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STRATEGIC MANAGEMENT

Competitiveness & Globalization

Concepts and Cases

12e

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***Strategic Management: Competitiveness & Globalization: Concepts and Cases*, 12e**

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Library of Congress Control Number: 2015955692

ISBN: 978-1-305-50214-7

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Printed in Canada
Print Number: 01 Print Year: 2016

To My Family:
I love each and every one of you. Thank you for all of your love and support.
— Michael, Dad, Papa

To Mary Ann:
"Now everyone dreams of a love lasting and true." This was my dream that you have completely fulfilled. Thank you for all of the love, support, and encouragement throughout our life together.
— R. Duane Ireland

To Kathy:
My love for you is eternal, and I hope that we can be eternally together. Thanks for all the support and love you've given me throughout my life.
— Bob

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Preface

Our goal in writing each edition of this book is to present a new, up-to-date standard for explaining the strategic management process. To reach this goal with the 12th edition of our market-leading text, we again present you with an intellectually rich yet thoroughly practical analysis of strategic management.

With each new edition, we work hard to achieve the goal of maintaining the standard that we established for presenting strategic management knowledge in a readable style. To prepare for each new edition, we carefully study the most recent academic research to ensure that the content about strategic management that we present to you is up to date and accurate. In addition, we continuously read articles appearing in many different and widely read business publications (e.g., *Wall Street Journal, Bloomberg Businessweek, Fortune, Financial Times, Fast Company,* and *Forbes,* to name a few). We also study postings through social media (such as blogs) given their increasing use as channels of information distribution. By studying a wide array of sources, we are able to identify valuable examples of how companies are using (or not using) the strategic management process. Though many of the hundreds of companies that we discuss in the book will be quite familiar, some will likely be new to you. One reason for this is that we use examples of companies from around the world to demonstrate the globalized nature of business operations. To maximize your opportunities to learn as you read and think about how actual companies use strategic management tools, techniques, and concepts (based on the most current research), we emphasize a lively and user-friendly writing style. To facilitate learning, we use an Analysis-Strategy-Performance framework that is explained in Chapter 1 and referenced throughout the book.

Several *characteristics* of this 12th edition of our book are designed to enhance your learning experience:

- First, we are pleased to note that this book presents you with the most comprehensive and thorough coverage of strategic management that is available in the market.
- The research used in this book is drawn from the "classics" as well as the most recent contributions to the strategic management literature. The historically significant "classic" research provides the foundation for much of what is known about strategic management, while the most recent contributions reveal insights about how to effectively use strategic management in the complex, global business environment in which firms now compete. Our book also presents you with many up-to-date examples of how firms use the strategic management tools, techniques, and concepts that prominent researchers have developed. Indeed, although this book is grounded in the relevant theory and current research, it also is strongly application oriented and presents you, our readers, with a large number of examples and applications of strategic management concepts, techniques, and tools. In this edition, for example, we examine more than 600 companies to describe the use of strategic management. Collectively, no other strategic management book presents you with the *combination* of useful and insightful *research* and *applications* in a wide variety of organizations as does this text.

Company examples you will find in this edition range from large U.S.-based firms such as Apple, Amazon.com, McDonald's, Starbucks, Walmart, Walt Disney, General Electric, Intel, American Express, Coca-Cola, Google, Target, United Technologies, Kellogg, DuPont, Marriott, and Whole Foods. In addition, we examine firms based in countries other than the United States such as Sony, Aldi, Honda, Tata Consultancy, Alibaba, IKEA, Lenova, Luxottica, and Samsung. As these lists suggest, the firms examined in this book compete in a wide range of industries and produce a diverse set of goods and services.

- We use the ideas of many prominent scholars (e.g., Ron Adner, Rajshree Agarwal, Gautam Ahuja, Raffi Amit, Africa Arino, Jay Barney, Paul Beamish, Peter Buckley, Ming-Jer Chen, Russ Coff, Rich D'Aveni, Kathy Eisenhardt, Gerry George, Javier Gimeno, Luis Gomez-Mejia, Melissa Graebner, Ranjay Gulati, Don Hambrick, Connie Helfat, Amy Hillman, Tomas Hult, Dave Ketchen, Dovev Lavie, Yadong Luo, Shige Makino, Costas Markides, Anita McGahan, Danny Miller, Will Mitchell, Margie Peteraf, Michael Porter, Nandini Rajagopalan, Jeff Reuer, Joan Ricart, Richard Rumelt, David Sirmon, Ken Smith, Steve Tallman, David Teece, Michael Tushman, Margarethe Wiersema, Oliver Williamson, Mike Wright, Anthea Zhang, and Ed Zajac) to shape the discussion of *what* strategic management is. We describe the practices of prominent executives and practitioners (e.g., Mary Barra, Jack Ma, Reed Hastings, Howard Schultz, John Mackey, Yang Yuanqing, Angela Ahrendt, Marilyn Hewson, Jeff Immelt, Ellen Kullman, Elon Musk, Paul Pullman, Li Ka-Shing, Karen Patz, and many others) to help us describe *how* strategic management is used in many types of organizations.

The authors of this book are also active scholars. We conduct research on a number of strategic management topics. Our interest in doing so is to contribute to the strategic management literature and to better understand how to effectively apply strategic management tools, techniques, and concepts to increase organizational performance. Thus, our own research is integrated in the appropriate chapters along with the research of numerous other scholars, some of whom are noted above.

In addition to our book's *characteristics,* there are some specific *features* and *revisions* that we have made in this 12th edition that we are pleased to highlight for you:

- **New Opening Cases and Strategic Focus Segments** We continue our tradition of providing all-new Opening Cases and Strategic Focus segments! Many of these deal with companies located outside North America. In addition, all of the company-specific examples included in each chapter are either new or substantially updated. Through all of these venues, we present you with a wealth of examples of how actual organizations, most of which compete internationally as well as in their home markets, use the strategic management process for the purpose of outperforming rivals and increasing their performance.
- **Twenty Cases** are included in this edition. Offering an effective mix of organizations headquartered or based in North America and a number of other countries as well, the cases deal with contemporary and highly important topics. Many of the cases have full financial data (the analyses of which are in the Case Notes that are available to instructors). These timely cases present active learners with opportunities to apply the strategic management process and understand organizational conditions and contexts and to make appropriate recommendations to deal with critical concerns. These cases can also be found in MindTap.
- **New Mini-Cases** have been added that demonstrate how companies deal with major issues highlighted in the text. There are 13 of these cases, one for each chapter, although some of them can overlap with other chapter content. Students will like their conciseness, but they likewise provide rich content that can serve as a catalyst for individual or group analysis and class discussion. Each Mini-Case is followed by a set of questions to guide analysis and discussion.

- **More than 1,200 new references** from 2014 and 2015 are included in the chapters' endnotes. We used the materials associated with these references to support new material added or current strategic management concepts that are included in this edition. In addition to demonstrating the classic and recent research from which we draw our material, the large number of references supporting the book's contents allow us to integrate cutting-edge research and thinking into a presentation of strategic management tools, techniques, and concepts.
- **New content** was added to several chapters. Examples include the strategic ecosystem such as the one used by Apple with its "ecosystem of app producers" (Chapters 1 and 4), sustainable physical environment (Chapter 3), mentoring new CEOs (Chapter 12), strategic leadership in family owned/controlled companies (Chapter 12), and acquisitions and innovation, open innovations, and managing the innovation portfolio (Chapters 4 and 13).
- **Updated information** is provided in several chapters. Examples include the stakeholder host communities (Chapter 1), all new and current demographic data (e.g., ethnic mix, geographic distribution) that describe the economic environment (Chapter 2), the general partner strategies of private equity firms (Chapter 7), information from the *World Economic Forum Competitiveness Report* regarding political risks of international investments (Chapter 8), updates about corporate governance practices being used in different countries (Chapter 10), updated data about the number of internal and external CEO selections occurring in companies today (Chapter 12), a ranking of countries by the amount of their entrepreneurial activities (Chapter 13), and a ranking of companies on their total innovation output (Chapter 13).
- **An Exceptional Balance** between current research and up-to-date applications of that research in actual organizations located throughout the world. The content has not only the best research documentation but also the largest number of effective real-world examples to help active learners understand the different types of strategies organizations use to achieve their vision and mission and to outperform rivals.

Supplements to Accompany This Text

Instructor Website. Access important teaching resources on this companion website. For your convenience, you can download electronic versions of the instructor supplements from the password-protected section of the site, including Instructor's Resource Manual, Comprehensive Case Notes, Cognero Testing, Word Test Bank files, PowerPoint® slides, and Video Segments and Guide. To access these additional course materials and companion resources, please visit www.cengagebrain.com.

- **Instructor's Resource Manual.** The Instructor's Resource Manual, organized around each chapter's knowledge objectives, includes teaching ideas for each chapter and how to reinforce essential principles with extra examples. This support product includes lecture outlines and detailed guides to integrating the MindTap activities into your course with instructions for using each chapter's experiential exercises, branching, and directed cases. Finally, we provide outlines and guidance to help you customize the collaborative work environment and case analysis project to incorporate your approach to case analysis, including creative ideas for using this feature throughout your course for the most powerful learning experience for your class.
- **Case Notes.** These notes include directed assignments, financial analyses, and thorough discussion and exposition of issues in the case. Select cases also have assessment

rubrics tied to National Standards (AACSB outcomes) that can be used for grading each case. The Case Notes provide consistent and thorough support for instructors, following the method espoused by the author team for preparing an effective case analysis.

- **Cognero.** This program is easy-to-use test-creation software that is compatible with Microsoft Windows. Instructors can add or edit questions, instructions, and answers, and select questions by previewing them on the screen, selecting them randomly, or selecting them by number. Instructors can also create and administer quizzes online, whether over the Internet, a local area network (LAN), or a wide area network (WAN).
- **Test Bank.** Thoroughly revised and enhanced, test bank questions are linked to each chapter's knowledge objectives and are ranked by difficulty and question type. We provide an ample number of application questions throughout, and we have also retained scenario-based questions as a means of adding in-depth problem-solving questions. The questions are also tagged to National Standards (AACSB outcomes), Bloom's Taxonomy, and the Dierdorff/Rubin metrics.
- **PowerPoints®.** An all-new PowerPoint presentation, created for the 12th edition, provides support for lectures, emphasizing key concepts, key terms, and instructive graphics.
- **Video Segments.** A collection of 13 BBC videos has been included in the MindTap Learning Path. These new videos are short, compelling, and provide timely illustrations of today's management world. They are available on the DVD and Instructor website. Detailed case write-ups, including questions and suggested answers, appear in the Instructor's Resource Manual and Video Guide.

Cengage Learning Write Experience 3.0. This new technology is the first in higher education to offer students the opportunity to improve their writing and analytical skills without adding to *your* workload. Offered through an exclusive agreement with Vantage Learning, creator of the software used for GMAT essay grading, Write Experience evaluates students' answers to a select set of assignments for writing for voice, style, format, and originality. We have trained new prompts for this edition!

Micromatic Strategic Management Simulation (for bundles only). The Micromatic Business Simulation Game allows students to decide their company's mission, goals, policies, and strategies. Student teams make their decisions on a quarter-by-quarter basis, determining price, sales and promotion budgets, operations decisions, and financing requirements. Each decision round requires students to make approximately 100 decisions. Students can play in teams or play alone, compete against other players or the computer, or use Micromatic for practice, tournaments, or assessment. You can control any business simulation element you wish, leaving the rest alone if you desire. Because of the number and type of decisions the student users must make, Micromatic is classified as a medium to complex business simulation game. This helps students understand how the functional areas of a business fit together without being bogged down in needless detail and provides students with an excellent capstone experience in decision making.

Smartsims (for bundles only). MikesBikes Advanced is a premier strategy simulation providing students with the unique opportunity to evaluate, plan, and implement strategy as they manage their own company while competing online against other students within their course. Students from the management team of a bicycle manufacturing company make all

the key functional decisions involving price, marketing, distribution, finance, operations, HR, and R&D. They formulate a comprehensive strategy, starting with their existing product, and then adapt the strategy as they develop new products for emerging markets. Through the Smartsims easy-to-use interface, students are taught the cross-functional disciplines of business and how the development and implementation of strategy involves these disciplines. The competitive nature of MikesBikes encourages involvement and learning in a way that no other teaching methodology can, and your students will have fun in the process!

MindTap. MindTap is the digital learning solution that helps instructors engage students and helps students become tomorrow's strategic leaders. All activities are designed to teach students to problem-solve and think like leaders. Through these activities and real-time course analytics, and an accessible reader, MindTap helps you turn cookie cutter into cutting edge, apathy into engagement, and memorizers into higher-level thinkers.

Customized to the specific needs of this course, activities are built to facilitate mastery of chapter content. We've addressed case analysis from cornerstone to capstone with a functional area diagnostic of prior knowledge, directed cases, branching activities, multimedia presentations of real-world companies facing strategic decisions, and a collaborative environment in which students can complete group case analysis projects together synchronously.

Acknowledgments

We express our appreciation for the excellent support received from our editorial and production team at Cengage Learning. We especially wish to thank Scott Person, our Senior Product Manager, and Tara Singer, our Content Developer. We are grateful for their dedication, commitment, and outstanding contributions to the development and publication of this book and its package of support materials.

We are highly indebted to all of the reviewers of past editions. Their comments have provided a great deal of insight in the preparation of this current edition:

Jay Azriel
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Suffolk University

Ruben Boling
North Georgia University

Matthias Bollmus
Carroll University

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University of New Orleans

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Michael Hitt is a University Distinguished Professor Emeritus at Texas A&M University and a Distinguished Research Fellow at Texas Christian University. Dr. Hitt received his Ph.D. from the University of Colorado. He has coauthored or coedited 27 books and authored or coauthored many journal articles. A recent article listed him as one of the 10 most cited authors in management over a 25-year period. The *Times Higher Education 2010* listed him among the top scholars in economics, finance, and management based on the number of highly cited articles he has authored. A recent article in the *Academy of Management Perspectives* lists him as one of the top two management scholars in terms of the combined impact of his work both inside (i.e., citations in scholarly journals) and outside of academia. He has served on the editorial review boards of multiple journals and is a former editor of the *Academy of Management Journal* and a former coeditor of the *Strategic Entrepreneurship Journal*. He received the 1996 Award for Outstanding Academic Contributions to Competitiveness and the 1999 Award for Outstanding Intellectual Contributions to Competitiveness Research from the American Society for Competitiveness. He is a fellow in the Academy of Management and in the Strategic Management Society, a research fellow in the Global Consortium of Entrepreneurship Centers, and received an honorary doctorate from the Universidad Carlos III de Madrid. He is a former president of both the Academy of Management and of the Strategic Management Society and a member of the Academy of Management's Journals' Hall of Fame. He received awards for the best article published in the *Academy of Management Executive* (1999), *Academy of Management Journal* (2000), *Journal of Management* (2006), and *Family Business Review* (2012). In 2001, he received the Irwin Outstanding Educator Award and the Distinguished Service Award from the Academy of Management. In 2004, Dr. Hitt was awarded the Best Paper Prize by the Strategic Management Society. In 2006, he received the Falcone Distinguished Entrepreneurship Scholar Award from Syracuse University. In 2014 and 2015, Dr. Hitt was listed as a Thomson Reuters Highly Cited Researcher (a listing of the world's most influential researchers), and he was also listed as one of The World's Most Influential Scientific Minds (a listing of the top cited researchers in science around the globe).

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of the Academy of Management. Dr. Ireland is a fellow of the Academy of Management and a fellow of the Strategic Management Society. He is a research fellow in the Global Consortium of Entrepreneurship Centers and received an award in 1999 for Outstanding Intellectual Contributions to Competitiveness Research from the American Society for Competitiveness. He received the Falcone Distinguished Entrepreneurship Scholar Award from Syracuse University in 2005, the USASBE Scholar in Corporate Entrepreneurship Award from USASBE in 2004, and the Riata Distinguished Entrepreneurship Scholar award from Oklahoma State University in 2014. He received awards for the best article published in *Academy of Management Executive* (1999), the *Academy of Management Journal* (2000), and the *Journal of Applied Management and Entrepreneurship* (2010). He received an Association of Former Students Distinguished Achievement Award for Research from Texas A&M University (2012). In 2014 and 2015, Dr. Ireland was listed as a Thomson Reuters Highly Cited Researcher (a listing of the world's most influential researchers), and he was also listed as one of The World's Most Influential Scientific Minds (a listing of the top cited researchers in science around the globe).

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Robert E. Hoskisson is the George R. Brown Chair of Strategic Management at the Jesse H. Jones Graduate School of Business, Rice University. Dr. Hoskisson received his Ph.D. from the University of California-Irvine. His research topics focus on corporate governance, acquisitions and divestitures, corporate and international diversification, and cooperative strategy. He teaches courses in corporate and international strategic management, cooperative strategy, and strategy consulting. He has coauthored 26 books, including recent books on business strategy and competitive advantage. Dr. Hoskisson has served on several editorial boards for such publications as the *Strategic Management Journal* (current Associate Editor), *Academy of Management Journal* (Consulting Editor), *Journal of International Business Studies* (Consulting Editor), *Journal of Management* (Associate Editor) and *Organization Science*. His research has appeared in over 130 publications, including the *Strategic Management Journal, Academy of Management Journal, Academy of Management Review, Organization Science, Journal of Management, Academy of Management Perspective, Academy of Management Executive, Journal of Management Studies, Journal of International Business Studies, Journal of Business Venturing, Entrepreneurship Theory and Practice, California Management Review*, and *Journal of World Business*. Dr. Hoskisson is a fellow of the Academy of Management and a charter member of the Academy of Management Journal's Hall of Fame. He is also a fellow of the Strategic Management Society and has received awards from the American Society for Competitiveness and the William G. Dyer Alumni award from the Marriott School of Management, Brigham Young University. He completed three years of service as a Representative-at-Large on the Board of Governors of the Academy of Management. Currently, he serves as Past President of the Strategic Management Society, and thereby serves on the Executive Committee of its Board of Directors.

Case Title	Manu-facturing	Service	Consumer Goods	Food/ Retail	High Technology	Internet	Transportation/ Communication	International Perspective	Social/ Ethical Issues	Industry Perspective
Amazon: Kindle Fire			●		●	●				
American Express		●				●				●
BP in Russia	●							●		●
Carlsberg	●		●					●		●
Fisk Alloy Wire, Inc. and Percon	●								●	
IKEA	●		●	●				●		●
Invitrogen					●				●	●
Keurig	●		●							
Kipp Schools		●								
Luck Companies	●								●	●
Martha Stewart		●	●							
Movie Exhibition Industry: 2015		●	●							●
Polaris and Victory Motorcycles	●		●				●			●
Safaricom		●			●	●	●			
Siemens	●				●					
Southwest Airlines		●					●	●		●
Starbucks			●	●		●			●	
Super Selectos			●	●				●		
Tim Hortons				●				●		●
W.L. Gore	●				●		●			

Case Title	Chapters 1	2	3	4	5	6	7	8	9	10	11	12	13
Amazon: Kindle Fire				●	●								●
American Express	●			●	●								●
BP in Russia					●			●	●				
Carlsberg		●			●		●	●	●				
Fisk Alloy Wire, Inc. and Percon		●		●			●						
IKEA		●						●	●				
Invitrogen							●					●	●
Keurig				●	●								●
Kipp Schools		●	●									●	●
Luck Companies		●	●	●		●	●			●		●	
Martha Stewart	●				●	●	●			●			
Movie Exhibition Industry: 2015		●	●	●	●								
Polaris and Victory Motorcycles		●	●	●		●	●						●
Safaricom	●	●			●			●				●	
Siemens			●			●					●	●	●
Southwest Airlines		●		●	●		●					●	
Starbucks						●	●	●				●	●
Super Selectos		●			●			●			●		
Tim Hortons				●	●		●		●				
W.L. Gore	●									●	●	●	●

1

Strategic Management and Strategic Competitiveness

Studying this chapter should provide you with the strategic management knowledge needed to:

1-1 Define strategic competitiveness, strategy, competitive advantage, above-average returns, and the strategic management process.

1-2 Describe the competitive landscape and explain how globalization and technological changes shape it.

1-3 Use the industrial organization (I/O) model to explain how firms can earn above-average returns.

1-4 Use the resource-based model to explain how firms can earn above-average returns.

1-5 Describe vision and mission and discuss their value.

1-6 Define stakeholders and describe their ability to influence organizations.

1-7 Describe the work of strategic leaders.

1-8 Explain the strategic management process.

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ALIBABA: AN ONLINE COLOSSUS IN CHINA GOES GLOBAL

China now has the world's largest number of internet users and Alibaba is China's largest ecommerce company (23 percent owned by Yahoo and 36 percent owned by Japan's SoftBank). In 2014, when Alibaba completed its initial public offering (IPO) on the New York Stock Exchange, it immediately became worth more than Amazon and eBay combined and has a larger market capitalization than Walmart. Transactions of goods on Alibaba's websites account for more than 2 percent of China's GDP in 2012. Comparatively, Walmart's sales account for 0.03 percent of U.S. GDP in 2012. Alibaba's presence has turned China into the world's second largest ecommerce market after the United States. Chinese consumers purchase products on Tmall, a consumer shopping site on Alibaba analogous to a department store and similar to Amazon. Because of China's vast size and underdeveloped consumer market, it has few national mainland malls or brick and mortar department store chains. As such, the presence of Alibaba is stimulating consumption that would not otherwise take place in China. Furthermore, Alibaba's presence changed consumer buying habits, especially in third- and fourth-tier (e.g., smaller and more geographically remote) cities because it gives consumers access to items that they could not previously obtain locally.

Alibaba Drone.PNG

Taobao is another website owned by Alibaba and is comparable to eBay in the United States. On Taobao, Alibaba does not stock or sell its own goods but rather provides platforms where manufacturers, resellers, and other middle-men open online storefronts. Larger consumer branded products prefer Tmall because Alibaba's policies promote this site more heavily and fraudulent brands are less likely to be found on this site. For instance, popular brands such as Prada handbags must provide evidence that they are a licensed distributor before they are allowed to sell on Tmall. Taobao is more focused on small sellers; it has 6 million registered sellers with a vast range in size.

Given these two websites, Alibaba is the easiest way for foreign retailers to enter the Chinese market because it has such reach. Online sales account for 90 percent of marketplace sales in China, compared with 24 percent for the United States in 2014. Accordingly, Alibaba provides the easiest way to enter the Chinese market for foreign retailers due the large access to consumers available through Alibaba's websites. Alibaba's websites also give smaller Chinese manufacturers the opportunity to increase domestic sales because of Alibaba's reach. For example, Weighing Apparatus Group, originally a supplier of household and industrial scales for Bed Bath & Beyond, set up a website on Taobao in 2009. In 2014, one-fifth of its domestic sales now flow through its Taobao online storefront, allowing it to move beyond being only a supplier for other firm's branded products.

