

# Chapter 1

## *FUNDAMENTALS OF STRATEGIC MANAGEMENT*

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### LEARNING OBJECTIVES

- 1** Explain how the strategic management process can be applied to an organization.
- 2** Define the three primary contributing theoretical influences to the strategic management field.
- 3** Describe the difference between strategic and non-strategic decisions.

### CHAPTER OVERVIEW

The first chapter is divided into three parts. The first part introduces basic concepts and presents the five steps in the strategic management model: (1) external analysis, (2) internal analysis, (3) strategy formulation, (4) strategy execution, and (5) strategic control.

Sagacious students often note that well-conceived strategies do not always work as planned. Mintzberg's notion of intended and realized strategies is introduced to explain this reality. A firm's intended strategy often requires modification before it is implemented due to changes in environmental and/or organizational conditions. Because these changes are often difficult to predict, substantial changes in the environment may transform an organization's realized strategy into one that is quite different from its intended strategy.

The second part of the chapter discusses theoretical contributions to the field. It is important to emphasize the perspectives that contribute to the strategic management because they relate to steps in the model. Industrial organization (IO) theory, contingency theory, and resource-based theory are based on widely varied assumptions about what leads to high firm performance, but each perspective has merit and contributes to an overall understanding of the field and to the strategic management process.

## **LESSON PLAN**

### ***Chapter Opening***

There are a number of ways to spark an interest in strategic management:

- Ask students to identify firms they believe to be effective or ineffective and clarify why.
- Discuss how current events can affect certain firms and/or industries.
- Ask students to discuss ways in which they believe their current employers—part-time or full-time—are effectively or ineffectively managed.

### ***Small Groups***

Several small group activities are possible:

- Also student groups to identify industries that seem to have been affected the most by the military conflicts in Afghanistan and Iraq, both positively and negatively.
- Ask student groups to identify and critique the business model of two well-known firms.

### ***Homework***

Many students are not aware of the myriad sources of business strategy news. Ask them to visit the Internet sites associated with the select sources of strategic management news in Table 1-1 and evaluate their usefulness. The sites can be analyzed along three dimensions:

- Free access vs. paid subscription required.
- Emphasis on business news of the day vs. emphasis on personalities or broad issues.
- Limited vs. extensive search capabilities.

## CHAPTER OUTLINE

### 1-1 What is Strategic Management?

**Strategy** refers to top management's plans to develop and sustain competitive advantage so that the organization's mission is fulfilled. **Competitive advantage** refers to a state whereby a firm's successful strategies cannot be easily duplicated by its competitors. Maintaining a **sustained competitive advantage** over time can be difficult.

**Strategic management** is a broader term than strategy and is a process that includes top management's analysis of the environment in which the organization operates prior to formulating a strategy, as well as the plan for implementation and control of the strategy.

There are five steps in the strategic management process:

1. External analysis.
2. Internal analysis.
3. Strategy formulation.
4. Strategy execution.
5. Strategic control.

An effective strategy is built on the organization's **business model**, the mechanism whereby the organization seeks to earn a profit by selling its goods

There are five factors associated with successful strategies:

1. Strategic managers understand the competitive environment.
2. The strategy is consistent with the firm's mission and goals.
3. Strategic managers understand how the organization's resources translate into strengths and weaknesses.
4. A plan for putting a strategy into action is designed with specificity before a strategy is implemented.
5. Possible future changes in the proposed strategy are evaluated before the strategy is adopted.

#### 1-1a Intended and Realized Strategies

Strategies are not always implemented as planned. The **intended strategy** (i.e., what management originally planned) typically differs from the **realized strategy** (i.e., what management actually implements). The gap between the intended and realized strategies usually results from unforeseen environmental or organizational events, better information that was not available when the strategy was formulated, or an improvement in top management's ability to assess its environment.

#### 1-1b Scientific and Artistic Perspectives on Strategic Management

Most strategy scholars have endorsed a **scientific perspective** of strategic management, whereby strategic managers are encouraged to systematically assess the firm's external

environment and evaluate the pros and cons of myriad alternatives before formulating strategy. Proponents of an alternate view (including Henry Mintzberg), the **artistic perspective**, suggest the lack of environmental predictability and the fast pace of change render elaborate strategy planning as suspect at best. Therefore, strategists should incorporate large doses of creativity and intuition in order to design a comprehensive strategy for the firm.

## 1-2 Influence on Strategic Management

There are three primary theoretical influences on strategy (summarized in Table 1-2).

