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chapter 1

What Is Strategy and Why Is It Important?

Strategy means making clear-cut choices about how to compete.
—Jack Welch, former CEO, General Electric

Without a strategy the organization is like a ship without a rudder.
—Joel Ross and Michael Kami

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

Managers of all types of businesses face three central questions: What's our company's present situation? What should the company's future direction be and what performance targets should we set? What's our plan for running the company and producing good results? Arriving at a thoughtful and probing answer to the question *"What's our company's present situation?"* prompts managers to evaluate industry conditions and competitive pressures, the company's current market standing, its competitive strengths and weaknesses, and its future prospects in light of changes taking place in the business environment. The question *"What should the company's future direction be and what performance targets should we set?"* pushes managers to consider what emerging buyer needs to try to satisfy, which growth opportunities to emphasize and which existing markets to de-emphasize or even abandon, where the company should be headed, and what outcomes the company should strive to achieve with respect to both its financial performance and its performance in the markets where it competes. The question *"What's our plan for running the company and producing good results?"* challenges managers to craft a series of competitive moves and business approaches—what henceforth will be referred to as the company's *strategy*—for heading the company in the intended direction, staking out a market position, attracting customers, and achieving the targeted financial and market performance.

The role of this chapter is to define the concept of strategy, identify the kinds of actions that determine what a company's strategy is, introduce you to the concept of competitive advantage, and explore the tight linkage between a company's strategy and its quest for competitive advantage. We will also explain why company strategies are partly proactive and partly reactive, why they evolve over time, and the relationship between a company's strategy and its business model. We conclude the chapter with a discussion of what sets a winning strategy apart from a ho-hum or flawed strategy and why the caliber of a company's strategy determines whether it will enjoy a competitive advantage or be burdened by competitive disadvantage. By the end of the chapter, you will have a clear idea of why the tasks of crafting and executing strategy are core management functions and why excellent execution of an excellent strategy is the most reliable recipe for turning a company into a standout performer over the long term.

What Do We Mean by "Strategy"?

A company's **strategy** is 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?"* A strategy represents *managerial commitment to undertake one set of actions rather than another* in an effort to compete successfully and achieve good performance outcomes. This commitment incorporates a coherent collection of choices and decisions about:

CORE CONCEPT

A company's **strategy** consists of the competitive moves and business approaches that managers employ to attract and please customers, compete successfully, pursue opportunities to grow the business, respond to changing market conditions, conduct operations, and achieve the targeted financial and market performance.

- *How* to attract and please customers.
- *How* to compete against rivals—and, ideally, gain a competitive advantage as opposed to being hamstrung by competitive disadvantage.
- *How* to position the company in the marketplace vis-à-vis rivals.
- *How* to capitalize on opportunities to grow the business.
- *How* best to respond to changing economic and market conditions.
- *How* to manage each functional piece of the business (e.g., R&D, supply chain activities, production, sales and marketing, distribution, finance, and human resources).
- *How* to achieve the company's performance targets.

In effect, when managers craft a company's strategy, they are saying, "Among the many different business approaches and ways of competing we could have chosen, we have decided to employ this particular combination of competitive and operating approaches in moving the company in the intended direction, strengthening its market position and competitiveness, and meeting or beating our performance objectives." Choosing among the various alternative *hows* is often tough, involving difficult trade-offs and sometimes high risk. But that is no excuse for company managers failing to decide upon a concrete course of action that spells out *"This is the strategic path we are going to take and here's what we are going to do to pursue competitive success in the marketplace and achieve good business results."*[2]

In most industries, company managers have considerable leeway in choosing the *hows* of strategy. For example, managers may see a promising opportunity for the company to compete against rivals by striving to keep costs low and selling products/services at attractively low prices. Often, there is room for a company to pursue competitive success by offering buyers more features, better performance, longer durability, more personalized customer service, and/or quicker delivery. Many companies strive to gain a competitive edge over rivals via cutting-edge technological features, longer warranties, clever advertising, better brand-name recognition, or the development of competencies and capabilities rivals cannot match. But it is foolhardy to pursue all of these options simultaneously in an attempt to be all things to all buyers. Choices of how best to compete against rivals have to be made in light of the firm's resources and capabilities and in light of the competitive approaches rival companies are employing.

Likewise, there are all kinds of market-positioning options.[3] Some companies target the high end of the market, whereas others go after the middle or low end. Some position themselves to compete in many market segments, endeavoring to attract many types of buyers with a wide variety of models and styles; other companies focus on a single market segment, with product offerings specifically designed to meet the needs and preferences of a particular buyer type or buyer demographic. Some companies position themselves in only one part of the industry's chain of production/distribution activities (preferring to be only in manufacturing or wholesale distribution or retailing), whereas others are partially or fully integrated, with operations ranging from components production to manufacturing and assembly to wholesale distribution to retailing. Some companies confine their operations to local or regional markets; others opt to compete nationally, internationally (in several countries), or globally (in all or most of the major country markets worldwide). Some companies decide to operate in only one industry, whereas others diversify broadly or narrowly into related or unrelated industries via acquisitions, joint ventures, strategic alliances, or starting up new businesses internally.