Alibaba through its Alipay system is working on a joint venture with Apple to provide back-end services for the Apple Pay payment system allowing iPhone users in China to pay for goods with Apple Pay using their Alipay accounts. This approach is fostering an improved mobile online strategy for Alibaba. It also facilitates better service for online Apple iPhone users who desire to browse and purchase on Alibaba websites.

Fraudulent goods can be an important strategic issue in China because of previous product liability suits from banned or recalled goods sold to U.S. consumers.

As such, Alibaba is collaborating with the United States Consumer Product Safety Commission to improve its credibility among U.S. consumers by helping to ban sale of fake and fraudulently branded or recalled goods. This is also facilitating Alibaba's global access strategy.

Alibaba is also moving into online media content and streaming video services. In 2014, it announced its acquisition of ChinaVision Media, producers or co-producers of films including "Crouching Tiger, Hidden Dragon" and "Breaking the Silence." Just as Amazon and Netflix are producing their own media content, Alibaba is moving in this direction as well, as it competes with other service providers such as Tencent and Baidu in web communications and broadcasting in China. Getting its strategies right in the local domestic Chines market as well as internationally is key to Alibaba's success.

Sources: D. Tsuruoka, 2015, Alibaba blocks sale of unsafe goods to U.S. shoppers, *Investor's Business Daily*, www.investorsbusinessdaily.com, Jan 13; S. Cendrowski, 2014, Alibaba's Maggie Wu and Lucy Peng: The dynamic duo behind the IPO, *Fortune*, www.fortune.com, September 17; R. Flannery, 2014, China media entrepreneur's fortune soars on Alibaba investment, *Forbes*, www.forbes.com, March 12; C. Larson, 2014, In China its meet me at Tmall, *Bloomberg Businessweek*, www.bloombergbusinessweek.com, September 11.

As we see from the Opening Case, Alibaba is highly successful because its strategy in China has allowed it to have a massive impact in regard to online sales in a large emerging economy. It is now seeking to grow globally and gain widespread name/brand recognition through its 2014 IPO in New York. These attributes have enhanced its ability to compete in global online markets. Therefore, we can conclude that Alibaba has achieved *strategic competitiveness*. It clearly has been able to earn *above-average returns*, at least, domestically. Yet Alibaba has received its share of criticism because of its perceived contribution to the sale of fraudulent goods. However, it is addressing this issue through its collaboration with the United States Consumer Product Safety Commission. The top management of Alibaba has used the strategic management process (see Figure 1.1) as the foundation for the commitments, decisions, and actions they took to pursue strategic competitiveness and above-average returns. The strategic management process is fully explained in this book. We introduce you to this process in the next few paragraphs.

Strategic competitiveness is achieved when a firm successfully formulates and implements a value-creating strategy. A **strategy** is an integrated and coordinated set of commitments and actions designed to exploit core competencies and gain a competitive advantage. When choosing a strategy, firms make choices among competing alternatives as the pathway for deciding how they will pursue strategic competitiveness. In this sense, the chosen strategy indicates what the firm *will do* as well as what the firm *will not do*.

Strategic competitiveness is achieved when a firm successfully formulates and implements a value creating strategy.

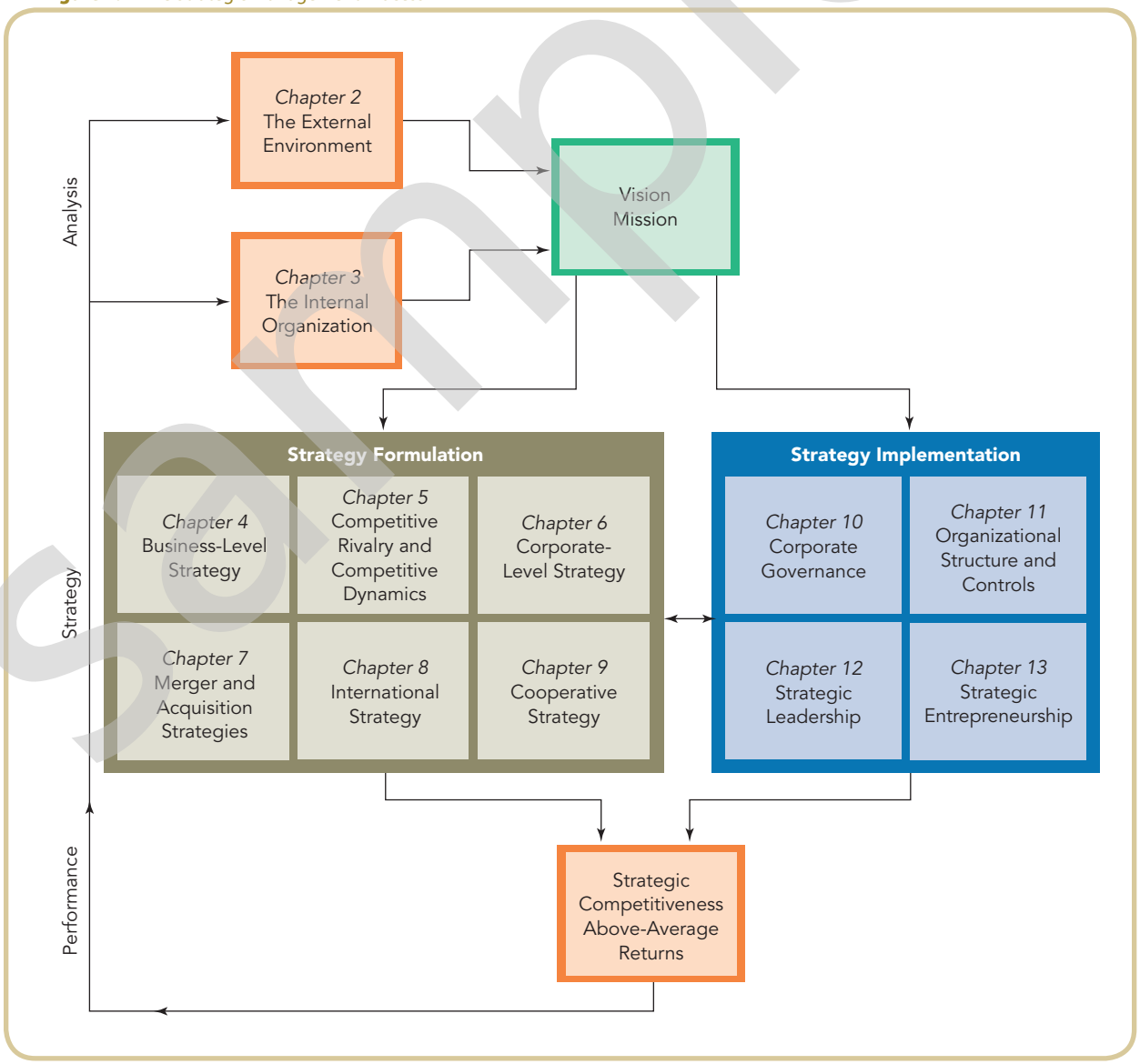
A **strategy** is an integrated and coordinated set of commitments and actions designed to exploit core competencies and gain a competitive advantage.

A firm has a **competitive advantage** when it implements a strategy that creates superior value for customers and that competitors are unable to duplicate or find it too costly to try to imitate.

As explained in the Opening Case, Alibaba has been a leader in its industry as one of the most successful facilitators of online sales in China and is now seeking to become a successful global business. However, in doing so it must respond to its changing environment. In fact, to adapt to local environments, it sometimes makes major changes. For example, it is coordinating with Apple Pay to improve access for the high number iPhones that Apple is now selling in China.

A firm has a **competitive advantage** "when it implements a strategy that creates superior value for customers and that its competitors are unable to duplicate or find too costly to imitate."[1] An organization can be confident that its strategy has resulted in one or more useful competitive advantages only after competitors' efforts to duplicate its strategy have ceased or failed. In addition, firms must understand that no competitive advantage is permanent.[2] The speed with which competitors are able to acquire the skills

Figure 1.1 The Strategic Management Process



needed to duplicate the benefits of a firm's value-creating strategy determines how long the competitive advantage will last.[3]

Above-average returns are returns in excess of what an investor expects to earn from other investments with a similar amount of risk. **Risk** is an investor's uncertainty about the economic gains or losses that will result from a particular investment. The most successful companies learn how to effectively manage risk.[4] Effectively managing risks reduces investors' uncertainty about the results of their investment.[5] Returns are often measured in terms of accounting figures, such as return on assets, return on equity, or return on sales. Alternatively, returns can be measured on the basis of stock market returns, such as monthly returns (the end-of-the-period stock price minus the beginning stock price divided by the beginning stock price, yielding a percentage return).[6]

Above-average returns are returns in excess of what an investor expects to earn from other investments with a similar amount of risk

Risk is an investor's uncertainty about the economic gains or losses that will result from a particular investment.

In smaller, new venture firms, returns are sometimes measured in terms of the amount and speed of growth (e.g., in annual sales) rather than more traditional profitability measures[7] because new ventures require time to earn acceptable returns (in the form of return on assets and so forth) on investors' investments.[8]

Understanding how to exploit a competitive advantage is important for firms seeking to earn above-average returns.[9] Firms without a competitive advantage or that are not competing in an attractive industry earn, at best, average returns. **Average returns** are returns equal to those an investor expects to earn from other investments with a similar amount of risk. In the long run, an inability to earn at least average returns results first in decline and, eventually, failure.[10] Failure occurs because investors withdraw their investments from those firms earning less-than-average returns.

As previously noted, there are no guarantees of permanent success. Companies that are prospering must not become overconfident. Research suggests that overconfidence can lead to excessive risk taking.[11] Even considering Apple's excellent current performance, it still must be careful not to become overconfident and continue its quest to be the leader for its markets.

The **strategic management process** is the full set of commitments, decisions, and actions required for a firm to achieve strategic competitiveness and earn above-average returns (see Figure 1.1)[12]. The process involves analysis, strategy and performance (the A-S-P model—see Figure 1.1). The firm's first step in the process is to *analyze* its external environment and internal organization to determine its resources, capabilities, and core-competencies—on which its strategy likely will be based. Alibaba has established its dominant position because it has excelled in using this process. The *strategy* portion of the model entails strategy formulation and strategy implementation.

With the information gained from external and internal analyses, the firm develops its vision and mission and formulates one or more *strategies*. To implement its strategies, the firm takes actions to enact each strategy with the intent of achieving strategic competitiveness and above-average returns (*performance*). Effective strategic actions that take place in the context of carefully integrated strategy formulation and implementation efforts result in positive performance. This dynamic strategic management process must be maintained as ever-changing markets and competitive structures are coordinated with a firm's continuously evolving strategic inputs.[13]

In the remaining chapters of this book, we use the strategic management process to explain what firms do to achieve strategic competitiveness and earn above-average returns. We demonstrate why some firms consistently achieve competitive success while others fail to do so.[14] As you will see, the reality of global competition is a critical part of the strategic management process and significantly influences firms' performances.[15] Indeed, learning how to successfully compete in the globalized world is one of the most significant challenges for firms competing in the current century.[16]

Several topics will be discussed in this chapter. First, we describe the current competitive landscape. This challenging landscape is being created primarily by the emergence of a global economy, globalization resulting from that economy, and rapid technological changes. Next, we examine two models that firms use to gather the information and knowledge required to choose and then effectively implement their strategies. The insights gained from these models also serve as the foundation for forming the firm's vision and mission. The first model (industrial organization or I/O) suggests that the external environment is the primary determinant of a firm's strategic actions. According to this model, identifying and then operating effectively in an attractive (i.e., profitable) industry or segment of an industry are the keys to competitive success.[17] The second model (resource-based) suggests that a firm's unique resources and capabilities are the critical link to strategic competitiveness.[18] Thus, the first model is concerned primarily

Average returns are returns equal to those an investor expects to earn from other investments with a similar amount of risk.

The **strategic management process** is the full set of commitments, decisions, and actions required for a firm to achieve strategic competitiveness and earn above-average returns.

with the firm's external environment, while the second model is concerned primarily with the firm's internal organization. After discussing vision and mission, direction-setting statements that influence the choice and use of strategies, we describe the stakeholders that organizations serve. The degree to which stakeholders' needs can be met increases when firms achieve strategic competitiveness and earn above-average returns. Closing the chapter are introductions to strategic leaders and the elements of the strategic management process.

1-1 The Competitive Landscape

The fundamental nature of competition in many of the world's industries is changing. Although financial capital is no longer scarce due to the deep recession, markets are increasingly volatile.[19] Because of this, the pace of change is relentless and ever-increasing. Even determining the boundaries of an industry has become challenging. Consider, for example, how advances in interactive computer networks and telecommunications have blurred the boundaries of the entertainment industry. Today, not only do cable companies and satellite networks compete for entertainment revenue from television, but telecommunication companies are moving into the entertainment business through significant improvements in fiber-optic lines.[20] More recently, internet only streaming services have started to compete with cable, satellite, and telecommunication offerings. "Sling TV is part of a growing wave of offerings expected from tech, telecom and media companies in the coming year, posing a threat to the established television business, which takes in $170 billion a year. Meanwhile, the streaming outlets of Amazon, Hulu and Netflix continue to pour resources into developing more robust offerings. Sony, CBS, HBO and others are starting Internet-only subscription offerings."[21] Interestingly, Netflix and other streaming content providers such as Amazon are producing their own content; Netflix is producing repeat series such as "House of Cards," "Orange Is the New Black," and "Marco Polo".[22] As noted in the opening case, Alibaba intends to enter the entertainment business as Netflix and other content distributors and producers enter international markets.

Other characteristics of the current competitive landscape are noteworthy. Conventional sources of competitive advantage such as economies of scale and huge advertising budgets are not as effective as they once were (e.g., due to social media advertising) in terms of helping firms earn above-average returns. Moreover, the traditional managerial mind-set is unlikely to lead a firm to strategic competitiveness. Managers must adopt a new mind-set that values flexibility, speed, innovation, integration, and the challenges that evolve from constantly changing conditions.[23] The conditions of the competitive landscape result in a perilous business world, one in which the investments that are required to compete on a global scale are enormous and the consequences of failure are severe.[24] Effective use of the strategic management process reduces the likelihood of failure for firms as they encounter the conditions of today's competitive landscape.

Hypercompetition describes competition that is excessive such that it creates inherent instability and necessitates constant disruptive change for firms in the competitive landscape.[25] Hypercompetition results from the dynamics of strategic maneuvering among global and innovative combatants.[26] It is a condition of rapidly escalating competition based on price-quality positioning, competition to create new know-how and establish first-mover advantage, and competition to protect or invade established product or geographic markets.[27] In a hypercompetitive market, firms often aggressively challenge their competitors in the hopes of improving their competitive position and ultimately their performance.[28]

Hypercompetition describes competition that is excessive such that it creates inherent instability and necessitates constant disruptive change for firms in the competitive landscape.

Several factors create hypercompetitive environments and influence the nature of the current competitive landscape. The emergence of a global economy and technology, specifically rapid technological change, are the two primary drivers of hypercompetitive environments and the nature of today's competitive landscape.

1-1a The Global Economy

A **global economy** is one in which goods, services, people, skills, and ideas move freely across geographic borders. Relatively unfettered by artificial constraints, such as tariffs, the global economy significantly expands and complicates a firm's competitive environment.[29]

Interesting opportunities and challenges are associated with the emergence of the global economy.[30] For example, the European Union (a group of European countries that participates in the world economy as one economic unit and operates under one official currency, the euro) has become one of the world's largest markets, with 700 million potential customers. "In the past, China was generally seen as a low-competition market and a low-cost producer. Today, China is an extremely competitive market in which local market-seeking multinational corporations (MNCs) must fiercely compete against other MNCs and against those local companies that are more cost effective and faster in product development. While China has been viewed as a country from which to source low-cost goods, lately, many MNCs such as Procter & Gamble (P&G), are actually net exporters of local management talent; they have been dispatching more Chinese abroad than bringing foreign expatriates to China."[31] China has become the second-largest economy in the world, surpassing Japan. India, the world's largest democracy, has an economy that also is growing rapidly and now ranks as the fourth largest in the world.[32] Simultaneously, many firms in these emerging economies are moving into international markets and are now regarded as MNCs. This fact is demonstrated by the case of Huawei Technologies Co. Ltd., a Chinese company that has entered the U.S. market. Barriers to entering foreign markets still exist and Huawei has encountered several, such as the inability to gain the U.S. government's approval for acquisition of U.S. firms. Essentially, Huawei must build credibility in the U.S. market, and especially build a positive relationship with stakeholders such as the U.S. government.

The nature of the global economy reflects the realities of a hypercompetitive business environment and challenges individual firms to seriously evaluate the markets in which they will compete. This is reflected in General Motor's actions and outcomes. General Motors sold 3.54 million vehicles in China while selling less in North America, 3.4 million.[33] One result of China being the largest domestic sales market is the increased competition GM now experiences in China from other competitors.

Consider the case of General Electric (GE). Although headquartered in the United States, GE expects that as much as 60 percent of its revenue growth through 2015 will be generated by competing in rapidly developing economies (e.g., China and India). The decision to count on revenue growth in emerging economies instead of in developed countries such as the United States and in Europe seems quite reasonable in the global economy. GE achieved significant growth in 2010 partly because of signing contracts for large infrastructure projects in China and Russia. GE's Chief Executive Officer (CEO), Jeffrey Immelt, argues that we have entered a new economic era in which the global economy will be more volatile and that most of the growth will come from emerging economies such as Brazil, China, and India.[34] Therefore, GE is investing significantly in these emerging economies, in order to improve its competitive position in vital geographic sources of revenue and profitability.

A **global economy** is one in which goods, services, people, skills, and ideas move freely across geographic borders.

For example, Netflix, a subscription media streaming-video service provider, has seen its growth slow domestically. In the fourth quarter of 2014, Netflix added 1.9 million domestic U.S. streaming subscribers, which was down from 2.3 million in the fourth

period a year earlier. However, Netflix was able to add 4.3 streaming customers overall because foreign markets grew faster than expected. When this was announced, its stock price increased 16 percent in after-hours trading. Netflix plans to expand to over 200 countries by 2017, up from its current 50 countries, while likewise seeking to stay profitable. Reed Hastings, Netflix's CEO, was encouraged by profitable results in Canada, Nordic countries, and Latin American countries. This group turned profitable notwithstanding the significant investment necessary to bring streaming services to these countries. In the first part of 2015, the company expects to add Australia and New Zealand and is exploring entering the Chinese market as well. Overall, Netflix added over 2.43 million subscribers outside of the United States, which exceed its expectation of 2.15 million subscribers. Besides international expansion, Netflix is adding a significant number of original shows including "House of Cards," "Orange Is the New Black," and "Marco Polo." It finds that this original content costs less given viewer support compared to licensed content from major studios. This proprietary content as well as its expansion of licensing has lured customers away from cable and satellite TV providers. Its superior technology in providing precisely what consumers want and when they want it provides a domestic advantage which will carry over into its international expansion push (see Chapter 8 Opening Case for an expansion on Netflix's international strategy).[35]

M4OS Photos / Alamy

Along with its international push, Netflix has expanded its ability to allow content to be viewed on many devices (including mobile devices) beside regular TVs, as is shown in the photo.

The March of Globalization

Globalization is the increasing economic interdependence among countries and their organizations as reflected in the flow of goods and services, financial capital, and knowledge across country borders.[36] Globalization is a product of a large number of firms competing against one another in an increasing number of global economies.

In globalized markets and industries, financial capital might be obtained in one national market and used to buy raw materials in another. Manufacturing equipment bought from a third national market can then be used to produce products that are sold in yet a fourth market. Thus, globalization increases the range of opportunities for companies competing in the current competitive landscape.[37]

Firms engaging in globalization of their operations must make culturally sensitive decisions when using the strategic management process, as is the case in Starbucks' operations in European countries. Additionally, highly globalized firms must anticipate ever-increasing complexity in their operations as goods, services, people, and so forth move freely across geographic borders and throughout different economic markets.

Overall, it is important to note that globalization has led to higher performance standards in many competitive dimensions, including those of quality, cost, productivity, product introduction time, and operational efficiency. In addition to firms competing in the global economy, these standards affect firms competing on a domestic-only basis. The reason that customers will purchase from a global competitor rather than a domestic firm is that the global company's good or service is superior. Workers now flow rather freely among global economies, and employees are a key source of competitive advantage.[38]

Thus, managers have to learn how to operate effectively in a "multi-polar" world with many important countries having unique interests and environments.[39] Firms must learn how to deal with the reality that in the competitive landscape of the twenty-first century, only companies capable of meeting, if not exceeding, global standards typically have the capability to earn above-average returns.

Although globalization offers potential benefits to firms, it is not without risks. Collectively, the risks of participating outside of a firm's domestic markets in the global economy are labeled a "liability of foreignness."[40] One risk of entering the global market is the amount of time typically required for firms to learn how to compete in markets that are new to them. A firm's performance can suffer until this knowledge is either developed locally or transferred from the home market to the newly established global location.[41] Additionally, a firm's performance may suffer with substantial amounts of globalization. In this instance, firms may over diversify internationally beyond their ability to manage these extended operations.[42] Over diversification can have strong negative effects on a firm's overall performance.

A major factor in the global economy in recent years has been the growth in the influence of emerging economies. The important emerging economies include not only the BRIC countries (Brazil, Russia, India, and China) but also the VISTA countries (Vietnam, Indonesia, South Africa, Turkey, and Argentina). Mexico and Thailand have also become increasingly important markets.[43] Obviously, as these economies have grown, their markets have become targets for entry by large multinational firms. Emerging economy firms have also began to compete in global markets, some with increasing success.[44] For example, there are now more than 1,000 multinational firms home-based in emerging economies with more than $1 billion in annual sales.[45] In fact, the emergence of emerging-market MNCs in international markets has forced large MNCs based in developed markets to enrich their own capabilities to compete effectively in global markets.[46]

Thus, entry into international markets, even for firms with substantial experience in the global economy, requires effective use of the strategic management process. It is also important to note that even though global markets are an attractive strategic option for some companies, they are not the only source of strategic competitiveness. In fact, for most companies, even for those capable of competing successfully in global markets, it is critical to remain committed to and strategically competitive in both domestic and international markets by staying attuned to technological opportunities and potential competitive disruptions that innovations create.[47] As illustrated in the Strategic Focus, Starbucks has increased its revenue per store through an emphasis on innovation in addition to its international expansion.

1-1b Technology and Technological Changes

Technology-related trends and conditions can be placed into three categories: technology diffusion and disruptive technologies, the information age, and increasing knowledge intensity. These categories are significantly altering the nature of competition and as a result contributing to highly dynamic competitive environments.

Technology Diffusion and Disruptive Technologies

The rate of technology diffusion, which is the speed at which new technologies become available and are used, has increased substantially over the past 15 to 20 years. Consider the following rates of technology diffusion:

It took the telephone 35 years to get into 25 percent of all homes in the United States. It took TV 26 years. It took radio 22 years. It took PCs 16 years. It took the Internet 7 years.[48]

Strategic **Focus**

Starbucks Is "Juicing" Its Earnings per Store through Technological Innovations

An important signal for a company is who is chosen as the new CEO. Howard Schultz of Starbucks has led the company through successful strategic execution over much of its history. In 2015, Kevin Johnson, a former CEO of Juniper Networks and 16 year veteran of Microsoft took over as CEO of Starbucks, succeeding Schultz. Johnson has engaged with the company's digital operations and will supervise information technology and supply chain operations.