1. **Industrial organization (IO)**, a branch of microeconomics, emphasizes the *influence of the industry environment* upon the firm.
2. **Resource-based theory** views performance primarily as a function of a firm's ability to utilize its resources and emphasize the development of a firm's **distinctive competence**.
3. **Contingency theory** represents a *middle ground* perspective that views organizational performance as the joint outcome of environmental forces and the firm's strategic actions.

**Table 1-2 Theoretical Perspectives on Firm Performance**

Theoretical Perspective	Primary Influence on Firm Performance	How Perspective is Applied to the Case Analysis
Industrial organization (IO) theory	Structure of the industry	Industry analysis portion of the external environment
Resource-based theory	Firm's unique combination of strategic resources	Analysis of internal strengths and weaknesses
Contingency theory	Fit between the firm and its external environment	SWOT (Strengths, Weaknesses, Opportunities, & Threats) analysis and SW/OT matrix

## 1-3 Strategic Decisions

**Strategic decisions** are the responsibility of the CEO, but are usually made by a **top management team**. Strategic decisions are marked by four distinctions:

1. They are based on a systematic comprehensive analysis of internal attributes and factors external to the organization, not just part of the organization.
2. They are long-term and future-oriented.
3. They are distinctively opportunistic.
4. They involve choices and trade-offs. *Note: Michael Porter is noted for his emphasis on trade-offs, particularly in his generic strategy typology discussed in Chapter 7.*

## CRITICAL THINKING QUESTIONS

- If strategic management is a straightforward concept, then why do many firms have difficulty formulating and executing effective strategies?
- Henry Mintzberg's argument that strategic management is an artistic endeavor. If he's right, then what value is there in systematic approaches to strategic planning such as those elaborated in this textbook (and most others)?

## WEB RESOURCES

- [http://en.wikipedia.org/wiki/Strategic\\_management](http://en.wikipedia.org/wiki/Strategic_management): This is Wikipedia's overview of strategic management. Note that Wikipedia is a free content encyclopedia, so it is not always authoritative.
- <http://www.henrymintzberg.com>: This site contains details about Henry Mintzberg, the strategy guru who coined the terms intended and realized strategies.
- <http://wsj.com>: The *Wall Street Journal* is the best-known business publication in the world. Most content requires paid access, however.
- <http://fastcompany.com>: *Fast Company* is a popular periodical about cutting edge approaches to management. Most content, including back issues, is available free of charge on-line.

## ANSWERS TO REVIEW QUESTIONS AND EXERCISES

1. Is it necessary that the five steps in the strategic management process be performed sequentially? Why or why not?

The answer depends on one's perspective. *Outsiders* analyzing a firm should apply a systematic approach that progresses through these steps in order. Doing so develops to a holistic understanding of the firm, its industry, and its strategic challenges.

In organizations, however, strategies are being formulated, executed, and controlled simultaneously while external and internal factors are being assessed and reassessed. In addition, changes in one stage of the strategic management process will inevitably affect other stages as well. After a planned strategy is implemented, for example, it often requires modification as conditions change. Hence, because these steps are so tightly intertwined, *insiders* treat all of the steps as a single integrated, ongoing process.

2. What is the difference between an intended strategy and a realized strategy? Why is this distinction important?

The intended strategy is what management "intends" to implement. The realized strategy—what management actually implements—is often quite different. The gap

between the intended and realized strategies usually results from unforeseen environmental or organizational events, better information that was not available when the strategy was formulated, or an improvement in top management's ability to assess its environment. This distinction is important because it recognizes that not even the best strategic management practices can produce strategies that never require modification and ongoing control to ensure their success.

3. How have outside perspectives influenced the development of the strategic management field?

Not everyone agrees on the factors that tend to be the primary forces behind a firm's profitability. Industrial organization (I/O) emphasizes the role played by the industry structure and is incorporated into the external analysis step in the strategic management process. Resource-based theory emphasizes the firm's unique combination of strategic resources and is incorporated into the internal analysis step in the strategic management process. Contingency theory emphasized the fit between the firm and its external environment and is incorporated into the SWOT analysis and SW/OT matrix portions of the strategy formulation step in the strategic management process. All three of these perspectives have validity and should be considered as part of a composite view of the field.

4. Does the CEO *alone* make the strategic decisions for an organization? Explain.

The chief executive is the individual ultimately responsible for the organization's strategic management, but he or she rarely acts alone. Except in the smallest companies, he or she relies on a team of top-level executives—including members of the board of directors, vice presidents, and various line and staff managers—all of whom play instrumental roles in strategically managing the firm.

## KEY TERMS

**Business Model:** The economic mechanism by which a business hopes to sell its goods or services and generate a profit.

**Competitive Advantage:** A state whereby a business unit's successful strategies cannot be easily duplicated by its competitors.