> There's no one roadmap or prescription for running a business in a successful manner. Many different avenues exist for competing successfully, staking out a market position, and operating the different pieces of a business.

Strategy Is About Competing Differently Mimicking the strategies of successful industry rivals—with either copycat product offerings or maneuvers to stake out the same market position—rarely works. *The best performing strategies are aimed at competing differently.* This does not mean that the key elements of a company's strategy have to be 100 percent different but rather that they must differ in at least *some important respects that matter to buyers*. A strategy stands a better chance of succeeding when it is predicated on actions, business approaches, and competitive moves aimed at (1) appealing to buyers in ways that *set a company apart from its rivals*—particularly when it comes to doing what rivals don't do or, even better, doing what they can't do and (2) staking out a market position that is not crowded with strong competitors. Really successful strategies often contain some distinctive "a-ha!" quality that goes beyond merely attracting buyer attention but that, more importantly, delivers what buyers perceive as superior value and converts them into loyal customers. Indeed, *the more a strategy is aimed at competing differently in ways that deliver superior value to buyers, the more likely the strategy will produce a valuable competitive edge over rivals*.[4]

> A creative, distinctive strategy that *sets a company apart from rivals and delivers superior value to customers* is a company's most reliable ticket for winning a competitive advantage over rivals.

Strategy and the Quest for Competitive Advantage

The heart and soul of any strategy are the actions and moves in the marketplace that managers are taking to gain a competitive advantage over rivals. A company achieves a **competitive advantage** whenever it has some type of edge over rivals in attracting buyers and coping with competitive forces. There are many routes to competitive advantage, but they all involve providing buyers with what they perceive as superior value compared to the offerings of rival sellers. Superior value can mean a good product at a lower price, a superior product that is worth paying more for, or a best-value offering that represents an appealing combination of features, quality, service, and other attributes at an attractively low price. Five of the most frequently used and dependable strategic approaches to setting a company apart from rivals, delivering superior value, achieving competitive advantage, and converting buyers into loyal customers are:

1. *Striving to be the industry's low-cost provider, thereby aiming for a cost-based competitive advantage over rivals that can then become the basis for charging lower prices and/or earning higher profits.* Walmart and Southwest Airlines have earned strong market positions because of the low-cost advantages they have achieved over their rivals and their consequent ability to underprice competitors. Achieving lower costs than rivals can produce a durable competitive edge when rivals find it hard to match the low-cost leader's approaches to driving costs out of the business.

2. *Competing successfully and profitably against rivals based on differentiating features such as higher quality, wider product selection, added performance, value-added services, more attractive styling, technological superiority, or some other attributes that set a company's product offering apart from those of rivals.* Successful adopters of differentiation strategies include Apple (innovative products), Johnson & Johnson in baby products (product reliability), Chanel and Rolex (top-of-the-line prestige), and Mercedes and BMW (engineering design and performance). Differentiation strategies can be powerful as long as a company is sufficiently innovative to thwart the efforts of clever rivals to copy or closely imitate its product offering and means of delivering superior value.

3. *Offering more value for the money.* Giving customers more value for their money by meeting or beating buyers' expectations regarding key quality/features/performance/service attributes while beating their price expectations is known as a *best-cost provider* strategy. This approach is a hybrid strategy that blends elements of the previous approaches. Toyota employs a best-cost provider strategy for its Lexus line of motor vehicles, as does Honda for its Acura line of cars and SUVs. Many consumers shop at L.L. Bean because of the good value it delivers: products with appealing quality/performance/features/styling and attractively low prices. Likewise, Amazon.com has been highly successful in attracting customers with its more-value-for-the-money combination of appealing prices, wide selection, free shipping, extensive product information and reviews, and online shopping convenience.

4. *Focusing on a narrow market niche and winning a competitive edge by doing a better job than rivals of serving the special needs and tastes of buyers that compose the niche.* Prominent companies that enjoy competitive success in a specialized market niche include eBay in online auctions, Jiffy Lube International in quick oil changes, and The Weather Channel in cable TV.

