

Business Policy and Strategy

CHAPTER 1

What Is Strategy and Why Is It Important?

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

Jack Welch
Former CEO
General Electric

Learning Objectives

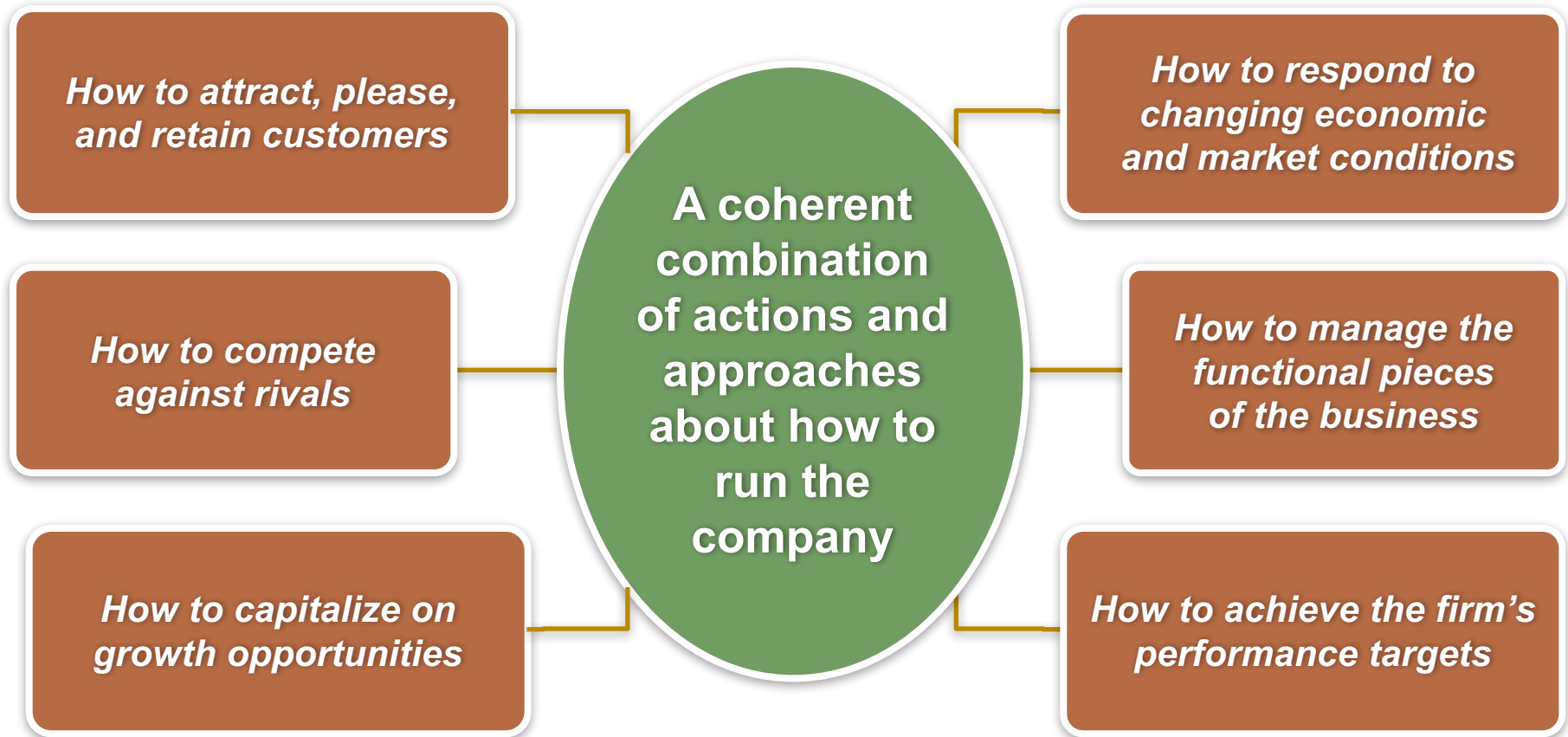
1. Understand the concept of “strategy,” how to identify a firm’s strategy, and the tight connection between its strategy and its quest for sustainable competitive advantage.
2. Learn why a firm’s strategy evolves over time and why its strategy is partly proactive and partly reactive.
3. Understand the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

What Do We Mean by “Strategy”

A company's *strategy* is defined by the specific market positioning, competitive moves, and business approaches that form management's answer to

“What's our plan for running the company and producing good results?”

