs associated with operating a satellite-based music delivery service. Fixed and variable costs related to programming and content royalties, marketing, and support activities.	***Revenue generation:*** Advertising sales to national and local businesses. ***Cost structure:*** Fixed costs associated with terrestrial broadcasting operations. Fixed and variable costs related to local news reporting, advertising sales operations, network affiliate fees, programming and content royalties, commercial production activities, and support activities.
	Profit margin: Sirius XM's profitability is dependent on attracting a sufficiently large number of subscribers to cover its costs and provide attractive profits.	***Profit margin:*** The profitability of over-the-air radio stations was dependent on generating sufficient advertising revenues to cover costs and provide attractive profits.

3. ***The Performance Test:*** *Is the strategy producing good company performance?* The mark of a winning strategy is strong company performance. Two kinds of performance indicators tell the most about the caliber of a company's strategy: (1) competitive strength and market standing and (2) profitability and financial strength. Above-average financial performance or gains in market share, competitive position, or profitability are signs of a winning strategy.

Strategies that come up short on one or more of the preceding tests are plainly less appealing than strategies passing all three tests with flying colors. Managers should use the same questions when evaluating either proposed or existing strategies. New initiatives that don't seem to match the company's internal and external situations should be scrapped before they come to fruition, while existing strategies must be scrutinized on a regular basis to ensure they have good fit, offer a competitive advantage, and are contributing to above-average performance or performance improvements.

WHY CRAFTING AND EXECUTING STRATEGY ARE IMPORTANT TASKS

Crafting and executing strategy are top-priority managerial tasks for a very big reason. A clear and reasoned strategy is management's prescription for doing business, its road map to competitive advantage, its game plan for pleasing customers, and its formula for improving performance. High-achieving enterprises are nearly always the product of astute, creative, and proactive strategy making. Companies don't get to the top of the industry rankings or stay there with illogical strategies, copy-cat strategies, or timid attempts to try to do better. Only a handful of companies can boast of hitting home runs in the marketplace due to lucky breaks or the good fortune of having stumbled into the right market at the right time with the right product. And even then, unless they subsequently craft a strategy that capitalizes on their luck, building on what's working and discarding the rest, success of this sort will be fleeting. So there can be little argument that a company's strategy matters—and matters a lot.

The chief executive officer of one successful company put it well when he said:

> In the main, our competitors are acquainted with the same fundamental concepts and techniques and approaches that we follow, and they are as free to pursue them as we are. More often than not, the difference between their level of success and ours lies in the relative thoroughness and self-discipline with which we and they develop and execute our strategies for the future.

Good Strategy + Good Strategy Execution = Good Management

> How well a company performs is directly attributable to the caliber of its strategy and the proficiency with which the strategy is executed.

Crafting and executing strategy are thus core management functions. 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-in, day-out strategy execution and operating excellence. Indeed, *good strategy and good strategy execution are the most telling signs of good management.* Managers don't deserve a gold star for designing a potentially brilliant strategy but failing to put the organizational means in place to carry it out in high-caliber fashion. Competent execution of a mediocre strategy scarcely merits enthusiastic applause for management's efforts either. The rationale for using the twin standards of good strategy making and good strategy execution to determine whether a company is well managed is therefore compelling: *The better conceived a company's strategy and the more competently it is executed, the more likely the company will be a standout performer in the marketplace.* In stark contrast, a company that lacks clear-cut direction, has a flawed strategy, or can't 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.

THE ROAD AHEAD

Throughout the chapters to come and in the accompanying case collection, the spotlight will be trained on the foremost question in running a business enterprise: *What must managers do, and do well, to make a company a winner in the marketplace?* The answer that emerges is that doing a good job of managing inherently requires good strategic thinking and good management of the strategy-making, strategy-executing process.

The mission of this book is to provide a solid overview of what every business student and aspiring manager needs to know about crafting and executing strategy. 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. The accompanying cases will help build your skills in both diagnosing how well the strategy-making, strategy-executing task is being performed and prescribing actions for how the strategy in question or its execution can be improved. The strategic management course that you are enrolled in may also include a strategy simulation exercise where you will run a company in head-to-head competition with companies run by your classmates. Your mastery of the strategic management concepts presented in the following chapters will put you in a strong position to craft a winning strategy for your company and figure out how to execute it in a cost-effective and profitable manner. As you progress through the chapters of the text and the activities assigned during the term, we hope to convince you that first-rate capabilities in crafting and executing strategy are essential to good management.