5. *Developing competitively valuable resources and capabilities that rivals can't easily imitate or trump with resources or capabilities of their own.* FedEx has superior capabilities in next-day delivery of small packages. Walt Disney has hard-to-beat capabilities in theme park management and family entertainment. Apple has formidable capabilities in innovative product design. Ritz-Carlton and Four Seasons have uniquely strong capabilities in providing their hotel guests with an array of personalized services. Hyundai has become the world's fastest-growing automaker as a result of its advanced manufacturing processes and unparalleled quality control systems. Very often, winning a durable competitive edge over rivals hinges more on building competitively valuable resources and capabilities than it does on having a distinctive product. Clever rivals can nearly always copy the attributes of a popular or innovative product, but for rivals to match experience, know-how, and specialized competitive capabilities that a company has developed and perfected over a long period of time is substantially harder to duplicate and takes much longer.

Forging a strategy that produces a competitive advantage has great appeal because it enhances a company's financial performance. *A company is almost certain to earn significantly higher profits when it enjoys a competitive advantage as opposed to when it competes with no advantage or is hamstrung by competitive disadvantage.* Competitive advantage is the key to above-average profitability and financial performance because strong buyer preferences for a company's products or services translate into higher sales volumes (Walmart) and/or the ability to command a higher price (Häagen-Dazs), which in turn tend to improve earnings, return on investment, and other important financial outcomes. Furthermore, if a company's competitive edge holds promise for being sustainable (as opposed to just temporary), then so much the better for both the strategy and the company's future profitability. What makes a competitive advantage *sustainable* (or *durable*) as opposed to temporary are actions and elements in the strategy that cause an attractive number of buyers to have *lasting reasons* to purchase a company's products or services, despite competitors' best efforts to nullify or overcome those reasons.

CORE CONCEPT

A company achieves **competitive advantage** when an attractive number of buyers are drawn to purchase its products or services rather than those of competitors. A company achieves **sustainable competitive advantage** when the basis for buyer preferences for its product offering relative to the offerings of its rivals is *durable*, despite competitors' efforts to nullify or overcome the appeal of its product offering.

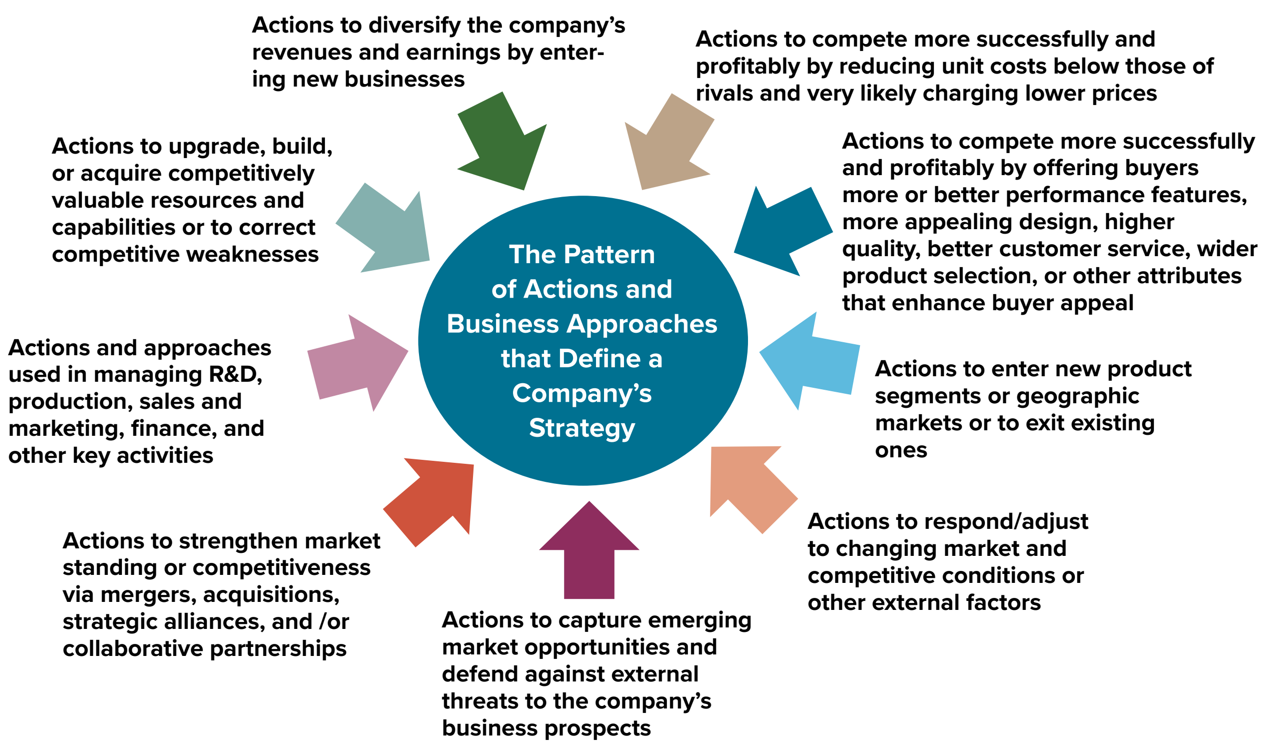
The tight connection between competitive advantage and profitability means the quest for sustainable competitive advantage is typically the foremost consideration in choosing the central elements of a company's strategy. Indeed, the competitive power of a company's strategy is governed by one or more differentiating attributes or strategy elements that act as a magnet to draw customers and give them strong and often durable reasons to prefer its products or services. Thus, what separates a powerful strategy from a run-of-the-mill or ineffective one is management's ability to forge a series of moves, both in the marketplace and internally, which tilts the playing field in the company's favor and produces a sustainable competitive advantage over rivals. The bigger and more sustainable the competitive advantage, the better a company's prospects for winning in the marketplace and earning superior long-term profits relative to its rivals. Without a strategy that leads to competitive advantage, a company risks being outcompeted by more strategically astute rivals and/or handcuffed by mediocre sales and uninspiring financial results.