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



Thinking Strategically

There is no one roadmap or prescription for running a firm in a successful manner.

A creative, distinctive strategy that sets a firm apart from rivals and delivers superior value to customers is its most reliable ticket for winning a competitive advantage over rivals.

The Key to Crafting a “Good” Strategy

- Crafting a good strategy entails deliberately choosing to *compete differently from rivals* by:
 - ▶ Appealing to buyers in ways that set a firm apart from rivals and that deliver superior value to buyers which requires
 - Doing what rivals don't do or can't do
 - Staking out a market position that is not crowded with other strong competitors

The Importance of Competing Differently

- Successful strategies contain distinctive “aha” elements that
 - ▶ Attract buyer attention with appealing product attributes unlike those of rivals
 - ▶ Deliver a perception of superior value that converts buyers into loyal customers
 - ▶ Gives the company added competitive power in the marketplace

Copycat strategies rarely work!!!

Strategy and the Quest for *Sustainable* Competitive Advantage

- A strategy that produces a sustainable long-term competitive advantage is most desirable.
- A short-lived nondurable strategy is soon offset or overcome by competitors.
- A strategy must include elements that cannot quickly or inexpensively be copied or overcome by rivals.

Discussion

Airline's loyalty program

- 1972 frequent-flyer programs
- United Airline



Starbucks' Strategy in the Specialty Coffee Market

Discussion:

How did Starbucks develop a sustainable competitive advantage in the specialty coffee market?



Starbucks' Strategy in the Specialty Coffee Market

a unique customer experience

- ✓ product
- ✓ environment
- ✓ service

The consistency of the customer experience through the consistency of their store operations.

Strategic Approaches to Building *Sustainable Competitive Advantage*

- Become the low-cost provider by achieving a cost-based competitive advantages over rivals
- Offer differentiating features that set the firm's products apart from rivals
- Offer customers more value for the money
- Focus on better serving the unique needs and tastes of buyers in a niche market
- Develop expertise, resources, and capabilities that are **competitively valuable** and that rivals cannot easily overcome

Strategic Approaches to Building *Sustainable Competitive Advantage*

- Low Cost Provider—Achieving a **cost-based** advantage over rivals.
- Broad Differentiation—Seeking to **differentiate** the company's product or service from rivals' in ways **that will appeal to a broad spectrum of buyers.**
- Focused Low Cost—Concentrating on a **narrow buyer segment** (or market niche) and outcompeting rivals by having lower costs than rivals and thus being able to serve niche members at a lower price.

Strategic Approaches to Building *Sustainable Competitive Advantage*

- Focused Differentiation—**Concentrating on a narrow buyer segment** (or market niche) and outcompeting rivals by offering niche members **customized attributes** that meet their tastes and requirements better than rivals' products.
- Best Cost Provider—Giving customers **more value for the money** by satisfying buyers' expectations on key quality/performance/service attributes, while beating their price expectations.

Strategic Approaches to Building *Sustainable Competitive Advantage*

- Low Cost Provider
- Broad Differentiation
- Focused Low Cost
- Focused Differentiation
- Best Cost Provider