Many brick and mortar stores have experienced decreasing sales in the United States as online traffic has increased. Interestingly, 2014 Starbuck sales store operations have risen 5 percent in the fourth quarter; this 5 percent came from increased traffic (2 percent from growth in sales and 3 percent in increased ticket size). The driver of this increase in sales is mainly an increase in technology applications.

To facilitate this increase in sales per store, Starbucks is ramping up its digital tools such as mobile-payment platforms. Furthermore, it has ramped up online sales of gift cards as a way to drive revenue. In December 2014, it allowed customers to place online orders and pick them up in about 150 Starbucks outlets in the Portland, Oregon area. Besides leadership and a focus on technology, Starbucks receives suggestions, ideas, and experimentation from its employees. Starbucks employees, called baristas, are seen as partners who blend, steam, and brew the brand's specialty coffee in over 21,000 stores worldwide. Schultz credits the employees as a dominant force in helping it to build its revenue gains.

To further incentivize employees, Starbucks was one of the first to provide comprehensive health benefits and stock option ownership to part-time employees. Currently, employees have received more than $1 billion worth of financial gain through the stock option program. As an additional perk for U.S. employees, Schultz created a program to pay 100 percent of workers' tuition to finish their degrees through Arizona State University. To date, 1,000 workers have enrolled in this program.

Starbucks is also known for its innovations in new types of stores. For instance, it is testing smaller express stores in New York City that reduce client wait times. As noted earlier, Starbucks has emphasized online payment in its approaches which facilitates the speed of transaction. It now gives Starbucks rewards for mobile payment applications to its 12 million active users. Interestingly, this puts it ahead of iTunes and American Express Serve with its Starbucks mobile payment app in regard to number of users.

To put its innovation on display, Starbucks opened its first "Reserve Roastery and Tasting Room." This is a 15,000 square foot coffee roasting facility and also a consumer retail outlet. According to Schultz, it's a retail theater where "you can watch beans being roasted, talk to master grinders, have your drink brewed in front of you in multiple ways, lounge in a coffee library, order a selection of gourmet brews and locally prepared foods." Schultz calls this store in New York the "Willie Wonka Factory of coffee." Based on this concept, Starbucks will open small "reserve" stores inspired by this flagship roastery concept across New York in 2015.

These technology advances and different store offerings are also taking place internationally. For example, Starbucks is expanding a new store concept in India and it's debuting this new concept store in smaller towns and suburbs. These new outlets are about half the size of existing Starbuck cafes in India.

Kevin Schafer/Getty Images

The photo illustrates the Starbuck's app that allows customers to pre-order and speed service and payment.

Sources: I. Brat & T. Stynes, 2015, Earnings: Starbucks picks a president from technology industry, *Wall Street Journal*, www.wsj.com, January 23; A. Adamczyk, 2014, The next big caffeine craze? Starbucks testing cold-brewed coffee, *Forbes*, www.forbes.com, August 18; R. Foroohr, 2014, Go inside Starbucks' wild new "Willie Wonka Factory of coffee", *Time*, www.time.com, December 8; FRPT-Retail Snapshot, 2014, Starbucks' strategy of expansion with profitability: to debut in towns and suburbs with half the size of the new stores, *FRPT-Retail Snapshot*, September 28, 9–10; L. Lorenzetti, 2014, Fortune's world most admired companies: Starbucks where innovation is always brewing, *Fortune*, www.fortune.com, October 30; P. Wahba, 2014, Starbucks to offer delivery in 2015 in some key markets, *Fortune*, www.fortune.com, November 4; V. Wong, 2014, Your boss will love the new Starbucks delivery service, *Bloomberg Businessweek*, www.businessweek.com, November 3.

The impact of technological changes on individual firms and industries has been broad and significant. For example, in the not-too-distant past, people rented movies on videotapes at retail stores. Now, movie rentals are almost entirely electronic. The publishing industry (books, journals, magazines, newspapers) is moving rapidly from hard copy to electronic format. Many firms in these industries, operating with a more traditional business model, are suffering. These changes are also affecting other industries, from trucking to mail services (public and private).

Perpetual innovation is a term used to describe how rapidly and consistently new, information-intensive technologies replace older ones. The shorter product life cycles resulting from these rapid diffusions of new technologies place a competitive premium on being able to quickly introduce new, innovative goods and services into the marketplace.[49]

In fact, when products become somewhat indistinguishable because of the widespread and rapid diffusion of technologies, speed to market with innovative products may be the primary source of competitive advantage (see Chapter 5).[50] Indeed, some argue that the global economy is increasingly driven by constant innovations. Not surprisingly, such innovations must be derived from an understanding of global standards and expectations of product functionality. Although some argue that large established firms may have trouble innovating, evidence suggests that today these firms are developing radically new technologies that transform old industries or create new ones.[51] Apple is an excellent example of a large established firm capable of radical innovation. Also, in order to diffuse the technology and enhance the value of an innovation, firms need to be innovative in their use of the new technology, building it into their products.[52]

Another indicator of rapid technology diffusion is that it now may take only 12 to 18 months for firms to gather information about their competitors' research and development (R&D) and product decisions.[53] In the global economy, competitors can sometimes imitate a firm's successful competitive actions within a few days. In this sense, the rate of technological diffusion has reduced the competitive benefits of patents.[54] Today, patents may be an effective way of protecting proprietary technology in a small number of industries such as pharmaceuticals. Indeed, many firms competing in the electronics industry often do not apply for patents to prevent competitors from gaining access to the technological knowledge included in the patent application.

Disruptive technologies—technologies that destroy the value of an existing technology and create new markets[55]—surface frequently in today's competitive markets. Think of the new markets created by the technologies underlying the development of products such as iPods, iPads, Wi-Fi, and the web browser. These types of products are thought by some to represent radical or breakthrough innovations (we discuss more about radical innovations in Chapter 13.).[56] A disruptive or radical technology can create what is essentially a new industry or can harm industry incumbents. However, some incumbents are able to adapt based on their superior resources, experience, and ability to gain access to the new technology through multiple sources (e.g., alliances, acquisitions, and ongoing internal research).[57]

Clearly, Apple has developed and introduced "disruptive technologies" such as the iPhone and iPod, and in so doing changed several industries. For example, the iPhone dramatically changed the cell phone industry, and the iPod and its complementary iTunes revolutionized how music is sold to and used by consumers. In conjunction with other complementary and competitive products (e.g., Amazon's Kindle), Apple's iPad is contributing to and speeding major changes in the publishing industry, moving from hard copies to electronic books. Apple's new technologies and products are also contributing to the new "information age." Thus, Apple provides an example of entrepreneurship through technology emergence across multiple industries.[58]

The Information Age

Dramatic changes in information technology (IT) have occurred in recent years. Personal computers, cellular phones, artificial intelligence, virtual reality, massive databases ("big data"), and multiple social networking sites are only a few examples of how information is used differently as a result of technological developments. An important outcome of these changes is that the ability to effectively and efficiently access and use information. IT has become an important source of competitive advantage in virtually all industries. The Internet and IT advances have given small firms more flexibility in competing with large firms, if the technology is used efficiently.[59]

Both the pace of change in IT and its diffusion will continue to increase. For instance, the number of personal computers in use globally is expected to surpass 2.3 billion by 2015. More than 372 million were sold globally in 2011. This number is expected to increase to about 518 million in 2015.[60] The declining costs of IT and the increased accessibility to them are also evident in the current competitive landscape. The global proliferation of relatively inexpensive computing power and its linkage on a global scale via computer networks combine to increase the speed and diffusion of IT. Thus, the competitive potential of IT is now available to companies of all sizes throughout the world, including those in emerging economies.[61]

Increasing Knowledge Intensity

Knowledge (information, intelligence, and expertise) is the basis of technology and its application. In the competitive landscape of the twenty-first century, knowledge is a critical organizational resource and an increasingly valuable source of competitive advantage.[62]

Indeed, starting in the 1980s, the basis of competition shifted from hard assets to intangible resources. For example, "Walmart transformed retailing through its proprietary approach to supply chain management and its information-rich relationships with customers and suppliers."[63] Relationships with customers and suppliers are an example of an intangible resource which needs to be managed.[64]

Knowledge is gained through experience, observation, and inference and is an intangible resource (tangible and intangible resources are fully described in Chapter 3). The value of intangible resources, including knowledge, is growing as a proportion of total shareholder value in today's competitive landscape.[65] In fact, the Brookings Institution estimates that intangible resources contribute approximately 85 percent of total shareholder value.[66] The probability of achieving strategic competitiveness is enhanced for the firm that develops the ability to capture intelligence, transform it into usable knowledge, and diffuse it rapidly throughout the company.[67] Therefore, firms must develop (e.g., through training programs) and acquire (e.g., by hiring educated and experienced employees) knowledge, integrate it into the organization to create capabilities, and then apply it to gain a competitive advantage.[68]

A strong knowledge-base is necessary to create innovations. In fact, firms lacking the appropriate internal knowledge resources are less likely to invest money in R&D.[69] Firms must continue to learn (building their knowledge-base) because knowledge spillovers to competitors are common. There are several ways in which knowledge spillovers occur, including the hiring of professional staff and managers by competitors.[70] Because of the potential for spillovers, firms must move quickly to use their knowledge in productive ways. In addition, firms must build routines that facilitate the diffusion of local knowledge throughout the organization for use everywhere that it has value.[71] Firms are better able to do these things when they have strategic flexibility.

Strategic flexibility is a set of capabilities used to respond to various demands and opportunities existing in a dynamic and uncertain competitive environment. Thus, strategic flexibility involves coping with uncertainty and its accompanying risks.[72]

Strategic flexibility is a set of capabilities used to respond to various demands and opportunities existing in a dynamic and uncertain competitive environment.

Firms should try to develop strategic flexibility in all areas of their operations. However, those working within firms to develop strategic flexibility should understand that the task is not easy, largely because of inertia that can build up over time. A firm's focus and past core competencies may actually slow change and strategic flexibility.[73]

To be strategically flexible on a continuing basis and to gain the competitive benefits of such flexibility, a firm has to develop the capacity to learn. Continuous learning provides the firm with new and up-to-date skill sets, which allow it to adapt to its environment as it encounters changes.[74] Firms capable of rapidly and broadly applying what they have learned exhibit the strategic flexibility and the capacity to change in ways that will increase the probability of successfully dealing with uncertain, hypercompetitive environments.

1-2 The I/O Model of Above-Average Returns

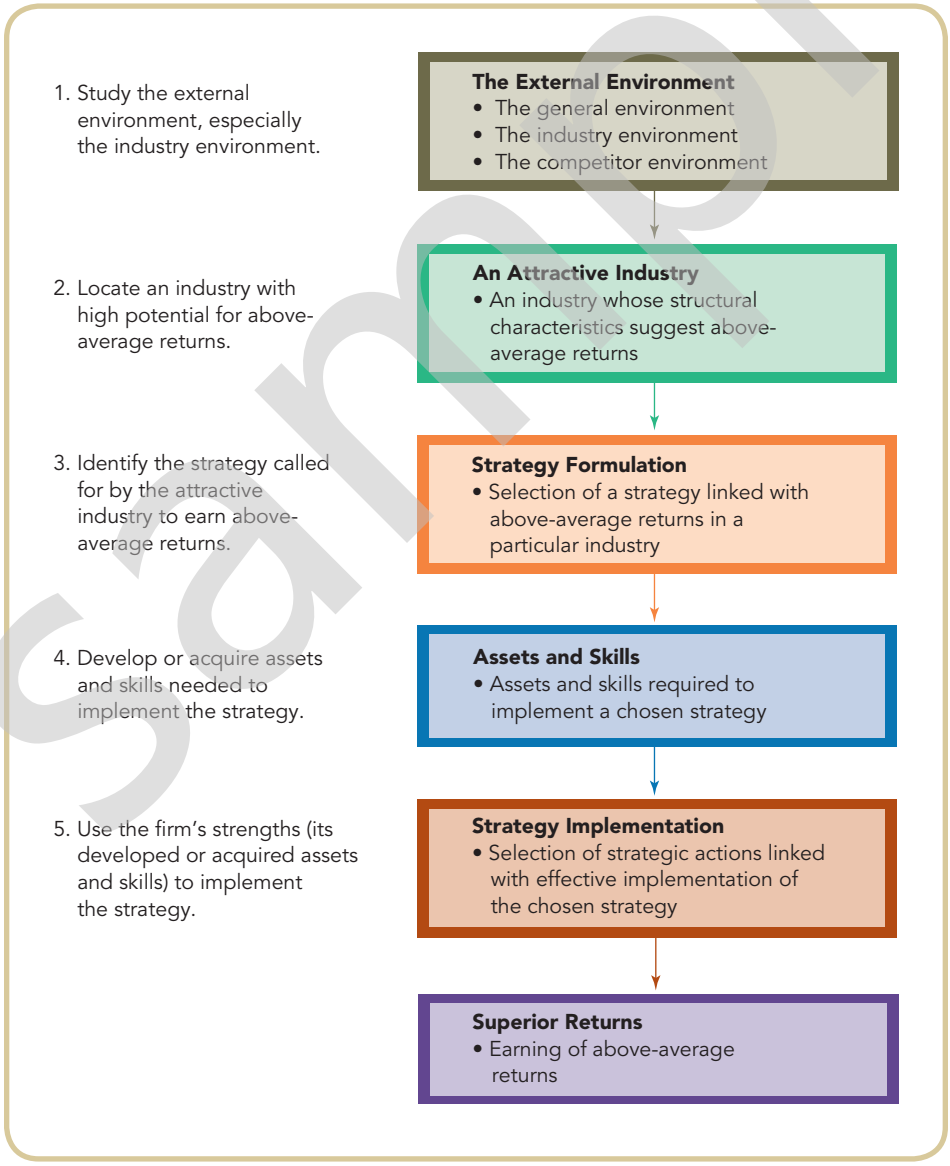
From the 1960s through the 1980s, the external environment was thought to be the primary determinant of strategies that firms selected to be successful.[75] The industrial organization (I/O) model of above-average returns explains the external environment's dominant influence on a firm's strategic actions. The model specifies that the industry or segment of an industry in which a company chooses to compete has a stronger influence on performance than do the choices managers make inside their organizations.[76] The firm's performance is believed to be determined primarily by a range of industry properties, including economies of scale, barriers to market entry, diversification, product differentiation, the degree of concentration of firms in the industry, and market frictions.[77] We examine these industry characteristics in Chapter 2.

Grounded in economics, the I/O model has four underlying assumptions. First, the external environment is assumed to impose pressures and constraints that determine the strategies that would result in above-average returns. Second, most firms competing within an industry or within a segment of that industry are assumed to control similar strategically relevant resources and to pursue similar strategies in light of those resources. Third, resources used to implement strategies are assumed to be highly mobile across firms, so any resource differences that might develop between firms will be short-lived. Fourth, organizational decision makers are assumed to be rational and committed to acting in the firm's best interests, as shown by their profit-maximizing behaviors.[78] The I/O model challenges firms to find the most attractive industry in which to compete. Because most firms are assumed to have similar valuable resources that are mobile across companies, their performance generally can be increased only when they operate in the industry with the highest profit potential and learn how to use their resources to implement the strategy required by the industry's structural characteristics. To do so, they must imitate each other.[79]

The five forces model of competition is an analytical tool used to help firms find the industry that is the most attractive for them. The model (explained in Chapter 2) encompasses several variables and tries to capture the complexity of competition. The five forces model suggests that an industry's profitability (i.e., its rate of return on invested capital relative to its cost of capital) is a function of interactions among five forces: suppliers, buyers, competitive rivalry among firms currently in the industry, product substitutes, and potential entrants to the industry.[80]

Firms use the five forces model to identify the attractiveness of an industry (as measured by its profitability potential) as well as the most advantageous position for the firm to take in that industry, given the industry's structural characteristics.[81]

Figure 1.2 The I/O Model of Above-Average Returns



Typically, the model suggests that firms can earn above-average returns by producing either standardized goods or services at costs below those of competitors (a cost leadership strategy) or by producing differentiated goods or services for which customers are willing to pay a price premium (a differentiation strategy). The cost leadership and product differentiation strategies are discussed more fully in Chapter 4. The fact that the fast food industry faces "higher commodity costs, fiercer competition, a restaurant industry showing little to no growth, and a strapped lower-income consumer,"[82] suggests that fast food giant McDonald's is competing in a relatively unattractive industry.

As shown in Figure 1.2, the I/O model suggests that above-average returns are earned when firms are able to effectively study the external environment as the foundation for identifying an attractive industry and implementing the appropriate strategy. For example, in some industries, firms can reduce competitive rivalry and erect barriers to entry

by forming joint ventures. Because of these outcomes, the joint ventures increase profitability in the industry.[83] Companies that develop or acquire the internal skills needed to implement strategies required by the external environment are likely to succeed, while those that do not are likely to fail.[84] Hence, this model suggests that returns are determined primarily by external characteristics rather than by the firm's unique internal resources and capabilities.

Research findings support the I/O model because approximately 20 percent of a firm's profitability is explained by the industry in which it chooses to compete. However, this research also shows that 36 percent of the variance in firm profitability can be attributed to the firm's characteristics and actions.[85] Thus, managers' strategic actions affect the firm's performance in addition to or in conjunction with external environmental influences.[86] These findings suggest that the external environment and a firm's resources, capabilities, core competencies, and competitive advantages (see Chapter 3) influence the company's ability to achieve strategic competitiveness and earn above-average returns.

Most of the firms in the airline industry are similar in services offered and in performance. They largely imitate each other and have performed poorly over the years. The few airlines which have not followed in the mode of trying to imitate others, such as Southwest Airlines, have developed unique and valuable resources and capabilities on which they have relied to provide a superior product (better service at a lower price) than major rivals.

As shown in Figure 1.2, the I/O model assumes that a firm's strategy is a set of commitments and actions flowing from the characteristics of the industry in which the firm has decided to compete. The resource-based model, discussed next, takes a different view of the major influences on a firm's choice of strategy.

1-3 The Resource-Based Model of Above-Average Returns

The resource-based model of above-average returns assumes that each organization is a collection of unique resources and capabilities. The *uniqueness* of its resources and capabilities is the basis of a firm's strategy and its ability to earn above-average returns.[87]

Resources are inputs into a firm's production process, such as capital equipment, the skills of individual employees, patents, finances, and talented managers. In general, a firm's resources are classified into three categories: physical, human, and organizational capital. Described fully in Chapter 3, resources are either tangible or intangible in nature.

Resources are inputs into a firm's production process, such as capital equipment, the skills of individual employees, patents, finances, and talented managers.

A **capability** is the capacity for a set of resources to perform a task or an activity in an integrative manner.

Core competencies are capabilities that serve as a source of competitive advantage for a firm over its rivals.

Individual resources alone may not yield a competitive advantage.[88] In fact, resources have a greater likelihood of being a source of competitive advantage when they are formed into a capability. A **capability** is the capacity for a set of resources to perform a task or an activity in an integrative manner.[89] **Core competencies** are capabilities that serve as a source of competitive advantage for a firm over its rivals.[90] Core competencies are often visible in the form of organizational functions. For example, Apple's R&D function is one of its core competencies, as its ability to produce innovative new products that are perceived as valuable in the marketplace, is a critical reason for Apple's success.

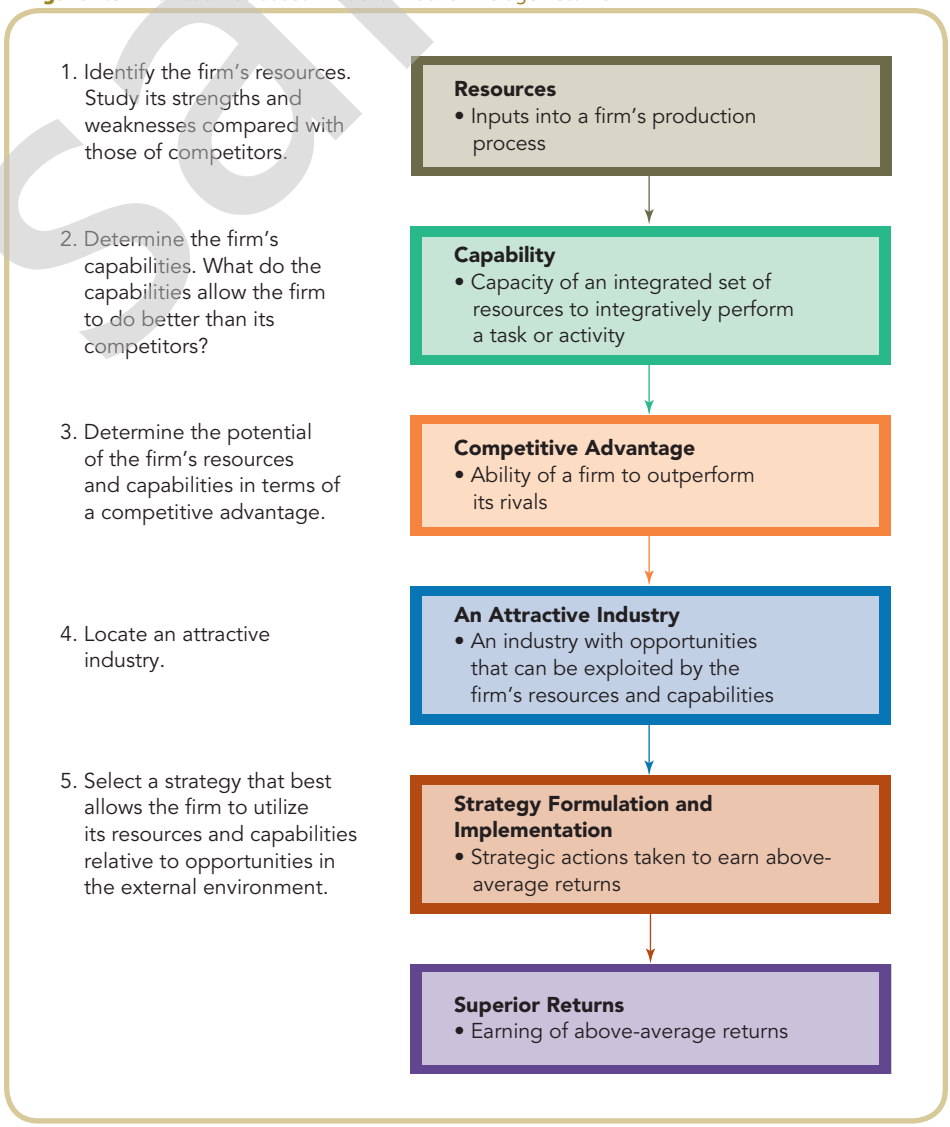
According to the resource-based model, differences in firms' performances across time are due primarily to their unique resources and capabilities rather than the industry's structural characteristics. This model also assumes that firms acquire different resources and develop unique capabilities based on how they combine and use the resources; that resources and certainly capabilities are not highly mobile across firms; and that the

differences in resources and capabilities are the basis of competitive advantage.[91] Through continued use, capabilities become stronger and more difficult for competitors to understand and imitate. As a source of competitive advantage, a capability must not be easily imitated but also not too complex to understand and manage.[92]

The resource-based model of superior returns is shown in Figure 1.3. This model suggests that the strategy the firm chooses should allow it to use its competitive advantages in an attractive industry (the I/O model is used to identify an attractive industry).