Identifying a Company's Strategy

The best indicators of a company's strategy are its actions in the marketplace and senior managers' statements about the company's current business approaches, future plans, and efforts to strengthen its competitiveness and performance. Figure 1.1 shows what to look for in identifying the key elements of a company's strategy.

Once it is clear what to consider, the task of identifying a company's strategy is mainly one of researching the company's actions in the marketplace and its business approaches. In the case of publicly owned enterprises, senior executives often openly discuss the strategy in the company's annual report and 10-K report, in press releases and company news (posted on the company's website), and in the information provided to investors on the company's website. To maintain the confidence of investors and Wall Street, most public companies are fairly open about their strategies. Company executives typically lay out key elements of their strategies in presentations to securities analysts (portions of which are usually posted in the investor relations section of the company's website), and stories in the business media about the company often include aspects of the company's strategy. Hence, except for some about-to-be-launched moves and changes that remain under wraps and in the planning stage, there's usually nothing secret or undiscoverable about a company's present strategy.

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



Why a Company's Strategy Evolves Over Time

All companies, sooner or later, find it necessary to modify aspects of their strategy in response to changing market conditions, advancing technology, the fresh moves of competitors, shifting buyer needs and preferences, emerging market opportunities, new ideas for improving the strategy, and/or mounting evidence that certain aspects of the present strategy are no longer working well. Most of the time, a company's strategy evolves incrementally from management's ongoing efforts to fine-tune this or that piece of the strategy and to adjust certain strategy elements in response to new learning and unfolding events. However, on occasion, major strategy shifts are called for, such as when a strategy is clearly failing, market conditions or buyer preferences suddenly change dramatically, or important technological breakthroughs occur (as in medical devices and shale fracking). In some industries, conditions change at a fairly slow pace, making it feasible for the major components of a good strategy to remain in place for long periods. But in industries like smartphones, medical devices, computer chips, and genetic engineering where market conditions and technology change frequently and in sometimes dramatic ways, the life cycle of a given strategy is short. It is not uncommon for companies in high-velocity environments to overhaul key elements of their strategies several times a year or even to "reinvent" how they intend to compete differently from rivals and deliver superior value to customers.[6]

CORE CONCEPT

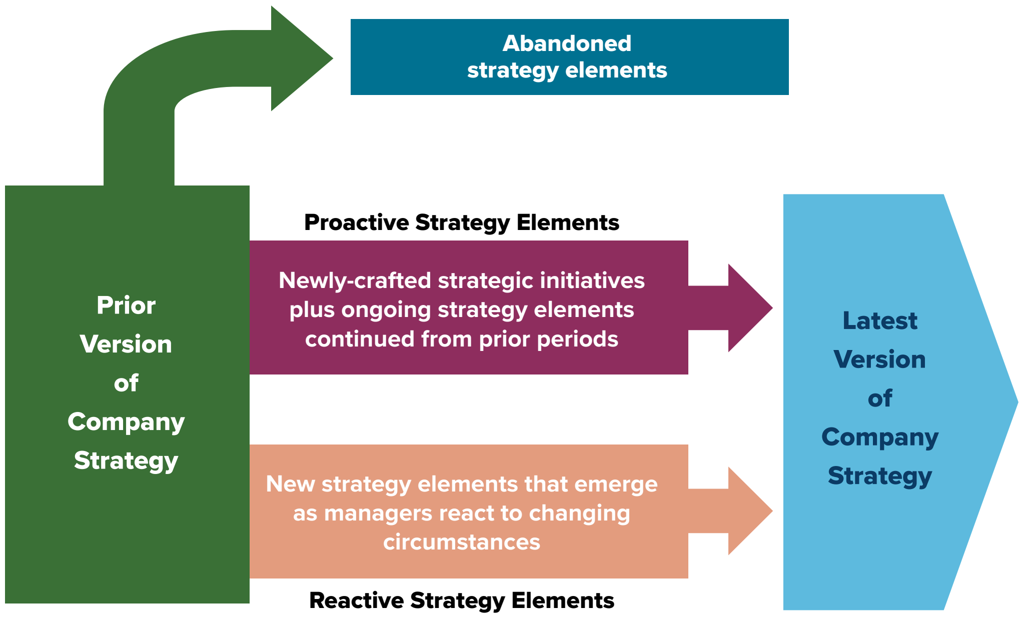
Changing circumstances and ongoing management efforts to improve the strategy cause a company's strategy to evolve over time—a condition that makes the task of crafting a strategy *a work in progress*, not a one-time or every-now-and-then event.