**Contingency Theory:** A view which states that the most profitable firms are likely to be the ones that develop the best fit with their environment.

**Distinctive Competence:** Unique resources, skills, and capabilities that enable a firm to distinguish itself from its competitors and create competitive advantage.

**Industrial Organization (IO):** A view based in microeconomic theory which states that firm profitability is most closely associated with industry structure.

**Intended strategy:** The original strategy top management plans and intends to implement.

**Realized Strategy:** The strategy top management actually implements.

**Resource-Based Theory:** The perspective that views performance primarily as a function of a firm's ability to utilize its resources.

**Strategic Management:** The continuous process of determining the mission and goals of an organization within the context of its external environment and its internal strengths and weaknesses, formulating and implementing strategies, and exerting strategic control to ensure that the organization's strategies are successful in attaining its goals.

**Strategy:** Top management's plans to attain outcomes consistent with the organization's mission and goals.

**Sustained Competitive Advantage:** A firm's ability to enjoy strategic benefits over time.

**Top Management Team:** A team of top-level executives, headed by the CEO, all of whom play instrumental roles in the strategic management process.

## PRACTICE QUIZ

### True or False

1. A strategy seeks to develop and sustain competitive advantage.

True.

Strategy refers to top management's plans to develop and sustain competitive advantage—a state whereby a firm's successful strategies cannot be easily duplicated by its competitors—so that the organization's mission is fulfilled.

1-1 What Is Strategic Management?

2. Strategic management refers to formulating successful strategies for an organization.

False.

Strategic management is a broader term than strategy and is a process that includes top management's analysis of the environment in which the organization operates prior to formulating a strategy, as well as the plan for implementation and control of the strategy.

1-1 What Is Strategic Management?

3. Each step in the strategic management process is independent so that changes in one step will not substantially affect other steps.

False.

All steps in the strategic management process are interrelated.

1-1 What Is Strategic Management?

4. The intended strategy and the realized strategy can never be the same.

False.

If a strategy is implemented just as it was planned, then the intended and realized strategies will be the same.

1-1a Intended and Realized Strategies

5. Whereas industrial organization theory emphasizes the influence of industry factors of firm performance, resource-based theory emphasizes the role of firm factors.

True.

Industrial organization emphasizes the influence of the industry environment upon the firm. Resource-based theory views performance primarily as a function of a firm's ability to utilize its resources.

1-2 Influence on Strategic Management

6. Strategic decisions are made by and are ultimately the responsibility of the chief executive alone.

False.

Although the chief executive alone is responsible for strategic decisions, he or she usually forms a top management team to assist in making the decisions.

1-3 Strategic Decisions

### Multiple Choice

7. Strategies are formulated in the strategic management stage that occurs immediately after

- A. the assessment of internal strengths and weaknesses.
- B. implementation of the strategy.
- C. control of the strategy.
- D. none of the above

A.

Strategies are formulated after the internal assessment, but before implementation and control.

1-1 What Is Strategic Management?

8. The strategy originally planned by top management is called the

- A. grand strategy.
- B. realized strategy.
- C. emergent strategy.
- D. none of the above

D.

The strategy originally planned by top management is called the intended strategy.

1-1 What Is Strategic Management?

9. The notion that successful firms tend to be the ones that adapt to influences in their industries is based on



- A. industrial organization theory.
- B. resource-based theory.
- C. contingency theory.
- D. none of the above

A.

The need for adapting to industry influences is based on industrial organization theory.

#### 1-2 Influence on Strategic Management

10. The notion of distinctive competence is consistent with

- A. industrial organization theory.
- B. resource-based theory.
- C. contingency theory.
- D. none of the above

B.

According to resource-based theory, firms succeed primarily because they develop distinctive competencies.

#### 1-2 Influence on Strategic Management

11. In order to contribute to sustained competitive advantage, firm resources should be

- A. valuable and rare.
- B. not subject to perfect imitation.
- C. without strategically relevant resources.
- D. all of the above.

D.

If resources are to be used for sustained competitive advantage—a firm's ability to enjoy strategic benefits over an extended period of time—those resources must be valuable, rare, not subject to perfect imitation, and without strategically relevant substitutes.

#### 1-2 Influence on Strategic Management

12. Which of the following is not a characteristic of strategic decisions?

- A. They are long-term in nature.
- B. They involve choices.
- C. They do not involve trade-offs.
- D. All of the above are characteristics of strategic decisions.

D.

Strategic decisions are based on a systematic, comprehensive analysis of internal attributes and factors external to the organization. They are long-term and future-oriented. They also involve choices. Although making “win-win” strategic decisions is often possible, most involve some degree of trade-off between alternatives, at least in the short run.

#### 1-3 Strategic Decisions