Core Concept

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

Why a Company's Strategy Evolves over Time

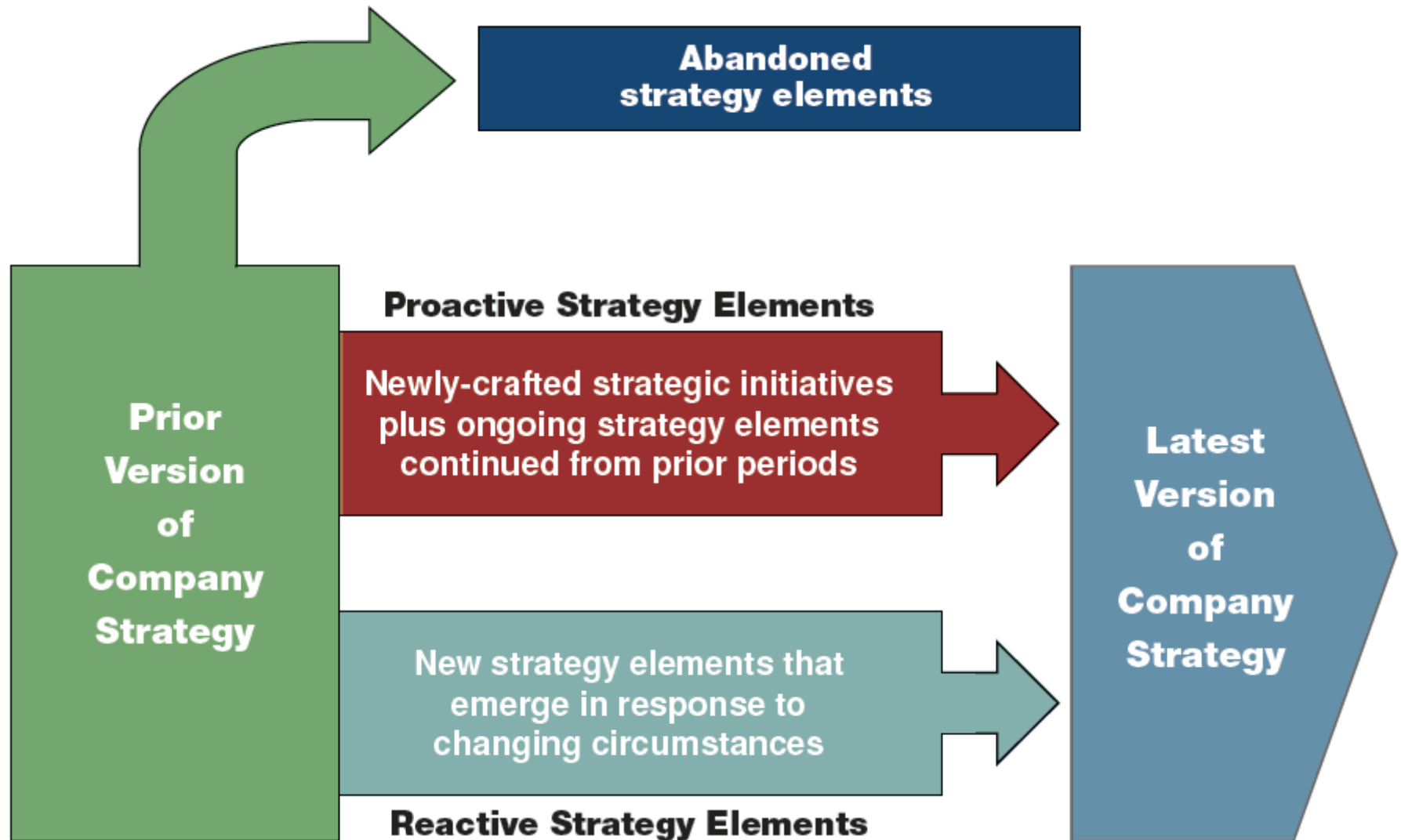
- It is advisable, if not necessary, for a firm to modify its strategy in response to:
 - ▶ Changing market conditions
 - ▶ Advancing technology
 - ▶ Fresh moves of competitors
 - ▶ Shifting buyer needs and preferences
 - ▶ Emerging market opportunities
 - ▶ New ideas for improving the strategy
 - ▶ Evidence that the current strategy is not working well

A Firm's Strategy Is Partly Proactive and Partly Reactive

- A firm's current strategy is typically a blend of:
 - ▶ Deliberate and *proactive* management actions to secure a competitive edge and improve the firm's financial performance
 - Many of the current proactive strategy elements have usually been previously initiated and are working well enough to be continued, with the remainder being freshly crafted or entirely new
 - ▶ *Strategic reactions* to unforeseen developments and fresh market conditions—emerge on an as-needed basis

The latest version of a firm's strategy reflects the disappearance of obsolete or ineffective strategy elements and the current prevailing combination of proactive and reactive elements.

Figure 1.2 A Company's Strategy Is a Blend of Proactive Initiatives and Reactive Adjustments



The Relationship Between a Firm's Strategy And Its Business Model

A Firm's Strategy

Deals with the firm's competitive initiatives and business approaches

A Firm's Business Model

Concerns whether the revenues and costs flowing from the **strategy** demonstrate the firm can be profitable and viable

Core Concept

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

Absent the ability to earn good profits, a firm's strategy and operating blueprint are flawed, its business model is not viable, and its ability to survive is in jeopardy.

The Two Crucial Elements of a Firm's Business Model

- **Its Customer Value Proposition**
- The customer value proposition lays out the company's approach to satisfying buyer wants and needs at a price customers will consider a good value.