Regardless of whether a company's strategy changes gradually or swiftly, the important point is that its present strategy is always temporary and on trial, pending management's next round of strategy initiatives, the emergence of new industry and competitive conditions, and other unfolding developments that management believes warrant strategy adjustments. Thus, a company's strategy at any given point is fluid, representing the temporary outcome of an ongoing process that, on the one hand, involves reasoned and creative management efforts to craft a competitively effective strategy and, on the other hand, involves ongoing responses to market change and constant experimentation and tinkering. Adapting to new conditions and constantly evaluating what is working well enough to continue and what needs to be improved are normal parts of the strategy-making process and result in *an evolving strategy*.[7]

A Company's Strategy Is Partly Proactive and Partly Reactive

The evolving nature of a company's strategy means the typical company strategy is a blend of (1) proactive actions to secure a competitive edge and improve the company's financial performance and (2) as-needed reactions to fresh market conditions and other unanticipated developments—see Figure 1.2. The biggest portion of a company's current strategy usually consists of a combination of previously initiated actions and business approaches that are working well enough to merit continuation and newly launched initiatives aimed at boosting competitive success and financial performance. Typically, managers proactively modify this or that aspect of their strategy as new learning emerges about which pieces of the strategy are working well and which aren't and as they explore and test new ways to improve the strategy. This part of management's action plan for running the company is deliberate and constitute its *proactive strategy elements.*

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



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

As shown in Figure 1.2, a company's strategy evolves from one version to the next as managers abandon obsolete or ineffective strategy elements, settle upon a set of *proactive strategy elements,* and then—as new circumstances unfold—make adaptive strategic adjustments, which gives rise to *reactive strategy elements.* The latest version of a company's strategy thus reflects the disappearance of obsolete or ineffective strategy elements and a *modified combination of proactive and reactive elements.*

Strategy and Ethics: Passing the Test of Moral Scrutiny

In choosing among strategic alternatives, company managers are well advised to embrace actions that can pass the test of moral scrutiny. Just keeping a company's strategic actions within the bounds of what is legal does not mean the strategy is ethical. Ethical and moral standards are not governed by what is legal. Rather, they involve issues of "right" versus "wrong" and *duty*—what one *should* do. A strategy is ethical only if it does not entail actions and behaviors that cross the moral line from "can do" to "should not do." For example, *a company's strategy definitely crosses into the should not do zone and cannot*

CORE CONCEPT

A strategy cannot be considered ethical just because it involves actions that are legal. To meet the standard of being ethical, a strategy must entail actions and behavior that can pass moral scrutiny in the sense of *not being* deceitful, unfair or harmful to others, disreputable, or unreasonably damaging to the environment.

pass moral scrutiny if it entails actions and behaviors that are deceitful, unfair or harmful to others, disreputable, or unreasonably damaging to the environment. A company's strategic actions or behavior cross over into the should not do zone and are *likely* to be deemed unethical when (1) they reflect badly on the company or (2) they adversely impact the legitimate interests and well-being of shareholders, customers, employees, suppliers, the communities where it operates, and society at large or (3) they provoke widespread public outcries about inappropriate or "irresponsible" actions/behavior/outcomes.

Admittedly, it is not always easy to categorize a given strategic behavior as ethical or unethical. Many strategic actions fall in a gray zone and can be deemed ethical or unethical depending on how high one sets the bar for what qualifies as ethical behavior. For example, is it ethical for advertisers of alcoholic products to place ads in media having an audience of as much as 50 percent underage viewers? Is it ethical for an apparel retailer attempting to keep prices attractively low to source clothing from manufacturers who pay substandard wages, use child labor, or subject workers to unsafe working conditions? Is it ethical for Nike, Under Armour, and other makers of athletic uniforms and other sports gear to pay a university athletic department large sums of money as an "inducement" for the university's athletic teams to use their brand of products? Is it ethical for pharmaceutical manufacturers to charge higher prices for life-saving drugs in some countries than they charge in others? Is it ethical for a company to ignore the damage its operations do to the environment in a particular country, even though its operations are in compliance with current environmental regulations in that country?