Not all of a firm's resources and capabilities have the potential to be the foundation for a competitive advantage. This potential is realized when resources and capabilities are valuable, rare, costly to imitate, and non-substitutable.[93] Resources are *valuable* when they allow a firm to take advantage of opportunities or neutralize threats in its external environment. They are *rare* when possessed by few, if any, current and potential competitors. Resources are *costly to imitate* when other firms either cannot obtain them or are at a

Figure 1.3 The Resource-Based Model of Above-Average Returns



cost disadvantage in obtaining them compared with the firm that already possesses them. And they are *non-substitutable* when they have no structural equivalents. Many resources can either be imitated or substituted over time. Therefore, it is difficult to achieve and sustain a competitive advantage based on resources alone. Individual resources are often integrated to produce configurations in order to build capabilities. These capabilities are more likely to have these four attributes.[94] When these four criteria are met, however, resources and capabilities become core competencies.

As noted previously, research shows that both the industry environment and a firm's internal assets affect that firm's performance over time.[95] Thus, to form a vision and mission, and subsequently to select one or more strategies and determine how to implement them, firms use both the I/O and resource-based models.[96] In fact, these models complement each other in that one (I/O) focuses outside the firm while the other (resource-based) focuses inside the firm. Next, we discuss the formation of a firm's vision and mission—actions taken after the firm understands the realities of its external environment (Chapter 2) and internal organization (Chapter 3).

1-4 Vision and Mission

After studying the external environment and the internal organization, the firm has the information it needs to form its vision and a mission (see Figure 1.1). Stakeholders (those who affect or are affected by a firm's performance, as explained later in the chapter) learn a great deal about a firm by studying its vision and mission. Indeed, a key purpose of vision and mission statements is to inform stakeholders of what the firm is, what it seeks to accomplish, and who it seeks to serve.

1-4a Vision

Vision is a picture of what the firm wants to be and, in broad terms, what it wants to ultimately achieve.[97] Thus, a vision statement articulates the ideal description of an organization and gives shape to its intended future. In other words, a vision statement points the firm in the direction of where it would like to be in the years to come. An effective vision stretches and challenges people as well. In her book about Steve Jobs, Apple's phenomenally successful CEO, Carmine Gallo argues that one of the reasons that Apple is so innovative was Jobs' vision for the company. She suggests that he thought bigger and differently than most people. To be innovative, she explains that one has to think differently about the firm's products and customers—"sell dreams not products"—and differently about the story to "create great expectations."[98] With Steve Jobs' death, Apple will be challenged to remain highly innovative. Interestingly, similar to Jobs, many new entrepreneurs are highly optimistic when they develop their ventures.[99] However, very few are able to develop and successfully implement a vision in the manner that Jobs did.

It is also important to recognize that vision statements reflect a firm's values and aspirations and are intended to capture the heart and mind of each employee and, hopefully, many of its other stakeholders. A firm's vision tends to be enduring while its mission can change with new environmental conditions. A vision statement tends to be relatively short and concise, making it easily remembered. Examples of vision statements include the following:

Vision is a picture of what the firm wants to be and, in broad terms, what it wants to ultimately achieve.

Our vision is to be the world's best quick service restaurant. (McDonald's)

To make the automobile accessible to every American. (Ford Motor Company's vision when established by Henry Ford)

As a firm's most important and prominent strategic leader, the CEO is responsible for working with others to form the firm's vision. Experience shows that the most effective vision statement results when the CEO involves a host of stakeholders (e.g., other top-level managers, employees working in different parts of the organization, suppliers, and customers) to develop it. In short, they need to develop a clear and shared vision for it to be successful.[100] In addition, to help the firm reach its desired future state, a vision statement should be clearly tied to the conditions in the firm's external environment and internal organization. Moreover, the decisions and actions of those involved with developing the vision, especially the CEO and the other top-level managers, must be consistent with that vision.

1-4b Mission

The vision is the foundation for the firm's mission. A **mission** specifies the businesses in which the film intends to compete and the customers it intends to serve.[101] The firm's mission is more concrete than its vision. However, similar to the vision, a mission should establish a firm's individuality and should be inspiring and relevant to all stakeholders.[102] Together, the vision and mission provide the foundation that the firm needs to choose and implement one or more strategies. The probability of forming an effective mission increases when employees have a strong sense of the ethical standards that guide their behaviors as they work to help the firm reach its vision.[103] Thus, business ethics are a vital part of the firm's discussions to decide what it wants to become (its vision) as well as who it intends to serve and how it desires to serve those individuals and groups (its mission).[104]

Even though the final responsibility for forming the firm's mission rests with the CEO, the CEO and other top-level managers often involve more people in developing the mission. The main reason for this is that the mission deals more directly with product markets and customers, and middle- and first-level managers and other employees have more direct contact with customers and the markets in which they serve. Examples of mission statements include the following:

Be the best employer for our people in each community around the world and deliver operational excellence to our customers in each of our restaurants. (McDonald's)

Our mission is to be recognized by our customers as the leader in applications engineering. We always focus on the activities customers' desire; we are highly motivated and strive to advance our technical knowledge in the areas of material, part design and fabrication technology. (LNP, a GE Plastics Company)

McDonald's mission statement flows from its vision of being the world's best quick-service restaurant. LNP's mission statement describes the business areas (material, part design, and fabrication technology) in which the firm intends to compete.

Clearly, vision and mission statements that are poorly developed do not provide the direction a firm needs to take appropriate strategic actions. Still, as shown in Figure 1.1, a firm's vision and mission are critical aspects of the *analysis* and the base required to engage in *strategic actions* that help to achieve strategic competitiveness and earn above-average returns. Therefore, firms must accept the challenge of forming effective vision and mission statements.

A **mission** specifies the businesses in which the firm intends to compete and the customers it intends to serve.

Stakeholders are the individuals, groups, and organizations that can affect the firm's vision and mission, are affected by the strategic outcomes achieved, and have enforceable claims on the firm's performance.

1-5 Stakeholders

Every organization involves a system of primary stakeholder groups with whom it establishes and manages relationships.[105] **Stakeholders** are the individuals, groups,

Strategic **Focus**

The Failure of BlackBerry to Develop an Ecosystem of Stakeholders

In 2007 the Apple iPhone was introduced as a consumer product which became known as the smartphone. At the time, the dominant player in this category was Research in Motion (RIM) and later known as BlackBerry. As late as 2010, BlackBerry held 43 percent of the commercial and government communication sectors. As consumers, including the business and government segments, found the smartphone to be superior as far as utility, BlackBerry's market share began to decrease precipitously. Although BlackBerry's technology allowed it to be a superior communication device for email and phone, the iPhone was superior as a handheld computer device, including communication and messaging, with much more versatility.

BlackBerry's demise provides an informed example of how the competitive landscape has changed in regard to successful business model implementation. Previously, having a good product or service and well run cost-effective company with sound capital structure was sufficient. With newer business models, having an effective strategy to manage the ecosystem or network of suppliers and customers has become more salient. Because BlackBerry had remarkably loyal customers and a strong product it failed to recognize the importance of Apple's ecosystem innovation, which allowed it to expand and diversify its range of applications for its handheld computer (smartphone). In particular, complementors to the industry (a concept explored in Chapter 2) were key; the innovation for Apple was its ecosystem of app developers. Apple not only focused on the value chain of making the iPhone and iPad, but it also focused on managing the ecosystem of creating valuable apps. As a result, an army of software developers were committed to producing iPhone applications, was behind the development of Apple's device for the general consumer and for business professionals. They created a network of stakeholders and facilitated a way to make it easy to install apps on the phone. App developers responded in huge numbers. When the app store launched in 2008, there were 500 apps. Within a year there were 55,000 apps and over a billion downloads. This was the significant difference between the small development community focused on BlackBerry and the massive development community that arose around applications for the iPhone. The "open" system strategy approach used by Google in fostering the Android system allowed a competitive ecosystem to develop that rivaled that of the iPhone.

Even now BlackBerry has not been able to create the type of stakeholder ecosystem comparable to those of Apple and Google.

Since 2010 BlackBerry has had two new CEOs and, although there are improvements, the firm has never recovered. Although BlackBerry has tried to focus on the business and government sectors using its classic look with physical keyboard, it still had a 34 percent drop in revenue in fourth quarter of 2014. The reviews of its latest product, the BlackBerry Classic, note that although consumers are likely to appreciate the retro feel of the device because of the perfected physical keyboard and mouse-like track pad, preloaded apps are slow and poorly designed. The app situation is problematic because BlackBerry doesn't have the number of app developers of the Apple or Google ecosystems. Many of the apps that you do find are difficult to download and often do not resize to fit the Classics' square screen well. As such you get a real physical keyboard to help with emails, manage your calendar, and browse the web, but few other good software applications. Although this is the Classic is the best model ever released, it is expected that BlackBerry will continue to decline due to the lack of quality apps such as the ones found in its competitors' ecosystems.

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Both the iPhone and Android systems have more fully developed app ecosystems than Blackberry, which has limited Blackberry's success.

Apple was able to outsource innovation to more developers than it could afford to employ thereby ensuring a steady stream of desirable new applications and content.

Transparent revenue sharing for these developers and a few early app millionaires created incentive at negligible expense. On the other hand, BlackBerry restricted its development community and could not hope to innovate fast enough to compete with the iPhone's positive feedback loop accruing value to customers, innovators, and content providers, resulting in profitable market share which drew capital market players as well.

In summary, BlackBerry's big failure was that it did not pay attention to the complementary software that became available on other ecosystems. A big lesson here is that managing supplier and stakeholder value creation also creates strong support from customers because it creates value for the all stakeholders and likewise draws financial capital and an associated increasing stock price.

Sources: S. Cojocaru & C. Cojocaru, 2014, New trends in mobile technology leadership, *Manager*, 19(1): 79–89; M. Cording, J. S. Harrison, R. E. Hoskisson, & K. Jonsen, 2014, "Walking the talk": A multi-stakeholder exploration of organizational authenticity, employee productivity and post-merger performance, *Academy of Management Perspectives*, 28(1): 38–56; B. Dummit, 2014, BlackBerry's revenue falls 34%; decline underscores challenges smartphone maker faces, even as it cuts costs, *Wall Street Journal*, www.wsj.com, Dec 20; M. Freer, 2014, Four success strategies from failed business models, *Forbes*, www.forbes.com, Jul 21; D. Gallagher, 2014, BlackBerry's new plan could bear fruit; attempt at revival is showing signs of life, *Wall Street Journal*, www.wsj.com, Nov 16; D. Reisinger, 2014, Why BlackBerry is showing signs of stability under CEO John Chin, *eWeek*, www.eweek.com, Dec 22; M. G. Jacobides, 2013, BlackBerry forgot to manage the ecosystem, *Business Strategy Review*, 24(4), 8; B. Matichuk, 2013, BlackBerry's business model led to its failure, *Troy Media*, www.troymedia.com, Oct 1.

and organizations that can affect the firm's vision and mission, are affected by the strategic outcomes achieved, and have enforceable claims on the firm's performance.[106] Claims on a firm's performance are enforced through the stakeholders' ability to withhold participation essential to the organization's survival, competitiveness, and profitability.[107] Stakeholders continue to support an organization when its performance meets or exceeds their expectations.[108] Also, research suggests that firms that effectively manage stakeholder relationships outperform those that do not. Stakeholder relationships and the firm's overall reputation among stakeholders can therefore be a source of competitive advantage.[109] This can be illustrated through the application of a strong stakeholder strategy in the comparison between BlackBerry's and Apple's ecosystem of stakeholders in the strategic focus. BlackBerry was unable to develop a strong set of application suppliers compared to the Apple ecosystem of app supplier stakeholders.[110]

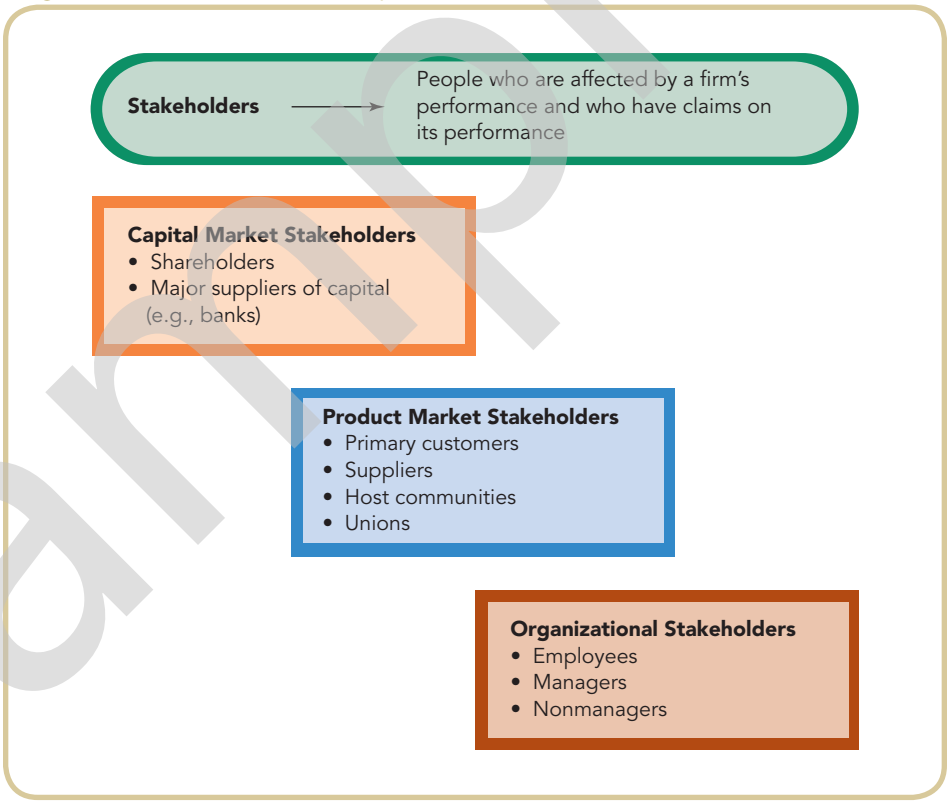
Although organizations have dependency relationships with their stakeholders, they are not equally dependent on all stakeholders at all times. As a consequence, not every stakeholder has the same level of influence.[111] The more critical and valued a stakeholder's participation, the greater a firm's dependency on it. Greater dependence, in turn, gives the stakeholder more potential influence over a firm's commitments, decisions, and actions. Managers must find ways to either accommodate or insulate the organization from the demands of stakeholders controlling critical resources.[112]

1-5a Classifications of Stakeholders

The parties involved with a firm's operations can be separated into at least three groups.[113] As shown in Figure 1.4, these groups are the capital market stakeholders (shareholders and the major suppliers of a firm's capital), the product market stakeholders (the firm's primary customers, suppliers, host communities, and unions representing the workforce), and the organizational stakeholders (all of a firm's employees, including both nonmanagerial and managerial personnel).

Each stakeholder group expects those making strategic decisions in a firm to provide the leadership through which its valued objectives will be reached.[114] The objectives of the various stakeholder groups often differ from one another, sometimes placing

Figure 1.4 The Three Stakeholder Groups



those involved with a firm's strategic management process in situations where trade-offs have to be made. The most obvious stakeholders, at least in U.S. organizations, are *shareholders*—individuals and groups who have invested capital in a firm in the expectation of earning a positive return on their investments. These stakeholders' rights are grounded in laws governing private property and private enterprise.

In contrast to shareholders, another group of stakeholders—the firm's customers—prefers that investors receive a minimum return on their investments. Customers could have their interests maximized when the quality and reliability of a firm's products are improved, but without high prices. High returns to customers, therefore, might come at the expense of lower returns for capital market stakeholders.

Because of potential conflicts, each firm must carefully manage its stakeholders. First, a firm must thoroughly identify and understand all important stakeholders. Second, it must prioritize them in case it cannot satisfy all of them. Power is the most critical criterion in prioritizing stakeholders. Other criteria might include the urgency of satisfying each particular stakeholder group and the degree of importance of each to the firm.[115]

When the firm earns above-average returns, the challenge of effectively managing stakeholder relationships is lessened substantially. With the capability and flexibility provided by above-average returns, a firm can more easily satisfy multiple stakeholders. When the firm earns only average returns, it is unable to maximize the interests of all stakeholders. The objective then becomes one of at least minimally satisfying each stakeholder.

Trade-off decisions are made in light of how important the support of each stakeholder group is to the firm. For example, environmental groups may be very important to firms in the energy industry but less important to professional service firms. A firm earning below-average returns does not have the capacity to minimally satisfy all stakeholders. The managerial challenge in this case is to make trade-offs that minimize the amount of support lost from stakeholders. Societal values also influence the general weightings allocated among the three stakeholder groups shown in Figure 1.4. Although all three groups are served by and, in turn, influence firms decisions in the major industrialized nations, the priorities in their service and influence vary because of cultural and institutional differences. Next, we present additional details about each of the three major stakeholder groups.

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As a firm formulates its strategy, it must consider all of its primary stakeholders in the product and capital markets as well as organizational shareholders.

Capital Market Stakeholders

Shareholders and lenders both expect a firm to preserve and enhance the wealth they have entrusted to it. The returns they expect are commensurate with the degree of risk they accept with those investments (i.e., lower returns are expected with low-risk investments, while higher returns are expected with high-risk investments). Dissatisfied lenders may impose stricter covenants on subsequent borrowing of capital. Dissatisfied shareholders may reflect their concerns through several means, including selling their stock. Institutional investors (e.g., pension funds, mutual funds) often are willing to sell their stock if the returns are not what they desire, or they may take actions to improve the firm's performance such as pressuring top managers and members of boards of directors to improve the strategic decisions and governance oversight.[116] Some institutions owning major shares of a firm's stock may have conflicting views of the actions needed, which can be challenging for managers. This is because some may want an increase in returns in the short-term while the others desire a focus on building long-term competitiveness.[117] Managers may have to balance their desires with those of other shareholders or prioritize the importance of the institutional owners with different goals. Clearly shareholders who hold a large share of stock (sometimes referred to as blockholders, see Chapter 10) are influential, especially in the determination of the firm's capital structure (i.e., the amount of equity versus the amount of debt used). Large shareholders often prefer that the firm minimize its use of debt because of the risk of debt, its cost, and the possibility that debt holders have first call on the firm's assets over the shareholders in case of default.[118]

When a firm is aware of potential or actual dissatisfactions among capital market stakeholders, it may respond to their concerns. The firm's response to stakeholders who are dissatisfied is affected by the nature of its dependence on them (which, as

noted earlier, is also influenced by a society's values). The greater and more significant the dependency is, the more likely the firm is to provide a significant response. Sometimes firms are unable to satisfy key stakeholders such as creditors and have to file for bankruptcy.

Product Market Stakeholders

Some might think that product market stakeholders (customers, suppliers, host communities, and unions) share few common interests. However, all four groups can benefit as firms engage in competitive battles. For example, depending on product and industry characteristics, marketplace competition may result in lower product prices being charged to a firm's customers and higher prices being paid to its suppliers (the firm might be willing to pay higher supplier prices to ensure delivery of the types of goods and services that are linked with its competitive success).[119]

Customers, as stakeholders, demand reliable products at the lowest possible prices. Suppliers seek loyal customers who are willing to pay the highest sustainable prices for the goods and services they receive. Although all product market stakeholders are important, without customers, the other product market stakeholders are of little value. Therefore, the firm must try to learn about and understand current and potential customers.[120]

Host communities are represented by national (home and abroad), state/province, and local government entities with which the firm must deal. Governments want companies willing to be long-term employers and providers of tax revenue without placing excessive demands on public support services. These stakeholders also influence the firm through laws and regulations. In fact, firms must deal with laws and regulations developed and enforced at the national, state, and local levels (the influence is polycentric—multiple levels of power and influence).[121]

Union officials are interested in secure jobs, under highly desirable working conditions, for employees they represent. Thus, product market stakeholders are generally satisfied when a firm's profit margin reflects at least a balance between the returns to capital market stakeholders (i.e., the returns lenders and shareholders will accept and still retain their interests in the firm) and the returns in which they share.

Organizational Stakeholders

Employees—the firm's organizational stakeholders—expect the firm to provide a dynamic, stimulating, and rewarding work environment. Employees generally prefer to work for a company that is growing and in which the employee can develop their skills, especially those skills required to be effective team members and to meet or exceed global work standards. Workers who learn how to use new knowledge productively are critical to organizational success. In a collective sense, the education and skills of a firm's workforce are competitive weapons affecting strategy implementation and firm performance.[122] Strategic leaders are ultimately responsible for serving the needs of organizational stakeholders on a day-to-day basis. In fact, to be successful, strategic leaders must effectively use the firm's human capital.[123] The importance of human capital to their success is probably why outside directors are more likely to propose layoffs compared to inside strategic leaders, while such insiders are likely to use preventative cost-cutting measures and seek to protect incumbent employees.[124] A highly important means of building employee skills for the global competitive landscape is through international assignments. The process of managing expatriate employees and helping them build knowledge can have significant effects over time on the firm's ability to compete in global markets.[125]

1-6 Strategic Leaders

Strategic leaders are people located in different areas and levels of the firm using the strategic management process to select strategic actions that help the firm achieve its vision and fulfill its mission. Regardless of their location in the firm, successful strategic leaders are decisive, committed to nurturing those around them, and committed to helping the firm create value for all stakeholder groups.[126] In this vein, research evidence suggests that employees who perceive that their CEO is a visionary leader also believe that the CEO leads the firm to operate in ways that are consistent with the values of all stakeholder groups rather than emphasizing only maximizing profits for shareholders. In turn, visionary leadership motivates employees to expend extra effort, thereby helping to increase firm performance.

Thomas SAMSON/Getty Images

Tony Hsieh, CEO of Zappos.com, an online shoe and clothing retailer, has been helpful in shaping Zappos's entrepreneurial culture.