Strategic Thinking Capsule

Rejuvenating and Restructuring Wipro

Of late, Wipro had lost its No. 3 position to Cognizant and looked to be falling apart. The company was not only lagging behind its peers in revenue and profit growth but rivals had overtaken it in India's over $70-billion IT sector. Lagging peers in making strategic, 'game-changing' acquisitions, consulting business had not delivered the desired results, and it was losing price premiums working only on thin margins.

Wipro Chief Executive TK Kurien started the turnaround process by poaching star performers from rival firms in a sweeping reorganization to signal that he meant business and that there was an urgency to remove the laidback work culture.[12] Within a year (in 2011), about 60 managers, some of them long-termers in the 31 year-old company, either had left on their own or had been asked to. The evaluation was based on how they were rated by customers directly or indirectly served by them. The company was trying hard to regain its market position. For that it had to remove the flab, introduce new capabilities, and reinvent the company's culture of excellence.

Kurien handpicked hard-charging specialists from the IT services market leader Tata Consultancy Services and revenue growth leader Cognizant and paid them the top dollar. These specialists were meant to fill the space vacated by the departing executives. A Wipro executive justified the large-scale revamp as follows: "Somebody has to look beyond the popularity index and start questioning the inertia. Wipro cannot keep watching others run past. The company has to pick the lessons very carefully and execute them now, dispassionately. A manager who left Wipro in December 2011 said that 'there are no pink slips, there are no slips at all; just an email about measuring up to the new benchmarks".

Company insiders familiar with the strategic plan thought that by the end of 2013, almost half the middle and senior management staff would have been replaced or ejected. The company's focus was more on delivery models and the new business transformation practice focused on high-value projects. For example, key people from TCS, Infosys, and Cognizant had been appointed at the Vice President level to help the company hunt for fresh business—an area where it had been lagging.

Customer Satisfaction as the Main Benchmark for the Wipro Staff

The most important new benchmark at Wipro was customer satisfaction. This meant that bonuses and pay hikes would be linked to customer satisfaction levels and not just revenue or profit growth. A quarter of incentives for each staff member now depended on the satisfaction levels among Wipro's clients such as Johnson & Johnson and Citibank.

Another measure introduced at Wipro was the evaluation of managers on their ability to work across teams and functions as well as leadership attributes that inspired other team members to perform better. One outside observer noted that "There is a method to this madness, which is focused on creating a completely different organization with momentum. What Kurien is doing is partly shaking up the existing system and partly bringing new talent to infuse energy". A company executive who was part of the revamp team said that, "Traditionally, Wipro has been top-heavy. Now we are investing heavily in building internal systems to empower decision-making down the chain to the level of project manager".

The first signs that this approach was working came in half-yearly results in fiscal year 2011-12, when Wipro beat Street revenue expectations for the first time in two years.

The New Strategy-Structural Initiatives

Kurien had also replaced the joint-CEO structure (which had two Managing Directors at the same time) and collapsed the overlapping business units, service lines, and geographic operations into fewer divisions headed by 'mini CEO-like' leaders with complete authority to take important decisions. This came along with strategic investments such as the acquisition of SAIC's IT unit. It was an effort to move away from a pure services-driven business model to one that involved developing platforms and products, including developing IP (Intellectual Property). It appointed a new Chief Technology Officer who was given a mandate to focus the company to offer differentiated and unique offerings to the customers. The company felt that the pure services business had become commoditized. Even global IT companies have successfully copied the global delivery model first, and there was now little that differentiates one from the other.

As another key structural initiative, Wipro had undertaken to form a Technology Executive Council (TEC) and a Technology Business Council (TBC) to gear up for future waves of growth. The TEC consists of about 50 technology leaders identified from across horizontal service lines and verticals. The TBC is a smaller council with around 18 members who work closely with customers in the field to bring insights from the client side. The TEC and TBC will together define the roadmap for future readiness of the company.