Senior executives with strong ethical convictions are generally proactive in linking strategic action and ethics; they forbid the pursuit of ethically questionable business opportunities and insist that all aspects of company strategy are in accord with high ethical standards. They make it clear that all company personnel are expected to act with integrity, and they put organizational checks and balances into place to monitor behavior, enforce ethical codes of conduct, and provide guidance to employees regarding any gray areas. Their commitment to ethical business conduct is genuine, not hypocritical lip service.

The reputational and financial damage that unethical strategies and behavior can do is substantial. When a company is put in the public spotlight because certain personnel are alleged to have engaged in misdeeds, unethical behavior, fraudulent accounting, or criminal behavior, its revenues and stock price are usually hammered hard. Many customers and suppliers shy away from doing business with a company that engages in sleazy practices or turns a blind eye to its employees' illegal or unethical behavior. They are turned off by unethical strategies or behavior and, rather than become victims or get burned themselves, wary customers take their business elsewhere and wary suppliers tread carefully. Moreover, employees with character and integrity do not want to work for a company whose strategies are shady or whose executives lack character and integrity. Besides, immoral or unethical actions are just plain wrong. Consequently, there are solid business reasons why companies should avoid employing unethical strategy elements.

The Relationship Between a Company's Strategy and Its Business Model

Closely related to the concept of strategy is the concept of a company's **business model.** A business model is management's blueprint for delivering a valuable product or service to customers in a manner that will generate revenues sufficient to cover costs and yield an attractive profit.[9] The two crucial elements of a company's business model are (1) its *customer value proposition* and (2) its *profit proposition* (or "profit formula").[10] The customer value proposition lays out the company's approach to satisfying buyer needs and requirements at a price they will consider a good value.[11] Plainly, from a customer perspective, the greater the value delivered and the lower the price to get this value, the more

CORE CONCEPT

A company's **business model** sets forth how its strategy and operating approaches will create value for customers while at the same time generating ample revenues to cover costs and realize a profit large enough to please shareholders. Absent the ability to earn good profits, a company's strategy and operating blueprint are flawed, its business model is not viable, and its ability to survive is in jeopardy.

appealing the company's value proposition and product offering. From a company perspective, however, the greater the value delivered and the higher the price that can be charged, the bigger the margin for covering the costs associated with its business approach and realizing an attractive profit and return on investment.

The *profit proposition* or profit formula portion of a company's business model concerns its business approach to generating sufficiently large revenues and controlling the costs of its customer value proposition, such that the company will be able to simultaneously deliver the intended value to customers and deliver appealing profits to shareholders. For a company's business model to result in both satisfied customers and satisfied shareholders, three outcomes are required:

- *The revenue stream that is generated must be big enough to more than cover the costs of delivering attractive value to customers.* The revenues that can be generated are a function of the volume of customers attracted at the price being charged.
- *There must be adequate ways and means to control the costs of the value being delivered to customers.* The costs of the company's business model approach are dependent on the costs of the resources and business processes it utilizes and the cost efficiency of its operating systems.
- *The amounts by which revenues exceed the costs incurred must please shareholders.*

The lower a firm's costs are in relation to its revenues, the greater its profit potential and the more attractive its profit proposition.

Magazines and newspapers employ a business model keyed to delivering information and entertainment they believe readers will find valuable and a profit formula aimed at securing sufficient revenues from subscriptions and advertising to more than cover the costs of producing and delivering their content to readers. Cell-phone providers, satellite radio companies, and Internet service providers also employ a subscription-based business model. The business model of network TV and radio broadcasters entails providing free programming to audiences but charging advertising fees based on audience size; profit is realized by generating sufficient advertising revenues to more than cover programming costs. Gillette's business model in razor blades involves selling a "master product"—the razor—at an attractively low price and then making money on repeat purchases of razor blades that can be produced cheaply and sold at high profit margins. Printer manufacturers like Hewlett-Packard, Canon, Dell, and Epson pursue much the same business model as Gillette—selling printers at a low (virtually breakeven) price and making large profit margins on the repeat purchases of ink cartridges and other printer supplies. McDonald's invented the business model for fast food—providing value to customers in the form of economical quick-service meals at clean, convenient locations. Its profit formula involves such elements as standardized cost-efficient store designs; equipment and food preparation systems that provide the capability to serve hotter, better-tasting food faster and accurately; extensive testing of new menu items; stringent specifications for ingredients; detailed operating procedures for each unit; heavy reliance on advertising and in-store promotions; and sizable investment in human resources and training.