When identifying strategic leaders, most of us tend to think of CEOs and other top-level managers. Clearly, these people are strategic leaders. In the final analysis, CEOs are responsible for making certain their firm effectively uses the strategic management process. Indeed, the pressure on CEOs to manage strategically is stronger than ever.[127] However, many other people help choose a firm's strategy and then determine the actions for successfully implementing it.[128] The main reason is that the realities of twenty-first century competition that we discussed earlier in this chapter (e.g., the global economy, globalization, rapid technological change, and the increasing importance of knowledge and people as sources of competitive advantage) are creating a need for those "closest to the action" to be making decisions and determining the actions to be taken. In fact, all managers (as strategic leaders) must think globally and act locally.[129] Thus, the most effective CEOs and top-level managers understand how to delegate strategic responsibilities to people throughout the firm who influence the use of organizational resources. Delegation also helps to avoid too much managerial hubris at the top and the problems it causes, especially in situations allowing significant managerial discretion.[130]

Organizational culture also affects strategic leaders and their work. In turn, strategic leaders' decisions and actions shape a firm's culture. **Organizational culture** refers to the complex set of ideologies, symbols, and core values that are shared throughout the firm and that influence how the firm conducts business. It is the social energy that drives—or fails to drive—the organization.[131] For example, Southwest Airlines is known for having a unique and valuable culture. Its culture encourages employees to work hard but also to have fun while doing so. Moreover, its culture entails respect for others—employees and customers alike. The firm also places a premium on service, as suggested by its commitment to provide POS (Positively Outrageous Service) to each customer.

Strategic leaders are people located in different areas and levels of the firm using the strategic management process to select strategic actions that help the firm achieve its vision and fulfill its mission.

Organizational culture refers to the complex set of ideologies, symbols, and core values that are shared throughout the firm and that influence how the firm conducts business.

1-6a The Work of Effective Strategic Leaders

Perhaps not surprisingly, hard work, thorough analyses, a willingness to be brutally honest, a penchant for wanting the firm and its people to accomplish more, and tenacity are prerequisites to an individual's success as a strategic leader. The top strategic

leaders are chosen on the basis of their capabilities (their accumulation of human capital and skills over time). Effective top management teams (those with better human capital, management skills, and cognitive abilities) make better strategic decisions.[132] In addition, strategic leaders must have a strong strategic orientation while simultaneously embracing change in the dynamic competitive landscape we have discussed.[133] In order to deal with this change effectively, strategic leaders must be innovative thinkers and promote innovation in their organization.[134] Promoting innovation is facilitated by a diverse top management team representing different types of expertise and leveraging relationships with external parties.[135] Strategic leaders can best leverage partnerships with external parties and organizations when their organizations are ambidextrous, both innovative and good at execution.[136] In addition, strategic leaders need to have a global mind-set, or sometimes referred to as an ambicultural approach to management.[137]

Strategic leaders, regardless of their location in the organization, often work long hours, and their work is filled with ambiguous decision situations. However, the opportunities afforded by this work are appealing and offer exciting chances to dream and to act. The following words, given as advice to the late Time Warner chair and co-CEO Steven J. Ross by his father, describe the opportunities in a strategic leader's work:

There are three categories of people—the person who goes into the office, puts his feet up on his desk, and dreams for 12 hours; the person who arrives at 5 A.M. and works for 16 hours, never once stopping to dream; and the person who puts his feet up, dreams for one hour, then does something about those dreams.[138]

The operational term used for a dream that challenges and energizes a company is vision. The most effective strategic leaders provide a vision as the foundation for the firm's mission and subsequent choice and use of one or more strategies.[139]

1-7 The Strategic Management Process

As suggested by Figure 1.1, the strategic management process is a rational approach firms use to achieve strategic competitiveness and earn above-average returns. Figure 1.1 also features the topics we examine in this book to present the strategic management process.

This book is divided into three parts aligned with the A-S-P process explained in the beginning of the chapter. In Part 1, we describe the *analyses* (A) necessary for developing strategies. Specifically, we explain what firms do to analyze their external environment (Chapter 2) and internal organization (Chapter 3). These analyses are completed to identify marketplace opportunities and threats in the external environment (Chapter 2) and to decide how to use the resources, capabilities, core competencies, and competitive advantages in the firm's internal organization to pursue opportunities and overcome threats (Chapter 3). The analyses explained in Chapters 2 and 3 are the well-known SWOT analyses (strengths, weaknesses, opportunities, threats).[140] Firms use knowledge about its external environment and internal organization, then formulates its strategy taking into account its vision and mission.

The firm's analyses (see Figure 1.1) provide the foundation for choosing one or more *strategies* (S) and deciding which one(s) to implement. As suggested in Figure 1.1 by the horizontal arrow linking the two types of strategic actions, formulation and implementation must be simultaneously integrated for a successful strategic management process. Integration occurs as decision makers review implementation issues

when choosing strategies and consider possible changes to the firm's strategies while implementing a current strategy.

In Part 2 of this book, we discuss the different strategies firms may choose to use. First, we examine business-level strategies (Chapter 4). A business-level strategy describes the actions a firm takes to exploit its competitive advantage over rivals. A company competing in a single product market (e.g., a locally owned grocery store operating in only one location) has but one business-level strategy, while a diversified firm competing in multiple product markets (e.g., General Electric) forms a business-level strategy for each of its businesses. In Chapter 5, we describe the actions and reactions that occur among firms in marketplace competition. Competitors typically respond to and try to anticipate each other's actions. The dynamics of competition affect the strategies firms choose as well as how they try to implement the chosen strategies.[141]

For the diversified firm, corporate-level strategy (Chapter 6) is concerned with determining the businesses in which the company intends to compete as well as how to manage its different businesses. Other topics vital to strategy formulation, particularly in the diversified company, include acquiring other businesses and, as appropriate, restructuring the firm's portfolio of businesses (Chapter 7) and selecting an international strategy (Chapter 8). With cooperative strategies (Chapter 9), firms form a partnership to share their resources and capabilities in order to develop a competitive advantage. Cooperative strategies are becoming increasingly important as firms seek ways to compete in the global economy's array of different markets.[142]

To examine actions taken to implement strategies, we consider several topics in Part 3 of the book. First, we examine the different mechanisms used to govern firms (Chapter 10). With demands for improved corporate governance being voiced by many stakeholders in the current business environment, organizations are challenged to learn how to simultaneously satisfy their stakeholders' different interests.[143] Finally, the organizational structure and actions needed to control a firm's operations (Chapter 11), the patterns of strategic leadership appropriate for today's firms and competitive environments (Chapter 12), and strategic entrepreneurship (Chapter 13) as a path to continuous innovation are addressed.

It is important to emphasize that primarily because they are related to how a firm interacts with its stakeholders, almost all strategic management process decisions have ethical dimensions.[144] Organizational ethics are revealed by an organization's culture; that is to say, a firm's decisions are a product of the core values that are shared by most or all of a company's managers and employees. Especially in the turbulent and often ambiguous competitive landscape in the global economy, those making decisions as a part of the strategic management process must understand how their decisions affect capital market, product market, and organizational stakeholders differently and regularly evaluate the ethical implications of their decisions.[145] Decision makers failing to recognize these realities accept the risk of placing their firm at a competitive disadvantage.[146]

As you will discover, the strategic management process examined in this book calls for disciplined approaches to serve as the foundation for developing a competitive advantage. Therefore, it has a major effect on the *performance* (P) of the firm.[147] Performance is reflected in the firm's ability to achieve strategic competitiveness and earn above-average returns. Mastery of this strategic management process will effectively serve you, our readers, and the organizations for which you will choose to work.

SUMMARY

- Firms use the strategic management process to achieve strategic competitiveness and earn above-average returns. Firms *analyze* the external environment and their internal organization, then formulate and implement a *strategy* to achieve a desired level of *performance* (A-S-P). Performance is reflected by the firm's level of strategic competitiveness and the extent to which it earns above-average returns. Strategic competitiveness is achieved when a firm develops and implements a value-creating strategy. Above-average returns (in excess of what investors expect to earn from other investments with similar levels of risk) provide the foundation needed to simultaneously satisfy all of a firm's stakeholders.
- The fundamental nature of competition is different in the current competitive landscape. As a result, those making strategic decisions must adopt a different mind-set, one that allows them to learn how to compete in highly turbulent and chaotic environments that produce a great deal of uncertainty. The globalization of industries and their markets along with rapid and significant technological changes are the two primary factors contributing to the turbulence of the competitive landscape.
- Firms use two major models to help develop their vision and mission when choosing one or more strategies in pursuit of strategic competitiveness and above-average returns. The core assumption of the I/O model is that the firm's external environment has a large influence on the choice of strategies more than do the firm's internal resources, capabilities, and core competencies. Thus, the I/O model is used to understand the effects an industry's characteristics can have on a firm when deciding what strategy or strategies to use in competing against rivals. The logic supporting the I/O model suggests that above-average returns are earned when the firm locates an attractive industry or part of an industry and successfully implements the strategy dictated by that industry's characteristics. The core assumption of the resource-based model is that the firm's unique resources, capabilities, and core competencies have more of an influence on selecting and using strategies than does the firm's external environment. Above-average returns are earned when the firm uses its valuable, rare, costly-to-imitate, and non-substitutable resources and capabilities to compete against its rivals in one or more industries. Evidence indicates that both models yield insights that are linked to successfully selecting and using strategies. Thus, firms want to use their unique resources, capabilities, and core competencies as the foundation to engage in one or more strategies that allow them to effectively compete against rivals in their industry.
- Vision and mission are formed to guide the selection of strategies based on the information from the analyses of the firm's internal organization and external environment. Vision is a picture of what the firm wants to be and, in broad terms, what it wants to ultimately achieve. Flowing from the vision, the mission specifies the business or businesses in which the firm intends to compete and the customers it intends to serve. Vision and mission provide direction to the firm and signal important descriptive information to stakeholders.
- Stakeholders are those who can affect, and are affected by, a firm's performance. Because a firm is dependent on the continuing support of stakeholders (shareholders, customers, suppliers, employees, host communities, etc.), they have enforceable claims on the company's performance. When earning above-average returns, a firm generally has the resources it needs to satisfy the interests of all stakeholders. However, when earning only average returns, the firm must carefully manage its stakeholders in order to retain their support. A firm earning below-average returns must minimize the amount of support it loses from unsatisfied stakeholders.
- Strategic leaders are people located in different areas and levels of the firm using the strategic management process to help the firm achieve its vision and fulfill its mission. In general, CEOs are responsible for making certain that their firms properly use the strategic management process. The effectiveness of the strategic management process is increased when it is grounded in ethical intentions and behaviors. The strategic leader's work demands decision trade-offs, often among attractive alternatives. It is important for all strategic leaders, especially the CEO and other members of the top-management team, to conduct thorough analyses of conditions facing the firm, be brutally and consistently honest, and work jointly to select and implement the correct strategies.

KEY TERMS

above-average returns 5
average returns 6
capability 16
competitive advantage 4
core competencies 16
global economy 8
hypercompetition 7
mission 19
organizational culture 25
resources 16

risk 5
stakeholders 19
strategic competitiveness 4
strategic flexibility 13
strategic leaders 25
strategic management process 6
strategy 4
vision 18

REVIEW QUESTIONS

1. What are strategic competitiveness, strategy, competitive advantage, above-average returns, and the strategic management process?
2. What are the characteristics of the current competitive landscape? What two factors are the primary drivers of this landscape?
3. According to the I/O model, what should a firm do to earn above-average returns?
4. What does the resource-based model suggest a firm should do to earn above-average returns?
5. What are vision and mission? What is their value for the strategic management process?
6. What are stakeholders? How do the three primary stakeholder groups influence organizations?
7. How would you describe the work of strategic leaders?
8. What are the elements of the strategic management process? How are they interrelated?

Mini-Case

Competition in the Airlines Industry

For many years, the airline industry was highly regulated which resulted in most airlines acting like each other by definition. However, the similarities among the large airline companies remained after the industry was partially deregulated more than 30 years ago. These similarities–in services, routes, and performance–have persisted even to the present time. For example, airlines often offer a new service (e.g., Wi-Fi availability on flights), but these services are easily imitated, therefore, any differentiation in offerings is only temporary.

In recent times, consolidation has occurred in both European and U.S. airline industries. In particular, poor performance led U.S. Air and America West to merge. Additionally, much for the same reasons, Northwest Airlines and Delta Airlines merged. Likewise United Airlines and Continental merged to create the largest airline in the industry. More recently, American Airlines and U.S. Air have been approved to merge. Much of the consolidation was approved because several of the airlines went through bankruptcy proceedings (e.g., Continental and United both went through bankruptcy before their merger). All of these mergers, however, have not created highly differentiated services (or prices). All of airlines largely provide the same type of services, and prices do not differ greatly among the large "full-service" carriers.

In fact, it seems that the primary competition is in trying to make fewer mistakes. In fact, industry statistics that report positive accounts, announce such outcomes as a reduction in lost bags, fewer cancellations of flights, and fewer delays. What this suggests is that all of these areas still likely represent major problem areas. It seems pretty bad when the most positive statement one can make is that fewer bags have been lost in recent times. Although profits have been up more recently, this is primarily due to lower fuel costs and stronger demand because the economy is growing, something that is not controlled by those in charge of the strategy.

Obviously, there are differences between airlines across time. United, the largest airline, merged with Continental to create more financial efficiencies and to offer greater travel options to customers.

However, it has had significant problems making the merger of the two systems work effectively. In fact, it announced a major net loss for 2012 because of its problems. For example, in November 2012, a computer malfunction (software problem) caused the delay of 250 of United's flights globally for almost two hours. Its reservation system failed twice during 2012, which shut down its website, stranding passengers as flights were then delayed or cancelled. United's on time performance suffered and was once of the worst in the industry for 2012. The number of customer complaints for United was much higher than in the past. In short, it is relatively easy to determine why the airline suffered a serious net loss in 2012. Yet, Delta, which performed very poorly a few years earlier, performed better in 2014. It made a net profit for the third year in a row. Its on-time performance was about 10 percentage points higher than United's. And, while United is eliminating flights and furloughing employees to cuts costs (trying to make a profit), in 2012 Delta purchased a 49 percent share of Virgin Atlantic to gain access to the highly valuable New York–London routes and gates in both locations. Delta was also one of the first airlines to introduce Wi-Fi to passengers during flights, although most other airlines have duplicated this service. Interestingly, the one program most airlines have used to establish some differentiation is their loyalty programs. However, benefits of these loyalty programs have been decreasing over time with less availability and more miles deducted. Furthermore, research shows that airlines attrack brand switching customers who tend to move to the brand with the most perks for them at the time.

Certainly, some reduced-service airlines have fared much better in most of the categories noted above (e.g., profits, on-time flights, customer complaints). Among these is Southwest Airlines. Interestingly, while it started as a low-price airline (and has maintained this feature), it also has generally offered superior service compared to the full-service airlines. The large airlines tried, but were unable, to imitate Southwest. In effect, Southwest developed its resources and capabilities which over time allowed it to provide service much more effectively and at a lower price than its full-service rivals. However, JetBlue has duplicated much of Southwest's strategy, although it is focused on business travelers.

Sources: E. Glusac, 2015, What price loyalty?, *Entrepreneur*, May, 16; S. Sharf, 2015, American Airlines reports lower revenue, higher profit, *Forbes*, www.forbes.com, April 24; S. Schaefer, 2015, Cleared for takeoff. *Forbes Asia*, May, 18; C. M. Voorhees, R. C. White, M. McCall, & P. Randhawa, 2015, Fool's gold? Assessing the impact of the value of airline loyalty programs on brand equity perceptions and share of wallet, *Cornell Hospitality Quarterly*, 56(2): 202–212; 2013, Anatomy of 99.5%, Delta Airlines Website, blog.delta.com, February 15; S. McCartney, 2013, Believe it or not, flying is improving, *Wall Street Journal*, www.wsj.com, January 9; J. Freed, 2012, Delta grabs bigger share of key NY–London route, *Bloomberg Businessweek*, www.businessweek.com, December 11; D. Benoit, 2012, Delta lands London space with Virgin joint venture, *Wall Street Journal*, blogs.wsj.com/deals, December 11; J. Mouawad, 2012, For United, big problems at biggest airline, *New York Times*, www.nytimes.com, November 28; C. Negroni, 2012, Good airlines news: Losing fewer bags, *New York Times*, www.nytimes.com, August 6.

Case Discussion Questions

1. How important is the environment to the performance of airlines in the airline industry? What does this suggest regarding the industrial organization (I/O) model to explain how firms can earn above-average returns?
2. Why is there a lot of imitation in the airlines industry, and how does this affect firm performance?
3. How important is the resource-based model to explain how well firms perform in the airlines industry?
4. How can strategic leaders be successful in an industry like the airlines industry?

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2

The External Environment: Opportunities, Threats, Industry Competition, and Competitor Analysis

Studying this chapter should provide you with the strategic management knowledge needed to:

2-1 Explain the importance of analyzing and understanding the firm's external environment.

2-2 Define and describe the general environment and the industry environment.

2-3 Discuss the four parts of the external environmental analysis process.

2-4 Name and describe the general environment's seven segments.

2-5 Identify the five competitive forces and explain how they determine an industry's profitability potential.

2-6 Define strategic groups and describe their influence on firms.

2-7 Describe what firms need to know about their competitors and different methods (including ethical standards) used to collect intelligence about them.

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ARE THERE CRACKS IN THE GOLDEN ARCHES?

McDonald's is the largest restaurant chain in the world. It has 14,350 restaurants in the United States, with the largest market share of any such chain (7.3 percent). In total, it has more than 36,000 restaurants worldwide. Over the years, McDonald's was a leader, not only in market share, but also with the introduction of new menu items to the fast food market. For example, it first introduced breakfast items to this market, and its breakfast menu now accounts for about 25 percent of its sales. It successfully introduced Chicken McNuggets to this market, and currently, McDonald's is the single largest restaurant customer of Tyson Foods, the largest distributor of chicken products. In more recent years, McDonald's successfully introduced gourmet coffee products and began to compete against Starbucks. With all of this success, what is the problem?

The problems revolve around competition and changing consumer tastes. Consumers have become more health-conscious, and competitors have been more attuned to customer desires. As a result, McDonald's suffered a decline in its total sales revenue of 2.4 percent and a drop in net income of 15 percent in 2014. This was the first decline in both figures in 33 years. It seems that McDonald's did a poor job of analyzing its environment and especially its customers and competitors. During this same time, some of McDonald's competitors flourished. For example, Sonic enjoyed a 7 percent increase in its sales, and Chipotle recorded a large 20 percent increase. Other specialty burger restaurants, such as Smashburger, have stolen business from McDonald's even though their burgers are priced a little higher than McDonald's burgers. The quality of these competitors' products is perceived to be higher and many are "made to order" and thus customized to the customer's desires. And, partly because the volume and complexity of the McDonald's menu items have grown, the time required for service has also increased. This change has been most evident in the drive-through lanes in which the wait time has grown by approximately 20 percent in recent years.

Ruaridh Stewart/ZUMA Press/Newscom

Because of the lack of understanding the changing market and competitive landscape, McDonald's was unable to be proactive and now is in a reactive mode. For example, in 2013, it decided to add chicken wings to its menu. Wings were sold successfully at McDonald's in Hong Kong, and it imported its "cayenne-and-chili-pepper coating" used there. The market test for the wings in Atlanta was successful, so the firm implemented a major campaign to sell them at its restaurants throughout the United States. The eight-week campaign was a miserable failure (some referred to it as the "mighty wings debacle"). Perhaps they were too spicy for the broad market, but some believe that they were also too expensive at $1.00 per wing, with a box of five wings costing $1.00 more than a similar number at KFC. Because of these problems, McDonald's hired a new CEO in 2015, hoping to overcome its woes.

The new CEO must act quickly. McDonald's has recently announced that it is changing to use only chickens raised without antibiotics to be sensitive to human health concerns. It has also market tested custom hamburgers in Australia with success. In fact, Australia is one of

McDonald's bright spots around the world. Sales have increased in Australia when they have fallen in the United States, Europe, and Asia. Making major changes to the McDonald's menu is challenging partly because of its scale and supply chain. It orders hundreds of millions of pounds of chicken each year, so it will take a few years to fully implement the change to antibiotic-free chicken. Changing vegetables in Happy Meals (e.g., adding baby carrots) and implementing new wraps which require additional (new) vegetables (such as cucumbers) will take time because they require obtaining large scale suppliers that can provide the necessary quantity and quality at the right price and in the right location(s).

McDonald's was once a leader, and now it is fighting from behind, trying to stem its downturn. It has to respond quickly and effectively to its external environment, especially its customers and competitors.

Sources: A. Gasparro, 2015, For McDonald's, a minor menu change takes planning, MSN, www.msn.com/en-us/money, March 5; A. Gasparro, 2015, McDonald's new chief plots counter attack, *Wall Street Journal*, www.wsj.com, March 1; M. Hefferman, 2015, It's still a happy meal in Australia for McDonald's, *Sidney Times Herald*, www.smh.com.au, March 10; J. Kell, 2015, McDonald's sales still down as a new CEO takes the helm, *Fortune*, www.Fortune.com, March 9; D. Shanker, 2015, Dear McDonald's new CEO: Happy first day. Here's some (unsolicited) advice, *Fortune*, www.Fortune.com, March 2; S. Strom, 2015, McDonald's seeks its fast-food soul, *New York Times*, www.nytimes.com, March 7; S. Strom, 2015, McDonald's tests custom burgers and other new concepts as sales drop, *New York Times*, www.nytimes.com, January 23; B. Kowitt, 2014, Fallen Arches, *Fortune*, December, 106–116.

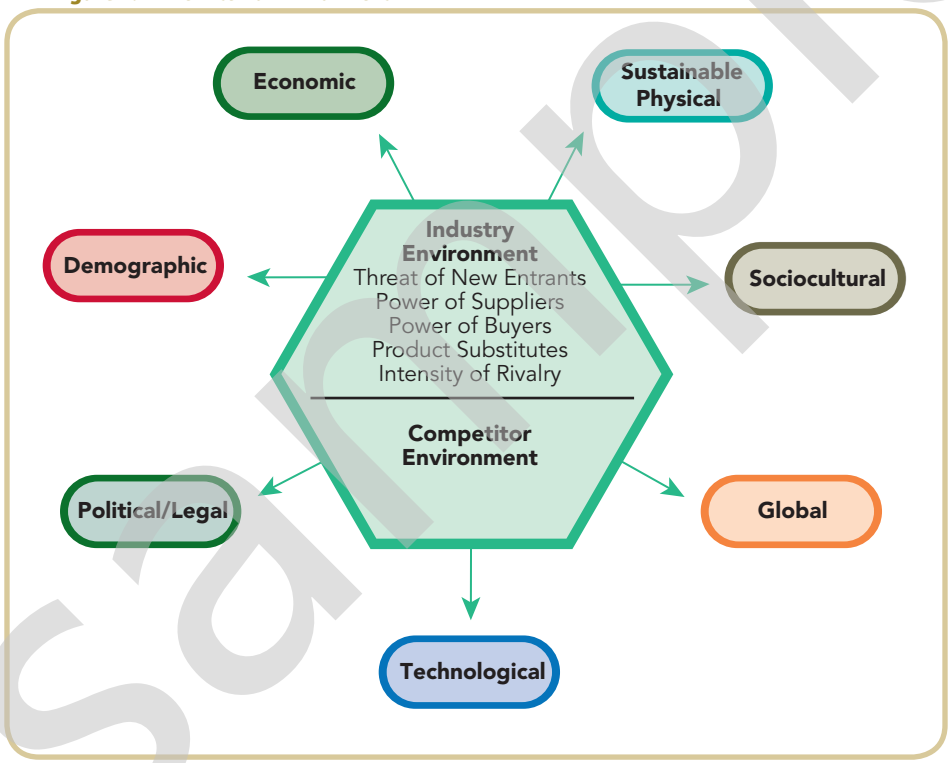
As suggested in the Opening Case and by research, the external environment (which includes the industry in which a firm competes as well as those against whom it competes) affects the competitive actions and responses firms take to outperform competitors and earn above-average returns.[1] For example, McDonald's has been experiencing a reduction in returns in recent times because of changing consumer tastes and enhanced competition. McDonald's is attempting to respond to the threats from its environment by changing its menu and types of supplies purchased. The sociocultural segment of the general environment (discussed in this chapter) is the source of some of the changing values in society placing a great emphasis on healthy food choices. The Opening Case also describes some of the ways McDonald's is responding to the specific concerns for health by purchasing only chicken that has not received antibiotics.