The Two Crucial Elements of a Firm's Business Model

- Its Profit Proposition (or “Profit Formula”)
- The profit formula describes the company's approach to determining a cost structure that will allow for acceptable profits, given the pricing tied to its customer value proposition.

The Business Model of Network TV and Radio Broadcasters

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

The Business Model of Newspapers and Magazines

- The Customer Value Proposition

- ▶ Delivering valuable or interesting information and entertainment to a diversity readers.

- The Profit Proposition

- ▶ Securing sufficient revenues from advertising fees and reader subscriptions to more than cover the costs of producing and delivering their products to readers.

Is this business model in danger of becoming obsolete and failing?

Case Study

- Pandora, Sirius XM, and Over-the-Air Broadcast Radio: Three Contrasting Business Models
- **Discussion Question 1:** What is the prominent difference between the business models of these three organizations?

Case Study

Value Proposition (what the customer sees)

- Sirius XM provides commercial free entertainment with some local content based upon a monthly fee
- Broadcast Radio provides entertainment with some local content with interruptions for commercials without a fee.
- Pandora bridges these two methods.

Case Study

The Profit Proposition

- Sirius XM must attract a large enough customer base in order to cover costs and provide profit
- Broadcast Radio must attract a large enough advertiser base to cover costs and provide profit.
- Pandora, once again bridging the two, generates profit by either an advertiser base or through ad-free services.

Class Exercise

- Analyze the Value Proposition and Profit Proposition for

NETFLIX

hulu

amazon
prime video

Testing a Firm's Profit Proposition

- Can the firm can create and deliver the intended customer value in a cost-efficient manner?
- Can a profitable price be charged for the value it provides to customers?
 - ▶ Revenues generated are a function of the volume of customers attracted at the price being charged
 - ▶ The costs of the firm's business model approach depend on the resources and business processes utilized and the cost efficiency of its operating systems
 - ▶ Lower costs in relation to revenues increase the profit potential and the attractiveness of the firm's profit proposition