The council members are based in Wipro centers across the world and meet formally once a quarter. However, they meet virtually once every fortnight. This requires a greater risk-taking culture than in the services business. To get the best brains, it was increasingly involving startups and universities for this initiative.

Another Wipro initiative was in emerging high-technology areas such as Nanoelectronics, robotics, and low cost tablets. Wipro has identified cloud, mobility, and analytics as its focus growth areas for the short term. Over the medium to long-term, the company sees the key growth drivers to be machine-to-machine cyber-physical integration (making objects talk to one another), web science (obtaining contextual information and acting on it), miniaturization, and natural user interfaces (interfaces that come almost naturally to humans, such as touch and motion, instead of having to learn it).

Wipro has also launched Wipro Desktop as a Service (WDaaS), a desktop virtualization solution that delivers desktops, applications, and data as an on-demand service. WDaaS is an integrated service offering which uses the market-leading desktop virtualization technologies of Citrix and Microsoft and provides efficient plug and play desktop and application virtualization capabilities. The solution is built on HP Converged Infrastructure. For enterprises that want to deploy desktop virtualization on-premises, WDaaS will offer a pre-configured appliance (hardware, software, and services) that can be managed remotely by Wipro. This solution lowers deployment cost and reduces the implementation time by half as compared to the traditional system integration approach. For enterprises seeking a hosted or cloud offering, Wipro delivers desktops and applications as a service from a dedicated private cloud environment in its own data-centers or by leveraging cloud infrastructure providers. These delivery models lower the Total Cost of Ownership (TCO) and move the desktop cost from a CAPEX (Capital Expenditure) to an OPEX (Operational Expenditure) model.

Finally, Mr Kurien was not satisfied with the progress so far.[13] According to him: "We have done some simple things well; we have done a lot of good things in front of the customer. But as an organization we are not aggressive enough. We are still not pushing enough into the market place and that is one thing we have to change. It's about a couple of things; one is enabling the front end itself. Deals are made and won, but delivery is won every day in the customer's premises. We are taking the power of Wipro to the customer but we have not done this universally. Wipro has an enormous amount of technology and knowledge but we don't put enough of that in front of the customers. That to some extent is our mindset, because we are very reticent as a company. In our business you don't have to sell, customers should come to you because they see value and that is the change we have to bring about. Many people talk about a trusted advisor and we have to get to that level."[14]

However there were doubts whether the change management process was being executed well. It resulted in heartburn among those who have been asked to leave while creating uncertainty among some of those who remained. A former employee said that "Just when you think it's over, it starts all over again" referring to the reorganization and key people leaving.

Questions:

1. Assess the Business Model of Wipro.
2. Where do you think is this transformation headed to?

Key Points

1. A company's strategy is its action plan for outperforming its competitors and achieving superior profitability.
2. The central thrust of a company's strategy is undertaking moves to build and strengthen the company's long-term competitive position and financial performance by *competing differently* from rivals and gaining a sustainable competitive advantage over them.
3. A company achieves a **competitive advantage** when it provides buyers with superior value compared to rival sellers or offers the same value at a lower cost to the firm. The advantage is **sustainable** if it persists despite the best efforts of competitors to match or surpass this advantage.
4. A company's strategy typically evolves over time, emerging from a blend of (1) proactive deliberate actions on the part of company managers to improve the strategy, and (2) reactive emergent responses to unanticipated developments and fresh market conditions.

5. A company's business model sets forth the logic for how its strategy will create value for customers, while at the same time generate revenues sufficient to cover costs and realize a profit. Thus, it contains two crucial elements: (1) the *customer value proposition*—a plan for satisfying customer wants and needs at a price customers will consider good value, and (2) the *profit formula*—a plan for a cost structure that will enable the company to deliver the customer value proposition profitably.
6. A winning strategy will pass three tests: (1) *Fit* (external, internal, and dynamic consistency), (2) *Competitive Advantage* (durable competitive advantage), and (3) *Performance* (outstanding financial and market performance).
7. Crafting and executing strategy are core management functions. How well a company performs and the degree of market success it enjoys are directly attributable to the caliber of its strategy and the proficiency with which the strategy is executed.