As noted in Chapter 1, the characteristics of today's external environment differ from historical conditions. For example, technological changes and the continuing growth of information gathering and processing capabilities increase the need for firms to develop effective competitive actions and responses on a timely basis.[2] (We fully discuss competitive actions and responses in Chapter 5.) Additionally, the rapid sociological changes occurring in many countries affect labor practices and the nature of products that increasingly diverse consumers demand. Governmental policies and laws also affect where and how firms choose to compete.[3] And, changes to a number of nations' financial regulatory systems that have been enacted since 2010 are expected to increase the complexity of organizations' financial transactions.[4]

Firms understand the external environment by acquiring information about competitors, customers, and other stakeholders to build their own base of knowledge and capabilities.[5] On the basis of the new information, firms take actions, such as building new capabilities and core competencies, in hopes of buffering themselves from any negative environmental effects and to pursue opportunities as the basis for better serving their stakeholders' needs.[6]

In summary, a firm's competitive actions and responses are influenced by the conditions in the three parts (the general, industry, and competitor) of its external environment (see Figure 2.1) and its understanding of those conditions. Next, we fully describe each part of the firm's external environment.

Figure 2.1 The External Environment



2-1 The General, Industry, and Competitor Environments

The **general environment** is composed of dimensions in the broader society that influence an industry and the firms within it.[7] We group these dimensions into seven environmental *segments:* demographic, economic, political/legal, sociocultural, technological, global, and sustainable physical. Examples of *elements* analyzed in each of these segments are shown in Table 2.1.

Firms cannot directly control the general environment's segments. Accordingly, what a company seeks to do is recognize trends in each segment of the general environment and then *predict* each trend's effect on it. For example, it has been predicted that over the next 10 to 20 years, millions of people living in emerging market countries will join the middle class. In fact, by 2030, it is predicted that two-thirds of the global middle class, about 525 million people, will live in the Asia-Pacific region of the world. Of course no firm, including large multinationals, is able to control where growth in potential customers may take place in the next decade or two. Nonetheless, firms must study this anticipated trend as a foundation for predicting its effects on their ability to identify strategies to use that will allow them to remain successful as market conditions change.[8]

The **industry environment** is the set of factors that directly influences a firm and its competitive actions and responses: the threat of new entrants, the power of suppliers, the power of buyers, the threat of product substitutes, and the intensity of rivalry among competing firms.[9] In total, the interactions among these five factors

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Table 2.1 The General Environment: Segments and Elements

Demographic segment	• Population size • Age structure • Geographic distribution	• Ethnic mix • Income distribution
Economic segment	• Inflation rates • Interest rates • Trade deficits or surpluses • Budget deficits or surpluses	• Personal savings rate • Business savings rates • Gross domestic product
Political/Legal segment	• Antitrust laws • Taxation laws • Deregulation philosophies	• Labor training laws • Educational philosophies and policies
Sociocultural segment	• Women in the workforce • Workforce diversity • Attitudes about the quality of work life	• Shifts in work and career preferences • Shifts in preferences regarding product and service characteristics
Technological segment	• Product innovations • Applications of knowledge	• Focus of private and government-supported R&D expenditures • New communication technologies
Global segment	• Important political events • Critical global markets	• Newly industrialized countries • Different cultural and institutional attributes
Sustainable physical environment segment	• Energy consumption • Practices used to develop energy sources • Renewable energy efforts • Minimizing a firm's environmental footprint	• Availability of water as a resource • Producing environmentally friendly products • Reacting to natural or man-made disasters

determine an industry's profitability potential; in turn, the industry's profitability potential influences the choices each firm makes about its competitive actions and responses. The challenge for a firm is to locate a position within an industry where it can favorably influence the five factors or where it can successfully defend itself against their influence. The greater a firm's capacity to favorably influence its industry environment, the greater the likelihood it will earn above-average returns.

How companies gather and interpret information about their competitors is called **competitor analysis**. Understanding the firm's competitor environment complements the insights provided by studying the general and industry environments.[10] This means, for example, that McDonald's needs to do a better job of analyzing and understanding its general and industry environments.

An analysis of the general environment focuses on environmental trends and their implications, an analysis of the industry environment focuses on the factors and conditions influencing an industry's profitability potential, and an analysis of competitors is focused on predicting competitors' actions, responses, and intentions. In combination, the results of these three analyses influence the firm's vision, mission, choice of strategies, and the competitive actions and responses it will take to implement those strategies. Although we discuss each analysis separately, the firm can develop and implement a more effective strategy when it effectively integrates the insights provided by analyses of the general environment, the industry environment, and the competitor environment.

How companies gather and interpret information about their competitors is called **competitor analysis**.

2-2 External Environmental Analysis

Most firms face external environments that are turbulent, complex, and global—conditions that make interpreting those environments difficult.[11] To cope with often ambiguous and incomplete environmental data and to increase understanding of the general environment, firms complete an *external environmental analysis*. This analysis has four parts: scanning, monitoring, forecasting, and assessing (see Table 2.2).

Identifying opportunities and threats is an important objective of studying the general environment. An **opportunity** is a condition in the general environment that, if exploited effectively, helps a company reach strategic competitiveness. Most companies—and certainly large ones—continuously encounter multiple opportunities as well as threats.

In terms of possible opportunities, a combination of cultural, political, and economic factors is resulting in rapid retail growth in parts of Africa, Asia, and Latin America. Accordingly, Walmart, the world's largest retailer, and the next three largest global giants (France's Carrefour, U.K.–based Tesco, and Germany's Metro) are expanding in these regions. Walmart is expanding its number of retail units in Chile (404 units), India (20 units), and South Africa (360 units). Interestingly, Carrefour exited India after four years and in the same year (2014) that Tesco opened stores in India. While Metro closed its operations in Egypt, it has stores in China, Russia, Japan, Vietnam, and India in addition to many eastern European countries.[12]

A **threat** is a condition in the general environment that may hinder a company's efforts to achieve strategic competitiveness.[13] Finnish-based Nokia Corp. is dealing with threats including one regarding its intellectual property rights. In mid-2013, the company filed two complaints against competitor HTC Corp. alleging that the Taiwanese smartphone manufacturer had infringed on nine of Nokia's patents. However, the patent dispute ended in 2014 when the two companies signed a collaboration agreement.[14] This threat obviously deals with the political/legal segment.

Firms use multiple sources to analyze the general environment through scanning, monitoring, forecasting, and assessing. Examples of these sources include a wide variety of printed materials (such as trade publications, newspapers, business publications, and the results of academic research and public polls), trade shows, and suppliers, customers, and employees of public-sector organizations. Of course, the information available from Internet sources is of increasing importance to a firm's efforts to study the general environment.

2-2a Scanning

Scanning entails the study of all segments in the general environment. Although challenging, scanning is critically important to the firms' efforts to understand trends in the general environment and to predict their implications. This is particularly the case for companies competing in highly volatile environments.[15]

Table 2.2 Parts of the External Environment Analysis

Scanning	• **Identifying early signals of environmental changes and trends**
Monitoring	• **Detecting meaning through ongoing observations of environmental changes and trends**
Forecasting	• **Developing projections of anticipated outcomes based on monitored changes and trends**
Assessing	• **Determining the timing and importance of environmental changes and trends for firms' strategies and their management**

An **opportunity** is a condition in the general environment that, if exploited effectively, helps a company reach strategic competitiveness.

A **threat** is a condition in the general environment that may hinder a company's efforts to achieve strategic competitiveness.

Through scanning, firms identify early signals of potential changes in the general environment and detect changes that are already under way.[16] Scanning activities must be aligned with the organizational context; a scanning system designed for a volatile environment is inappropriate for a firm in a stable environment.[17] Scanning often reveals ambiguous, incomplete, or unconnected data and information that require careful analysis.

Many firms use special software to help them identify events that are taking place in the environment and that are announced in public sources. For example, news event detection uses information-based systems to categorize text and reduce the trade-off between an important missed event and false alarm rates. Increasingly, these systems are used to study social media outlets as sources of information.[18]

Broadly speaking, the Internet provides a wealth of opportunities for scanning. Amazon.com, for example, records information about individuals visiting its website, particularly if a purchase is made. Amazon then welcomes these customers by name when they visit the website again. The firm sends messages to customers about specials and new products similar to those they purchased in previous visits. A number of other companies, such as Netflix, also collect demographic data about their customers in an attempt to identify their unique preferences (demographics is one of the segments in the general environment). More than 2.4 billion people use the Internet in some way including about 78.6 percent of the population in North America and 63.2 percent in Europe. So the Internet represents a healthy opportunity to gather information on users.[19]

2-2b Monitoring

When *monitoring*, analysts observe environmental changes to see if an important trend is emerging from among those spotted through scanning.[20] Critical to successful monitoring is the firm's ability to detect meaning in environmental events and trends. For example, those monitoring retirement trends in the United States learned in 2013 that 57 percent of U.S. workers surveyed reported that excluding the value of their home, they have only $25,000 or less in savings and investments set aside for their retirement. This particular survey also discovered "that 28 percent of Americans have no confidence they will have enough money to retire comfortably—the highest level in the (survey's) 23-year history."[21] Partly because of the major economic recessions and low wage growth, 67 percent of respondents to a more recent survey suggested that they had savings that would cover only six months or less of their expenses. And, approximately 28 percent of the respondents said that they had no savings.[22] Firms seeking to serve retirees' financial needs will continue monitoring this change in workers' savings and investment patterns to see if a trend is developing. Once they identify that saving less for retirement (or other needs) is indeed a trend, these firms will seek to understand its competitive implications.

Effective monitoring requires the firm to identify important stakeholders and understand its reputation among these stakeholders as the foundation for serving their unique needs.[23] (Stakeholders' unique needs are described in Chapter 1.) One means of monitoring major stakeholders is by using directors that serve on other boards of directors (referred to as interlocking directorates). They facilitate information and knowledge transfer from external sources.[24] Scanning and monitoring are particularly important when a firm competes in an industry with high technological uncertainty.[25] Scanning and monitoring can provide the firm with information. These activities also serve as a means of importing knowledge about markets and about how to successfully commercialize the new technologies the firm has developed.[26]

2-2c Forecasting

Scanning and monitoring are concerned with events and trends in the general environment at a point in time. When *forecasting*, analysts develop feasible projections of what

might happen, and how quickly, as a result of the events and trends detected through scanning and monitoring.[27] For example, analysts might forecast the time that will be required for a new technology to reach the marketplace, the length of time before different corporate training procedures are required to deal with anticipated changes in the composition of the workforce, or how much time will elapse before changes in governmental taxation policies affect consumers' purchasing patterns.

Forecasting events and outcomes accurately is challenging. Forecasting demand for new technological products is difficult because technology trends are continually driving product life cycles shorter. This is particularly difficult for a firm such as Intel, whose products go into many customers' technological products, which are consistently updated. Increasing the difficulty, each new wafer fabrication or silicon chip technology production plant in which Intel invests becomes significantly more expensive for each generation of chip products. In this instance, having access to tools that allow better forecasting of electronic product demand is of value to Intel as the firm studies conditions in its external environment.[28]

2-2d Assessing

When *assessing*, the objective is to determine the timing and significance of the effects of environmental changes and trends that have been identified.[29] Through scanning, monitoring, and forecasting, analysts are able to understand the general environment. Additionally, the intent of assessment is to specify the implications of that understanding. Without assessment, the firm has data that may be interesting but of unknown competitive relevance. Even if formal assessment is inadequate, the appropriate interpretation of that information is important.

Accurately assessing the trends expected to take place in the segments of a firm's general environment is important. However, accurately interpreting the meaning of those trends is even more important. In slightly different words, although gathering and organizing information is important, appropriately interpreting the intelligence the collected information provides to determine if an identified trend in the general environment is an opportunity or threat is critical.[30]

2-3 Segments of the General Environment

The general environment is composed of segments that are external to the firm (see Table 2.1). Although the degree of impact varies, these environmental segments affect all industries and the firms competing in them. The challenge to each firm is to scan, monitor, forecast, and assess the elements in each segment to predict their effects on it. Effective scanning, monitoring, forecasting, and assessing are vital to the firm's efforts to recognize and evaluate opportunities and threats.

2-3a The Demographic Segment

The **demographic segment** is concerned with a population's size, age structure, geographic distribution, ethnic mix, and income distribution.[31] Demographic segments are commonly analyzed on a global basis because of their potential effects across countries' borders and because many firms compete in global markets.

Population Size

The **demographic segment** is concerned with a population's size, age structure, geographic distribution, ethnic mix, and income distribution.

The world's population doubled (from 3 billion to 6 billion) between 1959 and 1999. Current projections suggest that population growth will continue in the twenty-first century, but at a slower pace. In 2015, the world's population was 7.3 billion, and it is projected to be 9 billion by 2042 and roughly 9.25 billion by 2050.[32] In 2015, China was the world's

largest country by population with approximately 1.4 billion people. By 2050, however, India is expected to be the most populous nation in the world (approximately 1.69 billion). China (1.4 billion), the United States (439 million), Indonesia (313 million), and Pakistan (276 million) are expected to be the next four most populous countries in 2050.[33] Firms seeking to find growing markets in which to sell their goods and services want to recognize the market potential that may exist for them in these five nations.

Firms also want to study changes occurring within the populations of different nations and regions of the world to assess their strategic implications. For example, 23 percent of Japan's citizens are 65 or older, while the United States and China will not reach this level until 2036.[34] Aging populations are a significant problem for countries because of the need for workers and the burden of supporting retirement programs. In Japan and some other countries, employees are urged to work longer to overcome these problems.

Age Structure

The most noteworthy aspect of this element of the demographic segment is that the world's population is rapidly aging. For example, predictions are that "by 2050, over one-fifth of the U.S. population will be 65 or older up from the current figure (in 2012) of one-seventh. The number of centenarians worldwide will double by 2023 and double again by 2035. Projections suggest life expectancy will surpass 100 in some industrialized countries by the second half of this century—roughly triple the lifespan that prevailed worldwide throughout most of human history."[35] In China, the 65 and over population is expected to reach roughly 330 million by 2050, which will be close to one-fourth of the nation's total population.[36] In the 1950s, Japan's population was one of the youngest in the world. However, 45 is now the median age in Japan, with the projection that it will be 55 by 2040. With a fertility rate that is below replacement value, another prediction is that by 2040 there will be almost as many Japanese people 100 years old or older as there are newborns.[37] By 2050, almost 25 percent of the world's population will be aged 65 or older. These changes in the age of the population have significant implications for availability of qualified labor, healthcare retirement policies, and business opportunities among others.[38]

In Japan, an expectation that the working age population will shrink from 81 million to about 57 million by 2040 threatens companies with an inadequate workforce. On the other hand, there may be an opportunity for Japanese firms to increase the productivity of their workers and/or to establish additional operations in other nations. A potential opportunity is represented by delayed retirements of baby boomers (those born between 1947 and 1965) expected in the United States (and perhaps other countries). Delayed retirements may help companies "avoid or defer the baby-boomer brain drain that has been looming for so long." In this sense, "organizations now have a fresh opportunity to address the talent gap created by a shortage of critical skills in the marketplace as well as the experience gap created by multiple waves of downsizing over the past decade."[39] Firms can also use their older more experienced workers to transfer their knowledge to younger employees, helping them to quickly gain valuable skills. There is also an opportunity for firms to more effectively use the talent available in the workforce. For example, moving women into higher level professional and managerial jobs could offset the challenges created by decline in overall talent availability. And, based on research, it may even enhance overall outcomes.[40]

Geographic Distribution

How a population is distributed within countries and regions is subject to change over time. For example, over the last few decades the U.S. population has shifted from

states in the Northeast and Great Lakes region to states in the west (California), south (Florida), and southwest (Texas). California's population has grown by approximately 5 million since 2000, while Texas's population has grown by 6.1 million, and Florida's by 3.9 million in the same time period.[41] These changes are characterized as moving from the "Frost Belt" to the "Sun Belt." Outcomes from these shifts include the facts that the gross domestic product (GDP) of California in 2011 was just under $2 trillion, an amount that makes California the ninth-largest economy in the world. In this same year, at a value of $1.3 trillion, Texas' GDP was second to that of California.[42]

The least popular states, based on people leaving in recent years, are Illinois, New Jersey New York, Michigan, Maine, Connecticut, and Wisconsin. In a shift in the pattern witnessed for the first decade-plus of the twenty-first century, Washington, D.C., has become one of the most popular destination for relocation along with Oregon. Washington, D.C., seemed to be popular because of its somewhat recession-proof economic opportunities generated by a maturing high-tech sector and federal government jobs. Additionally, the city of Portland, Oregon, is attractive for its mix of economic growth, effective urban planning, and scenic landscapes.[43]

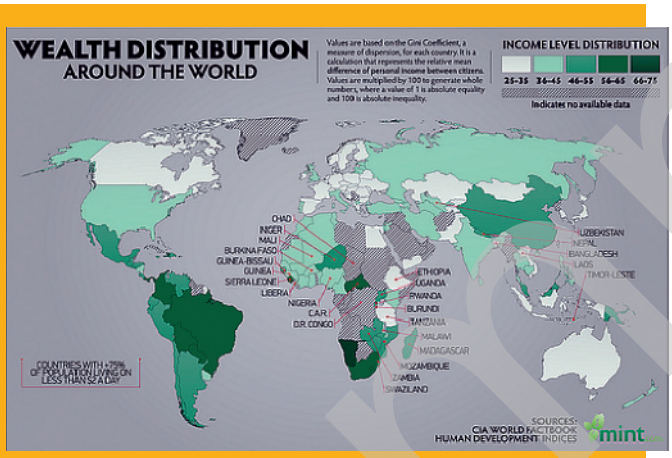
Firms want to carefully study the patterns of population distributions in countries and regions to identify opportunities and threats. Thus, in the United States, current patterns suggest the possibility of opportunities in Washington, D.C., as well as in states on the West Coast, including Oregon, and those in the South and Southwest. In contrast, firms competing in the Northeast and Great Lakes areas may concentrate on identifying threats to their ability to operate profitably in those areas.

Of course, geographic distribution patterns differ throughout the world. For example, in China, the majority of the population still lives in rural areas; however, growth patterns are shifting to urban communities such as Shanghai and Beijing.[44] Recent shifts in Europe show small population gains for countries such as France, Germany, and the United Kingdom, while Greece experienced a small population decline. Overall, the geographic distribution patterns in Europe have been reasonably stable.[45]

Ethnic Mix

The ethnic mix of countries' populations continues to change, creating opportunities and threats for many companies as a result. For example, Hispanics have become the largest ethnic minority in the United States.[46] In fact, the U.S. Hispanic market is the third largest "Latin American" economy behind Brazil and Mexico. Spanish is now the dominant language in parts of the United States such as in Texas, California, Florida, and New Mexico. Given these facts, some firms might want to assess how their goods or services could be adapted to serve the unique needs of Hispanic consumers. Interestingly, by 2020, more than 50 percent of children in the United States will be a member of a minority ethnic group, and the population in the United States is projected to have a majority of minority ethnic members by 2044.[47] The ethnic diversity of the population is important not only because of consumer needs but also because of the labor force composition. Interestingly, research has shown that firms with greater ethnic diversity in their managerial team are likely to enjoy higher performance.[48]

Additional evidence is of interest to firms when examining this segment. For example, African countries are the most ethnically diverse in the world, with Uganda having the highest ethnic diversity rating and Liberia having the second highest. In contrast, Japan and the Koreas are the least ethnically diversified in their populations. European countries are largely ethnically homogeneous while the Americas are more diverse. "From the United States through Central America down to Brazil, the 'new world' countries, maybe in part because of their histories of relatively open immigration (and, in some cases, intermingling between natives and new arrivals) tend to be pretty diverse."[49]



global wealth distribution.PNG

The illustration above shows the vast differences in income distribution around the world.

Income Distribution

Understanding how income is distributed within and across populations informs firms of different groups' purchasing power and discretionary income. Of particular interest to firms are the average incomes of households and individuals. For instance, the increase in dual-career couples has had a notable effect on average incomes. Although real income has been declining in general in some nations, the household income of dual-career couples has increased, especially in the United States. These figures yield strategically relevant information for firms. For instance, research indicates that whether an employee is part of a dual-career couple can strongly influence the willingness of the employee to accept an international assignment. However, because of recent global economic conditions, many companies were still pursuing international assignments but changing them to avoid some of the additional costs of funding expatriates abroad.[50]

The growth of the economy in China has drawn many firms, not only for the low-cost production, but also because of the large potential demand for products, given its large population base. However, in recent times, the amount of China's gross domestic product that makes up domestic consumption is the lowest of any major economy at less than one-third. In comparison, India's domestic consumption of consumer goods accounts for two-thirds of its economy, or twice China's level. As such, many western multinationals are interested in India as a consumption market as its middle class grows extensively. Although India has poor infrastructure, its consumers are in a better position to spend. Because of situations such as this, paying attention to the differences between markets based on income distribution can be very important.[51] These differences across nations suggest it is important for most firms to identify the economic systems that are most likely to produce the most income growth and market opportunities.[52] Thus, the economic segment is a critically important focus of firms' environmental analysis.

2-3b The Economic Segment

The **economic environment** refers to the nature and direction of the economy in which a firm competes or may compete.[53] In general, firms seek to compete in relatively stable economies with strong growth potential. Because nations are interconnected as a result of the global economy, firms must scan, monitor, forecast, and assess the health of their host nation as well as the health of the economies outside it.

It is challenging for firms studying the economic environment to predict economic trends that may occur and their effects on them. There are at least two reasons for this. First, the global recession of 2008 and 2009 created numerous problems for companies throughout the world, including problems of reduced consumer demand, increases in firms' inventory levels, development of additional governmental regulations, and a tightening of access to financial resources. Second, the global recovery from the economic shock in 2008 and 2009 continues to be persistently slow and relatively weak compared to previous recoveries. Firms have to adjust not only to the economic shock and try to recover from it, they have to respond to what appears to be an unpredictable recovery.