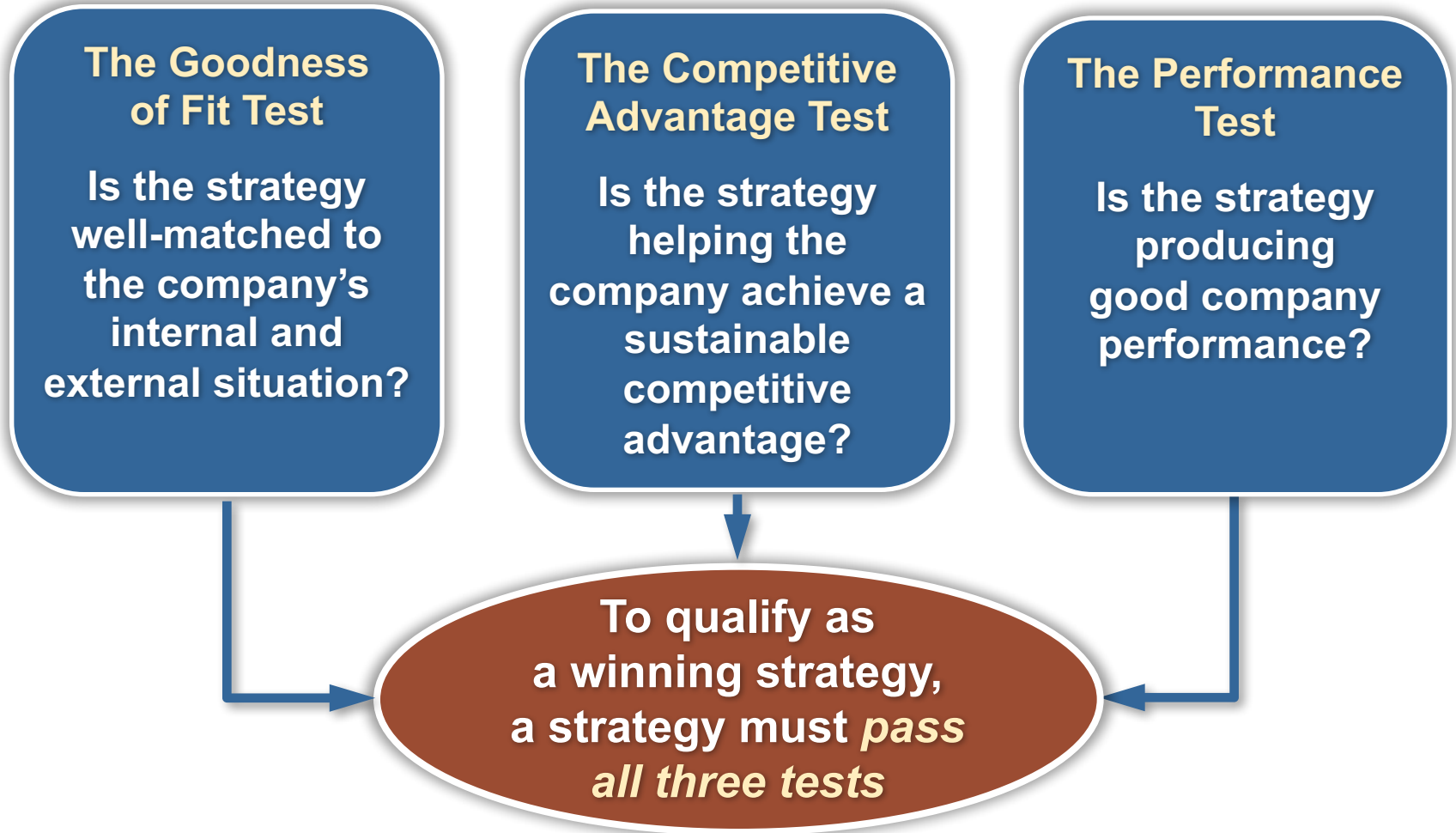
Proven vs. Unproven Business Models

- Companies that have been in business for a while and are making at least reasonably attractive profits have a “proven” business model—because there is hard revenue-cost evidence that their strategies and approaches to operating can yield good profits.
- Start-up firms and unprofitable firms have “questionable” or “unproven” business models because their strategies and operating approaches have yet to produce good bottom-line results, thus raising doubts about their blueprint for making money and their viability as business enterprises
- Companies that operate in uncertain, volatile market environments often have business models that quickly lose their effectiveness; for such companies to survive, they have to be adept at spotting the signs of impending crisis early and then swiftly reinvent their business model and strategy

What Makes a Strategy a Winner?

- Testing a strategy's merits versus another to distinguish a winning strategy from a flawed or weak strategy requires asking:
 1. How well does the strategy fit the company's situation?
 2. Is the strategy helping the company achieve a sustainable competitive advantage?
 3. Is the strategy producing good company performance?

The Three Tests of a Winning Strategy



Core Concept

A winning strategy must be well-suited to the firm's external and internal situation, help build a sustainable competitive advantage, and improve company performance.

Good Strategy + Good Strategy Execution = Good Management

- The better conceived and more competently a firm's strategy is executed, the more likely that the firm will be a standout performer financially in the marketplace.
- In contrast, a company that has a muddled or flawed strategy and/or can't seem to execute its strategy competently is most likely an underperformer and in need of better management.
 - ▶ Weak implementation and execution undermine a strategy's potential and pave the way for shortfalls in customer satisfaction and company performance.

The Road Ahead

- Every business student and aspiring manager needs to know the answer to the following question:
 - ▶ What must managers do, and do well, to give a firm its best chance to be attractively profitable and successful in the marketplace?
 - ▶ The answer will become the biggest lesson of this course—***doing a good job of managing requires good strategic thinking, good strategy-making, and good strategy execution.***

The Road Ahead (continued)

- The coming chapters explore *strategic thinking*, core concepts and tools of *strategic analysis*, and processes of *crafting and executing strategy*.
- In the strategy simulation exercise you will manage a firm in competition with firms managed by classmates, and have an excellent *learn-by-doing* opportunity to:
 - ▶ Apply what you have read about in the chapters.
 - ▶ Gain experience in crafting and executing strategy and being held accountable for how well your firm performs.

Class Exercise: Three Strategic Questions All Firms Must Answer

What is the firm's present situation?

- Industry conditions
- Competitive pressures
- Market standing vis-à-vis rivals
- Competitive strengths and weaknesses

What direction to head and what performance targets to set?

- New buyer needs to satisfy
- Growth opportunities to pursue
- Markets to deemphasize or abandon
- How to measure success

How to run the firm in ways that produce good results?

- Strategy for competing successfully
- How to attract customers
- Deciding what market position to stake out
- Actions to achieve performance targets