Amazon.com mainly utilizes an online direct sales business model whereby it procures merchandise for display on its web pages and operates a growing network of geographically scattered distribution centers that rapidly fill, package, and ship customer orders for delivery by third-party carriers (FedEx, UPS, and the U.S. Postal Service). Amazon generates revenues by providing an online marketplace for some 2 million third-party merchants from which it derives service fees and/or sales commissions—affiliated merchants can either use Amazon's order fulfillment capabilities or perform these activities themselves. However, Chinese-based Alibaba has adopted a "platform" business model whereby it operates online and mobile shopping marketplaces for consumers, merchants, and third-party service providers to conduct retail and wholesale trade; Alibaba's revenues come from the commissions and fees it earns on the hundreds of millions of transactions annually made by the merchants using its web-based sales platform and associated services (that includes web-page display, auction hosting, online money transfer, cloud computing, and logistics, among others). So far, the strategic elements in Alibaba's profit formula have delivered far superior performance compared to the strategic elements in Amazon's profit formula. Alibaba reported fiscal year 2018 operating profits of $11.0 billion on revenues of $39.9 billion (equal to an operating profit margin of 27.6 percent), whereas in calendar year 2018, Amazon reported operating profit of $12.4 billion on sales revenues of $232.9 billion (equal to an operating profit margin of 5.3 percent).

The nitty-gritty issue surrounding a company's business model is whether it can execute its customer value proposition profitably. *Just because company managers have crafted a strategy for competing and otherwise running various parts of the business does not automatically mean the strategy will lead to profitability—it may or may not.* 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. Companies that are in a startup mode or are losing money have "questionable" business models; 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.[12]

When a company pioneers a new and obviously successful business model approach, new entrants quickly appear with imitative business models—the key features of a successful business model are easy to identify and, often relatively easy to replicate.[13] For example, over the past 15 years, the business model for online retailing—a functional website, appealing product offerings, convenient checkout and payment options, fast delivery (and perhaps even free shipping), no-hassle merchandise return procedures, and cost-efficient order fulfillment and inventory management systems—has been successfully implemented thousands of times all across the world.

What Makes a Strategy a Winner?

Three tests can be applied to determine the merits of one strategy versus another and distinguish a winning strategy from a so-so or flawed strategy:

1. ***The Fit Test:*** *How well does the strategy fit the company's situation?* To qualify as a winner, a strategy must be well matched to industry and competitive conditions, a company's best market opportunities, and other pertinent aspects of the business environment in which the company operates. At the same time, it must be tailored to the company's resources and competitive capabilities and be supported by a complementary set of operating approaches (as concerns supply chain management, research and development, production, sales and marketing, and financial management). Unless a strategy exhibits good fit with *both the external and internal aspects of a company's overall situation*, it is likely to be an underperformer and fall short of producing good business results. Winning strategies also exhibit dynamic fit in the sense that they evolve over time in a manner that maintains close and effective alignment with the company's situation even as external and internal conditions change.[14]

CORE CONCEPT

A winning strategy must fit the enterprise's external and internal situation, help build sustainable competitive advantage, and improve company performance.

2. ***The Competitive Advantage Test:*** *Is the strategy helping the company achieve a sustainable competitive advantage?* Winning strategies enable a company to achieve a competitive advantage that is durable. The bigger and more durable the competitive edge that a strategy helps build, the more powerful and appealing it is.

3. ***The Performance Test:*** *Is the strategy producing good company performance?* To be a winner, a strategy must have resulted in substantially better company performance. Two kinds of performance indicators tell the most about the caliber of a company's strategy: (1) competitive strength and market standing and (2) profitability and financial strength. Gains in market share, improving competitiveness vis-à-vis rivals, above-average profitability, and strong financial performance over the past 2–4 years are all signs of a winning strategy.

Strategies—either existing or proposed—that come up short on one or more of the tests are plainly less appealing than strategies passing all three tests with flying colors. Failing grades on one or more tests should prompt managers to make immediate changes in an existing strategy. Likewise, when picking and choosing among alternative strategic actions, managers should be quick to discard alternatives that seem ill-suited to a company's internal and external situation or that offer little prospect of producing competitive advantage or improved performance.

Why Crafting and Executing Strategy Are Important Tasks

Crafting and executing strategy are top-priority managerial tasks for two big reasons. First, there is a compelling need for managers to proactively shape how the company's business will be conducted. A clear and reasoned strategy is management's prescription for doing business, its road map to competitive advantage, and its game plan for pleasing customers and improving financial performance. High-performing enterprises are nearly always the product of astute, creative, and proactive strategy-making. Companies don't get to the top of the industry rankings or stay there with flawed strategies, copycat strategies, or with strategies built around timid actions to try and do better. And only a handful of companies can boast of strategies that hit home runs in the marketplace due to lucky breaks or the good fortune of having stumbled into the right market at the right time with the right product—but the good fortunes of such companies are not long-lasting without subsequent success in crafting a strategy capable of long-term competitive success. So there can be little argument that a company's strategy matters—and matters a lot.