The **economic environment** refers to the nature and direction of the economy in which a firm competes or may compete.

For example, the economies in a number of European countries are still suffering from the major recession (e.g., Greece, Spain). Of likely concern to firms is the fact that historically, high degrees of economic uncertainty coincide with periods of lower growth. And again, according to some research, "it is clear that (economic) uncertainty has increased in recent times."[54] This current degree of economic uncertainty suggests the possibility of slower growth for the foreseeable future.

When facing economic uncertainty, firms want to be certain to study the economic environment in multiple regions and countries throughout the world. Although economic growth remains relatively weak and economic uncertainty has been strong in Europe, the economic growth has been better in the United States in recent times. For example, the projected average annual economic growth in Europe for 2015–2017 is 1.4 percent and in the United States it is 2.9 percent. Alternatively, the projected average annual economic growth for 2015–2017 is 7.0 percent in China, 6.8 percent in India, 2.6 percent in Brazil, and 3.6 percent in Mexico. These estimates highlight the anticipation of the continuing development of emerging economies.[55] Ideally, firms will be able to pursue growth opportunities in regions and nations where they exist while avoiding the threats of slow growth periods in other settings.

Christopher Polk/ACMA2010/Getty Images

To date, most legalized gambling has been provided in resorts such as MGM Resorts. However, recent changes in regulations within the state of Nevada in the United States allows online gambling which is now being evaluated as an opportunity for these resorts.

2-3c The Political/Legal Segment

The **political/legal segment** is the arena in which organizations and interest groups compete for attention, resources, and a voice in overseeing the body of laws and regulations guiding interactions among nations as well as between firms and various local governmental agencies.[56] Essentially, this segment is concerned with how organizations try to influence governments and how they try to understand the influences (current and projected) of those governments on their competitive actions and responses. Commonly, firms develop a political strategy to specify how they will study the political/legal segment as well as approaches they might take (such as lobbying efforts) in order to successfully deal with opportunities and threats that surface within this segment at different points in time.[57]

Regulations formed in response to new national, regional, state, and/or local laws that are legislated often influence a firm's competitive actions and responses.[58] For example, the state of Nevada in the United States recently legalized the business of online poker/gambling. New Jersey and Delaware quickly took the same action. In response to Nevada's regulatory change, firms such as MGM Resorts International were trying to decide the degree to which these decisions represented a viable opportunity. According to a MGM official, the immediate concern with respect to Nevada is that "the state may be too small to provide a lucrative online market on a standalone basis."[59]

At a regional level, changes in the laws regarding the appropriate regulation of European banks are still being actively debated.[60] For interactive, technology-based firms

The **political/legal segment** is the arena in which organizations and interest groups compete for attention, resources, and a voice in overseeing the body of laws and regulations guiding interactions among nations as well as between firms and various local governmental agencies.

such as Facebook, Google, and Amazon, among others, "the effort in Europe to adopt the world's strongest data protection law has drawn the attention of dozens of lobbyists from U.S. technology and advertising companies."[61] Highly restrictive laws about consumer privacy could threaten how these firms conduct business in the European Union. Finally, in a comprehensive sense, recent transformations from state-owned to private firms occurring in multiple nations have substantial implications for the competitive landscapes in a number of countries and across multiple industries.[62]

2-3d The Sociocultural Segment

The **sociocultural segment** is concerned with a society's attitudes and cultural values. Because attitudes and values form the cornerstone of a society, they often drive demographic, economic, political/legal, and technological conditions and changes.

Individual societies' attitudes and cultural orientations are anything but stable, meaning that firms must carefully scan, monitor, forecast, and assess them to recognize and study associated opportunities and threats. Successful firms must also have an awareness of changes taking place in the societies and their associated cultures in which they are competing. Indeed, societal and culture changes challenge firms to find ways to "adapt to stay ahead of their competitors and stay relevant in the minds of their consumers."[63] Research has shown that sociocultural factors influence the entry into new markets and the development of new firms in a country.[64]

The **sociocultural segment** is concerned with a society's attitudes and cultural values.

Attitudes about and approaches to health care are being evaluated in nations and regions throughout the world. For Europe, the European Commission has developed a health care strategy for all of Europe that is oriented to preventing diseases while tackling lifestyle factors influencing health such as nutrition, working conditions, and physical activity. This Commission argues that promoting attitudes to take care of one's health is especially important in the context of an aging Europe as shown by the projection that the proportion of people over 65 living in Europe will increase from 17 percent in 2010 to almost 30 percent by 2060.[65] At issue for business firms is that attitudes and values about health care can affect them; accordingly, they must carefully examine trends regarding health care in order to anticipate the effects on their operations.

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Healthcare is becoming increasingly important as the proportion of people older than 65 is growing larger in many nations throughout the world.

As the U.S. labor force has grown in size, it has become more diverse, with significantly more women and minorities from a variety of cultures entering the workplace. In 1993, the total U.S. workforce was slightly less than 130 million; in 2005, it was slightly greater than 148 million. It is predicted to grow to more than 192 million by 2050.

However, the rate of growth in the U.S. labor force has declined over the past two decades largely as a result of slower growth of the nation's population and because of a downward trend in the labor force participation rate. More specifically, data show that "after nearly five decades of steady growth, the overall participation rate—defined as the proportion of the civilian non-institutional population in the labor force—peaked at an annual average of 67.1 percent for each year from 1997 to 2000.

By September 2012, the rate had dropped to 63.6 percent"[66] and is expected to fall to 58.5 percent by 2050. Other changes in the U.S. labor force between 2010 and 2050 are expected. During this time period, the growth in Asian members of the labor force is projected to more than double in size, while the growth in Caucasian members of the labor force is predicted to be much slower compared to other racial groups. In contrast, people of Hispanic origin are expected to account for roughly 80 percent of the total growth in the labor force. Finally, "it is projected that the higher growth rate of the female labor force relative to that of men will end by 2020, and the growth rates for men and women will be similar for the 2020–2050 period."[67]

Greater diversity in the workforce creates challenges and opportunities, including combining the best of both men's and women's traditional leadership styles. Although diversity in the workforce has the potential to improve performance, research indicates that diversity initiatives must be successfully managed in order to reap these organizational benefits.

Although the lifestyle and workforce changes referenced previously reflect the attitudes and values of the U.S. population, each country is unique with respect to these sociocultural indicators. National cultural values affect behavior in organizations and thus also influence organizational outcomes such as differences in CEO compensation.[68] Likewise, the national culture influences to a large extent the internationalization strategy that firms pursue relative to one's home country.[69] Knowledge sharing is important for dispersing new knowledge in organizations and increasing the speed in implementing innovations. Personal relationships are especially important in China as *guanxi* (personal relationships or good connections) has become a way of doing business within the country and for individuals to advance their careers in what is becoming a more open market society. Understanding the importance of guanxi is critical for foreign firms doing business in China.[70]

2-3e The Technological Segment

Pervasive and diversified in scope, technological changes affect many parts of societies. These effects occur primarily through new products, processes, and materials. The **technological segment** includes the institutions and activities involved in creating new knowledge and translating that knowledge into new outputs, products, processes, and materials.

Given the rapid pace of technological change and risk of disruption, it is vital for firms to thoroughly study the technological segment.[71] The importance of these efforts is suggested by the finding that early adopters of new technology often achieve higher market shares and earn higher returns. Thus, both large and small firms should continuously scan the general environment to identify potential substitutes for technologies that are in current use, as well as to identify newly emerging technologies from which their firm could derive competitive advantage.[72]

As a significant technological development, the Internet offers firms a remarkable capability in terms of their efforts to scan, monitor, forecast, and assess conditions in their general environment. Companies continue to study the Internet's capabilities to anticipate how it allows them to create more value for customers and to anticipate future trends.

Additionally, the Internet generates a significant number of opportunities and threats for firms across the world. Predictions about Internet usage in the years to come are one reason for this. By 2016, the estimate is that there will be 3 billion Internet users globally. Overall, firms can expect that in the future the Internet "will have more users (especially in developing markets), more mobile users, more users accessing it with various devices

The **technological segment** includes the institutions and activities involved in creating new knowledge and translating that knowledge into new outputs, products, processes, and materials.

throughout the day, and many more people engaged in an increasingly participatory medium."[73] Considering that about 144 billion e-mails are currently sent each day, and there has been an explosive growth in the demand for mobile Internet access, the effect of this increase in users has significant implications for businesses.[74]

In spite of the Internet's far-reaching effects and the opportunities and threats associated with its potential, wireless communication technology is becoming a significant technological opportunity for companies to pursue. Handheld devices and other wireless communications equipment are used to access a variety of network-based services. The use of handheld computers with wireless network connectivity, Web-enabled mobile phone handsets, and other emerging platforms (e.g., consumer Internet-access devices such as the iPhone, iPad, Apple Watch, and Kindle) has increased substantially and may soon become the dominant form of communication and commerce. In fact, with each new version of these products, additional functionalities and software applications are generating multiple opportunities—and potential threats—for companies of all types.

2-3f The Global Segment

The **global segment** includes relevant new global markets, existing markets that are changing, important international political events, and critical cultural and institutional characteristics of global markets.[75] For example, firms competing in the automobile industry must study the global segment. The fact that consumers in multiple nations are willing to buy cars and trucks "from whatever area of the world"[76] supports this position.

When studying the global segment, firms should recognize that globalization of business markets may create opportunities to enter new markets as well as threats that new competitors from other economies may also enter their market.[77] In terms of an opportunity for automobile manufacturers, the possibility for these firms to sell their products outside of their home market would seem attractive. But what markets might firms choose to enter? Currently, automobile and truck sales are expected to increase in Brazil, Russia, India, China, and to a lesser extent, Indonesia, and Malaysia. In contrast, sales are expected to decline, at least in the near term, in Europe and Japan. These markets, then, are the most and least attractive ones for automobile manufacturers desiring to sell outside their domestic market. At the same time, from the perspective of a threat, Japan, Germany, Korea, Spain, France, and the United States appear to have excess production capacity in the automobile manufacturing industry. In turn, overcapacity signals the possibility that companies based in markets where this is the case will simultaneously attempt to increase their exports as well as sales in their domestic market.[78] Thus, global automobile manufacturers should carefully examine the global segment in order to precisely identify all opportunities and threats.

In light of threats associated with participating in international markets, some firms choose to take a more cautious approach to globalization. For example, family business firms, even the larger ones, often take a conservative approach to entering international markets. These firms participate in what some refer to as *globalfocusing*. Globalfocusing often is used by firms with moderate levels of international operations who increase their internationalization by focusing on global niche markets.[79] This approach allows firms to build on to and use their core competencies while limiting their risks within the niche market. Another way in which firms limit their risks in international markets is to focus their operations and sales in one region of the world.[80] Success with these efforts finds a firm building relationships in and knowledge of its markets. As the firm builds these strengths, rivals find it more difficult to enter its markets and compete successfully.

The **global segment** includes relevant new global markets, existing markets that are changing, important international political events, and critical cultural and institutional characteristics of global markets.

Firms competing in global markets should recognize each market's sociocultural and institutional attributes. For example, Korean ideology emphasizes communitarianism, a characteristic of many Asian countries. Alternatively, the ideology in China calls for an emphasis on *guanxi*—personal connections—while in Japan, the focus is on *wa*—group harmony and social cohesion.[81] The institutional context of China suggests a major emphasis on centralized planning by the government. The Chinese government provides incentives to firms to develop alliances with foreign firms having sophisticated technology in hopes of building knowledge and introducing new technologies to the Chinese markets over time.[82] As such, it is important to analyze the strategic intent of foreign firms when pursuing alliances and joint ventures abroad, especially where the local partners are receiving technology which may in the long run reduce the foreign firms' advantages.[83]

Increasingly, the *informal economy* as it exists throughout the world is another aspect of the global segment requiring analysis. Growing in size, this economy has implications for firms' competitive actions and responses in that increasingly firms competing in the formal economy will find that they are competing against informal economy companies as well.

2-3g The Sustainable Physical Environment Segment

The **sustainable physical environment segment** refers to potential and actual changes in the physical environment and business practices that are intended to positively respond to those changes with the intent of creating a sustainable environment.[84] Concerned with trends oriented to sustaining the world's physical environment, firms recognize that ecological, social, and economic systems interactively influence what happens in this particular segment and that they are part of an interconnected global society.[85]

Companies across the globe are concerned about the physical environment, and many record the actions they are taking in reports with names such as "Sustainability" and "Corporate Social Responsibility." Moreover and in a comprehensive sense, an increasing number of companies are interested in sustainable development, which is "the development that meets the needs of the present without compromising the ability of future generations to meet their own needs."[86]

There are many parts or attributes of the physical environment that firms consider as they try to identify trends in the physical environment segment.[87] Because of the importance to firms of becoming sustainable, certification programs have been developed to help them understand how to be sustainable organizations.[88] As the world's largest retailer, Walmart's environmental footprint is huge, meaning that trends in the physical environment can significantly affect this firm and how it chooses to operate. Perhaps in light of trends occurring in the physical environment, Walmart has announced that its goal is to produce zero waste and to use 100 percent renewable energy to power its operations.[89]

As our discussion of the general environment shows, identifying anticipated changes and trends among segments and their elements is a key objective of analyzing this environment. With a focus on the future, the analysis of the general environment allows firms to identify opportunities and threats. It is necessary to have a top management team with the experience, knowledge, and sensitivity required to effectively analyze the conditions in a firm's general environment and other parts such as the industry environment and competitors.[90] In fact, it seems that the prior CEO of Target may not have been committed to analyzing the environment in depth (See Strategic Focus on Target). But the new CEO, Brian Cornell, demonstrated his commitment by locating his office close to the center of the data collection unit and checking in with the staff in this unit each morning to gain the latest information.

The **sustainable physical environment segment** refers to potential and actual changes in the physical environment and business practices that are intended to positively respond to those changes with the intent of creating a sustainable environment.

Strategic **Focus**

Target Lost Its Sway Because Tar-zhey No Longer Drew the Customers

Target became known by consumers as Tar-zhey, the retailer of cheaper but 'chic' products. The firm offered a step up in quality goods at a slightly higher price than discount retailers such as Walmart, but was targeted below major, first line retailers such Macy's and Nordstrom. Additionally, it promoted its stores to offer one-stop shopping with clothing, toys, health products, and food goods, among other products. For many years, Tar-zhey "hit the bullseye" and performed well serving this large niche in the market. But the company took its eye off the target and began losing market share (along with other poor strategic actions).

The first major crack in the ship appeared with the announcement of a massive cyberattack on Target's computer system that netted customers' personal information. The attack exposed customers (data on 70 million customers) to potentially substantial losses due to credit card fraud. Not only was this a public relations disaster, it drew a focus on Target that identified other problems. The "light" on Target showed that the strategic decision to enter the Canadian market in a major way (133 stores across multiple geographic areas) was failing. Finally, the careful analysis showed that Target was losing customers to established competitors and new rivals, especially Internet retailers (e.g., Amazon.com).

Target's marketing chief stated that "it's not that we became insular. We were insular." This suggests that the firm was not analyzing its environment. By allowing rivals, and especially newer Internet competitors, to woo the company's customers, it lost sales, market share, and profits. It obviously did not predict and prepare for the significant competition from Internet rivals. Competitors were offering better value to customers (perhaps more variety and convenience through online sales). When combined with the loss of consumer confidence because of the massive hack of personal customer data, Target's reputation and market share were simultaneously harmed.

The unparalleled failure of the Canadian operations within a very short time (two years) also showed a lack of market understanding likely stemming from the failure to analyze the market. It is probable that all of the problems Target was experiencing were transferred to its Canadian operations as well. In addition, it failed to attract customers from its major Canadian retailers, such as Loblaw Companies, Canada's largest grocer that recently introduced low-cost clothing boutiques. Costco and Walmart were also well-established in the Canadian market. Target was unable to differentiate the value it provided from the established retailers in Canada. It also experienced problems in its Canadian supply chain suggesting again that it did not fully understand the business markets in Canada before entering the market.

Because of all of the problems experienced, Target's CEO resigned in May 2014. A new CEO, Brian Cornell, was hired three months later. He was a top executive at PepsiCo and had experience heading Sam's Warehouse for Walmart as well. Cornell is the first CEO to be hired from outside the company, and most of his experience is from outside the industry as well. Since arriving on the job in August of 2014, Cornell has started making changes. For example, he is trying to regain Target's "chic" image by focusing on fashion, infant's, children's, and health departments to increase customer traffic and sales. The focus in foods is more upscale, more organic food, specialty granola, coffee and tea, wine, and beer. Sales exceeded the forecast in the fourth quarter of 2014 with the highest growth in three years. In January 2015, Cornell also closed all Canadian stores and thereby laid off 17,600 employees, a painful but necessary move. Finally, he announced another layoff of close to 2,000 employees in March 2015. Most of these employees will come from the main office with the intent to make Target more nimble and agile.

Target Lily Pulitzer Line.PNG

Lily Pulitzer has been providing bold fashions for resort wear for more than 50 years.

Interestingly, Cornell did not take the large corner suite accorded to the former CEOs but instead chose a smaller office near the company's market data collection site. There a staff of ten employees gather information from social media sites such as Pinterest, Facebook, and Twitter and from television news from nine large TV screens. The CEO stops by every morning to learn the latest information. These actions alone suggest the importance he places on gathering and analyzing data on the market and competitors' actions.

Sources: 2015, What your new CEO is reading: Smell ya later; targets new CEO, *CIO Journal/Wall Street Journal*, www.wsj.com/cio, March 6; I. Austen & H. Tabuchi, 2015, Target's red ink runs out in Canada, *New York Times*, www.ntimes.com, January 15; H. Tabuchi, 2015, Target plans to cut jobs to help save $2 billion, *New York Times*, www.ntimes.com, March 3; P. Ziobro & C. Delaney, 2015, Target sales grow at fastest rate in three years, *Wall Street Journal*, www.wsj.com, February 25; J. Reingold, 2014, Can Target's new CEO get the struggling retailer back on target? *Fortune*, www.fortune.com, July 31; G. Smith, 2014, Target turns to PepsiCo's Brian Cornell to restore its fortunes, *Fortune*, www.fortune.com, July 31; P. Ziobro, M. Langley, & J. S. Lublin, 2014, Target's problem: Tar-zhey isn't working. *Wall Street Journal*, www.wsj.com, May 5.

As described in the Strategic Focus, Target failed to maintain a good understanding of its industry; hence, the loss of market share to new Internet company rivals and other more established competitors. It did not understand its markets, competitors, and suppliers in Canada, and thus its entry into the Canadian market failed miserably. We conclude that critical to a firm's choices of strategies and their associated competitive actions and responses is an understanding of its industry environment and its competitors. And, the country's general environment influences the industry and competitive environments.[91] Next, we discuss the analyses firms complete to gain such an understanding.

2-4 Industry Environment Analysis

An **industry** is a group of firms producing products that are close substitutes. In the course of competition, these firms influence one another. Typically, companies use a rich mix of different competitive strategies to pursue above-average returns when competing in a particular industry. An industry's structural characteristics influence a firm's choice of strategies.[92]

Compared with the general environment, the industry environment (measured primarily in the form of its characteristics) has a more direct effect on the competitive actions and responses a firm takes to succeed.[93] To study an industry, the firm examines five forces that affect the ability of all firms to operate profitably within a given industry. Shown in Figure 2.2, the five forces are: the threats posed by new entrants, the power of suppliers, the power of buyers, product substitutes, and the intensity of rivalry among competitors.

The five forces of competition model depicted in Figure 2.2 expands the scope of a firm's competitive analysis. Historically, when studying the competitive environment, firms concentrated on companies with which they directly competed. However, firms must search more broadly to recognize current and potential competitors by identifying

Figure 2.2 The Five Forces of Competition Model

An **industry** is a group of firms producing products that are close substitutes.

potential customers as well as the firms serving them. For example, the communications industry is now broadly defined as encompassing media companies, telecoms, entertainment companies, and companies producing devices such as smartphones.[94] In such an environment, firms must study many other industries to identify companies with capabilities (especially technology-based capabilities) that might be the foundation for producing a good or a service that can compete against what they are producing.

When studying the industry environment, firms must also recognize that suppliers can become a firm's competitors (by integrating forward) as can buyers (by integrating backward). For example, several firms have integrated forward in the pharmaceutical industry by acquiring distributors or wholesalers. In addition, firms choosing to enter a new market and those producing products that are adequate substitutes for existing products can become a company's competitors.

Next, we examine the five forces the firm needs to analyze in order to understand the profitability potential within an industry (or a segment of an industry) in which it competes or may choose to compete.

2-4a Threat of New Entrants

Identifying new entrants is important because they can threaten the market share of existing competitors.[95] One reason new entrants pose such a threat is that they bring additional production capacity. Unless the demand for a good or service is increasing, additional capacity holds consumers' costs down, resulting in less revenue and lower returns for competing firms. Often, new entrants have a keen interest in gaining a large market share. As a result, new competitors may force existing firms to be more efficient and to learn how to compete in new dimensions (e.g., using an Internet-based distribution channel).

The likelihood that firms will enter an industry is a function of two factors: barriers to entry and the retaliation expected from current industry participants. Entry barriers make it difficult for new firms to enter an industry and often place them at a competitive disadvantage even when they are able to enter. As such, high entry barriers tend to increase the returns for existing firms in the industry and may allow some firms to dominate the industry.[96] Thus, firms competing successfully in an industry want to maintain high entry barriers in order to discourage potential competitors from deciding to enter the industry.

Barriers to Entry

Firms competing in an industry (and especially those earning above-average returns) try to develop entry barriers to thwart potential competitors. In general, more is known about entry barriers (with respect to how they are developed as well as paths firms can pursue to overcome them) in industrialized countries such as those in North America and Western Europe. In contrast, relatively little is known about barriers to entry in the rapidly emerging markets such as those in China. However, recent research suggests that Chinese executives perceive that advertising effects are the most significant of seven barriers to China, while capital requirements are viewed as the least important.[97]

There are different kinds of barriers to entering a market to consider when examining an industry environment. Companies competing within a particular industry study these barriers to determine the degree to which their competitive position reduces the likelihood of new competitors being able to enter the industry to compete against them. Firms considering entering an industry study entry barriers to determine the likelihood of being able to identify an attractive competitive position within the industry. Next, we discuss several significant entry barriers that may discourage competitors from entering a market and that may facilitate a firm's ability to remain competitive in a market in which it currently competes.

Economies of Scale *Economies of scale* are derived from incremental efficiency improvements through experience as a firm grows larger. Therefore, the cost of producing each unit declines as the quantity of a product produced during a given period increases. A new entrant is unlikely to quickly generate the level of demand for its product that in turn would allow it to develop economies of scale.