Assurance of Learning Exercises

1. Based on what you know about the quick-service restaurant industry, does McDonald's strategy (as described in Illustration Capsule 1.1) seem to be well-matched to industry and competitive conditions? Does the strategy seem to be keyed to a cost-based advantage, differentiating features, serving the unique needs of a niche, or some combination of these? What is there about McDonald's strategy that can lead to sustainable competitive advantage? **LO 1, LO 2, LO 3**
2. Elements of Walmart's strategy have evolved in meaningful ways since the company's founding in 1962. Prepare a one- to two-page report that discusses how its strategy has evolved after reviewing all of the links at Walmart's About Us page, which can be found at **walmartstores.com/AboutUs/**. Your report should also assess how well Walmart's strategy passes the three tests of a winning strategy. **LO 4, LO 6**
3. Go to **www.nytco.com/investors** and check whether *The New York Times*' recent financial reports indicate that its business model is working. Does the company's business model remain sound as more consumers go to the Internet to find general information and stay abreast of current events and news stories? Is its revenue stream from advertisements growing or declining? Are its subscription fees and circulation increasing or declining? **LO 5**

Exercise for Simulation Participants

Three basic questions must be answered by managers of organizations of all sizes as they begin the process of crafting strategy:

- What is our present situation?
- Where do we want to go from here?
- How are we going to get there?

After you have read the Participant's Guide or Player's Manual for the strategy simulation exercise that you will participate in this academic term, you and your co-managers should come up with brief one- or two-paragraph answers to these three questions *prior* to entering your first set of decisions. While your answers to the first of the three questions can be developed from your reading of the manual, the second and third questions will require a collaborative discussion among the members of your company's management team about how you intend to manage the company you have been assigned to run.

1. What is our company's current situation? A substantive answer to this question should cover the following issues: **LO 1, LO 2, LO 3**
   - Is your company in a good, average, or weak competitive position vis-à-vis rival companies?
   - Does your company appear to be in a sound financial condition?
   - Does it appear to have a competitive advantage and is it likely to be sustainable?
   - What problems does your company have that need to be addressed?
2. Where do we want to take the company during the time we are in charge? A complete answer to this question should say something about each of the following: **LO 4, LO 6**
   - What goals or aspirations do you have for your company?
   - What do you want the company to be known for?
   - What market share would you like your company to have after the first five decision rounds?
   - By what amount or percentage would you like to increase total profits of the company by the end of the final decision round?
   - What kinds of performance outcomes will signal that you and your co-managers are managing the company in a successful manner?
3. How are we going to get there? Your answer should cover these issues: **LO 4, LO 5**
   - Which of the basic strategic and competitive approaches discussed in this chapter do you think makes the most sense to pursue?
   - What kind of competitive advantage over rivals will you try to achieve?
   - How would you describe the company's business model?
   - What kind of actions will support these objectives?

Endnotes

[1] Jan Rivkin, "An Alternative Approach to Making Strategic Choices," Harvard Business School, 9-702-433, 2001.
[2] Michael E. Porter, "What Is Strategy?" *Harvard Business Review* 74, no. 6 (November–December 1996).
[3] Ibid.
[4] **Walmartstores.com/download/2230.pdf**; Southwest Airlines Fact Sheet, July 16, 2009.
[5] Eric T. Anderson and Duncan Simester, "A Step-by-Step Guide to Smart Business Experiments," *Harvard Business Review* 89, no. 3 (March 2011).
[6] Shona L. Brown and Kathleen M. Eisenhardt, *Competing on the Edge: Strategy as Structured Chaos* (Boston, MA: Harvard Business School Press, 1998).
[7] Cynthia A. Montgomery, "Putting Leadership Back into Strategy," *Harvard Business Review* 86, no. 1 (January 2008).
[8] Henry Mintzberg and J. A. Waters, "Of Strategies, Deliberate and Emergent," *Strategic Management Journal* 6 (1985); Costas Markides, "Strategy as Balance: From 'Either-Or' to 'And,'" *Business Strategy Review* 12, no. 3 (September 2001).
[9] Mark W. Johnson, Clayton M. Christensen, and Henning Kagermann, "Reinventing Your Business Model," *Harvard Business Review* 86, no. 12 (December 2008); Joan Magretta, "Why Business Models Matter," *Harvard Business Review* 80, no. 5 (May 2002).
[10] Jan Rivkin, "An Alternative Approach to Making Strategic Choices."