CORE CONCEPT

How well a company performs and the degree of market success it achieves are directly attributable to the caliber of its strategy and the proficiency with which the strategy is executed.

Second, even the best-conceived strategies will result in performance shortfalls if they are not executed proficiently. Good day-in/day-out strategy execution and operating excellence are essential for a company to perform close to its full potential. There can be no applause for managers who design a potentially brilliant strategy and then stumble in their efforts to create an organization with the skills, resource capabilities, operating practices, and culture needed to carry out the strategy in high-caliber fashion. Flawed and/or inept implementation and execution of a company's strategy are a surefire recipe for underachievement, both financially and in competing against rivals.

Good Strategy + Good Strategy Execution = Good Management

Crafting and executing strategy are thus core management tasks. Among all the things managers do, nothing affects a company's ultimate success or failure more fundamentally than how well its management team charts the company's direction, develops competitively effective strategic moves and business approaches, and pursues what needs to be done internally to produce good day-in/day-out strategy execution and operating excellence. Indeed, *good strategy and good strategy execution are the most telling and trustworthy signs of good management*. Managers don't deserve a gold star for designing a potentially brilliant strategy and then failing to put the organizational means in place to carry it out in high-caliber fashion—weak implementation and execution undermine the strategy's potential and pave the way for shortfalls in customer satisfaction and company performance. Competent execution of a mediocre strategy scarcely merits enthusiastic praise for management's efforts either.

The rationale for using the twin standards of good strategy making and good strategy execution to determine whether a company is well-managed is therefore compelling: *The better conceived a company's strategy and the more competently it is executed, the more likely the company will be a standout performer in the marketplace.* In stark contrast, a company that 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.

The Road Ahead

Throughout the chapters to come, the spotlight is trained on the foremost question in running a business enterprise: *What must managers do, and do well, to give a company its best shot for being attractively profitable and successful in the marketplace?* The answer that emerges, and that becomes the biggest lesson of the course you are taking, is that doing a good job of managing inherently requires good strategic thinking and good management of the strategy-making, strategy-executing process.

The content of the upcoming chapters focuses squarely on what every business student and aspiring manager needs to know about crafting and executing strategy. We will explore what good strategic thinking entails, describe the core concepts and tools of strategic analysis, and examine the ins and outs of crafting and executing strategy. Then, in the accompanying strategy simulation exercise where you will run a company in head-to-head competition with companies run by your classmates, you will have a golden learn-by-doing opportunity to put the chapter content into practice and gain firsthand experience in actually crafting a strategy for your company and figuring out how to execute it cost effectively and profitably. In the process, we hope to convince you that first-rate capabilities in crafting and executing strategy are basic to managing successfully and are skills every manager needs to possess.

As you tackle the chapters and undertake the activities of being a co-manager of your assigned company, ponder the following observation by the essayist and poet Ralph Waldo Emerson: “Commerce is a game of skill which many people play, but which few play well.” If the chapters and the experience of running your company help you become a savvy player and better equip you to succeed in business, the time and energy you spend here will indeed prove worthwhile.

Key Points

The tasks of crafting and executing company strategies are the heart and soul of managing a business enterprise and winning in the marketplace. A company’s strategy is the game plan management is using to stake out a market position, conduct its operations, attract and please customers, compete successfully, and achieve the desired performance targets. The central thrust of a company’s strategy is undertaking moves to build and strengthen the company’s long-term competitive position and financial performance and, ideally, gain a competitive advantage over rivals that then becomes a company’s ticket to above-average profitability. A company’s strategy typically evolves and reforms over time, emerging from a blend of (1) company managers’ proactive and purposeful actions and (2) as-needed reactions to unanticipated developments and fresh market conditions.

Closely related to the concept of strategy is the concept of a company’s business model. A company’s business model is management’s story line for how and why the company’s product offerings and competitive approaches will generate a revenue stream and have an associated cost structure that produces attractive earnings and return on investment—in effect, a company’s business model sets forth the economic logic for making money in a particular business, given the company’s current strategy.

A winning strategy fits the circumstances of a company’s external situation and its internal resource strengths and competitive capabilities, builds competitive advantage, and boosts company performance.

Crafting and executing strategy are core management functions. How well a company performs and the degree of market success it enjoys are directly attributable to the caliber of its strategy and the proficiency with which the strategy is executed. No company’s management team deserves a grade of “good” for crafting a run-of-the-mill strategy and/or for executing a strategy satisfactorily and, as a consequence, achieving no better than adequate performance.