Economies of scale can be developed in most business functions, such as marketing, manufacturing, research and development, and purchasing.[98] Firms sometimes form strategic alliances or joint ventures to gain scale economies. This is the case for Mitsubishi Heavy Industries Ltd. and Hitachi Ltd., as these companies "merged their operations for fossil-fuel-based power systems into a joint venture aimed at gaining scale to compete against global rivals."[99]

Becoming more flexible in terms of being able to meet shifts in customer demand is another benefit for an industry incumbent and a possible entry barrier for the firms considering entering the industry. For example, a firm may choose to reduce its price with the intention of capturing a larger share of the market. Alternatively, it may keep its price constant to increase profits. In so doing, it likely will increase its free cash flow, which is very helpful during financially challenging times.

Some competitive conditions reduce the ability of economies of scale to create an entry barrier such as the use of scale free resources.[100] Also, many companies now customize their products for large numbers of small customer groups. In these cases, customized products are not manufactured in the volumes necessary to achieve economies of scale. Customization is made possible by several factors including flexible manufacturing systems. In fact, the new manufacturing technology facilitated by advanced information systems has allowed the development of mass customization in an increasing number of industries. Online ordering has enhanced customers' ability to buy customized products. Companies manufacturing customized products can respond quickly to customers' needs in lieu of developing scale economies.

Product Differentiation Over time, customers may come to believe that a firm's product is unique. This belief can result from the firm's service to the customer, effective advertising campaigns, or being the first to market a good or service.[101] Greater levels of perceived product uniqueness create customers who consistently purchase a firm's products. To combat the perception of uniqueness, new entrants frequently offer products at lower prices. This decision, however, may result in lower profits or even losses.

The Coca-Cola Company and PepsiCo have established strong brands in the markets in which they compete, and these companies compete against each other in countries throughout the world. Because each of these competitors has allocated a significant amount of resources over many decades to build its brands, customer loyalty is strong for each firm. When considering entry into the soft drink market, a potential entrant would be well advised to pause to determine actions it would take for the purpose of trying to overcome the brand image and consumer loyalty each of these giants possess.

Capital Requirements Competing in a new industry requires a firm to have resources to invest. In addition to physical facilities, capital is needed for inventories, marketing activities, and other critical business functions. Even when a new industry is attractive, the capital required for successful market entry may not be available to pursue the market opportunity.[102] For example, defense industries are difficult to enter because of the substantial resource investments required to be competitive. In addition, because of the high knowledge requirements of the defense industry, a firm might acquire an existing company as a means of entering this industry, but it must have access to the capital necessary to do this.

Switching Costs *Switching costs* are the one-time costs customers incur when they buy from a different supplier. The costs of buying new ancillary equipment and of retraining employees, and even the psychological costs of ending a relationship, may be incurred in switching to a new supplier. In some cases, switching costs are low, such as when the consumer switches to a different brand of soft drink. Switching costs can vary as a function of time, as shown by the fact that in terms of credit hours toward graduation, the cost to a student to transfer from one university to another as a freshman is much lower than it is when the student is entering the senior year.

Occasionally, a decision made by manufacturers to produce a new, innovative product creates high switching costs for customers. Customer loyalty programs, such as airlines' frequent flyer miles, are intended to increase the customer's switching costs. If switching costs are high, a new entrant must offer either a substantially lower price or a much better product to attract buyers. Usually, the more established the relationships between parties, the greater the switching costs.

Access to Distribution Channels Over time, industry participants commonly learn how to effectively distribute their products. After building a relationship with its distributors, a firm will nurture it, thus creating switching costs for the distributors. Access to distribution channels can be a strong entry barrier for new entrants, particularly in consumer nondurable goods industries (e.g., in grocery stores where shelf space is limited) and in international markets.[103] New entrants have to persuade distributors to carry their products, either in addition to or in place of those currently distributed. Price breaks and cooperative advertising allowances may be used for this purpose; however, those practices reduce the new entrant's profit potential. Interestingly, access to distribution is less of a barrier for products that can be sold on the Internet.

Cost Disadvantages Independent of Scale Sometimes, established competitors have cost advantages that new entrants cannot duplicate. Proprietary product technology, favorable access to raw materials, desirable locations, and government subsidies are examples. Successful competition requires new entrants to reduce the strategic relevance of these factors. For example, delivering purchases directly to the buyer can counter the advantage of a desirable location; new food establishments in an undesirable location often follow this practice. Zara is owned by Inditex, the largest fashion clothing retailer in the world.[104] From the time of its launching, Spanish clothing company Zara relied on classy, well-tailored, and relatively inexpensive items that were produced and sold by adhering to ethical practices to successfully enter the highly competitive global clothing market and overcome that market's entry barriers.[105]

Government Policy Through their decisions about issues such as the granting of licenses and permits, governments can also control entry into an industry. Liquor retailing, radio and TV broadcasting, banking, and trucking are examples of industries in which government decisions and actions affect entry possibilities. Also, governments often restrict entry into some industries because of the need to provide quality service or the desire to protect jobs. Alternatively, deregulating industries, such as the airline and utilities industries in the United States, generally results in additional firms choosing to enter and compete within an industry.[106] It is not uncommon for governments to attempt to regulate the entry of foreign firms, especially in industries considered critical to the country's economy or important markets within it.[107] Governmental decisions and policies regarding antitrust issues also affect entry barriers. For example, in the United States, the Antitrust Division of the Justice Department or the Federal Trade Commission will sometimes disallow a proposed merger because officials conclude that approving it would create a firm that is too dominant in an industry and would thus create unfair competition.[108] Such a negative ruling would obviously be an entry barrier for an acquiring firm.

Expected Retaliation

Companies seeking to enter an industry also anticipate the reactions of firms in the industry. An expectation of swift and vigorous competitive responses reduces the likelihood of entry. Vigorous retaliation can be expected when the existing firm has a major stake in the industry (e.g., it has fixed assets with few, if any, alternative uses), when it has substantial resources, and when industry growth is slow or constrained.[109] For example, any firm attempting to enter the airline industry can expect significant retaliation from existing competitors due to overcapacity.

Locating market niches not being served by incumbents allows the new entrant to avoid entry barriers. Small entrepreneurial firms are generally best suited for identifying and serving neglected market segments. When Honda first entered the U.S. motorcycle market, it concentrated on small-engine motorcycles, a market that firms such as Harley-Davidson ignored. By targeting this neglected niche, Honda initially avoided a significant amount of head-to-head competition with well-established competitors. After consolidating its position, Honda used its strength to attack rivals by introducing larger motorcycles and competing in the broader market.

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Apple's Watch was a highly anticipated entry into the smartwatch market. However, Google has formed a partnership with TAG Heuer and Intel to develop a smartwatch to respond to Apple.

2-4b Bargaining Power of Suppliers

Increasing prices and reducing the quality of their products are potential means suppliers use to exert power over firms competing within an industry. If a firm is unable to recover cost increases by its suppliers through its own pricing structure, its profitability is reduced by its suppliers' actions.[110] A supplier group is powerful when:

- It is dominated by a few large companies and is more concentrated than the industry to which it sells.
- Satisfactory substitute products are not available to industry firms.
- Industry firms are not a significant customer for the supplier group.
- Suppliers' goods are critical to buyers' marketplace success.
- The effectiveness of suppliers' products has created high switching costs for industry firms.
- It poses a credible threat to integrate forward into the buyers' industry. Credibility is enhanced when suppliers have substantial resources and provide a highly differentiated product.[111]

Some buyers attempt to manage or reduce suppliers' power by developing a long-term relationship with them. Although long-term arrangements reduce buyer power, they also increase the suppliers' incentive to be helpful and cooperative in appreciation of the longer-term relationship (guaranteed sales). This is especially true when the partners develop trust in one another.[112]

The airline industry is one in which suppliers' bargaining power is changing. Though the number of suppliers is low, the demand for major aircraft is also relatively low. Boeing and Airbus aggressively compete for orders of major aircraft, creating

more power for buyers in the process. When a large airline signals that it might place a "significant" order for wide-body airliners that either Airbus or Boeing might produce, both companies are likely to battle for the business and include a financing arrangement, highlighting the buyer's power in the potential transaction. And, with China's expected entry into the large commercial airliner industry, buyer power is likely to increase in the future.

2-4c Bargaining Power of Buyers

Firms seek to maximize the return on their invested capital. Alternatively, buyers (customers of an industry or a firm) want to buy products at the lowest possible price—the point at which the industry earns the lowest acceptable rate of return on its invested capital. To reduce their costs, buyers bargain for higher quality, greater levels of service, and lower prices.[113] These outcomes are achieved by encouraging competitive battles among the industry's firms. Customers (buyer groups) are powerful when:

- They purchase a large portion of an industry's total output.
- The sales of the product being purchased account for a significant portion of the seller's annual revenues.
- They could switch to another product at little, if any, cost.
- The industry's products are undifferentiated or standardized, and the buyers pose a credible threat if they were to integrate backward into the sellers' industry.

Consumers armed with greater amounts of information about the manufacturer's costs and the power of the Internet as a shopping and distribution alternative have increased bargaining power in many industries.

2-4d Threat of Substitute Products

Substitute products are goods or services from outside a given industry that perform similar or the same functions as a product that the industry produces. For example, as a sugar substitute, NutraSweet (and other sugar substitutes) places an upper limit on sugar manufacturers' prices—NutraSweet and sugar perform the same function, though with different characteristics. Other product substitutes include e-mail and fax machines instead of overnight deliveries, plastic containers rather than glass jars, and tea instead of coffee.

Newspaper firms have experienced significant circulation declines over the past 15 years. The declines are a result of the ready availability of substitute outlets for news including Internet sources, cable television news channels, along with e-mail and cell phone alerts. Likewise, satellite TV and cable and telecommunication companies provide substitute services for basic media services such as television, Internet, and phone. Tablets such as the iPad are reducing the number of PCs sold as suggested by the fact that worldwide shipments of PCs been declining each year since 2010.[114]

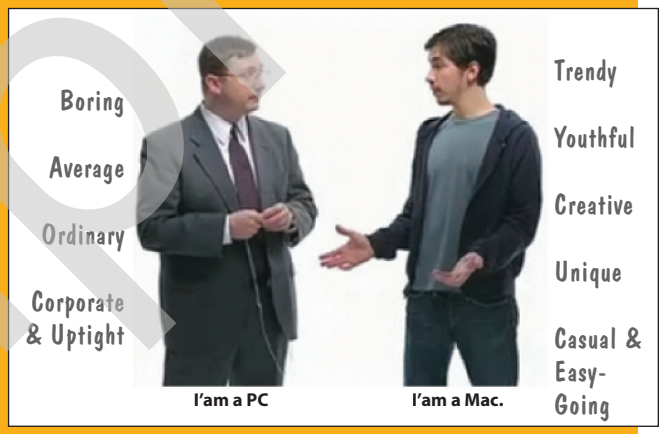
In general, product substitutes present a strong threat to a firm when customers face few if any switching costs and when the substitute product's price is lower or its quality and performance capabilities are equal to or greater than those of the competing product. Differentiating a product along dimensions that are valuable to customers (such as quality, service after the sale, and location) reduces a substitute's attractiveness.

2-4e Intensity of Rivalry among Competitors

Because an industry's firms are mutually dependent, actions taken by one company usually invite responses. Competitive rivalry intensifies when a firm is challenged by a competitor's actions or when a company recognizes an opportunity to improve its market position.[115]

Firms within industries are rarely homogeneous; they differ in resources and capabilities and seek to differentiate themselves from competitors. Typically, firms seek to differentiate their products from competitors' offerings in ways that customers value and in which the firms have a competitive advantage. Common dimensions on which rivalry is based include price, service after the sale, and innovation. More recently, firms have begun to act quickly (speed a new product to the market) in order to gain a competitive advantage.[116]

Next, we discuss the most prominent factors that experience shows affect the intensity of rivalries among firms.



Apple Commercial.PNG

Firms making PCs try to differentiate their products in order to gain a competitive advantage. For example, Apple visually shows and verbally explains the differences between its Mac and the typical PC.

Numerous or Equally Balanced Competitors

Intense rivalries are common in industries with many companies. With multiple competitors, it is common for a few firms to believe they can act without eliciting a response. However, evidence suggests that other firms generally are aware of competitors' actions, often choosing to respond to them. At the other extreme, industries with only a few firms of equivalent size and power also tend to have strong rivalries. The large and often similar-sized resource bases of these firms permit vigorous actions and responses. The competitive battles between Airbus and Boeing and between Coca-Cola and PepsiCo exemplify intense rivalry between relatively equal competitors.

Slow Industry Growth

When a market is growing, firms try to effectively use resources to serve an expanding customer base. Markets increasing in size reduce the pressure to take customers from competitors. However, rivalry in no-growth or slow-growth markets becomes more intense as firms battle to increase their market shares by attracting competitors' customers. Certainly, this has been the case in the fast-food industry as explained in the Opening Case about McDonald's. McDonald's, Wendy's, and Burger King use their resources, capabilities, and core competencies to try to win each other's customers. The instability in the market that results from these competitive engagements may reduce the profitability for all firms engaging in such battles. As noted in the Opening Case, McDonald's has suffered from this competitive rivalry.

High Fixed Costs or High Storage Costs

When fixed costs account for a large part of total costs, companies try to maximize the use of their productive capacity. Doing so allows the firm to spread costs across a larger volume of output. However, when many firms attempt to maximize their productive capacity, excess capacity is created on an industry-wide basis. To then reduce inventories, individual companies typically cut the price of their product and offer rebates and other special discounts to customers. However, doing this often intensifies competition. The pattern of excess capacity at the industry level followed by intense rivalry at the firm level is frequently observed in industries with high storage costs. Perishable products, for example, lose their value rapidly with the passage of time.

As their inventories grow, producers of perishable goods often use pricing strategies to sell products quickly.

Lack of Differentiation or Low Switching Costs

When buyers find a differentiated product that satisfies their needs, they frequently purchase the product loyally over time. Industries with many companies that have successfully differentiated their products have less rivalry, resulting in lower competition for individual firms. Firms that develop and sustain a differentiated product that cannot be easily imitated by competitors often earn higher returns. However, when buyers view products as commodities (i.e., as products with few differentiated features or capabilities), rivalry intensifies. In these instances, buyers' purchasing decisions are based primarily on price and, to a lesser degree, service. Personal computers are a commodity product and the cost to switch from a computer manufactured by one firm to another is low. Thus, the rivalry among Dell, Hewlett-Packard, Lenovo, and other computer manufacturers is strong as these companies consistently seek to find ways to differentiate their offerings.

High Strategic Stakes

Competitive rivalry is likely to be high when it is important for several of the competitors to perform well in the market. Competing in diverse businesses (such as semiconductors, petrochemicals, fashion, medicine, and skyscraper and plant construction, among others), Samsung is a formidable foe for Apple in the global smartphone market. Samsung has committed a significant amount of resources to develop innovative products as the foundation for its efforts to try to outperform Apple in selling this particular product. Only a few years ago, Samsung held a sizable lead in market share (33 percent to 18 percent), but in the fourth quarter of 2014, the two firms' market share was virtually equal. It seems that apple received a significant boost with the release of the iPhone 6.[117] However, this market is extremely important to both firms, suggesting that the smartphone rivalry between them (and others) will remain quite intense.

High strategic stakes can also exist in terms of geographic locations. For example, a number of automobile manufacturers have established manufacturing facilities in China, which has been the world's largest car market since 2009.[118] Because of the high stakes involved in China for General Motors and other firms (including domestic Chinese automobile manufacturers) producing luxury cars (including Audi, BMW, and Mercedes-Benz), rivalry among them in this market is quite intense.

High Exit Barriers

Sometimes companies continue competing in an industry even though the returns on their invested capital are low or even negative. Firms making this choice likely face high exit barriers, which include economic, strategic, and emotional factors causing them to remain in an industry when the profitability of doing so is questionable.

Exit barriers are especially high in the airline industry. Profitability in this industry has been very difficult to achieve in recent years partly because of the latest global financial crisis. However, profits in the airline industry increased in 2013 and 2014. Industry consolidation and efficiency enhancements to how airline alliances integrate their activities helped reduce airline companies' costs while improving economic conditions in a number of countries. This resulted in a greater demand for travel. These are positive signs, at least in the short run, for these firms given that they do indeed face very high barriers if they were to contemplate leaving the airline travel industry.[119] Common exit barriers that firms face include the following:

- Specialized assets (assets with values linked to a particular business or location)
- Fixed costs of exit (such as labor agreements)

- Strategic interrelationships (relationships of mutual dependence, such as those between one business and other parts of a company's operations, including shared facilities and access to financial markets)
- Emotional barriers (aversion to economically justified business decisions because of fear for one's own career, loyalty to employees, and so forth)
- Government and social restrictions (often based on government concerns for job losses and regional economic effects; more common outside the United States)

2-5 Interpreting Industry Analyses

Effective industry analyses are products of careful study and interpretation of data and information from multiple sources. A wealth of industry-specific data is available for firms to analyze for the purpose of better understanding an industry's competitive realities. Because of globalization, international markets and rivalries must be included in the firm's analyses. And, because of the development of global markets, a country's borders no longer restrict industry structures. In fact, in general, entering international markets enhances the chances of success for new ventures as well as more established firms.[120]

Analysis of the five forces within a given industry allows the firm to determine the industry's attractiveness in terms of the potential to earn average or above-average returns. In general, the stronger the competitive forces, the lower the potential for firms to generate profits by implementing their strategies. An unattractive industry has low entry barriers, suppliers and buyers with strong bargaining positions, strong competitive threats from product substitutes, and intense rivalry among competitors. These industry characteristics make it difficult for firms to achieve strategic competitiveness and earn above-average returns. Alternatively, an attractive industry has high entry barriers, suppliers and buyers with little bargaining power, few competitive threats from product substitutes, and relatively moderate rivalry.[121] Next, we explain strategic groups as an aspect of industry competition.

2-6 Strategic Groups

A set of firms emphasizing similar strategic dimensions and using a similar strategy is called a **strategic group**.[122] The competition between firms within a strategic group is greater than the competition between a member of a strategic group and companies outside that strategic group. Therefore, intra-strategic group competition is more intense than is inter-strategic group competition. In fact, more heterogeneity is evident in the performance of firms within strategic groups than across the groups. The performance leaders within groups are able to follow strategies similar to those of other firms in the group and yet maintain strategic distinctiveness as a foundation for earning above-average returns.[123]

The extent of technological leadership, product quality, pricing policies, distribution channels, and customer service are examples of strategic dimensions that firms in a strategic group may treat similarly. Thus, membership in a particular strategic group defines the essential characteristics of the firm's strategy.

The notion of strategic groups can be useful for analyzing an industry's competitive structure. Such analyses can be helpful in diagnosing competition, positioning, and the profitability of firms competing within an industry. High mobility barriers, high rivalry, and low resources among the firms within an industry limit the formation of strategic groups.[124] However, after strategic groups are formed, their membership remains

A **strategic group** is a set of firms emphasizing similar strategic dimensions and using a similar strategy.

Strategic Focus

Watch Out All Retailers, Here Comes Amazon; Watch Out Amazon, Here Comes Jet.com

Amazon's sales in 2014 were $88.99 billion, an increase of 19.4 percent over 2013. In fact, its sales in 2014 were a whopping 160 percent more than its sales in 2010, only four years prior. Amazon has been able to achieve remarkable gains in sales by providing high quality, rapid, and relatively inexpensive (relative to competitors) service. Amazon has taken on such formidable competitors as Walmart, Google, and Barnes & Noble, among others and has come out of it as a winner, particularly in the last 4–5 years.

Walmart has been making progress in its online sales. In 2014, it grew its online sales by about $3 billion, for a 30 percent increase. That is, until one compares it to Amazon's sales increase in 2014 of about $14.5 billion. Much opportunity remains for both to improve as total 2014 online sales were $300 billion.

Google is clearly the giant search engine with 88 percent of the information search market. However, when consumers are shopping to purchase goods, Amazon is the leader. In the third quarter of 2014, 39 percent of online shoppers in the United States began their search on Amazon, compared to 11 percent for Google. Interestingly, in 2009 the figures were 18 percent for Amazon and 24 percent for Google. So, Amazon appears to be winning this competitive battle with Google.

Barnes & Noble lost out to Google before by ignoring it as a threat. Today, B&N has re-established itself in market niches trying not to compete with Google. For example, its college division largely sells through college bookstores, which have a 'monopoly' location granted by the university. However, Amazon is now targeting the college market by developing agreements with universities to operate co-branded websites to sell textbooks, university t-shirts, etc. Most of the students already shop on Amazon, making the promotion easier to market to universities and to sell to students.

A few years ago, Amazon was referred to as the Walmart of the Internet. But, Amazon has diversified its product/service line much further than Walmart. For example, Amazon now competes against Netflix and other services providing video entertainment. In fact, Amazon won two Golden Globe Awards in 2015 for programs it produced. Amazon recently began to market high fashion clothing for men and women. Founder and CEO of Amazon, Jeff Bezos, stated that Amazon's goal is to become a $200 billion company, and to do that, the firm must learn how to sell clothes and food.

It appears that Amazon is beating all competitors, even formidable ones such as Google and Walmart. But, Amazon still needs to carefully watch its competition. A new company, Jet.com, is targeting Amazon. Jet.com was founded by Marc Lore, who founded the highly successful Diaper.com and a former competitor of Amazon, Quidsi. Amazon hurt Quidsi in a major price war and eventually acquired the company for $550 million. Lore worked for Amazon for two years thereafter but eventually quit to found Jet.com. Jet.com plans to market 10 million products and guarantee the lowest price. Its annual membership will be $50 compared to Amazon Prime's cost of $99. Competing with Amazon represents a major challenge. However, Jet.com has raised about $240 million in venture funding with capital from such players as Bain Capital Ventures, Google Ventures, Goldman Sachs, and Norwest Venture partners. Its current market value is estimated to be $600 million. The future competition between the two companies should be interesting.

Sources: G. Bensiger, 2015, Amazon makes a push on college campuses, *Wall Street Journal*, www.wsj.com, February 1; K. Bhasin & L. Sherman, 2015, Amazon Coutre: Jeff Bezos wants to sell fancy clothes, *Bloomberg*, www.bloomberg.com, February 18; L. Dormehl, 2015, Amazon and Netflix score big at the Golden Globe, *Fast Company*, www.fastcomany.com, January 12; S. Soper, 2015, Amazon.com rival Jet.com raises $140 million in new funding, *Bloomberg*, www.bloomberg.com, February 11; B. Stone, 2015, Amazon bought this man's company. Now he is coming for him, *Bloomberg*, www.bloomberg.com, January 7; M. Kwatinetz, 2014, In online sales, could Walmart ever top Amazon? *Fortune*, www.fortune.com, October 23; R. Winkler & A. Barr, 2014, Google shopping to counter Amazon, *Wall Street Journal*, www.wsj.com, December 15.

relatively stable over time. Using strategic groups to understand an industry's competitive structure requires the firm to plot companies' competitive actions and responses along strategic dimensions such as pricing decisions, product quality, distribution channels, and so forth. This type of analysis shows the firm how certain companies are competing similarly in terms of how they use similar strategic dimensions.